



Submission on the Draft Decisions Paper 'Initial Reset of the Default Price-Quality Path for Electricity Distribution Businesses'

12 October 2009

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## 1 EXECUTIVE SUMMARY

- ❖ Our views are aligned with the views taken by the Electricity Network Association (ENA) and PricewaterhouseCoopers (PWC), which reflect the collective view of the industry, and ENL proposes the Commission gives these views considerable weight. Eastland Network fully endorses both submissions.
- ❖ The Commission expects the following matters covered by input methodology determinations to be of relevance to various aspects of the Reset DPP, including:
  - starting price adjustments;
  - application of claw-back;
  - regulatory processes and rules; and
  - timing and requirements for CPP proposals.

The Commission proposes to amend the Initial Reset Determination following the publication of input methodologies to address such matters. Even though we support this proposal, we note that it creates a certain level of uncertainty for EDBs.

- ❖ Eastland Network is in favour of the Commission's draft decision regarding the structure of the Reset DPP to include separately assessed price and quality paths. Additionally, with regard to the consumer communication criterion, we note that, while having an understanding of the quality level that consumers demand is necessary, EDBs are not able to consult with every single consumer but consumer groups only. In fact, EDBs do not have a direct relationship between themselves and their consumers. That kind of relationship only exists between consumers and retailers.

Furthermore, while preferences in commercial consumer groups might be relatively homogenous, we believe that this is not necessarily the case for residential customers. We submit that the Commission is mindful of this and recommend the customer communication criterion to be excluded from the Reset DPP. We support nonetheless the Commission's proposal to develop an equivalent mechanism through the information disclosure work stream.

- ❖ Eastland Network greatly approves of the Commission's draft decision that the rate of change (X factor) will be set at 0% per annum for all EDBs for the Initial DPP. We believe that an X-factor of 0% will be an efficient mechanism to assist EDBs in the current economic climate, while they are adjusting to the new regulatory control regime. It sends an important signal to businesses and to a certain extent creates a higher level of certainty for the businesses and for potential investors.

- ❖ Eastland Network submits that the t-2 approach should be used as reference quantity for determining threshold compliance, as the quantities will be known with certainty and independently verified by third party auditors when prices are set, thus providing greater certainty and transparency. The Commission argues that a drawback of this approach is that a two year lag decreases the correlation between the assessment and actual quantities. Even though this argument has merit, we believe that the year-to-year variances will be too immaterial to distort significantly the correlation between the assessment and actual quantities.

## 2 INTRODUCTION

### *2.1 Introduction to Eastland Network Ltd*

Eastland Network Limited owns and operates the lines for the upper East Coast of the North Island. Eastland Network is 100% owned by the Eastland Community Trust with the Gisborne District Council as the capital beneficiary of the Trust.

Eastland Network distributes approximately 302 GWh of electricity to approximately 26,000 consumers, of which almost two thirds are in Gisborne City and Wairoa Township. The remaining connections are spread out widely, across two isolated distribution networks covering 11,952km<sup>2</sup>, resulting in an overall line density of less than seven connections per kilometre of line.

For more information on Eastland Network, please consult our website:

<http://www.eastland.co.nz>

### *2.2 Structure of this Submission*

Since the beginning of the Commerce Act review, Eastland Network has followed the development with great interest and has actively participated in the consultation processes in the belief that joint efforts achieve the best possible outcome. Eastland Network appreciates the opportunities afforded by the consultation processes. We thank the Commerce Commission (the "Commission") for continuing engagement with the industry and for providing us with an opportunity to respond to the draft decisions paper. Our views are aligned with the views taken by the Electricity Network Association (ENA) and PricewaterhouseCoopers (PWC), which reflect the collective view of the industry, and ENL proposes the Commission gives these views considerable weight.

This submission provides Eastland Network's opinion on some of the matters raised by the Commission in their draft decisions paper regarding the Commission's preliminary views on the initial reset of the default price-quality path ('DPP').

These matters will be addressed in section 4 of this submission.

Eastland Network does not wish to be heard in support of this submission.

### 3 BACKGROUND

#### *3.1 New Regulatory Regime for Electricity Lines Services under the Commerce Act 1986*

Suppliers of electricity lines services are subject to the regulatory provisions under subpart 9 of Part 4 of the Commerce Act 1986 (the "Act") from 1 April 2009. The Commerce Amendment Act 2008 (CAA), which received Royal assent on 16 September 2008, has introduced significant changes to those provisions in Parts 4, 4A, 5 and 6 of the Act that relate to the economic regulation of goods and services in New Zealand. Electricity lines services are defined in section 54C of the Act, which are supplied by Transpower and electricity distribution businesses (EDBs).

Under the current regulatory framework, EDBs are subject to:

- information disclosure regulation; and
- default/customised price-quality regulation, however suppliers that are "consumer-owned" (sec 54D) are exempt from this type of regulation.

A price-quality path sets the maximum average price that suppliers of electricity lines services can charge. It also defines the standards for quality of services that they must provide to their customers.

On 19 December 2008, the Commission published the Regulatory Provisions of the Commerce Act 1986 Discussion Paper (Provisions Paper), which set out the Commission's preliminary views on the new regulatory provisions that were introduced through the CAA. Subsequently, on 8 September 2009 the Commerce Commission released a draft decisions paper on the default price-quality paths to apply to electricity distribution businesses from 1 April 2010. This is the fourth paper released for consultation by the Commission as part of a process to reset the default price-quality paths that currently apply to electricity distribution businesses under Part 4 of the Act. The Commission has invited interested parties to submit their views and comments on this matter by 12 October 2009. In the following section, Eastland Network provides comments on the matters related to the regulatory framework of EDBs.

## 4 COMMENTS

### 4.1 Considerations for the Reset DPP

The Commission describes in the draft decision paper a number of issues and their implications on the Reset DPP that need to be considered when reaching the draft determinations.

These considerations are:

- **Government Policy Statements:** We have no comments on this matter.
- **Energy Efficiency:** We note that the Commission has not introduced new thoughts on matters relating to energy efficiency for the initial reset at 1 April 2010. We acknowledge that the time frame for developing an appropriate mechanism is fairly tight and thus, we support the intention to further consult in 2010 on possible energy efficiency and demand side mechanisms. We are looking forward to engaging with the Commission on this matter.
- **Decisions under the Electricity Act 1992:** We have no comments on this matter.
- **Context of the Reset DPP:** The Commission is required to specify all relevant input methodologies that apply to EDBs when making the Initial Reset Determination. Because input methodologies are not to be finalised until 30 June 2010 (with the possibility of a one-off extension of up to six months), there is a timing conflict with the commencement date of the Reset DPP (1 April 2010).

The Commission expects the following matters covered by input methodology determinations to be of relevance to various aspects of the Reset DPP, including:

- starting price adjustments;
- application of claw-back;
- regulatory processes and rules; and
- timing and requirements for CPP proposals.

The Commission proposes to amend the Initial Reset Determination following the publication of input methodologies to address such matters. Even though we support this proposal, we note that it creates a certain level of uncertainty for EDBs.

- **Structure of the Reset DPP:** The Commission delineates that a DPP is explicitly required to accommodate price and quality dimensions of the supply of goods and services. Because the Act does not set out how the DPP should incorporate these dimensions in terms of overall structure, the Commission suggests that there are two broad options for structuring the Reset DPP. These are that the Reset DPP should specify, either:

- two distinct paths that separately specify and assess price and quality (“dual path”); or
- a single path that explicitly links price and quality performance (“single path”).

Eastland Network is in favour of the Commission’s draft decision regarding the structure of the Reset DPP to include separately assessed price and quality paths (“dual paths”).

Additionally, with regard to the consumer communication criterion, we note that, while having an understanding of the quality level that consumers demand is necessary, EDBs are not able to consult with every single consumer but consumer groups only. In fact, EDBs do not have a direct relationship between themselves and their consumers. That kind of relationship only exists between consumers and retailers.

Furthermore, while preferences in commercial consumer groups might be relatively homogenous, we believe that this is not necessarily the case for residential customers. We submit that the Commission is mindful of this and recommend the customer communication criterion to be excluded from the Reset DPP. We support nonetheless the Commission’s proposal to develop an equivalent mechanism through the information disclosure work stream.

#### *4.2 Price-Path*

When setting a DPP, the Commission is required to define and incorporate starting prices and rates of change for regulated suppliers. The dual price-path mechanism has previously been used under the old threshold regime and it currently applies under the Initial DPP. The Commission notes that while the previous thresholds regime and the Reset DPP differ in various aspects, they are likely to share common features and implementation issues, including the manner in which price levels are assessed. The Commission concludes that the price-path used under the Initial DPP remains broadly appropriate and has sought to retain its features, where appropriate, under the Reset DPP.

Based on that, Eastland Network supports the following draft decisions on the DPP:

- The price path is to be specified using a form of Notional Revenue measured as price times a defined quantity for that price;
- Starting prices to be the actual prices that apply as of 31 March 2010;

- Any adjustments to starting prices will be made after input methodologies are finalised;
- Appropriate pricing methodologies to be chosen by the EDB
- No unbundling of transmission and distribution prices

The use of a CPI-X mechanism requires the assessment of the annual notional revenue with regard to changes in CPI. Forecasting CPI development bears a risk of forecast errors, which can cause technical breaches and causes uncertainty for regulated businesses. Eastland Network agrees with the Commission that a forecast CPI has the identified risks and that a lagged CPI potentially addresses these problems. However, the risk of inaccuracy remains due to the timing discrepancy.

Particularly for the upcoming reset, we are concerned that current economic developments will result in a distorted CPI. A particularly low CPI may lower the price-path substantially more than appropriate to meet future economic developments. As previously submitted<sup>1</sup>, we believe that a forecast CPI may be better suited to meet the changing economic climate.

### 4.3 Starting Prices

As outlined above, because of the time discrepancy between input methodology finalisation and initial reset, the Commission proposes for any potential starting price adjustments to take place after the determination of input methodologies. Further to this, the Commission's suggests that the deferred starting price adjustment should be aligned with the 2011/12 pricing year. Eastland Network supports the proposed process as outline in the table below.

Date	Milestone
<b>1 December 2009</b>	Publication of Initial Reset Determination specifying starting prices as those that applied on 31 March 2010
<b>February/ March 2010</b>	Process and issues paper published
<b>1 April 2010</b>	Reset DPP comes into effect
<b>30 June 2010</b>	Input Methodologies due to be published
<b>August/September 2010</b>	Consultation on adjustment methodology
<b>Late November 2010</b>	Amended Determination including adjusted starting price

<sup>1</sup> Eastland Network (July 2009): *Submission on the Reset of Default Price-Quality Path for Electricity Distribution Businesses*

	published
<b>1 April 2011</b>	Starting price adjustments take effect

#### 4.4 Rates of Change

The Commission is required to set a rate of change (“X-factor”) for EDB prices during the regulatory period. The Act provides for the X-factor for EDBs under a DPP to be “based on the long-run average productivity improvement rate achieved” by EDBs using whatever measures of productivity analysis the Commission considers appropriate. Either a single rate of change is applicable for all EDBs, or the Commission can chose to apply alternative rates for certain circumstances.

Because historic-based productivity measures use data that was mainly collected during a period of general economic growth, Eastland Network is concerned that this data may not appropriately reflect the economic climate during the period of the reset DPP.

Thus, Eastland Network greatly approves of the Commission’s draft decision that the rate of change (X factor) will be set at 0% per annum for all EDBs for the Initial DPP. We believe that an X-factor of 0% will be an efficient mechanism to assist EDBs in the current economic climate, while they are adjusting to the new regulatory control regime. It sends an important signal to businesses and to a certain extend creates a higher level of certainty for the businesses and for potential investors.

#### 4.5 Quality Standards

We compliment the Commission for noting the challenges that exist when attempting to accurately reflect consumer demands when setting quality standards under a DPP. These challenges include identifying consumers’ willingness to make a trade-off between the price and quality of electricity distribution services, and the lack of readily available information on consumer demands.

The decisions paper proposes that for the purpose of the price path, the quantities used in defining Notional Revenue and Allowable Notional Revenue are updated annually to ensure they are more aligned with current pricing structures and the volumes inherent in the pass through costs. Eastland Network supports this approach.

Further to that, the Commission considers that there are two quantity periods appropriate for use as a reference quantity.

- a period two calendar years prior to the assessment date ("t-2 approach"); or
- a period one calendar year prior to the assessment date ("t-1 approach").

The Commission's draft decision regards the t-1 approach as superior. We do not support the draft decision, based on the implication that estimates will be required to determine these quantities, causing uncertainty in terms of compliance for EDBs.

Eastland Network submits that the t-2 approach should be used instead, as the quantities will be known with certainty and independently verified by third party auditors when prices are set, thus providing greater certainty and transparency. The Commission argues that a drawback of this approach is that a two year lag decreases the correlation between the assessment and actual quantities. Even though this argument has merit, we believe that the year-to-year variances will be too immaterial to distort significantly the correlation between the assessment and actual quantities.

#### *4.6 Initial Reset Determination*

The Act requires the Commission to make a section 52P determination that gives effect to the Commission's decisions on the Reset DPP. The Act dictates a number of generic and specific requirements, which the Commission has to take into consideration when defining the Reset DPP. Thus, the Commission has made preliminary decisions on the Reset DPP and Eastland Network supports the following draft determinations:

- Publication of a single Determination to give effect to its decisions on the Reset DPP
- The Initial Reset Determination will specify the commencement date as 1 April 2010. The regulatory period for the Reset DPP will be five years from the commencement date (i.e., for the period 1 April 2010 to 31 March 2015)
- EDBs subject to the Initial Reset Determination will be specified as suppliers of Electricity Distribution Services, except those defined as Consumer-Owned
- If applicable, a provision will be included in the Initial Reset Determination that states it will be amended to specify any applicable input methodologies as soon as practicable after those methodologies are published. Starting prices will be adjusted as soon as practicable after the publication of the relevant input methodology determination in the Initial Reset Determination
- Transmission charges, local authority rates, Commerce Act levies and Electricity Commission levies to be treated as pass-through costs

- Require compliance related documentation to be submitted within 50 working days of each assessment date in the regulatory period (i.e., within 50 working days of 31 March)

Yours sincerely



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