CountiesEnergyTrust

23 January 2025

Cross-submission: Distribution connection pricing and stage one connections

Counties Energy Trust welcomes the Electricity Authority's acknowledgement that "Distribution networks have a critical role to play in the electrification of New Zealand" and agree "This role has grown in importance and will continue to grow as more businesses – like industrial plants, EV charge point operators, and other large energy users – look to connect directly to the network."

While there is opportunity to improve connection application processes and further improve distribution (including connection) pricing, which we would support, submissions highlight that the changes should not be rushed and significant more work is needed. Furthermore, as many submissions have highlighted electricity distributors around the country face significant differences with respect to growth, with some distributors seeing little to no growth wanting to encourage connections through low connection charges and high growth areas like Auckland increasing capital contributions to fund the growth.

There are serious and substantive concerns about the efficacy and efficiency of the Authority's proposals

It is clear from submissions that the Authority is wrong to claim its proposals would "benefit all parties" and would not result in cross-subsidies. The Authority's proposals would instead create winners and losers and a 'two-tier' regulatory regime which benefits new connections at the expense of existing customers, including households. Given that a high percentage of new connection charges in high growth areas are paid for by developers the winners from the proposal would principally be developers and the losers would be existing customers.

Whether by design or intent, the Authority is asking existing customers to take on risk of new connections without compensation.

The Authority is asking existing customers to subsidise new connections.

The Authority is asking existing customers to pay all transmission costs.

The Authority is asking existing customers to bear the bulk of shared and common costs.

The Authority is asking existing customers to pay more.

We do not consider this to be fair, efficient or consistent with the Authority's statutory objectives. Counties Energy Trust opposes the socialisation of connection costs and development risk. We share Vector's, and other stakeholders', concern the proposals are in direct conflict with the statutory objective to protect domestic consumers and small business consumers "by privileging new connecting customers over existing customers."

As a consumer trust, we are strongly focused on the interests of our consumer beneficiaries, including the 49,000 homes, farms and businesses in the Counties region, and ensuring they are not disadvantaged or unfairly treated by industry regulation.

Process matters

Counties Energy Trust welcomes that the Authority has included cross-submissions as part of its consultation process. We consider that cross-submissions should be included whenever consultations include matters that are likely to be contentious and/or have large potential welfare impacts, and not just for consultations at the Code

amendment proposal stage. Some other submissions have raised concerns about the timing of the consultation e.g. MEUG. We share these concerns and do not consider cross-submissions should have been required during the January holiday period.

Summary of Counties Energy Trust's views/support for the submissions of other stakeholders

- We consider it notable access seeker submissions were principally limited to EV charging interests, with little other access seeker submissions and no engagement from property developers.

- **There is insufficient clarity about what the Authority is proposing:** e.g. Sapere (on behalf of Drive Electric) commented: "After carefully going through the Authority's distribution connection pricing proposal we are not clear on exactly what the Authority is proposing". Meridian similarly commented "we found the consultation paper relatively complex and confusing" and "We have also observed that the proposals … caused considerable confusion amongst industry experts … creating further questions around whether the Authority's intended outcomes will be achieved."

  ENA commented that the proposals "lack clarity". We also agree key elements, such as the definition of incremental cost, are "vague at best" (Entrust) and, in relation to the reconciliation methodology, "unclear" (Vector).

  We agree with ETNZ that the Authority should "Find a Simpler Way to Achieve the Desired Outcomes".

- **Problem definition:** MEUG's observation that it is not clear what "the exact underlying problem the Authority is trying to address" is a common theme amongst submissions.

- **Lack of evidence:** A clear message from submissions is that the Authority has not provided any empirical evidence and has instead relied on flawed theoretical arguments e.g. Wellington Electricity commented that "there seems very little evidence presented to support the problems definition". Likewise, Vector commented that "The Authority's analysis is entirely theoretical". We agree with these statements, including basic facts such as how many new customers pay a connection charge because we understand it may be as low as 10%, with the remaining 90% of connections paid for by developers. This begs the question if a problem actually exists.

- **The Authority should ensure all consumers benefit from the changes:** Counties Energy Trust agrees with Entrust that distribution (connection) reform "if appropriately designed, should make all consumers better off." There is no need for the changes to harm existing customers, including in the short or longer-term, and should not harm domestic consumers and small business consumers.

- **Variation in connection charges is efficient:** No evidence has been provided that the diversity of connection charging/capital contributions policies are a problem per se or that the variation is excessive or inefficient. We agree with EECA that "it could be useful … to present evidence that the observed variability in charges is inefficient".

- **The reliance limit methodology does not support high-growth networks** e.g. Waipa Networks provides a good example based on its AMP that they "would exceed the proposed 47% cap from 2027 onwards" and "Such a cap would see existing customers covering the shortfall." We similarly agree with Counties Energy that "imposing a set limit on the percentage of total growth capex that can be funded by connection charges (regardless of the true cost of new connections as a share of total growth costs) will distort efficient pricing and increase the cross-subsidisation of connection charges."

  Counties Energy Trust shares MEUG's "concerns about how this reliance limit may impact the balance of connection costs paid by the new customers versus those costs covered by existing customers".

- **Mandated cross-subsidisation:** Counties Energy Trust agrees with Fonterra "It is important that the connection cost requested by businesses … is paid for by the parties requesting the change and not applied to existing users" and "The EA should not seek to dampen the true cost of connection signal, nor socialise the cost to other users". We similarly agree with ERANZ's concern that "If connection charges become too low, then the price of growth is essentially being subsidised by existing customers" and this would have negative cost of living impacts.

  It is unambiguous that the Authority's proposals would result in cross-subsidies. The so-called "neutral position" is not neutral and would leave existing consumers worse off. Houston Kemp is correct that the Authority's "Neutral point reflects pricing below the incremental cost of connection services".

  We agree with the recent joint position of the Commerce Commission and Electricity Authority that socialising risks amongst consumers would be bad for efficiency and competition and would be inconsistent with the latest Government Policy Statement (GPS) on Electricity.[1]

- **Allocation of shared and common costs:** New connections should not just pay incremental cost. We agree with Network Tasman and the Network Tasman Trust that this "would effectively shift shared network costs onto existing users, creating a two-tiered system where existing consumers disproportionately bear the burden of maintaining the network" and "Over time, this approach could lead to nearly half of all connections contributing only to incremental cost … a clearly perverse outcome".

- **Timeframes for applications:** We agree with Transpower that the Authority should not mandate timeframes for completion of an application: "There will be factors outside of a distributor's control, whether the applicant or other parties not subject to the Code. These are best dealt with through policies and agreements between the applicant and the distributor." We similarly agree with ENA that "The timescales suggested by the Authority for both distributed generation (DG) and load connection application processes … are much too short and inflexible."

- **Obligation to supply:** The proposed new obligations to connect load customers is a significant departure from the legislated reforms in the 1990s (ENA) and would effectively result in compulsory investment obligations.

- **Joint Task Force:** We support Contact's recommendation that "the Commerce Commission joins the next phase of this project to more closely consider the implications on the Part 4 regime." Vector made similar comments in their submission that there should be "collaboration with the Commerce Commission to ensure there is alignment between the regulatory agencies." The Vector/Axiom submissions highlighted that to the extent there is a problem the solution may best belong with Part 4 Commerce Act settings e.g. changes to the incremental rolling incentive scheme (IRIS).

- **More work required:** The proposed changes should not be rushed through. There is substantive work that needs to be done before it would be safe to implement the Authority proposals, including a sound problem definition (e.g. Axiom and MEUG), investigation into real world evidence of access issues (e.g. Vector/Axiom provides good example of what OFGEM has done), quantification of the costs/benefits (e.g. Aurora and Vector) and material revisions of the proposals.

  We agree with Aurora Energy "cost benefit analysis needs to be done by the Authority before proceeding to ensure the proposed changes are necessary, and do not benefit … new connecting customers at the expense of adding costs to existing consumers."

[1] Commerce Commission and Electricity Authority [Energy Competition Task Force], Entrant generators – context, headwinds and options for power purchase agreements: Working paper, published 17 January 2025.

The Authority is relying on theoretical arguments rather than actual evidence:

No real-world evidence has been provided, only weak theoretical arguments, that there is an actual problem.

We agree with Wellington Electricity that "there seems very little evidence presented to support the problems definition". MEUG similarly commented that "From our reading of the consultation paper, we are not clear on the exact underlying problem the Authority is trying to address – specifically what examples of inefficient increases in connection charges the Authority has identified …"

We agree with Vector who similarly commented that "The Authority's analysis is entirely theoretical" and "Almost no evidence has been presented to support the claim that connections are actually being prevented, let alone that those connections would have been efficient." The Vector submission detailed examples of evidence that should have been reasonably expected, including "regarding the number of projects where parties experienced difficulties connecting" and "quantitative data … on the reasons behind any such difficulties". We again reiterate our understanding that most connections nationally are within residential, commercial and industrial developments. These developments are driven by local council planning rules and section demand. As we understand it the electricity reticulation cost is a small component of the section cost, and with the section sold at a market rate, the increases in connection prices have had no impact on the number of new connections. Before advancing further with these proposals, It is incumbent on the Authority to understand and present these facts.

The approach the Authority is taking does not align with its regulatory principle that its decision-making should be evidence-based and understood.

There seems to be a clear dissonance between the way the Authority is looking at access issues in relation to distribution connections and in the hedge market as part of its risk management review. The Authority seems to be comfortable relying on theoretical arguments in relation to distribution connection but, in stark contrast, appears to be placing a very high evidential burden on whether access to hedging products is a problem.

Information provided by the Authority confirms the proposed Code amendments will result in subsidies

One of the recurring themes in the submissions is that the Authority proposals would result in/require existing customers to subsidise new connection customers.

While the Authority has stated "We are not proposing to subsidise business network connections at the household consumers' expense", and this may not be the Authority's intent, it is clear this is the effect of the Authority's proposals.

It is objectively unambiguous the proposals would result in subsidies.

We have clarified with the Authority, for example, that the purported "neutral position" does not include compensation to existing customers for the risk that the new connection customer (or developer) will close down or reduce the scale of its activities, resulting in asset stranding and the combination of up-front and ongoing connection charges being insufficient to cover the new connection customer's (access seeker's) own connection costs.[2] The neutral position is not neutral and would make existing consumers worse off.

Axiom (on behalf of Vector) has similarly noted "The proposal to base charges on net incremental cost does not recognise the vital distinction between the revenue received up-front via connection charges (with certitude) and revenue earned subsequently via usage charges (without certainty)." [footnotes removed] BusinessNZ also commented "Lower upfront contributions can mean a heightened risk of not being able to recover the cost of a connection if the asset becomes stranded due to a business failure. This cost will fall upon other customers … For example, if an EV charging business defaults, the additional capacity may become stranded, and a replacement customer may never eventuate." The Network Tasman/Network Tasman Trust submission illustrates the problem well using a Case Study of Maruia Feeder and EV Charging at Springs Junction.

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[2] E-mail exchange, subject "Distribution Connection Pricing Methodology: Queries", 18 December 2024.

While the Authority has suggested they “captured” this risk “in the decision to adopt 30 and 15 year revenue life assumptions”[3] all this does is reduce the scale of the required subsidies.

A genuine “neutral position” would require the up-front connection charges (capital contributions) are sufficient to fully fund the network connection costs or the ongoing connection charges include a risk premium to fully compensate existing customers for the additional risk the Authority’s proposals would expose them to. If the Authority wants existing customers to take on risk of business failure by new connections: (i) existing customers need to be fully compensated; and (ii) the Authority needs to explain why it is more efficient for existing customers to bear this risk.

The Commerce Commission and Electricity Authority have recently made clear that “Socialising risks” can be undesirable because it “shields parties from costs, which can amount to subsidising the activities of those parties.” The two regulators went on to express the view that transferring risk to consumers “would not align with the recent Government Policy Statement on Electricity, which emphasises buyers and sellers managing their own risk” and that “socialising risks would not promote the Authority’s efficiency and competition objectives.”[4] Despite the clear statements that socialising risks amongst consumers would be bad for efficiency and competition, and inconsistent with the latest GPS on Electricity, this is precisely what the Authority’s distribution (connection) pricing proposals would do.

The definition of incremental cost should be clarified

Entrust pointed out that subsidies would result from the approach to determining incremental cost understating the costs, including by excluding transmission costs.

We share Entrust’s concern that the definition of incremental cost is “vague at best” and it is unclear whether it is a short-term or long-run definition. The same issue was raised with the Authority’s distribution pricing principles when it used the term “marginal cost” without stating whether it meant SRMC or LRMC. Based on clarification provided by the Authority the intention is a LRIC approach is adopted.[5] This should be made clear in the proposed definition of incremental cost and would mean (appropriately) that transmission costs would be included (not excluded as the Authority proposals) from the incremental cost calculation because they are not genuinely fixed in the long-term or on a forward-looking basis.

The Authority should be able to quantify the effects of potential different new connection growth scenarios on individual electricity distribution transmission charges over-time (and the potential additional cross-subsidy if transmission costs are excluded from the incremental cost calculation).

The Authority proposals would encourage inefficient investment

The Axiom report highlights that if new connection customers do not pay the full initial connection costs upfront, and the risk of this cost recovery is transferred to existing customers, the Authority’s proposed charging framework could result in inefficient pricing signals and result in “bad investment” occurring.

We similarly agree with BusinessNZ that "Setting capital contributions too low risks inefficient subsidisation” and that “Some access seekers have determined many projects to be economically unviable due to high upfront connection and ongoing line charges. We emphasise that is warranted, and in fact vital that connecting parties pay for the costs involved in connecting their asset, be it a premises or charging point. This is equitable as they remain the main beneficiaries of the connection, upholding the use pay principle of internalising the cost of the benefits received.”

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[3] E-mail exchange, subject “Distribution Connection Pricing Methodology: Queries”, 18 December 2024.
[4] Commerce Commission and Electricity Authority [Energy Competition Task Force], Entrant generators – context, headwinds and options for power purchase agreements: Working paper, published 17 January 2025.
[5] E-mail exchange, subject “Distribution Connection Pricing Methodology: Queries”, 18 December 2024.

We agree with EECA that “a necessary precursor to introducing limits would be to understand the ‘efficient’ level of capital contribution and potential reasons for deviation from it in either direction. We should not assume that any particular approach is inefficient without evidence to support this.”

Variation in connection charging should be expected and is efficient

We reiterate that the optimal (and efficient) level of capital contributions is likely to vary amongst electricity distributors with a higher percentage of contributions likely to be optimal in high growth regions, but not as important in areas where the local economy is stagnant and there is little growth. The Counties Energy submission details how the cost of new connections has increased as a share of total growth capex for many electricity distributors.

Our initial submission highlighted this parallels that use of peak-charging is likely to be more beneficial in areas with high growth and capacity constraints than in areas where there is little growth. These observations should not be controversial, and it should not necessarily be seen as a concern if different electricity distributors tailor their pricing strategies to their local circumstances.

The Authority has acknowledged that “It may not be optimal for all distributors to have the same connection pricing methodology due to differences in circumstances” etc.

Despite this statement, the Authority has also asserted that “divergence across distributors <u>appears</u> excessively high” [emphasis added] but neither the Authority nor any stakeholders has provided any valid evidence to support this proposition.

It is not sufficient to provide evidence that there is variation in prices (BP and Meridian) to demonstrate a problem. The same exercise could be repeated, say, for property values across New Zealand but would not demonstrate the large variations are excessive or inefficient e.g. did not reflect regional supply and demand conditions.

As ENA notes: “Connections and connecting network situations are often diverse and complex. While urban residential connections, for example, can be relatively straightforward and can lead to consistent connection pricing outcomes across networks, many commercial, industrial, and rural connections are unique and will require outcomes that may be consistent in approach but result in varying pricing outcomes.”

We agree with EECA that if the Authority is going to raise variability of connection charges amongst electricity distributors as a problem, then “it could be useful … to present evidence that observed variability in charges is inefficient, to support the problem statement.”

We also agree with Axiom that “whether the existing differences genuinely constitute a problem is ultimately an empirical matter that requires quantitative assessment.” If there is excessive variation it means that some charges are too low and/or some charges are too high. In order for the Authority to be able to conclude there is too much variation it would need specific evidence of under/over-charging.

Electricity distributors should be able to decline a load connection when reasonable

We agree with ENA that “The introduction of an obligation to connection load customers is a significant departure from some core principles established when the sector underwent legislated reform in the early 1990s.”

We also agree with ENA that there are circumstances “where an EDB should retain the ability to refuse to offer a load connection to an access seeker” e.g. where “a location that would create excessive connection for other customers and remedy for upstream assets would take some years to install”. Wellington Electricity similarly point out “there are minimum technical standards that must be maintained to ensure continued operation of a network, and to ensure that a new connection does not adversely impact on existing customers. … the proposals for connection must not hamper the achievement of the expected standards … the paper does not appear to address these considerations.”

The Authority's proposals would, in effect, amount to a compulsory investment obligation which would be a very heavy-handed form of economic regulation. This goes well beyond existing economic regulation precedent in Part 4 Commerce Act and Part 6 Telecommunications Act.

Concluding remarks

As the Authority is aware, Counties Energy Trust has significant concerns about the way the Authority proposes to regulate connection charge pricing and network connection processes. The changes are being uncharacteristically rushed. We are concerned these changes have the potential to increase costs for existing consumers and make access arrangements less flexible.

We agree with Contact Energy it is important to ensure electricity distributors are "fairly compensated for the costs they incur, and incentivised to support efficient connection growth." Counties Energy Trust does not believe the Authority's proposals would achieve this as they presently stand.

As we previously commented, the Authority's proposals are likely to be particularly harmful to the interests of consumers in network areas like the Counties Energy area where there is an ongoing large amount of development and growth that has been occurring over decades.

Yours sincerely,

Chair
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