ERANZ

Electricity Retailers' Association of New Zealand

SUBMISSION TO THE COMMERCE COMMISSION ON UPDATED DECISION ON COST ALLOCATION FOR ELECTRICITY DISTRIBUTION BUSINESSES

13 OCTOBER 2016

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Contents

Executive Summary

In response to submissions in respect of the impact and appropriate regulatory treatment of emerging technologies, the Commission has proposed removing ACAM as a stand-alone cost allocation methodology for electricity distribution and gas pipeline businesses. It has done so stating that this will “ensure that consumers are not permanently precluded from sharing in efficiency gains from suppliers providing regulated and unregulated services together”. We support the Commission’s proposal in this regard, as it is consistent with the arguments put forward by ERANZ in our submission of 4 August 2016.

Removal of ACAM is a step in the right direction, but not sufficient in itself to ensure consumers enjoy the full benefits of new technologies

The Commission’s proposal is to be welcomed as a recognition that the current cost allocation options facilitate adverse behaviours by regulated suppliers at the expense of consumers of the regulated service. For the reasons identified in ERANZ’s previous submission we submit that such behaviour also has the potential to harm consumers of unregulated services.

The clear benefits to consumers of the Commission’s approach are:

- limiting the period over which regulated suppliers are able to cross-subsidise their unregulated/competitive market activities, while not sharing the efficiency benefits with consumers of the regulated service;

- the optional variation to the accounting-based allocation approach (“OVABAA”) permits deviation from the accounting-based allocation approach (“ABAA”) only to the extent necessary to ensure that the investment is not unduly deterred (solely as a result of the cost and asset allocation methodologies), thus meeting the requirement of s52T(3) of the Commerce Act 1986 (“the Act”); and

- the OVABAA arrangements require director certification that use of a cost allocation other than ABAA is justified, in terms of s52T(3).

However, to minimise the cost and maximise the benefits to consumers of the regulated service, the Commission will need to closely monitor the circumstances under which the OVABAA option is utilised going forward. This should include development and application of clear guidelines as justification for using OVABAA and especially over what timeframe this can be sustained. Whilst we recognise that the Commission has stated that ring-fencing will be dealt with in their final decisions on the IM review in December 2016, we reiterate that given the issue raised above, arms-length arrangements will produce better information, better prices, and lower transaction costs, ultimately to the betterment of consumers[1].

[1] Refer Castalia Report to ERANZ August 2016, attached to ERANZ submission to Commerce Commission on Input Methodologies for Emerging Technologies, 4 August 2016

The Commission's proposal to remove ACAM satisfies s52T(3) and does not unduly deter investment by a supplier of regulated goods or services in the provision of other goods or services

The Commission's proposed approach still allows regulated suppliers to remain in a privileged position in terms of the risk of competing in unregulated markets. Even under the Commission's proposal EDBs still have the ability to make investments that provide them access to unregulated/competitive markets while effectively having the risk underwritten by consumers of the regulated service and a guaranteed return. The persistence of a privileged position for regulated suppliers entering unregulated markets therefore confirms removal of ACAM should not unduly deter investment in other areas.

Likely costs of implementing the proposal to remove ACAM

We agree with the Commission's proposal that the costs borne by EDBs of changing cost allocation methods should be low.

It would seem to be imprudent for a business to enter a new business line or market without an understanding of the cost structure of servicing that business/market and how much of those costs the business/market is covering in the short, medium and long terms (i..e some basis on which management believes it is taking a value creating decision). It is the understanding of ERANZ based on expert advice that the changes required to accounting systems are likely to be minor.

The Commission has stated that it might be open to compensation or allowing exceptions for some EDBs to continue to use ACAM. We consider that any allowance to continue to use ACAM, such as smaller EDBs, would be a poor option as the costs to move from ACAM are low for all regulated suppliers and are significantly less than the share of benefits that consumers of the regulated service could receive. We also contend that it should not be necessary to compensate regulated suppliers for the cost of migration from ACAM to another allocation methodology as the cost is likely to be low. Whilst providing for compensation would effectively take away the basis for any opposition to the removal of ACAM, on the basis of cost to change, if it were to be considered we submit that compensation should be limited to cases where there is evidence the additional costs exceed a certain materiality threshold (relative to the size of the regulated supplier).

Impact on investment and commercial arrangements, particularly UFB

The view that moving from ACAM to ABAA or OVABAA will have a negative effect on EDBs incentives to look for other opportunities, especially partnering with UFB service providers, is one to be challenged.

The contention that regulated suppliers might have entered into commercial arrangements to share assets "with the ACAM threshold in mind", including UFB, suggests that regulated suppliers:

- may have had or have no intention of sharing efficiency gains from economies of scope with consumers of the regulated service - which seems inconsistent with the Part 4 purpose; and

- may have been short sighted in not considering that other opportunities to exploit economies of scope or otherwise diversify their businesses might arise that would eventually trigger the thresholds under the extant regulations requiring a switch away from ACAM and to ABAA.

Regulated supplier opposition to removal of ACAM as a stand-alone option may, in large part, be driven by concerns about the profitability of their unregulated activities. OVABAA provides a better pathway for regulated suppliers to invest in unregulated activities by minimising the extent of cross-subsidy from consumers of the regulated service and ensuring that consumers of the regulated service share in the benefits of efficiencies (including through lower prices

Research and trialing new technologies

Regulated suppliers should undertake R&D in relation to the impact emerging technologies may have on their networks, but questions need to be asked as to whether the research is genuinely focused on the impact on the network, rather than the opportunities to provide unregulated services and derive unregulated income; and at what point does a research trial cease being research and start being 'commercialised'? In essence, these questions relate to the extent that these are costs that consumers of the regulated service should face, with no other option than to bear them, and the distortionary effect it could have on the competitive market, especially looking at how the outcomes of such trials are treated.

ERANZ suggests that it might be helpful if the Commission provided some guidelines as to what it regarded as research and development appropriate to the network service as opposed to being for the benefit of the network company in developing its unregulated business.

Timing of implementation

ERANZ contends that the change in allocation methodology options should apply from the 2017/18 disclosure year. This would give the Commission the option of relying on more than one year's data, or relying on 2017/18 rather than 2018/19, if it thought this preferable, for the 2020 price reset for electricity distribution services. Applying the change a year earlier would also mean that any implementation issues can be flushed out in that first year. This is better to happen in 2017/18 rather than 2018/19 when the Commission is hoping to rely on the data for price reset purposes.

Practical implications of OVABAA

The Commission should give consideration to the extent of guidance available on the application of OVABAA. For example, a guidance note could reaffirm the meanings of 'unduly deterred' and 'solely'. Guidance as to what supporting information is necessary or appropriate would also be helpful. It is also likely that regulated suppliers will want to understand the extent of confidentiality that might be afforded to some of the information provided.

Introduction

In the ERANZ submission of 4 August to the Commerce Commission on Input Methodologies for Emerging Technologies, we submitted that if the Commission still chose not to take steps to maintain the separation between monopoly lines assets and the competitive market for emerging technology in its IM, that "the Commission should remove ACAM as a separate methodology option." We therefore welcome the proposal by the Commission. We also welcome the opportunity to provide further views and evidence in support of that approach.

In this submission we will first address why we support the Commission's proposal as a good first step, but also explain why it is not sufficient in and of itself, and it does not address concerns that without an arms-length or ring-fencing solution adverse impacts may occur to the detriment of competition and the consumer.

We then consider a range of issues likely to be raised to challenge the Commission's proposal, particularly issues relating to the costs of implementing the proposed allocation approaches, the impact on existing (and future) commercial arrangements, and the impact on research and development.

The final part of our submission addresses implementation issues such as timing and guidance that might be useful for regulated suppliers. We submit that an earlier timeframe for implementation should be considered. This is for the reasons that the change required may not be unduly difficult or costly, a delay in application may actually constrain the Commission from using sufficient data periods to determine the 2020 price reset, and an earlier implementation date allows more time to flush out any issues ahead of the price reset.

ERANZ supports the proposal to remove the ACAM

In response to submissions in respect of the impact and appropriate regulatory treatment of emerging technologies, the Commission has proposed removing ACAM as a stand-alone cost allocation methodology for electricity distribution and gas pipeline businesses.[2] ERANZ submitted in favour of that approach and submitted that ACAM's only relevance should be as the absolute limit to which regulated suppliers can vary from ABAA in order for a non-regulated investment to not be unduly deterred.[3]

Removal of ACAM is a step in the right direction, but not sufficient in itself to ensure consumers enjoy the full benefits of new technologies

There is a general consensus that emerging technologies will have the capacity to provide significant benefits to consumers through new services or combinations of services, reduced costs, and revised ways of doing business, but also that these changes present a range of challenges and opportunities for network providers and incumbent and emerging markets.[4]

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[2] Input methodologies review: Updated draft decision on cost allocation for electricity distribution and gas pipeline businesses; Commerce Commission; 22 September 2016

[3] *Ibid n2, para 34*

[4] For example, Commerce Commission; Input Methodologies review draft decisions - Topic 3: The future impact of emerging technologies in the energy sector; 16 June 2016; para 13. ENA; Input methodologies review - topic paper 3, impact of emerging technologies - Submission; 4 August 2016 paras 4 and 5. AEMC;

Realising these benefits is best achieved by ensuring that the provision of services through competitive markets is not stifled and that monopoly providers do not inefficiently cross-subsidise their offerings of new services, especially where those monopoly providers have advantages as a result of the regulatory environment. We strongly submit that regulated entities should not be able to take decisions to make investments to enter into competitive markets when the commercial risk is underwritten by consumers of the regulated service. Businesses operating in workably competitive markets do not have advantages of this nature.

ERANZ's preferred approach to the appropriate regulatory treatment of emerging technology is to provide for effective "arms-length" or "ring-fencing" mechanisms to separate potentially competitive activities from monopoly activities.[5] Whilst we recognise that the Commission has stated that ring-fencing will be dealt with in their final decisions on the IM review in December 2016, we reiterate that given the issue raised above, arms-length arrangements will produce better information, better prices, and lower transaction costs, ultimately to the benefit of consumers[6].

ERANZ has pointed to the approach of the AER as indicating the direction regulation could be following in New Zealand to ensure consumers of regulated services, and consumers in general, most effectively receive the benefits emerging technologies offer.

The improved performance and affordability of technologies creates a great deal of uncertainty for electricity distribution businesses and these effects, along with changing consumer behaviour patterns and other drivers may cause regulated suppliers to review their business models and seek to diversify their businesses. These are reasonable reactions and regulated suppliers should not be prevented from investing in emerging technologies and new or different markets. Similarly, arrangements should ensure that there are also reasonable opportunities for other providers to participate. Fundamentally, where services can be provided through businesses operating in competitive markets better outcomes for consumers are expected to be achieved.

The Commission's proposal to remove the ACAM option is to be welcomed as a recognition that the current cost allocation options facilitate adverse behaviours by regulated suppliers at the expense of consumers of the regulated service.[7] Also a concern to ERANZ and its members, is the potential adverse impact of those behaviours on competition for delivery of the unregulated services that emerging technologies can deliver.

The clear benefits of the Commission's approach are:

- limiting the period over which the regulated suppliers are able to cross-subsidise their unregulated/competitive market activities, while not sharing the efficiency benefits with consumers of the regulated service;

Integration of energy storage - regulatory implications - final report; 3 December 2015; Page 26; OfGem; Forward work programme 2105-16; 25 March 2015; pg 23

[5] It s noted that this consultation is not intended to address the question of ring-fencing. ibid. n1; para 4.

[6] *Ibid, n1*

[7] -ERANZ; Submission to the Commerce Commission on input methodologies for emerging technology; 4 August 2016; para 14 and para 134

- OVABAA permits deviation from the ABAA cost allocation approach only to the extent necessary to ensure that the investment is not unduly deterred (solely as a result of the cost and asset allocation methodologies), thus meeting the requirement of s52T(3); and

- the OVABAA arrangements require director certification that use of a cost allocation other than ABAA is justified, in terms of s52T(3).[8]

Removing ACAM is only a partial solution in that it limits (but does not remove) the ability of regulated suppliers from recovering their investment and costs from consumers of the regulated service while their investments enable them to enter unregulated/competitive markets. To minimise the cost, and maximise the benefits, to consumers of the regulated service the Commission will need to closely monitor the circumstances under which the OVABAA option is utilised going forward. This should include development and application of clear guidelines as justification for using OVABAA and especially over what timeframe this can be sustained.

Addressing the likely challenges to the proposal to remove ACAM

Looking at submissions and cross submissions to date, regulated suppliers are likely to express concerns with the Commission's proposal in terms of meeting the requirements of s52T(3), the potential cost of implementing changes to allocation approaches, the impact on existing (and future) commercial relationships, and the impact on research and development.

The Commission's proposal to remove ACAM satisfies s52T(3) and does not unduly deter investment by a supplier of regulated goods or services in the provision of other goods or services

The Commission highlighted concerns by EDBs that by removing ACAM as an allocation option it would reduce their incentives to invest in unregulated activities (such as might be facilitated by emerging technologies) and this would frustrate the intent of s52T(3).

In its 2010 Reasons Paper, the Commission identified that:

> *"The optional variation to the accounting-based allocation approach (OVABAA) allows suppliers to allocate a greater proportion of common costs to regulated services than would occur under ABAA, and is appropriate in situations where the application of ABAA might unduly deter investments in unregulated services. This reflects outcomes produced in workably competitive markets where some services may, for a period, bear most of the common costs while others bear little (e.g. during the start-up phase of a new service)."*[9]

It seems clear, and this view was expressed in ERANZ's submission, that the OVABAA mechanism delivers on the requirement of s52T(3), including facilitating expansion into new or start-up activities.[10]

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[8] Clause 2.9.2 of the Electricity Distribution Information Disclosure Determination 2012 – (consolidated in 2015); 24 March 2015, requires disclosure in schedule 18 "Certification for Year-end Disclosures"
[9] Commerce Commission; Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper December 2010; para X16
[10] ibid, n8; para 134

However, it is important to note that there remains an important distinction when comparing the context of a regulated supplier with what happens in workably competitive markets. Even under the Commission's proposal EDBs still have the ability to make investments that provide them access to unregulated/competitive markets while effectively having the risk underwritten by consumers of the regulated service and a guaranteed return. While this benefit should be limited (in duration) under the OVABAA approach, this is an advantage that is not available to unregulated competitors operating in workably competitive market places.

A firm in a workably competitive market that enters or establishes a new market is able to cover the costs of that move from its established business(es). However, if that new endeavour makes a loss during its early stages that loss is a cost to the business and ultimately the shareholders. A firm in a workably competitive market cannot increase prices to consumers in that market in order to fund the cost of a foray into a new market. The business faces the risk of not recovering its investment or other costs involved in entering the new market and that risk is ultimately borne by its shareholders, not its consumers.

This means that, even under the Commission's proposed approach regulated suppliers remain in a privileged position in terms of the risk of competing in unregulated markets, albeit that this privilege has been mitigated to an extent under the proposal to remove the ACAM option.

Essentially, the persistence of a privileged position for regulated suppliers entering unregulated markets confirms that, as identified by the Commission, OVABAA satisfies the requirement of s52T(3) and that ACAM is not required as a stand-alone allocation methodology.

Likely costs of implementing the proposal to remove ACAM

The Commission considers that:

> *"… allowing ACAM to continue to be applied on a permanent basis for all or some of the costs of some regulated suppliers may allow a significant amount of shared costs (in absolute dollar terms) to be permanently allocated to the regulated service. As a result, potentially significant efficiency gains from the supply of regulated and unregulated services together will not be shared with consumers of regulated services now, or in the future. The magnitude of these foregone benefits appears likely to significantly outweigh any costs of removing ACAM, particularly in the case of larger regulated suppliers."*[11]

The Commission has asked for feedback on the costs that EDBs might face as a result of removing ACAM.

The Commission has identified that these costs are:

- likely to relate to changing regulatory accounting and reporting systems;
- therefore mostly one-off or short-term in nature; and

[11] ibid. n2; para 23

- likely to be significantly less than the potential efficiency benefits that will be shared with consumers of the regulated service going forward.

We submit that there are a range of reasons why the cost of changing cost allocation methods should be low.

An assessment of whether costs are avoidable or not is already required in implementing the ACAM allocation. This means that regulated suppliers must already have systems and methodologies in place to extract and consider the nature of shared costs. Accordingly, the costs that might result from removing ACAM will be incremental costs only.

In running their businesses regulated suppliers should have an understanding of their cost structures, as they relate to different businesses (regulated or unregulated). As the Commission noted, when considering the OVABAA option in its 2010 Reasons Paper,

> *"… suppliers' understanding of their own business places them in the best position to judge the level of allocation of shared costs which does not unduly deter investments. … The OVABAA relies on suppliers' understanding of their unregulated services."*[12]

It would seem to be imprudent for a business to enter a new business line or market without an understanding of the cost structure of servicing that business/market and how much of those costs the business/market is covering in the short, medium and long terms (i..e some basis on which management believes it is taking a value creating decision).

In any case, the changes required to accounting systems are likely to be minor. ERANZ understands that typically in the case of regulated suppliers, while data is drawn from their accounting systems, the allocations are generally performed in separate systems such as spreadsheets or databases. These systems are relatively low cost to develop and maintain. Where businesses have multiple revenue generating activities it would be usual that the business considered cost allocation as a part of its profitability reporting for management purposes and often also for external segmental reporting. While the allocations may be different for these purposes than for regulatory reporting the information sourcing and allocation mechanisms are likely to be similar and already in place.

Some recurring cost might be expected in revisiting the cost drivers for each reporting period. The Commission notes that, under OVABAA, *"… suppliers … need to form a view on the viability of their current unregulated service(s) based on factors such as prices, demand, quality etc."*[13] and to gather information to support directors' certification and to provide appropriate supporting information to the Commission. However, this still looks like information that the regulated supplier would be requiring for its own purposes in prudently making decisions and managing its investments. A key concern with investments in new markets is pricing, which requires a strong focus on both internal costs and the market place.

There does not seem to be any strong basis to consider that removing ACAM will result in material costs for regulated suppliers, above those costs that would be required in any case for the prudent management of the unregulated investment.

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[12] ibid. n8; para 3.3.37 and 3.3.40
[13] ibid. n8; para 3.3.35

The Commission has considered the possibility of allowing smaller EDBs to continue using ACAM.[14] We contend that this would be a poor option as the costs to move from ACAM are low for all regulated suppliers and are significantly less than the share of benefits that consumers of the regulated service could receive. We believe the Commission is right to dismiss this option.

The Commission also raised the possibility of providing compensation at the next reset for costs regulated suppliers might face upon removal of ACAM.[15] Again, it should not be necessary to compensate regulated suppliers for the cost of migration from ACAM to another allocation methodology as the cost is likely to be low. However, providing for compensation would effectively take away the basis for any opposition to the removal of ACAM, on the basis of cost to change.

Given that, in seeking compensation, the regulated supplier would be seeking a further subsidy from consumers of the regulated service, the Commission must require suitable evidence from the regulated supplier that the costs are additional to those the business would be expected to incur in prudently managing its investments in unregulated activities. Compensation could be limited to cases where there is evidence the additional costs exceed a certain materiality threshold (relative to the size of the regulated supplier).

We would also point out that the Commission noted that "only a small number of businesses exclusively use ACAM for allocating both shared operating costs and shared asset values", which also points to the fact that costs for other accounting purposes will likely already have been incurred.[16]

Impact on investment and commercial arrangements, particularly for UFB

The Commission cites Vector in respect of regulated supplier concerns that proposals adversely impacting regulated suppliers' ability to rely on ACAM could have a negative impact on commercial arrangements already in place.[17] This might also, presumably, extend to the incentive for regulated suppliers to enter into some commercial arrangements in the future. Vector expresses the concerns as:

> *"At the time of setting the IMs the government was also in the process of undertaking its Ultra-Fast Broadband (UFB) which has sought to accelerate the deployment of fibre-to-the-home networks. With the assurance provided by section 52T(3) of the Act and the ACAM threshold in the IMs many EDBs have partnered with UFB service providers to assist with the rollout of their networks. … lowering the ACAM threshold will have a material bearing for some EDBs where they have shared infrastructure with UFB partners with the ACAM threshold in mind."*[18]

The Commission rightly identifies that retention of OVABAA, with the ability to adjust allocations as far as ACAM, if necessary, delivers the requirement of s52T(3). OVABAA also addresses the concern expressed above. However, the view that regulated suppliers might have entered into

[14] ibid. n2; para 41
[15] ibid. n2; para 40
[16] *ibid. n2*; para 38
[17] ibid. n2; para 32
[18] Vector; Submission to Commerce Commission on the IM review draft decision and IM report; 4 August 2016; para 160

commercial arrangements to share assets "with the ACAM threshold in mind" suggests that regulated suppliers:

- may have entered into commercial, asset-sharing, arrangements on the presumption that ACAM would apply for the duration of the arrangement. In other words, the regulated suppliers may have had or have no intention to share efficiency gains from economies of scope with consumers of the regulated service - which seems inconsistent with the Part 4 purpose and surely therefore cannot have been the intent of s52T(3).[19]; and

- may have been short sighted in not considering that other opportunities to exploit economies of scope or otherwise diversify their businesses might arise that would eventually trigger the thresholds under the extant regulations requiring a switch away from ACAM and to ABAA.

The suggestion that changing the rules on use of ACAM might impact regulated suppliers that have entered into commercial arrangements is expanded on in Vector's cross submission where the concern is focused on "value". Vector says:

> *"If the Commission did modify the ACAM threshold or the circumstances for its application as suggested in some submissions, suppliers will have to revisit asset sharing agreements to ensure the changes do not erode value. Were such value erosion to occur, suppliers will have to renegotiate agreements for shared services (including with UFB suppliers) to ensure their businesses are not worse off."*[20]

In moving from ACAM to ABAA, there is no value consequence for the regulated activity. Moving from ACAM to ABAA (if using ACAM under OVABAA is not justified) means that the regulated service is assessed as having lower costs/assets and that future revenues are set accordingly. Profitability of the regulated service is unaffected. The "value" that is referred to is most likely the profitability of the unregulated activity. As discussed above, this level of profitability is derived at the expense of providing consumers of the regulated service with a share of the benefits of efficiency of scope gains made by the regulated supplier. The Commission's obligations here are clear - it must be concerned with the prices charged to consumers of the regulated service and not with propping up the profitability of the unregulated service.

Vector also notes that proposals that affect use of ACAM *"… could reverse New Zealand's recent advances with fibre subscription growth …"*.[21] It is not clear to what extent the UFB roll-out is based on using electricity poles versus under-grounding. Assessment of the cost of the UFB roll-out is also complicated by the government funding arrangements. However, it is most likely that the UFB providers seek the lowest cost roll-out option which, in some situations and at the 'right' price, might include use of electricity poles. Regulated suppliers, though, seem to regard this as an opportunity to increase their corporate profitability rather than as an opportunity to benefit consumers of the regulated service.

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[19] s 52A(1) requires that regulated suppliers:
"… (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices *…"*
[20] Vector: Cross-submission on IM review submissions; 18 August 2016; para 51
[21] ibid. n21; para 52

Regulated supplier opposition to removal of ACAM as a stand-alone option may, in large part, be driven by concerns about the profitability of their unregulated activities.

In this context, the Commission is right to conclude:

> *"We consider that, rather than retaining ACAM and the existing thresholds, which potentially allow ACAM to be used permanently, the submissions on behalf of regulated suppliers support retaining the OVABAA option. Allocations under OVABAA can be used up to the ACAM limit on a temporary basis, consistent with s 52T(3), in circumstances where any other allocation would cause the unregulated service to be not provided or discontinued."*[22]

Ultimately, OVABAA provides a better pathway for regulated suppliers to invest in unregulated activities by minimising the extent of cross-subsidy from consumers of the regulated service and ensuring that consumers of the regulated service share in the benefits of efficiencies (including through lower prices).

The Commission should be comfortable that its proposal will not prevent the regulatory arrangements from meeting their objectives, as regulated suppliers may claim. In support of the extant regulatory arrangements, Vector has acknowledged that:

> *"The asset and cost allocation IM does not fetter the ability for EDBs to invest in assets for delivering the electricity lines service. The asset and cost allocation IMs also do not prohibit an asset from becoming a shared asset – where it is capable of delivering both the electricity lines service and another service."*[23]

Given that that OVABAA remains as an option and ACAM was only included in the original IMs on the basis that, as assessed at the time, it did not distort revenues in a material way, removal of the ACAM option would not seem to provide any basis for this assessment of the efficacy of the regulations to change.

Research and trialing new technologies

The Commission cites the Electricity Networks Association (ENA) as arguing that it is prudent for regulated suppliers to invest in trialing emerging technologies (such as solar PV and battery technologies) so they can understand the effects on their networks.[24] It does seem reasonable that regulated suppliers should undertake R&D in relation to the impact emerging technologies may have on their networks. But this does raise a couple of issues:

- whether the research is genuinely focused on the impact on the network, rather than the opportunities to provide unregulated services and derive unregulated income; and

- at what point does a research trial cease being research and start being 'commercialised'?

In essence, answers to these questions determine the extent to which the related research costs are costs that consumers of the regulated service should face.

[22] ibid. n2; para 33
[23] ibid. n19; para 113
[24] ibid. n2; para 31.3

There is also a question as to how the outcomes of such trials are treated. Research developed through projects funded by consumers of the regulated service could be regarded as a public good, bearing in mind that the regulated service is not provided in a competitive environment and charges are effectively a 'tax' on consumers. This situation is similar to research funding provided by Ofgem to regulated electricity networks in the UK, where the outcomes are required to be released in the public domain so they can be shared by all regulated suppliers. At the very least, this would reduce the likelihood of inefficient duplication of research across a number of regulated suppliers.

It might be helpful if the Commission provided some guidelines as to what it regarded as research and development appropriate to the network service (including the extent capital, operating and related overhead costs) as opposed to being for the benefit of the network in developing its unregulated businesses.

Implementation Considerations

Key issues with respect to the implementation raised by the Commission's proposal are the timing of the change and the provision of guidance that will assist regulated suppliers implementing the change.

Timing of implementation

The Commission's proposal is that removal of ACAM as a stand-alone option would apply from the 2018/19 disclosure year.[25] The desire to provide notice of changes to the allocation approach and provide time to establish new cost allocation and reporting mechanisms is understandable. However, the delay in application may constrain the Commission from using data periods other than the 2018/19 disclosure year for determining the 2020 electricity distribution services price reset. While the Commission may opt to rely only on 2018/19 data when determining building block costs for the 2020 reset, it may consider it preferable to rely on more than one year's data. It would be better if the change took effect for the 2017/18 disclosure year so that the potential to rely on that year's data is not foreclosed.

The discussion of the cost of changing allocation method, set out above, indicates that it is not a case of significant changes to major software systems (such as proprietary accounting software) but, rather, implementation of, or modifications to, low cost and flexible systems such as spreadsheets or databases. To the extent that the information is not already being considered by management of the regulated service provider, the additional effort required to gather the necessary data and identify cost drivers etc, should not be significant.

A further benefit of applying the change a year earlier would be that any implementation issues can be flushed out in that first year. This is better to happen in 2017/18 rather than 2018/19 when the Commission is hoping to rely on the data for price reset purposes.

[25] ibid. n1; para 42

Practical implications of OVABAA

Despite being an available option, to date no regulated supplier has used OVABAA, The Commission should give consideration to the extent of guidance available on the application of OVABAA. Assuming that regulated suppliers do have a case to apply allocations that vary from ABAA it may be helpful if the Commission consolidates the requirements into a guidance note for regulated suppliers and auditors. For example, a guidance note could reaffirm the meanings of 'unduly deterred' and 'solely'.

The 2010 Reasons Paper notes that:

> *"The IM provides that:*
>
> - *EDBs and GPBs must justify the use of an OVABAA using directors' certifications;*
> - *alongside the directors' certification, EDBs and GPBs may need to provide appropriate supporting information to the Commission."*[26]

Guidance as to what supporting information is necessary or appropriate would also be helpful. It is also likely that regulated suppliers will want to understand the extent of confidentiality that might be afforded to some of the information provided.

[26] ibid. n8; para B6.6