Submission on

Technical and additional consultation on the electricity distribution default price-quality path from 1 April 2015

31 October 2014

1. Introduction and summary

1. Powerco welcomes the opportunity to comment on the following draft determinations and companion papers, published by the Commission on 20 October 2014:

   1.1 revised version of proposed amendments to input methodologies (first and second type) for default price-quality paths;

   1.2 revised version of proposed amendments to the input methodologies for the incremental rolling incentive scheme ('IRIS') for electricity distribution and transmission services;

   1.3 revised version of the draft determination for the default price-quality paths for electricity distributors from 1 April 2015.

2. We have seen the Electricity Networks Association's (ENA) submission and support its content.

3. Broadly, Powerco supports many of the changes the Commission has made, particularly to the quality path. We appreciate the consideration that has been given to previous submissions by the Commission. The following table summarises Powerco's recommendations across technical details and other matters.

4. We have endeavoured to complete a full review of the technical drafting, but due to the limited time, there may be issues that arise when the determinations are implemented. If this occurs we will raise these and discuss with the Commission, as per the usual processes.

Area	Recommendation
DPP Draft Determination	
Price restructures	• The Commission should specify a timeframe to approve price changes as part of its ex-ante process, for example, 10 working days. • The Commission to provide more detail in the final DPP decision paper on the consequences of there being a material difference between forecast quantities and actual quantities in the annual compliance statement.
Quality standards and incentive scheme	• Support all changes
Pass through of EA levies	• Recommend the unexpected EA levy change in 2014/15 be allowed to be recovered by either bringing the new transmission balance concept forward, or allowing specific recovery next year with the time value of money applied.
Transmission asset wash up adjustments	• Recommend the adjustment specified for Powerco's purchase of spur assets at Hinuera be removed if the forecast purchase has been removed from the reset model post Powerco's response to the Commission's 53ZD notice issued in August 2014.
Amendment to IMs for EDBs	
Definition of "change event"	• This term needs to be defined and some more context added to the final decision paper on its meaning.
Draft Determination on IRIS	
Definition of	• It would be helpful if "building block revenues" were defined.

capex wash-up	• The impacts of differences in commissioned assets on the tax expense and revaluation income building blocks should be clarified.
Spur asset purchases	• We recommend the Commission clarify and address how the acquisition of Transpower assets would be treated under the IRIS.
Applying IRIS to gas	• We support the Commission deferring its decision on applying the IRIS to the gas distribution DPP.

PART 1: DRAFT DETERMINATION FOR THE DPP

2. Introduction

5. This section comments on the companion paper, “How we propose to implement default price-quality paths for electricity distributors from 1 April 2015”, and the draft determination “Electricity Distribution Services Default Price-Quality Path Draft Determination 2015”.

6. The companion paper seeks technical review and comment on a number of areas for additional consultation such as recoverable costs, price restructures and the quality path. Powerco’s comment on these matters is below.

3. Revised approach to pass-through and recoverable costs

7. The Commission has detailed a new approach that differs from the previous draft decision published in August. The Commission is proposing a method that is similar to the one proposed by Vector, where each EDB disaggregates each of its line charge prices into two components: one that recovers allowed revenue and one that recovers pass-through and recoverable costs.

8. Powerco has reviewed this change and supports it. We agree that it will address the cash-flow issue present in the hybrid approach. It will help ensure that pass-through costs and recoverable costs are recovered in full in future and eliminate the forecasting and volume risks that exist at present in relation to these costs.

9. The Commission notes that the new proposal requires EDBs to disaggregate each of its prices into a distribution price and a pass-through and recoverable price. Powerco agrees this is reasonable.

4. Price restructures

10. The Commission has made some changes to the price restructuring requirements. The main changes the Commission has made are to:

    10.1 Add a requirement to include certain information about the price restructure in the annual compliance statement; and

    10.2 Ex-ante reporting of the price restructure to the Commission.

11. On the ex-ante reporting, the draft determination states that, with any restructuring of prices where there is no quantity for the Q_{t-2} period, the supplier must demonstrate a reasonable estimate of the quantity to the Commission at least 30 working days prior to the restructure taking place. Powerco has a number of comments on this process.

12. Firstly, we note that Powerco is contractually obliged to give retailers at least 40 days’ notice before any price change. Powerco would seek the Commission’s approval of the price change before providing notice to retailers, as, if the Commission did not approve, we would not meet our contractual obligations. The term “at least 30 days” does not preclude this, but the Commission should expect that EDBs with similar agreements with retailers will come to the Commission much earlier than 30 days.

13. Secondly, the draft determination gives no timeframe for how long the Commission will take to provide approval. This timeframe needs to be defined so EDBs have certainty that

they can meet their contractual requirements with retailers. We recommend the Commission be allowed ten working days to either approve or reject the price change.

14. Thirdly, clauses 11.7-11.8 state that, if an EDB undertakes any price re-structuring, it must provide both the estimated quantities and the actual quantities in its annual compliance statement, along with an explanation of why they differ. The Commission does not discuss its expectations of what should happen if there were a material difference between forecast and actual quantities.

15. Powerco recommends the Commission include a discussion about this in the final decision paper so EDBs fully understand the risks of price restructuring.

5. Major transactions

16. The Commission notes that concerns have been raised that the drafting around major transactions did not appropriately address transactions between a non-exempt distributor and another party who was not a non-exempt distributor. The Commission has proposed a method using a translation factor, with a number of rules around how this would work. This approach seems generally sensible. We also support rules which allow alternative approaches to be proposed by EDBs.

17. The Commission has proposed that an ICP pro-rata approach is used to allocate SAIFI and SAIDI after a transaction. We recommend the Commission changes this to the EDBs as part of the transaction agreeing the re-allocation of SAIDI and SAIFI. This is because there is significant variation in SAIDI and SAIFI per ICP across networks.

18. The Draft Determination details in Schedule 3C that any adjustments to the price path following a Major Transaction need to be demonstrated to the reasonable satisfaction of the Commission. We recommend more information is detailed on this process in the final reasons paper. For example, what information the Commission expects and timeframes for approval.

6. Quality standards and incentive scheme

19. The Commission has proposed a range of changes to the quality standards and incentive schemes. These include:

    19.1 Separation of the quality standards from the quality incentive;

    19.2 Change to the calculation of the standard deviation; and

    19.3 Changes to the way SAIDI and SAIFI boundary values are calculated.

20. Powerco supports all of these changes, which are a substantial improvement on the draft decision. We appreciate the efforts the Commission has made to understand and address EDBs' concerns.

7. Pass through of EA levies

21. The Commission notes that the Electricity Authority made a change to how it allocates its 2014/15 levy without consultation. This meant EDBs were not able to adjust their forecasting of the EA levy in the DPP to adopt the change. The way that the price path is set up means EDBs cannot recover this cost. The Commission is inviting submission on this issue.

22. In Powerco's circumstance, the increase in the levy is around $240,000 a year. Given the limited variability and usual high certainty of the EA levy, we include very little headroom in our DPP pricing calculation. Usually any major changes are indicated by the EA well in advance by consultation. We support any mechanism that will allow us to recover this amount in line with the principle of recovery of pass-through costs. We consider this justified given the lack of notice from the EA.

23. We support ENA's proposal to address this, which is a calculation of the increase in levy from the EA for each EDB. We consider this approach is straight-forward, pragmatic and conservative for consumers.

8. Assurance requirements

24. The Commission is seeking feedback on if the requirement to determine whether "proper records to enable the complete and accurate compilation" of reliability data is needed. Powerco supports removing this term as we understand a number of smaller EDBs have issues with it.

9. Transmission asset wash-up adjustment

25. The Commission has included a Transmission asset wash up adjustment to allow for the situation where assets which have been forecast for purchase in FY2015 and included in the price reset, are not purchased in the period. This adjustment is to realign the price path via the recoverable cost mechanism recognising any purchases of assets forecast to occur in FY15 that do not occur. Powerco originally forecast the purchase of assets from Transpower at Hinuera in FY15. A Transmission asset wash-up adjustment has been allowed in the draft determination for the Powerco's forecast spur asset purchases at Hinuera. Powerco advised in their response to the 53ZD notice issued in August 2014 that this forecast purchase has now been delayed until FY16.

26. Powerco recommends that if the forecast purchase has been removed from the DPP reset model, then this adjustment allowance be removed from the DPP.

PART 2: AMENDMENTS TO THE INPUT METHODOLOGIES FOR ELECTRICITY DISTRIBUTION SERVICES

10. Introduction

27. This section comments on the companion paper "How we propose to implement amendments to input methodologies for electricity lines services: First and second type", and the draft determination "Draft Electricity Distribution Input Methodology Amendments Determination 2014".

11. First type amendments

28. First type amendments are those that primarily affect the model used to set starting prices. The Commission has proposed three amendments to:

    28.1 Reflect the mid-year timing assumption in the definitions of notional deductible interest and tax;

    28.2 Correct the double deduction of the term credit spread differential allowance;

    28.3 Correct the definition of amortisation of initial differences following the aging, sale or acquisition of assets.

29. Powerco has reviewed these changes and supports them.

12. Second type amendments

30. Second type amendments cover a range of areas such as incentive schemes, wash-ups and recoverable costs. Powerco has reviewed these changes and broadly agrees with them. We have the following technical recommendations.

12.1. Definition of a change event

31. The Commission has introduced a new recoverable cost – the "reconsideration event allowance". This allows for additional costs incurred as a result of a change event. The term "change event" is not defined in the amendments paper, but as it has been bolded we assume a definition should be provided.

Clause 4.1:

"**reconsideration event allowance** means the positive or negative amount determined by the **Commission**–

> "(a) for additional net costs (over and above those provided for in a **DPP** or **CPP**) prudently incurred by an **EDB** as a result of a **change event** in the period between the **change event** and the effective date of an amendment to the **DPP determination** or **CPP determination** under clause [to be confirmed] or clause 5.6.4(2)(c);
>
> "(b) to mitigate the effect of an **error** or provision of false or misleading information on the relevant **DPP determination** or **CPP determination** under clauses [to be confirmed], [to be confirmed], 5.6.4(2)(b) or 5.6.4(4); and
>
> "(c) for the impact of a **change event**, **error**, or provision of false or misleading information on any **quality incentive adjustment**;

32. The companion paper describes a change event as a “new or revised, regulatory or legislative requirement”. Powerco supports this definition.

33. The Commission is also consulting on the policy of adopting a re-opener provision. Powerco supports this and is aware of a number of areas where legislative or regulatory change may require the use of this clause in the future.

PART 3: DRAFT DETERMINATION ON THE INCREMENTAL ROLLING INCENTIVE SCHEME (IRIS)

13. Introduction

34. This section comments on the companion paper "How we propose to implement amendments to input methodologies for electricity lines businesses subject to price-quality regulation: Incremental Rolling Incentive Scheme (IRIS)", and the draft determination "Draft Incremental Rolling Incentive Scheme Input Methodology Amendments Determination 2014".

35. The ENA has provided a number of technical drafting comments that we support. Our main concern relates to the wording of the capex IRIS mechanism.

14. Definition of the "capex wash-up"

36. Clause 3.3.11 (1) defines the 'capex wash-up' in relation to the differences in a series of building block revenues when applying actual commissioned assets instead of forecast commissioned assets for the previous regulatory period. The IM amendments do not define which building blocks are included in 'building block revenues', but we assume from the absence of a definition that this incorporates all building blocks. It would aid the interpretation and implementation of this provision if 'building block revenues' were defined.

37. We note that the models supplied by the Commission that show the impact of applying the proposed amendments only factor in two building blocks into their calculation: depreciation and Opening RAB * WACC. The models ignore the impacts of differences in commissioned assets on the tax expense and the revaluation income building blocks.

38. The models provided by the Commission therefore do not provide sufficient detail to allow EDBs to thoroughly understand how the capex IRIS will be implemented in practice.

39. The IM amendments also do not specify how the 'building block revenues' will be measured in terms of Building Blocks Allowable Revenue before Tax or by using another measure. We recommend the drafting of the proposed amendments to the IRIS be better defined in order to allow EDBs to understand how this important mechanism will be operated in practice.

40. We note that the ENA submitted this point in their submission on 15 September (paras. 147-148).

15. Clarification of how acquisition of Transpower assets affects the capex IRIS

41. We note that PwC (on behalf of 19 EDBs) raised the issue in a previous submission that the IRIS proposals seem to ignore the impact of spur asset acquisitions from Transpower[1]. As there are no opex and capex allowances in the price path for spur asset purchases, the IRIS calculations should exclude any spur asset opex or capex.

[1] PwC submission on "Proposed amendments to input methodologies: IRIS", 29 August 2014, p. 11.

42. We recommend the Commission clarify and address how the acquisition of Transpower assets would be treated under the IRIS.

43. For example, our understanding, from reading the draft determination, is that such an acquisition will feed into the capex IRIS by adding to the “value of commissioned assets” that is used to generate revenues that are compared to the revenues implied by forecast capex (as the definition of “value of commissioned assets” in the IMs (clause 2.2.11) looks like it requires the EDB to use the unallocated opening RAB value of the assets (when buying the assets from another regulated supplier).

44. We understand this may be part of the further work the Commission is considering on how transactions impact the IRIS.

16. Applying the IRIS to gas distribution

45. We note that, for gas pipeline businesses, the Commission is not consulting on a revised version of the drafting of the determination until after 30 November 2014, as it has decided to defer a final decision on any amendments to the IRIS for gas pipeline services until early in 2015. Powerco is comfortable with this approach.