



Submission to the Commerce Commission

on

Default Price-Quality Paths from 1 April 2015 for
17 electricity distributors: Process and issues paper

30 April 2014

1. Introduction

- 1.1 We welcome the opportunity to submit on the Commerce Commission's (Commission) paper *Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper* (process and issues paper).
- 1.2 This submission's focus is on the incentives for service quality, the outstanding claw-back amounts, and the publication of enforcement guidelines. In all other matters our views are expressed by the Electricity Networks Association's and PricewaterhouseCooper's submissions.
- 1.3 This submission does not contain confidential information.

2. Incentives for service quality

- 2.1 We support the commission's proposal to replace the current so called 'pass/fail' approach with a 'revenue at risk' approach from 1 April 2015.
- 2.2 Our preference is for a revenue-linked quality incentive scheme that provides a symmetric approach whereby electricity distribution businesses (EDBs) are incentivized to improve the levels of service to consumers and disincentivized from providing a lower level of services to consumers.

Why we support incentives for service quality

- 2.3 An incentives approach transparently demonstrates the price/quality trade-off that EDBs constantly make in the normal course of the provision of distribution lines services.
- 2.4 For example, following the September 2013 storms we have several pine plantations on our network that are now unstable. The risk is that the trees may fall across our

lines causing unplanned interruptions on our network. The plantation owners want to harvest the trees however this will require a number of planned outages which are not currently allowed for under our planned maintenance.

- 2.5 Under the current pass/fail approach we face the risk that if we were to go ahead with the planned outages to fell the trees the SAIDI minutes incurred we could result in us exceeding our allowable limits. In turn causing us to breach the quality standards, which puts us at risk of pecuniary penalty of up to \$5 million under s87(3) of the Commerce Act.
- 2.6 To mitigate a breach we could defer other planned work on our network. But this may not be in the long term interest of consumers as it could result in us pushing out necessary maintenance on our network over a number of years.
- 2.7 The quality incentive scheme provides clearer signals to EDBs by putting revenue at risk when deciding the duration and number of planned outages in a given year. In the case of deciding whether, or not, to have a series of planned outages to harvest trees and still do our scheduled maintenance we might do so knowing that we will be putting \$40,000 of revenue at risk but avoiding \$100,000 of costs from trees falling through our lines and more potentially more in costs associated with having had deferred scheduled maintenance.

Key features of an incentives scheme

- 2.8 In your process and issues paper the Commission invite our views on how to set the:
 - incentive rate
 - reliability target
 - caps and collars for reliability
 - revenue at risk
 - method for normalization.
- 2.9 Unfortunately we have not been able to complete the full consideration of these in the time given for this submission, i.e., 40 days. We have put some thought into the key features but are reluctant to divulge these now without having fully tested the options. Accordingly, we recommend that the Commission allow proposals to be put to it outside of this consultation over the coming months by which an approach can be established that is rigorous, tested, and effective.

3. Outstanding claw-back amounts

- 3.1 We support the Commission's proposal to allow us, as one of the five distributors subject to the CPI+10% cap, to claw-back the total revenue under-recovered this regulatory period over the next regulatory period. Further, we agree that the claw-back amount should be smoothed across the period in present value terms, and if necessary the Commission apply alternative rates of change to avoid price shocks.
- 3.2 At the 2012 DPP reset when calculating the present value of claw-back amounts the

Commission decided that the cost of debt was the appropriate discount rate¹. You state in the process paper that the rate at which claw-back should be recovered under this reset has yet to be decided². We propose that the cost of capital is the more appropriate rate to apply to the claw-back in this instance.

- 3.3 The Commission's reasoning in 2012 for not using the cost of capital was that 'the cost of capital reflects the cost of equity, which in turn reflects exposure to systematic risk. However, there is not systematic risk associated with the recovery of claw-back amounts³.'
- 3.4 We are of the view that the CPI+10% cap placed systematic (aggregate) risk on us as we were vulnerability to risk arising from:
- market structure
 - the uncertainty faced by changes in the regulatory framework—for example, the unknowns of the current reset i.e., the method for the claw-back
 - international economic forces—for example, cost of copper, oil, and financing
 - acts of nature—for example, extreme weather events experienced across New Zealand in 2013.
- 3.5 Accordingly, we encourage the Commission to consider the circumstances of this claw-back, which is as a result of the CPI+10% cap discretely from its considerations for applying the cost of debt to the claw-back applicable in 2012.

4. Enforcement guidelines

- 4.1 While the process and issues paper does not invite views on the release of enforcement guidelines we would like to take this opportunity to once again raise our concerns about the lack of guidelines with the Commission.
- 4.2 Uncertainty around the process that the Commission will take when it exercises its enforcement discretion presents a serious concern for us. Part 4 of the Commerce Act gives the commission significant discretion to take enforcement action for breaches. Regulated suppliers currently only have limited precedent upon which to base how the Commission is likely to exercise its discretion when taking enforcement action.
- 4.3 To date the Commission has released two enforcement responses for breaches of the DPP at the 2011 and 2012 assessment dates. The Wellington Electricity Lines Limited settlement agreement provides some indication of the process that the Commission will take. However the Orion New Zealand limited warning letter provides none.
- 4.4 In the process and issues paper the Commission expressed the view that '[e]nforcement guidelines and informative precedents will contribute to reducing this

¹ Commerce Commission, *Resetting the 2010–15 Default Price-Quality Paths for 16 Electricity Distributors*, 30 November 2012, paragraph J30, page 149.

² Commerce Commission, *Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper*, 21 March 2014, paragraph 7.16, page 45.

³ Commerce Commission, *Resetting the 2010–15 Default Price-Quality Paths for 16 Electricity Distributors*, 30 November 2012, paragraph J30, page 149.

uncertainty...⁴, which is encouraging as it indicates that the Commission may be considering the release of enforcement guidelines.

- 4.5 We are of the view that enforcement guidelines will go a long way in providing regulated suppliers, including EDBs, with an appropriate level of certainty. And agree that while enforcement guidelines will reduce uncertainty the guidelines will never eliminate uncertainty entirely. Accordingly, we encourage the release of enforcement guidelines for the start of the next regulatory period.

5. Closing remarks

- 5.1 We hope that our submission is helpful to the Commission in making its determination of the default price-quality path effective from 1 April 2015. We are happy to discuss our views with you further if you would find it useful to do so.

- 5.2 The primary contact for this submission is:

Sara Carter
Regulatory and Pricing Manager
Alpine Energy
sara.carter@alpineenergy.co.nz
(03) 687 4306

⁴ Commerce Commission, *Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper*, 21 March 2014, paragraph 4.23, page 24.