networktasman
Your consumer-owned electricity distributor

Network Tasman Limited
52 Main Road, Hope 7020
PO Box 3005
Richmond 7050
Nelson, New Zealand

Tel: 64 3 989 3600
Freephone: 0800 508 098
Fax: 64 3 989 3631
Email: info@networktasman.co.nz
Website: www.networktasman.co.nz

4 August, 2016

Keston Ruxton
Manager, Input Methodologies Review
Regulation Branch
Commerce Commission

By email: im.review@comcom.govt.nz

Dear Keston,

Submission on the Input Methodologies Review Consultation

Network Tasman Limited (Network Tasman) welcomes the opportunity to provide comment on the Draft Decisions published by the Commission on 16 June 2016 in relation to the Input Methodologies Review.

Network Tasman supports the submissions prepared by the Electricity Networks Association (ENA) and by PwC on behalf of a number of electricity distribution networks. In what follows we additionally express views relating to:

- The IRIS implications of transmission asset acquisitions;
- The implications for the IMs of potential changes to the Distributed Generation Pricing Principles; and
- The effect of a revenue cap on incentives for changes to pricing structures.

1. IRIS implications of transmission asset acquisitions

Subpart 3 of the IMs sets out the methodology for the Incremental Rolling Incentive Scheme (IRIS). Network Tasman has a specific concern with the approach taken by the Commission to the calculation of the operating expenditure incentives where the distributor has acquired transmission assets.

The Commission's forecasts of operating expenditure for the period 2015/16-2019/20 made no allowance for operating expenditure relating to transmission assets acquired by Network Tasman in December 2014. The Commission took the view that: "Operating expenditure associated with purchased assets which is not captured by the general forecasting approach should be funded via the additional revenue allowance provided by including the avoided cost of transmission as a recoverable cost."[1] Network Tasman considers this to be a reasonable approach. However, doing so necessitates an amendment to the IMs so that the IRIS operational expenditure incentive is not adversely affected. In particular, the operational expenditure associated with transmission assets which is excluded from the 'forecast opex' in used in the formula set out in 3.3.3 of the IMs should also be excluded from 'actual opex'.

In the absence of this adjustment, distributors that have made a transmission asset acquisition face an IRIS penalty, which can be very significant. Network Tasman estimates that the IRIS operating expenditure incentive for the first year of the next regulatory period (commencing 1 April 2020) will result in a penalty to Network Tasman equivalent to approximately 1.5% of total annual revenue (2% of annual distribution revenue). This is an anomaly and is inconsistent with the intent of the IRIS mechanism. We note that we have put considerable emphasis within our business into operating the acquired transmission assets as efficiently as possible.

The issue described above was raised in previous consultations by Eastland Networks and the ENA.[2] The Commission did not make an amendment to address this matter because it considered that "any divergence from the forecasts can significantly increase both the

[1] Commerce Commission (29 November 2014) Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020 Main policy paper", paragraphs D44-D49.

[2] Eastland Network (29 August 2014) "Default price-quality paths from 1 April 2015 for 17 electricity distributors" para 40 and Electricity Networks Association (29 August 2014) "Submission on proposed amendments to IMs: Incremental rolling incentive scheme", paragraph 49.

complexity of the IRIS calculation and the also reporting of expenditure".[3] Network Tasman respectfully submits that failing to make an adjustment to the IRIS for the purposes of simplicity is, in this case, unacceptable given the material effect that it will have on revenue of distributors (including Network Tasman) that have acquired transmission assets.

Network Tasman also considers that it would not be appropriate for the Commission to assume that the avoided cost of transmission incentive, while covering transmission asset operating expenditure and providing an incentive to invest in transmission assets, would additionally offset the IRIS penalty. This is because the IRIS operating expenditure incentive will occur in a different regulatory period.

In conclusion, Network Tasman finds it disappointing that the issue was not resolved when it was raised in previous consultations. It is imperative that the Commission address this matter in the current IM review.

We would be happy to provide further information to the Commission demonstrating the materiality of this issue.

2. DGPP – Implications for the IMs

We note that the Electricity Authority is proposing to remove the Distributed Generation Pricing Principles (DGPP) from Part 6 of the Electricity Industry Participation Code. This has implications for the recoverable cost identified in 3.1.3 (1)(f) of the IMs – the distributed generation allowance.

The distributed generation allowance is defined in the IMs as:

> *Any positive allowance for costs incurred and amounts payable, or negative allowance for amounts receivable, in relation to avoided transmission charges arising from distributed generation, including embedded or notionally embedded generation, made in accordance with-*
>
> *(1) Schedule 6.4 of Part 6 of the Electricity Industry Participation Code; or*
>
> *(2) The Electricity Industry Act 2010.*

[3] Commerce Commission (27 November 2014), "Amendments to input methodologies for electricity distribution services and Transpower New Zealand – Incremental Rolling Incentive Scheme" paragraph B10.

Network Tasman recommends that the Commission consider whether a removal of the DGPP (should that eventuate) would require an amendment to the IMs. We draw particular attention to the situation where a contractual obligation to pay ACOT would endure even if the DGPP is removed. In that case it is important to ensure that these ACOT payments continue to be a recoverable cost.

Network Tasman considers that existing ACOT arrangements which reflect avoided transmission charges rather than avoided transmission costs are harmful as they ultimately result in higher charges for consumers. As a result, change is required in some form. It is important that the Authority and the Commission coordinate on this matter to achieve an outcome which is both in the interests of consumers and allows cost recovery by distributors. It may be that the Authority's final decision on the DGPP occurs after the Commission's IM Review process is concluded. In that case it is important that there is a means by which the IMs can be amended in future to address this issue.

3. Effect of a revenue cap on incentives to set efficient prices

We note that the Commission has proposed that the existing weighted average price cap be replaced by a revenue cap. The Commission has invited comments on the letter it received from the Electricity Authority in relation to the effect of the form of control on incentives to implement pricing structures that are more cost reflective than those that are currently in place.

Network Tasman is currently reviewing its pricing structures, and has a strong interest in moving towards more cost-reflective pricing. Primary drivers of Network Tasman's interest in improving its pricing structures include: (1) fair pricing where all consumers make a reasonable contribution to costs; and (2) providing end consumers with pricing signals that give incentives to make efficient decisions on when and how they use grid-supplied electricity as compared with alternative energy sources.

To date, key barriers to implementing cost-reflective pricing have been the Low Fixed Charge regulations and the low penetration of advanced metering. Whether the form of regulatory control is based on a revenue cap or a weighted average price cap has no bearing on our pricing strategy. However we do consider that a revenue cap would be easier administratively for a pricing restructure than a weighted average price cap.

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Network Tasman appreciates the opportunity to provide comments on the Commission's Draft Decisions. I would be happy to discuss our submission to provide further clarification on Network Tasman's views.

Yours sincerely

Network Tasman Limited

Emma Lanigan
Regulatory and Commercial Manager
DDI 03 989 3607
Email emma.lanigan@networktasman.co.nz