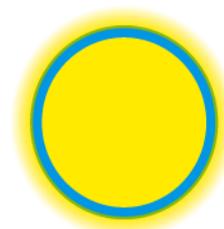


10 April 2015

John McLaren  
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Commerce Commission  
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**POWERCO**



Dear John

**Re: Feedback on process for resetting default price-quality paths for electricity distributors**

This is Powerco Limited's submission on the Commerce Commission's request for feedback on the process the Commission undertook to reset the default price-quality paths (DPPs) for electricity distributors (EDBs). We support the Commission's initiative to seek feedback on the recent DPP reset process. Powerco has seen the Electricity Networks Association's submission and agrees with it.

**Positive aspects of the process**

We begin our submission with observations on some positive aspects of the process, as it is important that these features are not lost from subsequent reviews:

Engagement by the Commission

We appreciated the Commission's support of and engagement with the industry working groups and look forward to further constructive work via such groups in the future. Areas where there appears to be substantial scope for further effort by working groups include:

- demand forecasting, given the multiple factors currently affecting electricity demand and the significant impact that the demand forecast has on the DPP;
- further refinement of the approach to capex forecasting;
- refinement of the approach taken to the quality path including customer engagement;
- the incentive framework.

Access to working models

The supporting material that the Commission has produced was clear and user friendly, and having access to the Commission's working models was very useful. However, there was a lot of overlap between models and supporting materials and it would be helpful if the Commission could provide an overview sheet to illustrate how the linked documents and models relate to one another. A further aid to understanding would be

step-by-step documentation of the calculation processes that the Commission has used to achieve its final results.

#### Q&A workshops

We appreciate the Commission's initiative to host question and answer sessions on the financial models. However, we feel that some of the potential value is lost by spending considerable time going over the models line by line. We suggest that more value could be gained by focusing on targeted questions about perceived problems with the models and how they work, particularly how they relate to the real world.

#### Information requests

With respect to information requests, we recommend that, when making a request, the Commission explain how it plans to use the information. This advice would help EDBs to frame their responses in ways that are most likely to be of practical use to the Commission.

### **Recommendations for improvements to the process**

#### Certainty of process, timeline and decision-making framework

As we have highlighted in previous submissions, uncertainty around regulatory processes, timelines and the decision-making framework applied by the Commission is a key concern for Powerco and, we would argue, for any regulated business. One of the least positive aspects of the recent DPP reset process is the uncertainty created by the introduction of disruptive and unexpected elements to the process, for example, the Commission's decision to undertake an out of cycle review of the WACC percentile. This concern has been well canvassed in previous submissions.

A further example (albeit less material and concerning) was the Commission's decision to introduce a capex incremental rolling incentive scheme (IRIS) late in the DPP reset process. In this case, Powerco's concern was more with there being insufficient time to test its application to a range of likely real world situations rather than concern about the principle of the incentive per se.

The concept of using SAIFI as the SAIDI major event day trigger was another initiative proposed as part of the draft determination that was completely unexpected and which, if implemented, would have had very serious negative implications for Powerco and other EDBs. Although this issue was ultimately resolved satisfactorily, we believe that introducing "left field" concepts of this sort as part of a draft determination is a poor process, as it puts intense pressure on EDBs and the Commission to assess the often complex issues associated with the new proposals in a very short timeframe, and consequently greatly increases the risk of an inappropriate outcome.

In our view, major changes should be signalled well ahead of time and sufficient time should be allowed to enable a thorough review of their implications in a range of credible circumstances and analysis of the possible "knock-on" effects they might have on other parts of the regulatory framework. In some cases this may mean delaying the introduction of a change to the next regulatory period.

#### Capex forecasting approach

With respect to the setting of capex allowances, we believe that more work should have been done to evaluate the appropriateness of EDBs' asset management plans (AMPs) as a satisfactory basis for setting capex allowances. We appreciate that the DPP is predicated on a low cost forecasting approach, but there seems to have been too much emphasis on historical expenditure and not enough on the likely need to raise future capex levels in order to maintain future quality performance given the age profiles of most EDB assets, which are heavily weighted towards assets installed in the 1950s and 1960s. We know that the Commission's view is that a CPP application is the appropriate

solution for those EDBs that foresee the need for a step change in investment but this is an expensive route to take, particularly if the drivers for a company's forecast of investment are clear.

### **Other matters**

#### Error correction and materiality thresholds

In relation to reconsideration of a DPP in response to an error, the definition of "error" in clause 4.5.1 of the Input Methodologies (IMs) currently means that the materiality threshold, that must be met before the DPP may be reconsidered, is set such that the incorrect data relied on must have an effect on the price path at least equivalent to 1% of the aggregated allowable notional revenue for the disclosure years affected by the incorrect data. For Powerco this means that the effect of the error must be equivalent to at least \$2.5million per annum. In our view, this is too high a threshold, especially if an error is outside of the control of an EDB. We would recommend that the definition of "error" be reviewed with the intention of lowering the materiality threshold, as part of the upcoming review of the IMs.

#### Setting realistic timeframes

As a final observation, we note that many of the concerns we have raised above are directly related to the very tight timeframes allowed for the consideration of what have sometimes been very material proposed modifications to the DPP. This point is pertinent to the Commission's recent proposal to bring forward, by 12 months, the review date for the Part 4 Input Methodologies. One of the reasons put forward by Powerco for preferring that the Commission retain the December 2017 timing was to allow sufficient time for a robust and thoroughgoing review.

Yours sincerely



Richard Fletcher  
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