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SUBMISSION ON INITIAL RESET OF THE DEFAULT PRICE-QUALITY PATH FOR ELECTRICITY DISTRIBUTION BUSINESSES – DRAFT DECISIONS PAPER

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the draft decisions paper on the *Initial Reset of Default Price-Quality Path for Electricity Distribution Businesses* (the **paper**) released by the Commerce Commission (the **Commission**) in September 2009.
- 2 The paper contains 22 draft decisions, the majority of which we agree with either in total or in part. Brief comments on each individual draft decision are contained in the schedule to this submission, and where necessary we detail additional comments below.

Starting prices

- 3 We agree in principle with the proposal to use the actual prices posted by each EDB as at 31 March 2010 as the starting prices. However, we note that if the 31 March 2010 prices are used as starting prices, then EDBs whose prices are currently set below their existing price paths will lose that 'headroom'.
- 4 We (and possibly many other EDBs) have consistently aimed to set prices below the Part 4A threshold limit (to avoid breaching), on the understanding that any under-pricing could be captured in the next year's pricing review.
- 5 Our understanding of the proposed approach is that it would:
 - 5.1 prevent this catch-up in future years; and

- 5.2 effectively eliminate some of the allowable price increase under the current regulatory framework.
- 6 We consider that an easy and workable solution to this issue would be to preserve any existing headroom through an explicit adjustment to the initial allowable notional revenue based on the existing headroom (adjusted by CPI).

Downwards price ratchet

- 7 We have some concerns about negative effects of the ‘downwards price ratchet’ that would result from the paper’s proposals.
- 8 The approach of updating base quantities each year and re-establishing the allowable notional revenue would effectively eliminate any headroom from year to year, ratcheting the limit down to previous prices, plus CPI. Any allowable price increase not taken would be foregone – essentially this would mean an annual adjustment of CPI or less.
- 9 Many situations exist where we might choose not to pass on a full increase, including to avoid rate-shock and to provide an element of price stability. We also note that the suggested approach would prevent us from temporarily lowering our price, as any lower level would be locked in.
- 10 As mentioned above, this could be fixed by simply allowing any headroom to be carried forward (and adjusted by CPI - X) in the calculation of allowable notional revenue (where headroom is the difference between notional revenue and allowable notional revenue).

$$R_t = (\sum P_{i,t-1} Q_{i,t-1} - K_{t-1} + R_{t-1} - NR_{t-1}) \times (1 + \Delta CPI_t)(1-X)$$

CPI lag

- 11 As noted in our earlier submission¹, we consider that a forecast approach to CPI would be superior to the proposed alternative six-month lagged approach².

¹ Orion, Submission on reset of default price-quality path for EDBs, 17 July 2009, p 35.

² As noted at paragraph 20 below, the proposed approach is actually an 18-month lag.

- 12 We say this because we believe that a forecast would more likely align EDB price movements with price movements in the wider economy over the relevant period.
- 13 It would also be a less complex result for EDBs, as the Commission would need only to publish the CPI movement to be used by all non-exempt EDBs.
- 14 We acknowledge that the Commission would need to state its method for deriving its forecast (which could be as simple as using the Reserve Bank’s forecast), and it would also need to carry forward overs and unders – arising from differences between forecast and actual CPI movements – from one assessment period to the next.
- 15 However, these are minor matters and we do not understand why the Commission considers that a forecast approach would incur materially higher cost than using lagged CPI.
- 16 If a forecast approach is accepted, we have considered the timing of price setting and availability of CPI updates, and we consider that a forecast of CPI to the mid-point of each pricing year provides the most desirable result. This approach allows any adjustment for prior under or over estimates to be applied in the following year, and allows prices to fairly reflect CPI movements for the pricing year (in theory, over collecting in the first 6 months, then under collecting in the next 6 months, or vice versa). With this approach, formula 8 would become:

$$\Delta\text{CPI}_t = \underbrace{(1 + \Delta\text{CPI}_{f,t-1})}_{\text{Forecast change}} \times \underbrace{\frac{(1 + \Delta\text{CPI}_{a,t-2})}{(1 + \Delta\text{CPI}_{f,t-2})}}_{\text{t-2 Adjustment}} - 1$$

where: ΔCPI_t is the change in CPI used in the calculations of R_t

$\Delta\text{CPI}_{f,t-1}$ is the forecast change in CPI for the year ending Septembert-1 (from Statistics NZ, the reserve Bank or similar)

$\Delta\text{CPI}_{f,t-2}$ is the forecast change in CPI for the year ending September t-2

$\Delta\text{CPI}_{a,t-1}$ is the actual change in CPI for the year ending September t-2, specified as:

$$\Delta\text{CPI}_{a,t-2} = \frac{\text{CPI}_{\text{Dec},t-3} + \text{CPI}_{\text{Mar},t-2} + \text{CPI}_{\text{Jun},t-2} + \text{CPI}_{\text{Sep},t-2}}{\text{CPI}_{\text{Dec},t-4} + \text{CPI}_{\text{Mar},t-3} + \text{CPI}_{\text{Jun},t-3} + \text{CPI}_{\text{Sep},t-3}}$$

- 17 With this approach the adjustment factor should not be applied in the initial assessment as there was no prior estimate for which an over or under correction is required.
- 18 Contrary to the Commission’s comments, we do not consider that this solution is overly complex. By the end of October each year, the Commission can simply prepare and publish the CPI forecast (with prior year adjustment) to use in price setting calculations generally carried out during December that year (for prices applying from 1 April the following year). The published CPI figure would then also be used for price path assessments at the end of the pricing year.
- 19 In relation to the proposed lagged CPI, we note that for the relevant assessment date, the CPI movement would actually be lagged by 18 months, not six months as stated. As an example, the CPI movement in the year to September 2009 would be used to determine and assess price movements to apply through to 31 March 2011.
- 20 The current threshold uses CPI to the end of the December quarter for the assessment at the end of the following March – a three-month lag. The suggested new method uses CPI to the end of September one year for the assessment at the end of March, not the next year, but the one after – an 18-month lag.

Estimated quantities

- 21 We agree in principle with the Commission’s draft decision to annually update base quantities in the notional revenue formula under a DPP, dispensing with the use of a fixed reference year. We also accept that the annual revision of quantities would go a considerable way towards addressing the pass-through anomaly.
- 22 However, we consider that there are some definitional problems with the specification of the price path assessment formula (Formula 7). In particular we note:
- 22.1 the draft decision to use t-1 quantities does not make it clear whether the quantities to be used in assessment are the actual t-1 quantities, or the *estimated* t-1 quantities used when the prices for period t are set. We believe the Commission intends the latter, (paragraph 4.42 says that “the Commission proposes to use these

estimated quantities”) in which case this needs to be more clearly stated, and Formula 7 needs to be clarified accordingly;

- 22.2 further confusion as to whether quantities are estimated or actual is added at paragraph 4.33 which refers to the “relevant audited quantity” for the preceding year, but this contradicts paragraph 4.42 which acknowledges these are estimates, at least at the time the prices are set. If there is an audit requirement here, it would presumably be that the estimated t-1 quantities were in the fact the ones used. This appears unnecessary.
- 22.3 if as we believe, and as we assume the Commission intends, the quantities to be used for assessment are estimated quantities for period t-1 when the prices were set, then the definition of $Q_i, t-1$ in box Formula 7, should read:
- “ $Q_i, t-1$ the base quantity for the service i in **year t-1**, which is the quantity of service i estimated to have been provided in assessment period t-1 at the time prices were set for assessment period t,”*
(emphasis added)
- 22.4 we suggest that the definition, as it stands, is incorrect in that it refers to “year t”, and ambiguous as to whether it is an estimated value or an actual value of the quantities for period t-1;
- 22.5 it is also unclear whether the Commission considers that the process described in paragraphs 4.83 and 4.84 solves the problem of variation between estimated and actual quantities. We do not believe that this step adds any value; actual quantities will always differ from estimates, and this is likely to be the “explanation”. Also given that there are in fact many quantities (Q_i), which will all vary from estimates in one direction or the other, it is unclear what the 5% threshold actually means. Perhaps auditors could be required to comment on the reasonableness of the estimate (at the time they were made); and
- 22.6 we believe that the allowable notional revenue calculation is also a little ambiguous, in that K_{t-1} is defined as “the sum of all pass through costs during assessment period t-1.” This, like Q_i , would not be known at the time prices are set for period t, so for consistency, this should be the estimated pass-through costs for period t-1, not actual. The difference, could be explained as part of the compliance process.

Price restructuring

- 23 We accept that the annual update of quantities might help facilitate tariff changes (for example, the formula would allow tracking of variations in pricing structures where one component was increased while another was reduced, or where a new component was introduced).
- 24 However, and contrary to the paper's view on price restructuring (paragraph B19), we submit that annual quantity updates would not resolve the problem of demonstrating price path compliance, at least not where entirely new quantities were devised (for example, where we move from kVA to kW, or where we move from summer assessment to winter assessment).
- 25 The problem (which also existed under the threshold regime) arises because the price for the new quantity simply did not exist in the previous period. It is not in fact possible to demonstrate compliance under both the old and new structures.

Re-openers

- 26 In our earlier submission³ we agreed with the Commission's proposal that no interim provisions for re-openers would be included in the Initial Reset Determination.
- 27 However, we consider that it is increasingly unlikely that input methodologies (IMs) will be developed by 30 June 2010 and that the Commission will require the additional six months allowed in the legislation to develop IMs.
- 28 We consider that it is appropriate for the Commission to take this additional time to provide an adequate consultation process on the IMs. This likely time extension before IMs become operational and consequently, before re-openers become available, will add some additional risk to EDBs.
- 29 We consider that the Commission could reduce EDBs' uncertainty in respect to significant events occurring prior to IMs being developed by issuing enforcement guidelines by December 2010.

³ Orion, Submission on reset of default price-quality path for EDBs, 17 July 2009, p23.

- 30 A longer term solution that we believe the Commission should consider is the treatment of significant events as general pass-through costs rather than events that require a total re-opening of the DPP. Presently, the Commission has proposed that pass-through costs for EDBs include transmission charges, local authority rates, Commerce Commission levies and Electricity Commission levies. In addition to these specific events, the Commission should allow for general nominated pass-through events.
- 31 The Australian Energy Regulator (AER) recognised recently that it is possible that events may occur during a regulatory period that are uncontrollable, unforeseen, and have a material impact on costs⁴. Examples of such an event may include a major natural disaster such as an earthquake, and liability for claims relating to asbestos or electric and magnetic fields. In these situations, although the occurrence of the event may be a possibility, its occurrence is unforeseen in that the event is not expected to occur during the next regulatory control period. It concluded that where an event is of such an unusual and unexpected nature, and the associated costs are likely to have such an effect on the returns of the business that services would be jeopardised, it may be appropriate that the associated costs be eligible for immediate pass-through.
- 32 We would encourage the Commission to adopt a similar approach. Specifically, consistent with the conclusion of the AER, we consider that an event should be classified as a general pass-through event, and eligible for immediate pass-through in the following circumstances:
- 32.1 the material change in costs of providing distribution services as a result of the event has such an impact on returns that services would be jeopardised [and/or compliance with allowable notional revenue would be impossible]; and
- 32.2 if it is an uncontrollable and unforeseeable event that falls outside of the normal operations of the business, such that prudent operational risk management could not have prevented or mitigated the effect of the event.

Pass-through costs

⁴ Australian Energy Regulator, *Final decision, New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, p.278.

- 33 We do not consider that the proposed approach to pass-through of costs would of itself remove the risk of non-compliance. As noted in our earlier submission⁵, three forms of pass-through exist:
- 33.1 those that are transparently passed-through as they are received (e.g., in Orion's case, transmission rental rebates (TRRs));
 - 33.2 those that are separately priced and recovered, (e.g. transmission costs (other than TRRs)); and
 - 33.3 those that form part of the estimated costs to be recovered when prices are set (Electricity Commission levies, rates, Commerce Commission levies).
- 34 Only the first of these completely insulates the EDB from compliance risk.
- 35 In relation to transmission costs, we have two concerns:
- 35.1 contrary to paragraph B16, transmission costs are not completely known in advance – interconnection costs are known (at least with the current transmission pricing methodology), but connection and new investment costs are not; and
 - 35.2 even if costs were known exactly, there is the risk, and indeed the near certainty, that actual transmission cost will be over or under recovered in the EDB's invoicing of its customers, due to the unpredictability of our chargeable quantities. For example, one of our main chargeable quantities for recovering transmission costs is our peak charge for general connections. This chargeable quantity is largely weather dependent, and is also affected by general economic conditions.
- 36 With the other pass-through costs, the same conceptual issues arise as with transmission, but there are no specific prices, so under and over recovery is less easy to assess. (However, these other pass-through costs are significantly less material than transmission.)
- 37 Orion supports the proposed treatment of Commerce Commission levies as pass-through costs. However, we also consider that the Commission should allow new, unavoidable costs associated with either: changes to

⁵ Orion, "Submission on reset of default price-quality path for EDBs", 17 July 2009, p 24.

existing legislation or regulation: or the introduction of new legislation or regulation, during the regulatory period to be included.

Enforcement guidelines

- 38 We believe that concerns EDBs may have about the risks with the DPP, as outlined above, are related to the fact that a breach is an illegal act, even though many of the breaches may be due to technical matters related to uncertainty and estimation and are likely to be very minor in terms of dollars and associated 'excessive' prices.
- 39 We consider that to provide EDBs with additional confidence in the regime, the Commission should be looking to release its proposed enforcement guidelines around December 2009, i.e. coincident with the time EDBs will be setting their prices for the 2010/11 year based on the Reset DPP.
- 40 If the guidelines contain some leeway for the Commission in declaring a breach, or in EDBs having to declare their own breach, then this would be useful. However, under the current timing we would not know about any leeway before we set prices for 2010/11.

Quality

- 41 We agree with the proposed use of a separately assessed quality path. We also agree with the quality standards being assessed on the basis of SAIDI and SAIFI measures.
- 42 We remain concerned about the proposed application of the IEEE 2.5 β method, and urge the Commission to continue to consider the work being carried out by the ENA in respect of extreme events.
- 43 We note that the proposal has the potential to ratchet down the SAIDI and SAIFI levels over time; we consider that this is inconsistent with the concept of no material deterioration in quality.
- 44 Paragraph C6 of the paper relating to the "two out of three" assessment process provides that if, for example, a SAIDI value that exceeds the reliability limit is followed the next year by **either** a SAIDI or a SAIFI value that exceeds the reliability limit this would result in a breach. We consider that in this respect the SAIDI and SAIFI values, as separate indices, should be treated independently and the two out of three assessment would take into account SAIDI and SAIFI measure separately.

X factor

- 45 We agree with the Commission's proposal for the X factor to be set at 0%. We also support the Commission's approach to consider a wide range of inputs when it comes to making this decision and not adopting a single mechanistic approach.
- 46 We remain unconvinced about the untested and radical approach proposed by Economic Insights. We recommend that the Commission should at the very least ignore the outputs from this source and engage with the industry to produce a more appropriate measure.
- 47 We endorse the work that the ENA is doing in this area and recommend that the Commission take it into further consideration

Concluding remarks

- 48 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. 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

SCHEDULE
Response to individual draft decisions

| Draft Decision | Decision | Comments |
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| Draft Decision on Re-openers | 3.49 The Commission's draft decision is to adopt the provisions for re-openers as set out in the relevant input methodology, following its publication. No interim provisions for re-openers will be included in the Initial Reset Determination. | <p>In our earlier submission⁶ we agreed with the Commission's proposal that no interim provisions for re-openers would be included in the Initial Reset Determination.</p> <p>However, we consider that it is increasingly unlikely that input methodologies (IMs) will be developed by 30 June 2010 and that the Commission will require the additional six months allowed in the legislation to develop IMs.</p> <p>We consider that it is appropriate for the Commission to take this additional time to provide an adequate consultation process on the IMs. This likely time extension before IMs become operational and consequently before re-openers become available will add some additional risk to EDBs.</p> <p>We consider that the Commission could reduce EDBs' uncertainty in respect to significant events occurring prior to IMs being developed by issuing enforcement guidelines by December 2010.</p> <p>A longer term solution could be for the Commission to consider significant events as general pass-through costs rather than events that require a total re-opening of the DPP see paragraphs 30 to 32 above.</p> |
| Draft | 3.65 The Commission's draft decision | We agree. |

⁶ Orion, Submission on reset of default price-quality path for EDBs, 17 July 2009, p23.

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| <p>Decisions on the Structure of the Reset DPP</p> | <p>is to structure the Reset DPP to include separately assessed price and quality paths.</p> <p>3.66 The Commission’s draft decision is to not include the customer communication criterion as part of the Reset DPP. The Commission proposes that the information disclosure work stream will seek to develop an equivalent mechanism.</p> | <p>We agree.</p> |
| <p>Draft Decision on the Use of CPI-X</p> | <p>4.12 The Commission’s draft decision is that the price-path under the Reset DPP should be indexed using a CPI-X mechanism. The CPI-X mechanism is incorporated in Formula 7 as set out Appendix B.</p> | <p>We agree.</p> |
| <p>Draft Decision on the Use of Weighted Average Price-Cap</p> | <p>4.19 The Commission’s draft decision is that the use of a weighted average price-cap is the most appropriate basis for the price-path under the Reset DPP, as set out in Formula 7 in Appendix B.</p> | <p>We agree that a weighted average price cap is an appropriate basis for the price path. However, we do not completely agree with the formulation as set out in Formula 7 in Appendix B.</p> <p>We consider that it should be clarified that the quantity amounts are the estimated quantities at the time the prices are set for the assessment period. We consider that the proposed formulation of Formula 7 should be corrected in this respect. This issue is discussed in greater detail in response to the draft decision on the definition of quantity.</p> |
| <p>Draft Decision on the Definition of Price</p> | <p>4.31 The Commission’s draft decision is that a definition of price based on that set out in the Thresholds Notice is appropriate under the Reset DPP. This is further discussed in paragraph 8.19.</p> <p>8.19 As set out in paragraph 4.31, the Commission’s draft decision is that it is appropriate to base the</p> | <p>We agree.</p> |

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| | <p>definition of price under the Reset DPP on that specified in the Thresholds Notice. The Initial Reset Determination would then define price as “a posted price in nominal terms (such as a tariff, fee or charge) or a component thereof, that an EDB charges in relation to a regulated service (and which may include discounts, provided those discounts are disclosed in accordance with relevant information disclosure requirements).” This definition of price should, however, exclude any pass-through where the EDB demonstrates that they were passed on transparently to its customers and/or electricity retailers.</p> | |
| <p>Draft Decision on Definition of Quantity</p> | <p>4.43 The Commission’s draft decision is that it is appropriate to annually update base quantities in the notional revenue formula under a DPP, dispensing with the use of a fixed reference year. Furthermore, the Commission’s draft decision is that the t-1 approach is appropriate. This approach is incorporated in Formula 7 as set out in Appendix B.</p> <p>4.44 The use of quantity in the notional revenue formula and the proposed t-1 approach for updating base quantities is discussed in paragraphs 4.83-4.84.</p> <p>4.83 Due to the potential occurrence of the pass-through anomaly due to mismatched quantities (as highlighted in paragraph 4.73), the Commission’s draft decision is that in conjunction with implementing a t-1 approach, an additional compliance step is appropriate. On assessment:</p> <p>(a) an EDB will be required, as</p> | <p>We agree in principle with the Commission’s draft decision to annually update base quantities in the notional revenue formula under a DPP, dispensing with the use of a fixed reference year.</p> <p>However, with reference to the specific formulation of the price path assessment formula (Formula 7), we consider that there are some definitional problems with the specification of this formula.</p> <p>Formula 7 does not make it clear whether the quantities to be used at the time of the assessment are the actual t-1 quantities, or the estimated t-1 quantities used when the prices for period t are set. We believe the Commission intends the latter (paragraph 4.42 says that “the Commission proposes to use these estimated quantities”) in which case this needs to be more clearly stated, and Formula 7 needs to be clarified accordingly.</p> |

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| | <p>part of its compliance statement, to state both the forecasted t-1 base quantity used when setting price and the actual quantity during the t-1 period; and</p> <p>(b) where a variance in the estimation of t-1 has occurred, an EDB shall provide an explanation of the variance.</p> <p>4.84 If EDBs should repeatedly misestimate the t-1 base quantity by a margin of error that exceeds 5%, the Commission may wish to reconsider the use of the t-1 approach (e.g., the compliance process could revert to the use of actual t-2 quantities).</p> | <p>If, as we believe and as we assume, the Commission intends that the quantities to be used for assessment are estimated quantities for period t-1 when the prices were set, then the definition of $Q_i, t-1$ in box Formula 7 , should read:</p> <p style="padding-left: 40px;"><i>“$Q_i, t-1$ the base quantity for the service i in year t-1, which is the quantity of service i estimated to have been provided in assessment period t-1 at the time prices were set for assessment period t.”</i> (emphasis added)</p> <p>For further details refer to paragraphs 21 to 22 above.</p> <p>As stated in the body of our submission, we do not consider that the proposal to provide a margin of error of 5% between the estimates of the Q_is compared to the actual outturn of the Q_is is relevant. We also note that the paper is silent on whether this 5% margin applies to each individual Q_i or to the total of Q_is (noting that the Q_is cannot be meaningfully summed).</p> <p>We also comment that Orion would have an issue if the Commission changed the formulation to use actual quantities as t-2. This is because we changed our price structure after that time, and we would not have any actual quantities that would correspond to the current service.</p> <p>We note there is a possible drafting error in Formula 7 – the multiplication symbol \times is not needed in the formula for R_t, but if it is to be used then it should, for consistency, also appear</p> |
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| | | after the CPI expression. |
| Draft Decision on Indexing the Price-Path | <p>4.53 The Commission’s draft decision is to implement a lagged CPI indexation of the price-path assessment formulae. The Commission’s draft decision is to allow a six month lag between the most recent quarterly CPI change used in the formula and the start of the pricing year. The proposed formula for the calculation of CPI is outlined in formula 3.</p> | <p>As noted in our earlier submission⁷, we consider that a forecast approach to CPI is superior to the alternative six-month lagged approach (as noted in paragraph 20 this is actually an 18-month lag).</p> <p>We recommend that the Commission should declare a CPI figure to use in advance (based on the Reserve Bank projections, and adjusted for differences between previous declared CPI projections and actual CPI movements). This issue is discussed in greater detail in paragraphs 11 to 20 above.</p> |
| Draft Decision on Pass-through of Local Authority Rates & Levies | <p>4.61 The Commission’s draft decision is that the following rates and levies should be treated as pass-through costs under the Reset DPP:</p> <ul style="list-style-type: none"> ▪ local authority rates; ▪ Commerce Act levies; and ▪ Electricity Commission levies. <p>4.62 The Commission considers that Commerce Act levies incurred by EDBs during the Initial DPP should, in principle, be eligible for pass-through under the Reset DPP (e.g., amortised under the regulatory period). A proposal to account for these during the regulatory period is discussed in Appendix B.</p> <p>Pass-through cost proposal</p> <p>B14 The Commission considers it</p> | <p>Orion agrees that local authority rates, Commerce Act levies and Electricity Commission levies⁸ should be treated as pass-through costs. However, we also consider that the Commission should allow new, unavoidable costs associated with either, changes to existing legislation or regulation, or the introduction of new legislation or regulation, during the regulatory period to be included. See also our comments in relation to general pass-through costs in the section on reopeners paragraphs 26 to 32.</p> |

⁷ Submission on reset of default Price-quality path for EDBs 17 July 2009 p 35

⁸ We note the possibility that the Electricity Commission will be replaced at some stage during the regulatory period. We believe that the Commission should ensure that any drafting of the DPP provides for the possible replacement of the Electricity Commission by one or more different entities (such as the possible EMA).

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| | <p>appropriate that the Commerce Act levies, paid by EDBs during 2009/10, be amortised (e.g., straight-line amortisation over the regulatory period) and included as a pass-through cost (i.e., the 2009/10 Commerce Act levies will be apportioned evenly over five years and included in the appropriate K term).</p> <p>B15 Consistent with the approach under the Initial DPP compliance statement, under the Reset DPP, EDBs will have to disclose the total pass-through costs for the assessment period. For transparency the Commission proposes that as part of the compliance statement EDBs will be required to state separately the total 2009/10 Commerce Act levy paid / payable and the appropriate amortisation charge in the pass-through deduction for the assessment period.</p> | <p>We agree with the Commission's draft decision that Commerce Act levies incurred by EDBs during the Initial DPP should, in principle, be eligible for pass-through under the Reset DPP (e.g., amortised under the regulatory period). We consider that the proposed approach to dealing with these costs set out in Appendix B of the paper is appropriate. However, we suggest that this should be explicitly stated in the definitions of Kt and Kt-1 in Formula 7.</p> |
| <p>Draft Decision on Pass-through of Transmission Charges</p> | <p>4.71 The Commission's draft decision is that transmission charges should be treated as a pass-through cost under the Reset DPP.</p> | <p>We agree that transmission charges should be treated as a pass-through cost under the Reset DPP. We also note that the paper indicates at paragraph 4.46 that it considers that avoided transmission costs should be treated as a pass-through. We agree with this decision and consider that for the avoidance of doubt, the Commission should explicitly refer to avoided transmission costs in the draft decision, for example:</p> <p><i>"The Commission considers that transmission charges and avoided transmission charges, including as a result of a transfer of assets from Transpower to an EDB or the development of distributed</i></p> |

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| | | <i>generation, should be treated as a pass-through cost under the Reset DPP.”</i> |
| Draft Decision on the Use of Starting Price Adjustments | 5.14 In light of these views, and having considered submissions, the Commission’s draft decision is that starting price adjustments should be considered for EDBs under the Reset DPP. The following section considers the appropriate timing of potential adjustments during the Reset DPP. | We agree, however we re-iterate our earlier suggestion ⁹ that it may be more appropriate for this initial reset to forgo a starting price adjustment and instead shorten down the regulatory period to four years. We consider that this option has a degree of simplicity and is commensurate with a low cost approach to setting the DPP, particularly as we consider that the Commission should take full advantage of the six-month time extension provided for in the Act to develop the IMs which would delay any starting price adjustment for a year. |
| Draft Decision on Timing of Starting Price Adjustments | 5.33 The Commission’s draft decision is that any potential adjustment to starting prices should take place after the determination of input methodologies. Further to this, the Commission’s view is that the deferred starting price adjustment should, if feasible, be implemented to take effect from 1 April 2011 to align with the 2011/12 pricing year. | We agree that any potential adjustment to starting prices should take place after the determination of input methodologies. However, we also consider that the Commission should take full advantage of the six-month time extension provided in the Act to develop the IMs which would delay any starting price adjustment to 1 April 2012 to align with the 2012/13 pricing year. |
| Draft Decision on Starting Prices for the Reset DPP | 5.44 The Commission’s draft decision is that starting prices for the Reset DPP will be those that applied at the end of the Initial DPP and that they should be specified as the Actual Prices posted by each EDB as at 31 March 2010. The role of starting prices when assessing price-path compliance is discussed in paragraph 4.81. | We agree with the use of the actual prices posted by each EDB as at 31 March 2010. However, we consider that the use of 31 March 2010 prices as starting prices means that ELBs whose prices currently fall below their existing threshold will lose that ‘headroom’. In addition, we (and possibly many other EDBs) have consistently aimed to set prices below the Part 4A threshold limit (to avoid breaching) on the understanding that any under-pricing |

⁹ Submission on reset of default Price-quality path for EDBs 17 July 2009 p 2

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| | | <p>could be captured in the next year's pricing review.</p> <p>Our understanding of the proposed approach is that it would prevent this "catch-up" in future years, and effectively eliminate some of the allowable price increase under the current regulatory period. This creates an additional problem in that if prices are set below the allowed level for any reason, they cannot be recovered at a later stage in the regulatory period.</p> |
| <p>Draft Decision on the Rate of Change</p> | <p>The Commission's draft decision is to set the rate of change under the Reset DPP (i.e., the X-factor) to be 0% per annum.</p> | <p>We agree with the Commission's proposal for X to be set at 0%. We also support the Commission's approach to consider a wide range of inputs when it comes to making this decision and not adopting a single mechanistic approach.</p> <p>We remain unconvinced about the untested and radical approach proposed by EI, and recommend that the Commission should at the very least ignore the outputs from this source and engage with the industry to produce a more appropriate measure. We endorse the work that the ENA is doing in this area and recommend that the Commission take this into further consideration.</p> |
| <p>Draft Decision on Definition of Quality</p> | <p>7.22 The Commission's draft decision is that the quality standards will be based on annual reliability performance as determined from measured SAIDI and SAIFI values for each EDB. EDBs with non-contiguous networks are to derive separate SAIDI and SAIFI datasets for each network.</p> | <p>We agree with using SAIDI and SAIFI as the basis on which annual reliability performance is determined. We do not agree with the use of separate datasets for non-contiguous networks. While we accept that the price and quality thresholds are separately assessed, we consider that it would be inconsistent if the quality path did not relate to the same network as the price path.</p> |
| <p>Draft</p> | <p>7.26 The Commission's draft decision</p> | <p>We agree.</p> |

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| <p>Decision on Reference Dataset</p> | <p>is that daily SAIDI and SAIFI data from the period 1 April 2004 to 31 March 2009 be used to inform quality standards under the Reset DPP.</p> | |
| <p>Draft Decision on Extreme Variation</p> | <p>7.52 The Commission’s draft decision is that the Reference Dataset and the annual Assessment Datasets should be normalised to take account of extreme events. This is to be done using the process described above and set out in detail in Appendix C.</p> | <p>We consider that the process set out in Appendix C should be completely separate for SAIDI and SAIFI measures. That is, the MEDs identified using SAIDI boundary values should apply only to SAIDI measures not be used in relation to SAIFI. We consider that for SAIFI, an independent set of MEDs relating to SAIFI should be used. We remain concerned about the Commission’s application of the IEEE 2.5β method in relation to extreme events. We recommend that the Commission continue to consider additional input from the ongoing work that the ENA has commissioned in relation to this issue.</p> |
| <p>Draft Decision on the Use of Dead-bands</p> | <p>7.67 The Commission’s draft decision is that normal variability be taken into account when setting the Reliability Targets though the use of a dead-band. The size of the dead-band is to be based on the standard deviation present in the normalised Reference Dataset. Further detail on this process is set out in Appendix C. Specifically, an EDB’s annual:</p> <p style="padding-left: 40px;">SAIDI Reliability Target: will be set as the sum of the average SAIDI value in the normalised Reference Dataset and one (1) times the standard deviation of the SAIDI data in the normalised Reference Dataset; and</p> <p style="padding-left: 40px;">SAIFI Reliability Target: will be set as the sum of the average SAIFI value in the normalised Reference Dataset and one (1) times the</p> | <p>We agree.</p> <p>Drafting Note – we consider that the DPP should refer to “limits” not “targets” in relation to quality measures.</p> |

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| | <p>standard deviation of the SAIFI data in the normalised Reference Dataset.</p> | |
| <p>Draft Decision on compliance with the quality path</p> | <p>7.80 The Commission’s draft decision is that an EDB would have complied with the quality standard during a particular assessment period if:</p> <p style="padding-left: 40px;">its SAIDI and SAIFI Assessed Values for the assessment period are both less than or equal to the respective Reliability Targets; or</p> <p style="padding-left: 40px;">its SAIDI and SAIFI Assessed Values in the previous two extant assessment periods did not exceed the respective Reliability Targets.</p> <p>7.81 This assessment process is set out in further detail, including worked examples, in Appendix C.</p> | <p>We also consider that the proposed approach, rather than maintaining a position of no material decrease in quality, will require improved quality levels over time. If an EDB manages to maintain SAIDI and SAIFI below current limits it will find that those limits inevitably ratchet down over time. This becomes increasingly onerous on EDBs and is inconsistent with the benchmark chosen by the Commission in its discussion paper, namely, “no material reduction in quality”.</p> <p>While we consider that determining a breach based on the two in a row (or two out of three) assessment process is a positive step forward, we note that according to paragraph C6, the multi-year assessment an EDB gets a fail (X) for a year if either SAIDI or SAIFI exceeds the limit. What this means is that if in year 1 you get a fail (X) for SAIDI, and in year 2 you get a fail (X) for SAIFI, this is a breach. We consider that it would be more appropriate to consider each (SAIDI or SAIFI) on its own merits by having the assessment with respect to each measure separately: i.e. you have to exceed the limit for the same measure twice for it to be a breach. SAIDI and SAIFI are separate indices and compliance should not be conflated so as to raise the bar for EDBs.</p> |
| <p>Draft Decision on the Form of the Determination</p> | <p>8.7 The Commission proposes to publish a single Determination to give effect to its decisions on the Reset DPP.</p> | <p>We agree.</p> |

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| <p>Draft Decision on the Regulatory Period</p> | <p>8.12 The Commission proposes that the Initial Reset Determination will specify the commencement date as 1 April 2010. The Commission’s draft decision is that the regulatory period for the Reset DPP be five years from the commencement date (i.e., for the period 1 April 2010 to 31 March 2015).</p> | <p>We agree.</p> |
| <p>Draft Decision on Annual Compliance Date</p> | <p>8.43 The Commission’s draft decision is to require compliance-related documentation to be submitted within 50 working days of each assessment date in the regulatory period (i.e., within 50 working days of 31 March).</p> <p>8.44 The Commission proposes that the Initial Reset Determination will specify the assessment date as 31 March for each year in the regulatory period. In addition, the Commission proposes that the Initial Reset Determination will specify that each EDB has 50 working days following each assessment date to demonstrate compliance with both the price-path and quality-path.</p> | <p>Orion still considers that it is more appropriate to have a single time to disclose information and that information should be disclosed only once.</p> |
| <p>Draft Decision on the Annual CPP Proposal Date</p> | <p>8.48 The Commission’s draft decision is to not specify an annual submission date for CPP proposals until the relevant input methodology has been published.</p> <p>8.49 The Commission proposes to include a provision in the Initial Reset Determination indicating that the Commission will amend the Initial Reset Determination to specify the annual CPP proposal date as soon</p> | <p>We agree.</p> |

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| | as practicable after the relevant input methodology is published. | |
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