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Dear Andy

## 2023 In-period adjustments

1. This is Vector's follow up submission on the workshop entitled 'Price-quality path in-period adjustment held on 29 November 2022 part of the input methodologies (IM) review.
2. We had anticipated further consultation on the topics of the workshop in early 2023 but we were subsequently made aware that the Commission would not be publishing any further issues papers on the matters covered at the workshop.
3. This submission contains Vector's views on some of the stakeholder submissions now published on the Commission's website, and some new ideas we believe will benefit the IM process stemming from our exploration of uncertainty mechanisms (UMs) used in Ofgem's RIIO-ED2 price control which began in April 2023.

## Executive summary

Topic	Vector recommendation
Limited use of a variety of UMs	The Commission should not limit itself to the use of only certain UMs, and consider fully the suite of UMs such as of Use-It-Or-Lose-It (UIOLI) allowances and volume drivers
Coverage of re-openers	Re-openers do not appear to cover Resilience expenditure, nor incremental demand growth
Capex vs opex re-openers	Re-openers should not discriminate between opex and capex expenditure
Process and administration	Vector supports the introduction of an assessment framework to help EDBs' expectations and keep the process 'light-touch' which is consistent with the DPP approach
Better guidelines	The Commission should publish a simple guidance document for re-opener applications. This could be done in collaboration with the ENA.
Proposals	Vector proposes the introduction of: <ol style="list-style-type: none"> <li>1. A UIOLI allowance for Resilience</li> <li>2. A UIOLI allowance for Worst Served Feeders</li> <li>3. A pass-through cost item for Storm Response</li> <li>4. Exploration of a volume driver for incremental demand</li> </ol>

## Themes from feedback to the workshop

### Limited use of a variety of uncertainty mechanisms

4. There are a range of uncertainty mechanisms at a regulator's disposal to ensure the default price-quality path (DPP) has enough flexibility to ensure allowances can be adjusted or passed through in order to manage uncertainty.
5. The table below outlines the five different UMs used by Ofgem in RIIO-ED2<sup>1</sup>:

Type of UM	Description
Volume drivers	Adjusts allowances in line with the actual volume of work delivered, where the volume of certain types of work is uncertain (but where the cost of each unit is stable).
Reopeners	Additional allowances, determined during a price control period, to deliver a project or activity once there is more certainty on the needs case, project scope or quantities.
Cost pass-through	Adjusts allowances for costs incurred by the DNO over which they have limited control and that Ofgem determine should be recoverable in full.
Indexation	Provides DNOs and consumers some protection against the risk that outturn prices are different to those that were forecast when setting the price control.
Use-It-Or-Lose-It (UIOLI)	Adjusts allowances where the need for work has been identified, but the specific nature of work or costs are uncertain.

6. In the IMs, electricity distributions businesses (EDBs) only have access to three of these: re-openers, cost pass-through and indexation. We believe there is merit in exploring the merit of the other two: UIOLI and volume drivers.
7. Along with Horizon and Orion, Vector has advocated for UIOLI allowances to ensure specific areas of focus are addressed.
8. Horizon explained that UIOLI allowances would enable them to respond to changing consumer needs that may not have been forecast at the start of the DPP period.
9. Orion suggested that the Commission considers a Contingent Allowance where such unforeseen expenditure is imposed on lines companies due to legislative or market changes (which sounds very similar to UIOLI).
10. Now used in its third price control in the UK, Ofgem has a Worst Served Customers (WSC) UIOLI mechanism to reduce the number of interruptions experienced by those customers who experience an unusually poor service. In order to gain access to the allowance, EDBs have to demonstrate that the service to the WSC has indeed improved on an annual basis.

<sup>1</sup> RIIO-ED2 Final Determinations Methodology Overview, <https://www.ofgem.gov.uk/publications/riio-ed2-final-determinations>

11. Ofgem put this in place to ensure that their reliability incentive was backed up by a second framework which aims to get distribution networks operators (DNOs) focused on the type of customers which the reliability incentive did not reward specifically for.
12. Vector believes that the IMs could benefit from UIOLI mechanisms for Resilience and Worst Served Feeders.
13. Volume drivers are a key tool used by Ofgem to keep ex ante allowances low in the face of significant uncertainty regarding the pace of the Net Zero transition.
14. It is our view that trigger events that can be used to automatically adjust an EDB's allowance would remove the administrative burden on the Commission and enable a smooth and faster way to address incremental demand (an area which is unclear to be covered by re-openers – see below Coverage on re-openers section).
15. Please refer to our Proposal section at the end of the document for more details on how we think UIOLI allowances and volume drivers could be used in New Zealand.

#### Coverage of re-openers

16. The topic of coverage of re-openers featured heavily in the feedback to the workshop. Amongst submitters a number of expenditure areas were deemed as not applicable to one of the Commission's re-opener categories.
17. We agree with Wellington Electricity (WELL) and Electricity Networks Aotearoa (ENA) that Resilience expenditure is an area that is not adequately covered by the IM re-openers.
18. We also concur with the ENA and PowerCo who deemed that incremental demand is not captured by the major capex re-opener. The expenditure to respond to this scenario is unlikely to take the form of large discreet projects. Rather it will comprise of programs of numerous smaller scale projects and therefore not reach the threshold.
19. Please refer to our Proposal section at the end of the document for more details on how we think a UIOLI allowance for Resilience and a cost pass through for Storm Response could be used in New Zealand.

#### Capex vs opex re-openers

20. We agree with Horizon that it is increasingly important for operating cost re-openers to be an option for EDBs.
21. Additionally, Unison explained that:  
  
*“Re-opener categories that enable recovery of opex and capex (or a combination thereof) will achieve better outcomes, including provision for opex that is consequential to capex solutions.”*
22. There should be no discrimination in re-openers between capex and opex expenditure. In order to achieve the best outputs for consumers the two expenditure types should be interchangeable in order to achieve the most efficient solution.

#### Process and administration

23. There was a common theme from feedback to the workshop that currently re-openers are deemed to be administratively burdensome and time consuming.

24. Unison explained that re-opener 'light' processes with short timeframes are essential and can be aligned to criteria that have simple information requirements.
25. Horizon called for the introduction of a triage process where a summary of the issue is provided that allows the Commerce Commission to advise what additional information is needed.
26. PowerCo explained that the idea of a preliminary evaluation step was an excellent idea, as it will support a cost-effective process for the Commission and EDBs by ensuring applications have a reasonable chance of success.
27. Vector supports the standardisation of an assessment framework where lower value re-openers are fast-tracked with a standard amount of scrutiny but dealt with within three months by the Commission. And where higher value re-opener applications have additional scrutiny and dealt with between six to twelve months by the Commission.
28. An assessment framework will help EDBs with timeframe expectations and ensure that applications are dealt with differently depending on the value, keeping the process 'light-touch' in the spirit of the DPP.
29. We also recommend that the Commission considers using third party validation of applications as a way of fast-tracking submissions and reducing the burden on the Commission staff.

#### Better guidelines

30. Vector agrees with Unison, Horizon and WELL that re-openers require clarity of criteria, information, assessment, and timeframe.
31. Horizon has called for supporting information such as guidelines and practical workshops to help EDBs navigate the reopener process.
32. WELL explained that:  
  
*“A clear process with examples of the types of information needed to demonstrate that reopener criteria have been met would help streamline the process and avoid having to resubmit information. Proformas, examples and guidance would all be useful tools to confirm what’s needed in an application.”*
33. Vector requests that the Commission considers pulling together a simple guidance document to assist EDBs when applying for re-openers. If the Commission outlines its requirements clearly (outside of the IM determination) using simple language each party would benefit. This could easily be produced in collaboration with the ENA.

## Proposals

We have outlined below four proposals which we believe are in the best interest of consumers and can be introduced and applied in a low-cost manner.

### 1. UIOLI allowance for Resilience

Purpose	Ensure EDBs are being funded efficiently to respond to climate adaption
Benefits	If not used the allowances are returned to the consumer via prices, if used EDBs have more resilient and reliable networks in the face of severe events
What is it addressing that is not covered by the IMs?	Re-openers do not explicitly cover resilience expenditure, and this should be a real focus after Storm Gabrielle
How will the allowance be determined?	Forecasts from AMP24 for Resilience expenditure
How can EDBs gain access to the allowance?	EDBs can access the allowance from the start of the DPP. The forecasts would have been verified through the DPP reset process

### 2. UIOLI allowance for Worst Served Feeders

Purpose	Ensure EDBs are being funded efficiently to respond to outages on worst served feeders
Benefits	If not used the allowances are returned to the consumer via prices, if used EDBs rural consumers at the end of feeders will see improved reliability
What is it addressing that is not covered by the IMs?	SAIDI and SAIFI targets are set at the high voltage level and the incentive pushes towards investing to where the best reduction in targets can be achieved
How will the allowance be determined?	Forecasts carved out in AMP24 for Worst Served Feeders expenditure, but verified via consumer engagement
How can EDBs gain access to the allowance?	EDBs can access the allowance from the start of the DPP and must continue the engagement from the AMP24 process

### 3. Pass-through costs for Storm Response

Purpose	Ensure EDBs are being funded efficiently to respond to severe weather events
Benefits	There is no need to apply for funding and ultimately what is passed through will be audited through the Annual Price Quality Electricity Compliance Statement
What is it addressing that is not covered by the IMs?	Currently covered by the Catastrophic Event re-opener which is administratively burdensome, bound by regulatory periods and subject to interpretation of the IMs for its application. Climate change will result in more severe weather events. It is not practical or efficient for EDBs to always use the Catastrophic event re-opener to recover costs incurred responding to these events.
How will the allowance be determined?	No pre-determined allowances
How can EDBs gain access to the allowance?	EDBs can invest in the best interest of consumers without having to apply for ex post funding which is uncertain, and the process is slow

34. For RII0-ED2, Ofgem made Severe Weather 1-20 costs a pass-through item. Previously DNOs had specific allowances specifically for these events but due to the difficulty in forecasting their frequency and impact, they changed it to pass-through.
4. Volume driver for incremental demand
35. We believe there is merit exploring a volume driver triggered by incremental demand during the course on the next DPP. At some point we need a regulatory tool which will address the uptake of Low Carbon Technologies (LCTs) which will soon be the dominant driver of system growth and/ or consumer connections expenditure e.g. uptake of Electric Vehicles (EVs) and transition away from gas.
  36. It is challenging to predict the pace, location and local network impact of these technologies. This creates uncertainty over the volumes of network interventions which will be needed to ensure that connections of LCTs can be supported without compromising network reliability.
  37. In the UK Ofgem has introduced volume drivers to help manage this uncertainty without providing excessive ex ante funding.
  38. We would like to explore these four proposals further with other EDBs and the Commerce Commission to come up with low-cost solutions benefitting consumers in New Zealand.

Yours sincerely



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