Transpower House, 96 The Terrace,
PO Box 1021, Wellington,
New Zealand
Telephone +64-4-590 7544
Facsimile: +64-4-495 7100
www.transpower.co.nz

TRANSPOWER

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John McLaren
Chief Advisor
Regulatory Branch
Commerce Commission
WELLINGTON

By email: regulation.branch@comcom.govt.nz

Dear John,

Consultation on Electricity Distribution 2015 DPP reset

We welcome the opportunity to submit on the Commerce Commission's Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper (2015 DPP Paper), 21 March 2014. No part of our submission is confidential.

Positive changes reflected in the Commission's proposals

The 2015 DPP Paper reflects positive evolution of the operation of Part 4 of the Commerce Act 1986, consistent with the purpose of promoting the long-term interests of consumers.

We agree with the Commission that Part 4 is still young and there is scope to improve and evolve the operation of the regime for the next resets.[1] This is inevitable given the Commission had very tight timeframes specified in legislation within which to establish the first set of price-paths for electricity and gas distribution and transmission, as well as Input Methodologies (IMs) and information disclosure.

There will also be further opportunities to enhance the regime, once the second suite of price-path resets have been completed, and the Commission embarks on its IM reviews.[2]

There are numerous changes the Commission is proposing which should help better achieve the Part 4 purpose, including but not limited to extension of IRIS to the DPP, consideration of revenue-linked service quality incentives, changes to remove the risk to regulated suppliers arising from attempting to forecast recoverable and pass-through costs, and changes to smooth out incentives to purchase Transpower's assets over the regulatory period

There are also other proposals such as rolling over Orion's end of CPP price into the (final year) DPP which we haven't considered in detail but appear to be pragmatic and sensible.

Pass-through and recoverable costs

As noted above, we agree the Commission should make changes to remove the risk to regulated suppliers arising from attempting to forecast recoverable and pass-through costs. This risk serves no benefit to consumers. All it does is make it more difficult for regulated suppliers to fully recover their allowable revenues and therefore more difficult to recover a normal rate of return.

[1] Paragraph 4.52.
[2] This wasn't possible under the previous Part 4A regime given its limited duration before it was replaced.

One of the major points of contention in the Electricity Authority's current transmission pricing methodology (TPM) review has been whether retailers or electricity distribution businesses (EDBs) should be charged directly by Transpower for transmission services. This debate essentially stems from the concern that the SPD charges in the Authority's original October 2012 would be too volatile and unpredictable for EDBs to manage within their DPPs. While the Electricity Authority has moderated its proposals to reduce the uncertainty around the SPD charges, this remains a live issue and there is no surety on where the Authority may land on its TPM proposals.

The Commission's proposed changes to remove the risk to regulated suppliers arising from forecasting recoverable and pass-through costs should address this matter in full.

Acquisition of Transpower's assets

We welcome the Commission's consideration of treatment of assets purchased by EDBs from Transpower.

The approach the Commission is proposing appears to be a sensible way of addressing some of the incentive impediments to the efficient transfer of assets from Transpower to EDBs, including incentives to purchase at a particular point in time during the regulatory period.

Specifically, we support the proposals to amend the IMs to include an additional recoverable cost term, and to ensure EDBs have similar, or the same, incentive to purchase assets from Transpower in each year of a regulatory period, and the use of an adjustment mechanism in the quality standards for the expected impact of asset transfers.

There are also two additional issues with the status quo the Commission should consider:

1. The current DPP regime incentivises EDBs to complete any acquisition of Transpower assets by 1 April. For example, if the transaction occurs in June, the EDB would miss out on two or more months of benefit from avoided transmission cost. This creates a bottleneck for Transpower trying to complete transactions with multiple EDBs at the same time that could be addressed through a wash-up or equivalent mechanism so the EDB is neutral on transaction timing.

2. The TPM charges for connection services on the basis of the service a customer receives rather than the specific assets employed for that customer. This means that the charge does not vary depending on the age of the asset which has the benefit for EDBs (and their consumers) of smoothing transmission charges.

   However, smoothed charging under the TPM has the effect of incentivising EDBs to purchase older assets and discouraging purchase of newer assets. This has been an impediment to ensuring efficient ownership of all connection assets but could be addressed by the Commission if recoverable costs were based on the cost of the acquired asset rather than the TPM charge that the EDB avoids.[3]

Attachment H

We note with interest the Commission's reference to its previous Attachment H analysis into whether regulated suppliers should receive an uplift in prices to address the asymmetric cost of a price that is too low (potentially below cost) or higher than necessary.

This is an issue that has attracted a lot of attention by regulated suppliers in the initial DPP reset consultation. From our observation, it would appear that whether Attachment H can be

[3] The Electricity Authority's consultation on Avoided Cost of Transmission (ACOT) payments has raised similar issues, and also suggested that ACOT payments should be based on actual avoided transmission costs rather than avoided transmission charges.

relied on to conclude no uplift is necessary or desirable for regulated suppliers that are subjected to the DPP/CPP regime hinges on the attachment's assumptions that: (i) CPPs are effectively costless to regulated suppliers; and (ii) they would apply for a CPP if the DPP precluded them from recovering at least a normal rate of return.

There has been considerable debate over these assumptions, particularly the suggestion that CPPs are costless or risk free for regulated suppliers, with the inference that regulated suppliers may reduce capex/opex below efficient levels as an alternative to applying for a CPP. To the extent these arguments are valid, the Attachment H modelling should factor in the likelihood regulated suppliers would reduce capex/opex below efficient levels, instead of applying for a CPP, and measure the detriments to consumers from network/service detriment (over-time).

While this may or may not result in different conclusions from those articulated in Attachment H it would help ensure the analysis is complete and robust.

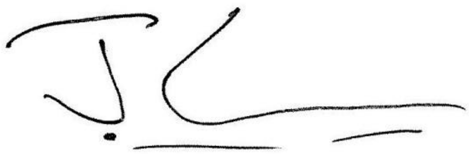
Concluding remarks

We recognise the Commission faces a busy and challenging year with the price-path resets for EDBs and Transpower, as well as its intention to complete the TSLRIC final pricing principle (FPP) determinations for Chorus' UBA and UCLL services before Christmas.

We are encouraged that the Commission is prioritising changes which should improve efficiency, and result in better long-term outcomes for consumers.

Please let me know if you would like clarify or discuss any of the points made in this submission.

Yours sincerely,



Jeremy Cain
Chief Regulatory Advisor