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Dear Keston Ruxton

INPUT METHODOLOGIES REVIEW: RESPONSE TO UPDATED DRAFT DECISION ON COST ALLOCATION

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to respond to the Commerce Commission's (**Commission**) updated draft decision on cost allocation.

The Commission's updated draft decision proposes to make a change to the draft decision by removing the avoidable cost allocation methodology (**ACAM**) as a cost allocation option. WELL considers the Commission's initial draft decision—which limits, but does not remove ACAM—should be retained as it better reflects the purposes of default price quality path regulation (section 53K of the Commerce Act 1986) for the reasons outlined below.

1. Changes to Input Methodologies—a demonstrable benefit

The use of ACAM provides a low cost mechanism for allocating immaterial shared costs. Retaining ACAM, albeit with a reduced threshold, is a prudent and pragmatic change to the existing input methodologies (**IMs**). Specifically, it avoids the need for customers to fund investment in costly accounting exercises and system changes when the associated revenue is immaterial and incidental to the primary business of maintaining an electricity distribution network.

We consider the reasons previously advanced by the Commission in allowing ACAM, as well as for retaining it (with a reduced threshold), remain valid. The review of IM's is a key part of the regulatory framework and changes to the IM's should be based on robust evidence and cost-benefit analysis for both consumers and suppliers. In proposing to remove ACAM, it is not clear what testing of the theoretical arguments that have been advanced by Contact Energy and the Energy Retailers Association of New Zealand (**ERANZ**) has been undertaken. It is difficult to understand, therefore, why the Commission now seeks to make such change, particularly when the need for more flexibility to trial new technologies to develop more efficient service offerings should be incentivised rather than dis-incentivised.

2. Use of ACAM and OVABAA

WELL's unregulated services currently account for one per cent of total income (regulated plus unregulated). These services are by-products of electricity distribution services (e.g. allowing access to poles by telecommunications providers) and to date none relate to the provision of emerging technologies. The costs associated with providing these unregulated services are largely administrative and immaterial (i.e. one per cent of the total costs of providing the regulated service). Accordingly, the use of ACAM is consistent with a simple, low-cost regulatory framework.

Importantly, the use of network poles by telecommunications providers also provides an efficiency to customers on the price of the telecommunications service they receive. This is achieved by avoiding duplicate infrastructure or expensive trenching by leveraging the existing power supply infrastructure to reduce service lead costs. This is an example of the wider benefits to consumers (outside of solely electricity) that is supported by the retention of ACAM.

Another example is the recent UFB roll-out, which is being supported by Wellington Electricity through Pole Connection agreements, delivering a more efficient cost to consumers for this service and is also being considered for a communications layer which is an important step for smart grid enablement. The ability to support a cost efficient UFB roll-out will also allow networks to consider active management of technology uptake so further services can be provided to customers. This includes the potential for the distribution network to allow private devices to inject or consume energy across a managed distribution network in a co-ordinated manner. This may well be a very important service for consumers in the future who wish to generate and trade their surplus energy.

The efficiency benefits to consumers from avoiding dual telecommunications and electricity infrastructure, where possible, should not be underestimated. We therefore strongly encourage the Commission to take a wider and longer term view on ACAM.

If ACAM were not available, WELL would need to develop systems for staff to allocate time to each of these services. It would also increase the administrative burden required to complete the annual information disclosure requirements. This would increase costs associated with the provision of electricity distribution services and therefore increase costs to consumers. WELL considers this would be an inefficient outcome for consumers of electricity lines services (as well as increase consumer costs for receiving infrastructure which supports the new UFB services) and is not consistent with the purposes of part 4 regulation. The absence of ACAM would also require WELL to re-evaluate its involvement in supporting the UFB roll-out and in the very least lead to significant delays for consumers whilst WELL implemented new systems.

The Commission also suggests that ACAM outcomes can be achieved through the use of the optional variation to the accounting-based allocation approach (**OVABAA**). This may not be the case, and to prove it requires the use of some form of cost allocation exercise, which immediately makes it more complex and costly. Although OVABAA allows for the use of proxy allocators, WELL would still need to identify the specific costs being shared between the regulated service and the unregulated services (e.g. identification of the approximate time specific staff spent on the unregulated service). As noted above, the time spent would be immaterial and significantly less than the share of total revenue received.

WELL notes the Commission's offer to compensate electricity distribution businesses (**EDBs**) for the costs of changing accounting systems should ACAM be removed. Whilst this will offset the expected upfront costs of system and process changes (not yet known), WELL considers this to be an unnecessary burden for EDB's, the Commission and ultimately consumers (through cost recovery), when the revenue value involved is immaterial.

3. Use and impact of emerging technologies

The testing of emerging technologies by EDBs is critical to ensure we can prepare for the possible impacts such technologies may have on the operation of our network for ongoing regulated electricity distribution services, particularly when customers start investing in these technologies on a large scale. This understanding will also assist EDBs to develop innovative network solutions that can both lower the cost of providing distribution services and improve the overall network delivery service to all customers over time. This includes the value of an effective communications layer to enable energy transfers from storage to load or from generation to storage, whilst maintaining a stable distribution network which meets the quality, security and reliability standards that is currently provided.

In its updated draft decision, the Commission noted submissions from Contact Energy and the ERANZ that raised concerns with the impact on contestable markets from allowing EDBs to apply ACAM. In addition to failing to recognise the benefits to consumers for other services such as telecommunications, the concerns set out by Contact Energy and the ERANZ are grossly overstated for the following reasons:

- the solar PV installation market in NZ is competitive, and includes many independent providers. This demonstrates that EDBs current practices (i.e. solar PV trials) are not prohibiting the development of competition;

- as noted by the ENA, if the business case for EDBs rolling out emerging technologies relied on ACAM, EDBs would never reach full competitive scale;¹ and
- should any of these concerns occur in practice (noting there is no evidence of this actually happening), the low materiality threshold applied to ACAM is a sensible and pragmatic solution.

As outlined previously, none of our unregulated incomes currently relates to the provision of emerging technologies. The arguments put forward about ACAM that solely focus on emerging technologies and a perceived market advantage fail to recognise 'other income' that EDBs may earn associated with the incremental use of assets by other utilities (such as telecommunications companies sharing the use of poles). As noted above a low cost, pragmatic approach for allocating costs enables EDB's to support the roll-out of the ultra-fast broadband network, making it easier for telecommunications customers to receive this service at a lower cost than if provided stand alone. This service also presents some additional commercial risk for EDB's with shared assets on their infrastructure increasing the risk of damage by third party strikes and requires maintenance and replacement planning to co-ordinate dual services. There are also risks to be considered for new health and safety standards where allowing access to poles requires checks on competency as well as collaboration, co-ordination and co-operation between the PCBU's. Any other costs are incidental and would not be avoided by electricity consumers (i.e. the costs for operating the electricity distribution network remain the same).

The use of ACAM with a low materiality threshold provides the right balance between ensuring a level playing field for all market players in emerging technologies, and incentivising EDB's to consider the longer term use of these technologies in their electricity delivery networks, for the benefit of all consumers. This recognises that these technologies can and will be used by both consumers and EDB's in the future. ACAM also provides wider benefits to consumers that should not be underestimated.

4. Conclusion

For the reasons stated above, WELL recommends the Commission maintain its draft decision to reduce the ACAM threshold to ten per cent of total income. Retaining ACAM with a lower threshold is more consistent with the purposes of default price-quality regulation than removing ACAM entirely. WELL considers that the evidence presented does not justify the Commission making this change to its draft decision.

WELL appreciates the continuing opportunity to contribute to the Commission's review of the input methodologies. If the Commission has any queries regarding WELL's submission, please do not hesitate to contact Jeff Anderson, Regulatory Projects Manager, at janderson@welectricity.co.nz.

Yours sincerely



Greg Skelton
CHIEF EXECUTIVE OFFICER

¹ ENA, *Input methodologies review draft decisions – cross submission*, 18 August 2016.