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SUBMISSION ON INITIAL RESET OF THE DEFAULT PRICE-QUALITY PATH FOR ELECTRICITY DISTRIBUTION BUSINESSES CONSULTATION UPDATE PAPER

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the *Initial Reset of Default Price-Quality Path for Electricity Distribution Businesses - Consultation Update Paper* (the **paper**) released by the Commerce Commission (the **Commission**) 16 November 2009.
- 2 The purpose of this technical consultation paper is to ensure that the Initial Reset Determination accurately reflects the Commission's updated draft decisions. We note that due to the contracted consultation process which resulted in consultation on the draft determination prior to the Commission finalising its draft decisions, interested parties have effectively been unable to comment on the full set of draft decisions.
- 3 We consider that there are a number of issues that the Commission needs to address in the draft determination which we outline below.

Avoided Transmission

- 4 While we welcome the Commission's inclusion of the 'Avoided transmission charge' in the definition of 'Transmission charge', we still believe that the definition of Avoided transmission charge does not reflect the Commission's views as outlined in the *draft decisions paper: initial reset of the DPP* which stated¹:

¹ Paragraphs 4.69 and 4.70 Commerce Commissions *draft decisions paper: initial reset of the DPP* 8 September 2009

The boundary between transmission and distribution systems, which are to some extent substitutes, can change over time, and it is possible that some movements in transmission costs will be offset by opposite movements in distribution costs. In addition to boundary changes, transmission charges may be partially avoided through the development of distributed generation. The Commission considers that avoided transmission charges, including as a result of the transfer of assets from Transpower to an EDB or the development of distributed generation, should continue to be treated as passthrough costs.

The Commission proposes to further specify pass-through costs in the input methodology determinations. If the specification or treatment of transmission charges as pass-through costs differs from how they are specified or treated under the Initial Reset Determination, the Commission will revisit the issue following the publication of input methodology determinations.

- 4 To reflect the Commission's intent we recommend that the definition of 'avoided transmission charge' should be amended to:

Avoided Transmission charge means:

- (a) any expense (including the cost of capital) of a Non-exempt EDB that arises during the Assessment Period from any activity which substitutes for the use of the Transmission System; and
- (b) where Electricity Lines Services are transferred between Transpower and the Non-exempt EDB includes the value of the Transmission Charges avoided from the date of the transfer.

- 5 We believe that unless this amendment is made the draft determination will:

- fail to reflect the Commission's decisions; and
- fail to deliver an appropriate incentive for EDBs to invest to avoid transmission costs.

- 6 The above definition remedies these deficiencies and also aligns the price path provisions with the draft determination's provisions in relation to quality, which do provide for the amendment of quality limits to reflect the transfer of assets between Transpower and an EDB.

- 7 We consider that it is essential that the 'Avoided transmission charge' concept should incentivise EDBs to invest in assets to provide lower overall costs to customers. Where transfer of service from Transpower to an EDB

can be made (and continued levels of service maintained) through more efficient investment by the EDB.

Pass-through costs – Commerce Act levies paid during 2009/10

- 8 The Commission's draft decisions Paragraph B14 provided that the Commerce Act levies, paid by EDBs during 2009/10, be amortised (eg straight line amortisation over the regulatory period) and included as a pass through cost. The definition of Pass-through costs (clause 4) should, for the avoidance of doubt, explicitly refer to these levies and the manner in which they can be passed through.

Allowable notional revenue – revenue adjustment term

- 9 We are pleased to see that the Commission has acknowledged this issue. However it is disappointing that the Commission considers that due to the time constraints it is unable to assess the effect of including the adjustment term.
- 10 We acknowledge the issues that the Commission has raised but we do not think that the issues are as complicated as the Commission seems to suggest. Without the adjustment term EDB's are denied that ability to recover the amount of revenue permitted under the legislation. If EDBs are sure they will be able to "catch up", it is possible that they will have larger safety margins – and therefore lower prices – in any given year.

CPI lag

- 11 We acknowledge the Commission's decision, but suggest that the simplest method could be for the Commission to just publish the appropriate CPI movement on an annual basis. A formula to be used by EDBs would not then be necessary. This could also resolve any issues that arise on those (admittedly rare) occasions when the CPI series are revised or re-based, which could change calculated CPI movements between when prices are set and when compliance is assessed.

Estimated quantities – $Q_{i, t-2}$

- 12 $Q_{i, t-2}$ is defined in clause 8.3 as the quantity corresponding to the i^{th} Price during the Assessment period t-2. This definition is problematic as in the second Assessment period the period t-2 is not an Assessment period as it occurs before the commencement of the regulatory period. A possible solution may be the following modification:

$Q_{i,t-2}$ is the quantity corresponding to the i^{th} Price during the Assessment period t-2

- 13 A further comment we would make is that the paper in response to issue 4 states that “*the t-2 approach has the advantage of dealing with audited quantities*” and “*the t-2 approach also more closely aligns with the transparency principle (given its use of audited quantities)*”. We consider that both these statements are incorrect; use of the t-2 approach does not in our opinion provide the advantage of dealing with audited quantities.
- 14 We do not believe that the quantities we will be using in the t-2 approach are audited, or for that matter readily auditable. The only time that we might be able to have quantities ‘audited’ is as part of the compliance process (and we are unclear how the auditor will deal with this issue). This audit process would occur some 15 months after the quantities have been used as part of the price setting process and provides no advantage that we can determine.

Estimated quantities – Q_{i2009}

- 15 We are unable to comply with the calculation of allowable notional revenue set out in clause 8.4 for the first assessment period. The reason for this is that the quantity $Q_{i,2009}$ is defined in clause 8.4 as the quantity corresponding to the i^{th} Price for the period 1 April 2008 – 31 March 2009. Orion changed its price structure at the commencement of the financial year 1 April 2009 – 31 March 2010, this structure change means that we have prices $P_{i,2010}$ being the set of prices at 31 March 2009 that have no matching quantities ($Q_{i,2009}$) in the previous year 1 April 2008 – 31 March 2009.
- 16 Clause 8.5 does not apply in this case as this structure change occurred before an assessment period. We consider that the only practicable solution is for the Commission to insert a new clause 8.7 along the lines of the old clause 5.5 of the electricity distribution threshold notice. We suggest the following wording:

Despite the other provisions of this clause 8, if the Commission is satisfied that because of lack of information or subclauses (1) to (6) being clearly meaningless in relation to a EDB, it is not practicable to determine whether the EDB has complied with those subclauses, the EDB will be regarded as having complied with the price path if it demonstrates to the satisfaction of the Commission by the use of an alternate approach that has equivalent effect to those subclauses, that the substance of those subclauses has been complied with.

Price restructuring

- 17 We consider that there remains a problem with demonstrating compliance if a price restructure is carried out. We would like the Commission to explain how the assessment of both previous and restructured price might be undertaken.
- 18 We believe that the intent of the draft decision would be complied with using the following method for a restructure that take effect at the start of an assessment period.

Assume an EDB wishes to introduce a new price restructure that is to take effect from the start of an assessment period say, 1 April 2013.

Under the old price structure (assuming no restructure will occur) the prices $P_{i,2013}$ for the assessment period commencing 1 April 2013 would be set by

$$NR_{2013} \leq R_{2013} \quad (1)$$

Where:

$$NR_{2013} = \sum P_{i,2013} * Q_{i,2011} - K_{2013} \quad (2)$$

$$R_{2013} = (\sum P_{i,2012} * Q_{i,2011} - K_{2012}) * ((1 + \Delta CPI_{2012}) * (1 - X)) \quad (3)$$

Substituting (2) and (3) into (1)

$$\sum P_{i,2013} * Q_{i,2011} - K_{2013} \leq (\sum P_{i,2012} * Q_{i,2011} - K_{2012}) * ((1 + \Delta CPI_{2012}) * (1 - X)) \quad (4)$$

If the price structure is changed the EDB must demonstrate that the notional revenue under the new structure would not result in an increase in notional revenue compared to that which would have been allowed under the previous structure. That is:

$$NR_{new2013} \leq NR_{2013} \quad (6)$$

Where:

$$NR_{new2013} = \sum P_{i,new,2013} * Q_{i,new,2011} - K_{2013} \quad (7)$$

Substituting (2) and (7) into (6)

$$\sum P_{i,new,2013} * Q_{i,new,2011} - K_{2013} \leq \sum P_{i,2013} * Q_{i,2011} - K_{2013} \quad (8)$$

This would satisfy the Commissions requirements that the restructuring would not result in an increase in notional revenue compared to that which would have been allowed under the previous structure. To avoid unnecessarily calculating a new set of prices $P_{i,2013}$ we make use of the equations (1) and (3) resulting in

$$\sum P_{i,2013}^{new} * Q_{i,2011}^{new} - K_{2013} \leq (\sum P_{i,2012} * Q_{i,2011} - K_{2012}) * ((1 + \Delta CPI_{2012}) * (1 - X))$$

That is $NR_{2013}^{new} \leq R_{2013}$

- 19 This approach avoids any confusion that EDB's would have to prepare a notional (fictitious) set of prices on the old price structure, as clause 11.1(b)(iii) appears to imply.
- 20 We recommend that the Commission include this method for showing compliance for price restructures. This could be done by including it as an example in either the final decisions paper or as an appendix to the determination.
- 21 For the avoidance of doubt we do not consider that any clarification in this area would resolve the issue of price restructuring carried out prior to the regulation coming into effect as outlined above.

Minor drafting errors

- 22 Clause 8.4 the definition K_{2010} is the sum of all pass-through costs allowable during the period 1 April 2009 to 31 March 2010. We question why the definition includes the word "*allowable*" as this is inconsistent with the equivalent definitions of K_t and K_{t-1} in clause 8.3. We recommend deleting the word allowable in K_{2010} .
- 23 Delete the word 'allowable' in clauses 8.5, 8.5(a) and 8.5(b) as it is the notional revenue that is in question, not the allowable revenue.

Concluding remarks

- 24 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.

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