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Dear Keston Ruxton

Scope, timing and focus of Input Methodologies review

1. Introduction

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to respond to the Commerce Commission's (**Commission)** *'Open letter on our proposed scope, timing and focus for the review of input methodologies'* published 27 February 2015.

2. Timing

The purpose of IMs is to provide certainty for suppliers and consumers in relation to the rules, requirements and process applying to regulation under Part 4, section 52R of the *Commerce Act 1986* (**Act**). Promoting the purpose of IMs relies on the IMs being reviewed and determined, before the Commission publishes draft decisions on price-quality path regulation, at the very latest.

WELL therefore supports the Commission's proposed timeframe for completing the IM review by December 2016 as this timeframe should enable the review of the IMs to be undertaken and completed in advance of the Commission's draft decision for Gas Distribution Network (**GDNs**). Completion of the IM review by December 2016 also prevents the GDNs experiencing the significant uncertainty and resource strain that was experienced by the Electricity Distribution Networks (**EDNs**) as a result of the Commission's decision to simultaneously review the WACC IM and determine the 2015-20 DPP in 2014.

3. Scope

WELL supports the Commission's proposal to review all Input Methodologies (**IMs**), including those determined in 2010, re-determined in 2012 and subsequent amendments. A holistic review of the IMs is important for ensuring that the regulatory regime, as a whole, promotes the purpose of Part 4 regulation in section 52A of the Act. Considering IMs in isolation from the rest of the regime can lead to inconsistent or unintended outcomes. Further, reviewing ad-hoc aspects of the IM's at different points in time would undermine the purpose of IMs to promote certainty of the rules applying to price-quality regulation, as set out in section 52R of the Act.

4. Focus

Notwithstanding WELL's view that the IM review should consider all IMs, a key area of focus should be the form of control. Under a weighted average price cap (**WAPC**) forecasts of constant price revenue growth (**CPRG**) have a material impact on the allowable notional revenue. Given the materiality the CPRG forecasts have on the revenue outcomes, the low cost nature of the DPP which involves very high level forecasting approaches is not compatible with a WAPC.

Importantly, network costs are predominantly fixed costs which do not vary with aggregate volume consumption, it is therefore counter-intuitive to link cost recovery with variable volume consumption. It is not in the long run interests of electricity consumers for regulated suppliers to face large fluctuations in revenue recovery and in-balances between revenue and efficient costs, as ultimately this situation leads to less than optimal operation of and investment in the electricity network.

WELL's own experience has demonstrated significant differences between the Commission's CPRG forecasts compared with the actual CPRG on WELL's network. As a result WELL has failed to recover the revenue allowances set by the Commission in the prior DPP and expects even larger under-recoveries in the current 2015-20 DPP. Evidence presented during the DPP consultation process demonstrated that actual CPRG outcomes have varied significantly from the Commission's forecast for the majority of EDNs. This outcome is not consistent with the purposes of Part 4 regulation as (section 52A of the Act):

- over-forecasting of CPRG, leading to revenue under-recovery, does not promote incentives for suppliers to innovate and invest or to provide services at a quality that reflects customer demands; and
- under-forecasting CPRG, leading to revenue over-recovery, does not limit suppliers ability to extract excess profits.

Further, the WAPC is directly inconsistent with section 54Q of the Act as it imposes disincentives on suppliers to invest in energy efficiency and demand-side management activities. While the Commission has attempted to mitigate some of the disincentive through its energy efficiency and demand side management incentive allowance, this scheme does not provide certainty to suppliers of full revenue recovery and introduces additional administrative costs. The scheme therefore only partially offsets disincentives but does not promote positive incentives for energy efficiency or demand-side management activities.

However, if the form of control was altered to a revenue cap, then suppliers have positive incentives to promote energy efficiency and demand-side management activities as doing so reduces or defers capex requirements. Suppliers then retain the benefits of reducing/deferring capex in accordance with the capex Incremental Rolling Incentive Scheme. The incentive properties of a revenue cap are therefore consistent with section 54Q of the Act.

Notably, regulators across many other jurisdictions, including Australia and the United Kingdom, have moved from the WAPC to a revenue cap. Reasons cited include promoting energy efficiency and demand side management, as well as acknowledgement that WAPC has increased costs to consumers and has not delivered demand-reflective tariffs.

WELL therefore supports a focus on the form of control as a key component of the IM review.

5. Closing

WELL appreciates the Commission's early engagement with stakeholders on the scope, timing and focus of the forthcoming IM review and we look forward in engaging in the consultation process.

Please do not hesitate to contact Megan Willcox, Regulatory Projects Manager, on MWillcox@welectricity.co.nz if you have any queries.

Yours faithfully

G Skelton

Greg Skelton

CHIEF EXECUTIVE OFFICER