

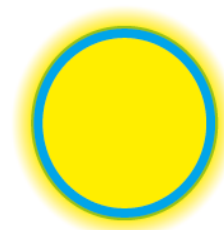
18 August 2016

Keston Ruxton
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POWERCO



Dear Keston

RE: Cross-submission on Input Methodologies review draft decisions

Introduction

1. Powerco welcomes the opportunity to provide feedback on the views submitted in relation to the Commerce Commission's (**Commission**) input methodologies (**IMs**) review draft decisions.
2. We have reviewed in draft the Electricity Networks Association's cross submission. We support the points made by the ENA in its cross-submission.
3. We have focused our submission on the small number of areas where a number of submitters have expressed views that diverge substantially from our own. To that end, the key issues we discuss are:
 - a. emerging technologies;
 - b. cost allocation;
 - c. form of control; and
 - d. CPP process.
4. Our comments are set out below.

Emerging technologies

5. We continue to support the Commission's pragmatic approach to the potential issues raised by emerging technologies set out in its draft decision paper.¹
6. As set out in our substantive submission, we think that any changes to the IMs should have a proper evidential basis,² and we agree with the Commission that pre-

¹ Commerce Commission, "Topic Paper 3: The future impact of emerging technologies in the energy sector" (16 June 2016).

² Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [251].

determining how these new technologies may be delivered, based on the evidence currently available, would not be in the interests of consumers. This is in-keeping with the Commission's stated policy objective for this review.

7. We don't agree with the concerns that have been expressed about the roll out of these new technologies. We think the charge that Part 4 regulation will give EDBs a market distorting competitive advantage is incorrect and does not properly reflect the transparency and controls that result from the proper application of the cost allocation IM. It also overlooks the Commission's observation that competition is made up of different business models with different features, and it is difficult to draw competition conclusions by focusing on one feature of one business model.
8. We also think the ring-fencing alternative is not an attractive policy option. Ring-fenced business units with contracts to the EDBs for services that relate to delivery of lines services will be in a similar situation to that reached under the cost allocation IM, but with an additional significant enforcement bureaucracy that consumers will end up paying for.
9. The essential difficulty for the Commission (and submitters) is that the specific evolution and roll out of technology is difficult to predict, and it is difficult to separate out policy, regulatory and commercial interests. We agree with the Commission that one aspect that can currently be predicted with some confidence is the potential for economic stranding of the distribution network – exactly by who, using what technology, and when is harder to specify. For that reason the Commission's proposal in relation to asset lives is prudent.
10. That said, we acknowledge that electricity retailers as a group are clearly concerned at ways that the markets could evolve. As set out in our previous submission, we consider that it would be an option for the Commission to undertake a mid-period review on the impact of emerging technologies.³

Cost allocation

11. A number of submitters support the Commission's proposal to reduce the unregulated revenue materiality threshold at which a supplier must move from ACAM to ABAA or OVABAA to 10%. Indeed, some submitters consider the Commission's proposed ACAM threshold reduction does not go far enough.⁴
12. As we set out in our previous submission, we do not consider that the Commission has properly articulated a sound rationale for moving away from the present 20% ACAM threshold.⁵ The threshold is there to reduce the costs of regulation and to avoid stifling innovation by EDBs, both objectives that are in the interests of consumers.
13. We do, however, acknowledge that retailers have expressed concerns with the ACAM threshold as it currently stands. Read together with the submissions on emerging technologies, this suggests there is room for further industry engagement on the cost allocation IM. We suggest that following the IM Review the Commission could lead an industry discussion on the objectives and detailed settings for cost allocation, potentially aligned with any mid-period review of emerging technologies.

³ Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [283].

⁴ For instance, the Major Electricity Users' Group (**MEUG**) and the Electricity Retailers' Association of New Zealand (**ERANZ**).

⁵ Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [269].

Form of control

14. Powerco supports the Commission's position with respect to changing the form of control for EDBs from a weighted average price cap (**WAPC**) to pure revenue control.⁶ While we have suggested some tweaks to the design of the revenue cap to improve its workability, we think the policy underlying the change to the form of control for EDBs is sound.
15. Some submitters have criticised the Commission's proposal on the basis that they consider it will lead to less efficient outcomes as compared with the WAPC. Specifically, we note MEUG's view that moving to pure revenue control will not be in the long-term interests of consumers.⁷
16. We reiterate our views expressed in our previous submission.⁸ In short, we do not agree that a pure revenue cap will lead to inefficient pricing structures. We provided expert advice from HoustonKemp, which addressed the Australian experience. HoustonKemp advise that the theoretical benefits of a WAPC were not realised, while less desirable behaviours were observed. For this reason the AER has made the move proposed by the Commission to revenue control.
17. There are a number of incentives operating on EDBs to experiment with changes to their price structures and to respond to the challenges and opportunities presented by emerging technologies. This includes both regulatory and commercial pressures.⁹ We think the Commission is right that the removal of forecasting risks under a pure revenue cap will allow EDBs to respond to these pressures and increase the level of innovation in their pricing structures.

CPP process

18. Powerco has already submitted on the full CPP process. In this cross-submission we respond to some specific suggestions made by MEUG.
19. MEUG suggests that the consultation requirements should be more prescriptive. MEUG also suggests that a verifier with expertise in public consultation should be engaged for the purposes of verifying this aspect of the CPP application process.¹⁰
20. We are concerned that MEUG's proposed amendments to both the consultation and verification requirements would "gold-plate" the CPP application process. As set out in our previous submission, we consider the consultation process is benefitted by striking the appropriate balance between prescription (what the Commission expects to see from the consultation process) and flexibility (allowing suppliers to tailor the process to

⁶ Our views are detailed in our previous submission: Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [15] – [49].

⁷ MEUG, "Submission on Input methodologies draft review decisions" (4 August 2016), at [12] – [13].

⁸ Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [30] – [48].

⁹ There is regulatory pressure for EDBs to undertake cost reflective tariff reform. The most visible example of this is the Electricity Authority's ongoing distribution pricing review that has charged EDBs with the responsibility of developing and implementing cost reflective pricing.

¹⁰ MEUG, "Submission on Input methodologies draft review decisions" (4 August 2016), at [15].

suit their needs).¹¹ In our view, the Commission's proposals in its draft decisions paper achieve this balance.

21. In a similar vein, requiring a specialised verifier to assess the adequacy of the consultation process is unnecessarily costly and resource-intensive, with no material benefit. Consumer consultation is no more complex than any other aspect of the verifier's role, and we see no reason why this is a part of the CPP application process that should be singled out for extra attention.
22. We recommend the Commission retain its present proposals in relation to these matters.
23. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact Richard Fletcher tel. (04) 978 9910, email Richard.Fletcher@powerco.co.nz

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Fletcher', written in a cursive style.

Richard Fletcher
General Manager Regulation and Corporate Affairs

¹¹ Powerco, "Submission on Input Methodologies Review: Draft Decisions" (4 August 2016), at [247].