

15 April 2009

David Healy
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Dear David

Aurora Energy Limited (Aurora) wishes to make the following submission on the process and issues for the 1 April 2010 reset of the default price-quality path (DPP). This is in response to the Process and Issues Paper entitled "*Reset of Default Price-quality Path for Electricity Distribution Businesses*"¹ published by the Commerce Commission (Commission) on 30 March 2009 (the Reset Paper).

Introduction

The Reset Paper serves two distinct purposes. First, it outlines the three stage process that the Commission intends to follow to reset Electricity Distribution Businesses (EDB) prices effective from 1 April 2010. Second, the Reset Paper provides a discussion of issues with respect to the 2010 reset, and identifies the Commission's initial views on how these issues are to be addressed. In the main these issues relate to the key parameters that shape the DPP. The key parameters are:

- the X-factor (i.e. the rate of change in prices for all EDBs over time);
- starting prices (i.e. the starting point of the price path for each EDB); and
- quality standards (i.e. reliability measures for each EDB).

Aurora provides comments on these issues below (the comment is relatively brief, at this stage. As the process unfolds it is likely further comment will be made).

¹ Commerce Commission; "*Reset of Default Price-quality Path for Electricity Distribution Businesses: Process and Issues Paper*"; 30 March 2009

Aurora's Submission on the Reset Paper

Aurora's comments/views are as follows:

1. Process

A three stage process is envisaged:

- i. *Discussion Stage* – the Commission's process for resetting the DPP commenced with its Reset Paper, and is to be followed by a Discussion Paper (May 2009).
- ii. *Decision Stage* – the Commission intends to provide its draft decision in September 2009, and after taking into account submissions, will publish its final decisions in mid-November 2009.
- iii. *Drafting Stage* – finally the Commission will draft the final DPP determination and Gazette notice before 1 December 2009.

The Commission intends to consult with interested parties in the course of each stage.

Aurora's Comment

- ♦ Aurora broadly supports the process outlined by the Commission for resetting the DPP.
- ♦ Aurora notes the timeframes are tight, and that 1 December 2009 is a statutory deadline – else the existing price path will automatically rollover. Given the timing constraints Aurora would appreciate:
 - the ability to make cross-submissions on responses to the Decision Paper; and
 - the Commission providing its draft decisions in 'instalments' from July to September – rather than waiting for the entire draft decision in September.

2. Process

The Commission must specify rates of change (X) for the regulatory period commencing 1 April 2010. The X-factor is to reflect productivity, and is the same for all EDBs². It is the Commission's initial view that total factor productivity (TFP) should be used to determine productivity. Aurora has previously supported the Commission's use of TFP (i.e. in the context of the B-factor – for the former price path thresholds – which takes into account relative movements in input costs between the EDB sector and the economy as a whole).

Aurora's Comment

- ♦ Aurora understands that the Commission would continue to use the method as was used for the B-factor – or an improvement of this method which would address its bias towards technical (rather than economic) efficiency.
- ♦ On this basis, Aurora cautiously supports the Commission's use of TFP for setting the X-factor however the Commission also needs to take into account the deteriorating economic situation in New Zealand.

² Except that the Commission may, in limited circumstances, adjust the rate of change for individual EDBs (pursuant to section 53P(8) of the Commerce Act 1986).

3. Starting Prices

The Commission must specify starting prices for the regulatory period commencing 1 April 2010. In so doing, the Commission may adopt those prices applying at the end of the previous (i.e. initial) DPP, or may apply a P_0 adjustment based on current and/or future profitability. The Commission has considered various options and its initial view was that the best option for setting starting prices is to:

- specify starting prices as those that applied at the end of the initial DPP; and
- adjust prices (i.e. P_0 adjustment), with claw-back if required, following the publication of input methodologies³.

This approach is favoured by the Commission as it involves only a single P_0 adjustment, allows consistency with input methodologies to be achieved, and allows adequate time to develop a methodology that takes future and current profitability into account⁴.

Aurora's Comment

- ◆ Aurora regards regulatory certainty, low cost regulation, and investment incentives to be more important principles than those cited by the Commission in justification of its initial view.
- ◆ It is noted that the specification of starting prices as those that applied at the end of the initial DPP provides regulatory certainty, low cost regulation, and avoids investment disincentives.
- ◆ On this basis, Aurora supports the Commission adopting the prices applying at the end of the initial DPP (i.e. a rollover of existing prices) as in the absence of input methodologies this approach provides the greatest regulatory certainty, and in the circumstances is the most pragmatic outcome.

4. Quality

The Commission's Reset Paper highlighted the two distinct issues in relation to quality/reliability of service. These are:

- SAIDI/SAIFI based minimum standards.
- Integration of price and quality.

With respect to the first of these, the Commission notes (albeit as an initial view), that it is important to address underlying reliability whilst at the same time ensuring that the propensity for technical breaches is minimised.

Aurora's Comment

- ◆ Aurora agrees with the Commission's position on minimum standards. In particular, Aurora adopts the position that it is the reliability trend rather than the reliability performance of a *single year* that is important.
- ◆ Aurora takes this opportunity to remind the Commission that the IEEE Beta 2.5 method is not appropriate as it provides insufficient confidence that technical breaches will not occur.

³ see Reset Paper p7

⁴ *ibid*

With respect to the second point (i.e. price-quality integration) Aurora notes that the current DPP is missing an integrated quality dimension. It is important that incentives/rewards are provided for superior reliability performance.

Aurora's Comment

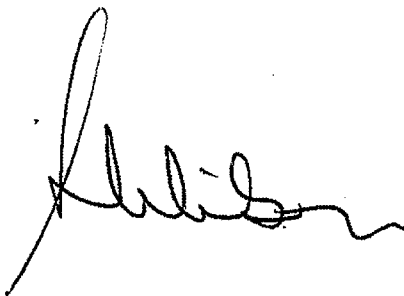
- ♦ Aurora is extremely disappointed that insufficient progress has been made in this area. Aurora has been a strong advocate of price-quality integration since before the 2004 reset of the price path threshold.
- ♦ The development of an S-factor in the future is supported in principle by Aurora.
- ♦ Aurora notes that the X-factor can be adjusted to incentivise EDBs to improve quality⁵. The Commission is urged to consider how this may be applied (even simplistically) in the 2010 reset. For instance, Aurora considers that this may be achieved (without comparative benchmarking) by rewarding EDBs whose SAIDI/SAIFI performance has been superior for several years, as this will incentivise EDBs to achieve similar outcomes over the regulatory period commencing 1 April 2010.

5. Transmission Pass-through Costs

For completeness of the reset process, Aurora requests that the Commission include a discussion of how it intends to treat EDB pass-through costs (such as Transmission) in the *May Discussion Paper*.

Aurora appreciates the opportunity to make this brief submission, and looks forward to engaging with the Commission in subsequent stages of the 2010 reset process. Should you have any questions in relation to the above, please do not hesitate to contact Lindsay McLennan (ph 03 479 6669).

Yours sincerely



Stephen Wilson
COMPANY SECRETARY

⁵ pursuant to Section 53P(8) of the Commerce Act 1986