

# Have your say on Wellington Electricity's proposal to change its prices

Process for determining Wellington Electricity's customised price-quality path

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## **Wellington Electricity has proposed changes to its prices and quality standards**

- 1 On 5 December 2017 Wellington Electricity Lines Limited (**Wellington Electricity**) submitted a proposal to the Commission for a customised price-quality path (**CPP**) to allow it to increase prices to invest in its electricity distribution network's ability to respond to a major earthquake.
- 2 In response, we have commenced a process to review Wellington Electricity's proposal and make a decision on the new prices that will apply. If the proposal complies with the relevant requirements, a final decision would apply to Wellington Electricity for three years starting 1 April 2018.

### **Why we have written this paper**

- 3 We expect the process to review and make a decision on Wellington Electricity's proposal will be completed by the end of March 2018. During this time we will be seeking feedback on both Wellington Electricity's proposal and a draft of our decision.
- 4 This paper is intended to prepare consumers and other interested parties to provide their views during our process to set Wellington Electricity's CPP. It does this by explaining:
  - 4.1 our role in setting prices and quality standards;
  - 4.2 how you can have your say on Wellington Electricity's proposal; and
  - 4.3 the changes we have made to the normal CPP process, to address Wellington Electricity's unique circumstances.

## Our role in setting prices and quality standards

- 5 The Commission is responsible for regulating the prices and quality of service provided by electricity distributors, such as Wellington Electricity, across New Zealand. This regulation exists because electricity distributors face little or no competition.
- 6 Our role is important as our decisions affect:
  - 6.1 the prices charged by electricity distributors which are passed on to consumers as a major component of retail electricity prices;<sup>1</sup> and
  - 6.2 the quality of service consumers receive, in particular the frequency and duration of power outages.
- 7 Our regulation is applied by setting the maximum revenues businesses are allowed to earn, and quality standards which impose minimum service levels. In doing this, we seek to promote the long-term benefit of consumers by:
  - 7.1 considering what outcomes would occur in a workably competitive market;
  - 7.2 promoting incentives for Wellington Electricity to innovate, invest, improve efficiency, and provide services at a quality that reflects consumer demands, and share efficiency gains with consumers; and
  - 7.3 limiting Wellington Electricity's ability to extract excessive profits.
- 8 Our decisions do not specify the individual prices that Wellington Electricity and other electricity distributors charge their customers. Electricity distributors may charge different prices across different regions and different types of customers—as long as they do not exceed the maximum revenue allowed by the Commission.
- 9 To understand more about our role in regulating electricity distributors please visit [www.comcom.govt.nz/regulated-industries/electricity/electricity-role/](http://www.comcom.govt.nz/regulated-industries/electricity/electricity-role/).

### How our role relates to Wellington Electricity's proposal for a CPP

- 10 Currently, Wellington Electricity's prices and quality standards are set through a default price-quality path (DPP). The DPP applies to 16 electricity distributors across New Zealand. It is reset every five years using generic assumptions as a relatively low-cost way to regulate these businesses.

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<sup>1</sup> 26.2% of the annual electricity bill of a typical New Zealand residential customer is made up of distribution charges. See Electricity Authority "My Power Bill" (16 March 2016) at: <http://www.ea.govt.nz/consumers/my-electricity-bill/>

- 11 The DPP will not suit the needs of all businesses over time however, and they may submit a proposal to the Commission for a CPP as Wellington Electricity has done. Under a CPP we can take into account more of the specific circumstances of the individual business, and determine a new set of prices and quality standards we consider appropriate.
- 12 To understand more about our role in setting CPPs please visit [www.comcom.govt.nz/regulated-industries/electricity/cpp/cpp-fact-sheet/](http://www.comcom.govt.nz/regulated-industries/electricity/cpp/cpp-fact-sheet/).

### Changes to the normal CPP process

- 13 Following the 2016 Kaikoura earthquakes, Wellington has faced an increased risk of a major earthquake occurring.
- 14 On 18 September 2017, a Government Policy Statement was issued outlining the expectation that the Commission would consider options to allow Wellington Electricity to recover urgent resilience-related expenditure that was not anticipated when its default price-quality path was set in 2015.
- 15 On 17 November we published a paper to consult on our proposed approach to assessing and setting Wellington Electricity's CPP, to enable this.<sup>2</sup>
- 16 The paper set out the changes that we intended to make to the normal CPP process in order to allow for a 'streamlined' CPP process, focussed primarily on the urgent resilience-related expenditure needed by Wellington Electricity.
- 17 We received submissions on our proposed process which were generally supportive of taking a 'streamlined' approach in Wellington Electricity's unique circumstances.<sup>3</sup>
- 18 There were also some potential risks identified in some submissions, for example, that the features of this process could be argued more widely, potentially undermining the regulatory framework.<sup>4</sup>
- 19 On balance we decided that our proposed approach is appropriate given the very specific circumstances, and our view that a streamlined CPP process would promote the long-term benefit of consumers in this case.
- 20 A brief discussion of submissions and how we have taken account of them is set out in the attachment to this paper.
- 21 To allow for this streamlined approach we have approved modifications and exemptions to the CPP process and content requirements. Our letter approving these modifications and exemptions is set out in Wellington Electricity's CPP application.<sup>5</sup>

<sup>2</sup> See: <http://comcom.govt.nz/dmsdocument/15910>

<sup>3</sup> For example, see submissions from Wellington City Council, Wellington Cable Car, Powerco and Firstgas.

<sup>4</sup> See submissions from Major Gas Users Group and Major Energy Users Group.

<sup>5</sup> See: <http://comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/wellington-electricitys-2018-2021-potential-cpp/>

- 22 We have also amended the DPP determination to introduce a new application window for Wellington Electricity to submit its CPP application.<sup>6</sup>

### **Determining Wellington Electricity's CPP**

- 23 In determining a CPP for Wellington Electricity, we will focus our scrutiny on whether Wellington Electricity's proposed resilience related expenditure is prudent and efficient.
- 24 Due to the urgent and unique nature of this proposal we are not proposing to re-scrutinise the expenditure that we have already allowed for under Wellington Electricity's DPP, except to ensure that any additional expenditure proposed has not already been provided for.
- 25 However, we will still need to determine WELL's expenditure levels for year three of Wellington Electricity's CPP, which is beyond the end of the current DPP period.

### **How you can have your say on Wellington Electricity's proposal**

- 26 To best ensure our decision on a CPP for Wellington Electricity promotes the long-term benefit of consumers, we are seeking consumer and others' views on Wellington Electricity's CPP proposal.
- 27 These views are important to help us understand how satisfied customers are that Wellington Electricity's proposal works for consumers. In particular, we are interested in consumers' willingness to pay for improvements to resilience, and whether Wellington Electricity has chosen the best options to address earthquake risks.

### **We are seeking your views on Wellington Electricity's proposal**

- 28 We are now seeking views on Wellington Electricity's CPP proposal which we have published alongside this paper.
- 29 To read Wellington Electricity's proposal please visit our website:  
<http://www.comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/wellington-electricitys-2018-2021-potential-cpp/>
- 30 We request that submissions on Wellington Electricity's proposal are received by 20 December 2017.
- 31 Please email submissions to [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz) with 'Wellington Electricity CPP proposal' in the subject line. All submissions will be published on our website.

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<sup>6</sup> See: <http://comcom.govt.nz/dmsdocument/15958>

- 32 During this consultation period, we will assess Wellington Electricity’s proposal for compliance with the relevant rules applying to CPPs.<sup>7</sup> We expect to advise stakeholders of the outcome of this process via a notification email, sometime in mid-December.

### **Other opportunities to have your say on Wellington Electricity’s CPP**

- 33 Next, in early February 2018, we will publish a draft decision on the allowed revenues and quality standards we consider should apply to Wellington Electricity. This draft will be open to feedback from all interested persons with submissions due late February 2018, and cross-submissions on matters raised in submissions from other parties, due in early March 2018.
- 34 We expect to make our final decision on Wellington Electricity’s CPP by 29 March 2018. Our decision will apply to Wellington Electricity from 1 April 2018.

### **Summary of our process**

<b>Process step</b>	<b>Expected Dates</b>
Process paper and CPP proposal published	6 December 2017
Submissions due on Wellington Electricity’s CPP proposal	20 December 2017
Draft decision on Wellington Electricity’s CPP	1 February 2018
Submissions due on draft decision	22 February 2017
Cross-submissions due on matters raised in submissions on draft decision	1 March 2017
Final decision on Wellington Electricity’s allowed revenues and required quality standards	29 March 2018

### **Please contact us with any questions**

- 35 Please contact Dane Gunnell, Wellington Electricity CPP Project Manager, if you have any questions. Email: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz), attention: Dane Gunnell.

<sup>7</sup> Under s 53S of the Commerce Act, within 40 working day after receiving a proposal, we must determine whether the proposal complies with the input methodologies, referred to in s 52T(1)(d), relating to the process and content of customised price-quality path proposals.

## Attachment – Summary of submissions on Wellington Electricity CPP discussion paper

Submitter	Submission	Topic	Commission response
Firstgas	Supports the Commission’s proposed approach for assessing the WELL CPP application. Considers that WELL’s high-level summary to the Commission provides the context for the additional resilience investment, enabling the Commission to confirm the separability of the expenditure before proceeding with the streamlined CPP.	Process	Noted.
Firstgas	Considers that the proposed approach for WELL, if confirmed, will provide a helpful precedent of what the “principle of proportionate scrutiny” means in practice, when applied to a CPP application.	Process	<p>We consider that WELL’s urgent and exceptional circumstances justify a streamlined CPP in this case (ie, the heightened earthquake risk following the Kaikoura earthquake and the government issuing a government policy statement). However, as outlined in paragraph 23 of the Discussion Paper, we are unlikely to adopt this approach in the future, unless similar exceptional circumstances were to arise.</p> <p>More generally we consider proportionate scrutiny will be relevant in determining where we focus our attention when assessing a CPP, and the depth of information we require. Further discussion of the proportionate scrutiny principle can be found in our IM review paper on CPPs available at: <a href="http://comcom.govt.nz/dmsdocument/15107">http://comcom.govt.nz/dmsdocument/15107</a></p>
Major Electricity Users’ Group	Considers that the circumstances may be sufficiently exceptional to warrant a streamlined CPP proposal just for approving WELL’s proposed earthquake readiness stage 1 expenditure.	Process	Noted
Major Electricity Users’ Group	Considers it would be imprudent to support development of a new process until a robust quantitative Cost-Benefit-Analysis (CBA) was available. MEUG is concerned that the Commission may feel compelled to rush decisions on deciding whether to develop a streamlined process.	Process	<p>We consider that applying the flexibility allowed in the IMs is appropriate in these exceptional circumstances. We do not consider that a CBA is necessary to make this decision. This is because:</p> <ul style="list-style-type: none"> <li>• This “streamlined CPP” is likely to be a one-off – ie, we do not see this process as opening the door to other CPPs of this nature.</li> <li>• We consider that assessment under s 52A of the long term benefit of consumers is promoted by ensuring that WELL is enabled to undertake this expenditure. The legislation does not mandate the use of CBA in undertaking analysis under s 52A.</li> </ul>

Submitter	Submission	Topic	Commission response
Major Electricity Users' Group	Suggest the Commission needs to consider if assets purchased for the stage 1 earthquake readiness phase are subject to the risk of stranding, justifying a lower WACC, or need an uplift on WACC as an incentive to invest and innovate	WACC	We are constrained by the IMs, which set out the WACC applicable to a CPP.
Major Electricity Users' Group	Suggests other measures of performance should be included otherwise there will be no accountability on WELL to deliver what it proposes to deliver. Those measures of performance are likely to be project milestone type measures.	Quality	We will consider new quality measures to hold WELL accountable for its resilience expenditure as part of preparing our draft decision.
Major Electricity Users' Group	Suggests that if there is a wind fall gain from moving to a revenue cap then it should be netted out either voluntarily by WELL or an urgent change made to the Input Methodologies	Allowable revenue	We do not consider that the move to a revenue cap will result in a windfall gain for WELL. As part of the 2016 IM review we made a decision to move new price paths for EDBs to a revenue cap because it would remove the quantity forecasting risk present under a price cap which may create disincentives to efficient expenditure.
Major Electricity Users' Group	There is a risk of precedents being set to incentivise other be-spoke streamlined CPP proposals to be sought.	Process	As outlined in paragraph 23 of the Discussion Paper, we are unlikely to adopt this approach in the future, unless similar exceptional circumstances were to arise.
Major Electricity Users' Group	Suggests that WELL could proceed at their own cost to deploy emergency assets.	Process	The capital expenditure required for this project is a significant uplift on Wellington Electricity's existing capital expenditure allowance. WELL advises that reprioritising expenditure within this allowance would lead to breach of its quality standards and we do not consider it likely that WELL will proceed with investments at its own cost. In these circumstances we consider that allowing for prudent resilience expenditure through this process will promote the long-term benefit of consumers and that this is the best available option to ensure this urgent resilience expenditure, which is supported by a GPS, is undertaken.
Major Gas Users Group	Concerned to ensure, that in developing a 'streamlined' CPP the Commission's particular approach does not undermine the overall regime for setting a CPP or key elements which are important to it.	Process	As outlined in paragraph 23 of the Discussion Paper, we are unlikely to adopt this approach in the future, unless similar exceptional circumstances were to arise.
Powerco	Supports the Commission's proposed approach to consider a streamlined CPP process for WE and any party facing a similar situation	Process	As outlined in paragraph 23 of the Discussion Paper, we are unlikely to adopt this approach in the future, unless similar exceptional circumstances were to arise.



<b>Submitter</b>	<b>Submission</b>	<b>Topic</b>	<b>Commission response</b>
Powerco	Supports the increased visibility and awareness of the need to focus and address network resilience needs	Process	Noted.
Powerco	Expects the Commission's determination will include consideration of the CPP expenditure objective	Process	Agree that the determination will include consideration of the CPP expenditure objective.
Powerco	A monitoring plan reporting on delivery and cost against the proposal has merit	Quality	We will consider this in preparing our draft decision.
Simon Fleisher – Wellington Cable car	Supports Wellington Electricity's approach to this difficult and challenging problem and the Commerce Commission's approach to dealing with the simplified CPP submission	Process	Noted.
Wellington City Council	Supports the proposed approach to considering Wellington Electricity's application for a streamlined price path.	Process	Noted.
Wellington City Council	Considers that procurement progress, state of these assets and progress of the system enhancements should be reported separately as part of Wellington Electricity's reporting regime.	Quality	We will consider this in preparing our draft decision