Response to the Commerce Commission

on the

Request for feedback on the process for resetting default price-quality paths for electricity distributors

PwC submission on behalf of group of 19 EDBs

Final

10 April 2015
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feedback on the process for resetting the default price-quality paths for electricity distributors</td>
<td>2</td>
</tr>
<tr>
<td>Summary</td>
<td>4</td>
</tr>
<tr>
<td>Key features of the process</td>
<td>5</td>
</tr>
<tr>
<td>ENA working groups</td>
<td>5</td>
</tr>
<tr>
<td>Early release of the financial model</td>
<td>5</td>
</tr>
<tr>
<td>Engagement with ENA representatives on information requests</td>
<td>6</td>
</tr>
<tr>
<td>Analyst briefings</td>
<td>6</td>
</tr>
<tr>
<td>Sequencing of consultation processes</td>
<td>7</td>
</tr>
<tr>
<td>Other areas of interest</td>
<td>8</td>
</tr>
<tr>
<td>General approach to consultation</td>
<td>8</td>
</tr>
<tr>
<td>Scope of changes introduced</td>
<td>8</td>
</tr>
<tr>
<td>Information about the process</td>
<td>9</td>
</tr>
</tbody>
</table>
Feedback on the process for resetting the default price-quality paths for electricity distributors

1. This paper responds to the Commerce Commission’s (the Commission’s) request for feedback on the process for resetting the default price-quality paths (DPPs) for Electricity Distribution Businesses, dated 27 February 2015 (the Feedback Request). This response has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 19 Electricity Distribution Businesses (EDBs).

- Alpine Energy Limited
- Aurora Energy Limited
- Buller Electricity Limited
- Eastland Network Limited
- EA Networks
- Electricity Invercargill Limited
- Horizon Energy Distribution Limited
- MainPower New Zealand Limited
- Marlborough Lines Limited
- Nelson Electricity Limited
- Network Tasman Limited
- Network Waitaki Limited
- Northpower Limited
- OtagoNet Joint Venture
- The Lines Company Limited
- The Power Company Limited
- Top Energy Limited
- Waipa Networks Limited
- Westpower Limited.

2. Together these businesses supply 26% of electricity consumers, maintain 44% of total distribution network length and service 72% of the total network supply area in New Zealand. They include both consumer owned and non-consumer owned businesses, and urban and rural networks located in both the North and South Islands.
3. The Feedback Request sets out the key features of the DPP reset process and poses specific questions for consideration by respondents. The 19 EDBs which support this paper welcome the opportunity to provide feedback on the DPP reset process, and this response largely follows the structure of the Feedback Request. We also consider the parallel Input Methodology (IM) work streams which were undertaken over the same period, and ultimately influenced the final DPP decisions.

4. We trust this response provides useful input for the Commission in considering how future consultation processes (including DPP and non DPP consultations) may be undertaken. We would be happy to answer any questions you may have regarding this response.

5. The primary contact for this submission is:

   Lynne Taylor  
   Director  
   PricewaterhouseCoopers  
   lynne.taylor@nz.pwc.com  
   09 355 8573
Summary

6. The following points summarise our feedback on the DPP reset process, and are explained more fully in the body of this document.

Key features of the process
7. The EDBs which support this paper:
   a) Note that the ENA working groups were an important feature of the reset, which contributed positively to a number of the core developments which were able to be included in the DPP.
   b) Support further use of industry working groups to assist with developments to price-quality paths and information disclosure requirements. We suggest that in future, working groups may be enhanced by inputs from other stakeholders such as consumers.
   c) Note that ultimately however the Commission has responsibility for its regulatory decisions.
   d) Appreciate the Commission’s efforts to make its DPP models as user friendly as possible.
   e) Note that there is potential for improved audit trails in the models, which clearly demonstrate how EDB specific inputs are used to generate outputs – at each stage of the modelling process.
   f) Support the suggestion for EDBs to undertake reviews of the models, prior to final determinations, to ensure their data is being applied as intended.
   g) Support efforts to ensure that any data requests are as timely and targeted as possible, to minimise compliance costs and ensure they are fit for purpose.
   h) Note that while analyst briefings are of limited benefit to EDBs, they are an important way for the Commissioners to engage more widely with stakeholders, and should be retained.
   i) Believe that the volume of consultation material issued at the draft decision stage was too large, and the consultation periods too short, to enable complete and meaningful consultation. This was heavily influenced by the parallel IM consultations.
   j) Suggest that future consultations could schedule some components of the reset decisions before others, plus other consultation steps after the draft decision phase (such as determination drafting), in addition to ensuring substantive IM changes fall outside of the core DPP reset timetable.

Other areas of interest
8. While the consultation papers were generally of a high quality we believe improvements could be achieved:
   a) By ensuring the determination drafting is unambiguous, able to be implemented, and consistent with the underlying policy intent.
   b) By ensuring explanations in the consultation papers are as complete as possible, including an explanation of the options considered and the justification for the proposed option.

9. Finally we acknowledge that the reset involved substantial work streams, but believe this work load is manageable if the refinements suggested in this document are adopted for future resets.
Key features of the process

ENA working groups

10. The ENA’s three DPP working groups (Quality of Supply, Energy Efficiency and Forecasting) considered discrete topics where there was potential for introducing new and improved features to the DPP. As a result, substantive research and development was undertaken which was able to be introduced into the DPP reset process well before the draft decision stage. In our view this timing was critical to the success of these working groups, which we fully support.

11. By drawing on the technical expertise of EDBs, the working groups were able to test whether and how DPP developments could be introduced. Some of the EDBs which support this paper contributed their time to the working groups, and they found the process constructive and beneficial. In our view the key features of the working groups which contributed to their success included:

   a) agreeing terms of reference with the ENA, and seeking comment on them from the Commission;
   b) including Commission and other policy/regulatory observers in working group meetings;
   c) seeking expert input and external secretariat assistance where necessary;
   d) defining clear deliverables and timelines; and
   e) undertaking robust analysis which drew on detailed data provided by all non-exempt EDBs.

12. We would support further use of industry working groups to assist with developments to price-quality paths and information disclosure requirements. We suggest that in future, working groups may be enhanced by inputs from other stakeholders such as consumers.

13. We note that in paragraph A6 of the Feedback Request, it is suggested that the focus of the forecasting working group may have been widened to include revenue growth forecasting. While we agree that the revenue growth aspect of the DPP forecasting has been problematic, we note that this challenge was identified in earlier DPP resets and highlighted by submitters to the Commission well in advance of the reset.

14. While we support the use of industry Working Groups to focus on discrete topics, we believe that the Commission has ultimate responsibility for its regulatory decisions. Accordingly, we were disappointed that the revenue growth modelling approach had not been further developed by the Commission prior to the draft decision.

15. If the DPP does maintain the price path as the form of control for future resets, then we believe that this is one topic which may benefit from an industry working group approach.

Early release of the financial model

16. The EDBs which support this submission appreciate the Commission’s efforts in making the DPP models as available and as understandable as possible. We acknowledge the considerable improvements which were made to the DPP models for the 2015 reset, and that the core financial model was released early in the process.

17. The EDBs which support this submission particularly appreciated the inclusion of a ‘change log’ in the models, the question and answer sessions and the Excel readable versions of the STATA
models. We also acknowledge that the Commission responded positively to feedback on the models during the consultation process.

18. We note that at the draft decision stage, the timing of the workshop was perhaps too soon, mainly because it was only at this stage that the full suite of models was made available. Prior to that only the core financial model had been released — and that did not include data which was relevant to the DPP decision. The main focus of non-exempt EDBs at that stage was on understanding the data inputs that were specific to their business, and how these were ultimately reflected in the draft price paths and quality standards.

19. We suggest that the workshop could have been more valuable if it was delayed slightly and/or, there was a more explicit audit trail for each EDB which showed how key inputs were used to generate the outputs, of each model. For example there was some confusion about the capex scaling approach, the treatment of spur assets, the quality standard calculations, etc. which may have been avoided with more transparency about how EDB specific data was used.

20. In paragraph A10 of the Feedback Request, there is a suggestion that EDBs could have been more involved in reviewing the final detail of the models, to avoid unanticipated errors. We support this suggestion which we believe will help to ensure that EDB specific data will be applied as intended in forming the final regulatory decisions.

Engagement with ENA representatives on information requests

21. The information requests for DPP resets have required a significant level of resource from EDBs over the past few years, including audit and Director input. Accordingly the non-exempt EDBs which support this paper are interested in any improvements which may be made to this part of the DPP reset process.

22. Accordingly we support a process which:

   a) signals the likely timing and content of information requests as early as possible;

   b) seeks to avoid periods where EDBs and auditors are involved in other compliance activities;

   c) uses as much publicly available information (such as information disclosures) as possible; and

   d) tests the content and explanations included in the information request with EDBs prior to the formal request being made, to ensure they are accurate, unambiguous and fit for purpose.

23. We agree that the ENA can usefully assist the Commission at the design and communication phases of information requests. We also support the Commission undertaking more informal information requests or clarifications with individual EDBs on an as needs basis.

Analyst briefings

24. While we appreciate the intent behind the analyst briefings, individual EDBs find the briefing sessions themselves of limited value. The analyst briefings are delivered to a wide range of stakeholders and accordingly include background material and reasonably high level descriptions which are well understood by those EDBs subject to price-quality regulation.

25. Notwithstanding this observation, we believe that the analyst briefings are a useful part of the process, because they enable the Commission to engage more widely on its decisions. They also provide an opportunity for direct engagement with Commissioners, who are generally not as
available during other steps in the process. In addition, the briefing presentation is a useful reference document for EDBs, as they may also have cause to explain the decision to a wider group of stakeholders.

**Sequencing of consultation processes**

26. As noted in paragraph A14 of the Feedback Request, the DPP consultation coincided with consultation on a number of IM amendments. These included DPP specific IM amendments (referred to as Type 1 and Type 2), an amended Incremental Rolling Incentive Scheme (IRIS) IM to apply to the DPP for the first time, and an amendment to the cost of capital IM used to set regulated price paths.

27. Unfortunately, all of these consultations culminated in draft decision papers and accompanying expert reports, models and draft determinations which were released over a four week period from late June into July. While the submission deadlines were staggered through July and August, the consultation periods overlapped, and there were multiple submissions required to be submitted on key dates.

28. The EDB which support this paper believe that this volume of material was too large, and the consultation periods too short, to enable complete and meaningful consultation. Most EDBs do not have dedicated regulatory teams or even a dedicated regulatory person. While the Commission is able to allocate different work streams to different teams, this is not the reality for EDBs, who cannot readily resource up and down to meet the ebbs and flows of the regulatory calendar.

29. We note that early consultation papers had signalled the likely timing of the key consultation steps; however the reality was somewhat different to what was signalled in advance. This was due to the additional IM work streams which were omitted from the initial papers, and the breadth and depth of the topics which were included in the reset.

30. As we have previously submitted, we question why substantive changes to IMs (such as the cost of capital percentile and the IRIS amendments) were introduced in 2014, less than four years after the IMs were first determined and well before the statutory seven year review deadline. These consultations added significant complexity to the DPP reset. We note that many of the EDBs which are represented by this submission did not support these IM amendments.

31. We acknowledge that the Type 1 and Type 2 amendments were necessary to give effect to the proposed price path and quality standards, and to correct for errors and omissions in the existing IMs.

32. We believe that the sequencing of the consultations was sub-optimal as they all came together at the same time. We expect that this timing was as challenging for the Commission as it was for EDBs; however we believe that a more spread out consultation process would have greatly improved the DPP reset. Accordingly we suggest that, in addition to scheduling substantive IM changes outside of the DPP reset process, future consultation timetables could:

   a) schedule some components of the reset before others (such as the quality standard or the productivity analysis); and

   b) schedule some components of the reset after the draft decision phase (such as the determination drafting or the compliance requirements).

33. We support the consultation on the determination drafting and believe that a two-step consultation is required, with a final step shortly before the final determination is made. The technical drafting is complex, and ensuing any errors or ambiguities are removed prior to gazetting is critical for minimising compliance costs to EDBs.
Other areas of interest

General approach to consultation

34. Our comments on the timing and volume of consultation material were included in the previous section. We generally believe that the consultation material was of a high quality. Our one exception to this was the first drafts of the determinations themselves, which appeared to have been produced too early in the process, and without sufficient consideration of the practical implementation challenges of the proposals.

35. We understand that determination drafting requires a particular attention to detail, however it is important that the determinations are unambiguous, able to be implemented in practice and consistent with the policy intent. We acknowledge the efforts invested by the ENA in its submissions on the drafting of the IM and DPP determinations during the latter part of 2014.

36. We understand the rationale for breaking the core topics out into different consultation papers, but felt that this resulted in some repetition and overlap, which could have been avoided. Given the papers had similar submission deadlines this was not as useful as it could have been.

37. We also felt that the explanations in some areas were not as detailed as they could have been (ie: it was necessary to look into the models to work out what was actually proposed). In addition the rationale for some of the draft decisions was not fully explained — ie: what alternatives had been considered, and why the proposed option had been chosen. We note that the areas where the explanations were less robust tended to be the areas where submitters focussed their attention, (such as the definition of the quality standard, the extreme event day normalisation for SAIDI and SAIFI and the base year for opex) and subsequently the draft decisions were modified.

Scope of changes introduced

38. We note that the DPP was further developed as a result of the reset, including:

   a) improved compliance (including removal of recoverable and pass through costs from the price path);
   
   b) introducing quality of supply incentives;
   
   c) introducing energy efficiency incentives;
   
   d) refinements to the forecasting of real revenue, opex and capex; and
   
   e) more clarity as to the incentives associated with the transfer of transmission assets to EDBs.

39. Some of these were substantial work streams, and as noted earlier, a number of them were aided by the ENA’s working groups. We acknowledge that this represented a substantial work load, and as suggested earlier, we believe that future resets could benefit from:

   a) continued use of working groups for discrete DPP developments;
   
   b) spreading out the key consultations steps on different topics; and
   
   c) scheduling substantive IM amendments outside of the core DPP reset timetable.
Information about the process

40. Finally, we believe that the process was well communicated throughout the DPP reset, although the one improvement we suggest is to also include information about other consultation processes (such as IMs and information disclosure) which are expected to occur at the same time.