CENTRALINES LIMITED

2 Peel Street, Waipukurau
Phone: 06 858 7770
Fax: 06 858 6601
http://www.centralines.co.nz
Email: centralines@centralines.co.nz

30 August 2014

John McLaren
Manager (Part 4)
Regulation Branch
PO Box 2351
Wellington 6140

Dear John

Cross Submission - Alternative rates of change in Default Price Path Determination

This letter represents Centralines' cross-submission on the ENA's submission on the Commerce Commission's Paper *Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015, 4 July 2014.* The ENA submitted as follows:

65. The Main Policy Paper proposes alternative rates of change for some ENBs (refer paragraph 4.24). These alternative rates of change defer the recovery of the revenue requirement until later in the regulatory period; however the total revenue requirement is able to be recovered in the five year regulatory period.

66. No alternative rates of change are proposed where the initial price step is negative, irrespective of the magnitude of the step.

67. The ENA has considered the method adopted for determining the alternative rates of change (as set out in Attachment C to the Main Policy Paper and relevant supporting models[1]) and make the following observations:

- *a)* The price cap used to determine whether an alternative rate of change applies is 5%. The Main Policy Paper does not explain how this cap was determined. We note that 5% is significantly lower than the caps that were considered for the 2012 reset (where a cap of 15% was initially proposed, and subsequently reduced to 10% for the final decision). As distribution prices make up approximately one third of delivered electricity prices, the price change impact on consumers is much less than 5%

- *b)* The impact of specifying large rates of change is that prices at the end of the regulatory period are substantially higher than at the beginning, and thus

[1] Model 10 – price changes draft EDB reset; Model 11 – revenue changes draft EDB reset; Model 15 – Claw back draft EDB reset

substantially higher than the underlying building blocks allowable revenue. This may result in a significant price step correction at the next regulatory period which we consider should be mitigated if possible. One way of doing this is to increase the cap at the beginning of the regulatory period.

68. We consider that where an alternative X factor is proposed, input from the relevant ENB should be considered before a final decision is made. This will allow particular customer and network demands to be considered before final price paths are determined.

Centralines supports the ENA submission that the Commission should seek input from the relevant distributor on the appropriate alternative rate of change. This letter sets out an approach which Centralines considers is in the long-term interests of its consumers.

Centralines considers it is appropriate for the Commission's to set the rate of change to smooth price increases over the regulatory period where an initial starting price adjustment would cause undue price shock to consumers. The Commission has stated that in setting the adjustment rate:

> In addition, we propose to take into account deferred revenue recovery when considering whether an alternative rate of change would be necessary or desirable.[100] This is because we are interested in the impact of our decision in aggregate on consumers, rather than any individual aspect, eg, the change in starting price.

Because Centralines had revenue recovery deferred from the current regulatory period, the proposed annual adjustment for Centralines is equivalent to CPI+6%. In nominal terms over the five year period, this would equate to around 45% increase in distribution charges on Centralines' network. We also note that Centralines already has very high charges due to its sparse population base, ranked third and fourth respectively in New Zealand for revenue per kWh and revenue per ICP in PwC's 2013 Information Disclosure Compendium.

Centralines considers that even though the Commission is proposing a much lower limit on price changes than in the current regulatory period[2], the proposed allowed price increases would still cause community hardship, particularly in the current economic climate. Although Centralines is a consumed-owned EDB,[3] because of the requirement on distributors to perform as a commercial entity, Centralines considers they must utilise a significant proportion of permitted price increases in order to meet the company's obligations, so we do not consider it an option for Centralines to forego taking any permitted price increase.

Accordingly, Centralines proposes that the Commission cap overall increases for Centralines at CPI+2% inclusive of the impacts of claw-back amounts held over from the current regulatory period. Adopting such a cap would mean that Centralines would again under-recover its required revenues, so the Commission would need to provide for claw-back of this under-recovery in the subsequent 2020-2025 regulatory period. The proposal to adopt CPI+2% would ensure distribution price increases are more modest, but still provide for a gradual increase towards revenues covering Centralines' costs.

The Commission may be aware that there is a proposal for a significant water storage scheme to be developed in Central Hawke's Bay.[4] If it proceeds, it would change the economic prospects for the region significantly, creating new employment and demand for electricity. Centralines

---

2 The current cap is 10%.

3 Centralines is not exempt from DPP regulation because two trustees are appointed rather than elected.

4 For details on the proposed Ruataniwha scheme see http://www.hbrc.govt.nz/Hawkes-Bay/regional_development/hbric/Pages/rws.aspx

submits it would be preferable to target the recovery of its costs when economic conditions are more favourable, which would be achieved by adopting Centralines proposal.

Centralines submits that the Commission should accept this proposal as being in the best interests of consumers (including through their ultimate ownership interest in the company).

In closing, Centralines would also like to comment on the Commission's assumption that electricity demand per user will stabilise, after recent observed declines. The Commission's reasons are that economic growth is increasing, electric vehicles are becoming viable and electricity price increases are moderating.

Centralines submits that it is important that the Commission does not generalise from factors that might be relevant to Auckland or Wellington. Incomes are not rising in Central Hawke's Bay, electric vehicles are unlikely to be taken up to any degree, and the distribution component of electricity prices in Central Hawke's Bay will increase substantially according to your own proposals. Even under Centralines' alternative proposal retail prices would still increase in real terms over the period by around 6%, even if retail charges remain constant. Accordingly, Centralines submits that it would be appropriate to assume electricity use per consumer will decline in Central Hawke's Bay. The ENA's submission that the Commission should adopt an assumption of 1% per annum decline in residential electricity use would be a reasonable starting point, although it may still be relatively optimistic for Central Hawke's Bay.

Thank you for considering these points. Centralines looks forward to receiving the Commission's final decisions.

Yours sincerely

Nathan Strong
General Manager Business Assurance