



15 March 2024

Ben Woodham
Manager, Electricity Distribution
Infrastructure Regulation
Commerce Commission
Wellington
Via email: infrastructure.regulation@comcom.govt.nz

Tēnā koe,

Powerco's submission on EDB DPP4 financeability paper

Powerco Limited (Powerco) welcomes the opportunity to contribute to the discussion on the Commerce Commission's issues paper, "DPP4 reset – Financeability of electricity distribution services in the default price-quality path."

Financeability in the DPP4 reset is crucial for EDBs and our customers as we strive to meet Aotearoa's electrification needs, contributing to a net-zero economy by 2050. As one of Aotearoa's largest gas and electricity distributors, servicing approximately 356,000 homes and businesses with electricity and 113,000 with gas across the North Island, our energy networks play a crucial role in achieving this goal.

Feedback on the consultation paper

Our response to the issues paper questions is provided in Attachment 1. If you have any questions about this submission, please contact Jeremy Smith (jeremy.smith@powerco.co.nz).

Nāku noa, nā,

A handwritten signature in black ink, appearing to read "Stuart Dickson".

Stuart Dickson
General Manager, Customer
POWERCO

Attachment 1: Powerco's views on matters raised

We support the ENA's submission on this paper and the "Big 6" submission of report by Oxera.

The issues paper concisely summarises the financeability issue as being:

"Financeability refers to the ability of firms to raise and repay debt and raise equity in financial markets, readily and on reasonable terms, to fund investment needs. In a Part 4 context, we interpret this as the ability of a prudent and efficient notional supplier of a regulated service to access capital on a basis that approximates the assumptions that underpin our estimate of the cost of capital. ¹"

Analysis of the notional supplier

The notional supplier is the basis of assumptions used for setting revenues for a DPP that is consistent with ex ante financial capital maintenance. These assumptions include the BBB+ credit rating, leverage and determined WACC. If an issue arises in this notional analysis, there is an issue of financeability in the DPP. Analysis of a particular supplier's actual circumstances, who will likely vary from the assumptions of a notional supplier, is not comparable or useful in setting the DPP. As the Commission has noted in the paper's introduction: "Our focus is the financeability of the provision of the regulated service, not the supplier of that service whose overall financial position and outlook may be affected by its management choices and non-regulated activities." The DPP should be set in a way that ensure the notional supplier of the regulated service, has cashflows sufficient to support approved expenditure and maintain the BBB+ credit rating throughout the period.

The Commission has proposed a 'sense check' to understand the extent to which financeability issues may be relevant, however has declined to outline the thresholds, metrics, or outcomes of this test. The paper continues (X11) where it describes the test for a "prudent and efficient supplier", without further explanation. EDBs need regulatory certainty on how these tests will be applied. Without a prescriptive test outlined, stakeholders are unable to comment on the suitability of such a test or provide constructive feedback. This gives the Commission a disproportionately high level of discretion on such a critical issue, as we take the next step in electrification.

DPP Decisions that will affect financeability

There are several aspects of the DPP reset that will impact the financeability of a supplier including:

1. X-factors applied to tilt the profile of cashflows (default or alternative)
2. Revenue smoothing limits, including the allowed P0 between DPP's

¹ Financeability paper page 7 (para 1.4)



The Commission has identified (3.15) that these mechanisms could result in negative cash flow to a prudent and efficient notional supplier requiring them to take debt beyond a level necessary to maintain the notional BBB+ credit rating and have to seek additional equity at a cost. The Commission should set revenue smoothing limits, and X-factors in a way that ensures the notional supplier that does not have periods of sustained negative cashflows, to ensure the financeability of the supplier. This will protect the long-term interest of consumers and preserve EDBs incentives to invest. Any Financeability test should be performed post application of X-factors or revenue smoothing.

The primary driver of the increase in revenue for the upcoming DPP period will be the updated WACC, increasing from abnormally low levels in DPP3, primarily due to the risk-free rate and the way the current IMs calculate the cost of debt. This required increase in revenue, also driven by the RAB growth seen over the DPP3 period, should not be impacted by any smoothing or x-factor mechanisms. Doing so could lead to financial hardship and financeability issues for the notional supplier, left without sufficient cashflow to support the existing network, before considering the heightened operational and capital expenditure required for this DPP period.

We are supportive of a smoothing limit specified in real terms (rather than nominal terms) to changes in distribution revenue and recoverable costs, including wash-up amounts. This limit should only bind as an exception and not capture variation in wash-up balances and incentive payments. The reference revenue against which the limit should be specified should be the forecast allowable revenue from the price-setting compliance in the year before. This will eliminate the concern of undercharging leading to a lower revenue limit in the future. This is consistent with having a limit that is less likely to bind in most cases and doesn't lead to excessive value in the wash-up account.

We are also supportive of including a 'quantity' adjustment to the smoothing limit, as the overall change in allowable revenue is not an accurate representation of the price change consumers will receive. As volumes and consumer numbers increase, revenues are spread over a greater number, leading to 'price' increases that are lower than the increase in forecast allowable revenue. For example, in 2024 Powerco's forecast allowable revenue increased by 8.8% when compared to 2023, however, overall price change was only 7.3%² due forecast increases in customers and usage.

We support the inclusion of additional allowances for equity issuance costs, equity raising, if required, is not a costless exercise and support the Commission adopting an approach like the AER in the financial model as part of the return on capital BBAR component.

It is inconsistent that the Commission's view is that financeability is better addressed with a CPP, however, go on to mention that financeability issues would not be grounds on their own for a CPP application. This supports addressing financeability within the DPP. Financeability is a concern for all EDBs and should be addressed by providing sufficient cashflows in the DPP to support the allowed expenditure and maintain the assumed BBB+ credit rating throughout the DPP.

² [Reasons for Change FY24](#)