Submission on

# The Commerce Commission ‘Powerco Customised Price-quality Path’ Draft Decision’ consultation paper:

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## Powerco’s response

1. This is Powerco’s response to the Commerce Commission’s draft decision on Powerco’s proposal to customise its prices and quality standards.

2. The draft decision is a key milestone in Powerco’s CPP application process; a process that started early in 2015 and which culminated in Powerco’s customised price-quality path proposal (the Proposal) submitted on 12 June 2017.

3. It is worth noting that our CPP proposal and the analysis and thinking underpinning the expenditure forecasts and outcomes we are planning to deliver, have over the past two years, been subject to robust and detailed challenge by multiple independent parties. The Commission confirms that their review process has taken these prior assessments and views into account prior to overlaying a “regulatory” lens to the assessment to further test our plans against the “expenditure objective” and the long term interests of consumers.

4. A critical step in the CPP review process is the independent verification assessment, which in Powerco’s case, was undertaken by the Australian companies, Farrier Swier and WSP. We support the fact that the Commission has reviewed, tested, and then built on the recommendations of the verifier in arriving at their draft decision. This streamlining of the CPP assessment process was an outcome targeted by the Commission when the CPP Input Methodologies were updated in 2016.

5. In summary the draft decision confirms that the Commission is satisfied that an uplift in expenditure is required in order for Powerco to invest to provide a safe and reliable network for its consumers, and that allowing for the uplift now is prudent to manage network reliability in both the short and long term.

6. The Commission’s draft decision proposes to allow for 96% or $1.27b of the total expenditure proposed by Powerco. In making this decision the Commission has made a draft decision to reject a small part of Powerco’s proposed investment and in the case of network evolution expenditure, to reduce all previously “verified” amounts, on the grounds that were unable to be satisfied that the projects in this category of expenditure meet the expenditure objective. We provide some comment on this latter decision below and make a recommendation that the Commission reconsiders each individual project on its standalone merits rather than reject the category of expenditure in toto.

7. Powerco’s most substantive comments on the draft decision relate to changes that have been proposed to the quality path mechanism. Left unchecked, the changes significantly increase Powerco’s compliance risk, whilst at the same time removing several of the key levers available to manage this risk. We

summarise our concerns below (and in Appendix A) and make a number of recommendations for the Commission to consider.

8. We have aimed to keep our submission focused on those few parts of the draft decision which we believe require priority consideration prior to the final determination.

## A Quality Path

9. The Commission's decision supports Powerco's proposal for separate quality standards to apply during the CPP period for planned and unplanned interruptions, but with some amendments. A summary of our main comments on the draft decision is provided below (refer also to Appendix A)

<u>Unplanned interruptions</u>

10. We have a concern with the Commission's proposal to introduce an annual improvement target for unplanned interruptions (SAIDI and SAIFI). As proposed it presents an unacceptably increased risk of non-compliance to Powerco, a risk that is largely outside of our direct control. We have proposed an alternative which we consider better achieves the right balance of incentives.

11. Our detailed quality performance modelling, supporting our CPP proposal, indicated that, despite increasing expenditure across a number of areas, we should expect at best, only marginal improvement in network performance (measured by the average level of unplanned interruptions) during the CPP period; but with increasing improvements over the longer term. The link between expenditure and the immediate and visible improvements in average network performance was reviewed in some detail during the verification process.

12. The draft decision introduces, what can be considered to be more of a top down SAIDI and SAIFI improvement target based on achieving a material improvement in SAIDI and SAIFI year on year during the CPP period. For SAIFI, an improvement from the starting target of 5% by the last year of the CPP and an improvement of 10% for SAIDI.

13. We understand (and the support) the Commission's desire to ensure there is appropriate incentive to focus expenditure where it will drive reliability outcomes for customers. The Commission's approach essentially applies both a <u>revenue incentive</u> and a <u>compliance incentive</u> to the unplanned quality path. It is the link between the Commission's "top down" improvement target and Powerco's legal compliance under the Commerce Act that causes us greatest concern.

14. We consider that with some minor adjustments, and by retaining an improvement target, and focusing on revenue at risk, an appropriate quality path incentive can be achieved whilst at the same time recognising that Powerco's uplift in network expenditure is likely to have some positive impact

on the level of unplanned interruptions by the later stages of the CPP period. In summary we propose the following (refer to Appendix A for more detail)

- **Compliance threshold:** The quality limit (which triggers non-compliance) should be set at the historical level (as per our original proposal)
- **Revenue at risk:** recognising the top down nature of the improvement target use improving SAIDI and SAIFI targets for revenue at risk only (based on 1% of MAR as per currently)
- **Review the level of the improvement target**: given the uncertainties associated with modelling a direct link between investment and immediate network improvement (even with bottom up modelling) we recommend that improvement target (year 5) for unplanned SAIDI is reduced from 10% to 5% and the SAIDI improvement target reduced from 5% to 2.5%)
- **Recognise that any observable network improvements will be lagged**: We propose a two year period (years 1 and 2) where the quality target is unmoved from the historical average, with annual improvements from year on year from the third year of the CPP.

<u>Planned Interruptions</u>

15. In the case of planned interruptions (SAIDI and SAIFI), we recommended in our CPP proposal, that these metrics were taken out of both the revenue incentive and quality standard compliance mechanisms but reported on annually (at a more detailed level than currently).

16. The Commission's draft decision supports the removal of the revenue incentive linkage but sets the quality standard for compliance purposes around Powerco's forecast of planned interruptions.

17. We remain of the view that our original proposal is preferable in that it removes any incentive for us to limit planned (and necessary) work in order to avoid exceeding the quality cap or to pursue a revenue bonus in any particular year. We consider that our proposal, coupled with enhanced public reporting of annual performance of expenditure, creates an appropriate incentive on us to work efficiently in line with CPP final decision.

18. Whilst our preference is for the Commission to reconsider its decision, were this decision to stand, we suggest that the mechanism for setting the compliance target is reconsidered, for the reasons explained below and in detail in Appendix A.

19. Powerco's quality model, used by the Commission to calculate the planned quality limit, derives an expected (P50) SAIDI/SAIFI outturn. The target proposed by Powerco was appropriate for tracking expected planned quality outcomes but if this target is now to be applied as a quality standard (with a 2 out 3 compliance mechanisms) then, to be consistent with the current DPP framework, the target should be set at a threshold above expected performance (at a standard deviation). A noted in Appendix A recommend that Commission reviews the process for setting the planned quality standard.

## B Network Evolution

20. The Commission in its draft decision proposes to reject $18 million of network evolution capex proposed by Powerco. The Commission is of the view that Powerco needs to further develop and finalise its network evolution strategy, and provide more tangible justification underpinning how consumers are likely to benefit from the specific projects it proposes to undertake.

21. We disagree with the decision to reject all project investments included in the network evolution portfolio, rather than review and consider the merits and priority of each individual project on a standalone basis.

22. Our proposed network evolution expenditure will support our transition from a conventional, largely passive network into a flexible, dynamic network that will respond quickly and efficiently to changing load patterns and can be tailored to customer requirements. It will provide for research and development of new network and non-network solutions or applications, testing of these applications on our network and developing promising solutions into fully-fledged network applications.

23. The new solutions we are planning to assess and test are being widely researched and tested across the world, and increasingly used in permanent, large-scale network applications. Widespread international evidence is emerging of how innovative solutions can outperform conventional network applications on function, flexibility and cost-effectiveness. In light of the considerable investment we face to renew assets and augment our network, it is paramount that we seize these opportunities to minimise costs without compromising service levels.

24. Examples of where we see major benefits that could arise from applying emerging technologies include:

- Increased asset utilisation and asset lives, allowed by real-time asset performance and condition monitoring
- Deferring augmentation by peak demand reduction, through energy storage or demand management schemes
- Load shifting, and self-healing networks, through network automation schemes
- Improved network planning and asset utilisation, through enhanced understanding of customer load patterns and associated incentive development

25. The network evolution portfolio is aimed at emerging solutions, where the practicality and benefits are not necessarily immediately clear. By its very nature, the exact scope, cost and outcome of such trials cannot be accurately predicted in advance. We have identified a number of areas that, based on literature studies and discussions with other parties who have been testing new solutions, appear most beneficial to pursue first.

26. We are keen to provide the Commission (and other stakeholders) with as much reassurance as possible that the investments we have identified and included in the CPP portfolio entitled “network evolution” are important enablers of our stated aim to develop a network that delivers for customers not only now, but for future generations.

27. As part of this submission to the Commission, we commissioned an expert review by Dr Allan Miller, former director of the EPEcentre and chair of the GREEN Grid research project, to assess each of the projects included in the network evolution expenditure portfolio. Dr Miller’s report is included as a separate report to this submission, and his assessment takes a global perspective on assessing the application of these new network technologies and how their use is currently driving benefits for consumers and other industry participants.

## C The Annual Delivery Report

28. As the Commission’s notes in the draft decision, Powerco is proposing a significant investment programme over the CPP period. This will require careful management to ensure it is delivered.

29. As the both the verifier and the Commission notes, Powerco has demonstrated that appropriate plans are in place to ensure that this happens.

30. We fully support the Commission’s draft decision to introduce a requirement for us to produce an annual delivery report explaining progress against what was forecast during the CPP period.

31. Our consultation with our stakeholders and customers indicates that greater transparency around how we are progressing with our work would be well received. We also believe that that the proposed requirement to hold annual stakeholder events to present and explain our progress will increase transparency around how we are tracking with delivering the outcomes we are targeting and provide another channel for our customers to receive information and to engage with us.

32. The draft decision includes an example, provided by Powerco, of what the delivery report could look like and the specific metrics and information we would commit to make publicly available via our annual reporting.

33. We note that the s53ZD example provided by the Commission, which essentially describes the reporting requirements in narrative form, goes beyond what Powerco has proposed by requiring both expenditure and volume metrics to be reported at a more disaggregated level and also requires us to report on average unit cost information for asset replacement.

34. In the case of the former (disaggregated reporting), whilst we can certainly provide this information but we question the additional benefit of this and suggest that, as its stands and without this additional reporting, the report would already run to some 40 to 50 pages when fully populated. We note also

the Commission's intent for the delivery report to be around 10 to 20 pages and for it to be a customer focused, non-technical document.

35. We have a more substantive concern with the Commission's proposal to include a requirement to report on the average unit cost of assets replaced, on an annual basis. From a point of principle this certainly goes beyond the intent of the delivery report (i.e. to transparently track delivery progress).

36. Perhaps more importantly we consider that attempting to report on a single, average unit cost measure, will be of little practical use to customers and stakeholders (or the Commission) and potentially very misleading. We manage and operate a diverse and heterogeneous fleet of assets, located across a range of geographies, and units costs are influenced by a range of factors and attempting to distil this into a single cost metric is problematic.

37. For the avoidance of doubt we think it is appropriate for the Commission to seek to understand how a company's costs are built up and how costs are trending over time. However, we don't believe that the Annual Delivery Report is the appropriate vehicle for this and recommend that the Commission reconsiders this part of the report for the final decision.

38. We have a few more minor comments on the Annual Delivery Report but these are more centred on amendments to the metrics and / or the timing of when certain information might be available. In the latter case, we would propose to phase in the requirement to report on low voltage network reliability performance to enable systems and data capture to put in place.

39. In other areas the metrics just need to be tweaked. For example, reporting for vegetation management has been proposed to be based on kilometres. Powerco uses the concept of 'tree sites' to manage and measure vegetation management, and this was also used in our CPP proposal as the primary output for vegetation management. Using tree sites rather than kilometres for these measurements both simplifies our reporting and better aligns to our CPP proposal.

## D CPP price-path compliance

40. Powerco's price-path compliance for 2018/19 will be determined in accordance with the requirements of the CPP determination. We will be regulated under a revenue cap, and so any actual under-recovery or over-recovery relative to forecast net allowable revenue will result in a wash-up balance that we will recover from, or return to, consumers in subsequent assessment periods. This ensures we recover no more, or less than is specified on the Commission's final decision.

41. Powerco will need to notify retailers of distribution charges commencing 1 April 2018 (FY19 year) by January 2018, and prior to the final determination being published in March. The Commission's draft decision confirms an option for Powerco to set FY19 distribution charges to recover the forecast net allowable revenue specified in the draft decision (with a subsequent wash-up to reflect

any difference between the draft and final decisions.

42. However, we consider that there is a potential issue under clause 8.4 of the draft determination that creates a risk that if forecast net allowable revenue decreases from the draft to the final determination, pricing against the draft will result in forecast revenue from prices that exceeds forecast net allowable revenue. In other words the precise wording of the determination does not fully align with the Commission's policy intent as expressed in the draft decision (with which we concur).

43. This can be easily remedied by amending clause 8.4 to clarify that we can price up to either the draft or final CPP determination. We do not see this as a significant issue as the draft determination emphasises the fact that the wash-up account ensures NPV=0 over the five years, irrespective of where we sets our prices in year one It is more a technical price path compliance issue that can be simply addressed by a technical fix in the determination as we set out in Appendix B to this letter.

44. Powerco appreciates the opportunity to provide input to the Commission's consultation paper.

45. If you wish to discuss this submission please contact Oliver Vincent, at oliver.vincent@powerco.co.nz. or on (06)75 93397, in the first instance.

Yours sincerely

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General Manager Commercial and Regulatory

# Appendix A

## Further commentary of the quality path draft decisions

### Planned Quality Limits

Whilst different from our proposal, we accept the Commission's decision of a planned quality incentive to ensure that customers are not unduly affected as a result of excessive outages (even if prior notice has been given of these). We also agree that there should not be a revenue incentive on out-performing the planned quality path, as this could inhibit the delivery of our planned programme of works. We however have some concerns with how the quality standard has been set. The Commission proposes that this be based on our model of planned SAIDI/SAIFI.

Our model of planned SAIDI/SAIFI was intended to show the expected planned quality outcomes of our CPP work, to use as a basis for stakeholder consultation of the impact of carrying out our proposed work programme. While planned SAIDI/SAIFI is less complex to model than unplanned SAIDI/SAIFI, there are still modelling assumptions with a material degree of uncertainty.

The model produces a P50 forecast of planned SAIDI/SAIFI under the additional workload planned for the CPP period, based on historical outage rates. Accordingly, there is a 50% chance in any year that the actual planned SAIDI/SAIFI will be higher than forecast to complete the work programme. Should the modelled value be taken as the limit, it is therefore very likely that we will breach the proposed 2 out of 3 rule. To avoid this exact issue, under the current DPP quality path, the SAIDI/SAIFI limit is set at a margin above an historical average (currently one standard deviation), to ensure a quality breach will happen on an exception basis only.

We therefore propose that a similar approach be adopted as currently applies to the DPP, where a non-compliance limit is set at one standard deviation above the target. Applying a threshold at a standard deviation above the target may not be appropriate for planned outages – determining this will require considerable additional analysis. As a pragmatic measure, we therefore proposed that the limit is set at a percentage above the target (as derived from the planned outage model) similar to that currently applied to the overall reliability figures in the DPP quality regulation, or 12% for SAIDI and 8% for SAIFI[1] . This would result in the following planned SAIDI and SAIFI paths during the CPP period:

**Table 1: Proposed planned quality path with tolerance**

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Planned SAIDI with 12% tolerance | 79.559 | 84.500 | 91.859 | 97.679 | 98.773 |
| Planned SAIFI with 8% tolerance | 0.340 | 0.365 | 0.388 | 0.409 | 0.408 |

We propose that the 2 out of 3 rule be applied with this quality path, which will keep consistency with the current DPP quality regulation approach, and will avoid an excessive

[1] Powerco's current DPP SAIDI / SAIFI target and limit are 188.9 / 2.341 and 210.6 / 2.520 respectively. This equates to an 11.5% and 7.6% tolerance.

(and unnecessary) number of non-compliances.

A further important input into the planned SAIDI/SAIFI model is the continued use of live-line work. In the proposed model, we included a provision for live-line work similar to historical levels. However, if all live-line work was stopped, the effect on the planned SAIDI/SAIFI path is modelled as shown in the table below.

**Table 2: Planned SAIDI/SAIFI model impact of stopping live-line work**

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Planned SAIDI CPP model | 71.034 | 75.446 | 82.017 | 87.213 | 88.190 |
| Planned SAIDI CPP model no live-line | 78.402 | 83.207 | 90.249 | 95.902 | 97.113 |
| *Increase* | *7.368* | *7.761* | *8.232* | *8.689* | *8.923* |
| | | | | | |
| Planned SAIFI CPP model | 0.314 | 0.338 | 0.359 | 0.378 | 0.378 |
| Planned SAIFI CPP model no live-line | 0.346 | 0.372 | 0.395 | 0.415 | 0.416 |
| *Increase* | *0.032* | *0.034* | *0.036* | *0.037* | *0.038* |

Should we have to discontinue live line work during the CPP period, we wish to reserve the right to re-open the determination of the planned quality target and proposed limit.

### Unplanned Quality Limits

We note that the Commission supports our proposal to separate planned and unplanned outages during the CPP period, to avoid a potential disincentive to the CPP delivery. However, we also note that this means there will be twice the likelihood to breach the quality path compared to the DPP, as unplanned and planned quality breaches will be separately measured. We also have reduced scope to manage the breach likelihood in a given year, as with planned and unplanned quality disconnected, it removes our ability to offset increased unplanned outages by a reduction in planned outages. All else being equal, the proposed changes to the quality path during the CPP will therefore materially increase the likelihood of a non-compliance.

However, as we discussed in our CPP proposal, our network performance is under serious pressure from deteriorating asset performance. While we have been largely managing to avoid increasing SAIDI and SAIFI through judicious application of network automation, this by itself is not sufficient to improve reliability.

Furthermore, we agree that the overall CPP investment will over time lead to stabilised asset and network performance, but this will take several years of investment and in most cases is not directly targeted at improving network performance.

The combination of these factors means that even without a requirement to improve reliability over the CPP period, we are likely to struggle to remain within the SAIDI as SAIFI limits. With the reducing unplanned quality path proposed by the Commission, the risk of non-compliance is very high, even if we carried out the full CPP programme as proposed.

To reduce the likelihood of non-compliance with the quality limit to a level we believe is realistically achievable; we therefore propose that the unplanned SAIDI and SAIFI limits for assessing quality path compliance (the two out of three test) be retained at a 10-year historical average.

We understand and accept the Commission's desire to ensure some direct benefit to customers, in the form of improved network quality and the signal that it wants to send in this regard. We therefore propose that the reducing quality path could still be used as the basis for the revenue-linked quality scheme. (This is in spite of the fact that we will run a high risk of losing revenue as a result of unavoidable performance issues on the network.)

We believe that limiting the quality improvement target to the revenue-linked quality incentive would still send a strong signal to customers, and provide a sufficient incentive for us to strive for improvements in unplanned SAIDI/SAIFI (while keeping the non-compliance threshold as a 'backstop' for deteriorating performance). The Commission will also be able to monitor our progress on planned deliverables via the CPP Annual Delivery Report, to ensure we carry out our work related to fault performance (such as overhead line renewal programmes, corrective maintenance and vegetation).

**Timing of reduction**

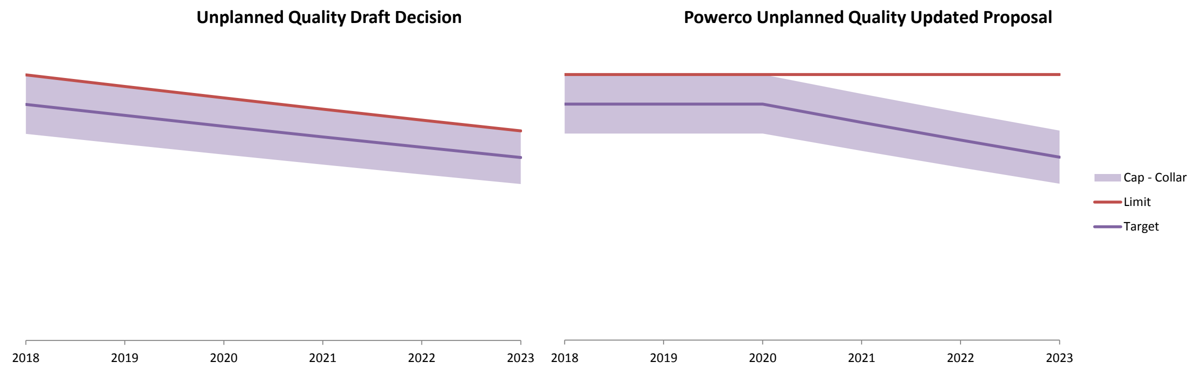
The draft decision states that the reduction in the unplanned quality path would begin from year 1 in the CPP period. We disagree with this timing and propose an two year period where the quality target is not reduced from the historical average, with the target then reducing from year three of the CPP period on.

There are a number of factors underlying this suggestion:

- Overhead renewal and maintenance work (especially conductor replacement) ramps up during the CPP period (rather than a single step change in year one), so an immediate reduction in faults is unlikely and would be minor at best. In the initial years the volume of assets improved is negligible compared with the overall asset volumes. The reliability improvements from these activities are therefore likely to be equally small.
- Our planned change in vegetation strategy to a full cyclical approach is staged during the CPP period, so like overhead line renewal the full effects of the programme will not be achieved until later in the period.
- The new preventive maintenance programmes will take time to deliver results, for example pole top photography will first need to be captured, then the information analysed and defects identified, and the defects then integrated into renewal and maintenance programmes.
- Asset management change programme such as improvements to data quality and asset criticality, and our ERP implementation, will occur during the CPP period and not be available in year 1 to effect immediate quality improvements

The impact of our proposal for the delayed quality path reduction, and using the historical limit for non-compliance assessment, is shown illustratively below.

**Figure 1: Illustrative example of proposed unplanned quality path**




## Unplanned Quality Reduction Targets

We modelled unplanned SAIDI and SAIFI as part of our quality path proposal for the CPP. The output of this modelling showed that for our proposed expenditure levels, by the end of the CPP period we could expect a generally stable SAIDI and SAIFI outcome (though the result in any one year will be greatly impacted by weather)[2].

The Commission in its draft decision referenced a number of areas where increased investment will have an impact on SAIDI and SAIFI[3]. We note that the increase in renewal expenditure on poles, crossarms and conductors, along with increased vegetation management Opex are also taken into account in our unplanned quality modelling.

Reliability Capex will also allow us to help manage the impact and duration of outages, thus relieving pressure from the deteriorating asset performance. However, this proposed investment will not by itself be sufficient to reduce overall SAIDI and SAIFI.

Defective equipment and vegetation SAIDI/SAIFI are the two main areas that contribute materially to network faults. As highlighted in the draft decision[4], over the past five years these two categories have contributed 56% of SAIDI and 48% of SAIFI. It is therefore these areas that will predominantly have to be targeted to improve network reliability. To achieve the required 10% and 5% reductions in SAIDI and SAIFI respectively will require 18% reduction in SAIDI from these categories, and an 11% reduction in SAIFI. These reductions would appear unrealistic to achieve within a five year timeframe.

Our own modelling of unplanned SAIDI and SAIFI shows a broadly flat SAIDI/SAIFI projection, forecasting a small reduction (6% and 2% respectively) in SAIDI and SAIFI by the end of the CPP period. Although unplanned quality modelling is notoriously complex and inexact, these results show how difficult it will be to achieve the Commission's proposed targets. However, we do accept that longer term, there is likely to be a reliability benefit to customers and that we should be incentivised to achieve this.

In view of the above, we propose the Commission reduces the targeted reduction in unplanned SAIDI and SAIFI to 5% and 2.5% respectively.

[2] Section 17.2.2. of the CPP Main Proposal
[3] Paragraph 518 of the draft decision

# Appendix B

## Further commentary CPP price path compliance in year 1

The Commission has identified (at para 559 of its Reasons Paper) two options to address the fact that we will have to set our price for the first CPP assessment period before the final CPP determination is released: (a) set prices based on the draft CPP determination (i.e. an increase of 4.4%), or (b) roll forward the current DPP (i.e. defer the impact of the CPP until the second assessment period).

We agree with the Commissions that these are the two feasible options available to us as a result of the timing associated with the final decision and pricing notification requirements. When considering the practicalities of setting prices based on the draft CPP determination, we consider that there is a potential issue under clause 8.4 of the draft determination that creates a risk that if forecast net allowable revenue decreases from the draft to the final determination, pricing against the draft will result in forecast revenue from prices that exceeds forecast net allowable revenue.

We do not see this as a significant issue as the draft determination emphasises the fact that the wash-up account ensures NPV=0 over the five years, irrespective of where we sets our prices in year one. It is more a technical price path compliance problem that can be simply addressed by a technical fix in the determination.

Our price-path compliance for 2018/19 will be determined in accordance with the requirements of the CPP determination. We will be regulated under a revenue cap, and so actual under-recovery or over-recovery relative to forecast net allowable revenue will result in a wash-up balance that we will recover from, or return to, consumers in subsequent assessment periods.

However, in addition to the wash-up process, there is a price path compliance requirement in clause 8.4 of the draft determination. That clause provides that:

***Forecast revenue from prices*** *for each* ***assessment period*** *must not exceed the* ***forecast allowable revenue*** *for the* ***assessment period***

Furthermore, clause 11.1 provides that we must, within five working days after the start of the first assessment period (i.e. by 6 April 2018), provide the Commission with a director-certified 'annual price-setting compliance statement' stating whether we has complied with clause 8.4, and indicating the prices and forecast quantities used to determine forecast revenue from prices for that period.

In short, notwithstanding the wash-up account ensures that we do not exceed MAR over the five years, it nonetheless has to show that our forecast revenue for each year does not exceed the allowable revenue for that year.

This is where we consider the problem potentially arises if we rely on the draft determination to set prices for 2018/19. Relying on the draft determination implies setting prices by:

- forecasting quantities for 2018/19; and

- setting prices that, when multiplied by our forecast quantities, result in forecast revenue that does not exceed forecast net allowable revenue in the draft determination (which is $278,559,000 for 2018/19).

There are two possible outcomes for how the final CPP determination will compare to the draft. Either: (a) the final determination will set a higher forecast net allowable revenue than the draft, or (b) the final determination will set a lower forecast net allowable revenue than the draft.

If the final CPP sets a higher forecast net allowable revenue than the draft then, assuming our quantity forecasts are reasonable, we should comply with clause 8.4 because its prices are targeting a lower allowable revenue figure. But, conversely, if the final CPP sets a lower forecast net allowable revenue than the draft, then our prices multiplied by its forecast quantities will result in forecast revenue from prices that exceeds the allowable revenue in the final CPP determination. That raises two problems:

a) We will not comply with clause 8.4 (and we will know this immediately that the CPP is released); and
b) We will have to state our non-compliance in the certified statement it provides the Commission on 6 April 2018.

The existence of the wash-up mechanism does not appear to relieve Powerco of the obligation to comply with clause 8.4. The wash-up is intended to account for divergence between forecast and actual revenue from prices, but doesn't relieve a regulated supplier of the obligation to set prices that are forecast to result in revenue that does not exceed allowable revenue.

We consider the Commissions intention is that there is flexibility in how we set prices for the first CPP assessment period and that we would remain compliant as a result of setting prices in reliance on the draft determination if it chose. This is based on the Commission highlighting the option in the draft determination. Second, the Commission says in para 560 that:

> *the MAR we will set in our final CPP decision is likely to be different from the assumption Powerco will use when it sets prices for the first year of the CPP period. The difference, however, will be accounted for in an NPV-neutral way through either a wash-up in the third year of the CPP period or a smoothing of the impact on pricing across the remaining three years of the CPP period.*

This suggests to us that the Commission is focused on ensuring that relying on the draft determination won't result in us exceeding MAR over the five year period. The wash-up mechanism ensures that. However the Commission has not focused on the possibility that we may nonetheless breach clause 8.4.

Based on the above interpretation of the situation, we propose the one simple solution would be to amend clause 8.4 as follows to clarify that we can price up to either the draft or final CPP determination, whichever is greater:

> 8.4. Subject to clause 8.4A, the **forecast revenue from prices** for each **assessment period** must not exceed the **forecast allowable revenue** for the **assessment period**.

8.4A Powerco will be deemed to comply with clause 8.4 in respect of the first **assessment period** if **forecast revenue from prices** does not exceed the greater of:

(a) **forecast allowable revenue**; or

(b) $278,559,000 + **forecast pass-through and recoverable costs** + **opening wash-up account balance**.