

9 August 2023

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Dear Charlotte

## **Cross submission on Draft Decisions: Input Methodologies Review 2023**

1. This is a cross submission from the Major Electricity Users' Group (MEUG) on the Commerce Commission's (the Commission's) consultation paper "*Context and summary of draft decisions: Part 4 Input Methodologies Review 2023*"<sup>1</sup> published for consultation on 14 June 2023 and the 81 individual submissions made during the first round of consultation.<sup>2</sup>
2. This cross-submission focuses primarily on the proposed Input Methodologies (IMs) amendments applicable to electricity distribution businesses (EDBs). Attached, and to be read along with this cover letter as part of the submission by MEUG, is a report by Mike Hensen, Senior Economist NZIER, dated 9 August 2023.
3. MEUG members have been consulted on the approach to this cross-submission. This cross-submission does not contain any confidential information and can be published on the Commission's website unaltered. Members may lodge separate cross-submissions.

### **Missed opportunity to engage with sector on meaningful improvements**

4. From MEUG's review of the submissions, it is evident that the sector is disappointed with the process the Commission has undertaken for the 2023 IMs review. This has subsequently flowed through to concerns that the Commission has not proposed amendments that will best position the electricity distribution sector for the challenges and opportunities we face through the energy transition.

<sup>1</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/318666/Part-4-IM-Review-2023-Draft-decision-Summary-and-context-paper-14-June-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/318666/Part-4-IM-Review-2023-Draft-decision-Summary-and-context-paper-14-June-2023.pdf)

<sup>2</sup> <https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-electricity-gas-and-airports/input-methodologies-projects/2023-input-methodologies-review?target=documents&root=323095>

5. Many submitters commented on the sheer volume of material to be reviewed in a relatively limited timeframe, for example:
  - *“...The short timeframe set out by the Commission for stakeholders to respond to the more than 1,000 pages of draft decision restricts stakeholders’ ability to provide comprehensive and reasoned responses befitting the importance of the IMs”, Electricity Networks Aotearoa<sup>3</sup>*
  - *“The volume of literature provided on 14 June 2023 was significant to work through in order to give due consideration to all aspects of the draft decision. We were therefore somewhat disappointed that the Commission declined an extension for submission”, Orion.<sup>4</sup>*
6. We share these concerns. As a trade association with limited resourcing and a diverse group of members, it has been a challenge to review the volume of consultation material, as well as discuss submission points with our members. Reviewing the large volume of detailed submissions and supporting evidence has been an equally difficult task, given the two-week period allowed for cross-submissions. Consequently, MEUG’s cross-submission points are relatively high-level.
7. We appreciate that the Commission are working within statutory deadlines, with a final decision on the IMs required by December 2023. However, this does not stop the Commission from starting engagement earlier in the seven-year cycle and allowing longer periods for consultation. It is important that all interested parties have time to make considered submissions and present the best information available to inform the Commission’s decisions.
8. Submitters raise numerous issues with the proposed IMs amendments for EDBs, noting issues with workability and often suggesting amendments or refinements. There are several issues MEUG believes merit further discussion – for example, WACC percentile, large customer connection mechanism and DPP reopeners. Many submitters are calling for opportunities to further engage with the Commission before decisions are made:
  - *“...cost of capital is a complex topic.... In future we would like the Commission to separately on this topic and allow more time for submissions” Aurora Energy.<sup>5</sup>*
  - *“.....The Commission’s process before its draft decision has been limited to publishing a narrowly focused consultant’s report, which has not provided stakeholders with the opportunity to understand and engage with the Commission’s views before the draft decision and its short consultation period.” Electricity Networks Aotearoa.<sup>6</sup>*

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<sup>3</sup> Page 1, Electricity Networks Aotearoa submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0014/323123/Electricity-Networks-Aotearoa-ENA-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0014/323123/Electricity-Networks-Aotearoa-ENA-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>4</sup> Paragraph 9, Orion submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0018/323154/Orion-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0018/323154/Orion-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>5</sup> Paragraph 16, Aurora Energy submission.

<sup>6</sup> Page 6. Energy Networks Aotearoa submission.

- *“There are several decisions from the Commission that will benefit from industry engagement and/or more demonstration material before the IMs are finalised. If this is not possible, an alternative is to plan for amendments before their application in the next gas and electricity resets” Powerco.*<sup>7</sup>
9. We would strongly support further engagement on the proposed IMs amendments, before the Commission finalises decisions for the 2023 IMs review. We believe that targeted workshops on key matters, discussion sessions with experts, and technical consultations would elicit greater insight that would lead to more informed and workable decisions for the electricity sector.

### Continued divide in treatment of WACC percentile

10. As expected, there is a clear split in views around the preferred WACC percentile, with regulated EDBs advocating to stay with the 67<sup>th</sup> percentile (or greater), and consumers and retailers (representing their customers) supporting the drop to the 65<sup>th</sup> percentile and suggesting the Commission could head further towards the mid-point:
- *“...All of the updated analysis, new evidence, and evolved regulatory settings point to the current 67th percentile WACC being too high” Contact Energy*<sup>8</sup>
  - *“.....the Commission’s decision to move to the use of the 65th rather than 67th WACC percentile seems a minor change. However, ENA is concerned that it represents the Commission’s apparent undermining of its long-standing empirical model in favour of “regulatory precedent” and is the first step in the abandonment of its empirical model” Electricity Networks Aotearoa.*<sup>9</sup>

### Analysis of expert reports

11. Regulated EDBs have commissioned further expert reports to support their case, with reports prepared by Oxera<sup>10</sup>, Competition Economists Group<sup>11</sup> and Frontier Economics<sup>12</sup>. To enable MEUG and our members to understand the evidence and arguments presented in these new reports, we engaged Mike Hensen, Senior Economist from NZIER to review these reports and compare the arguments presented in the expert submissions to the rationale in the Commission’s cost of capital topic paper. A copy of this NZIER report is provided in **Attachment 1** to this submission.

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<sup>7</sup> Page 2, Powerco submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/323155/PowerCo-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/323155/PowerCo-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>8</sup> Paragraph 42, Contact Energy submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0015/323115/Contact-Energy-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0015/323115/Contact-Energy-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>9</sup> Page 6, Electricity Networks Aotearoa submission.

<sup>10</sup> ‘Response to the New Zealand Commerce Commission’s draft decision for Part 4 Input Methodologies Review 2023 on the cost of capital — Prepared for the New Zealand electricity distribution businesses 19 July 2023’ Oxera. [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0016/323107/27Big-627-EDBs-Oxera-Response-to-Commission27s-draft-decision-for-IM-Review-2023-on-the-cost-of-capital-Submission-on-IM-Review-2023-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0016/323107/27Big-627-EDBs-Oxera-Response-to-Commission27s-draft-decision-for-IM-Review-2023-on-the-cost-of-capital-Submission-on-IM-Review-2023-19-July-2023.pdf)

<sup>11</sup> ‘Response to 2023 IM draft decision on cost of capital, Tom Hird, Ker Zhang and Samuel Lam, July 2023, Competition Economists Group’, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0012/323121/Electricity-Networks-Aotearoa-ENA-CEG-Appendix-B-Response-to-2023-IM-draft-decision-on-cost-of-capital-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0012/323121/Electricity-Networks-Aotearoa-ENA-CEG-Appendix-B-Response-to-2023-IM-draft-decision-on-cost-of-capital-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>12</sup> ‘Response to CEPA WACC report, Report for Transpower New Zealand, 1 February 2023, Frontier Economics, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/323164/Transpower-Ltd-Frontier-Economics-RAB-Indexation-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/323164/Transpower-Ltd-Frontier-Economics-RAB-Indexation-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

12. We draw the Commission's attention to NZIER's suggested next steps to progress discussion and decision on the WACC percentile.

The suggested key areas for review of the WACC uplift framework for the next DPP period after this decision are:

- The **definition and measurement of under investment in networks and the potential cost of underinvestment to consumers**. As the proportion of intermittent generation increases (in response to decarbonisation policies), the availability of generation capacity or affordable generation will become a more important driver of the pattern of load during peak and shoulder periods. Electricity retailers and third-party demand management service providers along with network owners are all likely to be offering alternative solutions to this problem. This will make the assessment of the effectiveness and efficiency of additional network assessment in meeting consumer expectations for access to electricity more complicated than assessing the consumer cost (probability of a network outage and value of lost load) attributable to network underinvestment.
- **Closer analysis of the rationale for and results of the mid-point setting of WACC by regulators in the UK and the AER**. These decisions provide a live experiment of both the success of measures other than WACC uplift to ensure optimal network investment and the effects of setting WACC at the midpoint on network investment decisions.<sup>13</sup>

#### **Progressing the WACC percentile discussion**

13. While MEUG continues to advocate for the WACC percentile to be set at the mid-point, we support Contact Energy's recommendation that:

- *"...Commission uses the 60th percentile of the WACC for setting the electricity lines revenue limits. This is still comfortably within the range of the loss analysis, and better reflects the weight of evidence showing that the percentile should be materially lower than its current level."* Contact Energy.<sup>14</sup>

14. We consider that Contact Energy has presented evidence that warrants consideration by the Commission. However, we recognise this debate may be better advanced by further engagement with the sector, prior to the final decision. We would welcome a workshop to discuss the evidence presented through the submission and cross submission process and would endorse the Electricity Network's Aotearoa idea of concurrent expert advice sessions on the costs of capital (also known as "hot tubbing").<sup>15</sup> We understand that this type of workshop was undertaken during the last IMs review and is the most efficient way for stakeholders to understand the expert reports and delve into the key areas of debate.

#### **Refinements needs to ensure effectiveness of large customer connection mechanism**

15. Like MEUG, many submitters support the policy intent of a large customer connection mechanism but there seems to be debate about the best way to implement this measure across the country. There was discussion around both the MW threshold and how it could be used:

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<sup>13</sup> Replicated from page 6 and 7 of the NZIER report prepared for MEUG.

<sup>14</sup> Paragraph 45, Contact Energy submission.

<sup>15</sup> Page 6, Electricity Networks Aotearoa submission.

- *“...we have some questions about how this mechanism would work in practice and how the contractual LCC risk will be managed. Furthermore, we feel the 10MW threshold will unnecessarily limit the application of this mechanism” Aurora Energy.<sup>16</sup>*
  - *“...While we see that there could be administrative challenges in isolating expenditure out between LCCs and the regulated asset base, this should provide benefit in responding to customers in a timelier manner..... We would like to see a 5MW capacity be adopted. 10MW for LCC’s may be too restrictive and is highly unlikely be used” Orion.<sup>17</sup>*
  - *“..to boost [the LCC] effectiveness, we suggest reducing the thresholds and including a financial threshold to align with reopener thresholds” Powerco.<sup>18</sup>*
16. Several gentailers echoed our concerns around bargaining power (Meridian, Mercury, and Contact Energy) and disagreed with the Commission’s stance that the risk will be mitigated as negotiations will generally be with “large customers with significant bargaining power”. For example,
- *“...the larger contracts may increase EDBs’ bargaining power particularly if an EDB’s customer is investing in larger generation or load assets that potentially could be placed at risk if a network connection is not provided. Furthermore, there is often little flexibility as to where the generation or load is located as it is often set by resource, availability of other infrastructure, agreements and consents. This gives an EDB bargaining power as in practice there is often no practical alternative to connecting other than via the EDB.” Mercury.<sup>19</sup>*
17. These gentailers also outlined further concerns with use of this proposed mechanism.
- How EDBs could take different approaches, and this would raise the transaction costs for customers seeking new connections. This is a real issue for several of our members with operations across the country.
  - There is significant risk *“associated with unconstrained monopoly pricing for these large connections”<sup>20</sup> and “limited incentives to seek out efficiencies”<sup>21</sup>*, with the new connections falling outside of the Regulated Asset Base (RAB).
  - How it would be applied. Meridian discusses the option of making the LCC mechanism *“an option that the distributor and connecting customer could negotiate, while retaining the existing approach for new connections as a backup.”<sup>22</sup>* Meridian also suggests that features of Transpower’s new investment contract process could be incorporated to make the process more efficient and mitigate the risk of monopoly pricing power.

<sup>16</sup> Paragraph 10, Aurora Energy submission.

<sup>17</sup> Paragraph 26 and page 14 of Orion submission

<sup>18</sup> Page 1, Powerco submission.

<sup>19</sup> Pages 1 and 2, Mercury submission.

<sup>20</sup> Page two, Meridian submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0017/323144/Meridian-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0017/323144/Meridian-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>21</sup> Page 4, Contact Energy submission.

<sup>22</sup> Page 2, Meridian submission.

18. Contact Energy presents a much stronger view on the issue noting that:
- *“.....Connection costs are now one of the most significant barriers to decarbonising industry in New Zealand. The draft IMs do little to improve this situation, and in one case make it significantly worse”<sup>23</sup>*
  - How the Commission has focused on *“the increased administrative burden that connections requests can place on EDBs and the Commission”*,<sup>24</sup> rather than looking at it from the customer perspective.
  - Provides several real-life examples that demonstrate the issues and scale of costs that large industrial and commercial customers are facing. We support the presentation of this information and believe it should be a considered point in the Commission’s deliberations.
19. Contact Energy also highlights how this proposed mechanism has links with the Electricity Authority’s work and goes on to suggest that the best way to create better connection costs settings is a joint project with the Electricity Authority.<sup>25</sup> We certainly believe that there is overlap in the two agencies work and there would be merit in exploring the idea further. We query what discussions the Commission has had with the Authority to date on connections and would recommend that Contact Energy’s proposed joint project is brought to the attention of the Electricity Authority.

#### **Recommended way forward for this mechanism**

20. Given the scale of evidence and recommendations set out in the submissions, we would be concerned if the Commission proceeded with this mechanism without seeking feedback on how best to implement it. MEUG considers the best way to progress this mechanism is to schedule a sector workshop to discuss options and determine a preferred approach.

#### **Timeframes required for DPP re-openers to best meet consumer needs**

21. MEUG recommends that the Commission amend the DPP reopener provisions to include a timeframe for considering re-opener applications and provide more detail on what information would be required from EDBs. There was a strong call from submitters for this information:
- *“....we are disappointed that the Commission has not provided more prescription about the information required to support a reopener process, or commit to evaluation timeframes. The lack of clarity and certainty about the process may result in additional resource costs for applicants and delays to projects to the detriment of consumers” Aurora Energy.*<sup>26</sup>

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<sup>23</sup> Page 2, Contact Energy submission.

<sup>24</sup> Paragraph 6, page 3 of Contact Energy submission.

<sup>25</sup> Pages 8 and 9 of Contact Energy’s submission.

<sup>26</sup> Paragraph 8 of Aurora Energy submission.

- *“...It also means the Commission playing its part in processing reopener applications quickly. The draft IMs do not provide consumers that assurance” Business Energy Council.<sup>27</sup>*
  - *“...Disheartened that Commission has not established timeframes to evaluate reopener applications or prescribe the information required for a reopener application. These two changes would have made a material difference to the usability, predictability, and practicality of the reopener provisions” Electricity Networks Aotearoa.<sup>28</sup>*
22. MEUG appreciates the resourcing issues that the Commission may face if a timeframe is specified for considering DPP re-openers. However, it is important to both customers and the regulated EDBs that re-openers are considered in a timely manner, so network investment can continue at the required rate to enable greater electrification. We believe there are several ways for the Commission to manage the potential situation of multiple DPP re-openers and providing guidance on the type of information required would certainly help smooth out the process for processing applications.
23. We consider that a short technical consultation on these amendments would enable the sector to provide feedback on reasonable timeframes for re-openers and what sort of guidance on information requirements would be beneficial.

#### **Additional commentary on submissions**

24. We have minor comments on the following areas:
- a) We consider that Powernet provides a useful insight with its discussion of major capital expenditure that has occurred on an exempt EDB.<sup>29</sup> This raises questions around the connection experience for customers connecting with a regulated EDB versus those connecting to an exempt EDBs network. Ideally customers should face similar incentives, approach, and timeframes for their connection requests, regardless of the type of distribution network. We query whether the Commission has investigated this issue.
  - b) Meridian *“urges the Commission to consider what role it should play and what role network companies should play in communicating the resulting price increases to consumers”*.<sup>30</sup> We agree that a consumer’s final electricity price is made up of several components, including the transmission and distribution charges regulated by the Commerce Commission. Therefore, effective communications from the retailer in parallel with EDB are important when explaining any price changes. We do query whether the Commission needs to take an increased role, or needs to look at differing ways of communicating the decisions from DPP resets (i.e., examples of

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<sup>27</sup> Page 1, BusinessNZ Energy Council submission, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0010/323110/BusinessNZ-Energy-Council-BEC-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0010/323110/BusinessNZ-Energy-Council-BEC-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf)

<sup>28</sup> Page 5, Electricity Networks Aotearoa submission.

<sup>29</sup> Paragraphs 25 – 27 of Powernet’s submission.

<sup>30</sup> Page 2, Meridian submission.

average price increases by network).

- c) We have reviewed submitters comments on the treatment of pass-through costs, namely the inclusion of Transpower's charges and the suggestion of other costs that EDBs deem are out of their control (i.e., insurance). MEUG believes that this issue warrants further discussion, looking at who should bear the increases – i.e., should it be spread over the supply chain or met by one party.

25. If you have any questions regarding our cross-submission, please contact MEUG on 027 472 7798 or via email at [karen@meug.co.nz](mailto:karen@meug.co.nz).

Yours sincerely



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