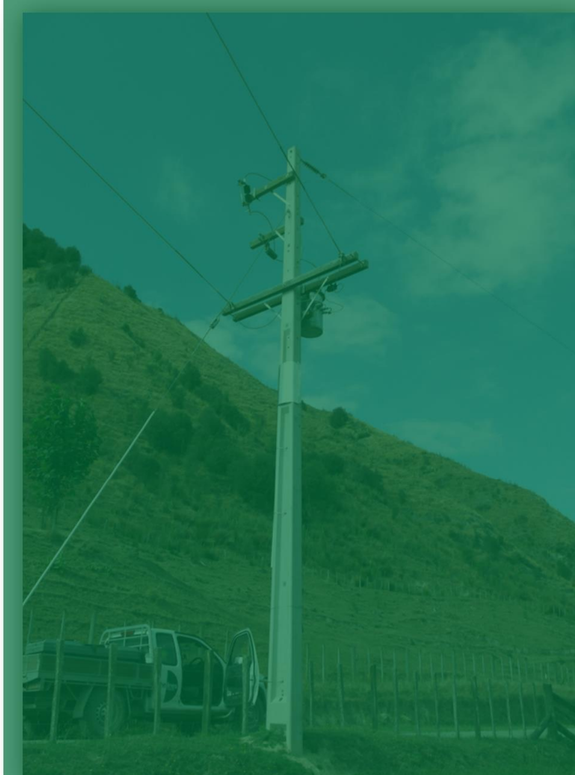
Submission on Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015



Introduction

The Lines Company (TLC) appreciates the opportunity to provide feedback to the Commerce Commission (the Commission) on the Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015 (DPP Policy Paper).

TLC is currently considering the DPP Policy Paper and the DPP Forecasting Paper, and the analysis and responses prepared by other submitters including, on behalf of industry groups, the ENA and PwC.

This submission sets out the issues which are of most interest/concern to TLC. We plan to respond within the cross submission period with further explanation, once we have digested the views of other submitters.

FY16 Price Step

- The estimated nominal price change from FY15 to FY16 is based on an FY15 allowable notional revenue value of $38.1m.
- The Commission estimates a decrease in nominal prices of 5.8% from FY15 to FY16 (prior to consideration of changes in pass-through and recoverable costs). This leads it to propose to use the industry-wide X-factor of 0%.
- However, the FY15 ANR value used is artificially high as a result of the price path error. If the price path error was corrected, we have estimated that the FY15 ANR would have been $33.4m (net of only PPD taken up).
- Based on this corrected value, the nominal price step to FY16 is 7.2% (before changes in pass-through and recoverable costs).
- This exceeds the Commission's threshold of 5%. Other EDBs with price steps of more than 5% have been proposed alternative X-factors.

TLC therefore proposes an alternative X-factor is applied, on the basis that had the Commission's analysis corrected for the price path, the Commission would have proposed an alternative X-factor in the draft decision.

Claw-back

- The other four EDBs which currently have alternative X-factors have been allowed claw-back in the next DPP period. This claw-back comprises compensation for two items: (i) under-recovery in FY13, and (ii) capped MAR in FY14 and FY15.
- TLC has not been allowed claw-back in the next DPP period in the draft decision.

- If claw-back had been calculated for TLC as it was for the other four EDBs, the value of the claw-back would be $7.13m (PV as at 1 April 2015). This comprises $4.26m related to the FY13 under-recovery, and $2.87m related to FY14-15 price path capping. This amount reflects revenue values net of the prompt payment discounts (PPDs) actually taken up.

- The Commission has not allowed this claw-back because the uplift in allowable revenue granted as a result of the price path error is "similar" to the value of claw-back.

- Our estimate of the additional revenue allowed in FY14 and FY15 due to the price path error is $6.96m (PV as at 1 April 2015). This amount is also net of the PPDs actually taken up.

- We agree with the Commission proposition that the two values are "similar", but note the claw-back is slightly more than the error ($170k).

- By pricing below the price path in FY15 (even when calculated after the error has been corrected), the Commission considers that TLC have effectively given up the opportunity to recover the FY13 claw-back allowance. We agree with this assessment.

The Commission has proposed not allowing recovery of any claw-back during the FY16-20 DPP period. This appears to be a pragmatic resolution to the information error issue (although there is a small amount given away by our calculations).

Capex Allowances

- Our network has very little growth and hence very low customer driven capex. Occasionally, a large customer will request additional capacity which can require significant connection capex. Our customers contract for this capacity on a take or pay basis for a fixed term. This means the profile of our customer connection capex is extremely variable and not suited to the capex cap approach.

- TLC is implementing new approaches to asset management planning that improve alignment to the Commerce Commission's AMMAT model (a subset of PAS-55). These will no doubt realign the capital investment planned for the network in future years and, allied with the proposed changes in quality standards, result in an increased capital forecast. The proposed capex cap, defeats the purpose of sound asset management practice.

- As with most electricity industry participants, the primary impediment to capital plan implementation has been availability of resources, in particular, skilled labour. The investment over time in training, and the slowdown in major construction and the Australian market, has seen access to labour improving. The 5-year trend in capital spend for TLC is steadily increasing and we anticipate this continuing.

- The capex cap has therefore been imposed through an arbitrary evaluation of historic spend which bears no reflection on true network needs or intentions for the future.
- The proposed non network capex cap penalises TLC because of our in house billing and works delivery model. The cycle of technology development, including the advent of smart meters, has necessitated inclusion in the 2015-20 regulatory period, capital investment for upgrading billing, data processing and customer engagement systems that other EDB's are not subjected to.
- Our pricing methodology enables us to recover costs from users of our network that cannot be recovered through standard retail billing. It also enables us to provide price signals to consumers which are truly reflective of the cost of service.
- Further we must invest in our office premises to meet earthquake standards, and invest in improved support systems in order to achieve the increases in efficiency and productivity that are a given for improving service and affordability for our consumers.
- Investments in systems to support these developments are necessary – the capex cap imposes limitations on our ability to achieve this.

TLC therefore does not support the imposition of a cap on recognisable capital expenditure driven solely off an average of historical actuals.

Opex Allowances

- The opex scale drivers give us very little by way of opex increases, because we have no movement in connections or circuit length.
- However our opex has increased over time, and one of the key reasons for this is the increasing compliance requirements. Health and safety is one example. The increased levels of audit, oversight, reporting and control for health & safety has imposed increased costs in the order of two FTE's. Further, the continued development of work standards, most notably on equipotential zones and arc-flash impose overheads in the form of new personal protective equipment, training and lengthier actual work practices.
- We expect additional resources will need to be added during the forthcoming regulatory period, to manage additional compliance obligations, some of which the Commission has outlined in its own Compliance Paper.
- Other reasons we have increased opex since FY10 are related to our customer engagement model. Having a direct relationship with our customers necessitates having regulatory compliant billing processes and systems (e.g., Fair Trading, EGCC and Electricity Authority), credit and debt control facilitates, call centre operations, customer liaison, etc.

- The need for these functions diverts opex from maintenance and technical functions.
- While some of these factors are a choice that TLC controls, it is never the less different from other regulated EDB's and may need the Commission to consider the application of low cost forecasting approach's going forward. This is particularly true for smaller EDB's and those with low forecast growth where scale factors have no benefit.
- Notwithstanding this trend for increasing opex, FY13 was a low year for TLC. As our outages were particularly low, we had low opex in that year and similarly low revenue as benign winter conditions held down demand (volume for others).

Accordingly we cannot maintain our quality, customer service and other important standards with opex driven solely from a FY13 base year. FY14 base year opex is more indicative of our normal level of opex.

Quality Standards:

- Proposed normalisation of SAIDI and SAIFI following major unplanned events will not generate a true underlying reliability measure.
- The SAIFI trigger for SAIDI MEDs does not capture the characteristics of our network because it is not representative of the challenges faced by rural networks in terms of the duration it takes to travel vast distances over rugged terrain in order to attend and repair faults. A large scale urban (underground) network would be more reflective of a SAIFI-driven performance outcome.
- The financial incentive scheme is not appropriate for us as we are unable to pass on the "reward" components but will incur the "penalty" component. If we maintain reliability levels this means we will be out of pocket
- FY13 was a very low year for outages, due to benign weather. Our recent SAIDI has been relatively stable over the last regulatory period. This can be attributed to the heavy investment over time in pole renewals, and the use of increased live line work and generators during planned outages. However the increased use of generators (to minimise SAIDI) has led to an increase in SAIFI as the switching required to establish the temporary supply causes frequency events (but causes low minutes). In order for TLC to reduce its SAIDI and SAIFI to meet the proposed quality targets means that a significant amount of capital expenditure will be required to further improve the network reliability.
- The proposed financial incentive rate is $2,389 per SAIDI minute. This amount of money is trivial compared to the investment required to make a sustained difference in reliability performance.

We will make further explanation of TLC's position in the subsequent submission on the Quality Incentive scheme.

D Factor

- TLC supports the D-factor incentive to compensate for foregone revenue as a result of demand management initiatives.
- TLC's pricing philosophy is directly related to managing demand.

Recoverable and pass through costs

- We note the substantial changes proposed to scope, process and timing of recoverable costs and pass through costs, which we are currently considering.

Volume risk

- Volume risk is a concern to TLC given our pricing methods, and refinements to these which are planned over the forthcoming period.
- Also we note the proposal to clarify treatment of prompt payment discounts, which we will respond to in submission on the Compliance Paper.