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Dane Gunnell
Manager, Price-Quality Regulation
Commerce Commission
44 The Terrace
WELLINGTON

By email only: regulation.branch@comcom.govt.nz

Dear Dane

SUBMISSION – DRAFT DECISION ON WELLINGTON ELECTRICITY LINES LIMITED'S TRANSITION TO THE 2020-2025 DEFAULT PRICE-QUALITY PATH

1 Aurora Energy welcomes the opportunity to submit on the Commerce Commission's (**the Commission**) draft decision on Wellington Electricity Lines Limited's (**Wellington Electricity**) transition to the 2020-2025 default price-quality path (**DPP3**).

2 No part of our submission is confidential.

Choice of transition

3 Under section 53X of the Commerce Act 1986 (**the Act**), the Commission has discretion to conduct a roll-over[1] or calculate a different starting price. The Commission notes that, in exercising its discretion to set alternative starting prices, it may consider the remaining term of the DPP and take a more or less complex approach, as it considers appropriate[2].

4 Given that Wellington Electricity will be subject to four years of DPP3, our view is that the Commission's proposal to apply a building blocks approach is not unreasonable, notwithstanding our further comments, below.

5 It must be noted, however, that roll-over under s53X is the default position in the absence of a positive decision by the Commission to adopt different starting prices. That is, if alternative starting prices are not determined within 4 months of the end of the CPP period, then prices must be rolled over.

6 In relation to rolling over prices, the Commission noted that:

> *"An s53X(2) roll-over has not been carried out before. It is not clear how a roll-over could be implemented for a price path that contains an Incremental Rolling Incentive Scheme."*[3]

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1 Where the DPP starting prices are equal to the prices that applied at the end of the CPP.

2 Commerce Commission. (2020). *Wellington Electricity Lines Limited's transition to the 2020-2025 default price-quality path: Draft reasons paper*. 25 September 2020, paragraph 2.11, p12.

3 Ibid, paragraph 3.11, p14.

7 It is concerning that the design of the Incremental Rolling Incentive Scheme (**IRIS**) mechanism has created a situation where; (a) if the Commission misses the deadline to advise different starting prices, effectively it cannot comply with s53X, and (b) s53X contemplates the Commission exercising a discretion to either roll-over prices or adopt different starting prices, but the Commission has fettered its discretion by implementing an IRIS mechanism that (it believes) rules out the default position.

8 Further, it appears that the design of the IRIS mechanism may preclude a more efficient process for resetting prices at the end of a CPP period, such as occurred at the end of Orion's CPP, where prices were rolled over with a CPI adjustment, after excluding claw-back.[4]

9 The Act takes primacy over the IMs. Given that the Act expressly contemplates roll-over as the default position at the conclusion of a CPP, the Commission must at least consider whether roll-over of prices would best meet the purpose of Part 4. The Commission cannot pre-emptively rule out roll-over simply because its current IM settings are not well-suited to a roll-over. Accordingly, we suggest that the Commission should consider changes to the IRIS mechanism to enable roll-over to be applied when necessary or warranted.

More recent information

10 The Commission has proposed using more recent data than was available at the time of the DPP3 decision[5], including updated escalators as inputs to the building blocks approach.

11 The Commission engaged NZIER to reforecast estimates of the Labour Cost Index (**LCI**), Producers' Price Index (**PPI**) and Capital Goods Price Index (**CGPI**).

12 While not explicitly stated in the reasons paper, we assume that the decision to reforecast escalation estimates is driven by concern for the economic impact of the global Covid-19 pandemic. In the case of LCI and CGPI, the reforecast estimates are materially changed from those applying to DPP3.

13 We have the following concerns with the Commission's approach:

13.1 The economic impact of Covid-19 remains uncertain for the New Zealand economy, as factors that are likely to affect the duration of the pandemic remain uncertain. We would have expected NZIER's report to have been made available to stakeholders, and for that report to carry some commentary on how uncertainty has been dealt with;

13.2 The specification of the LCI is problematic. The LCI, as specified, describes the movement in salary and wage rates for all industry sectors and all occupation groups. In the context of EDBs, which are essential services, the forecast indices are very likely to incorrectly supress Wellington Electricity's future labour costs, because LCI (as specified) will be skewed by the tourism, service and hospitality industries that have been heavily impacted by Covid-19;

13.3 The specification of the CPGI is problematic. The CPGI, as specified, describes the movement in all capital categories, including residential buildings and transport equipment. Like LCI, above, the inclusion of largely irrelevant capital cost categories is likely to produce a sub-optimal result;

13.4 Escalators are being selectively updated. As the Commission notes, the input methodologies preclude an updated forecast of CPI in this context.

4 Commerce Commission. (2016). *Orion New Zealand's transition to the 2015-2020 default price-quality path: Final report*. 7 October 2016, paragraph 3.3, p10.

5 Ibid, paragraph 3.3, p13.

14 Given the uncertainty regarding the economic impact of Covid-19, and that EDBs are likely to be less impacted by some indices (e.g., LCI), we do not support updating escalators as proposed. In our view, the Commission's draft decision to use reforecast escalators conflicts with its preference to ensure that Wellington Electricity is not on a "*materially different DPP to the other DPPs*".[6]

15 Moving forward, we consider that the Commission should employ a refined approach when forecasting escalators. This would involve selecting only relevant cost categories within LCI, PPI and CGPI, and applying an appropriate weighting to those relevant cost categories. Such an approach would produce a more defendable result and would not be so onerous as to compromise the relatively low-cost nature of DPP regulation required by S53K of the Act.

Insurance

16 The Commission's draft decision includes a rejection of updated insurance cost information provided by Wellington Electricity.

17 We note the Commission's concern that Wellington Electricity's insurance premiums are increasing markedly while cover is dropping.[7] Despite this, the Commission considers that EDBs have sufficient control over insurance costs.

18 However, the control that EDBs have is to accept greater immediate risk and pass costs to consumers when cover is insufficient. We agree with Wellington Electricity's view that:

> *"If the cost increase is not included in the base, WELL will have to consider reducing insurance cover so costs meet the allowances and rely on the ex-post CPP recovery mechanism following the event (which is both inefficient and ineffective)."*[8]

19 The key issue is that, having determined a level of insurance cover that is reasonable to manage risk on behalf of consumers, EDBs are being faced with premium increases that far exceed the CPI rate-of-change embedded in price paths.

20 We do not support the exclusion of Wellington Electricity's reasonably verifiable insurance costs in this instance.

21 Yours sincerely

Alec Findlater
General Manager, Regulatory & Commercial

6 Ibid, paragraph 2.5, p10.

7 Ibid, paragraph 3.28, p17.

8 Wellington Electricity. (2020). L*etter to Commerce Commission: Wellington Electricity DPP3 allowance calculation p preparation*. 26 August 2020.