
Submission to the Commerce Commission

on

Proposed Compliance
Requirements for the 2015 –
2020 Default Price-Quality
Paths for Electricity
Distributors and Associated
Input Methodology
Amendments

*PwC submission on
behalf of group of 19
EDBs*

Final

29 August 2014

Made on behalf of 19 Electricity Distribution Businesses

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Submission on DPP Reset: Compliance Paper and Input Methodology Amendments

This paper forms our submission on the Commerce Commission's (Commission) paper, "Proposed Compliance Requirements for the 2015-2020 Default Price-Quality Paths for Electricity Distributors" released on 18 July 2014 (the DPP Compliance Paper). Where relevant this submission also refers to the associated consultation paper "Proposed Amendments to Input Methodologies for Electricity Distribution Services" (the IM Paper) which was also released on 18 July 2014.

This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 19 Electricity Distribution Businesses (EDBs or distributors):

- 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.

Together these businesses supply 26% of electricity consumers, maintain 44% of total distribution network length and service 75% 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.

The DPP Compliance Paper describes the proposed compliance requirements for the 16 non-exempt EDBs which will be subject to the forthcoming DPP which is to apply from 1 April 2015. We note that it is proposed that Orion New Zealand is not included in the DPP reset at this time, due to their recent CPP Determination.

On 15 August we submitted on the DPP Policy Paper and the DPP Low Cost Forecasting Paper, and we have also submitted today on other associated papers (Quality Incentives and Targets, and Expenditure Efficiency Incentives)¹.

This submission presents the views of the 19 EDBs which support this submission. We also note and support the ENA's submission on the DPP Compliance Paper.

We trust this submission provides useful input in setting the 2015 DPP. We would be happy to answer any questions you may have regarding this paper.

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¹ As published at <http://www.comcom.govt.nz/regulated-industries/electricity/electricity-default-price-quality/default-price-quality-path> from 2015

Summary

1. In summary, we submit:
 - a. That additional compliance guidance is helpful to EDBs, ensuring the rules based approach to price-quality regulation is able to be implemented with as much certainty as possible.
 - b. This would be further enhanced by the publication of Enforcement Guidelines, and we encourage the Commission to develop and publish guidelines which set out its approach to enforcement, should a DPP be breached.
 - c. We believe that together the DPP Determination and the Input Methodologies (IMs) should provide a clear and unambiguous set of rules which set out the DPP obligations of each non-exempt EDB. We do not believe that there should be any ambiguity or judgement required when applying the DPP Determination. A rules based approach is consistent with achieving regulatory certainty.
 - d. Sufficient information to demonstrate compliance should be included in Compliance Statements. We do not support proposals for additional compliance information to be supplied to the Commission at different times and in different formats unless absolutely necessary.
 - e. We do not support the proposed introduction of pre-approvals for a number of recoverable costs. The IMs and DPP Determination are able to set out clearly the rules for compliance, and EDBs, auditors and Directors should be able to apply these with confidence. Pre approvals should only be required where there is some judgement required on behalf of the Commission. We believe this should only be required in very rare circumstances, or where a new provision is first being introduced, which has been previously untested, and is unable to be fully prescribed in the IMs or DPP Determinations.
 - f. We support the proposal for auditors to format their own assurance opinions, but note that the proposed scope of audit is expected to result in qualified opinions as it does not reflect the manual nature of outage recording processes. This feature is reflected in the scope of audit which is contained in the 2012 DPP Determination, and should be retained.
 - g. We support the proposed introduction of a number of new recoverable cost categories, and have included specific comments on them in this submission, including how the avoided cost of transmission (ACOT) recoverable cost is to be calculated after the transfer of transmission assets to an EDB. We also submit that new recoverable costs should be added to the DPP/CPP IMs for indirect transmission charges and costs associated with additional responsibility for customer service lines.
 - h. We also support refinements to the price path which reduce the impact of forecasting uncertainty and volume risk. These risks are currently managed by EDBs maintaining compliance headroom when setting prices. We have included suggested refinements to the proposals for a transmission revenue balance and the proposed ascertainable cost approach to other recoverable and pass through costs.
 - i. We do not support the proposed new Quality Incentive Scheme compliance standard which has significantly increased the compliance standard for EDBs with no financial compensation. This compliance standard is unrealistic and can be expected to result in non-compliance 50% of the time for every non-exempt EDB, on either (SAIDI or SAIFI) measure. It is unacceptable to place Directors of an EDB in a position of knowing they are likely to breach their DPPs multiple times during the next regulatory period, with limited opportunity to prevent the breaches, given the way in which the quality targets are proposed to be set.

- j. We support the intent to clarify how price and quality paths are adjusted following a large transaction, and have included some potential refinements to the proposals in this submission.
- k. We support the proposed compensation for revenue foregone for demand side management initiatives in principle, but note the proposed process disadvantages smaller suppliers due to its complexity relative to the potential value of the incentive. In addition the proposal excludes tariff based initiatives and therefore we believe it is inconsistent with the obligations on the Commission under section 54Q of the Act.

Compliance Requirements

Compliance and enforcement guidance

2. The EDBs which support this submission appreciate the publication of a compliance guide for the forthcoming DPP. We believe that this is a positive step which will assist interested parties, including those which must comply with the DPP price path and quality standards, understand the DPP, and achieve compliance.
3. As we have previously submitted, we also encourage the Commission to publish the Enforcement Guidelines that have been signalled in previous consultations. We believe that, while the proposed Compliance Requirements assist with maintaining compliance with the DPP, there remains considerable uncertainty as to the likely processes and consequences following a contravention of the DPP. We note that the EDBs which support this submission found the Commission's Part 4A Assessment and Inquiry Guidelines extremely helpful in this respect and that the publication of Enforcement Guidelines would be consistent with meeting the regulatory certainty objectives of Part 4.
4. There is a trade-off between how much information is included in the DPP Determination, the IMs and supporting papers such as Reasons Papers or compliance guidelines. In our view the DPP Determination should contain sufficient information to prescribe the price path and quality standard for each EDB, and set out how annual assessments are to be undertaken and reported. Relevant rules which are enduring (ie: are consistent between regulatory periods, and/or between CPP and DPP regulation) should be included in the IMs. The DPP Determination should contain references to the IMs where relevant.
5. We believe that together the DPP Determination and the IMs should provide a clear and unambiguous set of rules which set out the DPP obligations of each non-exempt EDB. We do not believe that there should be any ambiguity or judgement required when applying the DPP Determination. A rules based approach is consistent with achieving regulatory certainty.

Commission approval

6. For the reasons outlined above, we are concerned at the number of pre-approval processes which have been included in the Compliance Paper and Draft DPP Determination. We believe that any pre-approvals should be kept to an absolute minimum because they add cost, delays and uncertainty to the DPP. In our view, they should only be required where there is any judgement to be applied in applying the DPP rules. If the DPP Determination and IMs are appropriately drafted we believe that there should only be very rare instances where pre-approvals are required in order for an EDB to comply with the DPP.
7. In particular we do not believe that any Commission pre-approval is required where amounts to be included in a price path assessment reflect arms-length contractual arrangements (payments or rebates), which have been negotiated consistent with the relevant regulatory requirement (eg: consistent with the IM or DPP Determination), and for which there is transparent evidence (such as an invoice) for the amount to be included in the price path assessment. There is no need for the Commission to exercise any judgement in such instances, and Directors' certification and auditors' reports provide sufficient confirmation that the amounts are consistent with the DPP/IM rules.
8. We note that these rules may refer to other regulation, such as the Electricity Industry Participation Code (the Code), but we do not believe that this imposes any undue compliance risk. Rather, the reference to other regulation or legislation assists EDBs in meeting their compliance obligations.
9. The DPP Compliance Paper and Draft DPP Determination describe the proposed new Commission approval processes. We comment on each below:

- a) Recoverable costs which comprise charges associated with new investment contracts with Transpower** – currently the approval process comprises review of information to be presented in Compliance Statements, relevant to the contractual arrangements with Transpower. We support retention of this ex-post approval process which identifies a change in the services provided by Transpower to the network, and provides sufficient explanatory evidence of the value for those services recovered through prices.

We are not aware of any circumstances where charges associated with new investment contracts have not been able to be treated in this way, and cannot envisage why they would. They are legitimate charges for services provided by Transpower in order to deliver electricity to the network concerned.

If there are circumstances where the Commission believes it is not appropriate to recover new investment charges in full, these need to be stated clearly in advance, as they may influence the decision to enter into such contracts with Transpower. Otherwise, EDBs are at risk of earning sub-normal returns for reasons they are unable to predict or control.

We therefore do not believe that the proposed additional compliance requirements are justified, and the current arrangements should be retained. This will reduce compliance cost and reduce uncertainty relative to the proposal.

- b) Recoverable costs which comprise avoided transmission charges paid under contract to distributed generators, consistent with the Code, or other arrangements which the Electricity Authority (EA) may put in place in the future for distributed generation (DG)** – this recoverable cost is not currently subject to an approval process. In our view this is appropriate because EDBs have arms-length contracts with owners of DG for avoided transmission payments, and these arrangements must be consistent with the requirements of the Code (as currently specified in the IMs, with reference to Schedule 6.4 of Part 6 of the Code).

We note that there is an IM amendment proposed, which anticipates that changes may be made to the Code in this respect. We comment on this proposal later in this submission. However we do not believe that a possible future Code amendment is sufficient reason to introduce a pre-approval process for charges associated with existing contractual relationships, which comply with Schedule 6.4 of the Code. This adds unnecessary compliance cost, and importantly has introduced considerable uncertainty for those EDBs with such contracts, which are fully compliant with the current market rules, and hence IMs.

Further, even if new rules are introduced during the regulatory period, the fact that there are rules (which are most likely to be introduced by the EA under powers granted by the Electricity Industry Act (EIA)), provides the appropriate mandate for the recovery of the avoided transmission charge paid to an owner of DG. There should be no judgement required in this matter, as the charge is either compliant with the Code or it isn't, in which case it can't be passed through to consumers by distributors in their price paths.

- c) Recoverable costs which comprise avoided transmission charges associated with the transfer of spur assets from Transpower** – currently these charges are subject to ex-post approval by the Commission through review of information to be included in Compliance Statements. This is appropriate for asset transfers which have occurred to date, because they were undertaken on the basis of the current rules and expectations.

The DPP Policy Paper proposes a new method for establishing the value of the spur asset avoided transmission recoverable cost allowance. We comment on this proposal later in this submission.

In principle, it is our view that avoided transmission charges are able to be identified against a set of assets which are transferred and calculated consistent with the TPM with sufficient

rigour to enable auditors and Directors to certify that they are compliant with the IMs. If the Commission feels it needs to provide guidance in this matter, it is able to in the Compliance Paper, the DPP Determination or amendments to the relevant IM.

Accordingly, we submit that pre-approval should not be required, on the basis that the rules are explicit, and can be supported by additional explanation in Reasons Papers if deemed necessary. This is a lower cost and more certain process, than the proposed pre-approval process.

- d) **Recoverable costs for indirect transmission charges** – currently these charges are subject to pre-approval, but it is proposed that the pre-approval process is dropped for the next regulatory period. We support this proposal, because we believe that approving such costs is unnecessary, as their recovery through prices is fully justified. We also submit that this form of transmission charge should be included in the IMs as a recoverable cost, to maintain consistency with other charges incurred by EDBs, for the use of the transmission system.
- e) **Recoverable costs for charges/rebates which may arise from potential future automatic under-frequency load shedding (AUFLS) arrangements which may be implemented by the Electricity Authority** – this proposed new recoverable cost category may apply in the future. If it does, it will be in response to regulation imposed by the EA. For this reason we do not believe that any pre-approval by the Commission will be required, as there will be sufficient control over the arrangements through the appropriate regulation made under the EIA. Auditors and Directors will be able to confirm the value of any payments/rebates to be recovered, using financial transaction evidence, which will be able to be tied to any AUFLS event.
- f) **Recoverable costs which provide compensation for revenue foregone due to demand side management and energy efficiency initiatives** – this is a proposed new initiative to compensate EDBs for revenue foregone as a result of energy efficiency and demand side management initiatives. As there is some judgement required in how the value of this compensation is derived, and the proposed process involves application by the EDB and review by the Commission, we agree that a pre-approval process is warranted in this instance. We note that the proposed process incorporates a lag between the revenue impact occurring and the compensation payment being recovered, which allows for this application and review step.

Information in Compliance Statements

10. As stated above, we believe that the Compliance Statement is the appropriate place to demonstrate compliance and provide sufficient supporting evidence to support the compliance position of an EDB, and allow readers of the Compliance Statement to understand how compliance has been determined. We believe that the information requirements set out in the current 2012 DPP Determination largely meet these objectives.
11. It is now proposed however, that additional information is to be included in annual Compliance Statements. While some of this new information is associated with proposed new approaches to the price path and quality standards, other changes are also proposed. These comprise the following:
 - a) **Explanations for non-compliance with the price path** – this is to include why the price path was not complied with, a description of any mitigating actions taken as a consequence, and a description of any actions undertaken to prevent future non-compliance. We support this new information requirement, and believe this should assist the Commission to resolve breaches which were unintended, and subsequently mitigated, in a timely and cost effective manner. As stated above, we also submit that the publication of Enforcement Guidelines would improve regulatory certainty for businesses subject to the DPP, in providing information about the likely process and consequences as a result of breaching the DPP.

- b) Explanation for non-compliance with the quality standard** – this is to include why the quality standard was breached, descriptions of any mitigating actions, actions undertaken to prevent future non-compliance and explanations for any major event days (MEDs) which occurred during the assessment period.

As explained in our accompanying submission on the Quality Incentives Paper the proposed non-compliance threshold is too low, and does not adequately recognise the normal variability in annual reliability performance. The proposed compliance threshold (which is the SAIDI and SAIFI target for each EDB, derived from the recent ten year historical average SAIDI and SAIFI, after some normalisation for extreme events), is expected to result in breaches 50% of the time on either measure, for each non exempt EDB.

Thus, while we support the intent to include explanations for breaches in the Compliance Statement, we do not support the proposed compliance threshold, which if implemented, would make these explanations meaningless. The appropriate compliance threshold is the cap (which is one standard deviation above the target), and thus aligns with the present DPP quality limit compliance requirement. One standard deviation is a reasonable measure of the bounds of expected normal variation in SAIDI and SAIFI statistics. We also agree with the ENA's proposal to retain the two out of three year non-compliance test, as this is a better way of identifying potential material deterioration in quality performance, than a single year test.

Additional information

12. It is also proposed that additional information is to be provided to the Commission, outside of the annual DPP Compliance Statement. We believe that the Compliance Statement is the appropriate means for demonstrating compliance with the DPP. As is consistent with a rules based approach to regulation, this should be sufficient, particularly as the Compliance Statement is subject to audit and Directors' certification.
13. It is proposed that the following additional information is to be provided to the Commission. We comment on each requirement in the following paragraphs:
- a) Price restructure information** – certain information is to be supplied to the Commission at least 30 working days prior to restructured prices taking effect, where the restructure involves reestimating quantities for DPP Compliance Purposes.

The information to be provided includes:

- a 'price times quantity' schedule comprising each restructured price (using t-2 quantities)
- the method for determining the quantities
- a forecast of quantities for the assessment period where the restructured prices will first take effect.

It is not clear why this information is to be provided at this time. The Commission's review comes after the submission of the Compliance Statement 15 or so months later, and there is no approval required of the information to be submitted in advance of the prices taking effect.

The information sought can just as easily be included in Compliance Statements, including the forecasting assumptions used at the time the prices were set (this is similar to the current requirement to disclose in Compliance Statements, forecasts of recoverable and pass through costs at the time prices were set). We submit that the information required should be included in Compliance Statements instead, which streamlines the disclosure requirements, thus helping to minimise compliance costs. We comment further on the proposed information to be included, later in this submission.

- b) Digital copies of price x quantity schedules which support the price path** – we understand that the Commission currently seeks this information from EDBs, once they have published their annual Compliance Statements. We note the proposal to formalise this requirement in the DPP Determination, and that the information is to be provided within a week of submitting the statement. It would be helpful to understand why the Commission needs this information in digital form, in order to better respond to the proposal.
- c) Notification of large transactions** – it is proposed that certain information is to be notified to the Commission within 30 days of entering into a large transaction. We note that Part 3, subpart 2 of the IMs provide the overarching rules for how amalgamations are to be treated in price-quality regulation, and this is predicated on the fact that only non-exempt EDBs are subject to price quality regulation.

We note that transactions may occur between non-exempt EDBs and exempt EDBs, or they may result in a new non-exempt EDB. We submit that the current proposals require amending to recognise that the proposed approach of allocating price paths between buyer and seller, will only work in practice where both are existing non-exempt EDBs.

We note that the Act sets out the requirements for establishing price-quality regulation for EDBs which lose their exempt status, and while such transactions will result in a DPP Determination for that business, this may not occur in the same year as the transaction.

In addition a non-exempt EDB may purchase assets (and hence supply new consumers) from an exempt EDB, for which there is no existing price path. The current DPP provisions (in Schedule 1F) allow for an adjustment to ANR to reflect the new consumers supplied. The new proposal prevents this, and thus does not achieve its purpose.

We note that the proposed notification rules are subject to size thresholds, which we support, ie: only transactions of a reasonable size are to be notified to the Commission.

We also note that the information to be notified to the Commission following a Major Transaction which exceeds the size thresholds, is to be notified within 30 working days of entering into the agreement for the transaction. However the information that must be provided may not be known at that date because:

- the agreement may predate the transaction date to the extent that allowable notional revenue (ANR) or recoverable costs/pass-through costs have not yet been determined
- under the new transmission cost recovery proposal, transmission recoverable costs will not be determined until the end of an Assessment Period.

We therefore submit that the EDBs concerned should notify the Commission that the agreement has been entered into within the proposed timeframe, but provide the additional explanatory information alongside in Compliance Statements, at the end of the Assessment Period within which the transaction occurred.

- d) Application for demand side management and energy efficiency compensation payments** – The application for the proposed new demand side management allowance is to be submitted alongside an annual Compliance Statement, and address demand side initiatives for the relevant Assessment Period. We agree that the application ought to be separate to the Compliance Statement as the documents have different purposes, although they cover the same Assessment Period. We comment on the proposed content of the application later in this submission.

It will be important for the Commission to be able to approve any applications in a timely manner, to ensure the EDB concerned is able to reflect the allowance in prices to apply at the beginning of the Assessment Period following the application. Prices are generally set prior to

the end of the calendar year to allow for Directors' approval prior to notification to retailers, which must occur early in the new year (and possibly earlier if prices are to be restructured).

Accordingly, it is in an EDB's interest to submit an application in a timely way. However there are a number of compliance activities which occur in the first few months of the regulatory year, and we believe that it may be appropriate to provide for another 20 working days after the Compliance Statement deadline, to allow EDBs to complete their financial statements² and Compliance Statements, before submitting their demand side management initiative allowance applications. This would extend the proposed deadline from mid-June to mid-July, although there is no reason why applications could not be submitted earlier, and with Compliance Statements if desired.

Assurance requirements

14. Annual Compliance Statements must be accompanied by an audit report. It is proposed that the pro-forma report which is included in the 2012 DPP Determination is removed. In its place, a new Schedule to the DPP Determination is proposed, which sets out the requirements of audit reports. We support the proposal to allow auditors to format their own reports consistent with a prescribed set of requirements.
15. However the proposed scope of the audit opinion differs to that currently included in the 2012 DPP Compliance Statement, and is similar to that included in the 2012 Information Disclosure Determination. When developing the current DPP audit opinion, recognition was made of the manual processes used to compile outage data, which mean it is not always possible to determine with sufficient certainty that complete and accurate records have been kept. This requirement is therefore not currently in the pro-forma audit report for DPPs.
16. This situation is not an indictment on EDBs, it simply reflects the realities of network topography, where distribution network control and operation is only partly automated and thus systematic records must be supplemented by manual records when recording outage details.
17. The requirement for complete and accurate records was added into the requirements for audit Statements in the 2012 IDD. As a result, some auditors have issued qualified opinions in respect of the requirement to determine whether "proper records to enable the complete and accurate compilation" of disclosures have been met. These qualifications have been issued in respect of reliability data. Accordingly if the same requirement is to be included in the DPP requirements, we anticipate that this is likely to result in qualified opinions in respect of the quality standard information.
18. Thus we suggest that the requirement is removed. We believe that the remaining assurances are sufficient for readers of the Compliance Statements to gain sufficient assurance that the information in the Compliance Statement has been prepared in accordance with the Determination, and is based on the appropriate sources of information held by the EDB.

² We note that most, but not all EDBs report to a 31 March year end for statutory reporting purposes.

Input Methodology Amendments

19. It is proposed that a number of amendments are made to the IMs which apply to the DPP. These are explained in the IM Amendment Paper and associated IM Draft Determination.³

New recoverable costs

20. Some of the more substantial proposed amendments are to the provisions for recoverable costs, ie: costs charged to EDBs, which are able to be passed on to consumers outside the restrictions of the price path. We comment on each in turn below:

- a) Quality incentive adjustment** – this new recoverable cost provides the mechanism by which financial penalties are imposed on EDBs for reliability performance which is worse than the target, or financial rewards for reliability performance which is better than the target. While we have significant concerns about the design of the quality incentive scheme, we support the proposed new recoverable cost term, which is necessary if the financial incentive scheme is to be introduced.

We note that it is proposed that the recoverable cost will apply in the second year after each Assessment Period to which it relates. We acknowledge the need for this lag, as the value of the reward/penalty can only be calculated at the end of an assessment period, and included in prices at the next opportunity, which is the following pricing year.

- b) Energy efficiency and demand incentive allowance** – this new recoverable cost provides the mechanism by which compensation for revenue foregone as a result of demand side management and energy efficiency initiatives is able to be recovered. We support this new term which helps the DPP to comply with the requirements of section 54Q of Part 4 of the Commerce Act (the Act).

There will be a two year delay before the incentive allowance can be recovered, which allows for the proposal to be assessed, approved and a recoverable cost value determined, before being included in prices in the next pricing period. We submit that a time value of money adjustment should be included to recognise the value of this deferral.

- c) Capex wash-up adjustment** – a new recoverable cost is proposed, which adjusts for the difference between forecast and actual commissioned asset values for each non-exempt EDB in FY15. These values are used to determine the price path for each EDB. We support measures which ensure forecasting assumptions for the DPP price path are as accurate as possible. We note that the proposed approach for setting the price paths is not consistent in this respect (such as deriving opex for the price path from FY13 opex).

We note the capex-wash up is intended to derive the impact on the return of and on asset building blocks of the difference in the commissioned asset values for FY15. We therefore support the proposal to spread this adjustment over the regulatory period, which matches the profile of the underlying building blocks used to derive the asset components of the price path.

- d) Transmission asset wash-up adjustment** – some EDBs are proposing to purchase transmission assets in FY15, and the costs associated with those assets are to be reflected in

³ Commerce Commission, Proposed Electricity Distribution Input Methodology Amendments 2014

their price paths. A new recoverable cost is to be included to allow for a wash-up in the event that the proposed asset purchases do not go ahead as assumed. The recoverable cost will therefore be a negative amount to be deducted from allowable revenues. We support the proposed mechanism and the intent to quantify the wash-up amounts for each relevant EDB in the DPP Determination, and for them to be spread across the regulatory period to mirror the underlying building blocks.

We note that it is intended that the wash-up amount includes the opex and asset related allowances included in the price path across the five year regulatory period. As we have previously submitted, the proposed approach to setting the price path does not include any opex allowances for spur assets which are to be purchased in FY15. As the EDBs concerned have provided the Commission with forecasts of the opex associated with spur assets to be purchased in FY15, these allowances can be included in the price path, to be backed out via the wash-up should the purchases not proceed. This approach is consistent with the proposed IM definition of the ‘transmission asset wash-up adjustment’.

We note that costs of spur asset purchases which occur within the regulatory period are covered by a separate avoided transmission recoverable cost allowance (refer below).

- e) Catastrophic event wash-up adjustment** – a new recoverable cost is to be introduced to allow for the recovery of the net financial impacts of a catastrophic event, which occur between the date of the event, and a new price path being determined. This proposal aligns with the plans to amend the DPP re-opener provisions in the IMs to include catastrophic events, as directed by the High Court following Merits Review.

We support this new category of recoverable cost but submit that it has been defined too narrowly, as it:

- constrains the scope of the net financial impacts able to be recovered by excluding demand side impacts from consideration
- fails to consider the financial impacts on suppliers which may follow a catastrophic event, arising from the proposed quality incentive scheme, expenditure efficiency scheme, and energy efficiency and demand incentive scheme
- fails to consider the net financial impacts on suppliers of other re-opener events.

We do not believe this is justified because catastrophic events will each have their own unique characteristics and consequences, and it is therefore unduly premature to rule some impacts in and other impacts out in advance. The Commission retains a considerable amount of discretion in determining the value of this recoverable cost in any event, and in our view, there is no reason to limit this recoverable cost as proposed.

- f) AUFLS recoverable cost** – this new recoverable cost is proposed in anticipation of market developments which may be introduced by the EA for automatic under frequency load shedding. These proposed arrangements may include payments or charges to EDBs, which are to be passed onto consumers. We support this proposal, and have commented on the proposed approval process earlier in this submission.
- g) Transmission costs avoided as a result of distributed generation** - it is proposed that the definition of the recoverable cost allowance for avoided transmission costs associated with DG is updated. It is proposed to broaden the definition to include notionally embedded DG, and to refer to any relevant new regulation which may be imposed under the EIA (currently the IM definition refers solely to Schedule 6.4 of Part 6 of the Code). We understand this second amendment is to future proof for possible new regulations which may be introduced in this area, by the EA. We support the amendment, but as noted earlier we do not support the

proposal that the charges paid to owners of DG which are consistent with the current Code requirements (ie: Schedule 6.4 of Part 6) should now be subject to Commission approval.

- h) 2013-15 NPV wash-up allowance** – three EDBs were prevented from recovering their revenue requirements in the current regulatory period due to their price caps, in order to mitigate price shocks for consumers. A new recoverable cost category is to be implemented to allow the outstanding amounts to be recovered in the next regulatory period. We support this proposal which is consistent with the undertakings given to those businesses in the 2012 DPP Decision. We support the intention to publish the amounts to be recovered by each EDB in the DPP Determination, which provides transparency and makes compliance straightforward.

21. We also believe that two additional recoverable cost categories should be introduced in the DPP/CPP IMs. We comment on each in turn below:

- a) Indirect transmission charges** – these charges apply where EDBs are on-charged Transpower’s charges for the use of the transmission grid by a third party such as another EDB. In all other ways they are the same as the recoverable costs EDBs are permitted for direct charges from Transpower for use of the grid. For consistency, we submit that indirect transmission charges should be included as a recoverable cost, rather than as proposed, defined in the DPP Determination. This will improve certainty for those suppliers affected, and also ensure consistency for the treatment of grid related charges for DPPs and CPPs.
- b) Customer service lines** – We support the ENA’s submission for a new recoverable cost category for the costs associated with additional responsibilities which EDBs may assume for customer service lines during the regulatory period. The driver for this extension of EDB responsibility is public safety. However, the inability to recover associated costs through prices is a barrier to EDBs taking on this additional responsibility for addressing a growing public safety issue.

The ENA has discussed this issue with officials at MBIE, and has submitted a copy of associated correspondence to the Commission in this respect.⁴ The recent letter from MBIE acknowledges the issue, and endorses the ENA’s efforts in attempting to resolve the public safety issue. Their recent letter states:

‘I understand that the ENA’s proposal would involve most ENBs incurring additional costs, as most do not currently provide this service. I am aware that the Commerce Commission is currently resetting the default price-quality paths for non-exempt ENBs, and will need to consider the potential impact on line prices associated with the proposed service.’

Accordingly we submit that a recoverable cost provision is appropriate - in the same way that the proposed new AUFLS recoverable cost is being put in place in anticipation of new charges which may arise during the next regulatory period.

Given the representations to MIBE (and the correspondence from them acknowledging the importance of the issue) and the submissions to date to the Commission on behalf of the ENA, we submit that these costs are costs that have been anticipated, but are unable to be quantified at this time.

The IM definition of pass through costs (clause 3.1.2) allows for new pass through costs to be added during a regulatory period, which are levies and not anticipated when the price path is set. Additional costs associated with customer service lines would not meet this definition, because they are anticipated (but not quantified) and are not levies.

⁴ Letter to Alan Jenkins - ENA from Jamie Kerr - Manager, Energy Markets Policy, MBIE, 5 May 2014

EDBs do not have a good understanding of the likely costs to them of taking on customer service lines, and will not be able to establish this until they have undertaken their initial inspections of the assets in question. We suggest that the additional recoverable cost includes a pre-approval process for the next regulatory period, on the basis that EDBs can submit applications to the Commission for costs to be recovered associated with additional responsibility for customer service lines, with deferred recovery similar to the demand management incentive, to allow for the review and approval of the application for the recoverable cost.

Recovering transmission charges

22. A new approach to assessing the recovery of transmission charges is proposed, which is intended to remove volume and forecasting risk from these components of recoverable costs. Instead a transmission revenue balance approach is to be used, which is to sit outside the price path.
23. This is possible because EDBs publish transmission components of their posted prices. The revenue generated by these components of prices, calculated at the end of each assessment period using actual (not lagged) quantities is to be compared with transmission costs incurred during the period. Any over or under recovery is carried forward and offset against the balance in future assessment periods.
24. This proposal removes the requirement for EDBs to forecast transmission costs when determining DPP compliance prices (ie: reduces the need for compliance headroom), and allows transmission cost recovery to be assessed using actual volumes. Therefore the EDBs which support this submission believe this proposal is an improvement on the current approach. However, there is no reason why the balance needs to be cut off at the end of the regulatory period, particularly in an asymmetrical way. Overs and unders will reflect genuine variances between costs and recovery, and should be able to be carried forward between regulatory periods.
25. We acknowledge that the proposal includes no restriction on the magnitude of the variance which is able to be added to the balance each year. In order to provide incentives for EDBs to match revenues with costs when determining the transmission component of prices, we suggest that there should be time value of money penalties against EDBs for variances which exceed 5% of transmission charges for the year.
26. We support the proposal to include in the scope of the transmission recovery mechanism all of the recoverable costs associated with charges made under the transmission pricing methodology (TPM), new investment contract charges, avoided transmission charges payable to DG and system operator charges. These all reflect charges which are passed on to EDBs for transmission services.
27. The avoided transmission charges associated with spur asset transfers are not included. We support this approach, because these charges relate to cost recovery for assets which have become distribution assets once they are transferred. We note that at that time, EDBs will need to adjust their transmission and distribution components of posted prices to reflect the change in the transmission/distribution boundary.
28. We note that some EDBs publish tariffs which include posted discounts. We understand that posted discounts reflect discounts to distribution (not transmission) prices, on the basis that transmission prices are the pass through element of prices, whereas discounts on distribution prices reflect the particular ownership/distribution arrangements of the distributor. Prompt payment discounts however, are attributable to all components of prices (as they are applied on an invoice basis), and thus will apply to the transmission revenue component of the transmission balance, where used by the EDB.

Pass through and non transmission recoverable costs

29. It is also proposed to change the way in which the remaining recoverable costs and pass through costs are recovered. That is, there are to be no forecasts of these costs included in prices. They may only be included in prices where the amount to be recovered/passed on is certain, at the time prices are set. If

costs for one assessment period are unable to be recovered until a later assessment period, because they were not known with certainty at the time, they are to be adjusted with a time value of money adjustment. In addition, costs cannot be deferred more than two years.

30. We have already highlighted potential issues with proposed Commission approval processes and the recoverable/pass-through cost provisions. We also believe the two year limitation is unduly restrictive, as EDBs may be in the position of incurring legitimate costs they are unable to recover, which are not provided for in their price paths, due to circumstances outside their control.

Other compliance matters

Price path compliance

31. We support retention of the following current features of the price path:
- compliance assessed by ensuring notional revenue does not exceed allowable notional revenue, using t-2 quantities
 - inclusion of a revenue adjustment term which maintains the price path between assessment periods, which means it is not influenced by pricing decisions in a prior period.
32. We also support the following clarifications provided in the DPP Compliance Paper:
- how retailer wash-ups are to be treated when specifying quantities
 - how prompt payment discounts are to be treated when specifying quantities and prices
 - how quantities are to be determined when undertaking a price restructure
 - how quantities are to be determined if prices change during an assessment period.

Quality standard compliance

33. It is proposed that compliance with the quality standards will be determined where:
- assessed SAIDI is no more than the SAIDI target
 - assessed SAIFI is no more than the SAIFI target.
34. It is proposed that no enforcement action will be taken where SAIDI or SAIFI assessed values fall between the target and the cap (ie: the cap is where marginal financial penalties cease to apply) except in exceptional circumstances. However paragraph 4.6 of the DPP Compliance Paper states that in exceptional circumstances where quality standards are not met, the Commission may still seek pecuniary penalties under s 87 of the Commerce Act or criminal sanctions under s 87B for under performance.
35. Given the proposed compliance standard (as per paragraph 4.4 of the DPP Compliance Paper), the EDBs which support this submission do not support the proposed new compliance standard for the Quality Incentive Scheme which has significantly increased the compliance standard relative to the current DPP with no financial compensation. This compliance standard is unrealistic and can be expected to result in non-compliance 50% of the time for every non-exempt EDB, on either (SAIDI or SAIFI) measure.
36. It is unacceptable to place Directors of an EDB in a position of knowing they are likely to breach their DPPs multiple times during the next regulatory period, with limited opportunity to prevent the breaches, given the way in which the quality targets are to be set.
37. Our more detailed comments on the proposed Quality Incentive Scheme are included in our accompanying submission.

Large transactions

38. We support the intent to clarify how price and quality paths are adjusted following a large transaction. We are comfortable with the current proposals (which are to be retained) for combining price paths and quality standards following a merger or an amalgamation.

39. We note the new proposals for how price paths and quality standards are to be treated where a major transaction (other than a merger or amalgamation) occurs – ie: a subset of assets is transferred to another supplier. We agree that clarification is useful, and in principle support the proposal that it is the buyer and seller which determine how the price path, recoverable costs and pass-through costs are allocated following the transaction. We note that the proposals are only able to be implemented where both parties are non-exempt EDBs and suggest further clarification is required where one party is an exempt EDB, or a new EDB is created as a result of the transaction.
40. We also support the proposal that quality targets are restated by transferring the historical reliability performance of the assets from the seller to the buyer, and recalculating the targets, caps and collars.
41. It is proposed that average SAIDI and SAIFI is transferred, without normalisation adjustments. We do not support this proposal as the subsequent assessments will be undertaken using a different (normalised) method. In particular the seller will lose more SAIDI/SAIFI from its target than actually exists for those assets, where there has been a MED in the reference period, and outages associated with the assets transferred contributed to the MED. We believe that it is more correct, and thus distortions will be avoided, if the quality targets are recalculated using the modified reference dataset, including reestablishing the boundary values for MEDs, and associated normalisation.

Compensation for demand side management initiatives

42. While the EDBs which support this submission, support the proposed compensation for revenue foregone for demand side management initiatives in principle, we note:
- the proposed application and approval process appears cumbersome, complex and costly. This disadvantages smaller EDBs, who will have lower value compensation claims
 - the Commission could develop a template proposal to assist EDBs understand the Commission's expectations for a successful proposal, which would assist to manage compliance costs
 - the proposed incentive rules out foregone revenue as a result of tariff initiatives, but tariffs are one of the most important ways EDBs can influence consumption patterns of consumers in ways which are consistent with the objectives of section 54Q of the Act. We believe that this proposed exclusion is inconsistent with the obligations placed on the Commission in section 54Q, and the exclusion should be removed from the incentive scheme.

Avoided transmission recoverable cost following spur asset purchases

43. The DPP Policy Paper and Compliance Paper propose a revised approach to calculating the ACOT charge associated with an EDB's purchase of Transpower assets. This approach is proposed for determining the recoverable costs associated under clause 3.1.3(e) of the IMs. It is proposed that ACOT charges will be calculated as follows:

For the purposes of calculating the amounts in subparagraph 6(b)(i), the amount is the amount, calculated by Transpower in accordance with the Transmission Pricing Methodology –

(a) in the first Assessment Period following the purchase of the System Fixed Assets from Transpower, the difference between the costs of transmission payable to Transpower for the first full Assessment Period following the transfer of the System Fixed Assets and the costs of transmission that would have been payable to Transpower for the Assessment Period in question had the transfer of System Fixed Assets not occurred; and

(b) in each of the four following Assessment Periods after the first Assessment Period for which an amount is calculated, the amount calculated in accordance with subparagraph 7(a), in constant nominal terms.”

44. In our submission on the Draft Decision Paper, we noted a number of issues with the proposed approach, including that:
- it ignores the delay in the avoidance of interconnection charges, which are based on RCPD lagged 12 months
 - maintaining year 2-5 ACOT in nominal terms will not reflect either non-inflationary or inflationary increases in transmission charges.
45. We submit that a more reasonable approach is for EDBs to calculate their ACOT charges each year with reference to connection agreements that apply at the time the assets were transferred, and current inputs for RCPD peaks and the interconnection rate. Further, the calculation of ACOT in each assessment period would then be calculated for each sub-category of Transpower charges. Thus the approach will reflect whether transmission charges are calculated under contractual arrangements (ie under a Customer Investment Contract - CIC⁵) or under the current TPM, as follows:
- a) Customer Investment Contracts (CICs)** - Avoided charges are set with reference to annual charges that would have applied during the Assessment Period under the CIC (to which the transferred assets relate) which was in place the day prior to the transfer date, as though the assets had remained with Transpower.
 - b) Connection charges under current TPM** - Avoided connection charges are calculated for the transferred assets using the formulas in clause 8-26 of the TPM. This applies the inputs Transpower publishes as well as connection specific information relevant to the transferred assets at the time of the transfer (ie replacement costs, line length, number of AC switches)
 - c) Interconnection charges under current TPM** - Avoided interconnection costs are calculated by multiplying estimated avoided RCPD by Transpower’s published interconnection rate. Avoided RCPD is derived from actual half hourly metering data aligning to Transpower’s RCPD peaks where this replicates the grid conditions prior to the transfer, or using the last available RCPD figures published by Transpower.
46. We note the EA’s review of the TPM may make it difficult to calculate avoided connection and interconnection charges in the future if significant changes are introduced to the TPM. We therefore propose that, where there is a material change to the current TPM, ACOT is calculated as follows:
- a) Connection charges under revised TPM** - Avoided connection charges are derived using the same calculation as specified above, using the most recently published connection charge inputs, escalated forward for changes in CPI.
 - b) Interconnection charges under revised TPM** - Avoided interconnection charges are calculated by multiplying estimated avoided RCPD (as calculated above) by the most recently published interconnection rate, escalated forward for changes in CPI.

Other comments

47. We note there is currently a disconnect in the timing of when the ACOT recoverable charge first applies between the IMs and the Draft DPP Determination. Under clause 3.1.3(4) of the IMs, the 5 year period starts in the disclosure year in which the asset transfer takes place. Under the Draft DPP determination, ACOT is calculated in the assessment period following the transaction.

⁵ Referred to as new investment contract (NIC) in the IMs, or otherwise as a new investment agreement (NIA).

48. In our view, neither of these rules is helpful, particularly where interconnection charges are only avoided after a lag due to the TPM method. We propose that the wording of the IM and DPP Determination is amended to enable EDBs to recover ACOT for a period of 5 years from the date when each sub-component of ACOT is avoided. This is expected to be the transfer date for connection charges and CICs, however, for interconnection charges, it may be deferred.
49. We also note that the papers do not consider how the recoverable cost is to be calculated for asset transfers which have already occurred, ie: are past year one of the five year recoverable cost period. We believe that the current approach should continue to apply to those transfers which have already occurred, as to change means retrospective adjustments to regulatory rules which compromises regulatory certainty, and the information on which the decision to invest was initially made.