



**Submission to the Commerce Commission on its Discussion Paper on a
Reset of Default Price-Quality Path for Electricity Distribution Businesses**

Submitted by

Wellington Electricity Lines Limited

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Introduction

1. Wellington Electricity Lines Limited (Wellington Electricity) welcomes the opportunity to provide feedback to the Commerce Commission (CC) on its Discussion Paper on a Reset of Default Price-Quality Path for Electricity Distribution. Wellington Electricity's answers to the Commission's discussion questions follow in Appendix 1.
2. Wellington Electricity is concerned with the size and scope of this consultation as well as the others released in the CC's 19 June consultation package in addition to regulatory reporting, submissions to other regulatory bodies and the significant workload required to establish Wellington Electricity. The paper has put forward a number of ideas, but little analysis has been done on the actual impact of what is proposed. Given the far reaching effects of this consultation, we strongly suggest that more time is given for analysis before any final decisions are made and the CC provide qualitative and quantitative information as early as possible to enable analysis to be undertaken by Wellington Electricity.
3. Due to the limited time we had to respond, we have tried to focus on a few key issues which we believe will have the greatest impact on Wellington Electricity. We suggest the CC gives particular regard to the submission from the Electricity Networks Association (ENA). The ENA is considering a number of issues raised by this paper in some detail.

4. For any questions related to this submission, please contact:

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Appendix 1

Consultation questions

Q.1)	How might genuine innovations be rewarded under a DPP? Please explain.	<p>Part 4 of the Commerce Act encourages innovations in energy efficiency and demand side management. The CC considers the incorporation of energy efficiency and demand side management may be better managed through information disclosure and customised price paths.</p> <p>Wellington Electricity considers that innovation could be rewarded, or at a minimum built into the framework of a DPP through:</p> <ul style="list-style-type: none"> • financial incentives to engage in demand side management to reduce transmission peak demand. For example, a sharing of the benefits attributable to demand avoided through the use of load control systems. • mechanisms to offset the negative impact on revenues from reduced energy values resulting from the investment in energy efficient distribution assets through the adjustment of quantities in the price path.
Q.2)	Are there any other economic principles you believe are relevant to the DPP reset? If so, please explain.	Wellington Electricity considers that economic principles must be applied with pragmatism and in a cost reflective way. The cost of applying economic principles without consideration of cost will result in the benefit of regulation being significantly eroded or reversed.

Q.3)	What are your views on the Commission's proposal to have a single section 52P determination, which specifies requirements for each EDB?	Wellington Electricity agrees with this proposal in principle.
Q.4)	What are your views on the timeframes relevant to the DPP reset?	<p>As stated in paragraph two of this submission, Wellington Electricity encourages the CC to provide as much detail as possible regarding the form of the DPP. Given the potential for significant changes to the existing price path mechanism EDBs will be required to do considerable rework to derive prices and provide them to retailers within timelines permitted in Use of Network Agreements with electricity retailers.</p> <p>Wellington Electricity considers that 35 working days for Annual Compliance Reporting should be extended to three months. The end of the regulatory year coincides with a large financial and regulatory work load for lines businesses (and auditors) and an extension to the timeframe should not impact on the CC significantly.</p>
Q.5)	Are there any other relevant timeframes that should be included in a Determination, but have not been discussed in this paper?	We encourage the CC to provide timeframes around dealing with breaches of the DPP. We suggest there is a response period in order to present reasons for review prior to a final decision being made.

Q.6)	<p>What are your views on the proposed additional content of a Determination set out above? Are there additional matters that should be considered for inclusion?</p>	<p>Wellington Electricity supports the additional content in paragraph 90 and considers the CC provide additional guidance around information requirements for post breach processes.</p>
Q.7)	<p>What are your views on the Commission's proposed approach for meeting the section 54Q requirements for promoting incentives, and avoiding disincentives, for investment in energy efficiency and demand-side management under Part 4?</p>	<p>Wellington Electricity is of the view that the CC should consider energy efficiency incentives and potential disincentives in all of the applicable regulatory mechanisms which are consistent with Section 54Q of the Act and applicable to EDBs.</p> <p>Wellington Electricity suggests the CC works with the ENA on ways in which energy efficiency can be incentivised through the DPP. Ideally we would like to see such an energy efficiency incentive mechanism included in the current DPP determination; the details of which can be developed later within the regulatory period. One possibility for this could involve including a quantity adjustment in the DPP to provide financial compensation for investments which are undertaken by EDBs which result in reductions in losses.</p>

Q.8)	<p>The Electricity Commission is currently undertaking work in a number of areas relevant to electricity distribution services, which is yet to be finalised. What do you consider to be the potential impact of the Electricity Commission's work on the Reset DPP?</p>	<p>The Electricity Commission (EC) is currently working on a voluntary model approach to distribution pricing methodology. This methodology does not directly impact on the DPP as the principle of the DPP is average price. We consider that the CC needs to work closely with the EC on this subject. In our submission to the EC, Wellington Electricity stressed the need for the EC's model approach to be kept at a high-level and be principles based and not be overly prescriptive. Doing so will give EDBs more flexibility to accommodate factors unique to their networks, allow the adoption of emerging technologies and allow EDBs to effectively manage their respective networks with the highest degree of efficiency and flexibility possible. When looking at the Input Methodologies (IM) the CC needs to keep in mind that EDBs need this flexibility. It would be easy for the CC to take something from the EC's voluntary model and make it mandatory as part of the DPP Reset or IM, but doing so would not be desirable.</p>
Q.9)	<p>What are your views on the appropriate methods for analysing current and projected profitability?</p>	<p>Wellington Electricity does not consider it possible to submit on this question given that key elements (such as WACC, RAB) need to be finalised via the IM consultation process. Accordingly we consider the determination should allow for a consultation process for any P_0 adjustment following finalisation of the IM.</p> <p>Profitability is an important economic consideration for network investment. If there is no perceived reasonable profitability in infrastructure investment or risk in having profitability limited, then efficient investors will seek alternative opportunities.</p>

Q.10)	<p>What are your views on how the Commission should supplement the data made available under information disclosure regulation for the purposes of the DPP reset? What additional information should be requested that allows for estimates of projected profitability?</p>	<p>Consistent with question 9, Wellington Electricity does not consider it possible to submit on this question as the form of any additional information should be considered in light of the outcomes of the IM process.</p> <p>Changes in economic activity, asset age and asset replacement cycles can all influence annual profitability so it is important that a wider range of data is considered when determining a DPP reset.</p>
Q.11)	<p>What are your views on how the Commission should allow for current and likely future economic conditions for the purposes of the DPP reset? How, and to what extent, will these conditions impact on regulated utilities, in particular EDBs? Please explain.</p>	<p>Wellington Electricity supports a conservative approach to current and future economic conditions given the sustained and severe impact of the global economic decline. The impacts on EDBs will include an inability to access funding, lower consumption and lower new connections or a decrease in connections.</p> <p>The economic climate has differing effects on EDB's depending on their customer mix. It will not be possible for the CC to differentiate between EDBs and therefore a conservative approach should be adopted across the industry.</p>

Q.12)	<p>What are your views on whether it is appropriate and/or feasible to explicitly link price and quality performance under a single mechanism, such as an S-factor? What information and analysis would be required to implement a robust and effective mechanism?</p>	<p>The CC has noted that the development of an S-factor may not be feasible in the timeframe available for the DPP reset. Wellington Electricity is aware of the tight deadlines the CC has to work under, however, we are nonetheless disappointed by this and consider that the development of an S-factor should be taken further. Developing an S-factor would incentivise EDBs to make improvements in reliability performance which could then be wrapped into their price paths. The quality path would then not be needed which would significantly simplify regulatory requirements and reduce administrative and compliance costs for both the CC and EDBs. It will be difficult for the CC to fairly and consistently normalise for all underlying and natural variability in both SAIDI and SAIFI, so eliminating the quality path will give EDBs more certainty.</p>
Q.13)	<p>What are your views on the dual-path structure as proposed? What are your views on assessing EDBs against separate price and quality paths?</p>	<p>As the CC notes in 5.3, Form of the DPP, there are two potential options for incorporating starting prices, rates of change and quality standards into the DPP. The first is to specify two distinct paths that separately specify and assess price and quality (analogous to the form used under the Initial DPP) or alternatively, that the DPP is specified as a single path, explicitly linking the price and quality related elements of the DPP. Again given the limited timeframes the CC faces, the pragmatic decision might be to opt for the status quo of separate price and quality paths. This is disappointing, because as we note in Q.12, given time to properly develop it, an S-factor could eliminate the need for a separate quality path, which would greatly simplify reporting requirements and compliance costs for EDBs and also the CC itself. We wonder that CC should incorporate a mechanism into the determination to incorporate an S Factor at some later date or at a minimum develop a workplan to derive the S Factor .</p>

Q.14)	<p>Under what circumstances, if any, do you think the Commission should consider re-opening a DPP within a regulatory period? Under what process should such circumstances be considered, e.g., should the industry make a proposal for the Commission to consider?</p>	<p>We consider that certain unforeseen and significant circumstances might make it necessary to re-open a DPP within a regulatory period. Major natural disasters such as storms, earthquakes or volcanic eruptions would be examples of such circumstances.</p>
Q.15)	<p>What are your views on the appropriateness of the Commission's input methodology for pricing methodologies under the DPP? If appropriate, how and when should a related mechanism be implemented?</p>	<p>It is not appropriate that pricing methodologies be applied under the DPP. We agree with the CC that the costs of a pricing methodology are likely to significantly outweigh the benefits.</p>
Q.16)	<p>What are your views on the proposed use of notional revenue (in a general sense) to specify price under the Reset DPP?</p>	<p>Wellington Electricity supports the proposed use of notional revenue in principle.</p>

Q.17)	What are your views on the proposed pass-through costs including the incorporation of Commerce Commission levies?	Wellington Electricity supports the inclusion of CC costs (with the other costs) in the definition of pass through costs. However we remain concerned that the costs incurred in 2009-10 year will not be recovered given the commencement of the DPP at 1 April 2010 and consider the CC should ensure 2009-10 costs are recovered by EDBs over the regulatory period.
Q.18)	To what extent do you consider transmission charges to be outside the control of EDBs?	Wellington Electricity considers transmission charges are beyond the control of EDBs in the short term and we note that Transpower's pricing methodology is currently under review which drives an extra layer of uncertainty.
Q.19)	Are the Commission's proposed definition of price and the associated definition of excluded services appropriate? If not, please explain.	Wellington Electricity considers that where an EDB can demonstrate effective competition either in the provision of services or initially in the establishment of the service then the services, service quality and prices arising from that process should not be subject to a DPP.
Q.20)	What options might there be for the promotion of energy efficiency through the specification of starting prices?	Refer question 1.
Q.21)	Given the generic nature of the X-factor, to what extent might it be necessary to make starting price adjustments, based on EDBs' specific circumstances?	Consistent with question 9 Wellington Electricity does not consider that it is possible to make a submission on whether starting price adjustments are appropriate given that the IM have not been finalised.

Q.22)	<p>What are your views on whether it is appropriate for starting price adjustments to be deferred until after input methodologies determinations are published? Do you foresee any issues that may affect the Commission's ability to do so? Please explain.</p>	<p>Refer questions 9 and 21 above.</p>
Q.23)	<p>What are your views on the indicative timings in Table 4, including the date when the adjustment takes effect (i.e., 1 April 2011)?</p>	<p>Consistent with Wellington Electricity discussion in questions 9 and 21 above it is difficult to answer this question without the form of the IM. However, regardless, we consider that the timetable in Table 4 will be difficult to achieve given the complexity of the issues.</p>
Q.24)	<p>What are your views on whether starting prices should be specified in terms of Actual Prices? How should these prices be specified (e.g., in terms of prices for distribution services, net of pass-through costs, etc)?</p>	<p>We support specification that the price allowed in the regulatory year ending 31 March 2011 equates to actual prices at 31 March 2010 plus CPI-X and pass through costs.</p>

Q.25)	<p>What are your views on the WACC measure appropriate for comparing with a ROI in assessments of current profitability?</p>	<p>Consistent with our responses to questions 9 and 21 above, we consider that detailed discussions on WACC, ROI, P_0 adjustments and claw-backs are premature given that the Input Methodologies (IMs) have yet to be finalised. We have general concerns about how the CC will create ROI and WACC benchmarks and translate these into price adjustments. Year on year variation of profits, the effects from revaluations, tax and capital contributions also require further assessment which we consider cannot be properly done until the IMs are finalised.</p> <p>We recommend that CC spends more time analysing the implications of profitability, P_0 adjustments and claw-backs post finalisation of the IM and we look forward to consulting on these at the appropriate time.</p>
Q.26)	<p>Do you consider that a time series of cost data may provide more helpful contextual information when assessing current profitability than a single year's data? If a single year's data were to be used, is it appropriate to consider the latest available data received under information disclosure, which is likely to relate to the financial year preceding the adjustment? Please explain.</p>	<p>Refer questions 25 above.</p>

Q.27)	How do you consider a time series of cost data could inform the assessment of current profitability?	Refer questions 25 above.
Q.28)	In considering the current profitability of an EDB, is it appropriate to use a partial building blocks approach to estimate its current ROI? What are your views on Formula 2 above in this respect?	Refer questions 25 above.
Q.29)	What are your views on the Commission estimating an industry-wide WACC using historical data to inform current profitability assessments?	Refer questions 25 above.
Q.30)	What are your views on whether an industry-wide WACC should be used to inform projected profitability?	Refer questions 25 above.

Q.31)	What are your views regarding a quantitative returns-based assessment of projected profitability under the DPP?	Refer questions 25 above.
Q.32)	What are your views on the Commission's proposed approach for assessing projected profitability to inform its adjustments of starting prices?	Refer questions 25 above.
Q.33)	What other options do you consider there are for assessing projected profitability?	Refer questions 25 above.
Q.34)	What type of scenarios do you consider are likely to impact on an EDB's projected profitability that could be defined in advance and taken into account when adjusting starting prices?	Refer questions 25 above.

Q.35)	<p>What time period should assessments of projected profitability cover e.g. should these assessments consider periods beyond the applicable regulatory period?</p>	Refer questions 25 above.
Q.36)	<p>What are your views on the proposed two-step approach to calculating starting price adjustments?</p>	Refer questions 25 above.
Q.37)	<p>What are your views on whether a quantitative returns-band approach should be used reflecting the possible inter-temporal imprecision from partial building blocks analysis? How should such a returns-band be defined (e.g., as an absolute or relative amount to the WACC point estimate)? How should starting price adjustments reflect an EDB's position relative to the upper and lower bounds?</p>	Refer questions 25 above.

Q.38)	<p>What are your views on whether a qualitative scenario-based mechanism should be used to inform the starting price adjustment? What characteristics should be considered in determining appropriate scenarios and how should their magnitude be defined?</p>	<p>Refer questions 25 above.</p>
Q.39)	<p>How should EDBs that are likely to face scenarios affecting projected profitability be treated? Should adjustments be made to their returns-band? If so, how should this be done?</p>	<p>Refer questions 25 above.</p>
Q.40)	<p>What circumstances might constitute financial hardship for an EDB or price shocks to consumers? Which circumstances, if any, warrant the use of a glide-path?</p>	<p>Refer questions 25 above.</p>

Q.41)	Under what circumstances do you consider it would be appropriate for the Commission to apply claw-back?	We support the CC view of applying clawbacks only in exceptional circumstances. This is consistent with the CC's application of a 5 year regulatory period to support a stable regulatory environment. However, consistent with question 25 above it is difficult to submit in detail on this issue without the form of the IM.
Q.42)	How should claw-back be applied? Should it be done as an additional P_0 adjustment or using a glide-path?	Refer questions 25 above.
Q.43)	To what extent will a recessionary economic climate impact differently on the productivity of EDBs and the economy as a whole?	Wellington Electricity, the fourth largest EDB, has not had the time nor specialised resource to adequately deal the extensive TFP material and analysis provided by the CC on this subject. Further, without worked examples we cannot undertake any analysis to understand the impacts on the company. It is a concern to Wellington Electricity that a key component of the DPP is being developed in such a manner and request that the CC reconsider its approach to TFP and its application.
Q.44)	What are your views on the potential promotion of energy efficiency through the setting of the X-factor?	Refer questions 43 above.

Q.45)	How might international productivity data be used as a check for the reasonableness of results based on New Zealand data? Do you have any views on the likely sources of appropriate data (e.g., by jurisdiction or overseas regulators)?	Refer questions 43 above.
Q.46)	What are your views on the amended TFP formula? What are your views on the proposed practical application?	Refer questions 43 above.
Q.47)	What are your views on potential use of IHC, rather than ODV in the TFP analysis? Do you agree that the 2004 ODV is the best starting point for an electricity distribution IHC series? If not, what alternative starting point should be used?	Refer questions 43 above.

Q.48)	What are your views on an appropriate method of forming an IHC time series? How should this be achieved?	Refer questions 43 above.
Q.49)	Do you agree that transformer capacity, as well as line capacity, should be recognised in a measure of system capacity? Do you agree with the measure proposed to incorporate both transformer capacity and line capacity in the system capacity output?	Refer questions 43 above.
Q.50)	What are your views on forming a system capacity output measure, taking account of the need for such a measure to be relatively simple and easy to construct?	Refer questions 43 above. We note also that the process would distort results based on difference in network configurations (radial vs mesh). The network topography may assume that the capacity measure for rural networks does not require further growth investment, when an efficient business has avoided capacity investment in favour of voltage regulation as favoured in recent AMP reviews.

Q.51)	What are your initial views on whether an approach that accounts for sunk costs might effectively implement the input price differential?	Refer questions 43 above.
Q.52)	How should the Commission estimate capital expenditure for the forthcoming regulatory period in a cost effective manner?	Refer questions 43 above.
Q.53)	What are your views on whether annually updating the base quantities is preferable to using those from a fixed reference year? What is the minimum time period (lag) that would be required to allow the auditing of quantity data for use as the reference quantities?	Wellington Electricity supports the use of an annual update of base quantities. Updated base quantities should refer to the previous regulatory year.

Q.54)	<p>Would the use of a lagged CPI measure in price-path compliance lead to the removal of CPI forecast errors? Would a six month lag between the most recent quarterly CPI change used, and the start of the pricing year allow businesses sufficient time to implement pricing changes?</p>	<p>Refer question 55.</p>
Q.55)	<p>Are there alternative ways of including the CPI change that may be preferable to using lagged actual values while avoiding technical breaches, e.g., using an agreed recognised forecast of the CPI?</p>	<p>We consider that an agreed forecast for CPI is appropriate to ensure certainty with a true-up mechanism in the following year for the difference between actual CPI and forecast.</p>
Q.56)	<p>Have you any views on the inclusion of Commerce Act Levies as a pass-through cost under the DPP?</p>	<p>Refer question 17.</p>

Q.57)	<p>What are your views on the treatment of transmission charges as pass-through costs? How might avoided transmission charges be taken into account?</p>	<p>We support 100 per cent pass through of transmission charges and avoided transmission charges. Where the boundary between transmission and distribution changes during a regulatory period, and the distributor, for example, captures what were previously transmission services within the distribution services provided then mechanisms are needed to avoid resulting breaches. The relevant avoided transmission charges would be treated as a pass-through for the remainder of the regulatory period (a similar adjustment would also apply to the quality path) to compensate for the need to increase distribution charges for the additional service. The same principle would apply in reverse if the boundary moved to increase transmission services and reduce distribution services. This is consistent with the provisions in the current price and quality thresholds.</p>
Q.58)	<p>Should the Commission seek to address the pass-through anomaly identified under the thresholds regime? If so, what is the most appropriate mechanism for doing this?</p>	<p>We consider that transmission charges could be maintained in the price path in the same manner as under the thresholds as the quantity anomaly will be significantly mitigated where the CC uses updated quantities on an annual basis. Alternatively these costs could be split out, however, the added complexity and work may not warrant the benefits.</p>
Q.59)	<p>How feasible would it be to 'unbundle' distribution and transmission charges and, if so, how could this be done with least complexity? To what extent would such a mechanism address potential technical breaches relating to AC loss rental rebates?</p>	<p>Refer question 58.</p>

Q.60)	Alternatively, do you consider that an ex post approach might reduce the impact of the anomaly while increasing certainty?	Refer answer to question 58.
Q.61)	What are your views on the use of a separately assessed quality-path? Is such an approach appropriate for promoting incentives for EDBs to provide services at a quality that reflects consumer demands? If not, please explain.	Refer to question 13. In addition Wellington Electricity notes that the level of services is now addressed from a regulatory perspective through the disclosure regime and should not form part of the DPP. Customer service quality demands are difficult to measure and we that the disclosure regime through the AMP is the most appropriate mechanism to measure this aspect. Wellington Electricity supports the concept of 'no material deterioration' in the DPP.
Q.62)	In your opinion, to what extent should increased investment deliver higher levels of quality?	Refer answer to Q.13 on the discussions of an S Factor.
Q.63)	What other methods could be used to determine the price-quality trade-off deemed most appropriate by consumers?	Refer answer to Q.61.

Q.64)	What are your views on the use of a 'no material deterioration' basis in the quality standard, and how it may be appropriately reflected in the quality standard?	Refer answer to Q.61.
Q.65)	What do you consider are appropriate criteria for demonstrating an EDB's responsiveness to consumers?	Refer answer to Q.61.
Q.66)	What do you consider is the most appropriate regulatory mechanism under Part 4 for including a customer communication criterion?	Refer answer to Q.61.

Q.67)	<p>What are your views on the use of a five-year historic average as the basis for quality standards under the DPP? Do you have any comments on the potential for quality standards to be based on a moving five-year historic average?</p>	<p>Looking at the CC's suggestions on the 2.5 Beta Method, dead-bands, etc. ; many ideas have been put forward and these appear to have potential to manage year on year variation and we support this initiative.</p> <p>However, there appears to have been little work put into exactly what effect each of these proposal will have. Unfortunately, given the limited timeframe for this consultation and Wellington Electricity's limited resources we cannot comment further on any of these proposals. We understand that the ENA is working on a number of these and recommend that the CC works with the ENA on these issues and that appropriate time is given to consider the impacts of any that are implemented.</p> <p>With regard to the 2.5 Beta Method itself, there is a danger that it will be used to normalise for SAIDI without any focus on SAIFI. An EDB has just as much probability of breaching under SAIFI. Any potential normalisation methodology should consider more than just one threshold in isolation. This is another reason why more time needs to be put into analysing the effect of each proposal in the CC's paper.</p>
Q.68)	<p>What are your views on the proposal to include 2008/09 non-normalised daily outage data?</p>	<p>Refer answer to Q.67.</p>
Q.69)	<p>What are your views on the appropriateness of the IEEE 2.5 Beta Method for identifying extreme variability in quality data?</p>	<p>Refer answer to Q.67.</p>

Q.70)	What are your views regarding any other appropriate methods for identifying extreme variability that could be implemented under DPP reset?	Refer answer to Q.67.
Q.71)	Do you agree that dead-bands are an appropriate statistical method for accounting for the effects of normal variability in order to identify material deteriorations in quality? If not, please explain.	Refer answer to Q.67.
Q.72)	What are your views as to appropriate methods for calculating the size of the dead-band?	Refer answer to Q.67.

Q.73)	<p>How appropriate is the potential use of a three-year moving average scheme, as described above? Is three years an appropriate timeframe? Would such a scheme impact incentives related to the timing of planned maintenance?</p>	Refer answer to Q.67.
Q.74)	<p>What are your views on whether a multi-year assessment, as described above, is appropriate under a DPP? What, if any, potential problems do you see with adopting this type of mechanism?</p>	Refer answer to Q.67.
Q.75)	<p>What are your views on the incentives for EDBs with respect to quality performance given that a breach can only occur when an EDB's quality performance does not meet the required standard for two out of any three years?</p>	Refer answer to Q.67.

Q.76)	What are your views on the Commission's proposed approach for assessing quality standards under the Reset DPP? Refer answer to Q.67.
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