MANAWA ENERGY

28 March 2025

Electricity Authority

Level 7

AON Centre

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Response: Distributed Generation Pricing Principles (DGPPs)

Introduction

Manawa Energy (**Manawa**) welcomes the opportunity to provide a submission to the Electricity Authority (the **Authority**) on the issues paper titled *Distributed Generation Pricing principles* (the **Paper**).

Manawa is an independent power producer (**IPP**) that owns and operates a diverse portfolio of 41 power stations across 25 hydro-electric power schemes, supplying around 5% of New Zealand's electricity needs. It should be noted that on 11 September 2024 Manawa announced it had entered into a Scheme Implementation Agreement with Contact Energy Limited under which Contact agreed to acquire all of Manawa's shares through a Scheme of Arrangement (**Scheme**). Implementation of the Scheme is subject to a number of conditions, including New Zealand Commerce Commission approval. At the time of this submission Manawa is awaiting a decision from the Commerce Commission in relation to Contact Energy's clearance application. For the avoidance of doubt, this submission represents Manawa's current views and strategy as an IPP.

Summary of Key Points

While many of the issues the Authority have raised in the paper are valid concerns, it is Manawa's view that the root causes for these issues have not been properly identified, nor will the proposed solutions lead to the most economically efficient outcomes.

Manawa's key points of feedback are:

- The original justification for the DGPPs when they were first introduced is still valid, despite the large amount of change the industry has undergone: the DGPPs were created to safeguard against problems during network connection negotiations — where, due to distributors being monopolies, the priorities don't always align, and one side has more power in the negotiations;
- The Authority's has placed undue weight on the impact of the incremental cost cap when evaluating the current pricing principles, and the cap is not as restrictive as the Authority implies;
- Distributed generation (**DG**) paying more or less costs for transmission and distribution than grid-connected generation (**GCG**) is not relevant to the discussion – the key consideration is that the costs allocated to any one generator are broadly cost reflective (while avoiding needless complexity) and lead to efficient outcomes;
- Manawa's view is that, in terms of the incremental cost cap, the current arrangements *are* fit-for-purpose and lead to efficient outcomes;

- Manawa agrees that first mover disadvantage, and the difficulties distribution networks face when building ahead of the need (i.e. anticipatory capacity) are issues that justify changes to the current principles;
- Manawa acknowledges some aspects of the DGPPs may be impractical when applied to large numbers of small scale DG and suggests the Authority focus their attention on addressing these particular practical challenges (in addition to addressing the first mover disadvantage issue described above) – noting that the DGPPs were not designed with very small scale generation in mind (so further specific arrangements for this generation class may be appropriate); and
- Manawa believes this issue can be addressed easily via small changes to the existing DGPPs rather than the Authority's preferred option of a comprehensive overhaul of the DGPPs.

Further detail of Manawa's position is covered in the answers to the consultation questions below.

For any further information or questions on the submission contents, please contact Bennet Tucker (contact details in covering email).

Answers to consultation questions

Questions	Manawa Response
Q1. **Do you have a view on the definition of incremental cost that is contained in the Code? Should it be more tightly defined to include only network costs and to exclude consequential costs relating to factors such as frequency keeping and voltage support? Would this lead to more timely generation build and lower energy costs?**	Manawa believes the current definition of incremental costs is adequate and that distributors can efficiently recover necessary costs from DG under this definition. Manawa believes the Authority have applied an overly restricted definition in their assessment, that incorrectly assumes there are several costs that are attributable to DG, but don't fall within the scope of the incremental cost cap. For example, costs like staffing or network monitoring, if sufficiently material to have a significant impact on consumers, should be attributable to DG under the cost cap if they are the cause for those costs (e.g. resources dedicated to administrating and overseeing DG on their network).
Q2. **Do you agree with the problems with the incremental cost limit identified in this section? Why or why not? Do you have a view on the relative importance of the problems identified?**	Manawa does not agree with the problems with the incremental cost limit identified. **The incremental cost cap is not leading to poor outcomes for consumers** While Manawa agrees that the current arrangements prevent distributors from recovering more than incremental costs from DG; Manawa believes that this cost cap is sufficient for recovering all the costs that DG places on the networks and - any additional costs beyond incremental costs would lead to DG being at a competitive disadvantage to GCG. The Authority have identified several reasons why the incremental cost cap leads to poor outcomes for consumers, but several of these reasons appear to be simple truisms that have no bearing on the efficiency of the arrangements, highlight minor issues that either have little to no material impact on consumers or will not be resolved by making any changes to the incremental cost cap. • **The DGPPs restrict distributors from charging more than incremental cost** – this is correct, they do have that effect, but in and of itself is not an issue; • **The incremental cost limit imposes a real constraint on the costs recovered from DG** – this is by design and efficient; any costs that are not a result of the DG should be allocated to load (based on the same logic that results in a GCG not being charged for any transmission investment that doesn't result in a benefit to them); • **Investors in new assets are discouraged from accommodating future demand** – this is a validly recorded issue, however, the incremental cost cap is not causing this issue: the issue lies with the

	cost-sharing and reallocation arrangements that currently lead to first mover disadvantages (which are discussed in more detail below); • **Current incremental cost limit stands in the way of efficient arrangements** – the first mover disadvantage caused by some parts of the DGPPs is an issue and should be resolved, but, again, the incremental cost cap is not, in and of itself, causing this issue; • **The one-size-fits-all cost-sharing formula may discourage efficiency** – Manawa supports some revision of this section of the DGPPs (*Share of generation driven costs*), especially for small scale generation where it may not be practical for parties to negotiate a workable arrangement using bespoke contracts (which are typically quite technical and complex). However, again not directly an issue with the cap itself; • **The incremental cost limit yields weak incentives to dedicate resources to DG** – this can only be a relatively minor issue that will have no material impact because if it was a material issue, it would be easy to solve by allocating these costs, in an approximate way that is consistent with the DGPPs, to DG under the incremental cost cap (e.g. if a distributor needs to establish a team of engineers to manage the administration and operations of DG on their network, associated costs should be able to be recovered via the incremental cost cap, or should be if some minor changes are made similar to that described in the point above); • **The incremental cost limit creates other impediments to efficient pricing** – this is not correct: approximations can be used and are explicitly accounted for in clause B.1(b) of the current DGPPs (i.e. using reasonable estimates).[1] The exception to this is the Authority's argument that DG pays fewer costs than GCG. This is, in Manawa's view, the key aspect and Manawa agrees that if the aggregate sum of transmission and distribution costs are systemically favourable to one type of generation over another this may lead to poor outcomes for consumers. However, it will only lead to poor outcomes for consumers if this systemic favourability is not efficient – DG paying fewer costs than GCG in and of itself is not an issue. There is only an issue when DG is paying fewer costs than GCG because DG is not being allocated a category of costs that GCGs are being allocated.

[1] The other part of this section is around the cost cap precluding the distributor from broadening their revenue base. It is unclear on what the Authority's intent behind this statement – it could either be interpreted as a repeat of the first point at the start of the main section or suggest that DG should in some way cross-subsidise load growth because that load growth is price sensitive, despite the DG having no impact on the efficient cost of distribution for that load growth (any impact they do have should be allocatable under the cap) – neither of which appear to be strong arguments in favour of removing the cap.

	It is Manawa's view that there is no competitive advantage or disadvantage that is also inefficient (and thus distortionary) that leads to materially worse outcomes for consumers. To justify this statement, the different "types" of costs are covered separately below **Connection costs** are effectively equivalent for DG and GCG despite the fact they are recovered by different entities using slightly different arrangements. That is, there is no material difference between the costs distributors allocate to DG under the incremental cost cap and the connection charges Transpower charge GCG.[2] **Common costs and interconnection costs** are currently allocated to load on distribution networks (this is achieved indirectly via the incremental cost cap). On the transmission network these costs are recovered in two ways: via the residual charge and via benefit-based charges. The residual charge is allocated specifically to load (i.e. identical to the approach taken by distribution networks). Benefit-based charges are recovered from beneficiaries of the relevant assets under the new TPM, whereas in the distribution network, these interconnection costs are notionally only covered by load as described above. While on the surface this may seem to favour DG, there are two key aspects that need to be considered: • The vast majority of investments on distribution networks are related to reliability, resilience or capacity expansion caused by load growth. Given the former two are allocated only to load under the TPM and the latter will almost exclusively benefit load, it is unlikely DG would be justifiably charged any of these costs if the same approach used in the TPM was applied. • Of the very few remaining investments that might materially benefit DG, it should be possible to allocate appropriate costs to the benefiting DG under the incremental cost cap as it is likely the cost impact of DG on that investment will be quantifiable (either by comparing against options that don't favour the DG as much, or assessing what the investment would look like if DG was not there). In summary, the only way in which GCG and DG can have *material* economically inefficient differences in their transmission and distribution cost allocations is if:

[2] The only minor exception is shared connections, where the costs that cannot be specifically attributed to one of the connected parties gets spread between the two parties. This is unlikely to have a material impact on efficiency given to be materially inefficient requires a new generator to have the option to connect to a GXP, but chooses to embed in the network *and* draws significant benefit from the GXP (i.e. exports to the grid through it) *without* resulting in any impact on the costs associated with that GXP, which is a very rare set of circumstances.

	• It is due to the incremental cost cap not being effective in allowing distributors to fully recover incremental costs; or • It is a result of inefficiencies in the TPM and not related to the incremental cost cap. Simply removing the cap and allowing distributors to recover costs over and above incremental costs from DG would put DG at a significant, and inefficient, disadvantage compared with GCG. However, Manawa does acknowledge that distributors may be having to deal with large numbers of smaller scale generation investments, which may make some aspects of the current DGPPs impractical for distributors to adhere to. While Manawa does not agree with the Authority on the issues they have identified for the incremental cost cap, it may be appropriate for the Authority to investigate a tiered approach to application of the DGPPs (i.e. make it easier to apply approximations and cost sharing for small scale DG in particular). **Manawa supports initiatives that resolve first mover disadvantages** Manawa agrees with the Authority view that some aspects of the DGPPs are causing first mover disadvantages and limiting distribution networks from overbuilding ahead of the need (e.g. expected future growth or additional DG, etc.). Manawa also agrees that the current arrangements may incentivise new DG connecting to distribution networks to be resistant to the network overbuilding any capacity that would be allocated to them, making new connections unnecessarily complex and difficult. Manawa supports removing clause B.1(m) of the DGPPs as described in Option 2 of the paper. Manawa also encourages the Authority to reuse the same approach for first mover disadvantage/overbuilding ahead of need that is used in the current TPM (i.e. spreading the cost of overbuilding ahead of the need over all network customers).
Q3 **Do you agree circumstances have changed significantly since the DGPPs were introduced, including that there are now far fewer impediments to distributed generation than in the early 2000s?**	While Manawa agrees that there have been significant changes to the electricity industry since the DGPPs were introduced, the underlying issue that the DGPPs sought to address still remains: Distribution networks are regulated monopolies or consumer trust owned monopolies that have very different incentives and priorities compared to entities operating in a competitive environment. Without the appropriate safeguards that the DGPPs provide, it is likely DG would be inefficiently discouraged because of these differing incentives and priorities. For example, a consumer trust owned network would be strongly incentivised to shift as many of their costs onto any connected party who isn't a beneficiary of the trust (i.e. the beneficiaries being consumers on the

	network) as it will reduce the costs allocated to the beneficiaries, regardless of how much of an impact network connected non-beneficiaries have on the network's costs.
Q4 **Do you agree with the assessment of the current situation and implications of incremental cost pricing? If not, why not? What if any other significant factors should the Authority be considering?**	Manawa's response to this question is covered in the response to Q2 above.
Q5. **Do you agree these are the appropriate options to consider?**	No, Manawa does not agree with the options outlined. Manawa strongly recommends the Authority apply an "evolutionary" approach to the DGPPs rather than a "revolutionary" approach – that is, make small incremental changes to the DGPPs to correct the most material issues, rather than trying to redesign them from the ground up (or worse, removing them entirely). The Authority have not provided a compelling argument for large changes, especially regarding the incremental cost cap. Many, but not all, of the issues they have identified are either non-existent or do not materially impact the efficiency of generation investment and it is Manawa's view that the current DGPPs efficiently achieve the objectives of which they were initially developed to meet. This implies that a narrow review, focussing only on *material* issues is the best approach.
Q6. **Are there other options the Authority should consider for improving rules about costs that can be recovered from distributed generators?**	Conceptually option 2 is the best approach and the only option the Authority should be considering in the next phase of this work (in addition to the "do nothing" counterfactual). Manawa appreciates the Authority needs to always consider a wide range of options, but in this case the best option is fairly obvious (especially so given the Authority is resource constrained, so minor changes rather than large scale re-writing of regulations will enable them to deliver on their other priorities more effectively – a rewrite of DGPPs is unlikely to provide a large benefit compared to the effort required).
Q7. **Will new aggregator business models emerge to solve the problem?**	If small scale DG is indeed one of the most efficient options for new generation supply, then it follows that business models would adapt to this change. However, Manawa does support the Authority investigating a tiered approach to the incremental cost cap (while keeping the principle in place) if large numbers of small scale DG are resulting in some aspects of the DGPPs to become impractical to adhere to (noting that the DGPPs were put in place to manage large scale DG rather than small scale).

Q8. **Are distribution price signals alternative to, or complementary to contracting?**	Both voluntary contracting and regulated principles are useful in a well-functioning system. If commercial incentives align well, and there is an equitable balance of leverage between the negotiating parties, contracting is very effective at managing network connections and cost allocation. However, given the negotiations involve a monopoly on one side of the negotiation, it is not always possible to have balanced leverage and as discussed earlier the commercial incentives are not always aligned. As such, regulated principles (i.e. the DGPPs) are necessary safeguards to ensure efficient outcomes.
Q9. **Which, if any of the above options, do you consider would best support efficient pricing for recovery of distribution costs from DG?**	Option 2 as described above.
Q10. **Do you agree with the Authority's tentative view on a solution? In particular:** • **Should efficient price signals be sent through a revised set of pricing principles?** • **Would voluntary guidelines or mandating through the Code be the best approach?** • **Should we rely on the distribution pricing principles outside the Code or codified new pricing principles for DG? Why?**	• No, the current DGPPs, with some amendments, is the most efficient approach • The purpose of mandating through the Code is to provide a regulatory safeguard against inefficient outcomes; voluntary agreements are not prevented by the existence of mandated principles. As such Manawa supports the current approach using pricing principles. • Neither, as described above.
Q11. **Are there any unintended consequences from removing the existing DGPPs?**	Identifying unintended consequences is difficult, by design – if they were easily identified, they would often be able to be avoided or mitigated. However, the main unintended consequence of removing DGPPs would be to inefficiently discourage large scale DG – which invariably would result in higher prices for consumers in the long-run. It should be noted that the discouraging of/resistance to DG is not simply a possibility – there is historical precedent for it occurring where distributors have attempted to recover a disproportionate, and highly

• **Do you agree with the risks we have identified, and our assessment of them?** • **Do you think there are any other risks we should consider associated with the removal of the DGPPs?** • **Do you have any information that would allow the Authority to better assess such risks?**	inefficient, cost from DG (which then led to the development and introduction of the DGPPs as they are today).
Q12. **Do you agree market and regulatory settings provide efficient incentives for DG reducing or avoiding transmission costs? What, if any, other significant factors or options should the Authority consider?**	Manawa questions the validity of the case studies and analysis the Authority have provided (and have provided feedback in the past when these case studies were developed). While the addition of costs, or removal of payments (e.g. ACOT) may not result some DG becoming inviable, this should not be used as a justification to support any policy in and of itself. Manawa believes the current DGPPs to be broadly consistent with the philosophy and approach used in the current TPM, and believes their proposed options (such as removing the incremental cost cap) would conflict with the intent behind the TPM.