Vector Limited
110 Carlton Gore Road
PO Box 99882
Newmarket
Auckland 1149
[redacted]

7 October 2025

Ben Woodham
Electricity Distribution Manager
Commerce Commission
Wellington 6011
By email: infrastructure.regulation@comcom.govt.nz

Dear Ben

Open Letter: Ensuring our approach to price paths is delivering for consumers

1. This is Vector's submission on the Commerce Commission's (Commission) open letter, *ensuring our approach to price paths is delivering for consumers.*

2. No part of this submission is confidential, and we are happy for it to be published on the Commission's website.

Process

3. We appreciate the early engagement and commend the Commission for proactively engaging in an important conversation about DPP5. Early engagement outside the formal DPP5 process will allow stakeholders to consider a broader range of topics in greater depth and through different engagement processes than the traditional submission process allows.

4. In line with the Commission's approach to DPP4, we recommend in-person workshops on specific topics along with formal submissions to provide more opportunities for stakeholders to share and challenge the perspectives of all parties.

Context for the DPP5 review

5. The Government has recently published its response to Frontier Economics report into New Zealand's electricity market.

6. We look forward to engaging with the Commission on the Frontier Report and Government response in due course. Due to the submission deadline we have provided limited comments in this submission. However, we understand the Commission may wish to address outcomes from this review in price-quality regulation going forward including in the DPP5 reset.

7. We would welcome the Commission indicating early its areas of concern and/or "objectives' it wishes to focus on or emphasise within DPP5. To encourage engagement

this could start with a "problem statement" to then spur dialogue and engagement. Dialogue with the industry and stakeholders could then explore areas of identified concerns or problems and build ideas on how these could be addressed in DPP5. Continued engagement outside a formal IM or DPP process provides a valuable opportunity for constructive dialogue and exploration of ideas between the Commission and other stakeholders about solutions to these issues. Vector welcomes any opportunity to participate.

IM review

8. A key consideration for the Commission will be whether the next IM review is held before or after DPP5. We note with interest Frontier's observations on the boundary between what is an IM versus one contained in a DPP decision[1] and believe this observation could underscore the importance of an IM review ahead of DPP5.

9. DPP5 will begin on 1 April 2030. The last IM review was completed on 13 December 2023. If the next review follows the 7-year review cycle, the IM review will be completed December 2030. This would be just a few months into DPP5. Any IM changes would immediately date the 2030 DPP5 decision and, instead, take effect in DPP6 in 2035. This does not seem efficient or timely. It runs the risk of bias (within all parties) to defend and maintain the status quo for IMs to avoid undermining a very recent DPP decision.

10. In the interests of ensuring regulatory best practice and engaging with the rapidly changing context of electrification, we would hope that the Commission sees strong and obvious merit in using a review of the IMs ahead of DPP5 as a valuable opportunity to test the appropriateness of the key and fundamental building blocks of the regulatory regime and ultimately underscore the credibility of an eventual DPP5 decision.

11. Accordingly, we strongly recommend the Commission brings the IM review forward to ensure relevant IM changes can be in place for DPP5.

12. We consider there are some immediate candidate topics to be explored within the IMs including:
    - Moving to a trailing average approach to calculate the cost of debt;
    - The introduction of a financeability test;
    - IRIS and efficiency mechanisms including stronger incentives for avoided costs;
    - Clearer delineation between the roles of the Electricity Authority and Commission;
    - Better use of uncertainty mechanisms; and
    - Consistent treatment of asset lives.

[1] Frontier Economics, *Review of Electricity Market Performance* (23 May 2025). Frontier noted that, "*The Commission has increasingly relegated the process of determining the methodologies it will use to make important aspects of price-quality decisions to the price review process, rather than developing those methodologies as part of periodic IM reviews*" at 8.5.3

Trailing average cost of debt

13. The Commission is currently consulting on shared elements of the WACC as part of the 2027 Fibre IM review. Submissions on the issues paper (tranche 1) showed strong support for the Commission to introduce a trailing average approach to the cost of debt.

14. We consider a trailing average cost of debt will better support the long-term benefit of consumers by reducing volatility associated with changes in interest rates.

Financeability testing

15. The recently published Frontier report into New Zealand's electricity market recommended introducing, "*a mandatory obligation for the Commission to undertake financeability tests when making price-quality determinations. This provides an essential reasonableness check on the Commission's decisions, and provides investors with greater certainty that committing to large (welfare-maximising) network investments will not result in a deterioration in an efficient EDB's credit rating*."[2]

16. The Government disagreed with this recommendation, however, we understand this was based at least in part on the Commission considering and rejecting a financeability test in the 2023 IM review.[3]

17. We consider Frontier's recommendation provides an opportunity for the Commission to re-test its previous IM decision on financeability. As set out in the Frontier report, including a financeability test in the IMs would promote the long term benefit of consumers by providing greater confidence to investors and therefore support the ability and incentives of EDBs to invest.

18. We also recommend the Commission consider (including as part of the IM review) making explicit the principle that EDBs can recover their building blocks allowable revenue over the DPP period rather than deferring this recovery into later years. We note the Commission in DPP4 was very clear on the principle of "revenues within the DPP." We consider the long-term interest of consumers could be better served if that principle was now enshrined into an IM.

19. Deferring cashflows beyond the regulatory period would introduce significant uncertainty into the regime by:

---

[2] Frontier Economics, *Review of Electricity Market Performance* (23 May 2025), page 113

[3] MBIE, *Key Frontier recommendations and the Government's response,* available: https://www.mbie.govt.nz/dmsdocument/31231-key-frontier-recommendations-and-the-governments-response

- Introducing regulatory risk since there is no guarantee future regulatory settings will allow this cost recovery; and
- Introducing a systematic interest rate risk since longer term cashflows are more sensitive to changes in interest rates.[4]

20. Accordingly, making this principle clear in the IMs would provide regulatory certainty and therefore promote incentives to invest.

Clearer delineation between the roles of the Electricity Authority and the Commerce Commission

21. The Electricity Authority currently has a substantial and ongoing work programme involving widespread regulatory change in various areas.

22. It is important the sector has confidence that cost changes imposed by the Authority will be addressed in expenditure allowances by the Commission.

23. In addition, we have observed an increasing trend for the Authority to undertake work that would traditionally be assumed to fall within the Commission's remit. This creates uncertainty for regulated businesses and risks the duplication of costs.

IRIS and efficiency mechanisms

24. The next IM review provides an opportunity to consider whether IRIS is working as intended to promote efficiency or whether other mechanisms or amendments are necessary.

25. We note the IRIS currently does not reward avoided costs that were not already included in the price path (i.e. a proposed plan/strategy to avoid costs that is baked into a DPP reset means the broader avoided cost strategy is not recognised or rewarded as "savings").

Uncertainty mechanisms

26. The regulatory framework currently relies on re-opener and CPP applications to manage expenditure that was not included in the price-path. We consider reliance on re-openers and CPPs is a key source of uncertainty in the framework.

---

[4] Oxera's report for the Big Six EDBs during the DPP4 financeability consultation provides further details on why cashflows should not be deferred beyond the regulatory period. (Oxera, *Response to the New Zealand Commerce Commission consultation on the financeability of electricity distribution services in the fourth default price-quality path (DPP4)* (March 2024) available: https://blob-static.vector.co.nz/blob/vector/media/vector-2024/oxera-big-6-edbs-financeability-issues-paper-submission-15-march-2024-cleaned.pdf)

27. Re-openers and CPPs are unable to deal with situations where expenditure does not meet the high threshold to apply for a re-opener (i.e. $5 million for Vector) but is still significant. They also involve a substantial workload burden for the EDB to prepare and the Commission to assess. This incurs administrative costs.

28. As discussed above, the Electricity Authority currently has a substantial and ongoing work programme involving widespread regulatory change in various areas. Costs associated with these changes (for example changes to EDB processes that necessitate digital upgrades) may not meet the threshold for a re-opener individually. It is likely that cumulatively these changes would meet the threshold, however, as they relate to different Code amendments they may not qualify for a re-opener.

29. S54V of the Commerce Act requires the Commission to reconsider the price-path following a Code change if requested to by the Electricity Authority (and must amend the price-path "if it considers it necessary or desirable to do so"). However, this provision leaves significant discretion to the Commission (in considering) and the Authority (in making a formal request). It is unclear how it will be used over the DPP4 period and does not alleviate considerable uncertainty in the sector, particularly given the Authority's wide and ambitious work programme.

30. Changes arising from the Government's response to the Frontier report could also potentially result in this issue in DPP4.

31. We consider more streamlined mechanisms are needed to deal with unforeseen costs. We strongly recommend the Commission consider –
    - Use-it-or-lose-it or other contingent allowances; and
    - Greater use of pass-through and recoverable costs.

32. We have provided further comments on where these mechanisms could be needed in DPP5 below.

Asset lives

33. As raised during the DPP4 submission process, the current IMs do not treat asset lives consistently. The IMs require new additions to use a 45-year life while existing assets are calculated on an asset-by-asset basis.

34. We recommended this mismatch be addressed in DPP4. The impact of this issue is likely to be even greater in DPP5 as digitalisation continues and EDBs spend a higher proportion of expenditure on assets with shorter lives.

35. Accordingly, to avoid compromising incentives to invest we recommend amending the 45-year asset life assumption for new additions to be consistent with the asset-by-asset approach for existing assets.

Non-traditional solutions to manage load shifting

36. The open letter notes an area of focus could be whether current settings, "*promote the efficient use of EDBs' networks and existing capacity, including greater use of non-traditional solutions and managing or incentivising load shifting.*"

37. We agree greater use of non-traditional solutions to manage load shifting can support the long-term benefits to consumers and expect that, over the course of DPP4, EDBs will use INTSA funding to pursue innovative solutions to manage load.

38. We note there are limitations in the use of flexibility services (and other non-traditional solutions) to manage load to avoid traditional investment.

39. EDBs can only defer investment through load shifting when they have visibility and control over the devices. While EDBs can manage this for commercial customers with individual contracts, they do not have visibility or control over load shedding in the residential market. However, this is where the greater impact in terms of deferral of investment would occur on our network.

40. In addition, it is important to recognise deferring investment, unless it is for a meaningful period, may not always reflect the most efficient outcome for the network or consumers. In a period of high network growth and potentially inflationary cost pressures, it is not inconceivable that it may be more efficient to build than defer. i.e. anticipatory investment may in some circumstances be more efficient than the traditional "just-in-time" investment approach.

41. Accordingly, while we agree non traditional solutions and load shifting are an important tool to promote the use of the network and existing capacity, it is important to have realistic expectations about what this can currently achieve in terms of overall network expenditure and, in particular, those circumstances where an EDB may have little confidence of aggregators/intermediaries manging devices for network purposes.

42. We consider DPP5 can better incentivise the use of non-traditional solutions and load shifting by including:
    - **Appropriate uncertainty mechanisms**: Neither EDBs nor the Commission will have certainty over whether approaches to load shifting (e.g. through pricing or other non traditional solutions) will be successful in deferring the need for capex at the time the price path is set. The DPP will need to include more streamlined mechanisms (e.g. a contingent allowance) for EDBs to incur additional capex if needed. The re-opener process would be too uncertain, slow and administratively burdensome of EDBs to rely on in this context.

- **Appropriate opex allowances**: Non-traditional solutions may not be included EDB base years for DPP5. For example, the market for procuring flexibility services is developing in New Zealand. EDBs do not currently have opex allowances for procuring flexibility which is a disincentive for EDBs to invest in this market.
- Expenditure related to INTSA projects may transition to recurrent opex spending in DPP5.

- **Use of pass-through costs**: We consider pass-through costs would be an appropriate mechanism for an EDBs to make payments for flexibility procurement provided they can demonstrate the costs reflect market rates.
- Currently the IMs allow EDBs to treat connections to the transmission grid as a pass-through cost. However, connections to another EDBs network cannot be treated as a pass-through cost. There are opportunities for EDBs to connect to neighbouring EDBs to improve quality of supply without needing to incur capex (and instead paying lines charges). The IMs should incentivise this to occur by treating these payments as a pass-through cost in line with the approach to transmission charges.

Quality of supply

43. We recommend the Commission further consider quality of service measures that could deliver better customer outcomes in DPP5 beyond the current quality standards and quality incentive scheme.

44. We consider direct payments to customers affected by outages would reflect a better customer outcome than current quality standards that result in a penalty payment that is not targeted at the most affected customers.

45. It could be an option for EDBs to make payments to customers at poorly performing feeders funded through opex allowances (provided adequate customer consultation has been undertaken, and these customers are willing to accept more outages in return for these payments or lower charges). This could avoid the need for more expensive capex investment to strengthen the network in specific areas while still maintaining positive customer outcomes and therefore overall improve efficiency.

Better use of AMPs

46. We encourage the Commission to rely more on AMPs in setting expenditure forecasts for DPP5.

47. Historic expenditure is not a good predictor of future expenditure in a period of rapid change arising from electrification.

48. AMP forecasts with appropriate scrutiny from the Commission combined with uncertainty mechanisms in the price path are more likely to deliver an efficient level of expenditure.

49. We are aware the Commission has concerns about inconsistency in the assumptions used as inputs into EDB AMPs (e.g. assumptions on EV uptake and gas conversions), along with more generally how to improve the quality of AMPs. We agree these should be specific topics of engagement for DPP5.

Deferred tax allowance

50. The Commission currently uses Diminishing Value (DV) method for tax depreciation in its DPP modelling. However, some EDBs, including Vector, use Straight Line (SL) depreciation for tax.

51. We recommend the Commission use tax depreciation method actually used by each EDB by building in the ability to switch between DV or SL tax depreciation methods in its DPP5 financial model. This will ensure the Commission's model aligns with each EDBs tax depreciation method used for Information Disclosure, resulting in a more accurate Deferred tax balance and RIV.

Next steps

52. We look forward to engaging with the Commission on these important "shaping" topics. We would welcome any opportunity to engage.

Yours sincerely

Imogen Welling
Senior Regulatory Counsel