

**Submission on  
Default Price-Quality Path Refinements**

From the Electricity Networks Association

27 September 2010

## Electricity distribution businesses supporting this submission

The electricity distribution businesses listed below support this submission.

Alpine Energy Ltd  
Aurora Energy Ltd  
Buller Electricity Ltd  
Centralines Ltd  
Counties Power Ltd  
Eastland Network Ltd  
Electra Ltd  
Electricity Ashburton Ltd  
Electricity Invercargill Ltd  
Horizon Energy Distribution Ltd  
Mainpower NZ Ltd  
Marlborough Lines Ltd  
Nelson Electricity Ltd  
Network Tasman Ltd  
Network Waitaki Ltd  
Northpower Ltd  
Orion New Zealand Ltd  
OtagoNet Joint Venture  
Powerco Ltd  
Scanpower Ltd  
The Lines Company Ltd  
The Power Company Ltd  
Top Energy Ltd  
Unison Networks Ltd  
Vector Ltd  
Waipa Networks Ltd  
WEL Networks Ltd  
Wellington Electricity Lines Ltd  
Westpower Ltd

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## Executive summary

1. This submission is the Electricity Networks Association's (ENA) response to the Commerce Commission's (Commission) paper of 13 August titled "*2010 – 2015 Electricity Distribution Default Price-Quality Path Refinements Discussion and Draft Decisions Paper*" (DPP Refinements Paper).
2. The DPP Refinements Paper proposes a number of changes to the 2010 – 2015 Default Price-Quality Path (DPP). A determination for this DPP was published on 30 November 2009, and is to apply for a period of five years commencing 1 April 2010.
3. The changes contemplate a correction to the DPP for a previous omission in respect of the revenue adjustment term; proposed amendments to the DPP to ensure it is consistent with the (draft) input methodologies (IMs); and a proposed change to the CPI index used in the price path component of the DPP.
4. The DPP Refinements Paper does not address the legislative provisions contained in Part 4 of the Commerce Act which stipulate how the DPP must be determined and reset. The ENA submits that a reasonable interpretation of the Part 4 provisions for setting the DPP is that:
  - the DPP must be set for a defined period;
  - it may only be reopened in limited circumstances to be determined in advance in accordance with the pending processes and rules IM; or after the DPP has been set in the case of errors or omissions; and
  - transitional provisions apply for a nine month period following the 2010 IM determinations where changes may be implemented where they would result in a materially different DPP had the IMs applied when the DPP was initially determined.
5. As the DPP Refinements Paper does not provide an explanation of the Commission's interpretation of the legislative provisions in this respect the proposals contained in the DPP Refinements Paper must be considered against the interpretation we have set out above. As the majority of the proposed refinements relate to the IMs, and as the IMs have not yet been finalised, it is expected the Commission will need to re-consult on a number of the proposals in the Refinements Paper once the IM determinations are made. We urge the Commission to address the legislative requirements for reopening the DPP prior to further consultation on these proposals.
6. The ENA supports the inclusion of the proposed revenue adjustment term into the DPP, to take effect from 1 April 2011.

7. The forthcoming DPP Enforcement Guidelines include the Commission's approach to assessing compensating actions undertaken by an EDB following a DPP breach.
8. In response to the proposed modifications to the DPP arising from the draft IMs, the ENA recommends that:
  - the Commission consults further on the proposed amendments to the DPP which may arise from the IMs, once the submissions on the IMs have been considered and final IM determinations have been made;
  - the Commission fully considers the alternatives proposed in the ENA submissions on the IMs of relevance to the DPP before making the final IM determinations; and
  - any changes to the 2010-2015 DPP which arise from the IMs can only be made in accordance with section 54K(3) and (4) which impose a 'materially different' test and a nine month window for the changes to be implemented from the time the 2010 IM determinations are made.
9. The ENA recommends that the proposed CPI adjustment is not made to the DPP because it is inconsistent with the regulatory provisions for modifying the DPP and the components of the DPP as set out in the Act. In addition the proposed change is inconsistent with principled regulatory decision making and the Commission's objectives for indexation.
10. Finally, we are concerned that the proposed Individual Price-Quality Path (IPP) process for Transpower incorporates a breach of the four month notification period for regulatory decisions and the manner in which this breach has been made. We also submit that further work must be undertaken regarding the proposed wash up arising from the IPP for the 2011/12 pricing year to ensure it does not result in detrimental impacts on the DPPs applying to EDBs.

# 1. Introduction

11. This submission is the Electricity Networks Association’s (ENA) response to the Commerce Commission’s (Commission) paper of 13 August “*2010 – 2015 Electricity Distribution Default Price-Quality Path Refinements Discussion and Draft Decisions Paper*” (DPP Refinements Paper).
12. The DPP Refinements Paper proposes a number of changes to the 2010 – 2015 DPP. A determination for this DPP was published on 30 November 2009, and is to apply for a period of five years commencing 1 April 2010.<sup>1</sup>
13. The changes contemplate a correction to the DPP for a previous omission in respect of the revenue adjustment term; proposed amendments to the DPP to ensure it is consistent with the (draft) IMs; and a proposed change to the CPI index used in the price path component of the DPP. The Refinements Paper does not address possible starting price adjustments to the DPP, which have recently been consulted on in response to the Commission’s 5 August 2010 Starting Price Adjustment Discussion Paper.
14. The DPP Refinements Paper does not address the legislative provisions contained in Part 4 of the Commerce Act which stipulate how the DPP must be determined and reset. In this submission we set out our interpretation of the relevant provisions before commenting on each of the proposals for changes to the DPP contained in the DPP Refinements Paper. The submission is structured as follows:
  - Section 2 comments on the provisions in Part 4 of the Commerce Act (the Act) which provide for setting and resetting the DPP and raises some issues as to the scope, timing and sequencing of the proposed changes to the 2010 – 2015 DPP.
  - Section 3 comments on the proposed change to the price path to incorporate a revenue adjustment term.
  - Section 4 comments on the proposed amendments to the 2010 – 2015 DPP arising from the draft IMs.
  - Section 5 addresses the proposed modification to the CPI index in the DPP and in addition raises an issue with the proposed timing for Transpower’s 2011 individual price-quality path for EDBs seeking to set prices for 2011 to ensure compliance with the DPP.

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<sup>1</sup> Previously this DPP was referred to as the Reset DPP; however the DPP Refinements Paper indicates the Commission is to now refer to it as the 2010 – 2015 DPP.

## 2. Reopening a DPP

15. Part 4 of the Commerce Act contains two subparts, both relevant to the DPP:
- Subpart 9 states that electricity suppliers are all subject to Information Disclosure Regulation (IDR), and that non-exempt electricity suppliers are subject to DPP/CPD regulation. It also stipulates a number of transitional provisions;
  - Subpart 6 contains the core DPP/CPD provisions, some of which are also applicable to the transitional period.

### DPP regulatory period defined

16. The Act is clear that after the transitional periods (refer below) the regulatory period for the DPP must be for a defined term. Section 53M states that every price quality path must specify the regulatory period and that a regulatory period must be 5 years (or in some circumstances, 4 years).
17. At the end of the regulatory period the Commission is required to reset the DPP (including starting prices, rates of change, and quality standards) for the purposes of the next regulatory period, which by virtue of section 53M will be another period of 5 years.

### Can the DPP be reopened?

18. The Act does not provide the Commission general powers to reopen a DPP within a regulatory period after having set a DPP. Rather the circumstances in which the Commission can reopen a DPP after having set it are very limited.<sup>2</sup>
19. First, as noted, the Act is clear that the regulatory period must be a defined period at the end of which the Commission must reset the DPP. Extensive or substantive changes midterm would run the risk of being tantamount to a midterm reset and therefore inconsistent with these requirements.
20. Secondly, section 53ZB stipulates that a change in an IM does not provide a basis for reopening the DPP. The Commission can only reset the DPP under section 53P if the IM change arises from an appeal of the IM and the changed IM would have resulted in a materially different price path. This reinforces a strict approach to the Commission's ability to reopen.

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<sup>2</sup> Section 52T requires that an IM can include the circumstances in which a price quality path can be reconsidered within a regulatory period. In the ENA's view the stipulation in advance of those circumstances is not the same as attempted retrospective changes to the DPP itself after it has been set. This submission is addressed at the latter issue.

21. Thirdly, section 13 of the Interpretation Act (and the common law), support the view that while the Commission can correct an error or omission in the DPP, having set the DPP it cannot make changes of a substantive nature until the end of the regulatory period.

22. Section 13 of the Interpretation Act 1999 provides:

***13 Power to correct errors***

*The power to make an appointment or do any other act or thing may be exercised to correct an error or omission in a previous exercise of the power even though the power is not generally capable of being exercised more than once.*

23. Section 16 of the Interpretation Act 1999 provides:

***16 Exercise of powers and duties more than once***

*(1) A power conferred by an enactment may be exercised from time to time.*

*(2) A duty or function imposed by an enactment may be performed from time to time.*

24. Despite the seemingly broad application of this provision, its scope is limited. In *Goulding v Chief Executive, Ministry of Fisheries* [2004] 3 NZLR 173, the Court of Appeal quoted with approval a passage from Wade and Forsyth in relation to the equivalent UK provision (at paragraph 46):

*In the interpretation of statutory powers and duties there is a rule that, unless the contrary intention appears, 'the power may be exercised and the duty shall be performed from time to time as occasion requires'. But this gives a highly misleading view of the law where the power is a power to decide questions affecting legal rights. In those cases the courts are strongly inclined to hold that the decision, once validly made, is an irrevocable legal act and cannot be recalled or revised. The same arguments which require finality for the decisions of courts of law apply to the decisions of statutory tribunals, ministers and other authorities.*

*For this purpose a distinction has to be drawn between powers of a continuing character and powers which, once exercised, are finally expended so far as concerns the particular case. An authority which has a duty to maintain highways or a power to take land by compulsory purchase may clearly act 'from time to time as occasion requires'. But if in a particular case it has to determine the amount of compensation or to fix the pension of an employee, there are equally clear reasons for imposing finality. Citizens whose legal rights are determined administratively are entitled to know where they stand.*

25. The Commission’s power to set the DPP is not of a continuing character. Once exercised the power is finally expended until the end of the regulatory period. The Commission is given no right to continue exercising the power “from time to time”.
26. Fourthly, the presence of reopeners as a component of the IMs implies a DPP (or Customised Price-Quality Path (CPP)) remains unchanged unless the ‘reopener’ criteria are triggered. If the Commission were able to reset or alter a DPP (or CPP) at any time the ‘reopener’ IM would be redundant.
27. Finally, limitations on the Commission’s ability to reopen the DPP between regulatory periods are consistent with the Act’s purpose of promoting regulatory certainty and providing a cost effective regulatory solution.

## **Section 52Q**

28. Section 52Q addresses amendments to section 52P determinations. It states:

*A section 52P determination may be amended in a material way only after the Commission has consulted with interested parties, but may be amended in a non-material way without prior consultation.*
29. Section 52Q sets out the procedural requirements the Commission must follow when contemplating any changes to a section 52P determination. Section 52Q does not provide a statutory basis for the Commission to make midterm amendments to a DPP in a substantive way.
30. Section 52Q must be read as subject to the more detailed provisions of the rest of the Act, the legislative scheme and the Interpretation Act. It follows that any amendments to the DPP can be for errors and omissions only.
31. Finally, given the significance of the DPP reset, and the stipulation of the defined term, it would be reasonable to suppose that if the legislature had intended to allow the Commission to reopen the DPP midterm, it would have provided for this explicitly in subpart 6 or subpart 9. The better view is that the Commission has no power to reopen the DPP midterm other than:
  - to correct errors and omissions;
  - consequential on appeal from an IM; or
  - in response to a reopener event (as stipulated ex ante in the relevant IM).

## **Transitional periods**

32. The Act provides for three transitional periods. They are:

- a) 1 April 2009 to 31 March 2010, as set out in section 54J, which provides for the Part 4 thresholds to be deemed to be a section 52P determination;
  - b) 1 April 2010 to the date of publication of the IMs, as set out in section 54K(1), which provides for the Commission to reset the DPP to apply on and after 1 April 2010; and
  - c) nine months from the date of publication of IMs after 1 April 2010, as set out in section 54K(3), which provides for the Commission to reset the DPP if, had the IMs applied as at b), they would have resulted in a materially different path, and provides for the application of claw-back.
33. It follows that the Commission's powers to reset during the third transitional period are wider than in the case of non transitional resets. However, section 54K is a transitional power and cannot be used to justify substantive changes to the DPP outside the transitional period.

## Recommendation

34. Accordingly the ENA submits that a reasonable interpretation of the Part 4 provisions for setting the DPP is that:
- the DPP must be set for a defined period;
  - it may only be reopened in limited circumstances to be determined in advance in accordance with the pending rules and processes IM; or after the DPP has been set in the case of errors or omissions; and
  - transitional provisions apply for a nine month period following the 2010 IM determinations where changes may be implemented where they would result in a materially different DPP had the IMs applied when the DPP was initially determined.
35. As the DPP Refinements Paper does not provide an explanation of the Commission's interpretation of the legislative provisions in this respect we submit that the proposals contained in the DPP Refinements Paper must be reconsidered against the interpretation we have set out in the preceding paragraph. The majority of the proposed refinements relate to the IMs, and as the IMs have not yet been finalised, and it is expected that the Commission will need to re-consult on a number of the proposals in the Refinements Paper once the IM determinations are made. We urge the Commission to address the legislative requirements for reopening the DPP prior to further consultation on these proposals.

### 3. Revenue Adjustment Term

36. The DPP Refinements Paper sets out a proposed correction to the price path formula to incorporate a revenue adjustment term. The proposed correction is consistent with our submissions on the 2010-2015 DPP determinations. We have previously submitted such a term should be included in the DPP to ensure the price path is set for the five year period independent of actual pricing behaviour within the DPP period.<sup>3</sup>
37. We support the inclusion of the proposed correction in the DPP, to be included in a determination prior to 30 November 2010 and therefore to apply from 1 April 2011. We submit that this correction is consistent with Section 2 of this submission which sets out our interpretation of the circumstances under which a DPP may be reopened. The inclusion of the revenue adjustment term is a correction for a previous omission in the 2010-2015 DPP determination. It will remedy an inconsistency in the price path formula which prevented the price path operating in the manner in which it was intended. Accordingly the correction should be made, and must be made prior to 1 April 2011, to avoid unnecessary harm to those EDBs subject to the DPP.
38. We also note that the proposed revenue adjustment term will only capture and adjust for the difference between Notional Revenue and Allowable Notional Revenue from the prior year. The quantum of this difference will not be known with certainty at the time prices are set, (as they are set prior to year end), however they will be able to be estimated given the lagged nature of many of the DPP price path components and the manner in which most pass-through costs are forecast. A more complex formula could be developed to implement a rolling differential adjustment, however we believe the proposed adjustment is reasonable for this purpose as it is:
- simple and easy to apply consistent with the relatively low cost nature of the DPP; and
  - will capture the majority of overs/unders and thus materially give effect to the intended price path.
39. Under the previous price path threshold regime, EDBs have inadvertently breached the price path threshold and introduced compensating adjustments in the following period. In assessing the consequences of a breach the Commission has taken these actions into account when determining whether additional regulatory intervention has been required. This has been a sensible solution with low compliance costs.

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<sup>3</sup> For example ENA, *Submission on the Reset of the DPP for Electricity Distribution Businesses*, 10 October 2010, paragraphs 37-39

40. Although the DPP is different to the price path threshold, and accordingly technical breaches are less likely, it is expected they will still occasionally occur. We trust the Commission will consider any actions undertaken by an EDB to compensate for an inadvertent breach in assessing DPP compliance. This could usefully form part of the forthcoming DPP Enforcement Guidelines.

## **Recommendation**

41. The ENA supports the inclusion of the proposed revenue adjustment term into the DPP, to take effect from 1 April 2011.
42. The forthcoming DPP Enforcement Guidelines include the Commission's approach to assessing compensating actions undertaken by an EDB following a DPP breach.

## **4. Amendments to give effect to Input Methodologies**

### **Sequencing of proposed changes**

43. The DPP Refinements Paper sets out a series of proposed amendments to the 2010-2015 DPP to give effect to the IMs. As stated in Section 2, the ENA submits that these proposals must be reconsidered in the context of the legislative provisions for reopening the DPP and the transitional provisions for the 2010-2015 DPP as set out in section 54K. In particular changes to the 2010-2015 DPP determination must be either consistent with the provisions for reopeners (to be determined in the IMs), or arising from the IM determinations, but these must be made within 9 months of the determinations and only where they will result in a materially different DPP.
44. The proposals in the DPP Refinements Paper have been prepared on the basis of the Commission's draft decisions on the IMs published in June and July this year. ENA members have since this time invested a considerable amount of effort and resource into considering the draft IM decisions and preparing submissions on them. In many instances these submissions propose alternatives to the draft IMs which our members consider are materially better than the Commission's views. At the time of the preparation of the DPP Refinements Paper, these submissions had not been considered and the final IM determination had not been made. The final determinations are expected in November or December and in any event can be no later than 31 December 2010.

45. Accordingly the ENA submits that the Commission should re-consult on the proposed amendments to the DPP which may arise from the IMs, once the final IM determinations have been made. In addition, and consistent with Section 2 above, we submit that section 54K(3) and (4) impose restrictions on the scope and timing of any amendments that may be made to the DPP in response to the 2010 IM determinations. In particular section 54K(3) imposes a ‘materially different’ test and Section 54K(4) imposes a nine month window from the time the 2010 IM determinations are made.
46. As a result, it is possible that some of the proposed amendments may not meet the “materially different” test. In addition the proposed timing for some of the amendments, in particular those pertaining to the price path may need to be brought forward to ensure they fall within the nine month window. Alternatively they may be deferred until the next DPP reset. This alternative option is also an option for the proposed starting price adjustments as indicated in paragraph 7 of our recent submission on the proposed starting price adjustment discussion paper.
47. In the remainder of this Section we briefly summarise our responses to each of the components of the IMs which may impact on the DPP, as set out in the DPP Refinements Paper. These responses are consistent with our recent submissions on the draft IM decisions. Consistent with the preceding paragraphs however, they must be reassessed against the section 54K(3) ‘materially different’ test.

## **Relevant input methodologies**

### **Specification of price**

48. The draft IM proposes a weighted average price cap to be specified as a function of prices and quantities net of pass-through costs and recoverable costs. The 2010-2015 DPP already specifies price as a weighted average price cap, and the ENA supports this approach. The 2010-2015 DPP specifies the weighted average price cap as net of pass-through costs but not recoverable costs. The draft rules and processes IM introduced recoverable costs for the first time, and accordingly this component of price was not consulted upon during the determination of the 2010-2015 DPP.
49. Currently under the 2010-2015 DPP pass-through costs include:
- transmission charges paid to Transpower in accordance with the Transmission Pricing Methodology (TPM); the provision of system operator services; and new investment contracts;
  - avoided transmission charges paid to distributed generators and expenses incurred in activities which substitute for the transmission system;
  - local body rates on system fixed assets;

- Electricity Commission levies; and
  - Commerce Act levies.
50. The draft IM proposes that only the last three categories of cost are included as pass-through costs and that transmission charges and avoided transmission charges are to be classed as recoverable costs. In addition the proposed new net carry forward cost from the CPP Incremental Rolling Incentive Scheme (IRIS) is to be included as a recoverable cost. We address IRIS later in this Section.
51. Our submission on the rules and processes IM proposes:
- a different set of criteria for identifying pass-through costs;
  - the inclusion of an incentive mechanism procedure in the definition of pass-through costs thus avoiding the need for the recoverable cost category of pass-through costs;
  - the categories of costs which are included as pass-through costs to include transmission, avoided transmission, catastrophic events and costs associated with new legislation or regulation for DPPs;
  - qualified support for the proposed incentive mechanism for avoided transmission investments which substitute for an equivalent Transpower service (with an extension of the benefit period to the DPP reset immediately following five years from the date of the investment). In treating avoided transmission costs we propose that the Commission adopt a pass-through cost framework, and omit its proposed efficiency test; and
  - avoided transmission costs associated with embedded generation should be included as pass-through costs, consistent with the existing DPP but omitted from the draft IM.<sup>4</sup>

### **Incremental Rolling Incentive Scheme**

52. The draft rules and processes IM sets out a rolling incentive scheme for suppliers transitioning from a CPP to the DPP to enable the recovery of the carry forward amount as determined under the IRIS to apply under a CPP.
53. Our submission supports IRIS in principle, however we submit that the proposals should be amended to:
- include an IRIS in the DPP and insert appropriate provisions for this in the rules and processes IM (our submissions have included detailed amendments in support of this);

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<sup>4</sup> ENA, *Submission 5 Rules and processes Input Methodology*, 9 August 2010, Section 3

- the proposed IRIS is extended to 10 years to ensure rewards from merger activity are commensurate with the risks involved and reflect the period over which benefits can in practice be achieved;
- a baseline opex for the merged firm be derived from the sum of the individual firms involved, rolled forward at CPI-X; and
- for the purpose of IRIS under a DPP, controllable costs are defined as all opex except pass-through costs.<sup>5</sup>

### **CPP application window**

54. The draft CPP IM proposes that CPP applications may only be made at certain times. Accordingly the DPP Refinements Paper proposes that these provisions will be included in the DPP. Our submission on the draft CPP IM includes the following recommendations:

- that the Commission commits to considering all CPP proposals received as soon as practicable and in particular where fewer than four proposals are received for a regulated service within the application window; and
- catastrophic events are addressed as a pass through cost in DPPs (and CPPs) and do not require a supplier to make a CPP proposal.<sup>6</sup>

55. In addition we note that once these provisions are finalised, they will be included in the IM determinations. They are not necessarily required as part of the DPP determination in order to be effective. Accordingly, and consistent with section 54K(3) we submit they can be excluded from the 2010-2015 DPP, and if necessary consulted upon at the 2015 DPP reset.

### **Transactions between EDBs**

56. The Commission proposes that ‘transaction events’ are defined as one of the events that give rise to a possible reconsideration of a CPP (but not a DPP), but the rules and processes draft IM doesn’t develop this in any detail. In the Commission’s 2 July 2010 Companion Paper to the draft IM determinations the treatment of transaction events is developed as an issue in its own right, and not as if it is a reopener. The ENA supports this approach in principle.

57. However our submissions propose a number of amendments to the draft provisions some of which apply to IDR and thus are not relevant for the DPP.

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<sup>5</sup> Ibid, Section 5.

<sup>6</sup> ENA, *Submission 9 Customised Price-Quality Path Input Methodology*, 23 August 2010, Section 3

Our submission on the draft IM proposals includes the following recommendations:

- if two or more suppliers of electricity lines services become related entities, they may merge their price-quality paths (but are not required to do so), but if they do so, they must merge their information disclosures in the same reporting period;
- if the merging entities include an (exempt) consumer-owned supplier and a supplier that is not, the consumer-owned entity needs to adopt a DPP (and there need to be rules as to how that happens);
- if two or more consumer-owned suppliers of electricity lines services become related entities, they may merge their information disclosures (but are not required to do so);
- when merging price-quality paths, the merged entity must demonstrate that the merged price and quality paths are equivalent to the sum of the pre-existing price and quality paths, and provide transparency as to how the merged price and quality paths have been calculated; and
- when merging information disclosures the merged entity must provide transparency as to how the disclosures have been merged. This is different to the existing Information Disclosure Requirements (IDRs) which specify time weighted average rules for merging information disclosures as a result of a transaction.<sup>7 8</sup>

58. In addition we note that once these provisions are finalised, they will be included in the IM determinations. They are not necessarily required as part of the DPP determination as well in order to be effective. However Clause 10 of the 2010-2015 DPP includes some provisions for EDBs which transact during the DPP period. If the final IM ultimately conflicts with the existing Clause 10, then amendments will be required to avoid confusion where they would result in a materially different outcome. If not, in accordance with Section 54K(3) they may be deferred until the 2015 reset.

### **Reconsideration of a DPP**

59. The draft rules and processes IM sets out the circumstances under which a DPP may be reopened, being where an error is discovered in the DPP or where the DPP determination has been made on the basis of incorrect or misleading information. Our submission proposes that additional circumstances (if not

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<sup>7</sup> Supra n4, Section 4

<sup>8</sup> In addition our Submission 10 (*Input Methodologies, Draft Determinations Parts 1-4*, 25 August 2010) includes our proposed provisions to be included in the IM, for the treatment of EDBs which have transacted, for the purpose of the DPP.

included as pass-through costs) should be included to reflect costs which may arise during a DPP period which were not provided for in the DPP, such as costs associated with new legislation or catastrophic events.<sup>9</sup>

60. We note that the circumstances under which a DPP may be reopened will form part of the IMs, once they have been determined. Accordingly they do not necessarily need to be included in the DPP determination in order to be effective. Thus consistent with section 54K(3) we submit they can be excluded from the 2010-2015 DPP, and if necessary consulted upon at the 2015 DPP reset.

## **Recommendation**

61. The ENA recommends that:
- the Commission consults further on the proposed amendments to the DPP which may arise from the IMs, once the submissions on the IMs have been considered and final IM determinations have been made;
  - the Commission fully considers the alternatives proposed in the ENA submissions on the IMs of relevance to the DPP before making the final IM determinations; and
  - any changes to the 2010-2015 DPP which arise from the IMs can only be made in accordance with section 54K(3) and (4) which impose a ‘materially different’ test and a nine month window for the changes to be implemented from the time the 2010 IM determinations are made.

## **5. Other Issues**

### **Derivation of the CPI**

62. Chapter 3 of the DPP Refinements Paper includes a proposal to make a further change to the 2010-2015 DPP which is not in response to an IM, nor is it a correction to the DPP determination. Accordingly, and consistent with Section 2, we submit that the proposed amendment is contrary to the regulatory provisions for resetting the DPP.
63. The proposal is to alter the CPI index to be applied in the price path component of the DPP which would have the effect of modifying the published Statistics New Zealand CPI index which is currently included in the DPP. The proposed modification is a one off change to the published

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<sup>9</sup> Supra n 4, Pages 13 and 17

December 2010 quarter index to attempt to counter the impact on CPI of the change to the GST rate, which is to apply from 1 October 2010.

64. Section 53O sets out the requirements of a DPP which must include:
- a) starting prices;
  - b) rates of change in prices relative to the consumer price index;
  - c) quality standards;
  - d) the date on which the DPP takes effect;
  - e) the annual date which any proposed CPP must be received; and
  - f) the annual date which compliance must be demonstrated.
65. The proposed change would result in a price path index which is different to the consumer price index. This would be contrary to section 53O(b).
66. The draft CPP IM proposes a similar modification to the CPI for the purpose of establishing a CPP price path. In our submission on the draft CPP IM we set out our reasons for opposing the modification. The same reasons apply in respect of the DPP. In particular we note:
- we do not believe the proposed one-off adjustment is consistent with principled regulatory decision making. The IM consultation window has created this opportunity to adjust an input into the IMs in response to an announcement which has been made during that consultation window;
  - the Commission considers this change should be made as EDBs do not face the rise in GST in their costs directly, but it is not the intention that the CPI will measure input cost inflation for EDBs. Movements in the CPI over time will reflect a large number of factors, many of which are not directly relevant to EDBs, but the Commission is focusing inappropriately on this one particular change. The CPI is an established index used to measure changes in the prices of consumer goods and services and is widely used and recognised as a measure of general economy-wide price inflation; and
  - CPI indexes (or their equivalents) are used by regulators partly because they are readily available but primarily because they provide a measure of the real, versus the nominal value of money within an economy. Their use in a regulatory setting enables prices to be calibrated in real terms, and for returns on the regulated supplier's investments to be assessed in real terms. This ability to estimate the real value of money over extended periods of time is very important in regulated sectors that have very long life assets.

The Commission's proposed adjustment to the CPI index is inconsistent with using the CPI index for this purpose.<sup>10</sup>

## Individual Price-Quality Regulation for Transpower

67. We have recently reviewed the Commission's Revised Process Paper for setting Transpower's IPP.<sup>11</sup> We note that this paper proposes that the IPP determination which will take effect on 1 April 2011 will now be made in December 2010, along with the IM determinations applying to Transpower. Thus the determination will not be made four months prior to the date from which the IPP will come into effect (ie: on 1 April 2011).
68. This is contrary to the four month notification period specified in section 53M(7). We note that section 53ZC is used to permit the change, however we submit that this was not the intended purpose of section 53ZC which is to allow provisions for DPPs/CPDs from subpart 6 to be carried over into individual price-quality regulation.
69. We understand the rationale for aligning the determination dates however we note that it is important that EDBs receive their pricing notifications from Transpower at least four months prior to 1 April to ensure they are able to set their prices consistent with the DPP. We understand Transpower plans to meet this timetable this year however we are concerned at the potential precedent which has been set by breaching the four month notification period for regulatory decisions.
70. We also note that, given the IPP determination will be made after the 2011/12 transmission prices have been set, there will be a wash up to be factored into the EV accounts. This will reflect any difference between the 2011/12 revenue requirement consistent with the IPP, and the assumptions applied in the 2011/12 prices. The Process Paper suggests this will adequately address any impact of the deferral on interested parties.
71. In principle this appears a reasonable solution however we are concerned at the potential impact this may have on the DPP price paths of individual EDBs given the TPM is effectively an allocation methodology, and the allocations differ year on year due to proportional demand etc. In addition, as the DPP rolls forward each year with new quantities in the price cap, there is potential for a mismatch between the proposed wash up and the headline revenue used in the DPP.

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<sup>10</sup> Supra n6, pages 30-32

<sup>11</sup> Commerce Commission, *Individual Price-Quality Regulation of Transpower, Revised Process Paper*, 26 August 2010

72. We submit that further work needs to be undertaken before the wash up is determined and factored into transmission prices, to ensure each EDB's Allowable Revenue under the DPP, and the ability of each EDB to comply with the DPP is not compromised.

## **Recommendation**

73. The ENA recommends that the proposed CPI adjustment is not made to the DPP because it is inconsistent with the regulatory provisions for modifying the DPP and the components of the DPP as set out in the Act. In addition the proposed change is inconsistent with principled regulatory decision making and the Commission's objectives for indexation.
74. The ENA is concerned that the proposed IPP process for Transpower incorporates a breach of the four month notification period for regulatory decisions. In addition the manner in which this breach has been made appears to be contrary to the intention of the Act. We also submit that further work must be undertaken regarding the proposed wash up arising from the IPP for the 2011/12 pricing year to ensure it does not result in detrimental impacts on the DPPs applying to EDBs.