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**SUBMISSION ON THE 2010 – 2015 ELECTRICITY DISTRIBUTION DEFAULT PRICE  
QUALITY PATH REFINEMENTS DISCUSSION AND DRAFT DECISIONS PAPER**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the 2010-2015 Electricity distribution default price-quality path refinements discussion and draft decisions paper (the **paper**) released by the Commerce Commission (the **Commission**) in August 2010.
- 2 Orion has had the opportunity to review the submission on the 2010 -2015 DPP discussion and draft decisions prepared by the ENA. Orion supports that submission in its entirety and adopts its conclusions as its own.

**Chapter 2 - Revenue differential term**

- 3 Orion supports the Commission's draft decision to amend the compliance assessment formula to include a revenue differential factor, we also agree with the form of the amendment to the formula as set out in Appendix A of the paper.
- 4 Orion agrees with the Commission that the current compliance assessment formula would perpetuate the effects of a breach over the remainder of the regulatory period and that the use of a revenue differential term will correct the issue. However, we note with concern the delay in the Commission



releasing its consultation documents on its enforcement criteria. Orion has previously raised this issue with the Commission<sup>1</sup>

*“We believe that concerns EDBs may have about the risks with the DPP,” ... “are related to the fact that a breach is an illegal act, even though many of the breaches may be due to technical matters related to uncertainty and estimation and are likely to be very minor in terms of dollars and associated ‘excessive’ prices.*

*We consider that to provide EDBs with additional confidence in the regime, the Commission should be looking to release its proposed enforcement guidelines around December 2009, i.e. coincident with the time EDBs will be setting their prices for the 2010/11 year based on the Reset DPP.*

*If the guidelines contain some leeway for the Commission in declaring a breach, or in EDBs having to declare their own breach, then this would be useful. However, under the current timing we would not know about any leeway before we set prices for 2010/11.”*

- 5 While we are aware of the scope of issues that the Commission is currently dealing with in relation to development of input methodologies and the difficulties of EDB's to respond to additional consultation we believe that the enforcement guidelines require urgent attention.
- 6 We believe that having clear enforcement guidelines is particularly important because while the revenue differential term effectively deals with any difference between our estimate and actual pass through costs this does not remove the possibility of an inadvertent breach. We agree with the Commission that pass through costs other than transmission are relatively small, however regardless of our ability to accurately predict pass through costs, once we have set prices the amount we collect to recover these costs is at the mercy of our chargeable quantities<sup>2</sup>. Variations in electricity purchases will lead to under or over recovery on pass-through costs, particularly transmission costs, and this is not taken into account in the compliance assessment.

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<sup>1</sup> Paragraphs 38 – 40 *Submission on the initial reset of the default price quality-path for electricity distribution businesses – Draft decision paper* 12 October 2009

<sup>2</sup> Chargeable quantities may vary sustainably in any year in response to weather and economic conditions

- 7 The only way to effectively address this issue would be to adopt a separate assessment of transmission revenue against transmission costs, which was put forward by Orion in previous consultation<sup>3</sup> but not taken up by the Commission.

*Timing of the modification of the compliance assessment formula*

- 8 Orion agrees with the Commission that the compliance assessment formula should take effect from 1 April 2011 and that as set out in the indicative process the Commission should finalise and give effect to this decision by 1 December 2010 to allow EDB's to take account of these decisions in their price setting process for 1 April 2011.
- 9 We are therefore concerned that the Commission has in its "individual price-quality regulation of Transpower – Revised process paper"<sup>4</sup> 26 August 2010 proposed that:

*"The Commission now considers that the IPP determination should take effect on 1 April 2011. The reason for this is that the settlement only governs the setting of Transpower's revenue requirements up to, and including those which apply to Transpower's 2010/11 pricing year, which ends on 31 March 2011. The settlement does not apply to the setting of revenues for the 2011/12 financial year (which apply to the 2011/12 pricing year). If IPP regulation was only to apply from 1 July 2011, there would be a 3 month gap during which Transpower's revenue was not regulated.*

*Section 53M(7) sets out that a s52P determination does not apply to a supplier until the date specified in the determination, which must be a date at least four months after a summary of the determination is published in the Gazette. That section applies to an IPP determination pursuant to section 53ZC(2)(a). The Commission considers, however, that it is a necessary modification, as allowed under section 53ZC(2), to reduce the notification period, in this instance, to three months,..."*

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<sup>3</sup> Orion submission on proposed changes to distribution thresholds 14 December 2004

<sup>4</sup> Paragraphs 1.10 and 1.10 *Commerce Commission's Individual price-quality regulation of Transpower – Revised process paper* 26 August 2010

- 10 While we agree that Transpower's pricing year should commence on 1 April the Commission's proposal to shorten the period between publishing in the Gazette a summary of the determination and the start of the pricing year from 4 months to 3 months is unacceptable.
- 11 As the Commission has already noted in relation to the modification of the compliance acceptance formula, EDB's require the 4 month window provided by s53M(7) to establish their pricing. This pricing of necessity must include the impacts of transmission prices.

### **Chapter 3 – Amendments to the initial reset determination**

- 12 As the Commission rightly notes many of the issues discussed in chapter 3 relate to input methodologies, which are the subject of a consultation process and possible appeal process.
- 13 As we have noted in our IM submission (paragraph 5.1) Orion supports a number of aspects of the Commission's draft decisions in relation to regulatory rules and processes (subject to some amendments). However, several facets of the draft input methodology require significant further work before it is fit for purpose.
- 14 Many of the issues raised in chapter 3 of the Commission's discussion paper have been addressed in earlier submissions either by Orion or the ENA. We reiterate some of these responses below:

#### *Specification of price. Pass-through costs and recoverable costs*

- 15 As we noted in our submission on input methodologies (IMs) dated 9 August 2010 we consider that it would be better if the Commission collapse the distinction between 'pass-through' costs and 'recoverable' costs (which is needlessly duplicative) and to define the former more broadly.

*“Orion acknowledges the Commission's decision to adopt a new category of 'recoverable costs'. We have submitted previously that EDBs must have the ability to recover material costs arising from events that are uncontrollable and unforeseen. The definition of 'recoverable cost' appears to encompass such circumstances, which is a positive development. However, the Commission appears to have retained for itself an unfettered discretion to decide:*

- *when a cost is 'recoverable' and when it is not; and*
- *less than 100 per cent of a recoverable cost will be eligible for pass-through; and*
- *whether to approve new investment contracts with Transpower and avoided transmission arrangements as set out in clause 3.2.4(2)(a).*

*This is inappropriate. The best approach would be to collapse the distinction between 'pass-through' costs and 'recoverable' costs (which is needlessly duplicative) and to define the former more broadly. In our view, pass-through costs should be defined so as to include costs:*

- *that are unforeseen and outside the control of the supplier; and*
- *that have not otherwise been recovered under a DPP or were not included in the derivation of a CPP.*

*There should be a strong presumption that 100 per cent of such costs should be passed through. The Commission should also clearly specify those circumstances in which that presumption may be rebutted, and less than 100 per cent of the relevant cost passed through. It is yet to do so. This will provide much-needed certainty to EDBs.*

*The Commission should also specify the process by which it may decide not to approve new investment contracts (**NIC**) and avoided transmission arrangements under clause 3.2.4(2)(a). Overall, we are concerned that the Commission requirement to approve NICs anticipates a level of involvement by the Commission in an EDB's business which is not appropriate under a low cost DPP. We are also concerned that the proposed draft determination does not include the avoidance of an NIC as an avoided transmission charge.*

*The above issues need addressing to provide much-needed certainty to EDBs.*

*A key advantage of our proposed approach is the fact it is likely to limit the circumstances in which an EDB might otherwise wish to re-*

*open the DPP. Because the definition is non-exhaustive, this means that unforeseen and uncontrollable events (such as extreme weather or terrorist incidents) could be dealt with expeditiously through a well-defined, constrained process that does not require revisiting of all of the parameters underpinning the price path. DPP re-openers can then be confined to events that have broader impacts.*

*If the Commission chooses to retain a separate category of 'recoverable costs', it must still set out clear criteria describing when a cost will be considered to be 'recoverable' and when less than 100 per cent of such costs will be eligible for pass-through. In this regard, we suggest adopting the criteria described in paragraph 5.18 above. This serves to further illustrate why maintaining a distinction between pass-through and recoverable costs adds a needless layer of complexity."*

#### *Potential amendment to the derivation of the CPI*

- 16 Orion disagrees with the Commission's proposal in relation to the amendment to the derivation of CPI. We consider that this issue has been appropriately addressed in the ENA submission 9 customised price quality path input methodology at paragraph 114 to 120.
- 17 In summary: *"In deriving the inflation index to be applied in a CPP, the ENA submits that the proposed GST adjustment to the CPI is not undertaken for the index to be used for maximum allowable revenue and asset revaluations as it is inconsistent with principled regulatory decision making and the Commission's objectives for indexation.."*<sup>5</sup>

#### *Timing*

- 18 With many of the topics<sup>6</sup> that the Commission has identified in chapter 3 of the paper being challenged by Orion and the industry in general through the ENA submissions<sup>7</sup>, we agree with the Commission that there are timing issues that need consideration.

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<sup>5</sup> Paragraph 10 ENA submission 9 customised price quality path input methodology 23 August 2010

<sup>6</sup> Paragraph 3.4

<sup>7</sup> Orion supports that ENA submission in its entirety and adopt its conclusions as our own.

- 19 We believe that the chapter 2 proposal for a revenue differential term could be implemented in the proposed time frame as indicated above (subject to transmission pricing being appropriately dealt with.
- 20 In relation to the Chapter 3 proposals we repeat the ENA's recommendation made in its submission *Methods to adjust DPP starting prices* 10 September 2010<sup>8</sup>:

*“..., the Commission could forego the DPP reset pursuant to section 54K and instead focus on navigating an orderly implementation of Part 4 that anticipates the first DPP reset at the end of the current regulatory period. It is important that short term implementation challenges do not result in methods and outcomes that are found to be inconsistent with the purpose of Part 4 over the longer term.”*

- 21 The reasons for the ENA's recommendation resulted from a number of timing issues with the Commission processes which we consider will need to be resolved.

*Other issues*

- 22 We note that the “Headroom/Revenue Differential” amendment, refers to a commencement date of 1 April 2011. However the consolidated version of Decision 685, still refers to the determination commencing on 1 April 2010.
- 23 The consolidated version does however refer to amendments and notes

*Decision [XXX]  
On 30 November 2010, clause 8.4 of the original determination was substituted with a new clause 8.4. [Insert gazette summary reference] sets out a summary of the amendment.*

- 24 For the avoidance of doubt we suggest the following modification to this clause

*Decision [XXX]  
On 30 November 2010, clause 8.4 of the original determination was substituted with a new clause 8.4. [Insert gazette summary reference] sets out a summary of the amendment, which comes into*

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<sup>8</sup> Paragraph 7 ENA's submission *Methods to adjust DPP starting prices* 10 September 2010

*effect on and from 1 April 2011 and applies for the period 1 April 2011 to 31 March 2015.*

**Concluding remarks**

- 25 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email [dennis.jones@oriongroup.co.nz](mailto:dennis.jones@oriongroup.co.nz).

Yours sincerely

A handwritten signature in black ink that reads "D. L. Jones". The signature is written in a cursive, slightly slanted style.

Dennis Jones  
**Industry Developments Manager**