



Submission on the Consultation Paper
'Initial Reset Determination (Draft)'

2 November 2009

To
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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.
- ❖ As previously submitted, Eastland Network recommends 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 11,952km², 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 responses to matters raised by the Commission in their draft determination paper, which will be discussed 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.

The consultation paper 'Initial Reset Determination (Draft)' is the fifth 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 3 November 2009. In the following section, Eastland Network provides comments on the matters related to the regulatory framework of EDBs.

4 COMMENTS

4.1 Form and Content of the Draft Determination

Q.1) Are there any defined terms which you consider unclear in their description or inappropriate for the purposes of the draft determination? If so, please explain and where appropriate provide suggested wording.

Q.2) Do you consider the definitions of Transmission Charge and Pass Through Costs to be appropriate? If not, please explain why. Are there other elements (e.g. loss and constraint rentals) which you consider should be included in the definitions? If so, please explain and provide suggested wording.

The amended definition of pass-through costs now includes the levies payable under the Commerce Act, and is worded as follows:

Pass-Through Costs means:

(a) the Transmission Charges, Rates, Electricity Commission Levies and Commerce Act Levies, paid or payable by a Non-exempt EDB during an Assessment Period;

but does not include:

(b) any amounts described in paragraph (a) if the Non-exempt EDB demonstrates beyond reasonable doubt that those amounts were passed on transparently to its Consumers and/or electricity retailers

The definition of transmission charges has been simplified and addresses specifically the electricity services provided by Transpower to non-exempt EDBs, and are now defined as

"... any amount in respect of:

(a) Electricity Lines Services provided to a Non-exempt EDB by Transpower, and includes any amounts received from or payable in relation to charges in accordance with the Transmission Pricing Methodology; and

(b) Avoided Transmission Charges"

Eastland Network supports both amended definitions and positively notes in particular, the inclusion of Commerce Act Levies in the definition of pass-through costs.

4.2 Price-Path

Q.3) Do you consider the Allowable Notional Revenue assessment formulae to reflect the Commission's draft decisions? If not, please explain and provide suggested

amendments.

Q.4) Do you consider the definition of Allowable Notional Revenue for the First Assessment Period to be appropriate? If not, please explain and provide suggested amendments.

Q.5) Do you consider the price restructuring notification requirements to be clear and workable? If not, please explain and provide suggested amendments.

In 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 was supportive of this approach¹.

Further to that, the Commission considered 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 regarded the t-1 approach as superior and has maintained this view in the draft determination.

As previously submitted², Eastland Network does not support the draft determination, based on the implication that estimates will be required to determine these quantities, causing uncertainty in terms of compliance for EDBs.

Eastland Network strongly recommends 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. We believe there is a greater risk of statistical error by using forecast values, causing more rather than less certainty.

Thus, we do not support the Allowable Notional Revenue and Allowable Notional Revenue for the First Assessment Period calculation in the current form as proposed by the Commission.

¹ Eastland Network (2009). Submission on the Initial Reset DPP Draft Decisions Paper. <http://www.comcom.govt.nz/IndustryRegulation/Electricity/PriceQualityPaths/ContentFiles/Documents/Eastland%20Network.pdf>

² *ibid*

Allowable Notional Revenue

For each Assessment Period, a Non-exempt EDB's notional revenue (NR_t) must not exceed its Allowable Notional Revenue (R_t), such that:

$$\frac{NR_t}{R_t} \leq 1$$

where:

NR_t is the notional revenue for the Assessment Period t , being equal to:

$$\sum_i P_{i,t} Q_{i,t-1} - K_t$$

R_t is the allowable notional revenue for the Assessment Period t , being equal to:

$$\left(\sum_i P_{i,t-1} Q_{i,t-1} - K_{t-1} \right) \times ((1 + \Delta CPI_t) \times (1 - X))$$

where:

t denotes the Assessment Period for which compliance is being assessed;

i denotes each price relating to an Electricity Distribution Service;

$P_{i,t}$ is the i^{th} Price at the Assessment Date for the Assessment Period t ;

$P_{i,t-1}$ is the i^{th} Price at the Assessment Date for the Assessment Period $t-1$;

$Q_{i,t-1}$ is the quantity corresponding to the i^{th} Price during the Assessment Period $t-1$;

K_t is the sum of all Pass-Through Costs during the Assessment Period t ;

K_{t-1} is the sum of all Pass-Through Costs during the Assessment Period $t-1$;

X is the rate of change for the Non-exempt EDB as specified in schedule 2; and

ΔCPI_t is the derived change in the CPI to be applied during the Assessment Period t , being equal to:

$$\frac{CPI_{Dec,y-3} + CPI_{Mar,y-2} + CPI_{Jun,y-2} + CPI_{Sep,y-2}}{CPI_{Dec,y-4} + CPI_{Mar,y-3} + CPI_{Jun,y-3} + CPI_{Sep,y-3}} - 1$$

where:

y is the year of the Assessment Date in the Assessment Period t

CPI_{qy} is the CPI for the quarter q in the calendar year y

Allowable Notional Revenue in the First Assessment Period

R_t for the First Assessment Period, being R_{2011} , is the Allowable Notional Revenue for that period, being equal to:

$$\left(\sum_i P_{i,2010} Q_{i,2010} - K_{2010} \right) \times ((1 + \Delta CPI_{2011}) \times (1 - X))$$

where:

$P_{i,2010}$ is the i^{th} starting price as specified in Schedule 1;

$Q_{i,2010}$ is the quantity corresponding to the i^{th} starting price;

K_{2010} is the sum of all Pass-Through Costs allowable under this determination during the period 1 April 2009 to 31 March 2010;

X is the rate of change for the Non-exempt EDB as specified in Schedule 2; and

ΔCPI_{2011} is the derived change in the CPI to be applied during the First Assessment Period, being equal to:

$$\frac{CPI_{Dec,2008} + CPI_{Mar,2009} + CPI_{Jun,2009} + CPI_{Sep,2009}}{CPI_{Dec,2007} + CPI_{Mar,2008} + CPI_{Jun,2008} + CPI_{Sep,2008}} - 1$$

where:

$CPI_{q,y}$ is the for the quarter q of the calendar year y .

However, Eastland Network greatly approves of the Commission's draft determination 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.

4.3 Quality Standards

Q.6) Do you consider the quality standards assessment formulae to reflect the Commission's draft decisions? If not, please explain and provide suggested amendments.

Q.7) Do you consider the explanation of the annual and multi year assessments to reflect the Commission's draft decisions? If not, please explain and provide suggested amendments.

Eastland Network considers the proposed quality standard assessment formulae appropriate and requests no further amendments. We note however, that the

implications of the new assessment calculation are at this point uncertain for the first assessment period to the extent that only forecast data is presently available. Thus, we welcome the additional annual and multi year assessment criterion which potentially reduces the risk of a technical breach in the first assessment period.

4.4 Annual Compliance Statement

Q.8) Do you consider the compliance statement requirements of Clauses 10 and 11 to be appropriate? If not, please provide details.

Q.9) Are there additional matters which you consider should be addressed in the overall Initial Reset Determination? If so, please explain.

Clause 10 and 11 cover the issues 'Mergers and Acquisitions' and 'Annual Compliance Statement'. The requirements are already industry standard and thus, we believe the requirements to be appropriate and comprehensive.

Yours sincerely



Brent Stewart
Acting Chief Executive

For further enquiries on this submission, please do not hesitate to contact Henrike Seifert (ph 06 8691 603, email: henrike.seifert@eastland.co.nz) or Ben Gibson (ph 06 8690 725, email: ben.gibson@eastland.co.nz).