Eastland Network

Submission to the Commerce Commission

Input Methodologies Review

4th August 2016

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1 Summary

Eastland Network Limited (Eastland) appreciates the opportunity to respond to the Commerce Commission's (Commission) Input Methodologies (IM) Review Draft Decisions dated 16 June 2016.

Eastland is aware that some of the matters raised in this submission are not referred to directly in the draft decision papers, however, Eastland considers these matters are of significant importance that they should be addressed as part of the current IM Review.

Eastland supports the introduction of a revenue cap and believes that they industry is facing strong commercial incentives to introduce pricing that is more cost reflective and efficient.

Eastland submits that the impact of not including opex relating to assets acquired from Transpower into the IRIS opex forecasts significantly affects Eastland, therefore opex relating to the assets acquired from Transpower should be adjusted for when calculating IRIS opex.

Eastland also supports the submissions prepared by the ENA and PWC on behalf of 17 Electricity Distribution Businesses.

2 Introduction

Eastland have prepared this submission in response to the Consultation Papers "Input Methodologies Review draft decisions" dated 16 June 2016. If you have any questions regarding this submission please contact

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Eastland owns and operates the electricity distribution network located in the East Coast of the North Island. Eastland is 100% owned by the Eastland Community Trust with the Gisborne District Council as the capital beneficiary of the trust.

Eastland distributes approximately 300 GWh of electricity to approximately 25,500 consumers of which almost two thirds are located in Gisborne City and Wairoa township. The remaining consumers are widely dispersed across two isolated networks covering approximately 12,000km^2. This results in an overall consumer density of 7 connections per circuit km, less than the industry average of 13 connections per circuit km and the industry median of 9 connections per circuit km. Eastland has considerable diversity across the network, with rural connection density less than 3 connections per km, and urban connection density approximately 25 connections per km.

We have experienced little growth for the past decade, as most of our consumers are domestic users, and many of them with relatively small consumption. A significant proportion of our revenue is recovered via variable tariffs. In addition, our network supply area is one of the lowest socio-economic regions in New Zealand, and this is reflected in low energy consumption growth due to resistance to retail electricity prices.

3 Form of Control

Eastland agrees that the adoption of a revenue cap for EDBs would remove the quantity forecasting risk for distributors when setting price-paths and determining compliance. Eastland considers that there are significant incentives within the industry to develop cost reflective prices and that current weighted average price cap are a disincentive to developing new pricing.

Over the past few years, consumption on the Eastland network has stagnated or reduced. This is a reflection of the socio-economic status of the region and consumer resistance to increasing retail prices. Eastland also faces considerable uncertainty regarding emerging technologies and the impact these technologies could have on the network.

Under the current price tariffs, 78% of Eastland's revenue is dependent on variable consumption yet the majority of our costs are fixed. This leaves Eastland subject to considerable risk of not earning sufficient revenues to cover total costs particularly where emerging technologies provide partial or total alternatives to network delivered energy.

Eastland agrees that the current weighted average price cap is a disincentive to introducing more cost reflective pricing due to the difficulty in proving lagged quantities where the data for these quantities was either not available or collected historically. There would be significant time, cost and effort involved in determining the appropriate methodology for forecasting quantities and determining past quantities. This would be a deterrent for an EDB the size of Eastland which has limited resources to allocate to this type of exercise.

4 Impact of Opex IRIS for Assets acquired from Transpower

On 31 March 2015, Eastland Network Ltd acquired the regional Transmission spur assets from Transpower for $12.7m. The following day, the Commerce Commission's Incremental Rolling Incentive Scheme commenced. The IRIS scheme rewards or penalises EDBs if their expenditure varies around the Commission's forecasts. The Commission's operating expenditure forecasts are based on historical base year data and do not take into account significant acquisitions and the impact these acquisitions may have on future operating expenditures after the base year.

In August 2014, Eastland Network submitted[1] on the initial proposal by the Commission to introduce IRIS. Our submission disagreed with the Commission's proposal to exclude all spur asset opex from the price path and IRIS. In the Final Reasons Paper[2], the Commission stated that there was not "sufficient reason to justify the increased complexity that would arise from diverging from forecasts used in the price-quality path."

Eastland disagrees with this statement as the impact to Revenues and cash flows will be a reduction of $1.3m or 5.4%[3]. This is a significant decrease for Eastland Network particularly when this decrease follows on from the end of the 5 year ACOT allowance for the acquisition of assets from Transpower. These two impacts combined will require Eastland to decrease revenue by $5m (21%) within a 2 year time period. This will have a serious impact on Eastland.

Eastland remains of the view that opex incurred in relation to spur assets acquired should be removed for the purposes of calculating opex IRIS. While the Commission is concerned about the complexity of the reporting of expenditure[4], Eastland does not believe this would be a significant issue for most EDBs and that this would only be an issue until the next reset period ie five years at most.

[1] Eastland Network Ltd "Default price-quality paths from 1 April 2015 for 17 electricity distributors" 29 August 2014

[2] Commerce Commission "Amendments to input methodologies for electricity distribution services and Transpower New Zealand Incremental Rolling Incentive Scheme" 27 November 2014, Paragraph B11

[3] Based on Distribution line charge revenue of $23.874m for 2015/16 disclosure year.

[4] Commerce Commission "Amendments to input methodologies for electricity distribution services and Transpower New Zealand Incremental Rolling Incentive Scheme" 27 November 2014, Paragraph B10