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SUBMISSION ON THE INITIAL RESET OF THE DEFAULT PRICE-QUALITY PATH CONSULTATION UPDATE PAPER AND REVISED DRAFT DETERMINATION

1. Introduction

Unison Networks Limited (Unison) welcomes the opportunity to respond to the Commerce Commission (Commission) on the *Initial Reset of the Default Price-Quality Path for Electricity Distribution Businesses Consultation Update Paper* (Consultation Update Paper).

We appreciated the release of the Consultation Update Paper as the Draft Determination dated 16 October 2009 was based on the Draft Decisions Paper dated the 8 September 2009. Although the Commission states that the Consultation Update Paper provides for technical consultation on the Initial Reset Determination, it is important that the Commission takes into account and gives consideration to the key issues raised in the submissions to the Draft Decisions Paper. In respect to our previous comments on the price restructuring provision, thank you for taking the opportunity to meet with our representative, Mr Andrew Shelley, on Wednesday 18 November.

2. Price Restructuring

We considered your meeting with Mr Andrew Shelley as a very productive exchange of views on how clause 8.5 (concerning price restructuring) might work in practice.

As discussed in that meeting, Unison has relied on retailers (who have the direct relationship with the consumer), to correctly allocate consumers to the correct tariff class. Recent investigations have highlighted that there are a large number of consumers in the wrong tariff class, including consumers on the low-user tariff that do not meet the legal definition of low-user, and commercial consumers in the standard domestic tariff. We are in the process of reallocating consumers to the correct tariff class. We are also considering tariff structures that would better meet the draft Pricing Principles issued by the Electricity Commission, including the adoption of time-of-use (TOU) tariffs where appropriate.

One concern that we raised was that in order to apply the clause as drafted it would be necessary to 'backcast' prices under the new structure, as well as remapping quantities, in order to calculate the Allowable Notional Revenue (ANR) under both the old and new price structures. Quantities might not be available, and the information might not be available to remap old quantities onto the relevant new quantities. Backcasting prices is also potentially extremely difficult, particularly if the price restructure utilises a new pricing model that requires data that was not available in previous years.

The price restructuring test is more complicated than suggested by the drafting in the Consultation Update Paper, and in particular the use of t-2 quantities alters the timing of the test. A proposed solution we have considered that could address concerns about backcasting is:

- In the year of the Price restructure the ANR is calculated from actual t-1 Prices and actual t-2 quantities, as would occur in any normal year;
- In the year following the Price the EDB would need to demonstrate that the ANR under the new pricing methodology was not greater than the ANR under the old pricing methodology (we refer to this as the 'ANR test'); and
- In the second year following the Price restructure the ANR is calculated from the actual t-1 Prices and actual t-2 quantities from the new pricing structure.

Rather than backcasting the restructured Prices, it would simply be necessary to run both the old and new pricing methodology in the year of the restructure and use the resulting Prices when conducting the ANR test in the following year. This proposal has the benefit of being forward-looking.

However, there remains a practical problem with the implementation of the ANR test: some of the quantities required under the new pricing structure may simply be unavailable on a t-2 basis. A flaw in the current market structure is the limited access that EDBs have to meter data from their own networks. Third party meter providers and/or retailers own the data and are reluctant to make it available for EDB needs. Further, the data may have been kept in a form that is suitable for the retailers' needs but not suitable for EDB purposes.

To acknowledge this problem we consider that a revenue neutrality test in such circumstance would be reasonable. There may also be some circumstances in which the ANR test subjects the EDB to unreasonable risk and again the revenue neutrality test would also be reasonable in those circumstances.

Unison strongly supports a forward-looking revenue neutrality test. This test establishes that on an ex-ante basis the EDB expects to earn the same revenue under its old and new pricing structures. In common with the ANR test, both the old and new pricing methodology would need to be run in the year of the price restructure. Having demonstrated compliance with the revenue neutrality test in the year of the restructure it would be unnecessary to apply a backward-looking test in the following year.

2.1 Compliance Risks

After further analysis of the proposed refinement of the ANR test we have concluded that the test continues to create compliance risks that are beyond the EDB's control. For example, if prices are restructured in 2011:

- Prices are set in 2011 so that the Notional Revenue test is met (i.e. Notional Revenue is not greater than ANR). Both Notional Revenue and ANR are calculated using t-2 quantities (i.e. those from 2009);

- The ANR test is performed in 2012 using 2011 prices and 2010 quantities. The ANR test is violated if the ANR under the new pricing structure is greater than the ANR under the old pricing structure.

The EDB can be compliant with the Notional Revenue test in 2011 but fail the ANR test in 2012. Simple modelling indicates that this will occur if the quantities applicable to the restructured Prices grow faster than the quantities applicable to the old Prices. This could arise, for example, if the EDB switched from kWh to kW (peak) pricing and a small number of very hot days caused a significant spike in air conditioner usage – this will have a much greater impact on kW than on kWh. A further example of where this could arise is when an industrial consumer has a major increase in production that was unexpected by the EDB, or has an unexpected outage of an embedded generation plant (which could affect kW more than kWh). The quantities that would apply to the ANR test in 2012 are the quantities from 2010, which were only partially known at the time that prices were set for 2011. The EDB could therefore fail the ANR test because of factors beyond its control.

Given this potential for a breach, Unison strongly recommends that the Commission replaces the ANR test with the revenue neutrality test embodied in clause 5(2) of the Threshold Regulations. We believe that the forward-looking nature of the test is appropriate under Part 4:

- Workably competitive markets are forward-looking and operate on the basis of expected outcomes, not on the basis of past outcomes that differed from expectations; and
- The forward-looking nature of the test is consistent with the forward-looking nature of the process for assessing P0 resets.

The Commission is clearly concerned that a price restructure is not used as a mechanism for increasing revenue beyond that which is allowed by the price path. The revenue neutrality test meets the Commission's objective, but does so in a way that eliminates the risk of a technical breach.

2.2 Recommendations

In order to give effect to the proposition that the ANR test applies in the year after a Price restructure, clause 8.5 would need to be modified as follows:

If a Non-exempt EDB restructures its Prices ~~that apply during an Assessment Period~~, it must demonstrate to the satisfaction of the Commission in its Annual Compliance Statement for ~~that~~ the following Assessment Period (with supporting evidence as set out in clause 11.1(b)(i)-(iii)) whether or not the restructuring of itself increased its allowable notional revenue for that Assessment Period above that which would have applied if the restructuring had not occurred...

Unison supports the ENA's recommendations on the addition of a further provision to clause 11.1(b)(iii), which addresses the situation where prior period quantities are not available, and is inclusive of tests such as a revenue neutrality test. However, we recommend that this amendment is incorporated into clause 8.5 as follows:

8.5 Price Restructuring

- (a) If a Non-exempt EDB restructures its Prices ~~that apply during an Assessment Period~~, it must demonstrate to the satisfaction of the Commission in its Annual Compliance Statement for ~~that the following~~ Assessment Period (with supporting evidence as set out in clause 11.1(b)(i)-(iii)) whether or not the restructuring of itself increased its allowable notional revenue for that Assessment Period above that which would have applied if the restructuring had not occurred, and –
- (i) If the restructuring of itself did not increase...
 - (ii) If the restructuring of itself did increase...
- (b) Despite the other provisions of this clause, because of lack of information, it is not practicable to comply with subclause(a) the Non-exempt EDB will be regarded as having complied with this clause by demonstrating compliance by use of an alternative approach that has the equivalent effect;

A further change is required to reflect the proposition that an EDB could apply an alternative test if the risk of a technical breach was considered to be too high. This could be addressed by a further addition to clause 8.5:

- (c) Despite the other provisions of this clause, if the Non-exempt EDB considers that there is too much risk in applying the test set out in subclause (a), then the Non-exempt EDB will be regarded as having complied with this clause by demonstrating compliance by use of an alternative approach that has the equivalent effect.

3. Technical Breaches

Unison strongly urges the Commission to amend the Draft DPP Determination to reduce the prospect of technical breaches arising. Given the criminal status of a breach of the Determination, it is not appropriate to allow for technical breaches to occur and then rely on the Commission exercising its discretion.

We have three particular concerns regarding technical breaches:

- Capital contributions;
- Pass-through costs; and
- The ANR test.

I have already discussed the ANR test above, and recommend that it is replaced with a revenue neutrality test.

3.1 Capital Contributions

We presume that capital contributions are captured by the definition of Electricity Lines Services in section 54(c) of the Commerce Act. If this is true then we are exposed to a considerable risk of a technical breach. Capital contributions received by Unison for the past five years are shown in Table 1 below. As can be seen from the table, capital contributions are highly volatile and are driven by factors that are beyond Unison's control and very hard to predict.

Table 1: Unison’s Capital Contributions Revenue by Year (\$000)

Year	2005	2006	2007	2008	2009
Capital Contributions	7,443	7,989	6,021	8,951	6,079

Given the downturn in the housing market Unison expected capital contributions for the current year to be very low, but a significant volume of (unexpected) work by Transit has seen capital contributions much higher than we expected. If capital contributions are not excluded from the price path then Unison would risk a breach of the price path.

We therefore recommend that the Commission expressly excludes capital contributions from the price path. This will not remove capital contributions from scrutiny: they will still feature in the ROI calculation and be taken into account when the Commission is conducting profitability assessments.

Exclusion of capital contributions would be achieved by the following modification to the definition of Price:

Price means:

- (a) a posted price (as defined in section 52C of the Act) in nominal terms (such as a tariff, fee or charge) or a component thereof, in relation to an Electricity Lines Service; and may include a discount, provided that discount is disclosed;

but does not include:

- (b) any amounts described in paragraph (b) of the definition of Pass-Through Costs; or
- (c) capital contributions.

3.2 Pass-Through Costs

Unison’s submission on the Draft Determination raised the issue of technical breaches arising due to pass-through costs being different from estimated or forecast. As noted in that submission, the clear intent of pass-through costs is that the EDB will not be exposed to the risk of changes in an uncontrollable cost.

In the Draft for Technical Consultation the Commission has amended the requirements for the Annual Compliance Statement so that the EDB must disclose both the forecast pass-through costs used when prices were set and the actual amounts (clause 11.1(b)(ii)). However, clause 11.1(a) is silent on whether actual or forecast pass-through costs or actual pass-through costs are to be used for assessing compliance. In the absence of any statement to the contrary, we assume that actual pass-through costs would be used, which raises the risk of a technical breach where estimates and forecasts differ from actual. It is not appropriate for an EDB to be held in breach when it has set prices in good faith and with an intention to comply with the price path.

We therefore recommend that clause 11.1(a) be amended by the addition of an additional qualification as follows:

- (d) a written statement that states whether or not the Non-exempt EDB has complied with the price path in clause 8 and the quality standards in clause 9 in respect of the Assessment Period ending on that Assessment Date;
- (i) the assessment against the Price Path should be performed using the forecast pass-through costs employed at the time that Prices were set

4. Other Matters

Unison supports the submission from the Electricity Networks Association.

Please contact me directly on 06 873 9301 if you require further information on this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ken Sutherland', written in a cursive style.

Ken Sutherland
Chief Executive