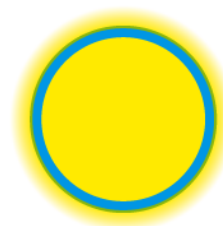


31 July 2018

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**POWERCO**



Dear Matthew

**RE: Request for feedback on recent customised price-quality path processes**

Powerco appreciates the opportunity to provide feedback on the Commerce Commission's open letter of 3 July 2018 regarding feedback on recent customised price-quality path processes.

We are committed to engaging and supporting the Commerce Commissions (Commission) work to ensure the customised price-quality path (CPP) Input Methodologies (IMs) are fit-for-purpose. As the IMs are tested through CPP applications, it is prudent to review and refine the process to reflect the environment they are being applied in. The CPP framework is a cornerstone component of New Zealand electricity distributions regulation, and as such, it is important that it is a viable alternative to the default price-quality path.

On 12 June 2017 Powerco submitted a CPP application under the Electricity Distribution Services Input Methodologies 2012. While amendments to the IMs have occurred as a result of the 2016 review, a high proportion of the IM requirements remain the same. We have provided extensive feedback of our application experience directly to the Commission. Some of which is reflected in the Commissions open letter. Appendix A of this submission provides additional views against the specific questions raised in the Commissions open letter.

Our experience of applying the IMs was broadly positive. However, we see opportunities to further evolve the CPP IMs and wider regulatory regime to support the development of electricity distribution services asset management in New Zealand. As such, we have taken the opportunity to provide views that not only relate to the CPP IMs but other components of the regulatory regime.

We consider the threshold to warrant the amending of CPP IMs is high as certainty is highly valued by electricity distribution businesses (EDBs). Amends to the IMs are only justifiable where clear and agreed benefits for customer can be demonstrated. Fully exploring alternatives is required before IM changes are proposed as often outcomes can be achieved via other means, such as Information Disclosures.

Other considerations we believe underpin the review of the CPP IMs are ensuring unnecessary complexity and cost is not introduced, a pragmatic approach is applied to changes and recognition is given that all EDBs are at various stages of asset management maturity. We are strong supporters of raising the asset management 'bar' in New Zealand and consider that the regulator regime should be designed to support and enable EDB development rather than become a barrier.

While we consider that all CPP applicants need to be assessed equally, we recognise the need for the CPP IMs to retain a high level of flexibility to cater for the range of issues and approaches that will require addressing.

Thank you again for the opportunity to engage on the CPP process and we look forward to further discussions. If you have any questions about this submission, please contact Oliver Vincent ([oliver.vincent@powerco.co.nz](mailto:oliver.vincent@powerco.co.nz)).

Yours sincerely

Stuart Marshall

General Manager Regulation and Commercial

## Appendix A: Powerco responses to the topics raised for feedback

ComCom questions on topics for feedback	Powerco Response
<b>A. Consideration of alternatives</b>	<b>Powerco summary:</b> Applied pragmatically, the consideration of alternatives to traditional network solutions has the potential to promote efficient distribution network investment for the long-term interests of consumers. This would be achieved by enhancing consistency, transparency and predictability in planning processes.
1. Whether we should require market testing of major investments, and if supported then:	Yes, we support the concept, if it is pragmatically applied. Creating a situation that results in excessive project delays and additional costs must be avoided.
1.1. What is an appropriate threshold to require market testing (e.g. minimum dollar value of a project before it is required to be market tested);	In the first instance we consider \$5 million to be a suitable threshold. This level would provide substantial opportunity for market involvement while avoiding the excessive burden to EDBs that would arise from having to prepare numerous small project proposals. It is also the observed threshold used in the Australian Regulatory Investment Test for Distribution (RIT-D) process.
1.2. What information and processes should be required for market testing; and	The Australian Regulatory Investment Test for Distribution (RIT-D) process has proven to be a workable solution. The process required by Transpower also addresses the concerns but could involve excessive effort for relatively small projects.
1.3. When the market tested should be conducted, with reference to the CPP application date.	The requirement for market testing shouldn't be defined by a CPP application but by what is in the best interest of consumers. Therefore, market testing of appropriate projects should occur regardless of an EDB operating in a DPP or CPP environment. AMPs will provide visibility over projects that meet a trigger threshold and the associated indicative timing of projects. As some projects may not be scheduled until the latter stages of a CPP it is not feasible to test these prior to submission. It should become a 'BAU' process to test and integrate into DPP and CPP frameworks.
<b>B. Use of cost-benefit analysis</b>	<b>Powerco summary:</b> The use of cost-benefit analysis is part of maturing asset management practises across New Zealand EDBs. Its application must be considered carefully and not seen as a replacement or substitute for the assessment criteria and expenditure objective that are currently specified in the current CPP IMs. CBAs should be one of many tools used in the 'basket' of techniques used when preparing and evaluating proposals to optimise the overall outcome.

<p>1. areas of potential customised price-quality path proposals that could be the focus of further work to understand how benefits can be quantified (e.g., health and safety);</p>	<p>We support further quantification and industry discussion of the quantification of risks in areas that have historically been difficult to quantify (e.g. safety). A pragmatic approach to using CBA is needed for its use to ensure feasibility and reflect that EDBs are all developing their asset management maturity and as such won't be able to quantify all benefits immediately. EDBs obligation to maintain supply to 'non-economic' consumers should also be recognised.</p>
<p>2. how an asset criticality framework could help support identifying expected benefits of additional expenditure; and</p>	<p>We support further development of criticality frameworks. If suitably applied, they help to better understand the risks posed by EDBs assets and the targeting of expenditure to areas of greatest cost/benefit. Criticality frameworks should be considered as part of a wider 'basket' of assessment measures and consideration given to other tools and techniques being applied.</p>
<p>3. potential changes to the customised price-quality path requirements that could help support the use of cost benefit analysis as a tool to inform customised price-quality path proposals</p>	<p>A blanket cost-benefit approach at an overall CPP level or across all investment portfolio categories is extremely difficult, with limited benefits. Its use in selected circumstances to complement assessment against the s52A purpose statement would provide optimum results. CBA techniques are best used at the individual project or programme level and tailored to the particular types of investments. For example, CBA techniques were used to assess our major project investments for our CPP application, using tools developed for that particular purpose. Other types of investments were supported by different justification aligned to that particular portfolio better than CBA techniques.</p>
<p><b>C. Long term pricing impact</b></p>	<p><b>Powerco summary:</b> We support the principle of presenting indicative long-term price impacts to stakeholders as part of the consultation requirements. We do not consider the threshold for amending the CPP IMs would be met and therefore is not appropriate. This is reinforced when we consider that alternative options to achieving the objective exist.</p>
<p>1. an applicant should be required to consult on the long-term price impact of its proposal;</p>	<p>We support the principle of presenting indicative long-term price impacts to stakeholders as part of the consultation requirements. Complicated doesn't mean impossible, and it is important that distributors can present a view (potentially using scenarios – to reflect the nature and scale of future price levels and changes. It's therefore not clear that a distinction should be made between a DPP and CPP.</p>

<p>2. the option of making an input methodology amendment is appropriate; and</p>	<p>We consider the threshold to amending IMs to be high and only justifiable where clear and agreed benefits for customer can be demonstrated, errors corrected or unnecessary complexity removed. Where alternative means can be used to achieve an outcome we support the further investigation of it. In relation to the long-term pricing topic we have proposed some alterative options below.</p>
<p>3. there are other options available that will encourage applicants to consult on the long-term pricing impact.</p>	<p>Some alternatives include</p> <ul style="list-style-type: none"> <li>- amend the Information Disclosure requirements relating to pricing methodology (2.4.1) to include a clause on forecast prices.</li> <li>- Amend the IM's to require publication of a pricing strategy and amend information disclosure clause 2.4.4 to include price changes for a 10 year period.</li> </ul>
<p><b>D. Calculating revenue and pricing changes</b></p>	<p><b>Powerco summary:</b>  We agree in principle with a standard approach applying to the applicant and the Commission however recognition should be given to allowing an applicant to customise their approach as long as it exceeds the standard approach. While the typical or 'average' customer approach has its limitations, it does provide a workable solution when engaging with mass market customers.</p>
<p>1. whether there are any issues in using a standard approach to calculating revenue and price changes consistently for consumer consultation purposes as well as in our customised price-quality path decisions;</p>	<p>We agree in principle with a standard approach applying to the applicant and the Commission.  An applicant should be allowed to exceed the standard approach to tailor the impact assessment for their customers and better reflect their pricing methodology. Pricing approaches can evolve over time and the impact can't be forecast if the methodology hasn't been set, so there is a risk of price changes being misleading.</p>
<p>2. whether our proposed approach to calculating these changes and the assumptions we make as outlined in Attachment B are appropriate;</p>	<p>The approach needs to account for changes to the number of customers, consumption, and potentially the applicants pricing methodology applicable to the typical customer. The Commission's calculations capture the change in MAR without allowing for any growth in quantities. The quantity assumptions could come from the AMP that accompanies the CPP application, so would be internally consistent with the MAR.</p>
<p>3. whether focusing the analysis on the 'typical consumer' as outlined in Attachment B is appropriate; and</p>	<p>We support the typical or 'average' customer approach. This is because they represent 99% of customer connections to our network.  We support assessing the impact on a monthly electricity bill is pragmatic given the dominance of consumers on that billing cycle at present.</p>

	<p>As noted above to question 2, the impact on a typical/average customer may apply to no customer if there are aspects of an applicant's pricing methodology which are not averaged e.g. locational differences.</p> <p>The MBIE data assumes a typical customer uses 8,000 kWh/year which is likely to be higher than the average consumption on an applicant's network. This will overstate the impacts of any charges that are on a 'per kWh' basis.</p>
<p>4. whether there are any other relevant consumer types that should be included in this analysis and, if included, where the necessary information could be sourced from.</p>	<p>We suggest EDBs make that assessment based on the nature of their CPP application and their customer base.</p> <p>Agree that this analysis should be limited to the residential / mass market consumers utilising publicly available information.</p> <p>There are a number of interdependencies to consider on this issue. We are happy to engage further with the Commission on our experience with pricing issues given we are on a CPP and a revenue cap.</p>
<p><b>E. Delivery and accountability of CPP Commitments</b></p>	<p><b>Powerco summary:</b></p> <p>We support improving transparency that shows how a CPP applicant is delivering against the commitments in its proposal and believe it should apply under both DPP and CPP frameworks.</p>
<p>1. there needs to be improved transparency that demonstrates a customised price-quality path applicant is delivering the commitments for which it has been funded in a transparent and easily understandable way;</p>	<p>We support improving transparency that shows how a CPP applicant is delivering against the commitments in its proposal. It is essential that EDBs continue an ongoing dialogue with its stakeholders and customers about its delivery commitments – this should be business as usual and regardless of whether an EBD is under a CPP or DPP. This transparency should also allow the applicant to explain to its stakeholders and customers how it has evolved its investment plans and assumptions over time through further information, innovation or efficiency. Supporting stakeholders understand how an applicant is key in demonstrating accountability and building trust.</p>
<p>2. an applicant should be required to provide a stakeholder facing delivery report that sets out how it is delivering the major projects and wider commitments it has been funded for under a customised price-quality path; and</p>	<p>We support the formal publication of a stakeholder facing document to explain to stakeholders and customers progress against commitments of a CPP. The requirements of such a document however need to be flexible to suit the different types of commitments made in CPP and complementary to the Information Disclosure requirements.</p> <p>Asset Management Plans could play a role here, if they were required to include more focus on communicating delivery as well as future plans.</p>

<p>3. it is appropriate to require customised price-quality path applicants to propose additional quality measures that are closely linked with the key drivers of its proposal to establish greater accountability for increased revenue, and whether these should be linked with revenue.</p>	<p>We agree in principle, but further industry consultation and thought is required to how best implement such measures. The impact of investments and other improvements could take several years to manifest in traditional quality measures (SAIDI/SAIFI). Normal variance across years (e.g. due to weather) will also hamper their effectiveness. Other more output focused measures could constrain an EDB from finding more innovative or efficient ways of delivering the same service.</p>
<p><b>F. Link between price and quality</b></p>	<p><b>Powerco summary:</b>  The link between price and quality is a complex topic and while we support further exploration of it, we do not consider it necessary to address it through the CPP IM's at this current time. We see many benefits from improved visibility of network performance for different customer groups or regions and consider that it would also better support customer engagement on price quality issues.  While an asset criticality framework is a useful tool in supporting conversation around the link between price and quality it has its limitations in the current environment. EDBs are all on their own individual asset management improvement journeys. This creates implementation challenges such as different levels of data quality and asset information available.  While we agree in principle we consider significant more work is required by EDBs before the impact of individual investments on quality outcomes for consumers can be demonstrated.  The Powerco public consultation material ('Have your Say') presented on approach to communicating the price quality trade-offs to consumers. When tested, the approach appeared to achieve its goal while addressing the challenges of communicating non-negotiable investment, such as that associated with safety.  We recommend that the Commission undertake further discussions with the sector to consider what options exist and what will be achievable as EDBs asset management matures.</p>
<p>1. What is the current practice within the sector for making decisions on investment trade-offs, and communicating trade-off decisions?</p>	<p>See topic summary</p>
<p>2. What are the potential compliance costs of implementing an asset criticality framework?</p>	<p>See topic summary</p>
<p>3. What is preventing asset criticality being implemented across the sector?</p>	<p>See topic summary</p>



<p>4. How do price and quality trade-offs get communicated to consumers so they can more meaningfully engage?</p>	<p>See topic summary</p>
<p><b>G. Consumer Consultation</b></p>	<p><b>Powerco summary:</b>  We do not consider that the CPP IMs require amending to contain a formal process relating to agreeing and aligning consultation expectations. Flexibility is key to a pragmatic approach to consumer consultation that works in all application scenarios. Consumer panels are a viable and good reference point, but the use should be a decision for the applicant.</p>
<p>1. whether a process is required to align expectations between the Commission and applicant prior to consultation being undertaken;</p>	<p>We do not consider that the CPP IMs require amending to contain a formal process relating to agreeing and aligning consultation expectations. Requirements relating to early engagement between a potential applicant and the Commission already provide adequate opportunity to discuss the consultation approach.  The IMs have specified consultation requirements at a high level to provide applicants with the flexibility to customise the consultation to meet the requirements of their application. Any tightening of these requirements could shift ownership of the process away from the applicant.  The relationship between the Commission and potential applicant should be developed to enable the Commission to have open discussions on the subject and reinforce their expectations while providing guidance if required.</p>
<p>2. the role of specific tools such as consumer panels;</p>	<p>Consumer panels are just one of many methods that an applicant may choose to utilise in their application development. We consider their being merit in consumer panels at different stages of the consultation process and it should be up to applicants to choose if they are used, how they are used and when they are used.  EDB led and regulator led consumer panels are widely used overseas with significant success. However, the wider context of the regulatory regimes they are applied in has to be considered. The recent ENA Consumer Reference Panel is a good example of how they can offer a useful reference point when engaging with consumer representatives. No requirement should be added to the CPP IMs requiring an applicant to use consumer panels. This would not, and should not, prevent the Commission establishing their own panel as part of their assessment process.</p>
<p>3. scope for specifying the existing requirements to provide further clarity; and</p>	<p>The current consultation requirements do not need amending. They provide the required flexibility and applicants can seek further clarification from the Commission if required.</p>



	Engaging an audience that is largely disinterested and uneducated in discussions on the investment plans of an EDB is challenging, complex and expensive. The industry will learn as more applications are submitted and the knowledge base of approaches are applied and tested. As such flexibility is essential to allow evolution of approaches and development of best practise.
4. the role of incentives at improving consumer engagement to get better long-term outcomes for consumers.	<p>As detailed in the <i>Strengthening the Consumer Voice in Energy Network Company Price Controls</i> report prepared by Involve for the Citizens Advice (UK) in March 2018, EDBs have internal incentives to continually focus on consumer engagement. Notably that:</p> <ul style="list-style-type: none"> <li>• making companies and regulators more responsive to consumers' needs;</li> <li>• achieving better outcomes for consumers;</li> <li>• increasing the legitimacy of monopolies; and</li> <li>• enhancing transparency and accountability both of company activities and of the regulatory process itself.</li> </ul> <p>Additionally, IM requirements already require an applicant to demonstrate a high level of meaningful consumer engagement. The verification and Commission assessment processes have the opportunity to comment on a EDBs consumer engagement and views can be reflected in the outcome of the final decision.</p>
<b>H. Verification</b>	<b>Powerco summary:</b> The current arrangements provide adequate flexibility. Communication and early engagement between the verifier, applicant, Commission and auditor is key to ensuring expectations, roles and approaches of all stakeholders is clear. We support the development of a verifier emerging views paper or preliminary report as long as it remains confidential for the verifier and applicant only.
1. whether the present verifier flexibility is sufficient and if the verifier should be required to signal early in the verification process the projects and programmes that they intended to verify;	Yes. The current arrangements provide adequate flexibility. There is significant benefit to EDBs and the verifier in having early insight into projects and programmes that the verifier intends to verify. We recommend that discussions related to the process for identifying programmes and projects should be agreed at the tripartite meeting.
2. should we be more prescriptive about the extent of the material required for the verified projects and programmes, keeping in mind	No, part of the verification appointment RFI process and tripartite meeting is to flesh out expectations. The current flexibility ensures that the required material can be aligned to the programme or project being assessed.

that the Commission may also request additional material during its own assessment of the proposal;	
3. whether we need to formalise the applicant information provision requirements to ensure information is provided to the verifier in a timely manner;	No. See above.
4. whether a verifier emerging views paper or preliminary report has merit;	Yes. A verifier emerging views paper or preliminary report provides valuable insights that can draw errors or misunderstandings to the attention of the applicant and verifier. This improves the quality of the final report used by the Commission in their assessment. As any emerging views paper or preliminary report would be produced pre-application submission, it should not be made public or available to any other party than the applicant (including ComCom). Adopting this approach is important in ensuring meaningful discussions can occur between the applicant and verifier.
5. whether the boundary between the audit and verification processes is sufficiently clear and if not, how can it be improved;	A key learning for us was that there are significant benefits in ensuring that the verifier and auditor have detailed discussions with each other as early as possible. The IMs provide enough clarity, however due to the possible approaches a verifier may adopt in assessing an application the finer details may need further consideration.
6. Have the changes to the verification process, made during the last input methodologies review, improved the verification and Commission customised price path assessment processes.	We are unable to comment at this stage as Powerco's application was made under the pre-2016 IM review and no other company has tested the current IMs relating to the verifier.
<b>1. Defining and applying proportionate scrutiny</b>	<b>Powerco summary:</b> We support the Commissions approach to defining and applying proportionate scrutiny. Further work is required to support the understanding of when and how to apply proportionate scrutiny.
1. your view regarding the current definition of proportionate scrutiny and whether you consider this is sufficient and provides enough clarity to potential customised price-quality path applicants	Yes the definition is sufficient. Finding a balanced definition is challenging but the negatives of having to tight a definition are outweighed by benefits of a more open and flexible definition. The definition must be broad enough to cater for all possible scenarios while ensuring stakeholders have confidence in the regulatory assessment process.

<p>2. whether you believe there is a need for the Commission to better define the principle of proportionate scrutiny and the circumstances when it may be applied in practice; and</p>	<p>Yes. To ensure that no barriers exist to applying for a CPP, the Commission need to ensure that the industry is clear on how they will apply proportionate scrutiny. Until actual examples exist the use of scenarios, alongside open discussions, provide a potential solution.</p>
<p>3. any further steps you think could be taken by the Commission to provide more certainty to all industry participants and stakeholders about how customised price-quality path applications will be assessed?</p>	<p>We consider that there is a need for the Commission to better communicate around its approach to assessing when and how to apply proportionate scrutiny.</p>