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15 April 2009

Dear Sir

Submission on the Reset of the Default Price-quality Path for Electricity Distribution Businesses - Process and Issues Paper

We thank you for the opportunity to respond to the Process and Issues Paper which provides the Commerce Commission's (the Commission's) initial views on the process for, and some of the relevant issues involved in, resetting the Default Price-quality Path (DPP) for Electricity Distribution Businesses (EDBs). This letter forms Wellington Electricity Lines Limited's (Wellington Electricity's) submission on the Process and Issues Paper.

The Proposed Process

Wellington Electricity appreciates the Commission setting out its proposed timetable for the DPP reset in detail, in advance. The Commerce Amendment Act 2008 has provided for only a short timetable for the DPP reset and the three stage (Discussion, Decision and Drafting) approach and proposed timelines are to a certain extent driven by the statutory deadlines. We note that much of the work undertaken by the Commission for the now superseded threshold reset will contribute to the DPP reset. Wellington Electricity requests that the Commission provides interested parties with the proposed publication dates for each of its major consultation papers in advance, so that it is possible to ensure that we have the right people available to consider and respond to these papers as effectively as possible.

We also request that the Commission includes as much detail as possible in the May Discussion Paper about the form of the default price-quality paths including how prices, rates of change, quantities, pass through costs, P_0 adjustments, claw back mechanisms, reliability, and extreme events are to be defined and assessed including over the time periods that will apply.

As a new EDB, Wellington Electricity is in a unique position of having to establish its own regulatory capability and knowledge specific for the Wellington network in the context of Part 4 of the Commerce Act. This requires a significant amount of information and analysis to be undertaken by us in the coming months prior to the DPP reset. It is therefore important that we are able to consider the proposals in detail, assess how Wellington Electricity's current prices and service quality will be impacted and to understand the information we will be required to establish and maintain in order to meet the new regulatory requirements.

Productivity Improvements

The Process and Issues Paper proposes that the price path be in the form of a CPI-X path with the X factor to be based on Total Factor Productivity (TFP) analysis. Wellington Electricity has four major concerns with the proposed TFP approach to measuring expected productivity improvements for the purpose of deriving an X factor for the DPP reset, as follows:

- The current economic climate and the significant changes that have occurred over the past nine months suggest that past performance of productivity and more importantly improvements will not be a relevant predictor of future performance, at least in the near term, for either the economy as a whole, or the electricity distribution sector.
- Whether sufficiently robust data is available either in New Zealand or internationally, to be able to apply TFP in a manner which is meaningful and of a high enough standard to be able to set industry wide productivity targets for the next five years.
- How the current financial market crisis is taken into account in determining the X factor.
- Whether the TFP analysis which the Commission is proposing to undertake can be communicated with sufficient detail to interested parties, to enable them to replicate it, test it and critically examine it within the consultation windows proposed.

With respect to CPI, Wellington Electricity is concerned about the inherent need to forecast CPI and pass through costs such as transmission costs under the initial DPP (and the original thresholds which preceded this). Under the new Part 4 the consequences following any breach of the DPP are severe, and for this reason Wellington Electricity believes it is inappropriate for EDBs to have to set regulated prices based on forecasts of CPI (or an alternative index) and pass through costs. Accordingly any unforeseen variance in inflation (and pass through costs) should not cause a breach of the DPP and the DPP must be specified to accommodate technical breaches of this kind.

Wellington Electricity encourages the Commission to address these four issues in its imminent Discussion Paper on the DPP Reset.

Starting Prices

We note that the new Part 4 of the Commerce Act provides for starting prices for each DPP to be either the prices that applied at the end of the preceding regulatory period or prices to be determined by the Commission, based on current and future profitability of each EDB. The Process and Issues Paper proposes that the former is most appropriate in this instance. In addition, once input methodologies are determined, the Commission suggests that P_o adjustments may be made, with possible claw back arrangements, after consideration of the level of returns reported by each EDB under the new input methodologies.

Notwithstanding Wellington Electricity's fundamental concerns with P_o adjustments, we agree that any potential profitability adjustments should not be made until after input methodologies are determined. These possible future adjustments however create uncertainty over short term revenues for EDBs. This uncertainty should be mitigated as much as possible consistent with the objectives of the Commerce Amendment Act including potentially delaying implementation of any P_o adjustment to the following price reset. We therefore request the Commission to provide more information about the form, timing and process for any potential P_o adjustments and claw back arrangements in the forthcoming consultation papers, prior to the DPP reset.

The Process and Issues Paper does not define the starting prices (that applied at the end of the preceding regulatory period). We note that actual prices for each EDB will differ to the effective average prices inherent in the initial DPPs. Wellington Electricity believes that the starting prices for the DPP reset should be the maximum of either the initial DPP prices or actual prices at 31 March 2010. Due to the nature of the existing DPP, it is impossible for EDBs to set prices exactly equal to the DPP, as the DPP itself must be estimated when actual prices are set. Those EDBs which currently have prices below their DPP should not be penalised when the DPP is reset. Those which have exceeded their DPP should also not be penalised unless the Commission has imposed alternative prices on them.

Quality Standards

Wellington Electricity supports the Commission's proposal that for the purpose of the DPP reset, quality is to be assessed using reliability performance, to be measured as SAIDI and SAIFI. We also support the Commission's acknowledgement of the potential for technical breaches of quality standards. This is particularly important as the new Part 4 of the Commerce Act imposes significantly greater penalties if DPP paths are breached than the previous Part 4A. Reliability performance can be influenced by externalities that vary over time. These factors must be addressed when the DPPs are defined. We also strongly support a DPP which defines quality

standards for EDBs on the basis of no material deterioration in quality with consideration of the EDB's asset management phase and customer driven service provision.

Energy Efficiency

The Process and Issues Paper suggests that each of the DPP, information disclosure regime and Customised Price-quality Paths (CPPs) need not address the energy efficiency requirements which are set out in the new Part 4. In particular, in relation to the DPP, the Paper proposes that energy efficiency (including energy losses) and demand side management may be better addressed through CPPs and information disclosure than the DPP.

We note that section 54Q of the new Part 4 requires the Commission to:

- promote incentives for energy efficiency; and
- avoid imposing disincentives on energy efficiency.

Wellington Electricity therefore believes that the Commission must consider the energy efficiency requirements of the new Part 4 when resetting the DPP and must ensure the DPP does not impose disincentives and should encourage appropriate incentives for energy efficiency measures, including load control.

Should you require any further information regarding this submission please contact the writer on 04 915 6113 (gskelton@welectricity.co.nz) or John Calleja on 04 915 6126 (icalleja@welectricity.co.nz).

Regards



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