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Vector's submission on the EDB DPP4 capex workshop

1. This is Vector's ('our,' 'we,' 'us') submission on the Commerce Commission's (Commission) default price-quality path (DPP) capex workshop. No part of this submission is confidential, and it can be published on the Commission's website.

2. In this submission we address a number of topics related to the capex framework design, then we respond to the specific questions raised by the Commission in the workshop.

Proportionate scrutiny

3. In a low-cost regulatory regime such as the DPP, the Commission's expenditure scrutiny must me consistent with that low cost / low touch approach.

4. For a customised price-path (CPP) or an individual price path (IPP), scrutiny can be applied at a more detailed project level.

5. With that in mind, scrutiny of expenditure forecasts for a DPP needs, in the first instance, to use information already available to the Commission's. Such as:

   a. EDB's Information Disclosures (EID);
   b. EDBs' 2024 Asset Management Plans (AMPs) (for final decision);
   c. EDBs' s53zd forecasts for expenditure values and drivers, supported by EDBs' 2023 AMPs for underlying explanations;
   d. EDBs' 2023 AMPs; and

e. AMP Reviews e.g., IAENGG's 'NZ EDB 2023 AMP Review'.

6. The Commission explained in the workshop that due to the low-cost nature of the DPP regime, they would not reach out to individual EDBs who required further scrutiny (via for example a s53zd request). We see this approach as being too limited and contrary to what the DPP4 Issues Paper had indicated.

7. Row four of Table 3.3[1] below states, a potential information gathering request for more information about EDB forecasts. Vector considers that if the Commission has concerns on supplier forecasts post scrutinising the information available, then it should request additional information / clarifications from individual suppliers. We see this as an opportunity to close any information gaps and misinterpretations the Commission may have after using existing available information.

Table 3.3 Summary of key capex milestones in DPP4

Date	DPP4 Milestone	DPP3 Comment
November 2023	Issue s 53ZD notice for early disclosure of 2024 AMP forecast expenditure and explanation for material variances	New to DPP4
15 December 2023 (indicative)	Section 53ZD information due	New to DPP4
Early 2024	Publish 2023 AMP review report/findings	New to DPP4
	Potential information gathering request (s 53ZD notice) for more information about EDB forecasts, following release of 2023 AMP review report/findings	New to DPP4
	Potential workshop to get feedback on early thinking on the draft capex framework and how the findings from the 2023 AMP review have been used to shape this	Early thinking on the capex framework included in Issues paper
31 March 2024	2024 AMPs due	No change from DPP3
May 2024	Publish reasons paper and draft determination paper setting out capex framework and draft capex forecast amounts	No change from DPP3
September 2024	Information disclosure data for the year ended 31 March 2024 available	No change from DPP3
By 29 November 2024	Final reasons and determinations paper	No change from DPP3

8. Ultimately the aim of scrutiny is to ensure EDBs have the right level of allowances and cashflows to enable suppliers to provide the services that consumers expect. The aim is not to

[1] Table 3.3 from the DPP4 Issues Paper p.29, available here https://comcom.govt.nz/__data/assets/pdf_file/0025/332944/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2025-Issues-paper-2-November-2023.pdf

provide insufficient allowances or cashflows resulting in consumers receiving lower than expected services as a result of available information having gaps or the Commission drawing incorrect conclusions from the available information . By way of example there were errors in the IAENGG report, which we will by way of separate correspondence be pointing out to the Commission. It would be disappointing if such errors led to a supplier receiving a lower level of allowance when this could be addressed by requesting additional information.

9. In fact, we noticed the same issue when it comes to opex step changes where there is currently no formal process to submit information to the Commission which demonstrates how step changes meet the Commission's step change criteria.

Drivers: emerging vs traditional

10. While we somewhat agree with the Commission's emerging view that higher shares of spend on emerging drivers are indictive of more uncertainty in expenditure forecasts. The Commission must be mindful of the way that different EDBs have reported their drivers in the s53zd submissions.

11. Vector allocated drivers in a way that meant the primary driver of the expenditure was reported. We gathered from the workshop that other EDBs may have used the driver which triggers the expenditure.

12. For consistency it would be beneficial (as suggested in the workshop) that Electricity Networks Aotearoa (ENA) provides a common view on drivers and the interpretations from the s53ZD responses.

Network constraints

13. The Commission asked in the workshop where could they look for network constraint information. We refer them to sections 10.7.1 to 10.7.15 of our 2023 AMP where we list our network constraints by planning area.

14. Schedule 12b is also a source of clear information on whether or not there is a current or forecast constraint at each of our zone substations.

Scope of unforeseen/ foreseen project reopeners

15. Vector is concerned that the scope of the unforeseen and foreseen project reopeners, does not account for opex resilience as the primary driver of the project or programme. Currently the Input Methodologies (IMs) only list capex resilience with the possibility for consequential opex to be captured. We assume the intention behind the IM final decision was not to preclude from these reopeners, efficient opex solutions or to encourage capex bias.

16. To that end, the Commission should revise its drafting to ensure that opex resilience is included. This could prove detrimental to consumers if the need for a reopener is met with an opex

solution. For example, a vegetation related solution (if the Tree Regulations were to allow for out of zone cutting) is a more cost-effective solution to a traditional capex measure (such as cable hardening).

Consideration of new flexibility mechanisms

17. The IM review final decision did not allow for a number of flexibility mechanisms[2]. Slide 62 of the workshop slide deck outlines the reasons for not introducing each of them. Below we provide our alternative view:

DPP flexibility mechanism	Key reason(s) for introducing
Increasing the scope of pass through or recoverable costs to cover wider spectrum of costs	Categories of costs in scope could be limited to smaller areas of expenditure. Low cost in nature as they require auditors to sign off in EDBs' annual compliance statements. Good candidate: Insurance costs, extreme weather event related costs
Contingent expenditure allowances	Allowances are granted upon hitting a set of targets or outputs – drives performance in areas where there needs focus. Information disclosure can be used to track targets/ outputs are met/ delivered. Good candidates: Worst performing feeders; EV load growth
Use-it-or-lose-it (UIOLI) allowances	Provides suppliers and consumers greater certainty that funding will be available when needed. Could be granted based on consumer engagement or an expert panel. Solves deliverability concerns. Good candidates: Resilience; wider customer electrification[3]
Quantity wash-ups	We agree there is complexity in establishing and tracking quantity wash-ups, but once the mechanism is set up and running it becomes low-cost. There is still merit exploring these wash-ups or volume drivers for DPP5.

[2] During the IM review and with our response to the DPP4 Issues Paper, Vector submitted an overview by Complete Strategy of the available uncertainty mechanisms in the UK under RIIO-ED2, available here: https://comcom.govt.nz/__data/assets/pdf_file/0030/339780/Vector-additional-information-1-DPP4-issues-paper-submission-19-December-2023.pdf

[3] We note that in Transpower's RCP4 proposal, the independent verifier accepted UIOLI mechanisms for Resilience and Customer Electrification

	Good candidate: Incremental growth from EV uptake

Questions from Session 1: Setting capex allowances within a DPP, including use of 2023 AMP Review

- *In your view how could the "NZ EDB 2023 AMP Review" report be taken into account within our capex framework?*

18. We outlined under the heading 'Proportionate scrutiny' how the Commission could best use the information already at their disposal to assess EDBs' forecasts where further scrutiny is required. We have expressed our concerns on the timing of the IAENGG report in other submissions so will not repeat those concerns again here. We were however also concerned that a draft of the IAENGG report was not provided to suppliers prior to it being released. This would have enabled factual errors in the report to have been addressed before release. There is some risk that a desk top review of 2023 AMPs coupled with a low engagement model could lead to incorrect conclusions being drawn. We believe therefore that IAENGG's report should have a low weighting in regard to the Commission's considerations of supplier forecasts.

Questions from Session 2: Assessing capex forecasts

<u>Metrics for assessing system growth, consumer connections, and renewal-related expenditure</u>

- *Are the proposed metrics (individually and/or in combination) useful for identifying EDBs where additional scrutiny may be warranted?*

- *Are there other metrics we should consider? Please explain your reasons and provide evidence to support your proposal.*

19. With four DPP consultation responses due in March 2024 alone, Vector does not consider that two weeks is enough time to properly consider the metrics proposed and to investigate alternatives supported by evidence.

20. We suggest that a separate consultation takes place to consider the options. Due to the complexity of the use of metrics in setting capex allowances, suppliers or the ENA may want to engage experts to assist in this area. Two weeks is insufficient time to undertake such engagements. Considering there is the potential for millions of capex dollars to be at stake in this area it is important the , we stress the importance of getting this right.

<u>System growth</u>

- *Where an EDB's capex intensity is expected to change significantly (eg, 5% or more than historical), please provide indication where your 2023 AMP or s53ZD response explains the overall expected change in expenditure mix and the extent to which you have assessed the efficiency of this change (given the emerging scope for non-network/nontraditional solutions).*

Alternatively, please state whether you are expecting to provide an explanation as part of your 2024 AMP.

21. For further information about the capex intensity of our system growth forecast, please refer to Section 2 of our 2023 AMP (and soon of our 2024 AMP) under 'Future Network Roadmap' (FNR). The FNR details the initiatives supporting Vector's Symphony strategy. The premise of Vector's Symphony strategy is that non-network solutions, specifically demand side response, will enable an affordable and fair transition by optimising for distribution network costs as customers deploy distributed energy resources (DERs).

- *How could we assess that forecast expenditure has appropriately considered impacts that could be achieved through distribution pricing (in the context of a relatively low-cost DPP)?*

22. To support our Symphony strategy, our 2024 AMP will demonstrate significant effort to strengthen and develop internal capability to support the practical deployment of DER capacity, and orchestration of DERs through third parties and directly. At a high level, it includes the following key focus areas:

    a. Development of dynamic operating envelopes (DOEs);
    b. Practical deployment of third-party DER orchestration, including through advanced pricing incentives;
    c. Enabling digital systems, integration protocols, cyber security, and new data platforms;
    d. Industry collaboration, operating protocols, and common industry standards;
    e. Ongoing development of our DER tariff; and
    f. Further development and refinement of cost-reflective pricing.

<u>Application of additional tests</u>

- *Some EDBs are expected to be identified (according to the proposed metrics or alternative metrics) to belong to a 'further scrutiny grouping', for one or several expenditure categories. Please identify effective means of providing additional assurance (consistent with the relatively low-cost nature of a DPP) that the forecast levels of investments are in the long-term interest of consumers:*

    - *additional information requirements and/or tests that could be applied*
    - *how investments that are particularly uncertain could be identified (on the basis that they may be better addressed through reopeners)*

23. In response to the first bullet point above, please refer to the section under the heading 'Proportionate scrutiny' above.

24. For uncertain investments, Vector clearly signalled in our s53zd response that the two areas or uncertainty were expenditure forecasts related to resilience and EV growth.

25. In chapter 1 of our 2024 AMP, we will summarise the expenditures which are both foreseen and unforeseen so there is full transparency for the Commission and stakeholders on uncertain forecast areas which could be contenders for potentials reopeners in DPP4.

- *Historical reference periods are likely required to assess the scale of change. What reference period should the capex framework adopt for DPP4 and why?*

26. The reference period 2022-2024 (2022-2023 for the draft decision) should be adopted in the capex framework to provide a balanced representation of EDB expenditure of capex delivery in a post-Covid era. A more recent period will also pick up exposure to supply chain constraints which have increased material costs for EDBs across Aotearoa which are unlikely to subside over the DPP4 period. In addition, a more historical profile will not pick up emerging expenditure related to large and small connection growth, energy transition (growing cities, data centres, process heat conversion, EV uptake etc.).

27. We are unclear why the Commission has not included RY24 in their proposed reference periods, as they will have that information available on the 31st of August in the EID, ready for the DPP final decision. This will also mean a longer reference period so statistically more representative of the trends described above.

Questions from Session 3: Other factors which apply to a DPP capex framework

Large connection contracts

- *Please identify whether LCC-eligible connection expenditure is listed in AMP 2023 and/or information provided in response to the s53ZD notice (issued November 2023) and the location of this information within the documentation provided.*
    - *If you haven't identified LCC-eligible connection expenditure please comment on the feasibility of creating a list of connection projects and programmes that would potentially meet the definition of an LCC in AMP 2024.*
    - *If the information is readily available, please provide the listing*

28. We are hugely disappointed with the supposition by the Commission that LCC eligible expenditure must be disclosed in our AMP. There are a number of reasons why:

    a. It would have been impossible/ impractical to have highlighted LCC expenditure in either our 2023 AMP or s53ZD submission because the LCC mechanism was only introduced in its final form in the IM Review decision in December 2023.

    b. The IM Review determination reads that the LCC's expenditure is 'not explicitly or implicitly provided for in the DPP', surely it can not be provided for if it is not forecast/ disclosure in EDBs' AMPs.

c. Large connections (over $5million and 5MW) are extremely difficult to forecast. Customers can turn up at any stage during the regulatory period, and as much as we try to engage externally to anticipate for these large connections (see Sections 9.3.3, 10.3.2 and 16.2.2 of our 2023 AMP), they are not easy to predict years ahead.

d. LCCs do not lend themselves well to information disclosure. Very often these contracts are commercially sensitive and therefore we keep the projects and consumers confidential.

29. We are now very concerned that the LLC mechanism will be redundant to EDBs who have not disclosed eligible expenditure. Especially when the scheme lends itself very well to large connections that could be negotiated on a bespoke, commercial price parallel to our capital contributions policy. We note that Transpower's equivalent mechanism, the 'new investment contract', has no such IM provision to disclose eligible expenditure.

<u>Additional reporting requirements</u>

- *What are your views regarding our proposal to place additional reporting requirements on EDBs with significant increases in work programmes?*
    - *What alternative proposals can you suggest that would achieve a similar outcome of enabling interested stakeholders to assess how well EDBs are delivering their significantly increased work programme?*

30. If the Commission is considering additional reporting requirements on EDBs to mitigate deliverability concerns, it must also consider that we operate in a low-cost DPP. EDBs already face a huge regulatory burden through ID. If more disclosures such as an annual delivery report (ADR) are being contemplated by the Commission, then the Commission must provide the additional opex that would be required to set up these reporting mechanisms as a minimum. It is our view that ADR has no place in the low-cost DPP framework. ADR has been used in CPPs, this would seem appropriate as projects and programmes of work have had detailed scrutiny by the Commission and the verifier. This is not the case under the DPP where many of the expenditure categories are "buckets" of spend which are fungible. ADR will add little or no value in our view in a DPP context.

31. If the Commission is concerned with forecasts being funded and then programmes of works not being delivered, then mechanisms such UIOLI should be introduced that eliminate the risk on consumers without burdening them with the unnecessary cost of extensive reporting. We also suggest that the Commission first looks at Schedule 14 of the EID where EDBs are already required to provide explanations by category of variances of actual against forecast expenditure from Schedule 7.

32. The Commission must also consider the cost-benefit analysis of any additional disclosure and ascertain in advance which stakeholders would a. read it and b. benefit from its content. As we have said in our submissions on the targeted information disclosure review (TIDR) the Commission should do extensive research with stakeholders to establish use cases for

additional information disclosures. This would enable an evaluation of the costs vs benefits thus ensuring that any costs are incurred in providing such disclosures are value adding to stakeholders.

33. We propose that the Commission reconsiders the regulatory calendar and removes the requirement for AMP disclosures in years 1, 2 and 5 of the DPP. Instead in those years, EDBs could provide updates on their Year 4 AMP of the previous regulatory period, i.e., the AMP used to inform the reset. Those updates should not require director certification. Full AMPs would remain in place for years 3 and 4 to inform the draft and final decisions of the reset.

- *What are the challenges you perceive in providing additional reporting?*
    - *Are there any implementation or workability concerns that we should be aware of?*
    - *What information do you currently produce for internal reporting purposes that could be used to achieve similar outcomes?*

34. Additional reporting comes at a cost (especially when subject to audit and director certification) which is ultimately borne by consumers. Our opex expenditure on reporting has grown throughout DPP3 and we can see a further step change in DPP4. The Commission must consider the increasing costs as a result of increasing requirements in the areas of regulatory, legal and sustainability affairs as an opex step change for DPP4.

<u>Deliverability</u>

- *We understand that forecast expenditure is driven by project size & scope, volume of work and cost of the work programme. To the extent that the increase in the forecast work programme is due to cost, please explain the variation in cost increases across capex categories beyond CGPI. What support information / analysis can you provide?*

35. We are currently collaborating with ENA on the increase in unit costs impacting overall capital expenditure (possibly over and above CGPI and other indices). We understand that ENA will share the figures once they are obtained.

- *Apart from having considered the challenges of delivering your work programme at an individual EDB level, what approach and evidence do you have that you have also taken into account potential sector-wide deliverability constraints?*

36. Please see Section 16 of our 2023 AMP which provides an overview of our Programme Delivery process that enables us to consistently deliver our work safely, to quality, cost effectively and to schedule. We also provide an overview of our approach to prioritising works and optimising resources for delivering our works programme as well as the challenges that we face in terms of improving the reliability and resilience of our network.

37. There are always potential deliverability constraints be they supply chain issues in Covid, skilled labour shortages, difficulties in accessing capital in the GFC etc. The key consideration is that

EDBs are best placed to understand these constraints and manage them. EDBs have traditionally delivered their work programmes despite constraints of the past. If the Commission is concerned with awarding allowances and then EDBs being unable to deliver, then they should use other ways such as UIOLI mechanisms or contingent allowances rather than making bold and broad-brush scaling back of allowances due to perceived concerns on deliverability of work programmes.

- *What are your views on our proposal to consider deliverability as part of uncertainty regarding EDB expenditure, alongside need, timing and cost?*
    - *What alternatives do you propose?*
    - *Are there particular categories of capital expenditure which are more likely to be exposed to potential deliverability constraints?*

38. Given deliverability requires a highly individualised assessment of each EDB's capacity to deliver capex, it is unlikely that an assessment of deliverability as part of capex forecasting would be compatible with the low-cost objective of DPP regulation.

39. The Commission's DPP4 Issues Paper discussion of deliverability highlights the risk that consumers are required to fund additional returns to EDBs due to non-delivery, whereas the greater risk to consumers is that prudent and efficient investments are not delivered. This suggests that the Commission should instead be focusing on ensuring that the regulatory settings support EDBs in delivering their AMPs.

40. A solution we have already mentioned above, which could limit the Commission's deliverability concerns is to provide more uncertainty mechanisms in DPP4, in particular UIOLI mechanisms. UIOLI schemes provide carved out funds for specific projects or programmes of work, which if not delivered ensure the related funds are returned to consumers.

Yours sincerely

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