

24 August 2011

Regulation Branch
Commerce Commission
PO Box 2351
WELLINGTON

ATTENTION: Mathew Lewer

By email to: regulation.branch@comcom.govt.nz

Submission to the Commerce Commission on the 2010 -15 Default Price Quality Path Reset – Draft Decisions Paper

Our Submission

1. We appreciate the opportunity to comment on the Commission's various papers on this matter.
2. We support the submission by PricewaterhouseCoopers (PWC) on the 2010 -15 Default Price Quality Path Reset – Draft Decisions Paper which is made on behalf of 19 EDB, and the Electricity Networks Association (ENA) on the 2010-15 Default Price-Quality Path for Electricity Distribution Businesses, of which we are a party. The views expressed in those submissions are expressly incorporated in this our submission.
3. In addition to the views expressed in the PWC and ENA submissions referred to above, this paper sets a number of points that are particularly salient for Nelson Electricity Limited (NEL). This submission includes analysis specific to NEL and illustrates why the currently proposed SPA mechanism needs to be amended to deliver a suitable low cost regulatory solution.
4. We further reiterate the comments made by the Electricity Networks Association, (ENA), submission that starting prices for the reset of the DPP be considered an Input Methodology (IM). Dispute the requirement of Part 4 to provide regulatory certainty the Commission has continued to make changes to this element which provide very different outcomes for EDBs and their consumers even when input data has remained unchanged.
5. This submission set out our particular views on:
 - a. The requirement for the DPP to accommodate business as usual circumstances for all EDB's including NEL.
 - b. The Application of Regional Growth Assumptions
 - c. The Revenue Weights
 - d. Allowable Notional Revenue Calculation 31 March 2013

- e. Transmission cost within the definition of “recoverable costs”

DPP must accommodate business as usual circumstances for all EDB’s

6. The Starting Price Adjustment (SPA) is an integral part of the DPP regime. It is our strongly held view and that of our owners that the DPP including the SPA, needs to be robust enough to accommodate all non exempt EDB’s in business as usual circumstances. A low cost regulatory regime should not require a non exempt EDB to apply for a CPP in order to achieve the allowable rate of return in normal operating circumstances. The DPP must be specified in such a way that it provides for the business to make the allowable rate of return. If it provides an erroneous result, then the model is either not robust enough to deal with the range of businesses it applies to and/or it includes inappropriate assumptions. In this case we submit that the regulator has failed in its task and not provide something that is fit for purpose.
7. Any suggestion that the CPP is substitute for a fit for purpose DPP is in our view underestimating the resources required to make an application for a CPP and the level of risk inherent in taking that course of action. NEL is a relatively small EDB and therefore seeking a full building blocks based price path determined under the CPP would be a very significant undertaking vis a vi the scale of its operations. Although the process of obtaining a CPP would be less costly than for a larger EDB, the variance in costs is unlikely to be proportional to the size of the asset base and resources of the business. There is also the additional risk of uncertainty of outcome surrounding such an application particularly as the Commission still appears to be quite fluid in its development of these methodologies.
8. We submit that to meet the stated objectives of the Regulatory framework the DPP must generally provide for all non exempt EDBs operating within their normal business circumstances to make a return consistent with the allowable return as stated in the Input Methodologies. In the case of NEL the current proposal as set out in the 2010-15 Default Price quality Path Reset – Draft Decisions Paper, July 2011, does not provide this outcome.
9. We acknowledge that the Commission has tried to adapt the proposed methodology to better suit the range of EDBs subject to it. However the current proposal does not go far enough to provide an equitable outcome for NEL. Despite the limited timeframe remaining to finalise this work, we submit that there are some further quite straight forward modifications that can be made to make the current methodology more realistic for NEL. These proposed changes are consistent with the direction of recent “refinements” made by the Commission to this methodology. We set these particular points out below in more detail.

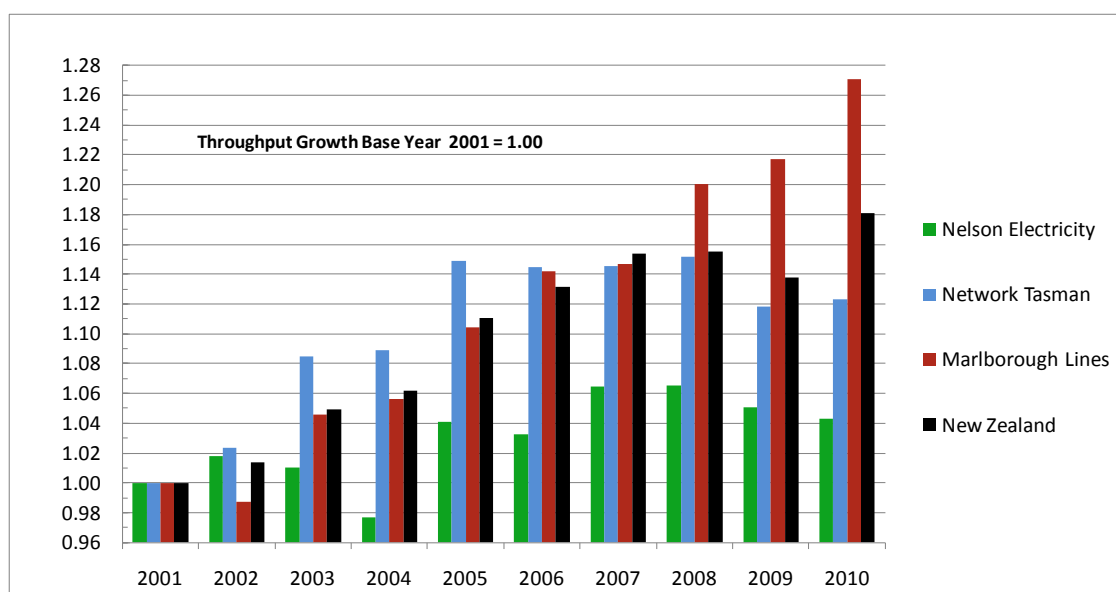
The Application of Regional Growth Assumptions

10. One key change between the April and current Draft Decisions has been the proposed inclusion of regional growth rates rather than industry wide growth rates for forecasting purposes. We submit this is generally an improvement. In the instances where either the regional boundaries broadly coincide with the network boundaries or the regions used in the forecast are made up of broadly homogeneous sub regions, the proposed approach of utilising regional forecasts appears valid. However for NEL the above conditions do not hold true.
11. NEL is concerned at the approach the Commission has undertaken in using regional growth assumptions instead more network specific data where available and applicable to assess the Starting Price Adjustment for 2012/2013. The regional data applied does not correspond at all to the real growth observed or likely to occur on the NEL network. We submit that the Commission consider applying network specific disclosed data to amend the regional forecasts where appropriate in their assessments. We also submit that more up to date information be used where available.

Throughput growth for NEL

12. Firstly looking at “throughput growth” for NEL, the Commission based its forecasts on volumes for the Nelson/Marlborough Region. NEL actual volumes are disclosed annually and provide more accurate growth rates. Comparing NEL growth rates to Network Tasman and Marlborough Lines demonstrates that using regionally based information in this instance will provide an erroneous result. The outcome is made worse by using the 2004 - 2008 period which does not accurately reflect forecasted growth rates at all. NEL has had reducing throughput since 2008.

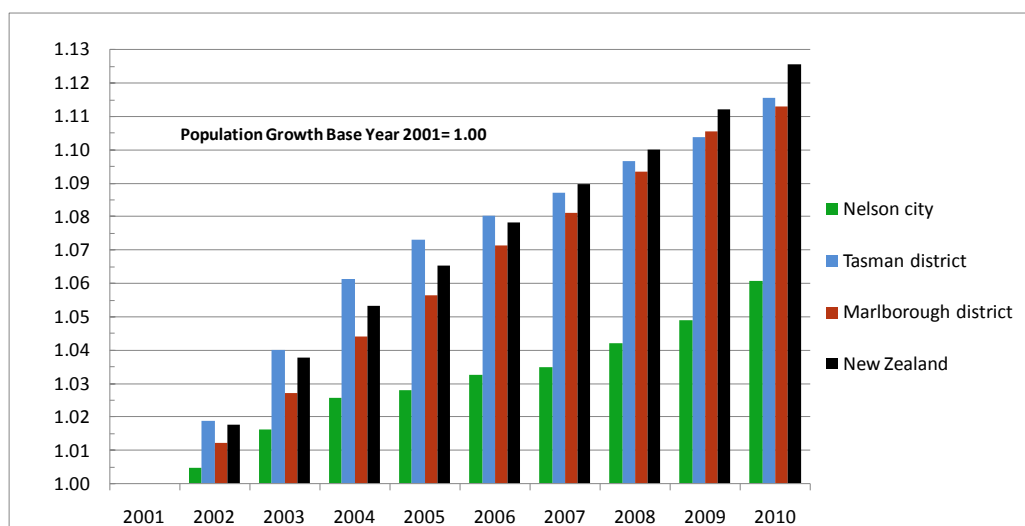
Graph 1: Throughput Growth New Zealand & Tasman /Marlborough Region



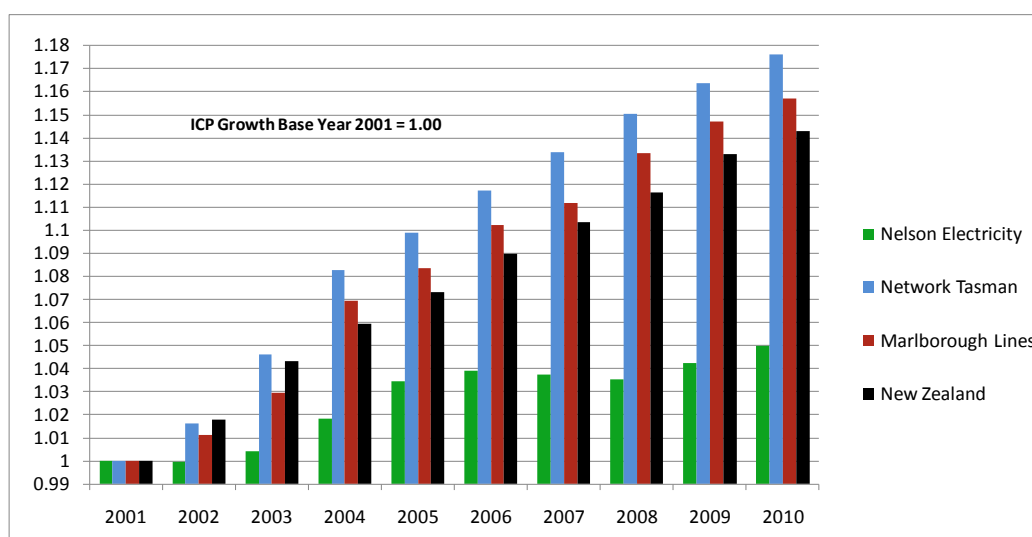
Population Growth for NEL

13. Population Growth assessed by the Commission for NEL was based on population growth forecasts for the Nelson/Tasman regions which include the Nelson City Council and Tasman District Council. NEL distributes electricity to less than half of the population of the Nelson City Council. The population growth figures for the Nelson City Council should be used as this is demonstrably more accurate.
14. Nelson is surrounded on three sides by Network Tasman and the sea on the fourth side and that opportunities for ICP growth are thus very limited due to the entirely built up nature of the supply area. The reason there is such a divergence in growth rates is that most of the subdivisible land in the Nelson/Tasman region is contained within the Tasman District Council, and therefore most of the growth occurs there. It is clear that the forecast for growth rates for NEL will be dramatically overstated in the Commission uses the approach proposed in the draft decision.

Graph 2: Population Growth New Zealand & Tasman /Marlborough Region



Graph 3: ICP Growth Rates: Nelson, Tasman, Marlborough & NZ



15. The Graph above shows the ICP growth rates of the Nelson Electricity, Network Tasman and Marlborough Lines and New Zealand. When compared to Graph 2, the strong but not perfect correlation between ICP growth is evident. We submits that the more relevant specific forecast of population growth for Nelson City be incorporated within this assessment as this is quite clearly a far better representation of what has occurred and what is more likely to occur in the future.
16. NEL supports that up to date network specific indicators be used as much as practicable to ensure an accurate growth forecast is used to assess the starting price adjustment for the year ending 31 March 2013.
17. ICP Growth could be used as a measure for fixed charges and potentially also for capacity or demand charges. The relevant information has previously been disclosed and demonstrates the growth rates for NEL distribution charges. This further reinforces the point that using regionally based indicators instead of network specific indicators can lead to significant errors.

The Revenue Weights.

18. NEL had provided the distribution revenue weights in accordance with the Commission's Notice to Supply Information dated 15 June 2011. There was a lack of description of the allocation methodology in the Notice which meant that NEL submitted revenue weights as it interpreted the requirement. The subsequent 2010 -15 Default Price Quality Path Reset – Draft Decisions Paper and associated models outlines the utilisation of those weights which provides more detail as to how the revenue weightings should be allocated. NEL has reassessed these weightings and resubmit them to the Commission.
19. The revised weightings are included in Table 1 and also attached as an excel spreadsheet with this submission.

Table 1 - Revised Distribution Weights for Nelson Electricity Limited

EDB Name		Nelson Electricity Limited	
Distribution Revenue Weights (excluding transmission charges)		2010	2011
Estimated Proportion of Distribution Revenue Recovered via:			
Variable (throughput) unit charges (e.g. c/kwh)	%	39%	42%
Capacity or demand charges (e.g. \$/kva/day or \$/MW)	%	9%	10%
Fixed or other charges (e.g. \$/ICP, daily monthly or annual charges)	%	51%	48%
(to add to 100%)		100.0%	100.0%

Note: The quantities relating to each pricing year should relate to the quantities from the pricing year two years earlier. This means that for 2010 the quantities should cover the period 1 April 2008 to 31 March 2009. For 2011 the quantities should cover the period 1 April 2009 to 31 March 2010.

20. Nelson Electricity charges a fixed charge to all consumers based on the fuse size at the network connection point. Although this is specified as a \$/kVA/day, this is clearly a fixed charge and does not change.

21. The fixed nature of these charges is clear when you consider that all domestic consumers have their capacity assessed at 15kVA. All residential consumers therefore have their fixed charges assessed at the same level. This is done to enable compliance with the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004.
22. The original distribution revenue weightings included these charges in the Capacity or Demand Charges section, which was clearly incorrect. They are now reallocated to the fixed charge section.
23. Only charges that can change due to a consumer's electricity consumption behaviour are included in the Capacity or Demand Charges. These charges are a controlled period demand charge called Winter Demand and also the Power Factor Charge, both are applied to all time of use metered consumers.

31 March 2013 Allowable Notional Revenue Calculation.

24. NEL would like to see the calculation for allowable notional revenue for 2012/2013 assessment period to include the $(R_{t-1} - NR_{t-1})$ revenue adjustment that is applied to the current DPP allowable notional revenue calculations. The formula takes into account any differences in allowable notional revenue and notional revenue to continue to be taken into account throughout the 2010 -2015 DPP period. To not apply this calculation consistently throughout the period disadvantages those who are conservative in their pricing approaches for the year ending 31 March 2012 or have not priced to the allowable notional revenue ceiling in that year.

Definition of Transmission Charges as a Recoverable Cost.

25. NEL currently derives and makes payments for its transmission services through Network Tasman. This is because the GXP that serves Nelson Electricity customer is contained within the Tasman Network boundary. The definition of transmission charges as a recoverable cost in the Input Methodologies determination applicable to electricity distribution services 3.1.3 (1) only includes payments made directly to Transpower. The current definition excludes the NEL situation from being a recoverable cost.
26. The intent of the recoverable cost definition is to include transmission costs and the Commission may not have appreciated the NEL situation. NEL has submitted separately to the Commission a Request for Clarification/Amendment of clause 3.1.3 (1) of the Input Methodologies.

General and Contact Details.

27. Thank you for the opportunity to consider the elements of the Draft Decision. We trust this submission provides some useful analysis and views that can be considered by the commission and potentially incorporated into the next iteration of the process.
28. We would be happy to answer any question you may have regarding the issues raised in this paper. Please direct any questions in the first instance to Phil Goodall, General Manger, Nelson Electricity.

The Contact details for this submission are

Phil Goodall
General Manager
Nelson Electricity
phil@nel.co.nz
PO Box 7083,
63 Haven Road
Nelson

Ph 03 546 0486
Mob: 027 227 4086