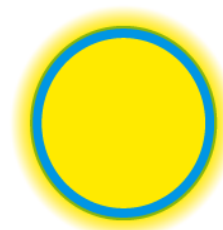


29 August 2014

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Dear John

Cross submission on DPP reset proposals and low cost forecasting approaches

This is Powerco Limited's cross submission on submissions made on the Commission's consultation papers *Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015* and *Low Cost Forecasting Approached for Default Price-Quality Paths*. Our responses to a number of points made by other submitters are set out below.

This cross submission has been prepared in liaison with the Electricity Networks Association (ENA). We agree with the ENA cross submission.

MEUG

We agree with MEUG that the DPP proposal is increasing in complexity, but disagree that increasing DPP complexity necessarily discourages CPP applications, or that the number of CPP applications should be seen as a measure of the success of the regulatory framework. CPP applications are themselves complex and expensive and should only be advanced if the DPP cannot accommodate an EDB's needs. The real problems with increased DPP complexity are increased compliance costs, unintended outcomes when all of the new components are fitted together and implemented, and the potential for incentives to become less clear. Increased complexity therefore necessarily brings with it increased uncertainty and risk.

We strongly dispute MEUG's argument that rates and levies should not be pass-through costs because EDBs are substantial enterprises that can influence local authorities, the Commerce Commission and the Electricity Authority. MEUG provides no evidence that any submission from a major industry has actually influenced the setting of local authority rates or Crown entity levies.

We disagree with MEUG's claim that exceeding the quality targets provides diminished utility to consumers and that EDBs should therefore have no incentive to out-perform the targets. Studies of the value of lost load show that the initial lost load is often more valuable to consumers than incremental losses. In those instances incremental reductions in the length of outages would, in fact, be more valuable to consumers not less. However, we agree that further work to enable differentiation of the value of quality by customer class could be valuable.

With respect to the "D-factor", MEUG argues that late adopters of an innovation should receive a lesser incentive, in line with what would happen in the private sector. This misses the point that the aim of the D-factor is to incentivise investment that would

otherwise reduce EDBs' revenue and which would therefore never be undertaken by the private sector without an incentive.

Castalia (for Vector)

We support Castalia's querying of the Commission's use of a higher elasticity of lines revenue to real regional GDP (0.73 versus 0.52 previously) as this seems counter-intuitive given the decoupling of the relationship between electricity consumption and GDP observed in recent years.

We agree that using population to estimate growth in ICP numbers can be misleading.

We recommend the Commission take particular note of Castalia's observation that electricity prices increasing at a reduced rate, or even declining, will have little effect on consumption, because of electricity's low price elasticity of demand (-0.26 according to the Electricity Authority), which means that even a 10 per cent reduction in price would increase consumption by only 2.6 per cent. This contradicts the Commission's suggestion that a declining rate of price increase will help arrest the decline in residential consumption.

We agree that mass market penetration remains merely a long-term aspiration for electric vehicle manufacturers, made even more difficult by the vehicle fleet's low turnover rate.

We also agree that there is ample scope for further energy efficiency gains in the 2015-20 period. Castalia cites KEMA's 2007 report *New Zealand Electric Energy-Efficiency Potential Study* which estimated that 6,437GWh of savings were economic and could be realised by 2016. The decrease in consumption since the peak in 2009 has been 769GWh, according to MBIE. If all of this was due to energy efficiency, potential savings of 5,668GWh remain, at least some of which are likely to be achieved in the next regulatory period.

Vector (main policy paper)

We agree with Vector that the revenue shortfall due to errors in the Commission's forecast of CPI should be compensated for. This risk was never meant to be part of the regulatory framework.

We strongly agree that the revenue cap approach to pass-through and recoverable costs should allow a negative balance of unrecovered costs to be carried forward to the next regulatory period. Not permitting this will inevitably mean that EDBs will under-recover these costs, which the Commission accepts are intended to be fully recoverable.

We agree that the reopener mechanism for catastrophic events should also apply to change events. We also strongly agree that the "two out of three" rule for quality standard enforcement should be retained to accommodate inevitable statistical variability and that, in general, the IEEE framework should be adhered to and not "cherry picked".

We agree that the Pacific Economics Group's (PEG's) analysis of the opex partial productivity factor and X-factor should be preferred to that of Economic Insights, as the PEG analysis is more consistent with the Commission's broader forecasting approach (e.g. use of all industries LCI and opex forecast drivers).

We strongly agree that the "D-factor" should be able to be applied to tariff-based energy efficiency initiatives, as these often have the greatest potential to be effective. In our view, the Commission should be able to consider tariff-based proposals on a case by case basis.

Meridian

We agree that the Commission should review its implied national energy forecasts to confirm whether or not they fall within the ranges of national demand forecasts developed by other parties.

Wellington Electricity

We strongly agree with Wellington Electricity that SAIFI should not be used to trigger the normalisation of SAIDI as there is no necessary relationship between SAIDI and SAIFI and this is contrary to the IEEE standard. We note that, because Powerco has an extensive rural network, some major storms that affect a limited area may result in lengthy outage durations from a relatively small number of interruptions. We provide an example of this effect in our submission on the proposed quality framework.

We agree that the Commission should not explicitly exclude the recovery of revenue forgone due to catastrophic events in the proposed IM amendments.

We agree that ongoing energy efficiency improvements, insulation and the roll out of smart meters can be expected to lead to further reductions in residential electricity use per ICP in the coming RCP.

We strongly agree that 2014 should be used as the base year for the opex forecast as it represents the most up to date data and is closer to being a normal year, while 2013 was atypical

We agree that all the empirical analysis indicates that the industry has experienced negative opex partial productivity growth.

We agree that the Commission's approach to capping capex does not recognise the lumpy and often cyclical nature of infrastructure capex and that the Commission should give more consideration to the interrelationships between its proposals that affect opex, capex and reliability

Unison

We agree with Unison that the Commission should review the forecasting accuracy of its econometric models against historical performance.

We agree that the Commission should recognise that 2013 was an unusually benign year for weather. Powerco is consequently recommending that 2014 be used as the base year for the opex forecasts, but, if the Commission decides to continue to use 2013, we agree with Unison that the data should be normalised to recognise the atypically benign weather conditions in that year.

We agree that the Commission should acknowledge the distortions to EDB pricing caused by the regulation of fixed charges for low use residential consumers.

We agree that the Commission should adopt Pacific Economic Group's (PEG's) partial productivity growth estimate of -2%, because PEG's approach is consistent with the Commission's scale forecast model, while Economic Insight's is not.

We note Unison's quote from the 2013 MBIE *Energy Outlook: Electricity Insight* that:

“At the moment, electric vehicles are not economic when compared with similar petrol or diesel vehicles. If they become economic over the next decade, it will take several decades for electric vehicles to have any significant impact on total electricity energy demand due to slow turnover in the vehicle fleet.”

This contradicts the Commission's assertion that electric vehicles are becoming viable

Orion

We agree with Orion that the Commission should clarify how it will determine the price and quality targets that will apply when an EDB transitions from a CPP back to the DPP.

We also agree that an IRIS scheme should not be applied to a CPP following a catastrophic event.

We strongly support Orion's observation that the proposed formulation of the DPP quality targets departs significantly from the International IEEE standard and that the "two out of three" assessment approach, in particular, should be retained.

Network Tasman

We recommend that the Commission particularly note Network Tasman's example of investment in a new GXP as a demonstration of the frequently lumpy character of infrastructure capex that cannot easily be accommodated by an arbitrary capex capping mechanism, but which should not require the EDB to incur the expense of a CPP application for a one-off investment.

We agree with Network Tasman's observation that the factors that have driven accelerating declines in residential consumption per ICP in the current RCP are likely to persist and drive further declines in the next RCP.

Aurora

We agree that the Commission's under-forecasting of opex could undermine the potential benefits of the opex IRIS, as the consequent forecasting error will be treated as inefficient opex and the affected EDBs penalised as a result.

We agree with Aurora's observation that the Commission's draft decisions on the opex base year, the capex limit and opex partial productivity are not supported by empirical evidence.

We agree that loss of revenue and maintaining customer relations provide strong incentives to reconnect customers as quickly as possible even when a major event day (MED) has been triggered (contrary to the Commission's assertion that there is no incentive for EDBs to maintain their efforts to reconnect customers once a MED is triggered).

We agree with Aurora that a duration-related index (e.g. SAIDI) should trigger major event days because it is a better indicator of total costs to consumers than a frequency-related index (e.g. SAIFI).

Alpine

We agree with Alpine that we should adhere to the IEEE method for determining major event days and that the Commission has provided no evidence that New Zealand has a systemic problem with EDBs unnecessarily prolonging outages.

Horizon

We agree that the Commission has provided no evidence to support its view that electric cars are becoming viable in New Zealand and has taken no account of the effect that photovoltaic generation is having on EDBs' revenues.

Yours sincerely



Richard Fletcher
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