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ORION'S TRANSITION TO THE 2015-2020 DEFAULT PRICE-QUALITY PATH – SUGGESTED APPROACHES

1 Further to our submission on the Commerce Commission's (the **Commission**) consultation paper "Orion's transition to the 2015-2020 default price-quality path – Key considerations and possible approaches" (the **Paper**), and our subsequent telephone conversation.

2 During our telephone conversation we indicated that we were considering how a rollover of Orion's price's excluding clawback and including CPI adjustment could be implemented. We understood that the Commission would be interested to see this possible approach, this letter outlines our suggested approach.

3 The 2015 DPP sets a starting allowable notional revenue (ANR) based on a specific maximum allowable revenue (MAR) for each EDB. This is then rolled forward with a formula.

4 No initial MAR is specified for Orion. The approach of setting an initial MAR is aligned with a building blocks calculation of allowable revenue, rather than a roll-over.

5 To achieve a roll-over of prices for Orion, a formula to calculate ANR based on previous prices is needed. The roll forward formula specified for years 2 to 5 in the 2015 DPP can't be used because it relies on a "distribution price" in the prior period, and no such distinction exists for Orion in FY2019.

6 We consider that there are three options to address this:

6.1 Require Orion to set separate distribution and pass through prices for 2019. This is difficult to achieve via an amendment to a determination that only applies after 2019. It would also impose a risk on Orion in relation to actual pass through costs varying from forecast (we would be incentivised to under-forecast pass through costs so that distribution prices are as high as possible, noting that the differential would not be captured in a pass through balance), or

6.2 Retrospectively determine the proportion of 2019 prices that relate to pass through costs once the actual amount is known. This is more workable, but the amount of each price that relates to pass through costs is not consistent across prices, and it would be difficult to set out a concise and reasonable approach, or

6.3 Set a roll over formula that establishes allowable revenue by deducting actual recoverable costs. This is the most straight forward approach and is largely consistent with the roll forward formula specified in Orion's CPP determination.

7 The last of these options is the most workable and acceptable for a single year. The formula in the CPP can be carried over to the 2015 DPP via an Orion specific amendment, and adjusted to provide for the removal of the

$$ANR_{2020} = \left(\sum_i P_{i,2019}\,Q_{i,2018} - (K_{2019} + V_{2019}) + (ANR_{2019} - NR_{2019}) - \text{Clawback}\right)(1 + \Delta\text{CPI}_{2020})(1 - X)$$

clawback allowance, as follows:

Note that:

7.1 X is specified in schedule 2 of the Determination and the 0% figure is applicable to Orion, and

7.2 The proposed formula uses "Price" rather than "Distribution Price", and "Price" is already appropriately defined in the Determination.

8 The approach can be implemented with the amendment (red lined) set out in Appendix 1 to add a second Orion specific paragraph to Schedule 3B of the 2015 DPP Determination.

9 We are happy to discuss this suggested approach and if you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email dennis.jones@oriongroup.co.nz.

Yours sincerely

Dennis Jones
Industry Developments Manager

Appendix 1 – suggested changes to schedule 3B of the Electricity Distribution services Default price-quality path Determination 2015 [2014] NZCC33

Schedule 3B: Calculation of allowable notional revenue for the remaining Assessment Periods

1. Subject to paragraph 2, ~~T~~the allowable notional revenue for all Assessment Periods other than the first Assessment Period of a Regulatory Period or CPP Regulatory Period must be calculated in accordance with the formula .....

2. The allowable notional revenue for Orion for the Assessment Period ending in 2020 must be calculated in accordance with the following formula -

$$ANR_{2020} = \left(\sum_i P_{i,2019} Q_{i,2018} - (K_{2019} + V_{2019}) + (ANR_{2019} - NR_{2019}) - \text{Clawback}\right)(1 + \Delta CPI_{2020})(1 - X)$$

where-

i	denotes each Price;
$P_{i,2019}$	is the i^{th} Price during any part of the Assessment Period ending in the year 2019;
$Q_{i,2018}$	is the Quantity for the Assessment Period ending in the year 2018 corresponding to the i^{th} Price;
K_{2019}	is the sum of all Pass-Through Costs that Orion published in its Customised Price Path Compliance statement for 2019
V_{2019}	is the sum of all Recoverable Costs that Orion published in its Customised Price Path Compliance statement for 2019
$ANR_{2019} - NR_{2019}$	is the difference between allowable notional revenue and notional revenue that Orion published in its Customised Price Path Compliance statement for 2019;
Clawback	is one fifth of $34.8m
X	is the annual rate of change applicable to Orion as specified in Schedule 2; and
ΔCPI_{2020}	is the derived change in the CPI to be applied for the Assessment Period ending in the year 2020, being equal to:

$$\frac{CPI_{Dec,2017} + CPI_{Mar,2018} + CPI_{Jun,2018} + CPI_{Sep,2018}}{CPI_{Dec,2016} + CPI_{Mar,2017} + CPI_{Jun,2017} + CPI_{Sep,2017}} - 1$$

where-

$CPI_{q,t}$ is the CPI for the quarter ending q in the in the year *t*.