Submission by

to the

Commerce Commission

on the

EDB default price-quality path (DPP4) draft decision

12 July 2024

SUBMISSION BY THE BUSINESSNZ ENERGY COUNCIL

EDB DEFAULT PRICE-QUALITY PATH (DPP4) DRAFT DECISION

Introduction

1. BusinessNZ Energy Council (BEC) welcomes the opportunity to submit on the Commerce Commission's default price-quality path (DPP4) draft decision.

2. The outlook for electricity demand shows that there is likely to be significant growth both in the near term and out to 2050. Several models across the energy sector depict this outlook. MBIE's Electricity Demand and Generation Scenarios (EDGS), which regrettably did not included biogas and offshore wind, show that across all scenarios, about half of all energy needs will be met by electricity by 2050.[1] This is similar to the New Zealand Energy System Model, TIMES-NZ[2], developed by BEC and 60 other industry, research, and government partners. In Kea, where climate change is prioritised as the most pressing issue, electricity supplies up to 59% of total energy supply and 54% in Tūī, where climate change is one of many pressing issues.[3]

3. Additional demand, coupled with volatile weather and natural disaster risk, in the backdrop of aging assets that require replacing and upgrading, underscore the need for timely and efficient investment to New Zealand's distribution and transmission infrastructure.

General comments on the draft decision

4. The Commission's task in setting revenue allowances in DPP4 and RCP4 is difficult. There is a trade-off between charging the consumers of today or pushing investment out into the future when the extent of demand growth is more certain. There are also equity considerations concerning who pays between current and future generations, and situations where to make investments viable, costs might be shared with some consumers paying more without receiving any direct benefit.

5. In the face of these equity concerns, conflicting trade-offs, and varying objectives, **we believe the Commission's draft decision is pragmatic and balanced**. The decision to lift revenue allowances has been constrained by concerns relating to affordability as inflation impacts consumers, not only in the domain of energy costs.

6. The Commission has justified smoothing the potential price shock for the benefit of consumers. Such smoothing is important as the price of electricity impacts the cost of doing business in New Zealand, with cost being a determining factor in the amount of electrification and emission reductions that will occur across the economy. Revenue smoothing, both in RCP4 and DPP4, address concerns raised by some stakeholders about deliverability and future demand uncertainty, while also ensuring the impact on consumers is softened to the extent possible. **We <u>support</u> the Commission's approach to smooth revenue allowances across the period, both in RCP4 and DPP4.**

7. The Commission's restraint in increasing allowances has not led to an insignificant change. The draft decision provides a large uplift in capital and operating allowances compared to previous regulatory periods. The uplift varies among Electricity Distribution Businesses (EDBs), but the decision will have an impact on the cost of energy, as noted by the Commission's own rigorous analysis which estimates an extra $15 on electricity bills each month on average. **We <u>believe</u> the**

[1] Electricity Demand and Generation Scenarios: Results summary
[2] TIMES-NZ and the data underlying the model is currently going through a significant update and should be available next year.
[3] New Zealand Energy Scenarios TIMES-NZ 2.0

increase in revenue allowances is needed, as agreed by the Commission, due to the capital and operating expenses required to maintain the network and ensure it meets increasing demand.

8. However, there are justifiable concerns that the resulting uplift in revenue allowances is not adequate to build and upgrade assets that are required to meet increasing demand. The Commission's decision means allowances will largely remain adjusted to account for changes to the weighted average cost of capital (WACC), inflation and interest costs. These factors have changed markedly since the start of RCP3 and DPP3. This is particularly accurate for interest costs and the WACC. The WACC for RCP3 and DPP3 decreased compared to previous regulatory periods.

9. Considering the underlying context for RCP4 and DPP4, with fluctuations in the WACC across regulatory periods leading to significant increases in costs to consumers, **we <u>recommend</u> the Commission reviews the process for setting the WACC.** A process that smooths the WACC across longer periods could allow for less volatility over multiple regulatory periods, which could be in the interests of consumers in the long-term.

10. Overall, the draft decision helps maintain allowances in line with inflation and increased costs – a necessary outcome – **but additional revenue that would fund new investments required for more demand remains greatly limited.**

11. This could be a material risk to the reliability and capability of the network in the future if necessary investments are delayed and network demand increases. Delaying investment could simply defer costs to the next regulatory period, and with it, risks the possibility of increasing the overall cost if it is more expensive to upgrade the network in the future due to foreseen or unforeseen reasons.

12. Revenue allowances that would better reflect forecasted investment plans could see a marginal cost increase to the average $15 increase assessed by the Commission in exchange for significant benefit in investing early, reducing the need to defer a potentially higher cost in the 2031-2035 regulatory period, reducing the risk of future cost and capacity shortfalls. On the other hand, the cost difference may not be marginal, and the stated benefits may not justify the cost as speculated by some. Nevertheless, providing transparency on the cost to consumers of both potential pathways would be beneficial.

13. The Commission could further communicate the differences, outlining the scenario of paying more in DPP4 and RCP4 to better reflect investment plans compared to the Commission's current draft decision. The sector could then benefit from a clear contrast in trade-offs between the two pathways and have dialogue over the possible course of action.

14. Salient problems with deteriorating water and transport infrastructure demonstrate the issues with deferring investment, yet the potential for inefficient over-build and higher cost on current consumers should not be forgotten. An exercise comparing these scenarios might provide a clearer and more certain preferred outcome. On the other hand, **we recognise addressing the problem of inadequate revenue allowances in the face of uncertain demand growth could be better addressed through the reopener process readily available to EDBs.**

Reopener process

15. The Government's pledge on electricity supply, promising to double renewable generation, is supported. However, as noted, there's uncertainty to whether the network will be able to keep up with supply, and whether their regulated revenues will be sufficient. In the reality of uncertainty, **we <u>support</u> the Commission's flexibility throughout the regulatory period by way of initiating reopener processes** if costs unexpectedly rise and such cost is evidenced.

16. In an environment where electrification will grow predictably but not in a linear trend, it is essential possible drivers of uncertainty are acknowledged and reflected in policy settings. The opportunity for reopeners contrasts with rigid and locked-in allowances that do not account for changing circumstances. Over the next five years, technology could change rapidly and with it the increase in demand for electricity, impacting EDBs investment plans.

17. It is important however that the reopener process operates in a timely fashion and lengthy delays are avoided. **We <u>recommend</u> providing assurance to EDBs that reopener applications will be streamlined** but the overall process remains robust and transparent to stakeholders, ensuring any amendments to revenue allowances are validated on accurate and tested evidence. A lengthy process could translate to the slowing down of projects which involve building or maintaining critical infrastructure, and as a result, could potentially impact security and quality of supply.

Non-network solutions

18. Despite the uplift in capital expenditure, minimising the need to build new assets is crucially important to minimise cost on consumers. This extends also to transmission under RCP4. Non-network solutions, in tandem with clear incentives and financial capability to implement such solutions should be a top priority. These solutions will be in part funded through operating expenditure. Operating expenditure allowances remain tight. This protects consumers from near term cost increases.

19. However, tight opex allowances could limit the innovation and implementation of non-network solutions, especially in the face of other opex pressures that take priority to the operation of EDBs. Tight opex allowances could risk a suboptimal expansion of EDBs' regulated asset base through traditional capex. The system needs to adapt to an environment with more distributed and flexible resources. Simply building more poles, wires and transformers will not do. Non-network solutions that can shift and lower peak demand will reduce investment need, and system costs in the long term.

20. **We <u>support</u> the Commission's decision to increase the Innovation Project Allowances in DPP4**. This development is promising, increasing the incentive to undertake projects and develop services that reduce the need for traditional capex, while optimising existing assets and minimising increases to system costs. We are concerned that the innovation allowance is low compared to the significant need for non-network solutions in the face of large demand for capex. The innovation allowance cap must provide enough room to invest in non-network solutions and unleash innovation. **We <u>believe</u> it would be beneficial for the Commission to increase the cap**. Determining the cap will have to balance near term cost implications on consumers.

Workforce development

21. Whilst EDBs remain confident to plan for and develop its workforce required to meet its investment plans, their financial capacity for workforce training and development must be adequate. For some EDBs, several workforce step change requests were declined by the Commission in the draft DPP4 decision, for example funding for an enhanced graduate programme. The Commission is concerned EDBs and Transpower do not have the capability to deliver their proposed investment plans due to, in part, a limited workforce. Yet restricting funding, in part, on this basis, could inadvertently reinforce workforce constraints. It is important EDBs and Transpower have confidence that they can grow their workforce to meet demand.

Appendix One - Background information on BusinessNZ Energy Council

About the BusinessNZ Energy Council

The BusinessNZ Energy Council (BEC) is a group of New Zealand energy organisations taking on a leading role in creating an affordable, reliable, and sustainable energy system for New Zealand. The BEC is a division of BusinessNZ, New Zealand's largest business advocacy group and the New Zealand Member Committee of the World Energy Council (WEC). The BEC offers a unique opportunity to shape the New Zealand's energy-system with business leaders, government, and research as well as access to global thinking on energy issues via our involvement with WEC.

About the World Energy Council

The World Energy Council is an independent global organisation that promotes an affordable, reliable and sustainable energy system for all. It is comprised of over 100 member countries. The Council provides impartial information on critical issues that affect society's well-being such as climate change mitigation strategies; energy efficiency; renewable energies; nuclear power; clean coal technologies; rural electrification; energy access; regional integration; urbanisation; geopolitics; innovation; finance; human capital; governance; resilience; hydrogen; storage; digitalisation; mobility; cooling; heating; behaviour change; scenarios; and transition leadership.

About the BusinessNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods
- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy. In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

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