

Our Ref: LTR150

5 September 2011

Matthew Lewer
Regulation Branch
Commerce Commission
PO Box 2351
WELLINGTON

Dear Matthew

CROSS SUBMISSION ON 2010-15 DEFAULT PRICE-QUALITY PATH RESET OF STARTING PRICES, CPI ADJUSTMENT AND OTHER AMENDMENTS DRAFT DECISIONS PAPER

1. Horizon Energy Distribution Limited (“Horizon Energy”) welcomes the opportunity to make this cross submission to the Commerce Commission (“Commission”) on the *Draft Decisions Paper 2010-15 Default Price-Quality Path Reset of Starting Prices, CPI Adjustment and Other Amendments* (“Draft Decisions”).
2. In general, submitters are seeking improvements to the forecasting assumptions applied to each Electricity Distribution Business (“EDB”), in particular in respect of the real revenue growth rates. The common issue throughout submissions is the disjoint between historical performance and projected growth rates applied to many EDBs. To a large extent, submitters are looking for the Commission to apply detail at an increased level of granularity specific to individual suppliers. This general view is supportive of our submission for the Commission to look to apply a lower level of publicly available information such as; Territorial Local Authority (“TLA”) boundaries for population projections, and supplier specific actual reported (from Information Disclosures) electricity volumes for calculating throughput projections.
3. The Draft Decisions throughput projections have almost unanimously been challenged by submitters due to the Commission’s use and application of the ‘2009 projections’¹ in a way that they were never intended. Many of the submitters have highlighted the underlying data used to build these projections are out-of-date, and that the projections do not appropriately reflect the actual performance subsequently experienced by suppliers. The New Zealand Institute of Economic Research (“NZIER”) was commissioned by Wellington Electricity Lines Limited (“WELL”) to effectively re-forecast real revenue growth, using the Commission’s approach, but with up-to-date underlying

¹ 2009 Electricity Demand Forecasts Prepared for Electricity Authority by Brian Kirtlan, 16 December 2009.

projections for GDP growth². The outcome of that paper clearly demonstrates the erroneous conclusions that the Commission reached using out-of-date assumptions. The NZIER's re-stated real revenue growth projections are different for all suppliers and demonstrate that there are material errors within the real revenue growth projections following the Commission's use of the '2009 projections'.

4. We note a number of submitters, including Vector Limited ("Vector"), PowerCo Limited ("PowerCo") and WELL have submitted for consistency in input assumptions, the timing of cash flows and growth drivers. This is consistent with the view set out in our submission for the use of the 2011-2021 Asset Management Plan ("2011 AMP") data. Horizon Energy believes the current approach requires improved consistency in the model and inputs and this can be achieved by consistently applying the most up-to-date information to the model. The method is highly dependent on forecasts and an unnecessary source of forecast error is introduced by using out of date information. In addition, we believe the use of 2011 AMPs is consistent with the submission from PricewaterhouseCoopers ("PwC") to include 2010/11 actual results.
5. Horizon Energy understands the Commission's objectives in resetting the 2010-15 Default Price-Quality Path ("DPP") and intends to work within the parameters given to us, provided that they are reasonable and take into account information specific to suppliers so that reset prices, are based on a reasonable projection of profitability for our business.
6. We support other submitters that have expressed to the Commission that changes can easily be implemented within the modelling. This would avoid suppliers being forced to proceed down the costly and time consuming Customised Price-Quality Path ("CPP") route simply to gain the Commission's acceptance of errors within the modelling. As mentioned by other submitters there is sufficient time to act now, and make the necessary changes, therefore providing the low cost regulation the Commission is attempting to maintain.
7. Horizon Energy supports Vector's request to the Commission to allow for a re-statement of their regulatory asset base following the Commission's information request under section 53ZD(d) and 53ZD(f) of the Act. Vector submits others may wish to revise the application and interpretation of the Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010 ("IM determination") on an individual basis. We agree in principle that this should be permitted given the scope for interpretation in the information request and IM determination (particularly in the context of the first application of them by the Commission, EDBs, engineering reviewers and auditors). Horizon Energy does not consider it necessary to re-state our initial regulatory asset base.
8. We note the concerns raised in Vector's submission that the Commission's modelling may be open to error due to the complexities both in the approach and application of the modelling undertaken. We support the request for independent assurance of the Commission's modelling calculations prior to the release of the Final Decisions Paper. We expect that internal review of the modelling would have followed best practice prior to the release of the Draft Decisions, however it is evident some errors were not identified.

² <http://www.comcom.govt.nz/assets/Electricity/201015-Reset-DPP/Submissions-on-Reset-of-Starting-Prices/Wellington-Electricitys-NZIER-submission-on-draft-decisions-for-resetting-2010-15-DPP-24-August-2011.pdf>

It follows good regulatory practice to compensate for this by commissioning external independent assurance services to vet and review the models, to ensure they are operating as the Commission intends they should prior to the release of the Final Decisions Paper.

9. We support the submissions from the Electricity Networks Association (“ENA”) and WELL regarding the introduction of an adjustment to the notional allowable revenue formula to compensate for any under/over recovery in the 2012/13 year. While we support in principle the Commission’s revised notional allowable revenue formula for the third assessment period, we believe where actual growth is materially different to that projected by the Commission inequitable penalties will be incurred by suppliers. An adjustment to the formula to compensate for these variances in growth goes some way to mitigating the effect on suppliers’ ability to earn a normal rate of return.

10. We support the ENA and PwC submissions requesting for the retaining of the Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 definition for Avoided Transmission Charge in that the replacing definition of Recoverable Costs in the IM determination does not allow for the recovery of avoided transmission charges where investments have been made which substitute for the Transmission System. We understand that the proposed new definition is to be applied retrospectively to the 2011/12 assessment period. As this definition differs to that assumed when prices were set it may result in unintentional breaches as avoided transmission charges associated with investments which substitute for the Transmission System will no longer be passed through. It is unreasonable to change the compliance formula retrospectively. Accordingly the existing definition of Avoided Transmission Charge should be retained until at least until the end of the current assessment period and we submit this should be extended to the end of the 2010-15 DPP period which is consistent with the expectations of EDBs when such investments were made.

11. In closing we urge the Commission to spend some time considering our earlier submission that clearly demonstrates how the application of the most up to date supplier specific data produces a vastly different result to that used by the Commission. We reiterate that there is no merit in limiting the model inputs to 2009/10 data. All businesses review their investment and business plans annually. Accordingly 2011 actual outcomes and AMP projections are the best starting point to determine the likely future performance of a business.

12. Thank you for considering this cross submission. Please contact the undersigned to discuss any of these matters further.

Yours sincerely



Ajay Anand
CHIEF EXECUTIVE