MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

# COVERSHEET

| Minister | Hon Simon Watts | Portfolio | Energy |
|---|---|---|---|
| Title of Cabinet paper | Investigating Options to Amend or Remove the Amount of Generation that Electricity Distribution Businesses May Own | Date to be published | 8 April 2025 |

| List of documents that have been proactively released | | |
|---|---|---|
| **Date** | **Title** | **Author** |
| 17 October 2024 | Investigating Options to Amend or Remove the Amount of Generation that Electricity Distribution Businesses May Own | Office of the Minister for Energy |
| 23 October 2024 | Investigating Options to Amend or Remove the Amount of Generation that Electricity Distribution Businesses May Own<br><br>ECO-24-MIN-0239 Minute | Cabinet Office |
| 17 October 2024 | Regulatory Impact Statement: Removing the thresholds on distribution businesses owning generation. | Office of the Minister for Energy |

**Information redacted** **YES / NO**

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Some information has been withheld for the reasons of Commercial Information and Privacy of Natural Persons.

# Regulatory Impact Statement: Removing the thresholds on distribution businesses owning generation.

## Coversheet

| Purpose of Document | |
|---|---|
| Decision sought: | *Cabinet agreement to remove the thresholds on distribution businesses owning generation to improve the security of supply.* |
| Advising agencies: | *Ministry of Business, Innovation and Employment* |
| Proposing Ministers: | *Minister for Energy, Minister for Resources* |
| Date finalised: | *17 October 2024* |

**Problem Definition**

New Zealand faces a risk of energy shortage during seasons and periods of high demand. Our electricity networks are also at risk from severe weather events, which can lead to damaging outages. Increasing opportunities for investment in distributed generation can reduce these risks. It is a key government priority to find ways to improve resilience and increase generation to improve security of supply.

Distributors, and businesses which own distributors, are a potential source of additional generation, particularly in their own areas, which are typically the focus of their investment plans. The problem is how to encourage further investment in generation without diminishing competition.

There are restrictions on cross involvement in electricity distribution and generation in the Electricity Industry Act 2010 (“the Act”) or the Electricity Industry Participation Code (“the Code”). The restrictions are intended to limit the opportunities for distributors to foreclose competition by exercising their monopoly power.

The system does provide some flexibility through the exemption process, and investment in generation by distributors has taken place. Nonetheless, distributors and investors in distributors, have argued that the restrictions impose unnecessary costs which deter further investment that could take place. The strongest advocates for removing these restrictions are the distributors who have obtained exemptions and invested.

There are other regulatory safeguards which address these or related problems. We have to weigh up the net impact on competition, and on generation investment, of removing the restrictions on cross involvement, while retaining these safeguards.

**Executive Summary**

This Regulatory Impact Statement (RIS) considers a range of options around removing or amending the thresholds that currently restrict distributors’ ability to invest in generation.

### Status quo

In 1998, as part of a series of reforms, electricity distribution businesses were required to divest generation and retail assets. This also resulted in the breakup of the Electricity Corporation of New Zealand (ECNZ). The 1998 ownership prohibitions were progressively relaxed during the next two decades.

### The restrictions

Part 6A of the Code imposes corporate separation and arm's-length rules in respect of distributors, if a person is involved both in a distributor and in a generator with connected generation of more than 50 MW of generation connected to the distributor's network. In other words, there is no prohibition on a distributor's involvement in generation above this limit, if that distributor implements the restrictions set out in Part 6A. No exemption is necessary in this case.

Section 73 of the Act provides that a person who is involved in a distributor must not be involved in 1 or more generators that have a total capacity of more than 250 MW that is generated by 1 or more generating plants that are directly connected to the national grid.

The Electricity Authority can offer exemptions from these restrictions, to date all exemptions have been approved by the Authority, either to all or some of the cross-involvement rules.

The cross-involvement rules are intended to promote competition in the generation market by limiting a distributor's ability to:

- cross-subsidise its contestable generation business from its monopoly distribution business,
- misuse information it acquires as a distributor to benefit its generation business, or
- discriminate against competing generators.

However, there are existing rules contained in the Commerce Act and other parts of the Code that address these potential problems.

### What we are trying to do

We are trying to address the risks from energy shortages during seasons and periods of high demand. We are also trying to address risks from severe weather events, which can lead to damaging outages. This is directly related to the key government priorities of increasing resilience and improving energy security of supply.

Increasing opportunities for investment in distributed generation can reduce these risks. However, distributors and investors in distributors are reluctant to invest further in local distributed generation, because of requirements in the Act or the Code.

### What the benefit might be

Removing these restrictions could increase investment in generation to increase resilience and security of supply.

These restrictions currently exist to protect against anti-competitive behaviour from distributors. Other safeguards exist to deter such behaviour that may otherwise be incentivised if distributors invest in generation on a larger scale.

### Options

The options being considered are to:

- Remove the 50MW threshold for cross-involvement in generation connected to a distributor 's own network, and the restriction in cross-involvement in more than 250 MW of generation connected to Transpower's national grid.
- Remove the national grid limits, exclude consumer-owned distributors from the limits, and amend the thresholds for distribution.
- Remove the national grid limits and allow the Authority to deal with the distribution network limits through its investigation into Part 6A of the Code.

### Preferred option

MBIE's preferred option is to:

remove the 50MW threshold for cross-involvement in generation connected to a distributor 's own network (by amending the Code via primary legislation), and

remove the s73 restriction in cross-involvement in more than 250 MW of generation connected to Transpower's network.

This option is preferred as it is expected to increase the potential investment in generation and support regional electricity resilience. Removing these restrictions would reduce a barrier to investment in generation and increase regional resilience and security of supply. The advantages of additional investment in local distributed generation have been clearly demonstrated in the recent Northland outage.

There are some concerns that this option may contribute to anti-competitive behaviour by distributors when connecting independent generators to their network. However, MBIE's analysis is that other rules in place in Parts 6 and 6A of the Electricity Industry Participation Code and Part 4 of the Commerce Act 1986 will provide sufficient protection against anti-competitive behaviour in the generation market and ensure that open-access for all generators continues.

## Limitations and Constraints on Analysis

### Cabinet decisions

As part of a series of actions to address the serious risk to New Zealand's energy security and affordability, Cabinet has committed to ease restrictions on electricity lines companies owning generation. This is a key government priority and MBIE has been directed to address this issue quickly.

The removal of cross-involvement limits between distribution and retail is not being considered.

### Time constraints

Due to the short period of time MBIE had to complete this analysis, targeted engagement was undertaken with limited number of stakeholders.

### Evidence

There was limited evidence about investment intentions, in the event of the restrictions being removed. Some EDBs said that they had not focused on such opportunities, given the restrictions currently in place. It is difficult to assess the "investment gap" in these circumstances, as project do not get to the starting gate.

### Amendments to the Code – primary legislation not a limitation

Amendments to the Code can be made through primary legislation.

### Coalition agreement

This investigation is part of a coalition agreement between NZ First and National.

## Responsible Manager(s) (completed by relevant manager)

*John McCabe*

*Acting Manager, Electricity, Generation, Infrastructure and Markets*

*Energy Markets*

*Ministry of Business, Innovation and Employment*

Privacy of natural persons

*02 October 2024*

## Quality Assurance (completed by QA panel)

| | |
|---|---|
| Reviewing Agency: | Ministry of Business, Innovation and Employment |
| Panel Assessment & Comment: | MBIE's Regulatory Impact Assessment review panel has evaluated the Regulatory Impact Statement (RIS) on 'Removing the thresholds on distribution businesses owning generation'. The panel notes deficiencies in empirical evidence on the impact these changes would make on investment behaviour, and the limited engagement with stakeholders, leading to a **'partially meets'** assessment against quality assurance criteria. However, the RIS communicates these limitations and their implications for the presented information. The panel believes this transparency is adequate to support decision-making regarding the options outlined in the proposal. |

# Section 1: Diagnosing the policy problem.

## What is the context behind the policy problem and how is the status quo expected to develop?

**Distribution businesses are restricted from owning generation connected to their own network (50 MW) without safeguards, and from owning generation connected to Transpower's network (250 MW)**

In 1998, as part of a series of reforms, electricity distribution businesses were required to divest from holding generation and retail assets. This also resulted in the breakup of the Electricity Corporation of New Zealand (ECNZ).

The 1998 ownership prohibitions were progressively relaxed during the next two decades. The current restrictions (in the Code and the Act) are essentially the same as those in place in 2010, when the policy was last reviewed.

The Electricity Industry Reform Act was repealed in 2010 and the restrictions on distributor involvement in generation were transferred into the Act.

The arms-length rules (applying to more than 50 MW of distributed generation) were transferred from the Act into the Code in 2022. The Authority administers the Code and can amend it according to its statutory objectives and process requirements. The Authority is an independent body, but changes can be made to the Code via primary legislation.

The rules are intended to promote competition in the generation market by limiting a distributors ability to:

- Cross-subsidise its contestable generation business from its monopoly distribution business,
- misuse information it acquires as a distributor to benefit its generation business, or
- discriminate against competing generators.

The prohibition on cross involvement between distribution and grid-connected generation above 250 MW remains in section 73 of the Electricity Industry Act. It is intended to promote competition by limiting opportunities for a business obtaining substantial market power in a region through vertically integrating into a regionally dominant generation-distribution business. However, the policy rationale behind this prohibition seems unclear as distribution businesses have no power over the national grid nor connections to the national grid, which are entirely managed by Transpower.

The restrictions on cross involvement also apply between distribution and retail supply. However, there are no limits for a distributor who wishes to invest in generation connecting to another distributor's network or in a retail business serving customers on another distributor's network.

**The restrictions are contained in primary and secondary legislation.**

The restriction regulations apply when:

- a distributor is involved (has an ownership interest or a material influence) in more than 50 MW of generation connected to its own network as set out in Part 6A of the Electricity Industry Participation Code (the Code).
- a distributor is involved in more than 250 MW of generation connected to the National Grid (Transpower's network) as set out in the Electricity Industry Act 2010.

**Separation of distribution and retail arms is intended to prevent vertical integration of non-regulated monopolies and promote competition.**

The purpose of Part 6A of the Code is to promote competition in the electricity industry. The corporation separation and arm's length rules that relate to distributor-owned generation over 50 MW are:

- **Prohibition on cross-directors** and shared senior managers, requirement for two independent directors of each business and restrictions on the businesses having input in the operations of each business,
- **Corporate separation** and rules requiring parties to act independently, not prefer interests of or favour the related party, focus on the interests of the right ultimate owner; not sharing information: and the distribution and generation businesses must be held in separate companies,
- **Records and reporting:** each business must keep a register of transactions entered into between the businesses and must report compliance with the arms-length rules to the Authority,
- **Monitoring and enforcement** if a distributor fails to comply with the arms-length rules which allow the Authority to revoke or amend exemptions or investigate an alleged breach of the Code.

These cross-involvement rules apply when a distributor owns more than 50MW connected to its own network. If a distributor complies with these rules (or invests in generation connected to other distribution networks) there is no upper limit as to how much generation they may own.

During agency consultation the Commerce Commission signalled some concern about the impact of removing cross-involvement restrictions on competition. It suggested that retaining Clause 6A.4 of the Code would go some way towards mitigating the potential competition concerns by curtailing EDBs' ability to favour their own generation.

Clause 6A.4 requires that:

> (1) Every distributor in respect of which there is a connected retailer or a connected generator must—
>
> > (a) have a comprehensive, written distributor agreement that provides for the supply of line function services and information to the connected retailer or connected generator (as the case may be); and
> >
> > (b) ensure that the terms of that distributor agreement do not discriminate in favour of one business and do not contain arrangements that include elements that the business usually omits, or omit elements that the business usually includes, in distributor agreements with parties that are—
> >
> > > (i) connected or related only by the transaction or dealing in question; and
> > >
> > > (ii) acting independently; and
> > >
> > > (iii) each acting in its own best interests; and
> >
> > (c) operate in accordance with that distributor agreement; and
> >
> > (d) publish that distributor agreement and provide it to the Authority

(2) A distributor agreement required by subclause (1)(a) must be entered into, in the case of a business to which the corporate separation rule does not apply, as if the distribution business and the connected retailer or connected generator were separate legal persons

We do not propose to remove this Clause under any options (although it would be open for the Authority to amend it under Option 3) and the protections it offers will be retained in the Code.

### Exemptions from the restrictions are available

The Authority can give exemptions from the restrictions. The Authority can grant exemptions from the restriction in the Act if it is satisfied that the:

- Proposed prohibited involvement will either promote, or will not inhibit, competition in the industry; and
- The exemption will not permit an involvement in a distributor and a generator that may create incentives and opportunities to inhibit competition in the electricity industry

Part 6A of the Code contains provisions that relate to the separation of distribution from certain generation and retailing. The Authority may grant an exemption to a participant, exempting them from the obligation to comply with the Code or specific provisions of the Code, if satisfied that the statutory test is met, which is that:

- it is not necessary, for the purpose of achieving the Authority's objectives under section 15 of the Act, for the participant to comply with the Code or the specific provisions of the Code; or

- exempting the participant from the requirement to comply with the Code or the specific provisions of the Code would better achieve the Authority's objectives than requiring compliance

For example, the Authority recently approved an exemption to Part 6A of the Electricity Industry Participation Code, which allowed electricity distributor WEL Networks to install two new solar power arrays and a battery storage system on their own network in the Waikato. They noted that this will provide just under 64MW worth of energy that can be stored and released into the market, as and when the region needs it most. WEL's application initially sought an exemption and dispensations from all the arm's length rules in Part 6A of the Code. WEL subsequently narrowed its application to an exemption and dispensations from some arm's-length rules.

### To date all exemptions to these rules have been approved. Part 6 of the Code also protects against anti-competitive behaviour

The rules in Part 6 of the Code are distinct to Part 6A. Part 6 of the Code imposes positive obligations on distributors to ensure an efficient and fair connection processes for generators.

Part 6 of the Code regulates the process for generators to connect to a distributor's network. A distributor must connect generation unless technical standards are not met.

Part 6 sets out rules which apply when connecting of distributed generation. It sets out **regulated terms for connection** that will apply unless parties have agreed otherwise.

It imposes detailed requirements for the distributor to provide information to the connecting party. For example:

> A distributor must give a distributed generator that makes an initial application the following within 30 business days of receiving the completed initial application:
>
> (a) information about the capacity of the distribution network, including both the design capacity (including fault levels) and actual operating levels

The Code also constrains the ability of distributors to set prices for connection in a way that deters generators from connecting. In particular, it requires that **distributed generation pays only for incremental costs** when connecting to a distributor's network (i.e. does not contribute to shared network costs). This is widely considered a favourable regime for connecting generation. It also sets **maximum fees** that can be charged for a wide range of standard transactions.

This is a significant provision, as one of the key problems arising from vertical integration can be that there is discriminatory pricing as between the terms offered to the distributor's generation arm and to other generators connecting to the distributor's network. By contrast this provision provides favourable price terms of interconnection.

Part 6 also **includes arm's length requirements in relation to distributed generation connections**.

Specifically, clause 6.11 requires a distributor to use the same reasonable efforts in processing and considering applications and notices under Schedule 6.1, regardless of whether the distributor has an ownership interest or a beneficial interest in the distributed generator; or who the distributed generator is.

Clause 6.3 sets out information a distributor must make publicly available, including connection and operation requirements, regulated terms and how applied, a statement of circumstances in which distributed generation will or may be curtailed, a list of locations the distributor expects to become subject to export congestion within the next 12 months, a maximum power threshold, fees, and types of inverters.

These rules mitigate a key concern for generators that distributors may unfairly favour their generation over an independent generator. With these rules in place the removal of Part 6A rules will not impact independent generators ability to connect to a distributors network.

### The Authority can amend Part 6 of the Code. Part 4 of the Commerce Act 1986

Distributors are monopoly businesses that are regulated under Part 4 of the Commerce Act 1986 (Part 4).

Under Part 4, the Commerce Commission determines the revenue that "price-quality" regulated distributors (also known as "non-exempt" distributors) and Transpower can earn from consumers during set regulatory periods (known as price paths).

It also monitors "exempt" distributors (consumer-owned distributors not subject to price regulation) through an information disclosure regime. The Explanatory Note to the Commerce Amendment Bill 2008 which introduced this distinction stated that "the reason for this relatively light-handed regime is because consumers, as owners, are able to ensure that the business acts in their interests", and with regard to 100 percent consumer trust-owned businesses, "in principle the case for economic regulation is relatively weak where the customers are the owners of the firm".

Consumer-owned distributors are distinct as they have trustees who are elected by the community they serve and will focus more on consumer interests than profits.

The Commission is currently consulting with Transpower and price-quality regulated distributors on the price paths that will apply to them in the coming regulatory period, starting on 1 April 2025. The Commission is due to decide the price paths by 30 November 2024.

Part 4 of the Commerce Act imposes cost allocation and related party requirements **which limit opportunities for EDBs to cross-subsidise or prefer a related party** when acquiring or providing regulated distribution services.

### The 250MW restriction serves little purpose

This restriction was intended to promote competition by limiting opportunities for a business obtaining substantial market power in a region through vertically integrating into a regionally dominant generation-distribution business at the time of its introduction.

Various elements of regulation have been introduced since this restriction was implemented, such as:

- in 2007, regulation was introduced for the connection of distributed generation (now Part 6 of the Code) to allow open access to connecting generation,
- in 2008, price quality regulation was introduced (as discussed above),
- in 2017, the Commerce Commission strengthen its arms-length requirements for related-party transactions helping prevent cross-subsidisation, and
- in 2023, the Commerce Act was expanded to test if market power arrangements substantially lessen competition.

Transpower also **ensures equal access for all generators who wish to connect to the national grid**. Distributors, gentailers and independent generators are all treated the same when trying to connect generation to Transpower's network. Generators attempting to connect to the grid **are connected if the connection is feasible**.

Distributors are permitted unlimited involvement in generation connected to other distributors' networks, on the basis that they cannot leverage their monopoly power in that situation. The situation is not different for connections to Transpower's network.

Cross-involvement between a distributor's own network, and a retail business serving customers on that network will still be restricted. So long as that is the case, we do not consider this change would lead to different consequences to involvement in generation connected to other distributors' networks.

### How is the status quo expected to develop?

Electricity demand in New Zealand is expected to increase between 35 and 82 per cent by 2050.[1] While there is a significant pipeline of generation likely to meet New Zealand's electricity needs, generation investment needs to occur at pace to support this growth.

Analysis shows that 500 MW of new capacity is needed every year until 2050, which may not be met solely by gentailers or independent generators. The government's view is that in order to meet this generation needed, additional investment in generation should be encouraged unless there are strong reasons not to.

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[1] Electricity Demand and Generation Scenarios: Results summary July 2024 (mbie.govt.nz)

Electricity distribution businesses who wish to invest in generation will continue to do so by.

- staying under the limits (250 MW for grid connection and 50 MW for network connection),
- complying with the cross-involvement rules when investing above the 50 MW limit, or
- seeking exemptions from the Electricity Authority.

The Authority is undertaking a review by looking at whether the rules in Part 6A continue to provide the appropriate settings for distributor involvement in generation connected to their network. However, the outcome of this review remains uncertain until at least early 2025 and the status quo may remain unchanged.

Removing the threshold in s73 of the Act is recommended in all three of the options considered in this Regulatory Impact Statement, and this change requires primary legislation. Undertaking this legislative process provides an opportunity to also change the cross-involvement rules when investing above the 50 MW limit. Although legislative change is likely to progress at a roughly similar pace to the Authority's review, it will deliver greater certainty if they also include any changes to restrictions on involvement in generation on a distributor's own network, and this path is preferred for this reason.

There is a significant pipeline of generation projects but projections of increasing demand are also high, and it is not clear what proportion of these projects will actually come into operation. Many projects get consented but do not get built.

The restrictions on cross-involvement are not the only barrier to investment reported by distributors and investors in distributors. They have also pointed to difficulties in getting consents under the Resource Management Act, and in obtaining financing for intermittent renewable generation projects, without access to backup from less intermittent generation.

However, distributors which faced these barriers as well (such as Mainpower and Westpower) still argued that the restrictions represented an additional barrier that had to be overcome if these problems were solved.

| Distributor | Known pipeline of generation projects |
|---|---|
| **Top Energy** | • 56MW of geothermal<br>• 32MW geothermal consented waiting on shareholder approval<br>• 20MW of diesel standby generation<br>• 10MW Resource act consented solar |
| **WEL Networks** | • 35MW of embedded generation (BESS)<br>• 64MW 2 solar farms |
| **Clarus** | • 150MW Tauhei solar farm joint venture |
| **Westpower** | • 7.6MW Amethyst run of river hydro<br>• 22MW hydro scheme – fast track approval process |
| Commercial Information | |

| | |
|---|---|
| Commercial Information [redacted] | |
| **Mainpower** | • 1MW of hydro-generation at Cleardale on the EA Networks network<br>• Resource consent to establish and operate Mt Cass Wind Farm with maximum generation output of 95MW at Waipara in North Canterbury. Held in separate company to meet arm's length rules.<br>• Resource consent to establish 8MW solar farm at Thongcaster Road Eyre Forest in North Canterbury |

We would expect this volume of projects to increase modestly in the status quo.

## What is the policy problem or opportunity?

New Zealand faces a risk of energy shortage during seasons and periods of high demand. Our electricity networks are also at risk from severe weather events, which can lead to damaging outages. The Government is committed to addressing these risks and has a high priority focus on resilience and security of supply.

New Zealand electricity distributors (distributors) are restricted from "involvement in" (having an ownership interest in or a material influence on) generation connected to their own network or the national grid (Transpower's Network).

This leads to problems including:

- deterring investment in generation to support increased security of supply,
- a lower level of regional resilience than desirable.

These problems are discussed below.

### New Zealand has been facing a serious risk to the security and affordability of electricity.

New Zealand has been experiencing an energy shortage. The past month has shown the importance of an affordable and reliable supply of energy to reduce costs on households and keep our businesses internationally competitive. For example, pulp and paper manufacturers have come under immense stress from these far too high wholesale prices and we have seen factories shut or pause production.

New Zealand's wholesale electricity prices are currently very volatile. Wholesale prices reached their peak at over $1,700/MWh on 7 August 2024. In the short-term what we've seen is New Zealand Aluminium Smelters reduce its demand, Methanex has shifted its gas temporarily to electricity production. This has helped stabilised prices in the market and we have seen further normalisation of wholesale prices as wind generation has picked up and there has been rainfall in hydro catchments.

Commercial Information [redacted]

## Resilience

The report into the Northland tower collapse highlighted the value of distributed generation that can respond to grid emergencies in a region vulnerable to transmission outages. In Northland, Top Energy and Vector both had distributed energy resources that boosted the grid capacity in the region, meeting 45 per cent of the peak demand.

Additionally, Westpower has one key Transpower transmission line servicing 13,000 customers over 2,000kms. If a natural hazard or other emergency were to impact this line, consumers in Westpower could be severely affected.

More extreme weather events can cause damage to generation equipment, lines and other assets which can lead to supply disruptions especially for rural consumers. As these events increase the distribution of assets will be increasingly important for resilience.

Consumer-owned distribution businesses in particular are interested in increasing resilience on their networks as resilience of electricity becomes more prevalent to consumers.

## Restrictions have an impact on investment.

Many distribution businesses are interested in investing in generation to support regional resilience, deliver lower costs to customers and diversify their business, especially consumer-owned distribution businesses.

As distributors have familiarity with their regions they are well placed to respond by investing where generation is needed to ensure the resilience of their lines and assets. This can support responses to severe weather (such as Cyclone Gabrielle) or unforeseen events (such as the Northland tower collapse). They also know where critical infrastructure is in place in their regions where generation might be strategically placed to support resilience (e.g., water treatment, hospitals).

There are no restrictions on investment in generation connected to other distributors networks. Distributors have not made use of this opportunity. We do not consider that this necessarily means that they are only interested in investing where they can leverage their monopoly power. Distributors are likely to consider local opportunities more attractive as they complement their current assets and expertise. Consumer-owned distributors are often concerned about broader issues of local resilience or affordability of power.

Investors who have an ownership interest in distributors as part of a wider portfolio have reported that the prohibition on cross-involvement in generation connected to Transpower's network is deterring investment in generation.

While the current regime for generation on distributor's own networks has become more flexible over time, it is still reported to be burdensome by distributors and deters them from considering investment in generation. Increasing (without removing) the thresholds could address some of these issues.

Small distributors in particular face higher management and governance costs associated with operating separate businesses and complying with arms-length obligations. In a recent exemption process, Top Energy reported that the costs of adopting a full corporate and management structure separation were in excess of $1.5M each year. Top Energy sought and obtained an exemption from these obligations, but other distributors are reluctant to invest in regulatory processes to avoid these costs. Applying for an exemption itself presents time and financial costs that may not be insignificant to a small distributor, even if it wants to avoid these costs,

Distributors consulted during this process were concerned about what they saw as the inflexibility of the regime:

- Limitations in current rules requiring 'separate companies' may limit joint venture opportunities, where limited partnerships may be more appropriate.
- The current limits refer to the maximum nameplate[2] generation operating at its fully intended output. The actual generation is often lower for intermittent generation sources such as solar. This means that the effective limits are much lower for new intermittent and standby generation than it appears from the "nameplate" limits.
- Nameplate generation is also an issue for distributors who wish to invest in batteries. In order to preserve their life span, batteries almost never import or export to their nameplate capacity.

**Distributors still face compliance costs despite the availability of exemptions**

Exemptions from some cross-involvement rules are available from the Authority but are still reported to impose some costs and to deter consideration of further investment.

Distributors who participated in exemption processes (such as Top Energy and WEL Networks) still strongly argued that the restrictions should be removed as:

- exemptions could be narrower than desirable, which imposed costs
- the term of exemptions did not match the long investment horizon of generation assets, which created uncertainty
- EDBs had limited capacity to foreclose competition in generation anyway, and were restricted from doing so by Part 6 of the Code, and Part 4 of the Commerce Act.

**Consumer owned distributors are unnecessarily restricted**

The regulatory regime for regulating monopoly lines businesses distinguishes between two classes of lines businesses;

> Non-exempt businesses, which are more commercially oriented, and are more profit motivated, and are subject to revenue caps
>
> Exempt businesses which are owned by the consumers they serve, and do not have the same profit driven incentives, and which are subject to a more light-handed regulatory regime.

Consumer-owned distributors generally have elected trustees that represent the interests of the community they serve.

The risk of foreclosing competition arises from the incentive to generate higher profits. Absent such incentives, there is not an obvious case for regulation.

Current protections against anti-competitive behaviour are less relevant for consumer-owned distributors and may unnecessarily restrict investment. Consumer-owned distributors are not

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[2] The theoretical output of a generating source

profit-maximising entities and have a broader focus on improving outcomes for the community they serve, for example by improving resilience.

The regulatory regime in Part 4 of the Commerce Act, which regulates the distribution sector as monopolies, recognises their different incentives. It imposes lighter touch regulation on them, by only requiring information disclosure, rather than setting limits on their revenue. Consumers also have a direct say in the election of the distributor's trustees.

### The challenge is to encourage greater investment in generation without compromising competition

#### Independent generators remain concerned

Some independent generators are concerned that changes to the restrictions on cross-involvement will enable distributors to favour their own generation projects. For example, they were concerned that distributors could take advantage of the information asymmetry with other generators to favour their own projects.

However, on balance the requirement in Part 6 of the Code protects against these concerns as distributors must connect all generation where practical, on terms that do not fully compensate the distributor for the costs incurred.

#### Consultation on this proposal

MBIE consulted with the Electricity Networks Association (ENA) who represents all distributors in New Zealand and who provided written feedback across the distribution network and connected us with a small number of distributors who were interested in discussing this matter individually. MBIE also met with the Independent Electricity Generators Association, some interested generation businesses and government agencies.

## What objectives are sought in relation to the policy problem?

The objectives sought to address the above policy problem are:

- **Promoting regional resilience –** to ensure reliable energy is delivered in regions with local generation in particular at the ends of lines and to support responses to severe weather, natural disasters and other unforeseen events,
- **Promoting security and affordability** to ensure improved security of supply with increased investment in generation assets and affordability of wholesale electricity prices,
- **Protecting competition and consumers** - to achieve these outcomes while limiting and balancing any adverse impacts on competition, consumers, and electricity prices.

# Section 2: Deciding upon an option to address the policy problem.

## What criteria will be used to compare options to the status quo?

The following criteria have been used to assess the options. The criteria are based on the four dimensions that MBIE uses to assess the efficacy of its regulatory systems, and how likely they are to meet the overall objectives:

- **Effectiveness** – to what extent does this option increase investment in generation? To what extent does this option improve regional resilience? To what extent does this option deliver electricity security of supply and wholesale affordability?
- **Efficiency** – To what extent are the administration and compliance costs proportional to the benefits? Does this option remove administrative burden from the Authority and companies?
- **Protecting competition and consumers** – To what extent does this option enhance, preserve or diminish competition in the generation market? To what extent are businesses able to compete with each other and have access to equal levels of information? To what extent is anti-competitive behaviour limited?

The ability to monitor and act, or for parties to make a complaint, depends in part on the extent of information disclosed. For example, information would be less available to the Commission or others where if a distributor falls under the light-handed disclosure provisions in relation to related parties, although the Commission also receives Part 2 complaints from customers and competing businesses.

## What options are being considered?

**Option One** – ***Removing the 50MW threshold for cross-involvement in generation connected to a distributors own network, removing the s73 restriction in cross-involvement in more than 250 MW of generation connected to Transpower's network.***

This option proposes:

- Removing the restriction on cross-involvement in more than 250 MW of generation connected **to Transpower's network.**
- Removing the requirements for safeguards if there is cross-involvement in more than 50 MW of generation connected to a distributor's own network.
- Retaining the requirement for distributor agreements under Clause 6A.4 of the Code

**Effectiveness**

This option will be the most effective in increasing generation in the market. Distributors will have significantly fewer restrictions on them (other than protections in the Code and Commerce Act, and Clause 6A.4) and fewer formal restrictions to comply with when investing in generation. Distributors will be incentivised to make investment in regional resilience such as batteries that support their communities during severe weather events. This option will also offer the strongest incentive to invest in generation.

**Efficiency**

This option presents the most efficiencies for distributors and regulators. This is particularly important for smaller distributors who do not have the capacity to comply with cross-involvement rules under the status quo. The Authority will no longer have to monitor arms-length compliance or deal with costly exemption applications, which do not add significantly to the safeguards provided by other rules.

**Protecting Competition and Consumers**

Absent other protections, removing the cross-involvement/arms-length rules could create greater risks to competition than the other options. However, protections for competition remain through the other rules in the Code and Commerce Act, which address cross-subsidisation, information asymmetry, lack of transparency about terms for connection, and high charges for connecting to the network. These rules would be preserved, and provide similar incentives to deter anti-competitive conduct, without some of the formal costs of the rules under Part 6A.

As noted in the body, clause 6A.4 curtails an EDB's ability to favour their own generation and will be retained across all options presented in this RIS.

Given the concerns about the potential impact of removing the cross-involvement restrictions, we consider that it is worth retaining this additional safeguard.

It is not intended to remove the Authority's power to reinstate the rules if necessary (or to amend Part 6), which should provide an additional safeguard. As if the Authority determines that the rules were necessary, they may be added back in as per the Authority's statutory powers to amend the Code.

**Option Two – *Removing the transmission grid limits, excluding consumer-owned distributors from the limits, and amending the thresholds for distribution.***

This option proposes:

- Removing the restriction on cross-involvement in more than 250 MW of generation connected **to Transpower's network**.
- Removing the requirements for safeguards for consumer-owned distributors if there is cross-involvement in more than 50 MW of generation connected to a ***consumer-owned*** distributor's own network.
- Increasing the distribution limits for non-consumer owned distributors involved in generation connected to their own network **to 250 MW**.
- Retaining the requirement for distributor agreements under Clause 6A.4 of the Code

**Effectiveness**

This option may be somewhat effective in increasing generation in the market, by giving more headroom for investment. The rules will still apply to *non-exempt* distributors. Community-owned distributors would be able to support energy affordability in their communities. Removing consumer-owned distributors' obligations to comply with generation thresholds would align with the lower level of regulation applied under Part 4 of the Commerce Act.

The 50 MW limit is low in the context of contemporary energy projects and this would give more scope for routine projects to proceed without unnecessary process steps.

Distributors may still be deterred from making larger investments with bigger benefits for New Zealand.

**Efficiency**

This option is less efficient than the preferred option as the compliance costs remain for larger projects. However, this does support efficiency for consumer-owned distributors allowing them to invest more in their networks.

**Protecting Competition and Consumers**

This option would create similar concerns about competition as Option One, as distributors with larger generation assets could have similar incentives to prefer their own generation. The other regulatory safeguards would still operate, but the higher threshold would not provide much reassurance to those concerned about anti-competitive behaviour. Consumer owned distributors do not have the same motivations as profit driven distribution businesses and are less likely to participate in anti-competitive behaviour as they are overall focused on the benefits for their networks rather than profits.

**Option Three** – Removing the transmission grid limits and allowing the Authority to deal with the issue through its investigation into Part 6A of the Code.

This option proposes:

- Removing the restriction on cross-involvement in more than 250 MW of generation connected to Transpower's network.

- Allow the Authority to address the issues through its investigation into Part 6A of the Code.

The Authority is looking at whether the rules in Part 6A continue to provide the appropriate settings for distributor involvement in generation connected to their network. The Authority has indicated it will work with the Government to ensure a joint approach addresses all issues. Final decisions are likely to be made late 2024 or early 2025 with amendments to the Code, if any, made by March 2025.

The Authority cannot address the s73 prohibition because it is in the Act. As an independent agency the Authority can choose to amend, removing or retain any of the rules around distributor investment in generation. The Authority is sensitive to issues around local resilience following the tower collapse in Northland and could craft a nuanced change which would better balance the risks to competition.

**Effectiveness**

This option may or may not be as effective in increasing generation, as the outcome of the process the Authority is undertaking is not yet known as the Authority is an independent agency.

**Efficiency**

There is likely gained efficiencies through removing the national grid thresholds for distributors.

The Authority's investigation outcome is uncertain and may not lead to rules or thresholds being relaxed, and this could require further intervention by the Government at a later point.

**Protecting Competition and Consumers**

The Authority's statutory objectives require it to give strong consideration to the risks and advantages of change, and it can be expected to do a thorough job, which may result in a more nuanced and effective outcome.

### How do the options compare to the status quo/counterfactual?

The key to the table is:

**-** Not as good as SQ **0** Same as SQ **+** A little better than SQ **++** A lot better than SQ

| | ***Status Quo / Counterfactual*** | **Option One -** | **Option Two –** | **Option Three -** |
|---|---|---|---|---|
| **Effectiveness** | 0 | **++**<br>This will increase local generation investment opportunities for distribution businesses and support increased local resilience, as demonstrated during the recent Northland power outage. | **+**<br>This will increase investment opportunities for distribution businesses connecting to Transpower's network. Increasing the distribution limits may lead to some additional projects going forward. | **0**<br>Impact unclear |
| **Efficiency** | 0 | **++**<br>Will likely reduce administrative costs for the Authority and distributors as the arms-length rules and exemption regime will no longer be required. | **+**<br>May reduce administrative costs for the regulator and reduce transaction costs for distribution businesses. However, the Authority will still have to approve and administer the exemption regime, which is the more costly element. | **-**<br>Will increase uncertainty without necessarily increasing effectiveness. |
| **Protecting competition and consumers** | 0 | **0**<br>Will allow for greater investment in generation, no significant change to protecting competition and consumers, due to the existing rules that address the | **0**<br>Will allow for greater investment in generation, no significant change to protecting competition and consumers | **+**<br>Likely to be highly sensitive to competition concerns |

| | | | | |
|---|---|---|---|---|
| | | same behaviour as Part 6A. | | |
| **Overall assessment** | 0 | ++ | + | + |

## What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

MBIE recommends progressing with option one - Removing the 50MW threshold for cross-involvement in generation connected to a distributors own network, removing the s73 restriction in cross-involvement in more than 250 MW of generation connected to Transpower's network.

Across all criteria this option provides the best improvement to the status quo.

## What are the marginal costs and benefits of the option?

| **Affected groups** *(identify)* | **Comment** *nature of cost or benefit (e.g., ongoing, one-off), evidence and assumption (egg, compliance rates), risks.* | **Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.* | **Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.* |
|---|---|---|---|
| **Additional costs of the preferred option compared to taking no action** | | | |
| Regulated groups – distributors | One-off– distributors who own generation at arms-length will likely return to regular ownership models | Low | Medium |
| Regulators- The Electricity Authority and Commerce Commission | One-off – amendments to the relevant regulatory regime to ensure new rules are in place.<br>On-going – monitoring of existing rules relating to anti-competitive behaviour. | Medium | Medium |
| Others (e.g., wider govt, consumers, etc.) | Unlikely that there will be any additional costs for consumers. | Medium | Low. |
| **Non-monetised costs** | | *Medium* | *Medium* |
| **Additional benefits of the preferred option compared to taking no action** | | | |
| Regulated groups - distributors | More investment in generation allowed. Some distributors will investigate ways to invest in generation such as batteries and solar. | High | Medium |

| | | | |
|---|---|---|---|
| | Fewer compliance costs associated with complying with regime. | | |
| Regulators – Electricity Authority and Commerce Commission | Less costs associated with monitoring compliance and approving exemptions. | Medium | Medium |
| Others (e.g., wider govt, consumers, etc.) | More reliable and secure energy for consumers. | High | Medium |
| **Non-monetised benefits** | | *High* | *Medium* |

# Section 3: Delivering an option.

## How will the new arrangements be implemented?

The preferred option will require amendments to the Act and the Code which will be progressed in the Energy and Electricity Security Bill by early 2025. The Bill will amend the Code to remove the cross-involvement rules for distributors involved in generation on their own network.

As a general rule, secondary legislation such as the Code should not be amended by primary legislation.  However, for reasons of administrative convenience, and to provide greater certainty more rapidly, this Bill will be used to amend the Code. As noted in the body of the paper, the outcome of the Authority's review process is, by contrast, uncertain, and the Government would be able to progress its preferred option as quickly to deliver greater certainty.

MBIE will lead the development of the Bill.

Implementation changes are expected to be straight forward and not unduly costly for the Authority or Government.

## How will the new arrangements be monitored, evaluated, and reviewed?

The Authority will have the power to impose similar rules in the future if needed, and will be able to monitor complaints about distributors favouring their own generation or cross subsidising their services. The Authority is empowered to make changes to the Code (including Part 6 of the Code) and as the kaitiaki for the electricity system they ensure the system is working well.

The Authority may review the changes to see the effect they have had on competition, resilience and generation. As the Authority is now monitoring the pipeline of generation more closely, they can examine if this change has led to an increase in generation by distribution businesses.

From time to time the Office of the Auditor General reviews how electricity distribution businesses were managing, maintaining and investing in their networks to ensure that they could provide services to consumers for the long term.