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**SUBMISSION ON EMERGING VIEWS ON OPPORTUNITIES TO  
IMPROVE THE WAY DEFAULT AND CUSTOMISED PRICE-QUALITY  
PATHS WORK TOGETHER**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the Commerce Commission's (the **Commission**) consultation paper "Input methodologies review, Emerging views on opportunities to improve the way default and customised price-quality paths work together" (the **Paper**).
- 2 We have also reviewed the draft submission by the Electricity Networks Association (the **ENA**) on the Paper.
- 3 **Introductory Comments**
- 4 The Commission has identified that:<sup>1</sup>

*There are opportunities to improve the way default and customised price-quality paths, including the path change mechanisms within them (ie, pass-through costs, recoverable costs, and re-openers), work together to promote the long-term benefit of consumers. These opportunities involve changing aspects of the current regulatory settings for price-quality paths to enable*

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<sup>1</sup> Paragraph X3.

*them to better meet the circumstances of individual suppliers where this can be achieved in a way that remains consistent with the relatively low-cost purpose of DPP/ CPP regulation.*

5 We agree with the Commission that there are opportunities to improve the way default and customised price-quality paths work together to promote the long-term benefit of consumers. We think the suggestions put forward by the Commission in the Paper are positive steps forward, although in some cases they do not go far enough.

6 The Commission has also identified that:<sup>2</sup>

*There are broadly three situations where amending the application and/or design of DPPs, CPPs and path change mechanisms may better promote the long-term benefit of consumers:*

- *During the setting of the DPP, where the supplier's circumstances can be accommodated upfront in a relatively low-cost way;*
- *At the beginning of the regulatory period, if once set, the DPP could be changed to better meet the supplier's individual circumstances in a relatively low-cost way; or*
- *During the DPP or CPP regulatory period, if circumstances materially change during the regulatory period from the circumstances that were assumed when the DPP or CPP was set.*

7 In general we agree with the Commission. We note that both the CPP and DPP IMs now allow for reconsideration of the price path following a catastrophic event or a change event, which goes some way towards meeting the third bullet point above.

### **Comments on Emerging Views**

The Paper puts forward eight emerging views.

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<sup>2</sup> Paragraph 25.

*Emerging view 1: We are open to taking a more tailored approach to setting the DPP where this can be done without significantly increasing cost*

- 8 We agree that the Commission should adopt an approach to tailor the setting of a DPP where this can be done at a reasonable cost, bearing in mind that the alternative of a CPP remains a very high cost option.
- 9 The Paper states that in the short term adopting a tailored approach may need to be restricted to gas pipeline businesses as there are fewer regulated gas businesses than there are EDBs. We disagree with this view. The larger number of EDBs compared to the number of regulated gas businesses means that the Commission should consider a tailored approach for EDBs as a priority. Otherwise a proportionally larger number of business (and their consumers) will either inefficiently remain on a DPP that is not suitable or will have to apply for a higher cost CPP.
- 10 We are unclear what the broader implications are from the Commission's view that it does not consider tailoring an EDB's DPP is feasible at this stage. For example, if tailoring a DPP for EDBs is not feasible at the time of a price reset, does that mean DPP reopeners may also not be available if they were needed by multiple EDBs?

*Emerging view 2: We consider that 'single-issue' CPPs are not appropriate*

- 11 We are open to the suggestion that 'single issue' CPPs are not appropriate, provided that an EDB is able to obtain a tailored DPP and to request a DPP reopener.

*Emerging view 3: We should apply a proportionate scrutiny principle in continuing to refine the CPP requirements and in assessing CPP proposals*

- 12 The Paper notes that the depth of scrutiny will be subject to the proportionate scrutiny principle and the Commission's level of confidence in the supplier's own forecasts. The proportionate scrutiny principle is:

*The level of scrutiny applied should be commensurate with the price and quality impact on consumers of the tailoring being sought.<sup>3</sup>*

- 13 We agree in principle with the suggestion that the level of scrutiny that is applied to different inputs could be targeted based on the impact of those inputs on price/quality outcomes. We do see this as challenging to implement and look forward to further detail emerging.

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<sup>3</sup> Paragraph X4.

- 14 We note the Commission's view that any CPP should be 'full scope' meaning that all inputs are potentially subject to scrutiny. To be most effective in reducing the costs of a CPP application, the proportionate scrutiny principle should be able to be applied *before* the CPP application is made.
- 15 It would be unfortunate for a supplier to go through the cost and effort of developing a full CPP for the Commission to only scrutinise limited aspects of the application material. We think the IMs could usefully include a process for suppliers to engage with the Commission on which items within a CPP would and would not need detailed scrutiny (in accordance with the proportionate scrutiny principle). The supplier can then tailor their application accordingly and only incur significant costs in preparing those aspects of the application that are most material.
- 16 At the extreme, the proportionate scrutiny principle could effectively deliver a single-issue CPP where a supplier makes an application but only one topic is deemed significant enough to scrutinise in depth. In such circumstances a DPP reopener may be more appropriate.

*Emerging view 4: We are open to expanding the role of DPP reopeners*

- 17 We support expanding the role of DPP reopeners. We note that the Commission has indicated in relation to its emerging view on tailoring DPP's that initially it may need to exclude EDB's due to:
  - 17.1 the number of EDB's; and
  - 17.2 while the Commission gains more confidence in the forecasts of suppliers and the limitations the Commission perceives in the summary and analysis of information disclosure.

We believe further discussion is needed on whether DPP reopeners for EDBs may also be restricted in a similar manner.
- 18 We support reopeners for revenue growth (if a pure revenue cap is not introduced for EDBs) and for quality standards. Also, if a revenue cap form of control is implemented then a re-opener for new connections is needed to ensure EDBs have an incentive to connect the new consumers and are able to recover the costs of the new connections.
- 19 Orion does not agree with the Commission having the ability to initiate reopeners. Further information is needed about how or when this would be exercised. We are concerned that EDBs would have to operate in an environment of uncertainty regarding its price path and the resultant impact on investor confidence.

- 20 We also submit that DPP reopeners shouldn't be only be used where the price/quality impact is "relatively low". If this is the case any significant price or quality shock will need to be addressed through a CPP (or left unresolved), which would undermine the goal of making the DPP more suitable for more suppliers.

*Emerging view 5: The quality-only CPP option should be replaced with a DPP reopener*

- 21 We agree that the quality only CPP option should be replaced with a DPP reopener, provided that the DPP quality reopener can be used for significant shifts in quality requirements. As noted above, if the reopener can only be used when impacts are "relatively low" it will have a limited value.

*Emerging view 6: We are open to considering a CPP reopener for contingent and unforeseen projects*

- 22 We agree in principle with this proposal. However, a reopener for contingent and unforeseen projects should also be available under a DPP.

*Emerging view 7: We are open to considering approval of net additional costs incurred prior to CPP approval*

- 23 We agree in principle with this proposal. The catastrophic event and change event reconsideration provisions in the IMs may cover additional net costs incurred from the event up to the time the CPP application is made. This reopener could then cover the prudent costs incurred between the application and the CPP taking effect.

- 24 However, there is still a gap relating to costs incurred in advance of a CPP that is not related to a catastrophic event or a change event. For example, a CPP may be needed to address a "capex wave" and it may be prudent to incur some additional net costs before the CPP begins, rather than leaving all additional capex to be incurred during the CPP period. It should also be possible to recover these costs where the applicant can demonstrate that they were prudent and efficient.

*Emerging view 8: We are open to providing for the expansion of the range of pass-through costs that can be added when setting the DPP*

- 25 We agree with this emerging view.

### **General comments**

- 26 We agree with the Commission that it needs to address the potential for perverse incentives to arise when there is a difference between the weighted average cost of capital under a DPP and CPP.
- 27 We have previously submitted<sup>4</sup> that we support the view that the CPP WACC should be fully-aligned with the DPP WACC. This would eliminate perverse incentives and disincentives for CPPs. It would also reduce uncertainty. Full alignment is the only method to fully eliminate these effects. This could require (depending on the length of the CPP) a technical price reset part way through a CPP regulatory period to account for any change to the prevailing DPP WACC, by way of a recoverable cost. This was not mentioned in the Paper but we trust the issue remains on the table and will be addressed through the draft decision.
- 28 We note the comment in the Paper that there are opportunities within and outside the IM review to “better enable or promote tailoring of the price-quality path”.<sup>5</sup> While welcome in principle, this does raise the question of how much certainty the IMs provide. Also, for CPPs, it may create challenges for verifiers in confirming that a CPP proposal complies with the IMs. Any tailoring provisions should take this into account.
- 29 We also submit that the CPP fast track amendments determined in November 2015 may not achieve their goals without further improvements to make CPPs more cost effective and proportionate. We support the use of a workshop to discuss, in detail, potential revisions to the CPP information requirements to consider further improvements.

### **Concluding remarks**

- 30 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email [dennis.jones@oriongroup.co.nz](mailto:dennis.jones@oriongroup.co.nz).

Yours sincerely

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<sup>4</sup> Orion, Submission on the IM Review, 21 August 2015,

<sup>5</sup> Paragraph 12.

A handwritten signature in black ink, appearing to read 'Rob Jamieson', written in a cursive style.

Rob Jamieson  
**Chief Executive**