

31 January 2019

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Dear Dane Gunnell

Default price-quality paths for electricity distribution businesses from 1 April 2020 – Issues paper cross submission

1. Introduction

Wellington Electricity Lines Limited (WELL) welcomes the opportunity to make a cross submission in response to submissions provided to the Commerce Commissions (Commission) issues paper “Default price-quality paths for electricity distribution businesses from 1 April 2020” published on 15 November 2018. This cross submission refers to this paper as the “Issues Paper”.

WELL’s cross submission considers the opinions expressed in the 28 submissions submitted by the industry in response to the Commission’s Issues Paper.

2. Executive Summary

Overall, WELL commends the Commission in providing a regulatory regime which provides strong price regulation, a level of quality customers are seeking¹, at an affordable cost. The price reset provides a good opportunity to refine the price-quality path, specifically, improving the quality incentives and ensuring opex and capex forecasts reflect changes to the operating environment with the introduction of wider customer choices in the adoption of new technology. WELL is concerned around the number of potential new quality measures and changes to the incentives. These potential changes could expose EDBs to increases in risk which won’t be reflect in the WACC, and add costs which aren’t consistent with a low cost regulatory regime. The change in DPP WELL is seeking is greater flexibility for EDBs to invest in distribution systems operator technology to enable the capability of an active low voltage (LV) network for monitoring the accommodation of two-way power flow.

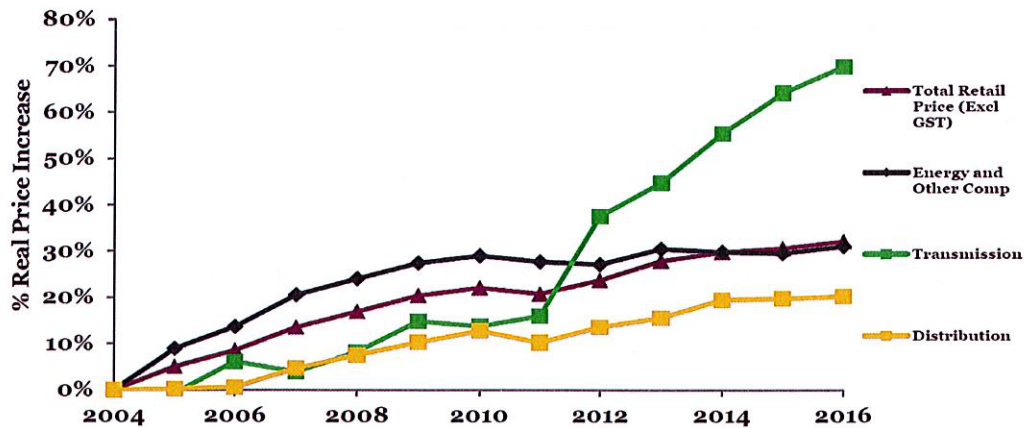
3. General forecast comments

The retailers Genesis and Mercury both commented that distribution and transmission price increases have been the cause of electricity price increases. Meridian recognised that distributor price increases were modest, but commented that it was still an increase when the competitive components of the market have been decreasing.

¹ 85% of WELL’s customers would not pay more for fewer power cuts.

PWC provided an analysis of residential electricity prices to the ENA in 2017. Figure 1 below provides a breakdown of electricity price increases from that analysis. Distribution prices have increased, on average by 1.5% p.a. and energy/retailers have increased by 2.3% p.a.

Figure 1: Real price increase by component of total delivered electricity changes (excl. GST) for a domestic consumer using 8,000kWh (%) 2004-2016²



There may be periods of modest increases as EDBs reinvest at the end of asset lives to maintain services or invest in new capability. Prices should be viewed over the long term to capture the long replacement lifecycles assets require. EDBs will also have to invest in new capacity or in improving the efficiency of the existing capacity to meet the expected exponential increased in electricity usage from new technology like electric vehicles. Prices will be higher while the extra capacity is being developed, and will fall again when the capacity is being used.

WELL supports more open communication and collaboration with retailers to ensure prices align. This will be especially important as usage based prices are introduced.

3.1. Operating efficiencies of EDBs

Genesis, ██████████ and Vector expressed concerns that some EDBs do not have the scale to operate efficiently.

WELL believes that the economy of scale in infrastructure can provide efficiencies for consumers. The economy of scale in electricity distribution can be attained in a number of ways, including sourcing best practice services and sharing functions between EDBs.

3.2. Inflationary uplifts

Aurora, Orion, the Lines Company, Unison and Vector all commented that inflationary uplifts should reflect the sector.

WELL agrees that inflationary uplifts should reflect the underlying costs they will be applied too as accurately as possible. Various sectors putting pressure on government for wage and salary increases and international trade disputes, will affect the price inputs for delivering customers their

² Produced by PWC for the Electricity Networks Association July 2017

lines function services. WELL supports Unison's idea that expert advice should be used to help inform this.

3.3. Econometric measures

For the econometric measures to be used to forecast growth, then they must be good predictors for all EDBs. WELL does not support using econometric measures because submissions showed that econometric measures were not a good predictor of growth for all networks.

WELL is also concerned that the proposed metrics are based on historical data and may not be good predictors of growth for cost categories that are changing (like network growth due to EV uptake).

WELL preferred approach is to use the AMP for forecasting both Opex and Capex.

4. Operating expenditure forecasts

4.1. Forecasting using historical expenditure

WELL strongly agrees with the view of Fonterra, Orion, Unison, Powerco and Vector who all commented on the importance of allowing for individual changes in operating expenditure not captured in the base year (or for expenses in the base year that are no longer required). Unison summarised this view well by saying 'It's important that the forecast not be a mechanical rollover, but should allow for reasonable adjustments to accommodate to changes in the operating environment'.

The Electricity Price Review has signalled greater EDB involvement in social services to retailer customers - an additional investment for services to low or energy poor customers which haven't been factored into current allowances.

WELL would support exploring Powerco's suggested 'in between' mechanism with careful consideration given to materiality and how a low cost regime would be maintained.

4.2. Steps changes

WELL agrees with Vector that the current step change mechanism was too restrictive as it did not cater for uncertain changes. Vector recommends that the mechanism be adjusted for changes that are reasonably likely to occur'. WELL strongly supports this concept. This adjustment to the step mechanism would also maintain the low cost approach.

The Lines Company also suggested including labour shortages caused by large CPP programmes in the step change mechanism. WELL agrees this should be captured by either the step change mechanism or the partial productivity factor.

4.3. Partial productivity factor

Aurora, ENA and Unison submitted that the partial productivity factor should be based on evidence rather than a working assumption of 0% (as was done in DPP2). WELL agrees with a new study to calculate partial productivity. This will ensure any new influences are captured.

Fonterra suggests using a positive factor to encourage cost savings. WELL strongly disagrees with this idea as applying a positive factor could encourage EDBs to forgo legitimate and needed expenditure and create a conflict with the existing IRIS cost saving incentives.

5. Capital expenditure forecasting

5.1. Level of capital scrutiny

Like Aurora, ENA, Fonterra Powerco and Vector, WELL supports using the AMP to forecast capital expenditure. WELL also agrees with Powerco, that care must be taken around the level of scrutiny applied to the AMP so that a low cost model is retained. WELL disagrees with Fonterra's suggestion that the forecast should be scrutinised by accredited ISO auditors and Genesis suggestion of a high level of scrutiny due to the high costs this would add. These high levels of scrutiny are more in line with the CPP process.

For this reason, WELL also disagrees with Contact Energy suggestion of the Commission developing the capital programmes. EDBs have the expertise and knowledge to develop capital programmes for their individual networks. Using the AMP to forecast capital also maintains independence expected from price-quality regulation.

5.2. Capital expenditure cap

WELL strongly agrees with Vectors view that caps on capital expenditure are not appropriate for asset replacements as past expenditure is unlikely to be a good predictor of future expenditure due to long asset lives and short regulatory periods. WELL agrees with Vector that the AMP should be used to forecast Capex.

Powerco suggested using a similar approach to that used in the Gas DPP, using a threshold to delineate the level of scrutiny applied to the capex. WELL believes this option has merit. It would help avoid sub-optimal investment decisions caused by limiting capital expenditure and retains a low cost approach by limiting scrutiny to peaks in capital forecasts.

5.3. Capital retention factor

WELL supports the view of Powerco, Vector and Aurora who do not support increasing the retention factor – that increasing the retention factors could lead to incentives to decrease quality.

5.4. Incentivising non-wire/non-capital solutions

New technology is providing new and innovative solutions that allow trials for distributing electricity usage to off peak times, delaying the need for investment in new traditional distribution capacity to meet increases in demand. These are subject to further LV investment to make the performance of these assets visible and manageable to meet supply standards which must be maintained to continue to deliver quality at the LV customer level.

WELL supports Vector's and Unison's view that the current regime discourages investing in non-wire or non-capital solutions.

5.5. Introducing new technology

WELL supports Unisons and Powerco comments that the Issues paper was silent on incentives or compensation for EDBs to invest in research and development. WELL agrees that it's important to innovate and without incentives, consumers could face higher future costs due to short term under investment (for example, the Transpower glide path as illustrated in figure 1).

5.6. Transpower spur assets

Eastland Network commented that the scheme needs to be adjusted so EDBs are not penalised through the IRIS for Transpower asset purchases. WELL supports this approach.

6. Quality incentives

6.1. Reliability incentives – are they effective

MEUG (via NZIER's submission), ENA, Unison and Vector all commented that the current reliability incentives are not incentivising the right outcomes. This is due to the quality measures include events that the EDBs cannot control. WELL strongly agrees with these submissions. The reliability mechanism needs adjusting so that incentives are linked with quality measures an EDB can control – asset performance and outage responsiveness.

WELL agrees with Fonterra that bad weather should not abdicate an EDB's responsibility for maintaining a strong network. However, if weather events are worsening, then networks will have to be strengthened to a higher level of quality to meet the same standard. There will be a price-quality trade off. If customers want a more robust network to withstand more severe weather events, EDBs will need the ability to increase their capital programme.

6.2. Increasing revenue at risk

NZIER (as part of the MEUG submission), Orion, The Lines Company, ENA, Unison, Meridian and Vector do not support increasing the revenue at risk to 5% because the shortfalls of the current regime (discussed in section 6.1) would make increasing the size of the at risk percentage ineffective in incentivising the right outcomes. WELL strongly supports this view.

6.3. Separating planned outages

Orion and Meridian do not support separating planned outages and removing them from the incentive regime because they still inconvenience the customer. WELL agrees with this view. WELL has comparatively few planned outages because WELL has proactively kept the power supplied through portable generation. In the last year this has cost WELL an additional \$600k p.a. in direct costs – a cost that will maintain the SAIDI result.

6.4. Cap and collar

WELL agrees with the ENA's submission, that until the effectiveness of the current reliability measures are improved, the cap and collar levels cannot be addressed.

6.5. Calculating quality revenue reference period

Aurora suggested that the referenced period should not change, otherwise any improvements will be penalised as they will be included in the new dataset and lower the quality targets. WELL

disagrees with not changing the period of the dataset. WELL supports reducing the reference period to five years and using the most recent data-set. Using a five year data-set of the most recent information ensures the data-set captures current work practices. Vectors submission supported this view. Mercury supported a 15 years data set which WELL disagrees with for the same reasons.

6.6. Normalising the reliability metrics

Aurora, Unison, ENA and Vector all support the current 2/3 year approach to measuring breaches. WELL also supports this view as it partially mitigates the impact of uncontrollable events. WELL also supports 'resetting' the number of breaches back to zero if the an EDB does breach in two of three years. This will give an EDB time to correct the causes of a breach without a subsequent breach threat.

6.7. LV Monitoring and Reporting

Generally, EDBs can see the benefits of LV monitoring and reporting but have concerns around how this can be practically measured. WELL agrees around the challenges of developing robust LV monitoring and so does not support collecting LV performance data and does not support LV data being provided as part of the information disclosure until we have LV monitoring in real time in place. Clear standards for grid-tie inverters so they incorporate communication and monitoring is also needed (like those provided in Energy Networks Australia's 'Electricity Network Transformational Roadmap').

LV performance monitoring and reporting will require investment to implement effectively. WELL would support LV performance monitoring to enable customers to commercialise their Distributed Energy Resource (DER) investments which provide long term benefits by deferring the need to pay for network capacity. Retailer's charges for smart meter data would need to be treated as a pass through cost to customers as it would be an efficient cost in comparison to EDBs installing their own devices. Smart Meter data does not provide real time LV monitoring so it is DER devices which need support from industry standards to make this an efficient cost for customers.

Fonterra highlighted the importance of LV measures and the impact it has on farmers. If this view is representative of all customers, and customers are willing to fund the new measures due to the benefits derived, then WELL would support its introduction.

6.8. New customer incentives

ENA, Fonterra, Mercury and Genesis support the new measures. Alpine, Aurora and Orion have concerns around the practicalities of implementing the measures. Vector recognised the importance of measuring what's of importance to customers.

WELL does not support the introduction of two new customer metrics because of the investment required to effectively implement and monitor the proposed performance measures.

However, if customers want the new measures, are willing to fund its implementation (and the cost is included as an increment to current prices) and they can be practically implemented before they are included as a quality incentive, WELL could support its implementation.

6.9. Operation of the revenue cap

WELL congratulates the Commission on moving from a price cap to a revenue cap and the associated change in forecasting approach – moving from a forecast under a price cap where the Commission had more forecast responsibility, to a ‘light touch’ under the revenue cap where the EDB has more forecasting responsibility.

Orion suggested providing a provision in the revenue cap mechanism for retailer default. WELL supports this idea as under the current mechanism, lost revenue from a retailer default could not be recovered.

6.10. Enforcement guidelines

Vector suggested that the Enforcement Guidelines should provide direction around the ‘trade-offs’ the Commission makes when assessing a breach – what does the Commission consider a ‘false positive’ or outages that does not indicate a deterioration in quality. WELL supports clarifying how the Commission will assess breaches.

7. Closing

WELL appreciates the opportunity to provide a cross submission on the Commerce Commissions issues paper “Default price-quality paths for electricity distribution businesses from 1 April 2020”.

If you have any questions or there are aspects you would like to discuss, please don’t hesitate to contact Scott Scrimgeour, Commercial and Regulatory Manger, at sscrimgeour@welectricity.co.nz .

Yours sincerely



Greg Skelton

Chief Executive Officer

