

5 July 2019

Dane Gunnell

Manager, Price Quality Regulation  
Commerce Commission,  
PO Box 2351,  
Wellington 6140.

By email to [regulationbranch@comcom.govt.nz](mailto:regulationbranch@comcom.govt.nz)

**Re: EDB and Transpower IM amendments**

Dear Dane

Thank you for the opportunity to submit on matters raised in the Commission's paper: **Proposed amendments to input methodologies for electricity distributors and Transpower New-Zealand Limited Reasons paper-29 May 2019 (Reasons paper)**.

Given the compressed timeframe the ENA may consider other matters to comment on in cross-submissions to this consultation, however there are two aspects of the proposed changes that we wish to comment on now, as follows.

#### [Clarification of the inclusion of fines and penalties in opex](#)

The Commission proposes to include an exclusion in the Input Methodologies from treating fines and penalties from costs. It suggests that this is a 'clarification'.

ENA submits that there is no confusion or lack of clarity about the definition of costs. The present definition of costs is absolutely clear: fines and penalties are operating expenses incurred from time to time in the course of carrying out the business of conveying electricity. There is no doubt about this current position from an accounting perspective. EDBs have always included these in reported costs (e.g., from motor vehicle related breaches, minor RMA breaches and the like).

From an ENA perspective, the proposal is a **change** in the input methodologies, not a **clarification** in an area of doubt. In that respect, any change must be applied consistent with the requirements of section 53ZB and must not be applied retrospectively.

From a policy perspective, on balance ENA agrees that fines and penalties should be borne by the EDB, however, this needs to be seen in a context of business trade-offs and potential for unintended consequences from extreme levels of risk aversion. As currently drafted, the range of penalties caught by the clause would capture a significant range of statutory penalties that should not be expected to be excluded from operating expenditures.

While EDBs are likely to operate to very low risk tolerances for breaches of the law, there is always more that can be expended to increase business controls to avoid the potential for breach. Under the opex IRIS scheme an EDB bears 26% (at likely 2020 WACC) of the NPV cost of permanent expenditures to increase controls. Logically this would be traded off against incurring 100% of the costs of fines and penalties under the proposals in the Commission's Reasons paper and therefore this arguably distorts efficient business decisions by driving the potential for excessive risk aversion. It may be socially optimal not to incur the costs of some controls to avoid the risk of breach of legislation or regulations.

On balance however, the ENA accepts that the distorted incentives created by changing the IM to exclude fines and penalties from opex is reasonable in this context. While it may drive more risk aversion and higher levels of costs in EDBs, we consider that consumers should not bear any proportion of the costs of fines and penalties, and therefore support the change to the definition of operating cost in the IM.

We would also point out that, to preserve the consistency with the IRIS mechanism and to align DPPs CPPs and ID, any changes need to be staged through time. We suggest for those EDBs on DPPs or CPPs that the change take place at the start of the next regulatory period (April 2020) and for ID from RY 2021. This will preserve alignment.

### Annual increase in revenue from price changes

While members support the notion of 'smoothing' revenue through DPP3 to avoid price shocks from the year on year changes (volumes changes, wash-ups and the like), they have concerns about the following technical issues.

- If applied on a gross revenue basis, the proposed price limits create risks that an EDB cannot recover its efficient costs – or earn a commercial return – simply because pass-through items have increased. For example, proposed changes to the Transmission Pricing Methodology may result in the net lines revenue being compromised the gross price cap and also result in other EDB incurred recoverable costs not being able to be included in revenue for some EDBs. This would undermine confidence in the regulatory framework and deter efficient investment
- The cap should therefore apply to net distribution network charges only, and exclude pass-through items such as Transpower's charges, annual inflation, and local authority rates.

- We also note that many of the recoverable costs from this period, such as IRIS and the capex wash up will take effect in year 2 of the next DPP period which will have a material effect on timely recovery of efficiency benefits under a revenue smoothing cap.

Yours sincerely

A handwritten signature in grey ink, appearing to read 'David de Boer', is positioned below the closing text.

David de Boer

Principal Advisor