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Commerce Commission

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By email: infrastructure.regulation@comcom.govt.nz

Dear Ben

Reconsideration of DPP3 default-price quality path for Vector – Cyclone Gabrielle catastrophic event: submission on draft determination

1. This is Vector's submission in response to the Commission's draft decision on our application for a catastrophic event reopener.
2. Overall, we welcome the Commission's decision to reopen the DPP3 price path and determine a catastrophic event allowance of \$3.649 million to compensate for IRIS penalties that would otherwise be incurred in relation to remediation costs incurred in response to Cyclone Gabrielle, plus the impact on our quality incentive adjustment.
3. We also welcome the Commission's confirmation that, for purposes of applying the materiality threshold, event-related capex is treated as being incurred in the year in which it is spent, even if the assets are commissioned in a later year.
4. In two respects the Commission has taken a different approach to that presented in our application.
5. First, the Commission has interpreted "additional net costs" as meaning those approved remediation costs not recovered through capex retention or IRIS mechanisms. While we remain of the view that it was open to the Commission to interpret this in terms of the difference between BBAR amounts, we acknowledge that the Commission's approach is simpler as it does not require IRIS adjustments to prevent double-recovery. It does, however, mean that recovery of remediation expenditure is deferred, which may have significant cashflow implications for affected EDBs, particularly if those remediation costs are very substantial.
6. Second, the Commission has determined that the January flooding and Cyclone Gabrielle are separate "events" for purposes of the catastrophic event reopener, and therefore the materiality threshold has to be met independently for each of the flooding and the Cyclone. In our view that distinction is somewhat artificial and the Commission could reasonably adopt a more flexible approach that would also be consistent with the IMs and the purpose of Part 4.

7. The remainder of our submission focuses on that issue.

Characterisation of the January floods and Cyclone Gabrielle as separate events

8. As defined in the IMs, the catastrophic event reopener applies to a catastrophic “event”. For purposes of our application, we defined the relevant “event” as the state of emergency declared across the Auckland region between the dates of 27 January 2023 and 14 March 2023. That state of emergency was occasioned by an unprecedented and extended period of extreme weather, including severe flooding events on 27 January and 1 February and Cyclone Gabrielle.

9. In its open letter of 20 October 2023, the Commission said:

“Our preliminary view is that the impacts of Cyclone Gabrielle and Auckland floods of 2023 cannot be combined into one catastrophic event for the purposes of a reopener, as the two are separate meteorological events with different causes. We would be happy to consider information/analysis which may support a different view.”

10. In our application, we explained why we considered the event should be defined with reference to the continuous state of emergency rather than the flooding events and Cyclone Gabrielle separately

11. In the draft decision, the Commission said:

“Our view remains that “the impacts of Cyclone Gabrielle and Auckland floods of 2023 cannot be combined into one catastrophic event for the purposes of a reopener, as the two are separate meteorological events with different causes.”

Based on the information currently before us, we are not satisfied that combining multiple events into one is consistent with the relevant IMs or better promotes the long-term benefit of consumers under s 52A of the Act. Cyclone remediation costs may have been higher for reasons related to the floods, but costs directly related to the floods are ineligible under this reopener.”

12. The IMs do not themselves define what an ‘event’ is, which leaves some flexibility to determine what comprises an event and – critically – whether a sequence of extreme weather constitutes a single continuous event or several discrete events. We do not think the drafting of the IMs prevented the Commission from taking a more flexible approach in this case. The term ‘event’ is sufficiently broad to capture a series of proximate and related occurrences with a related cause or impacts.

13. Whether a weather sequence constitutes a single event or several discrete events is ultimately a question of characterisation. From our perspective, the period between 27 January 2023 and 14 March 2023 was a single and continuous weather-related state of emergency. That was the ‘event’ for which we sought to reopen the price path.

14. In our application we explained that:

- The January floods and Cyclone Gabrielle were proximate in time, taking place within a period of three weeks;
- The impact on Vector's network was essentially continuous. Auckland suffered major flooding on 27 January and then further flooding on 1 February. By 8 February it was apparent Cyclone Gabrielle would be a major event for Auckland;
- Both the January floods and Cyclone Gabrielle occurred under a continuous regional and then national state of emergency declared on 27 January 2023. That state of emergency was extended on 3 February and again on 9 February. The state of regional emergency was superseded by the declaration of a national state of emergency on 14 February 2023. That national state of emergency was terminated on 14 March 2023;
- The impacts of the January floods and Cyclone Gabrielle were closely connected and cumulative. Damage to the network that was immediately caused by Cyclone Gabrielle was made more likely or exacerbated by damage to assets suffered in the January floods, as well as continuation inundation and wet ground conditions that precipitated further damage to assets;
- The costs of responding to that period of extreme weather cannot be precisely attributed to either event. Some proportion of the costs incurred during and subsequent to Cyclone Gabrielle would also be partly or wholly attributable to the January floods. For example, damage suffered as a result of Cyclone Gabrielle was made more likely as a result of ground inundation in the prior weeks.

15. In contrast, the Commission has characterised that period as constituting two discrete events on the basis that were "separate meteorological events with different causes". While we acknowledge that is an available interpretation, it is not the only interpretation available.

16. Moreover, whether a something is defined as one event or several depends in part on how the proximate cause is defined. Even within a single meteorological event, it would be possible to determine more granular instances of localised damage with differing proximate causes. The definition therefore depends on how the proximate cause is described, which again requires choices to be made.

17. Plausible scenarios help to illustrate that this exercise can be somewhat artificial. Imagine, for example, a major earthquake with a series of aftershocks occurring in the immediately following days. An aftershock can quite credibly be described as a distinct 'event' as that term is used in ordinary language, or equally as part of an overall earthquake event. A reasonable approach in that scenario would be to assess the damage related to that sequence of earthquakes as a whole, rather than seek to draw artificial distinctions.

18. In our view, seeking to distinguish between aspects of the unprecedented period of extreme weather between late January and early March is similarly artificial. It certainly does not reflect the lived experience of Vector during that time.

19. We also don't think this approach is inconsistent with the purpose of the reopener or the scheme of the IMs. Whether the flooding and cyclone are treated as several events or one event is only relevant to the application of the materiality threshold. There is no doubt, in our view, that the flooding in isolation would meet the remaining criteria for a catastrophic event. The flooding was beyond Vector's reasonable control, unforeseen, extremely damaging, and required expenditure not in contemplation when the DPP was set. So its characterisation as a separate event is only relevant to the application of the materiality threshold. The Commission's 2010 Reasons Paper explained that the purpose of the materiality threshold was to ensure that price paths were only reconsidered where the benefits of doing so outweighed the expected costs:¹

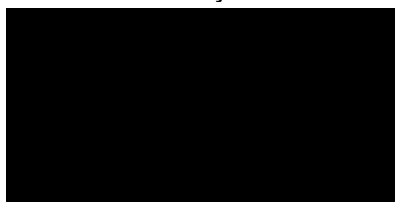
Reconsidering a price-quality path could be a costly and time consuming task, and leaving the criteria too broad could give rise to moral hazard.³⁹⁸ As a result, price-quality paths should only be reconsidered in circumstances where the benefit of reconsidering the path is expected to outweigh the likely cost (including both immediate and longer term costs), with other risks the responsibility of the supplier.

(³⁹⁸ Moral hazard refers to the situation where the regulated supplier would not be sufficiently incentivised to minimise the costs or likelihood of events that constitute a reconsideration of the price-quality path.)

20. We don't think characterising the sequence comprising the floods and the Cyclone as a single continuous catastrophic event engages these concerns. Given the price path is being reopened in any event, it is not the case that extending that consideration to the flooding results in costs that outweigh the benefits of reconsideration. Moreover, compensating Vector for the impacts of the flooding is unlikely to create a moral hazard for future events.

21. We recognise that this issue calls for judgement, but under the very unique circumstances of these events, we think it would be reasonable for the Commission to treat the 'event' as the state of emergency occasioned by a sequence of extreme weather, rather than characterising the flooding and cyclone as discrete events.

Yours sincerely



Richard Sharp
GM Economic Regulation and Pricing

¹ Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) – Reasons Paper* (December 2010) at paragraph 8.4.8.