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Input Methodology review

Commerce Commission

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Dear Commerce Commission

Price-quality path in-period adjustment mechanisms workshop follow-up questions

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to provide further feedback to the Commerce Commission's (**Commission**) "*In-period adjustment mechanisms workshop*" workshop held on 29 November 2022. We appreciated the opportunity to provide feedback during the workshop – the workshop format of providing pre-reading and a detailed agenda allowed us to prepare in advance of the workshop which help us to actively participate. These follow up questions are an equally important step to capture anything missed at the time of the workshop.

While we can be confident that Electricity Distribution Networkers (**EDBs**) will have to build new capacity in response to New Zealand Emissions Reduction Plan (**ERP**), the size and pace of the demand increase and when new capacity will be needed is still uncertain. Regulation needs the ability to adjust and flex when allowances are provided so they match changes in an EDBs investment profiles. Flexible regulation is important to customers to ensure that investments are not made earlier than necessary (customers paying more than is needed) or later than is required (impacting reliability and slowing New Zealand decarbonisation). The development of flexible regulation is a priority Input Methodology issue for WELL. Central to this is the refinement and expansion of in period adjustment mechanisms available to EDBs.

A. Questions relating to reopener process

A1. Would our proposed updated reopener process address any concerns you may have on the current perceived lack of clarity in the reopeners?

Answer: We support any actions that clarifies, simplifies or streamlines the reopener process.

The current reopener process is relatively untested so support around what information is expected will help avoid prolonging future applications with repeated information requests.

Set review timeframes would support the customer connection process. We are in the process of making two applications and a current challenge is building uncertain reopener timelines into the overall customer project plan. We are currently assuming a truncated six month time block for the reopener consideration (which is significantly less than the 12 months it took for the Union reopener) and this is still the second longest project element after the build itself. The six-month timeframe is also an estimation – it's the most uncertain element in the project plan and it's on the project critical path.

A2. What do you think of our current thinking on updating the process steps for a reopener, broadly in line with the equivalent process under the Fibre IMs with relevant Part 4 reopener process additions?

Answer: A clear process with examples of the types of information needed to demonstrate that reopener criteria have been meet would help streamline the process and avoid having to resubmit information.

Trigger stage

There is merit in providing guidance around what would trigger a reopener. There is also merit in making the trigger stage an early assessment step for **some** opportunities – we have examples of potential reopener opportunities where it's not clear whether they would meet the reopener criteria. Some sort of early, very fast, assessment with the Commission for potential reopeners with circumstances where it's not clear whether it would meet the criteria would be useful and could save an EDB wasting resources on applications that will not get approved.

However, the key weaknesses of a reopener is the time it takes to secure the funding. The main reasons for projects that we have decided not to proceed with making a reopener application, is that the works need to start earlier than the funding would be secured. An additional trigger stage could lengthen this process. We would recommend designing a very fast trigger assessment (less than a week ideally). If the process takes longer, then making the application for a trigger assessment optional. It would then be up to the EDBs to decide whether an early assessment was needed.

Fast track applications

This is a great idea. An obvious examples are applications where the customer is paying for the full investment (there are no benefits that will be shared with other customers) and wider mass market tariffs won't increase with the new connection. In these examples, the Commission could rely on arm's length commercial negotiations between the customer and EDB to ensure an efficient price and the public consultation stage could be avoided.

A3. As our current thinking is based largely on our review of the EDB reopeners, with reference to the Fibre reopener provisions, are there any significant variations to this process that we should consider for Gas or Transpower IMs?

Answer: n/a

A4. From a workability point of view, how significant is the overhead to produce information for a reopener application? Could suppliers repurpose or use existing business case justification information that they already produce internally for reopener applications?

Answer: From our experience of drafting an application (our application still needs to be assessed by the Commission), the overhead costs has been high as we make our first application and we are uncertainty about what information to provide. As suggested, some of the information can be repurposed from the business case. However, extra information is needed to demonstrate that the specific reopener criteria have been meet.

The form of the commercial model and what aspects of the model need to be included in the application, also has a bearing on the time to develop an application:

- Whether a financial model is needed to calculate unique or non-standard tariffs
- Whether a direct agreement is needed to be negotiated and included in the application to demonstrate what commercial terms are being applied.

A5. Note that this topic was not discussed at the workshop:
We are making refinements to DPP reopener IMs to reduce ambiguity, improve clarity and consistency. Please provide examples of areas that could be improved in this respect.

Answer: Areas where further clarity would be useful include:

- For applications that have a wider network reinforcement element that benefit customers other than the connecting customer, and will result in an increase in an EDBs wider tariffs, what evidence would the Commission require to demonstrate that the expenditure is efficient (e.g. show that alternatives options have been considered, external verification etc.)?
- The extend of evidence needed to support an application. For example, evidence to demonstrate an efficient investment could range from a general narrative that relies on the customer letter saying they agree to the commercial terms (and therefore price), to providing a copy of the contract with the customer that demonstrates the exact commercial terms agreed and providing external verification of the price.
- High level guidance for examples of where its not clear whether an investment would meet the reopener criteria. Examples like:
    - Retrospective investments where a customer has had to invest before an application could have been made and have had to fund the whole project rather than a share in line with the Customer Capital Contribution Policy. Could an application be made retrospectively to revert investment levels back in line with a contribution policy?
    - New connections that have a very small connection element but a very large network reinforcement component that would be funded in the majority by wider network customers.

Proformas, examples and guidance would all be useful tools to confirm what's needed in an application.

B. Questions relating to reopener thresholds

B1. **Are the current reopener materiality thresholds still appropriate? If not, please explain why.**

Answer: Yes, the materiality thresholds are generally appropriate for capex spend.

A lower threshold would be required if a reopener will be used to consider unforeseen opex cost. Annual opex costs will naturally be lower than one-off capex projects. This will be important if reopeners are used to consider non-wire alternatives.

B2. **Some submissions on our Process and Issues paper raised that the cost of more than one project should be able to be considered to meet the lower DPP reopener threshold level. Our current thinking is that projects should only be considered for a cumulative application if each project is substantive, and the projects are part of the same programme or relate to the same scenario. What are your views on this?**

Can you please provide examples of:

- **where you would have applied for a reopener, if projects could have been considered together?**
- **potential future situations where you think you might have a number of projects, the combined cost of which will meet the current threshold?**

Answer: Projects should be considered together if they are cumulative and are part of the same programme or relate to the same scenario.

We also think that a reopener should consider projects that bridge multiple regulatory periods.

C. Questions relating to the type and extent of reopeners

C1. Could you please provide feedback on our initial assessment of coverage provided by our existing DPP reopeners of the scenarios from submissions on the Process and Issues paper?

Answer: Our network modelling shows that most likely unforeseen investment will be from:

- large new decarbonisation related connections (from the electrification of public transport or larger fossil fuel boiler transitions)
- network reinforcement upgrades (to the wider high voltage network) triggered by incremental growth from new customer devises like EV chargers or larger new decarbonation connections.

Our initial concerns were that unforeseen network reinforcement from incremental demand growth wasn't capture by the reopeners. It appears from the workshop conversation that the reopeners do capture these scenarios. Reopeners for this scenario will be an important tool going forward. Clear guidance will be needed about what supporting information will be needed for these applications that won't have direct connecting customer agreement for the investment, to rely on. What alternative information will the Commission need to be confident that the investment is efficient.

Supporting operating costs also need to be included in the reopener.

Other areas not covered by the current reopener coverage are resilience related investment programmes. Unforeseen investments could be driven from:

- local government sea level adaptation programmes (sea level rise rezoning decisions) that also require electrical assets to be shifted.
- Wider earthquake resilience programmes that also capture electrical assets. An example of this type of unexpected investment was Wellington Lifeline Group earthquake readiness programme which drove WELL's single issue CPP.

C2. What are the electrification scenarios that you consider need to be accounted for in DPP reopeners, and why?

Answer: As above – unforeseen investments from large new decarbonization related connections (boiler conversions and public transport electrification) and wider network reinforcement triggered by decarbonisation related growth.

As highlighted in Case Study 4 provided in our Process and Issues Paper submission, historic modest and steady demand growth has meant we have been able to closely match network capacity with peak demand. This has enabled us to avoid building capacity early and to keep prices low. However, this also means we don't have spare capacity to meet step changes in demand. The case study shows that our high value sub-transmission network has little spare

capacity and decarbonisation related demand increases could trigger the need for more capacity earlier than planned upgrades.

The regulatory framework also needs to account for non-wire solutions for unforeseen investments. We note that other mechanism like the IRIS could eliminate the need for a specific reopener requirements.

C3. Process and issues paper submissions suggested that new or expanded reopeners may be needed to address the higher levels of general uncertainty anticipated. Please provide specific examples of scenarios to enable us to assess coverage provided by our current reopeners.

Answer: As highlighted in Case Study 5 provided in our Process and Issues Paper submission, uncertain decarbonisation related peak demand growth means that networks are less certain about when network reinforcement will be needed. As highlighted in question C2, there is little spare capacity in the network to meet unexpected step changes in demand. A relatively small (relative to overall peak demand) increase in peak demand can trigger expensive sub-transmission reinforcement. Scenarios that could trigger earlier than expected network reinforcement includes:

- Faster than expected EV growth due to unforeseen government EV subsidies
- Customer decarbonisation decisions like electric aircraft (rather than hydrogen powered), electric boilers (rather than bio gas), commercial solar (rather than relying on grid supplied power) can impact demand growth rates.
- If next year's Gas Strategy decides to transition all or some of the current gas connections to electricity.

A real example of this type of uncertainty was Kiwirail's decision to purchase hybrid Interisland Ferries rather than traditional diesel-powered ferries. The decision to consider electric ferries was not known at the time of the last price rest. The request came with short time frames that wouldn't allow investment to wait until the next regulatory period.

C4. Is expenditure relating to disaster readiness, cyber security, greater use of digitalisation and data able to be foreseen and is it within the control of suppliers? If not, please explain.

Answer: The need for expenditure on items like disaster readiness, cyber security, digitization etc. is foreseeable but the timing of when its needed and the extent may not be.

For example, investment in low voltage visibility and monitoring could be provided in a number of different ways and combinations of opex and capex investment. However, networks are still developing what the best initial solution will be and when future upgrades will be needed (i.e. for example, when real time monitoring will be needed for more advance flexibility services). Given the fast-moving nature of some new functions like flexibility services, we may not know what investment is needed before DPP4 and its likely we will need to start investing before DPP5.

Examples of new expenses, that are uncertain in their timing and magnitude and are outside of an EDBs control are:

- Cyber investment in response to changing cyber threats
- Resilience programmes driven from changes in local government sea level policy
- Firming up investment requirements for incorporating flexibility services into EDB demand management responses (including LV monitoring)

- Large increases in insurance costs following an earthquake (WELL's earthquake insurance costs increased $0.5m per year or $2m over the DPP3 regulatory period).

C5. Note that this topic was not discussed at the workshop:
We are reviewing whether DPP reopeners should provide more scope for opex, for example:

- **there may be scenarios where an opex solution might be more cost-effective than a capex solution**
- **opex that is consequential to capex**

Can you tell us about any other scenarios which might be appropriate for opex to be included in DPP reopeners?

Answer: These two scenarios cover the most likely scenarios where additional opex spend might be needed.

D. Questions relating to other in-period adjustment mechanisms

D1. Can you identify circumstances in which suppliers might want to make use of a potential DPP contingent project reopener?[1] Please explain why the current reopeners are not suitable in those circumstances.

Answer:
WELL believes contingent project reopeners will be important for investments that are likely to fall within a regulatory period, but their exact timing is uncertain. These will be for investments that are triggered by step changes in demand (most likely decarbonisation driven) and where that demand is uncertain. As outlined in Case Study 5 of our submission to the Process sand Issues Paper, ERP related demand is very uncertain.

As described in our response to question C2, WELL does not have spare capacity available to meet step changes in demand. Faster than expected demand increases could trigger large investment programmes earlier than expected. Contingent reopeners would allow networks to closely match investments in new capacity with peak demand increases.

Furthermore, contingent reopeners would help support flexibility services. Flexibility services are currently immature – they have not been developed to the point that the industry understands how effective they will be at delaying network investment. Contingent reopeners would allow networks to adjust their investment programmes for uncertain demand increases, but also to uncertain flexibility responses (i.e. if flexibility services are better than expected at shifting peak demand electricity use, then investments in new capacity can be delayed).

Contingent reopeners could also provide an opportunity to provide an investment mechanism that spans regulatory periods. As provided in our submission to the Process and Issues consultation, reopeners in their current form are limited in their value because they have to be approved, the investment designed and built, and the final assets commissioned within the same regulatory period. Practically, this limits the use of reopens to smaller

[1] A contingent project is a project that has been listed as a 'contingent project' with an associated trigger event in a DPP/CPP determination. Projects are identified and listed in advance, well supported by information in Asset Management Plans.

projects that can be started early in the regulatory periods so that they can be completed before the regulatory period ends. Increasing equipment lead times, resource shortages and reopener application consideration timeframes will all reduce the time periods available within a regulatory period for an EDB to complete works funded by a reopener. The timeframe restrictions means that reopeners in their current form will only be available for a limited number of unforeseen investments.

We are currently putting together a reopener application which provides a good example of this challenge. We are working with a customer who is electrifying a large public transport network. The project includes upgrading multiple parts of the network, including sub-transmission assets. The project is unforeseen and will take five years to build. The challenge is that the larger upgrade components will take three years to construct. This means we cannot start these components until DPP4 as we will not be able to apply for reopener funding and complete this part of the project before the end of the DPP3 period. Furthermore, if we include this project in the DPP4 capex forecast and the capex gates cut the expenditure back, there will be a further delay as we will have to make a reopener application for the shortfall. The inability for an investment to span regulatory periods could delay the project by 2-3 years. We are currently working with the customers to re-programme the order of the project components to fit with the artificial delivery windows created by the regulatory time periods.

A contingent reopener could be designed to be regulatory period agnostic. If the project starts in one regulatory period, any remaining investment needed to complete the works could be automatically rolled into the next regulatory. Automatically including capex for the part completed project into the next DPP capex allowance would allow the EDB to complete the project without the uncertainty of re-applying for further funding (even though the project would have already been approved once).

The advantages of a contingent reopener are:

- **Streamline reopener process**: A contingent reopener would streamline the project plan by 6-12 months (depending on the reopener assessment period), reducing delivery times. 6-12 months is a significant proportion of the limited five-year regulatory windows networks have to design and delivery a project.
- **Planning and investment certainty**: Essentially provides pre-approval of the allowances, providing EDBs and customers with certainty that funding will be available when its needed. The current reopener format means that EDBs and customers must wait for reopener approval before having confidence that the project will proceed – investments are less certain because an investment decision is at the discretion of the Commission.
- **Expanding their use**: If the continent reopener also has the ability to span regulatory periods, it would allow networks to also use the mechanism for projects that fall towards the end of the regulatory period, a time period where project planning becomes less certain and the ability to reopen the price path has the most value (noting that reopeners could also be given this ability).

We believe there is a place for both a contingent reopener and reopeners in their current form. The most appropriate reopener will be dependent on specific situations:

- Contingent reopeners will be more appropriate for investments that are likely to fall within a regulatory period but where the timing is uncertain.

- Reopeners in their current form suit investments that are unforeseeable (like unexpected large customer connections) or where changes in their value is unforeseeable.

D2. Which scenarios could we consider including under a DPP wash-up mechanism, and why?

Answer: The washup could be useful for investments relating to faster than expected incremental growth from multiple small connection – growth that is difficult to forecast but can be easily validated post investment.

D3. Do you consider that there may be value in us considering a range of in-period adjustment mechanisms, eg, reopeners used for larger suppliers and as part of the DPP, use-it-or-lose-it allowances[2] for smaller suppliers, and if so, why?

Answer: Yes, we believe a range of tools should be developed that can be used to respond to different types of uncertainty. As highlighted above, contingent reopeners would suit investments that are certain, but there timing is uncertain due to demands growth uncertainty. Reopeners in their current form would suit unforeseen investments for new larger customer connections.

D4. Can you identify any other potential in-period adjustment mechanisms which you think we should consider? What situations would this cover, which are not covered by current reopeners or other mechanisms we are considering as outlined in questions D1-D3?

Answer: n\a

E. Questions relating to the CPP mechanisms

E1. What are the barriers or challenges of applying for a CPP?

Answer: The main barriers to applying for a CPP are:

- The time and cost of making an application (noting applications costs are unfunded and will result in IRIS penalties).
- The uncertainty around the final funding decision and whether the final price path will provide enough funding to deliver the programme the EDB commits to on making the application.
- The discrete, ring-fenced nature of the five-year CPP investment window does not suit the sustained (across multiple regulatory periods), uncertain nature of ERP related investment programmes. Part 4 only allows one CPP submissions, covering one regulatory period to be made at once. Networks will be required to make a step change in investment that is sustained across multiple regulatory periods. The demand uncertainty will mean that some of that investment could move between regulatory years and periods. It will be difficult to ring fence and cut the investment programmes to fit a standalone CPP programme.

E2. How do you view the effectiveness of the modification and exemption provisions in the current CPP IMs?

Answer: The effectiveness of the modification and exemption provision will depend on how its applied in practice and whether supporting processes and tools are developed so that its use and the expected outcomes can be relied with confidence. If the exception provisions can

[2] Use-it-or-lose-it allowances are provided where the need for funding has been identified at the time of setting the DPP, but the timing or exact amount of expenditure is uncertain. Unspent allowances are returned.

be used to develop an application and assessment framework that result in outcomes similar to a single issue CPP application (or other alternative streamlined CPP formats) then the provision could be an effective alternative to developing new IMs.

E3. Keeping in mind the need for: (1) scrutiny of expenditure for large step-changes in investment associated with CPPs, (2) transparency of information, and (3) ability to consult for interested parties eg, consumers:

- **How might the current CPP IMs be refined to better promote the overarching objectives of the IM Review?**
- **Are there information or application requirements that you consider are not needed for the regime? If so, which ones are they, and why?**

Answer: We would support a CPP that has a closer alignment with an IPP – a price path that:

- Makes it easier to shift investment packages between regulatory periods and potentially removing the need to reassess those investments, reducing regulatory costs.
- Include a longer term/high level investment programme to guide the movement of investment packages between regulatory periods.
- Allow the application process to be streamlined, reducing regulatory costs.
- Building in the cost of developing CPP/IPP applications and consulting with customers into a network's cost base.

As highlighted in our response to this topic in our Process and Issues paper submission, changes are needed to the overall regulatory framework that allows investment profiles to flex and adjust to changes in the underlying investment drivers. This could mean a different approach to both the DPP/CPP model of discrete, ring-fenced price paths based on five-year regulatory periods. Networks will need the ability to move investment packages between regulatory periods in response to changes in the underlying investment drivers. Flexibility is also needed to adjust the size of investments to reflect any change in the underlying capacity requirements.

E4. If you hold a view that our current suite of DPP reopeners does not fulfil a similar purpose as a single-issue CPP, please explain why, and provide examples of scenarios that would not be covered by existing DPP reopeners.

Answer: The current suite of DPP reopeners doesn't fulfil a similar purpose as a single-issue CPP because:

- A single issue CPP can include both opex and capex cost types and any supporting change in overheads needed to support an investment.
- A single issue CPP can be for investment programmes that are not triggered by new customer connections, network reinforcement or asset relocations. Resilience projects (for example earthquake resilience or programs resulting from climate change) are not captured by a reopener.
- The window to deliver a reopener is short due to most unforeseen projects falling in the later years of as regulatory period, limiting reopeners to smaller projects that can be planned and delivered before the end of a regulatory period. Whereas a single issue CPP is planned in advance and can capture larger projects that need multiple years to deliver.

A good test to see whether the reopeners would fulfil the purpose of a single issue reopener, would be to apply WELL's earthquake readiness programme (which was essentially treated as a single issue reopener) to the reopener criteria. The earthquake readiness investment programme was for $30m in capex and opex so it would have fallen within the reopener value limits. However, the programme would not have meet the reopener criteria because:

1. The investment was for a resilience programme, and not for a new connection, network reinforcement or asse relocation
2. It included ongoing overhead costs for the continued operation of the new functionality
3. It includes opex costs in its implementation.

1. Closing

WELL appreciates the opportunity provide further feedback to the Commerce Commission's (**Commission**) "*In-period adjustment mechanisms workshop*" workshop.

If you have any questions or there are aspects you would like to discuss, please don't hesitate to contact Scott Scrimgeour, Commercial and Regulatory Manager, at scott.scrimgeour@welectricity.co.nz .

Yours sincerely

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