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Dear Charlotte

Draft decisions: Part 4 Input Methodologies Review 2023

1. This is a 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*"¹ and supporting papers and modelling published for consultation on 14 June 2023.
2. MEUG members have been consulted on the approach to this submission. This submission does not contain any confidential information and can be published on the Commission's website unaltered. Members may lodge separate submissions.
3. This submission focuses primarily on the Input Methodologies (IMs) amendments applicable to electricity distribution businesses (EDBs), with comments on Transpower's IMs amendments to be made via a separate submission.

Context for the 2023 IMs review

4. The Commerce Commission has succinctly captured the challenges, opportunities and operating context that will influence and impact the Commission's 2023 IMs review. Regulated energy businesses and their customers are now facing a much stronger focus on decarbonisation to meet New Zealand's climate change targets, with the move towards greater electrification and distributed energy resources. This is coupled with a greater focus on the need for adaption and resilience to increasing natural hazard events (such as Cyclone Gabrielle), and the cost-of-living crisis which is being felt by consumers and businesses across the country.
5. The Commission references the energy trilemma and the challenge for government in balancing the outcomes of reliability, affordability, and sustainability.² We draw the Commission's attention to the Ministry of Business, Innovation and Employment (MBIE)

¹ 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

² Paragraph 2.4, page 13, consultation paper.

recent work on the New Zealand Energy Strategy, where it has added “building a productive, inclusive economy” to the trilemma to form a quadlemma.³ We believe this is a useful addition that supports the four outcomes sought through section 52A of Part 4 of the *Commerce Act 1986*. It is to the long-term benefit of consumers to have an affordable electricity supply that supports communities and businesses to grow, while also ensuring that regulated businesses can earn a fair return.

Support change to WACC percentile but preference for midpoint

6. MEUG welcomes the proposed changes to the WACC parameters to incorporate the latest empirical evidence and to reflect the current regulatory environment facing EDBs and their customers. MEUG continues to focus on and scrutinise the Commission’s decisions around WACC for both EDBs and Transpower due to the significant impact that this parameter has on consumer prices. As we outlined in our February 2023 submission to the Commission:
 - a) MEUG members currently pay between \$10 to \$15 million per annum more because of the WACC uplift.⁴
 - b) Overall, CEPA estimate that all consumers pay an additional \$80 million, following the Commission’s decision to set the WACC percentile above the midpoint.
7. Going forward, we can expect these costs to continue to grow. Latest information shows that we need a substantive increase in both the transmission network capacity and distribution network capacity as we increase the level of electrification of both the transport sector and process heat within industry, as well as meet the growth in overall electricity demand.⁵
 - a) For the next regulatory period (2025 to 2030), Transpower is forecasting a requirement of \$3,712.7 million to deliver a reliable and safe network.
 - b) The Commerce Commission has noted that: “...recently disclosed EDB asset management plans (AMPs) for 2023 show that some electricity distribution businesses (EDBs) are planning significant increases in expenditure on their networks. These mark a step change on 2022 AMP forecasts and in some cases (e.g., Orion and Wellington Electricity) they are more than increases considered previously in customised price-quality paths (CPPs). Some EDBs have also signalled they expect 2024 AMP forecasts to be higher, particularly resilience expenditure is reconsidered in light of recent extreme weather events”.⁶
8. It is important to consider who is best placed to face this risk, as EDBs increase their investment into the network and look to innovate to support decarbonisation efforts. By maintaining WACC above the true cost of capital, consumers will continue to pay more for electricity than we consider is reasonable, putting pressure on all consumers and businesses who are already facing increased costs for essential services such as groceries, transport, and energy.

³ <https://www.mbie.govt.nz/dmsdocument/25373-terms-of-reference-new-zealand-energy-strategy>

⁴ Paragraph 4, MEUG submission to the Commerce Commission, 3 February 2023, https://comcom.govt.nz/_data/assets/pdf_file/0028/308386/Major-Electricity-Users-Group-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-10-February-2023.pdf

⁵ See paragraph 18, MEUG submission to the Climate Change Commission,

⁶ Paragraph 16.2, https://comcom.govt.nz/_data/assets/pdf_file/0032/316886/Default-price-quality-paths-forelectricity-distribution-businesses-from-1-April-2025-Proposed-process-25-May-2023.pdf

Support shift to 65th percentile for EDBs but is it sufficient?

9. MEUG supports the Commissions draft decision to use the 65th percentile of the WACC for Price-Quality regulation of EDBs and Transpower. However, we question whether the Commission has gone far enough to balance the risk of underinvestment against the impact on consumers of a higher WACC.
10. MEUG continues to hold the view that the WACC should be set at the 50th percentile (midpoint) for regulated energy businesses, a view also shared by the Major Gas Users' Group (MGUG). The Commission itself notes that "midpoint WACC is the best unbiased estimate of true cost of capital", when looking at the factors that influence its decision.⁷
11. We acknowledge the impact that underinvestment can have, when considering WACC, and agree that outages from an unreliable network are expensive for consumers and remediating an unreliable network can take several years.⁸ This needs to be balanced with the fact that consumers also need an affordable electricity supply. Electricity is a key input cost for our members businesses– it is also an essential commodity that supports our economy and wellbeing. For industrial consumers, it enables the manufacture of value-added products, the revenue from which supports our regional communities, employs hundreds or thousands of kiwis in well-paying jobs, and helps pay for the services we all take for granted like education and healthcare.

Broad evidence base considered through this 2023 IMs review

12. We consider that the Commission has undertaken a robust process to gather information to update its decisions for the 2023 IMs review. The Commission has continued to collect a considerable amount of evidence, since the High Court appeal that brought WACC percentile down from 75th to 67th percentile. The Commission has sought reports directly from independent experts, alongside considering and expert reports that have been commissioned by regulated suppliers. The Commission has also provided a concise summary of consumers views, including the evidence presented by MEUG in recent years.⁹
13. From our review of the new evidence and information, we make the following observations:
 - a) We agree that it is not possible to set a precise WACC percentile using solely empirical evidence. Setting the WACC percentile is a matter of judgement.¹⁰
 - b) Greater weight should be given to the practices adopted in international jurisdictions. The CEPA report makes it clear that regulators are considering whether to use WACCs above the mid-point and then choosing to aim at the mid-point. We consider that a more detailed explanation is needed to justify why New Zealand should take a different approach.
 - c) We agree that the WACC percentile is not the best tool to incentivise the type of investments that are needed to support our country's decarbonisation journey. The Commission has canvassed this issue across its range of topic papers and considered the full range of mechanisms it has available, such as amendments to

⁷ Paragraph 6.7, *Cost of capital topic paper*, Commerce Commission, 14 June 2023, https://comcom.govt.nz/_data/assets/pdf_file/0024/318624/Part-4-IM-Review-2023-Draft-decision-Cost-of-capital-topic-paper-14-June-2023.pdf

⁸ Paragraph 6.13, *Cost of capital topic paper*.

⁹ Paragraph 6.29.1, *Cost of capital topic*.

¹⁰ Paragraph 6.21, *Cost of capital topic*.

the Innovation Project Allowance.

- d) We consider that greater weight should be given to the work the Commission has undertaken in recent years to monitor and address quality issues with EDBs.¹¹ This has brought much greater scrutiny to the quality of service that EDBs provide to their customers and the planning of their network investment.
 - e) The Commission's reasonableness checks t point to no investment problem under the current 67th percentile.¹² As noted above, EDBs are looking to invest much more into their networks to meet the increasing demand from a range of customers.
14. Given all these factors, MEUG still believes there is a strong case to move towards a midpoint WACC. At a minimum, there is a case to move the WACC percentile down to between the 60th and 65th percentile, to recognise the international precedent and the increased measures in place to monitor investment and quality of EDBs networks.

Support refinements to DPP reopeners

15. MEUG is comfortable with the proposed refinements to the DPP reopeners available to EDBs. We believe that the DPP reopener mechanism is one way to deal with the uncertainty that EDBs are facing in their operating environment, while still ensuring that EDBs' expenditure is adequately scrutinised by the Commission. In addition, it is beneficial for the Commission to adopt its learnings from the development of the Fibre reopener process. We have comments on the following aspects:
- a) We support the **requirement for the Commission to publish notices** for reopener event applications.¹³ To ensure consumers are aware of the proposed changes and have an opportunity to comment, it is important that information is made publicly available. A central repository would enable MEUG and its members to gain a clear view of the DPP reopeners under consideration. However, we would encourage EDBs to also publish information about potential DPP reopeners on their own company websites or through existing customer communication measures (i.e. newsletters), so that impacted consumers can access information via a range of channels.
 - b) While we recognise the difficulties the Commission may face, we are concerned that the Commission has not set **timeframes for the DPP reopener process**. In our view, it is important that reopeners are considered in a timely manner, reflecting the importance and impact that the proposed change will have on the consumers in that region.

As an alternative, we encourage the Commission to monitor the number of DPP reopeners it receives over the coming 7 years, the time it takes to process them, and get feedback from stakeholders on the process. This would inform any future changes that may be required if DPP reopeners are increasingly used by EDBs.

¹¹ Paragraphs 6.52 to 6.54, *Cost of capital topic*.

¹² Paragraph 6.33.2, *Cost of capital topic*.

¹³ Paragraphs 5.31 – 5.33, *CPP and in-period adjustment mechanisms topic paper*, 14 June 2023, Commerce Commission, https://comcom.govt.nz/_data/assets/pdf_file/0025/318625/Part-4-IM-Review-2023-Draft-decision-CPPs-and-In-period-adjustments-topic-paper-14-June-2023.pdf

- c) We support the Commission having the option to decline a **DPP reopener if the application is more suited to a CPP**. It is important that the scrutiny and process is proportionate to the level of change in expenditure / quality standards.
- d) MEUG is concerned that the Commission has elected not to **prescribe when consultation is required on a DPP reopener**.¹⁴ While we acknowledge that many EDBs may undertake consultation with impacted consumers as they develop their DPP reopener application, and the Commission has requirements to consult with interested parties,¹⁵ MEUG would prefer customer consultation to be part of the prescribed process (proportionate to scale of change sought). This is consistent with testing that any changes are in the “long-term benefit of consumers”. At a minimum, EDBs should at least identify the consumer groups that will be impact by the DPP reopener.
- e) We consider that the “**catastrophic event**” **provisions are prudent**, when considering the resilience of networks after severe natural hazard events. However, we question why the Commission has set different limits for Vector and Powerco, separate to the rest of the regulated EDBs.

Welcome intent of large customer contract mechanism for EDBs

16. MEUG welcomes the introduction of the large connection contract mechanism for EDBs.¹⁶ We believe that this mechanism will be beneficial for both regulated EDBs and their consumers as:
 - a) It provides a timelier option and process for customers looking to enter into large contracts with EDBs, whether to support decarbonisation activity (fuel switching to electricity) or business growth / expansion. The timeframe is dictated by parties involved, not the regulator, therefore better meeting consumer needs.
 - b) It addresses the expenditure uncertainty that has been raised by numerous EDBs.
 - c) It is modelled off an existing mechanism – Transpower’s new investment contract mechanism (NIC). This is a known mechanism and creates a more even playing field when large customers are considering where to connect into the electricity system (transmission or distribution network).
 - d) Ensures that costs attributable to a particular party are not recovered across the broader customer base in a EDB region.
17. The Commission does note that “*there is a risk that EDBs utilise their bargaining power to extract excessive profits from these contracts, which could affect the promotion of the s 52A purpose*”.¹⁷ However, the Commission considers that risk will be mitigated as negotiations will generally be with “large customers with significant bargaining power”. We do not necessarily agree with this statement. Where the large customer is restricted by the site it must use (physical features of site, location to services such as transport), it cannot necessarily negotiate with other EDBs or look to shift from its selected location. In these cases, it is important to understand if the large customer is getting comparable and competitive terms to customers in comparable locations. This is where information disclosure may be key for the Commission to be reassured that there isn’t an imbalance

¹⁴ Paragraphs 5.62 to 6.54, *CPP and in-period adjustment mechanisms topic paper*.

¹⁵ Section 52Q(1) of the Commerce Act 1986.

¹⁶ Chapter 8, *CPP and in-period adjustment mechanisms topic paper*.

¹⁷ Paragraph 8.14, *CPP and in-period adjustment mechanisms topic paper*.

in bargaining power as these provisions are rolled out. MEUG is also interested in ensuring that the large customer connection process is relatively consistent across all EDBs, whether they are subject or exempt from the Price-Quality regulation. We query whether this is an area the Commission has considered.

18. We consider that limiting the mechanism to contracts at least 10MW seems prudent. However, we do query how this will exactly be defined, for example, capacity of connected load, name plate rating.

Support maintaining RAB indexation for EDBs

19. MEUG supports the Commission's decision to maintain RAB indexation to inflation for EDBs (status quo).
20. This is a key issue for consumers as changes in this space could have a significant impact on consumer prices over the short to long term. It has also been the subject of considerable debate in the sector over recent years. We welcome the robust analysis the Commission has undertaken prior to making its draft decision.
21. We agree with the reasoning that the Commission has presented, particularly that the status quo protects both suppliers and consumers from inflation and promotes pricing profiles that are more likely to be consistent with allocative efficiency. It also ensures that FCM is continued and is NPV neutral (NPV = 0) for regulated suppliers. The Commission sets out the negative impact that changing the approach could have:

"By setting a price higher than it needs to be to recover an efficient spreading of costs over time is likely to reduce consumption that consumers value above costs. Such an outcome is allocatively inefficient, and therefore would detract from s 52A(1)(b), which directs [the Commission] to provide suppliers with incentives to improve efficiency".¹⁸

22. We also agree that the use of indexation should not be used as a proxy to address other issues facing the sector, such as financeability or in the case of the gas pipeline businesses, the risk of asset stranding. The Commission has other tools available to address these issues, either at the sector basis, or on a case-by-case basis for individual suppliers.
23. We agree with several stakeholders that there should be a consistent approach taken with indexation for both EDBs and Transpower. We agree with the statements from Vector, Unison and Contact that there is no justification for a difference in approach, and Contact has provided a view on how indexing Transpower's RAB will be beneficial for consumers in the long term, particularly as we move to greater electrification.¹⁹ We will expand on the change proposed for Transpower in our separate submission.

¹⁸ Paragraph 3.10.1, *Financing and incentivising efficient expenditure during the energy transition topic paper*, 14 June 2023, Commerce Commission, https://comcom.govt.nz/_data/assets/pdf_file/0026/318626/Part-4-IM-Review-2023-Draft-decision-Financing-and-incentivising-efficient-expenditure-during-the-energy-transition-topic-paper-14-June-2023.pdf

¹⁹ Paragraph 3.15, *Financing and incentivising efficient expenditure during the energy transition topic paper*.

Additional commentary on draft decisions

24. We have minor comments on the following areas:
- a) **Innovation Allowance:** We support measures to improve the interpretation and the usability of the Innovation Project Allowance. Due to its limited use to date, it would seem sensible to make improvements to ensure it meets its intended purpose.
 - b) **Connections volume wash-up mechanism for EDBs on a CPP:** We support the intent of the connections volume wash-up mechanism for EDBs on a CPP. We believe that there is some merit to it, and there is the opportunity to learn from its application to Chorus. It will be important to ensure that it is set up robustly so it works smoothly for EDBs.
 - c) **Four-year regulatory period for EDBs:** MEUG agrees with the proposal to adjust the applicable IMs to enable a four-year regulatory period for both EDBs and Transpower if required. This is another tool that enables the Commission and EDBs to deal with uncertainty and has been applied at the last gas DPP reset. While there are different circumstances facing EDBs compared to gas pipeline business, we agree with Aurora that the modifications will be relatively mechanical and uncontroversial.²⁰
25. We look forward to engaging with stakeholders and the Commission throughout the cross-submission process. If you have any questions regarding our submission, please contact MEUG on 027 472 7798 or via email at karen@meug.co.nz.

Yours sincerely



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²⁰ Paragraph 6.128, *Cost of capital topic*.