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Tēnā koe,

DPP5: setting a renewed approach to regulate & incentivise future electricity distribution

Powerco Limited (**Powerco**) welcomes early engagement and the opportunity to respond to the Commerce Commission's (**Commission**) Open Letter.[1] As acknowledged by the Commission, the energy sector is in a period of change and uncertainty, and the pace of this change may accelerate over the fourth Default Price-Quality Path (**DPP4**) period.

The transition to a net zero emissions energy system is fundamental for New Zealand's future both in terms of responding to climate change and to capitalise on the commercial opportunities for the country that the transition represents. DPP5 regulatory settings are critical to ensuring the right incentives exist for electricity distribution businesses (**EDBs**) to deliver the electricity services that customers want in the future. It is clear that many efficiency opportunities can be delivered via flexibility arrangements that defer (or replace) capital expenditure and incentives for EDBs to actively pursue such efficiencies should therefore be a priority. In our view, the priority topics to investigate for DPP5 are:

Incentives to drive efficiency

- Regulatory incentives should drive efficiency and affordability, but current incentive mechanisms[2] result in neutral economic outcomes where capex and opex are substituted within a period. The equivalence of IRIS means that EDBs aren't penalised for substituting one for the other, but they are also not always better off if they do.
- The base year sets a clear starting point for setting allowances and measuring performance. Tracking improvements over time and identifying areas for efficiency gains relies on accurately setting the base year. Current scrutiny of the base year is limited.
- We also don't think sufficient incentives exist to drive scale economies or consolidation.

Consistent regulatory

- Tighter regulation is a useful mechanism to lift performance, however, to benefit all consumers, all distributors need to be consistently regulated. If the regulatory settings do not support investment in capability adequately and consistently, it

[1] Commerce Commission, *Open letter: Ensuring our approach to price paths is delivering for consumers*, 25 August 2025
[2] The equivalence of IRIS retention rates for capex and opex for non-exempt EDBs

treatment to lift performance	creates a real risk of postcode differences in electricity services, quality and affordability. • Regulation that targets highest performance across the sector, will be most effective for the energy transition. Increased scrutiny of performance may be required.
Quality metrics that reflect what customers value	• Quality metrics need a new approach to better align with what customers are looking for in electricity services (e.g. resilience and customer service metrics). • Metrics need adjusting to reflect New Zealand's future electricity system and changes in how we use assets and services (e.g. Distributed Energy Resources (**DER**), utilisation and affordability of connection process metrics). • Decentralised solutions for supply and demand will require new capabilities from all EDBs and will also increase variances between different parts of a network. Metrics will need to capture these changes.

We comment further on these priority topics in the attached. These topics, the interrelationship between them, and their impact makes for complex analysis. This period ahead of DPP5 is an opportunity to consider new approaches to regulatory settings. We encourage the Commission to use this period to undertake in-depth analysis and workshops with an openness to potential for bold changes. A few of our priority topics may not be possible with current legislation, however we strongly encourage consideration of a review of Part 4 of the Commerce Act 1986 (**Part 4**) prior to DPP5 – as this is a critical time.

While we have tried to keep our discussion in this response focused on the regime issues we have seen, Powerco has given considerable thought to the opportunities for improvement and areas for analysis ahead of DPP5 and would welcome the opportunity to engage further with the Commission on our thinking as a next step.

This submission does not contain any confidential information and may be published in full. If you would like to follow up this submission, please contact Emma Wilson (Emma.Wilson@powerco.co.nz).

Nāku noa, nā,

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1. Incentives to drive efficiency

The DPP4 reset came during the perfect storm – higher interest rates and inflation compared with DPP3, the need to accelerate investment in response to growth in demand for electricity, and gas supply uncertainty increasing the pressures to electrify – all contributing to higher electricity network charges. Forecast demand growth has been slower than forecast amplifying affordability pressures, which has seen energy pricing becoming increasingly politicised.

We appreciate the challenges surrounding regulatory resets and balancing price shocks to customers with ensuring adequate levels of funding, as well as the need to balance certainty and predictability with the ability for dynamic regulatory mechanisms that deal with uncertainty.

With an uplift from electrification still expected, albeit with uncertain timing, energy affordability is a growing concern. Distribution system operator (**DSO**) capability is evolving in New Zealand and is one of the most effective ways of responding to the energy trilemma by:

- Reducing energy cost to our communities
- Enabling rapid customer decarbonisation
- Customers becoming an integral part of the energy solution and monetising these services
- Helping maintain network stability.

The low-cost DPP regulatory regime under Part 4 has served the sector well through a period that was stable and predictable. Decarbonisation through electrification is likely to see substantial growth in both supply and demand on distribution networks but with unpredictable timing. With a methodology and framework based on the principle that the historical operating environment is a good predictor of the future, it's evident that the DPP4 reset pushed the limits of the DPP framework's ability to deal with growth and an uncertain operating environment, where the delivery of and type of regulatory service, is changing.

It's fundamental that DPP5 regulatory settings support and incentivise EDBs to deliver the growth and DSO capability required to meet evolving customer preferences to deliver New Zealand's electrification needs, if we are going to successfully deliver the lowest cost energy transition to our customers.

To ensure the service remains affordable we need to consider the whole regime including the approach to weighted cost of capital (**WACC**) as WACC volatility between periods also impacts affordability. The current WACC methodology can create shocks to customers when prices are reset given it's based on prevailing rates at that point in time compared to a trailing average approach, which the industry has been advocating for.[3]

1.1 Driving efficiency

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 and incentivising EDBs to enable them to foster emerging markets in flexibility that reduce

[3] ENA, *Joint letter to the Commerce Commission – part of the fibre IM review consultation process*, 7 August 2025.

long-term costs and enhancing security of supply. The current regime doesn't reflect the key role opex has in delivering non-network solutions and does not incentivise EDBs to discover or pursue opportunities to defer or replace capex with opex.

Our view is that DPP4 is all about trialling and gathering evidence to support optimal DPP5 settings. As we trial various flexibility solutions, we are learning and understanding quirks of the regulatory regime which potentially create barriers to being able to roll out flexibility solutions at scale.

For example, larger flexibility solutions do not fit well within a 5-year regulatory window, and there is a timing issue whereby you need to start spending opex in one period (to build sufficient flexibility capacity), to defer capex that is planned for the following period. This has implications for incremental rolling incentives scheme (**IRIS**) which only deals with capex/opex substitution within a regulatory period.

Despite changes made in DPP4, there is still a capex anchor in the regime because:

- While equal IRIS incentives mean a non-exempt EDB is no worse off substituting capex for the same amount of opex within a regulatory period, this does not incentivise companies to seek out opportunities to do so in the same way that the incentive exists to reduce costs, in order to retain profits across the regulatory period.
- A traditional capital solution is generally a lower risk solution than a non-network opex solution.
- Current incentives don't reward trade-offs between affordability and investment.
- Future options / solutions are different from historical delivery of services, and can deliver electricity services more cheaply and efficiently, therefore the regime might need to nudge EDBs to incentivise companies to identify and pursue them in the short term.

To unlock these opportunities at scale, the Commission should explore:

- Stronger incentives to pursue opex solutions through enhanced and/or targeted incentive mechanisms that reward EDBs for delivering outcomes through non-traditional means
- Recognition of the value of avoided or deferred investment
- Highly ambitious INTSA, or use-it-or-lose-it type mechanisms, which can give certainty of opex funding that can be drawn upon over the period.[4]

While the use of non-network solutions to defer and avoid capex has great potential to minimise the price impact of networks on customers, it is not an end in itself, as the UK National Infrastructure Commission notes:

> *Currently, distribution network operators follow a 'flex first' approach, deferring or avoiding investment where it is lower cost than building new infrastructure. While the 'flex first' approach could be justified while electricity demand has been relatively stable, it is not appropriate in a world of rapidly increasing demand*[5].

[4] Commerce Commission, *Default price quality path for electricity distribution businesses from 1 April 2025*, pg 280-281.
[5] National Infrastructure Commission, *Electricity distribution networks: Creating capacity for the future,* Feb 21 2025. p. 13

Where there is enduring demand growth, networks are the least cost solution for supplying customers – the role of flexibility is to optimise the timing of investment. The importance of regulatory incentives to ensure continued network investment was recently made by the UK's Independent Water Commission:

> *There is a need to ensure that allowances provided for capital maintenance are used by companies to maintain assets*
>
> *The totex system introduced in Price Review 2024 provides flexibility over spending but it also reduces transparency over how companies spend their allowances. For example, companies may bid for and receive base allowance as part of their totex settlement to cover capital maintenance – but, by underspending against that allowance (which is counted as 'efficiency savings'), spend the allowance on enhancement, other costs instead or distribute the unused allowance as dividends. In the absence of fully mapped asset health registries, assets might not be maintained to an adequate standard … The regulator should ensure funding directed appropriately to maintain assets by clearly defining and ring-fencing base capital expenditure (capital maintenance), base operational expenditure and enhancement capital expenditure allowances.*[6]

Capex remains the fundamental cost driver for network industries, but it is opex that enables optimal investment for the long-term benefit to consumers – it's about incentivising the most efficient solution over the long-term.

1.1.1 Opex base year efficiency incentives

The base year plays a critical role in the setting of DPP allowances. In particular, it is the starting point for forecasting opex costs over the regulatory period by setting the benchmark for trend analysis, escalation and adjustments. Therefore, any anomalies or errors can distort the entire forecast. The base year is also used to assess whether current spending is efficient and/or requires adjustment, and therefore determines, what costs are embedded in the forecast. If the base year is wrong or poorly chosen it will either:

- Overstate costs which can lead to inflated revenues or
- Understate costs which may result in underfunding EDBs.

As discussed above, in theory IRIS should be driving EDBs to make efficient investment and seek out efficiencies, however, this hasn't resulted in reduced opex. It could be that IRIS hasn't delivered cost reductions because EDBs faced an increase in input costs, especially through DPP3, which made finding cost savings difficult.

Accurately setting the base year sets a clear starting point for measuring performance, costs, and service levels as well as tracking improvements over time and identifying areas where efficiency gains are being made (or not). As the Commission has signalled a willingness to explore the use of efficiency metrics, essential to this is an accurate base year. This ensures the Commission can better determine differences between genuine efficiency gains vs shifting of costs.

[6] Independent Water Commission, *Final Report,* 21 July 2025. P. 205

Overseas regulations highlight the importance of the base year in setting allowances, by applying detailed review and scrutiny, in particular to assess if base year costs are efficient. The table below compares the level and type of base year assessment applied.

Table 1. Comparison of regulator's base year assessment

Regulator	Base year scrutiny level	Benchmarking	Stakeholder review	Adjustments for inefficiency
AER	High	Yes	Yes	Yes
Ofgem	Moderate	Partial	Yes	Yes
Ofwat	Moderate-High	Yes	Yes	Yes
Commission (DPP)	Low	No	No	No

1.1.2 Certification of non-network solutions

Regulation of New Zealand EDBs under Part 4 requires Directors to certify that asset management plans are accurate, complete, and not misleading, including, strategies for expanding and upgrading the network, maintaining and replacing assets over their lifespan and both forecast capex and opex over a multi-year horizon (typically 10 years) based on reasonable assumptions and reflect the company's genuine plans for the future.

This certification process is the main mechanism in the current regulatory regime to ensure that base year revenues reflect the least-cost, long-term solutions for delivering the regulated service (including exploring non-network alternatives to capex). Given the growing opportunity to use non-network solutions to optimise investment timing, it is important that all EDBs observe this requirement in DPP5 and that appropriate mechanisms exist to ensure this. However, we believe more needs to be done to ensure that the base year is both efficient and accurate representation of the costs required to deliver over the period.

It's clear that the level of scrutiny that can be applied to individual EDBs is limited given the 'low-cost' objective of the regime. Our experience with the CPP was that independent verification of the AMP was a strong discipline on discovering efficient costs for the base year. Something like this could be added to the low-cost DPP regime, potentially requiring different companies to undergo independent verification at each reset depending on their circumstances and the Commission's concerns about their efficiency.

It may also be worth considering whether this verification could extend to exempt EDBs, to help ensure a consistent standard of asset management practices and quality outcomes across the sector. The Commission could consider other processes to increase scrutiny of all EDBs through tools such as ad hoc deep dives of some AMPs. In our view, customers would support increased scrutiny, and the benefits would likely outweigh the costs.

Below we discuss further limitations of capex forecasting and the issues with relying on historical reference period.

1.2 Incentives to drive scale to benefit all consumers

Decentralised solutions for supply and demand (e.g. DER) will require substantial new capabilities and new services from EDBs. Regulation must ensure that all consumers are able to make the most of customer and community-owned technology to minimise the cost of the transition, regardless of where they are located and which network they are connected to. This capability will be expensive to establish and maintain, because of this we believe the regime could benefit from a strong incentive for collaboration and/or consolidation.

Tighter regulation is a useful mechanism to lift performance, however, for that to be effective for all customers in New Zealand, all EDBs need to be consistently regulated to achieve high sector performance across the whole country, not just limited to localised areas.

More granular quality regulation and reporting could ensure that all consumers are able to enjoy the cost reduction and new opportunities of decentralised and distributed energy resources as we decarbonise, regardless of where they are located. Performance across the sector can also be lifted by ensuring regulation is designed to consistently incentivise highest performance.

2. Setting expenditure allowances and improvements in asset management practices

2.1 A regulatory cycle with flexibility and a longer-term horizon

Electricity infrastructure is long-lived. While the regulatory cycle only has a 5-year view, this can potentially incentivise short-term thinking and planning. The fixed cycle also makes it hard to respond to rapid changes in technology, customer demand or climate risks as there is often a lag between identifying a need and being able to fund or deliver a solution. This creates some challenges:

- Uncertainty around future revenue and allowances – allowable revenue and expenditure allowances are only certain for 5 years, which can lead to conservative planning or a preference for a series of small projects as they are lower risk (but potentially less efficient) than large multi-year projects. This can be heightened when EDBs are underfunded due to expenditure allowances being set based on historical needs, which may require EDBs to make short-term trade-offs to stay within allowances.
- Creates challenges for innovative solutions – whereby flexibility services or DER integration often require longer lead times and cross-period investment (as highlighted in the example above).
- Limited flexibility – while DPP4 uncertainty mechanism has addressed some of the concerns around being able to respond to rapid changes, these mechanisms don't go across periods so are only a short-term fix with a short-term view.

It is timely to review the length of the DPP period to provide certainty in a longer-term horizon. The Cunliffe review of the water regulation in the UK also identified the nature of the five-year price review cycle as a barrier to long-term planning. This can lead to underinvestment and / or reduced ability to optimise lifecycle costs as short-term constraints lead to reactive or piecemeal upgrades.

2.2 Historical patterns not reflective of expenditure needs going forwards

As previously noted,[7] EDBs are in a period of transition where the future operating environment is relatively unstable and uncertain, in addition to this, the needs and service customers want us to provide is evolving. DPP forecasting approaches using base-step-trend (**BST**) and capex scaling (using historical expenditure as a baseline) have considerable limitations[8] when attempting to estimate future expenditure requirements, and is unlikely to sufficiently forecast future expenditure requirements – when what's required is vastly different from historical needs.[9]

We understand the limitations the low-cost objective brings when attempting to set DPP allowances for 16 EDBs, however, relying on past expenditure does risk the potential slowdown in the energy transition. We would welcome consideration of alternative methods such as different treatment for particular categories of expenditure, independent verification of AMPs and increased scrutiny of the opex base-year (as discussed above), or workshops to explore options and determine how best to forecast expenditure in DPP5.

In addition to this, forecasting is becoming inherently difficult so it's critical that uncertainty mechanism remain fit for purpose, to ensure EDBs can respond to situations when they arise. We welcome the expanded scope and formal guidelines on reopeners as part of the DPP4 decision, we plan on testing these over the DPP4 period, however we are still unsure if the scope is wide enough, as we advocated for during DPP4.[10]

3. Quality metrics should reflect what customers want

Current quality standards under the DPP have served the sector well over the years, however, the current quality standards may not reflect the realities of a changing energy system, and the performance customers want, including impacts of climate change, electrification, increasing resilience and changes in the way customers use the network. For example, as generation and storage becomes more distributed, the current model for defining quality and reliability won't reflect the customers' outcomes e.g. High-voltage lines could be down but low-voltage batteries maintain supply – so the customer doesn't experience an outage.

We believe it's a god time to review the approach to quality metrics and suggest the following considerations:

- Resilience – there is a growing need to enhance network resilience, especially in light of recent extreme weather events like cyclones Dovi and Gabrielle. This potentially requires a shift from reliability to resilience where current measures don't capture an EDB's ability to recover quickly from extreme weather events.
- Change in customer expectations – the energy transition is increasing customer expectations for reliability and responsiveness, and customer needs are changing. For example, current measures don't capture customer satisfaction, time to connect, affordability.

[7] Powerco, *Powerco response to the DPP4 draft decision*, at 2.1 and pg 3.
[8] Limitations of the BST are discussed the section 1.1.1.
[9] Powerco, *Powerco response to the DPP4 draft decision*, 12 July, at 60 & pg 9.
[10] Powerco, *Powerco response to the DPP4 draft decision*, 12 July, at 5.1

- Utilisation – there is growing expectations for high utilisation of existing assets. Measuring this in a meaningful way is complex, and an area that EDBs could lead the development. Agreeing on metrics will then enable robust incentives.
- Backward looking – quality standards are backward looking and based on past performance, which don't reflect changing risk profiles, and can also lock in past performance rather than incentivising improvement.
- One-size-fits-all – that current quality standards are network wide and highly averaged, and don't take into account differences in geography, customer density etc. this means that reliability in some parts of the network, for some groups of customers may be poor but are hidden amongst the reporting across the wider network.

DPP5 is an opportunity to develop more granular quality regulation that reflects what customers actually value. This is relevant to all EDBs.