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Tēnā koe Ben,

Powerco's response to Aurora Energy's transition to the 2025-2030 DPP Draft decision reasons paper

Powerco Limited (**Powerco**) welcomes the opportunity to respond to the Commerce Commission's (**Commission**) draft decision on Aurora Energy's (**Aurora**) transition to the 2025-2030 Default Price Quality Path (**DPP**). The Commission's approach to setting DPP4 was pragmatic and set electricity distribution businesses (**EDBs**) up well to deliver towards the energy transition over the next 5 years.

As the majority of the Commission's draft decision adopts DPP4 settings we do not comment further here but rather, focus our submission on the Commission's draft decision regarding opex. It's a critical time for EDBs and expenditure allocations have a fundamental impact on our ability to support the energy transition. Our summary views on this include:

Applying strict efficiency adjustments during a period of change can be counterproductive

- We agree in principle that, all else being equal, EDB costs should step down post Customised Price Quality Path (**CPP**) to reflect where one-off CPP costs are no longer required and ongoing efficiencies have been realised through the CPP investment.
- However, the Commission's recommendation is based on an extrapolation of historical / desktop benchmarking undertaken by Strata in 2019/20. DPP4 settings highlight the investment and growth outlook for EDBs has changed significantly to a period of substantial investment in capacity and reliability.
- We query the appropriateness of applying downward efficiency adjustments in anticipation of discovery, during a period of investment. In a competitive market, firms need to increase inputs (new capability, capacity, systems and staff) in the short-term before outputs / efficiencies "catch-up".
- Ofgem recognises applying efficiency adjustments during periods of investment growth can discourage necessary investment and undermines long-term outcomes.

More analysis is required to ensure

- Application of elasticities as part of the scale trend, already accounts for efficiencies by capturing the fact that opex will grow more slowly than output growth and

no double counting of efficiencies

accounts for an 11% ($5.6m) reduction in non-network opex for Aurora across DPP4.

- Given the importance of ensuring opex allowances are sufficient, we propose the Commission update its analysis and clearly set out how each of the efficiency adjustments have been taken into account within each of the BST mechanisms.
- This ensures there has been no double counting of efficiencies.

If you have any questions regarding this submission or would like to talk further on the points we have raised, please contact Emma Wilson (Emma.Wilson@powerco.co.nz)

Nāku noa, nā,

Emma Wilson
Head of Policy, Regulatory and Markets
POWERCO

It's a critical time for EDBs, in a difficult environment

The Commission's decision on Aurora's transition to a DPP comes at a critical time for ensuring all EDBs have the right incentives and funding to deliver the growth and change required to meet evolving customer preferences and Aotearoa's electrification needs.

Changes in demand, and increasing resilience needs, are difficult to forecast perfectly, but the one thing we can be sure of is that they will not be linear. Electrification is likely to move in step-changes with the adoption of new technology and climate impacts being unpredictable and potentially sudden. In addition, the impact of DPP4 price increases is still sensitive, and affordability is front and centre for the whole sector.

In this context, we appreciate how challenging these regulatory resets are as the Commission's decision must balance price shocks to customers with ensuring adequate levels of funding to efficiently meet the demands of consumers.

The Commission's primary purpose is to promote the *long-term* benefit to consumers. Underfunding opex in the short-term creates problems for future periods where catch-up on spend is required. This was evident during DPP3 where allowances were too low given the level of inflation and escalating costs, which required big step-changes for DPP4.

Focusing on short-term impacts is likely to be detrimental to customers over the long term if underfunding EDBs results in slowed energy transition as EDBs are forced to trade-off investing in the energy transition against maintaining performance. Ofgem also recognises this point by noting that incentives alone, intended to drive efficiencies in expenditure, could instead potentially encourage short-term decision making and result in underinvestment.[1]

EDBs are in a transition away from steady state to a period of growth

In a stable operating environment, we agree with the Commission that any EDB transitioning off a CPP to a DPP should be expected to see reduced opex reflecting the removal of one-off costs to support the CPP works programme and ongoing efficiencies realised through the accelerated CPP investment.[2]

However, the Commission's draft decision fails to acknowledge that EDBs are not currently in a steady state environment as is frequently referred to and relied upon throughout the draft decision.[3] Rather, the Commission's decision is taking place in a period of change and investment for the sector, where EDBs play a key role in enabling the electrification of New Zealand.

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[1] https://www.ofgem.gov.uk/sites/default/files/2025-04/ED3-Framework-Decision.pdf, para 3.24

[2] Commerce Commission, *Aurora Energy's transition to the 2025 to 2030 default price quality path draft decision reasons paper*, 29 July 2025, at 4.23

[3] Commerce Commission, *Aurora Energy's transition to the 2025 to 2030 default price quality path draft decision reasons paper*, 29 July 2025, at 4.23, 4.24

To meet customer expectations and support forecast demand growth, a material uplift is needed in both network and non-network solutions, supported by improved capability and systems. That investment needs to include adequately resourcing EDBs to enable them to foster emerging markets in flexibility that reduce long-term costs and enhancing security of supply.

We want to reiterate key messages from our submissions during the DPP4 reset process,[4] which highlight the risks of underfunding opex at a such a critical time. There is real risk that if EDBs are forced to prioritise opex to core functions to stay within allowances and meet quality standards, this could be incentivising them to make capex investment to support electrification even when an opex solution was the more efficient solution or defer critical expenditure.

As previously noted by the Commission,[5] opex allowances provide resources for EDBs to fund recurring activities that are not capex, including activities essential to the network operation such as maintenance and planning. This does not recognise the key role of opex in preparing for and delivering non-network solutions, nor does it capture the increase in operations activities due to network growth, decarbonisation requirements, and advances in data and digital led solutions.

We recommend the Commission updates and expands its analysis to ensure unrealistic efficiency assumptions aren't applied

We are concerned the Commission's draft decision is focused on an operating environment back in 2020 and heavily relies on benchmarking analysis conducted using outdated information. This causes real concern at a time where underfunding opex can have material consequences which ultimately come at a cost to customers over the longer-term.

We highlighted in our submissions throughout the DPP4 process that the base-step-trend (**BST**) approach, despite the tweaks made for DPP4, do not account for changing customer preferences and emerging technologies that are not reflected in historical expenditure. The BST has limited application in these circumstances which increases the forecasting risk in a dynamic operating environment.[6]

In addition, it's important the application of the BST methodology clearly explains how efficiency adjustments of each type of gain are being accounted for, otherwise there are risks of double-counting or setting unrealistic efficiency targets. NERA's report sets out types of productivity gains and how each BST mechanism captures the different types of efficiency.[7] Types of productivity gains include:

- **Catch-up productivity** – an inefficient firm becomes more efficient (i.e. a firm was underperforming and now adopts industry best practice)
- **Scale economies** – a firm's average costs decrease as it increases output (fixed costs don't scale with output)

[4] Powerco, *Powerco Submission on EDB DPP4 draft decision*, 12 July 2024 at para 9

[5] Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – Draft decision*, at 2.72

[6] Powerco, *Powerco Submission on EDB DPP4 draft decision*, 12 July 2024 at para 60

[7] Nera, Chorus opex productivity target for PQP2, 16 May 2024, table 2.1 and 2.2

- **Frontier shift** – an efficient firm becomes more efficient (e.g. technology advancement).

Table 1. Productivity mechanisms and the corresponding types of productivity gain they can capture

BST Mechanism	Description	Effective at targeting
Step Changes	One-off adjustments made to the base year	Catch-up productivity / efficiency
Elasticities	Scale factor to the output trend that determines how much allowed opex should grow for a given increase in outputs (i.e. connections). A higher elasticity increases the opex allowance, all else equal. If the elasticities of the outputs sum to less than 1, then the model incorporates an assumption of increasing returns to scale (e.g. a 1% increase in output results in a less than 1% increase in opex)	Scale economies
Productivity	An offsetting reduction to the output trend based on an overall expectation of annual improvement in opex efficiency	Frontier shift

Using NERA's analysis, it's not clear how the 6% per annum negative step change for SONS and business support for assumed efficiency reconciles with the efficiency assumption already included in the Commission's BST approach.

The Commission's BST methodology applies a cost elasticity assumption, which already reflects economies of scale and scope (i.e. efficiencies), through the assumption that opex grows more slowly than output growth.[8] On the face of it, it appears that the annual negative step change for SONS and business support is attempting to address a mix of the above efficiency mechanism, which risks double counting.

We suggest the Commission conducts further analysis, to clearly show what efficiency adjustments are taken into account as part of the elasticity assumption, and then separately consider whether there are any further factors (i.e. additional efficiencies through SONS and business support) that justify any additional efficiency adjustments. Our initial analysis suggests the elasticity assumption accounts for an 11% ($5.6m) reduction in non-network opex for Aurora across the DPP4 period.[9]

While the Commission has responsibility to safeguard that customers aren't paying for inefficient costs, it also has equal responsibility to ensure that it does not preclude efficient costs by over-applying assumed efficiency gains in anticipation of discovery. Given the Commission has relied on outdated information to determine the downward efficiency adjustment in SONS and business support opex, it must be absolutely sure that they are not double counting efficiencies.

[8] This point is illustrated by Incenta's work for Chorus' PQP2 proposal – Including a productivity assumption in opex forecasts, 16 May 2024

[9] Powerco analysis of Opex projections model Aurora DPP4 Draft 29 July 2025.