CROSS SUBMISSION ON THE UPDATED DRAFT DECISION ON COST ALLOCATION FOR ELECTRICITY DISTRIBUTION AND GAS PIPELINE BUSINESSES

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Cross-Submission - Cost Allocations Updated Draft Decision

SUMMARY

In response to submissions on the Commerce Commission's "Input methodologies review - Updated draft decision on cost allocations for electricity distribution and gas pipeline businesses" ERANZ makes the following submissions:

In respect of the cost/benefit of removing avoidable cost allocation methodology ("ACAM") as a stand alone option ERANZ submits that:

- the cost of removing ACAM as a stand alone methodology is minimal;
- the benefits in terms of the sharing of efficiencies of scope with consumers of regulated services will greatly exceed the cost of changing allocation approach;
- the optional variation to the accounting based allocation approach ("OVABAA") provides all the protections and mechanisms necessary to support competitive market outcomes (and satisfies s 52T(3)).

In respect of the Commission's process ERANZ submits that:

- the Commission must be entitled to amend its view between the draft decision and the final determination based on submissions received in the process;
- providing an updated draft decision for consultation is an additional step for which the Commission is to be commended rather than criticised;
- the Commission has sufficient evidence to revisit the assessment in its draft decision;
- while the concept of regulatory certainty is important, it should not be used to limit or restrict the Commission in making reasonable decisions within a reasonable process.

In respect of proposals for a review of OVABAA ERANZ submits that:

- a review of OVABAA is not necessary, at least until there is experience of it being used;
- there are benefits to the Commission requiring the change in allocation method earlier, i.e. for the 2017/18 regulatory year;
- simplification or streamlining of the cost reallocation process will not address regulated supplier concerns about director risk and reluctance to certify the necessity of using an allocation other than the accounting based allocation approach ("ABAA");
- concerns about director risk are inconsistent with the information prudent directors prudently require in respect of businesses that are unable to sustain ABAA cost/asset allocations.

1. COST/BENEFITS OF REMOVING ACAM AS A STAND ALONE OPTION

A number of submissions argue that ACAM is a less costly option than ABAA and OVABAA and therefore should be retained. It has also been submitted that ACAM is 'fit for purpose' because it "better reflects competitive market outcomes". There is little regard, in submissions by regulated suppliers, PwC (on behalf of electricity distribution businesses ("EDBs")) and the Electricity Networks Association ("ENA") for the benefits of removing ACAM, i.e. the sharing of benefits with consumers of the regulated service. The idea of sharing efficiency gains with consumers is dismissed by claims that ACAM "does no harm".

1.1 Incremental cost of changing from ACAM is minimal

In its updated draft decision, the Commission noted that *"… we do not consider the costs of changing allocation methodology are likely to be large"* but, nonetheless, *"… welcome*[d] *stakeholders' views on this, along with supporting evidence"*.[1]

The parties best placed to provide evidence on this are the EDBs themselves, however little useful evidence on the cost of change is provided in the submissions. Unison alone usefully identified that the cost of change for them is likely to be low (in the region of $50k-$150k).[2] Other EDBs referred to system changes and the need to identify costs and drivers in order to undertake the allocations and asserted this would be difficult and costly.[3]

The proposition that the cost of changing allocation method is material, because of the extent of work to identify costs and cost drivers, is unpersuasive. Use of ACAM does not require a simple and sweeping decision that all costs not directly attributable would be 100% avoidable if the non-regulated activity was not entered into or was discontinued. Rather, the input methodologies require that, for both operating costs and regulated service assets, *"an assessment must be made as to the proportion of each that would be non-avoidable were the EDB not to supply unregulated services."*[4] Where the regulated supplier provides more than one regulated service, such as PowerCo and Vector, then not directly attributable costs that have not been allocated to unregulated activities under ACAM, must be allocated between regulated services using ABAA.[5] For these businesses, at least, information about the nature of the costs and cost drivers must already be known.

In the case of all regulated suppliers, ERANZ reiterates the view expressed in its submission that an understanding of the costs of various activities must be fundamental to investment decisions and ongoing management of any diversified business, meaning that the incremental cost to change from ACAM to another cost allocation approach is highly likely to be minor at most.

[1] Commerce Commission; Input methodologies review - Updated draft decision on cost allocations; for electricity distribution and gas pipeline businesses; 22 September 2016; para 40

[2] Unison Networks; letter to Keston Ruxton "Unison Submission on Amended Draft Decision to remove ACAM as a Cost Allocation Option from the Input Methodologies"; 13 October 2016; page 2

[3] For example: PowerCo; Submission on input methodology review: Updated draft decision on cost allocation for electricity distribution and gas pipelines; 13 October 2016; page 6. Wellington Electricity Lines Limited; Letter to Keston Ruxton "Input Methodology review: response to updated draft decision on cost allocation; 13 October 2016; page 2

[4] Commerce Commission; Electricity Distribution Services Input Methodologies Determination 2012; consolidated version published 3 February 2016; para 2.1.4(1)

[5] Commerce Commission; Electricity Distribution Services Input Methodologies Determination 2012; consolidated version published 3 February 2016; para 2.1.4(3)

1.2 The benefits of removing ACAM exceed the costs

The Commission makes the point that its concern with ACAM is that *"… allowing ACAM to continue to be applied on a permanent basis for all or some of the costs of some regulated suppliers may allow a significant amount of shared costs (in absolute dollar terms) to be permanently allocated to the regulated service."*[6]

It is evident from the submissions that EDBs do not consider that the benefit of removing ACAM could be material.[7] Some EDBs have implied that the cost of changing from ACAM to another cost allocation approach would exceed the benefits that would flow to consumers by noting that additional costs would result in increased charges to consumers. WELL states that:

> "[The costs associated with changing allocation method] *would increase costs associated with the provision of electricity distribution services and therefore increase costs to consumers."*[8]

It is not clear to ERANZ that the cost of changing cost allocation approach would result in upward pressure on lines charges. However, this would be the case under the Commission's proposals to compensate regulated suppliers at the next price reset. We remain of the view, however, that the share of economy of scope benefits that consumers would receive would far outweigh the recovery of the costs of changing methodology - and would do so by a significant margin over time. Overall, prices to consumers of the regulated service should be lower as a result of removing ACAM.

Under the regulatory regime regulated suppliers are expected to make efficiency gains (of which economies of scope is just one driver) and to share those gains with consumers. This requirement, to *"share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices"*, in the Part 4 purpose statement is paramount.[9] The High Court concluded that, while it was argued *"ss 52A(1)(c), 52T(1)(a)(iii), 52T(3) and the August 2006 GPS, read together, direct that regulated suppliers be encouraged to invest in unregulated services (through being able to leverage off existing assets) provided that the consumers of regulated services are not worse off, for example, as a result of cross-subsidisation … an interpretation of paragraph [52A(1)](c) which limits sharing, as a matter of law, in the manner proposed … is not in our view the correct interpretation.*[10]

Several submitters suggest that the Commission should have regard to the effect a change in allocation methodology will have on investment in unregulated activities.[11] Aurora argues that *"Consideration should be given to the implications for cost recovery on incentives to invest, including in the provision of other goods or services."* However, the High Court spelled out the requirements placed on the Commission by Part 4 of the Commerce Act 1986 ("Part 4"):

> *"Part 4 is about regulated goods and services and s 52A(1) sets out the purpose of Part 4 as being to promote the long-term benefit of consumers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. It is concerned with incentives to innovate and invest because innovation and investment in regulated goods and services are necessary to the long-term benefit of consumers of those goods and services.*

[6] Commerce Commission; Input methodologies review - Updated draft decision on cost allocations; for electricity distribution and gas pipeline businesses; 22 September 2016; para 23
[7] For example: Vector; Letter to Keston Ruxton "Vector submission on the draft decision of cost allocation for electricity distribution and gas pipelines"; 13 October 2016; para 17
[8] Wellington Electricity Lines Limited; Letter to Keston Ruxton "Input Methodology review: response to updated draft decision on cost allocation; 13 October 2016; page 2
[9] Commerce Act 1986; s 52A(1)(c)
[10] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; paras 1853, 1855
[11] For example: Aurora Energy Limited; Submission - Input Methodologies review: Updated Draft Decision on Cost Allocation; 13 October 2016; page 1.

We consider that it is not part of the Part 4 purpose that suppliers of regulated goods and services also have incentives to innovate and invest in unregulated goods and services on similar terms as they are to have incentives in relation to regulated goods and services. Rather, the topic of unregulated goods and services is left to s 52T(3)'s protection against undue deterrence of investment."[12]

1.3 ACAM is not "fit for purpose"

Submitters have suggested that ACAM is fit for purpose because it better reflects competitive market outcomes.[13] Submitters have also suggested that ACAM is a sound method for identifying cross subsidy.[14]

The discussion in section 1.2 above, clearly demonstrates that ACAM is not fit for purpose as the perpetual retention by the regulated supplier of (all) the benefits from efficiencies of scope is inconsistent with s 52A(1)(c).

ACAM may prevent economically inefficient cross subsidy to the extent that it ensures the unregulated activity must cover its directly attributable costs. However, that is quite different to forcing consumers of the regulated service to cover all the shared costs of regulated and unregulated activities when the unregulated activity is able to make a contribution to these costs. This is also a 'subsidy' and is directly addressed by s 52A(1)(c).

The argument that ACAM better reflects competitive market outcomes has two limbs:

- that firms invest in additional activities when the net present value ("NPV") of the incremental cash flows relating to those activities is positive; and

- that firms investing in new activities sometimes incur losses in the early stages of the new activity but expects subsequent cash flows to (more than) make up for these early period losses, thereby delivering a positive NPV over the life of the investment.

One argument that arises from these propositions is that removing ACAM will prevent the the business from achieving the necessary level of net cash flows in later periods to compensate for early period losses.

However, not all investments go through this pattern of cash flows. The submission from Wellington Electricity ("WELL") provides an example of such an activity.[15] WELL's submission identifies that its current unregulated activity (allowing telecommunication providers access to poles) amounts to 1% of revenue (circa $1.6m p.a.). Under ACAM, consumers of the regulated service are allocated all the non directly attributable costs (e.g. the value of the poles - although, for some reason, no costs or asset values are identified as not directly attributable in WELL's 2016 Information Disclosures). The unregulated activity generates $1.6m revenue per annum but has no capital investment and makes no contribution to shared costs. The revenue may flow entirely to profit and the resulting NPV is significantly positive.

In fact, the identification of an appropriate discount rate for use in a NPV calculation as described above is problematic. A discount rate that includes an allowance for capital risk is simply not

[12] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Paras 1870-1

[13] For example: Unison Networks; letter to Keston Ruxton "Unison Submission on Amended Draft Decision to remove ACAM as a Cost Allocation Option from the Input Methodologies"; 13 October 2016; pages 2-3. The ENA; Input Methodology review Updated draft decision on cost allocation - Submission to the Commerce Commission; 13 October 2016; paras 21-25.

[14] Aurora Energy Limited; Submission - Input Methodologies review: Updated Draft Decision on Cost Allocation; 13 October 2016; pages 4-5

[15] Wellington Electricity Lines Limited; Letter to Keston Ruxton "Input Methodology review: response to updated draft decision on cost allocation; 13 October 2016; page1-2

appropriate to assess a business (or proposed business) when there is no capital at risk (or where the capital risk is covered by returns from other businesses).

WELL advises that the revenue from unregulated activities is 1% of total revenue. That means that, in terms of the revenue threshold for ACAM, WELL could conceivably increase its unregulated activity(/ies) (or unregulated charges) by the order of 20 times, that is up to $32m p.a., and still not have the unregulated activity make any contribution to shared costs.

Subsidisation of shared costs by consumers of the regulated service is not justified on the grounds of 'competitive market outcomes'. The High Court concluded that *"some degree of sharing of efficiency gains would occur in workably competitive markets"*[16] and that *"*[w]*e think a reasonable approach to considering s 52T(3) is that, so long as the unregulated service receives some portion of efficiency gains (and thus bears less than its SAC) … investment in the unregulated service will not be unduly deterred. It follows that we conclude that the use of ABAA cannot of itself unduly deter investment in unregulated services."*[17,18]

Where an unregulated activity makes losses in the early periods this might be a justification for the directors to continue to apply OVABAA up to the ACAM limit for a period of time. This would address the concern expressed by Unison about not achieving the NPV > 0 outcome.[19] Accordingly, ACAM is not necessary as a stand alone allocation approach in order to achieve 'competitive market outcomes'.

In some situations the 'competitive market outcome' is that a venture (new or existing) fails. The Commission will need to consider how long it will allow ACAM to be applied under the OVABAA option where it is simply supporting a 'lost cause' activity.

1.4 EDBs show little regard for sharing efficiency gains with consumers

A common theme among submissions from regulated suppliers is the view that ACAM 'does no harm'.[20]

The view seems to stem from the belief that consumers of the regulated service would face a certain level of cost in the absence of any unregulated activities and so are no worse off if they face that same level of cost when unregulated activities are entered into.

This is clearly a perverse interpretation of the legislative history, the intent of s 52T(3) and the Part 4 purpose statement. The government policy statement that predated the introduction of Part 4 provided encouragement for regulated service providers to invest in other activities, as well as in their regulated activities, because there may be efficiencies to be achieved in such investment. These efficiencies would be evident if the consumers of the unregulated service, or the consumers of the regulated service, or both received their services for a lower cost than would otherwise occur. According to some regulated suppliers' submissions that should not happen, at least as far as consumers of the regulated service are concerned.[21] Regulated suppliers believe that the

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[16] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Paras 1876
[17] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Para 1861
[18] *"SAC"* refers to stand alone cost.
[19] Unison Networks; letter to Keston Ruxton "Unison Submission on Amended Draft Decision to remove ACAM as a Cost Allocation Option from the Input Methodologies"; 13 October 2016; pages 2-3
[20] For example: PricewaterhouseCoopers; Submission to the Commerce Commission on Input methodologies review: Updated draft decision on cost allocation for electricity distribution and gas pipeline businesses; 13 October 2016; page 6. The ENA; Input Methodology review Updated draft decision on cost allocation - Submission to the Commerce Commission; 13 October 2016; paras 11-13.
[21] For example: Wellington Electricity Lines Limited; Letter to Keston Ruxton "Input Methodology review: response to updated draft decision on cost allocation; 13 October 2016; "*Importantly, the use of network poles by telecommunications providers … provides an efficiency to customers on the price of the telecommunications service they receive. … This is an example of the wider benefits to consumers (outside of solely electricity) that is supported by the retention of ACAM."*

beneficiaries of economies of scope efficiencies should (possibly) be consumers of the unregulated service but, more likely, the owners of of the regulated supplier.

Arising from the proposal that ACAM have wider application, the High Court concluded that as a result of using ACAM *"… the economic common costs are allocated in full to the regulated business, and thus all the efficiency gains are enjoyed by the unregulated business (or its customers)"*[22] but concluded *"where efficiency gains result from the joint use of assets or sharing of operational expenditure those efficiency gains, by their very nature, are shared."*[23]

In Part 4, s 52T(3) gives effect to Parliament's intent for economies of scope to be encouraged by providing that cost allocation methodologies should not unduly deter a regulated service provider from investing in an unregulated service. However, Parliament's overarching intent is made clear in s 52A - that consumers of the regulated service should share in the efficiencies that are achieved. The High Court confirmed that *" … there is in our view no doubt that in workably competitive markets sharing between businesses would not … be permanently limited to ACAM sharing."*[24]

Aurora comment that: *"Just because a change results in lower prices doesn't necessarily make it a good idea"*.[25] Contrary to the view expressed by Aurora, in this case it clearly is a good idea. Depriving regulated service consumers of efficiency benefits that they are funding is doing harm to those consumers. The WELL example above makes this abundantly clear. Harm is being done to regulated service consumers in order to provide greater levels of profit for the regulated supplier and their shareholders.

The sentiments and drivers, expressed by EDBs in the submissions are exactly the sorts of concerns that the Australian Energy Markets Commission ("AEMC") identify when supporting ring-fencing of regulated activities in Australia. AEMC notes that ring-fencing aims to avoid harm that arises when network service providers *"… cross-subsidis*[e] *the affiliate's services in the contestable market with revenue derived from its regulated services"*.[26] Outside of this consultation process the need for consideration of more formal ring-fencing provisions remains.

1.5 Summary of ERANZ position on the cost/benefit of removing ACAM

ERANZ submits that:

- the cost of removing ACAM as a stand alone methodology is minimal;
- the benefits in terms of the sharing of efficiencies of scope with consumers of regulated services will greatly exceed the cost of changing allocation approach.

2. THE COMMISSION'S PROCESS

Some submitters have argued that the Commission's draft decision to remove ACAM has come late in the process, is not based on new or compelling evidence and serves to undermine regulatory certainty.

[Page 1] *and "The efficiency benefits to consumers from avoiding dual telecommunications and electricity infrastructure, where possible, should not be underestimated."* [page 2]

[22] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Para 1834

[23] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Para 1855

[24] *Wellington Airport & others v Commerce Commission* [2013] NZHC 3289; Para 1859

[25] Aurora Energy Limited; Submission - Input Methodologies review: Updated Draft Decision on Cost Allocation; 13 October 2016; page 1

[26] Australian Electricity Regulator; Draft Ring-fencing Guidelines - Explanatory statement; August 2016; Page 11

2.1 The updated draft decision is not 'late in the process'

In reviewing the appropriateness of input methodologies the Commission should be expected to consider whether the input methodologies individually and as a group are achieving their purpose. In the case of ACAM they have concluded the cost allocation is not achieving its purpose.

ERANZ believes that it is not unreasonable for the Commission to reflect on submissions and propose appropriate changes to the input methodologies, including reaching positions in the final determination that may not have been included at draft decision stage. A range of submitters have suggested that the Commission's proposal to remove ACAM somehow falls outside of an acceptable consultation process. It is hard to understand how this concern has arisen when the Commission has provided an additional consultation step in light of it adopting a revised position.

The Commission has followed a reasonable process. The Commission has undertaken consultation on cost allocations and on the impact of emerging technologies, arrived at draft positions in respect of both areas and issued draft decisions. In response to the emerging technology issue the Commission identified some concerns and, in its draft decision, proposed to reduce the revenue threshold for using ACAM from 20% to 10%, as an alternative to removing the ACAM option. The Commission then called for further submissions (and subsequent cross-submissions) in respect of the draft decisions.

Some of the submissions and cross submissions proposed:[27]

- that the revenue threshold should be reduced further, perhaps to 5%; and
- that thresholds in respect of applying ACAM to operating costs and to assets should also be reviewed.

ERANZ also submitted, in the alternative, that ACAM be removed.[28] The Commission's updated decision is not the extreme and unheralded shift it is being painted as.

Having considered these submissions, including the evidence that indicated the benefit of change would materially exceed the cost of change (including that the benefits derive from removing the potentially permanent application of ACAM), the Commission proposed removal of the ACAM option. The Commission has added an additional step, by way of an updated draft decision, allowing a further round of consultation.

This process is reasonable and fair. It would be unreasonable for the Commission to be bound by its draft decision, and unable to reflect salient points raised in the submission process.

2.2 The Commission has sufficient evidence that the benefits outweigh the costs of change

Submitters have suggested that the Commission has reached the updated draft decision to remove ACAM without new or compelling evidence.

It is unfair to suggest that the Commission has come to this decision without some basis arising from the submission process. Submitters on the original draft decisions, such as Contact and ERANZ, identified issues with the working of the stand alone ACAM option and, as noted above, promoted its removal. Whether the evidence or 'facts' are new should not be a critical issue. If the Commission's perspective on any particular matter is altered or enlightened, and the Commission wishes to address a concern, it should be able amend its position without having to identify some

[27] Electricity Retailers Association of New Zealand; Submission to the Commerce Commission on the input methodologies for emerging technology; para 135
[28] Electricity Retailers Association of New Zealand; Submission to the Commerce Commission on the input methodologies for emerging technology; 4 August 2016; para 134

new fact or evidence. In this case the Commission has determined that the ability for regulated suppliers to retain efficiency of economy of scope benefits in perpetuity is not consistent with the purpose statement (or with the intent of s 52T(3)) and has identified appropriate action, for which the benefits to consumers of regulated services outweigh the costs.

The line of logic pursued by submitters would suggest that even if, due to some bizarre set of circumstance, the Commission included a blatant error in a final determination it would require new evidence to invoke a correction at a subsequent review. This is nonsensical. The Commission must be able to approach a decision, assessing the evidence available (new or old) with an open mind. The Commission making decisions now is not bound by decisions of the Commission that determined the input methodologies in 2010.

Unison submits that, from a legal perspective, in forming its draft decision the Commission has taken into account irrelevant considerations about the impact on competition in other markets.[29] It is unclear how Unison arrives at this conclusion when the Commission explicitly states:
"Contact also submitted that the ability for regulated monopolies to operate in contestable markets using regulated funding, as a result of applying ACAM, has the potential to seriously distort competitive market outcomes. … Our proposal to remove ACAM does not depend on any of the possible wider benefits that might arise if removing ACAM were to mitigate some of Contact's concerns."[30]

2.3 Regulatory certainty is not undermined

ERANZ does not believe that the Commission process has the effect of undermining regulatory certainty. The view that regulatory certainty is being undermined, as expressed by some submitters, is based on the assumption that new or compelling evidence is required before the Commission should change an extant input methodology. As discussed in section 2.2 above, this should not be the case. Regulatory certainty is an important concept but should not be used to limit or restrict the Commission in making reasonable decisions.

In any case, the Commission had considered removing ACAM in its draft decision, because it recognised a concern, but at that point settled on reducing the revenue threshold as being sufficient. In submissions it was identified that:

- the benefits of addressing the economies of scope that might not otherwise be shared with consumers were significant (to consumers if not, seemingly, to regulated suppliers);
- addressing the revenue threshold on its own was not sufficient, i.e. the operating cost and asset value thresholds would also need attention;
- the revenue threshold may be subject to manipulation by regulated suppliers in some circumstances, to prolong the retention of efficiency gains.

The Commission had legitimate cause to reconsider its assessment in its draft decision.

2.4 Summary of ERANZ position on the Commission's process

ERANZ submits that:

[29] Unison Networks; letter to Keston Ruxton "Unison Submission on Amended Draft Decision to remove ACAM as a Cost Allocation Option from the Input Methodologies"; 13 October 2016; Page 1
[30] Commerce Commission; Input methodologies review - Updated draft decision on cost allocations; for electricity distribution and gas pipeline businesses; 22 September 2016; paras 28-9

- the Commission must be entitled to amend its view between the draft decision and the final determination based on submissions received in the process;

- providing an updated draft decision for consultation is an additional step for which the Commission is to be commended rather than criticised;

- the Commission has sufficient evidence to revisit the assessment in its draft decision;

- while the concept of regulatory certainty is important, it should not be used to limit or restrict the Commission in making reasonable decisions within a reasonable process.

3. REVIEW OF OVABAA

The ENA and PwC, for example, have submitted that, in the event ACAM is removed as a stand alone option, the Commission should review the OVABAA mechanism to reduce its complexity.[31] The submitters suggest this review could be completed by December 2017. There are also concerns about 'director risk' in having to certify that an allocation other than ABAA is justified in terms of s 52T(3). Other submitters have suggested removing the OVABAA option as well.

3.1 Review of OVABAA is not necessary

ERANZ has already submitted that, there would be benefits to effecting the change earlier than the proposed 2018/19 regulatory year, i.e. effecting the change for the 2017/18 regulatory year. While this would provide the Commission with the option of using an additional year's data for the 2020 electricity price reset, it would also provide regulated suppliers with experience in using the OVABAA option (if they so chose). This still seems the most sensible option.

Regulated suppliers may choose not to use the OVABAA option, not because of its level of complexity but because of difficulties in meeting the requirements for proving it is necessary (i.e. that cost allocation is the sole reason an unregulated activity will not commence or will be discontinued), or because of concern about director risk and reluctance to certify the necessity of using an allocation other than ABAA.[32] Simplification or streamlining of the cost reallocation process will not address these issues. It may be that no regulated suppliers opt to use the OVABAA process, in which case a review by the Commission would represent a waste of effort.

In any event, if a review of the OVABAA mechanism, which was subject to consultation in 2010, delays application of the Commission's proposed change then the disclosed data on which the Commission must rely for the 2020 electricity price reset will be of little value. The effect of ACAM allocations will persist (in regulated prices, if not in subsequent disclosures) for a further five years. This might suit regulated suppliers but will not suit consumers of regulated services.

3.2 Director Risk

Several submitters have expressed concern that directors would face an unnecessary and/or unreasonable risk in certifying the need to adopt a cost allocation, other than ABAA, under the

[31] The ENA; Input Methodology review Updated draft decision on cost allocation - Submission to the Commerce Commission; 13 October 2016; Paras 34-5. PricewaterhouseCoopers; Submission to the Commerce Commission on Input methodologies review: Updated draft decision on cost allocation for electricity distribution and gas pipeline businesses; 13 October 2016; para 15.

[32] For example: PowerCo; Submission on input methodology review: Updated draft decision on cost allocation for electricity distribution and gas pipelines; 13 October 2016; paras 22, 24. PricewaterhouseCoopers; Submission to the Commerce Commission on Input methodologies review: Updated draft decision on cost allocation for electricity distribution and gas pipeline businesses; 13 October 2016; para 16.

OVABAA option. While establishing this may not be a trivial task, is seems to be only a part of much more significant decisions that directors, in executing their fiduciary duties to shareholders and investors, must make, such as launching into an unregulated activity or continuing to allocate resources to an unregulated activity. The paradox in the view that this question is particularly vexing is that if an activity is on such a financial knife edge that it would be non-viable under an ABAA allocation then questions such as 'why?' and 'by how much?' seem to be the very type of questions directors would be interested in.

3.3 ERANZ has sympathy with the view that OVABAA should also be removed

Some submitters have suggested that, as well as ACAM, OVABAA should also be removed.[33] This reflects concern that ACAM can still be used under the OVABAA option and efficiency gains could still be withheld from consumers of the regulated service, potentially in perpetuity. ERANZ has some sympathy with this view. Having ABAA as the only cost allocation option would be more consistent with the ring-fencing approach in place in Australia.

3.4 Summary of ERANZ position on a review of OVABAA

ERANZ submits that:

- a review of OVABAA is not necessary, at least until there is experience of it being used;
- there are benefits to the Commission requiring the change in allocation method earlier, i.e. for the 2017/18 regulatory year;
- simplification or streamlining of the cost reallocation process will not address regulated supplier concerns about director risk and reluctance to certify the necessity of using an allocation other than ABAA;
- concerns about director risk are inconsistent with the information prudent directors prudently require in respect of businesses that are unable to sustain ABAA cost/asset allocations.

[33] Major Electricity Users' Group; letter to Keston Ruxton - Submission on Update draft decision on Cost Allocation; 13 October 2016, para 4. Contact Energy; letter to Keston Ruxton - Input Methodologies Review - updated draft decision on cost allocation; 12 August 2016 [*sic*]; pages 1-2.