

Commerce Commission New Zealand

Te Komihana Tehokohoko

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### CEPA's EDBs Productivity Study

1. Unison Networks Limited (**Unison**) is part of the six larger EDBs who jointly commissioned NERA to review CEPA's Draft EDB Productivity Study. We strongly support NERA's report and findings.

#### No robust evidence to support a productivity target

2. CEPA's Study provide the results of analysis using 'measured outputs' which do not include the breadth of services consumers expect and value from EDBs. Many additional EDB services are required to electrify New Zealand and to serve consumers at the quality they demand, including to maintain social licence and facilitate New Zealand's energy transition.
3. Our primary feedback is that the Study does not provide robust evidence of declining productivity to the Commission. It should not be relied upon to apply a productivity target for operating expenditure (opex) efficiencies (partial productivity factor PPF) and / or capital expenditure (capex) informing an X factor for setting allowances.

#### EDBs have been delivering uncompensated outputs that are valued by consumers

4. The reports of both CEPA and NERA support the impact of unmeasured outputs of EDBs over the period assessed (2008 – 2023). NERA find:<sup>1</sup>

*The question is then whether the **observed** negative measured productivity is evidence of negative **actual** productivity. As CEPA notes, it could be, but caution is warranted as negative measured productivity could be an artifact of the modelling approach (i.e. fail to account for all outputs, mismeasure capital inputs or not account properly for changing weather patterns).*

*There is evidence of EDBs overspending allowances and earning returns below the regulatory WACC. Given the mechanistic base-step-trend model penalises EDBs for delivering outputs unrelated to growth in circuit length or customer numbers, this suggests that either EDBs are delivering uncompensated outputs that consumers value, or that EDBs are irrationally delivering outputs consumers don't value/the broader incentive framework is not working.*

*The combination of declining measured productivity, returns below the regulatory WACC, and expenditure in excess of allowances therefore suggests that the most likely explanation for declining measured productivity is that EDBs have been delivering uncompensated outputs that are valued by consumers.*

5. NERA detail the uncompensated outputs in their Table 3.1 at page 12 of their Report in four categories:
  - a. consents, regulation and compliance;
  - b. new product/service;
  - c. digitisation/IT; and
  - d. network resilience.

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<sup>1</sup> NERA Review of CEPA Productivity Study, 24 April 2024, pgs 1 - 2 [C - E].

6. Those categories demonstrate additional outputs expected of a prudent and efficient EDB during the assessed period and, Unison considers, valued by consumers.

### **Improving efficiency and providing services at a quality that reflects consumer demand**

7. Section 52A(1)(b) of the Commerce Act 1986 includes the outcome of “*incentives to improve efficiency and provide services at a quality that reflects consumer demand*”. Those integrated considerations are fundamental to a balanced outlook promoting the long-term interests of consumers.
8. A ‘prudent’ response to the incentives and disincentives of the current regulatory regime (i.e. whether to sacrifice a service or quality consumers value to manage costs within allowances) does not always correlate to a ‘prudent and efficient’ business decision that is in the long-term interests of consumers.
9. Unison appreciates the Commission will consider CEPA’s Study, alongside other expert opinion (including NERA’s Report), against broader information obtained in the DPP4 reset. Consumer demand is obviously a key factor as are the differences in electricity lines services since 2008 and EDBs new significant role facilitating an energy transition.<sup>2</sup> Including, NERA’s finding that:<sup>3</sup>

*The presence of uncompensated outputs in the base-step-trend model means that EDBs need to achieve efficiency gains to deliver all the outputs valued by consumers without being financially penalised for doing so – i.e. they already face a form of productivity target.*

*Applying a further productivity target on top of this in the form of a positive opex PPF would essentially be a double counting and would be punitive. Providing an allowance that is not sufficient to deliver all outputs consumers value is unlikely to be in the long-term interest of consumers.*

### **Maintaining prudent and efficient decisions during DPP3 despite material under-recovery**

10. Consistent with NERA’s report, DPP3 reflects the growing number of uncontrollable external factors with substantial cost, most of which were uncertain/unknown at the DPP3 reset:
  - a. a global pandemic and impacts on supply chain, work programmes and workforce;
  - b. sector specific material and labour cost increases;
  - c. high inflation;
  - d. increasing severe weather events and expectations as a lifeline utility delivering an increasingly critical service (essential to community wellbeing);
  - e. Government policy changes;
  - f. increasing reliance on data and digitisation to innovate and improve efficiency (and subsequent pressure on opex vs. capex allowances);
  - g. growth of, and adaption to, distributed energy resources (solar, batteries and EVs);
  - h. increasing regulatory requirements relating to health and safety, and various Commerce Commission and Electricity Authority requirements; and
  - i. insurance premium increases given New Zealand’s exposure to catastrophic events (and regional impacts).
11. Unison has continued to put the long-term interests of consumers at the forefront of its decisions by tolerating exceeding opex allowances in DPP3 (and suffering the resulting IRIS penalties) given the under-recovery provided by allowances.
12. For example, an increasingly concerning rise in opex in DPP3 has been insurance premiums to maintain an efficient level of insurance (noting all step changes were rejected in the DPP3 reset). The DPP3 regulatory allowances did not compensate Unison for that increase. An available cost cutting decision in the context of the many external factors constraining opex allowances during the period would have been culling insurance cover to reduce premiums allocating more risk to the consumer for catastrophic events such as Cyclone Gabrielle. That outcome would have led to a materially higher contribution from future consumers to rectify damage to the network suffered in February 2023.

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<sup>2</sup> To support accepted net-benefits to society as per the definition of energy efficiency in the Energy Efficiency and Conservation Act 2000.

<sup>3</sup> NERA’s Report on CEPA’s Productivity Study, pg 2 [G-H].

13. Consistent with NERA's Report, Unison's DPP3 experience highlights some of the drivers of productivity and efficiency improvements being external factors discussed below.
14. The changing energy landscape means EDBs must incur costs to address today's issues and emerging features that were not present in the past and therefore not considered in the rearward looking Input Methodologies and DPP framework and allowances. For example, increasing numbers, complexity, and size of Distributed Generation (**DG**) applications that require administration, assessment, and engineering. Increasing DER penetration combined with increasing sensitivity of electronic appliances and processes increases reactive power quality investigation and intervention, and proactive network modelling including down to the low voltage level. This also requires ICP level consumption data and associated infrastructure, cyber controls and analytics.
15. Alongside general changes to health and safety legislation, specific requirements for traffic management in the road corridor which is overseen and enforced by corridor managers has resulted in a step change in the cost of doing work for EDBs. A high proportion of existing assets are located in, or adjacent to, the road corridor, and new assets are almost exclusively established in the Utility corridor (either encouraged or required by planning rules).
16. Vegetation is causing more outages as reliability targets have ratcheted down to ever more challenging levels (as severe weather makes lines more vulnerable to trees, and tree owners continue or choose to exacerbate risks to lines). A lack of reform of the Electricity (Hazards from Trees) Regulations 2003 has meant that EDBs have had little leverage since for twenty years (and throughout CEPA's assessed period) to reallocate that risk fairly. As a direct consequence EDBs are forced to spend increasing amounts on vegetation management to achieve performance within reliability targets, as well as the sunken costs of restoring damaged assets.
17. A maturing regulatory framework is placing greater emphasis on the sophistication of asset management planning and specific investment decisions, including the use of data, digitisation, and stakeholder/consumer input. This supports understanding consumer expectations and decisions on a least cost life-cycle basis, however, it comes with currently uncompensated costs.

#### **CEPA's Study and increasing severe weather**

18. Regarding external factors impacting EDBs, CEPA comment:

*It is widely recognised that EDB customers care a great deal about the reliability of the service. Involuntary loss of supply is considered to have a material impact on the overall economic value of the network. It follows that quality of service measures should be included when comparing how the productivity of EDBs has evolved over time.*

*However, as usual, there are quite material problems to address. One of the problems is that reliability is, to a large extent, driven by weather conditions which are exogenous to the actions of the EDB. It may take several years of data before it is possible to distinguish the actions of the EDB (in improving resilience, say) from just the luck of the weather. With changing climatic conditions this task is even more complicated.*

19. Climate change will increasingly complicate this picture, including whether consumers wish to pay the cost that may come with maintaining reliability at current standards.
20. Cyclone Gabrielle presents a clear picture of this tension for EDBs and the growing reliance of consumers on electricity lines services (which the Commission has accepted in its clear message on expecting EDBs to invest in resilience). Unison's consumer survey results post-Cyclone conveyed consumers are:
  - a. more concerned about severe weather events and resilience; and
  - b. prepared to pay more for resilient electricity lines services.<sup>4</sup>

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<sup>4</sup> Further discussed in Unison Networks Pricing Methodology 2024 published here: <https://www.unison.co.nz/media/y1fjezjr/2024-unison-pricing-methodology-disclosure.pdf>

21. While understood in the context of the energy trilemma (security, equity and sustainability)<sup>5</sup> and the dichotomy of balancing three at times contradictory outcomes; efficiency and quality need to be similarly considered. EDBs are producing more outputs as the scope of electricity lines services extends and consumers' demands evolve, including with technology.
22. Noting the historical basis for CEPA's Study (the measured outputs), it will be critical to understand how the DPP4 Draft Decision provides for the change in consumer demand to promote the long-term interest of consumers. If the Commission consider fair costs to meet consumer demand will not otherwise promote s 52A, is there robust evidence that consumers will accept a decrease in services and quality (including reliability) to balance cost, risk, and performance?

#### **The risk of harm to consumers and EDBs of a productivity target in DPP4**

23. There has been ample information about the criticality of opex to EDBs investing in innovation and efficiencies in DPP4 in the IM Review 2023 and DPP4 reset to date. There is in fact likely a success story embedded in the results, given CEPA and NERA's findings on the unmeasured outputs that are not factored into CEPA's analysis.
24. A productivity factor that further constrains EDBs' allowances in DPP4 presents a risk of harm to consumers and EDBs given NERA's finding of likely actual improvement in productivity and efficiency (to make room for the external factors impacting EDBs). EDBs having sufficient operating expenditure allowances to facilitate future (non-traditional) solutions is critical to New Zealand's energy transition (as is EDBs being able to invest in adequate capex solutions to implement least cost life-cycle asset management). The likely harm therefore relates to both promoting the long-term interests of consumers pursuant to the Part 4 objectives in s 52A, consistent with the s 54Q constraint to 'promote incentives to invest and avoid disincentives to invest in energy efficiency and demand side management', and EDBs necessary role in facilitating an energy transition<sup>6</sup> and New Zealand's statutory commitment to its net zero target by 2050.<sup>7</sup>
25. If that risk presents, future sacrifices will need to be made that undermine 'quality' that reflects consumer demand (including maintaining social licence) in the long-term interests of consumers. Maintaining the financeability of EDBs is another critical factor to balance against adverse funding decisions to EDBs.
26. Given the short turnaround to obtain expert advice and respond to CEPA's Productivity Study, we look forward to further consideration following the Draft DPP4 Decision.

Ngā mihi

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<sup>5</sup> World Energy Council, <https://www.worldenergy.org/publications/entry/world-energy-trilemma-report-2024>

<sup>6</sup> EDBs provided substantial comment in the IM Review 2023 on the BCG 2022 Report quantifying the investment need for the different parts of the industry.

<sup>7</sup> Section 5Q of the Climate Change Response Act 2005.