

19 April 2010

Network Performance Branch
Commerce Commission
Wellington

by email: Regulation.Branch@comcom.govt.nz

POST-WORKSHOP SUBMISSION ON THE CPP INFORMATION REQUIREMENTS WORKSHOP

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to make a post-workshop submission on several matters that arose at the Commerce Commission's (**Commission**) recent workshop relating to the Input Methodologies Customised Price-quality Path (**CPP**) Information Requirements –
 - 1.1 the Commission's draft Independent Verifier engagement framework;¹ and
 - 1.2 Strata Energy Consulting Ltd's (**Strata**) draft information requirements papers (**Strata papers**).²
- 2 We believe the workshops are a useful element of the consultation process and thank the Commission for taking the time to engage with industry participants. We also appreciate the opportunity to discuss various issues with Strata staff.

Outline of submission

- 3 Our submission is in two parts:
 - 3.1 general comments; and

¹ Commerce Commission, *Draft Independent Verifier Engagement Framework and Terms of Reference* (11 February 2010).

² Strata, *Specifying the CPP Information Requirements Relating to Capital Expenditure, Operating and Maintenance Expenditure and Demand (Draft); Draft Qualitative CPP Information Requirements; and Draft Quantitative CPP Information Requirements* – prepared for the Commerce Commission (February 2010).

- 3.2 our responses to specific questions related to the key points raised by the Commission at the workshop, namely:
- (a) assigning projects to proposed service categories;
 - (b) regulated and unregulated services;
 - (c) information used for Board decision making;
 - (d) materiality;
 - (e) quality;
 - (f) pre-submission verification; and
 - (g) evaluation criteria.

General comments

- 4 The purpose of default/customised price-quality regulation is:

[T]o provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances.³

- 5 We believe that the purpose statement set out in section 53K indicates that the basic form of the regulation is the default price path (**DPP**). EDBs will then have the opportunity, should they so choose, to apply for a customised price-quality path (**CPP**).
- 6 We also consider that the section 53K purpose statement implies that any information requirements, set by the Commission, in relation to supporting an EDB's *individual* proposal for a customised price path, should not impose any obligations on *all* EDBs (some of which may never apply for a CPP) to collect this information. Nor should the CPP information requirements be structured so as to force an EDB to collect the same information in multiple different formats.
- 7 We accept that the Commission will require a significant amount of detailed information to satisfy itself of the appropriateness of a CPP proposal or to implement its own alternative price-quality path. However, the level of

³ Commerce Act 1986 Part 4 section 53K.

prescription of this information requirement should not be so onerous that it acts as a disincentive to an EDB applying for a CPP when it is in the long term interests of customers. An appropriate balance between long-term outcomes and regulatory compliance costs is required.

- 8 In this context, we note that the workshop provided a degree of clarity over what Strata (and the Commission) was intending to achieve in the draft qualitative and quantitative requirements. It also highlighted many areas where further work is required.
- 9 As indicated at the workshop, the Strata draft requirements are fundamentally based on the Australian AER approach.⁴ We believe, however, that the Australian approach is an example of the type of high cost regulation that the government was trying to avoid in enacting Part 4 of the Commerce Act. The Australian approach requires intensive, regular, full building block reviews (5 yearly) by the regulator and involves considerable information gathering on an ongoing basis. Importantly, the Australian model is in its third iteration, and businesses' proposals are developed according to past Australian experience. That learning has not yet occurred in New Zealand. While this approach may be suitable for the Australian market, we believe it is inappropriate as a starting point for CPP regulation in the New Zealand context.
- 10 The draft Strata proposal would require businesses to allocate their cost structures, asset categorisations and service categories into a separate standardised format. This process is unnecessary, inefficient and may lead to additional complexity in verification of the data. Nor is standardisation of data vital in this context: all that is required is that the Commission be satisfied of the appropriateness of a CPP proposal.
- 11 The workshop clearly indicated that the proposal has a number of requirements which were interpreted by participants in ways that Strata had not intended or foreseen. Those misunderstandings must be corrected in an updated draft of Strata's requirements.

The role of benchmarking

- 12 At the workshop considerable discussion occurred in relation to benchmarking. We do not consider that benchmarking has a place in the evaluation of a CPP. The only legislative requirement is that a CPP proposal is appropriate for a particular EBD. The CPP is intended to

⁴ *Input Methodologies: Opex/Capex Requirements for CPP Proposals Workshop* (30 March 2010), transcript, pages 12, lines 18 – 23.

provide the opportunity for individual regulated EDB's to have alternative price-quality paths that better meet their particular circumstances. It was pleasing to note Mr Heaps' comment:

*"I think you certainly, in terms of a CPP and the drivers, then you could expect that they would be quite unique or they could be quite unique to the business, and so I think you're right from that perspective actually benchmarking them wouldn't be relevant."*⁵

Improvements to the process

- 13 We concur with the ENA's suggested improvements that the process should:
- 13.1 provide more recognition of the information disclosed in Asset Management Plans (**AMPs**) and restructure the requirements to align with and supplement the disclosed AMP;
 - 13.2 allow for an applicant to prepare quantitative information consistent with its own cost structures, accounting methods, asset categorisations and service categories, while providing guidance (via template examples) as to the scope and level of detail required, thus meeting the information certainty objective;
 - 13.3 allow for the independent verifier to use its judgment in selecting which forecast projects and programmes to examine and providing guidance by way of expanded evaluation criteria. This may include, for example, the additional guidance provided in Table 19 of the Farrier Swier Consulting Paper (3 June 2009) and additional criteria such as assessment of project or programme risk; project triggers; size; the quantum of projects; and the drivers for the CPP application. The objective must always be to ensure an appropriate scale of information is disclosed and assessed, rather than assuming a large fixed number of projects must be analysed;
 - 13.4 permit the draft requirements to be reviewed to ensure any duplication and replication is eliminated; to clarify definitions and ensuring the information requests are precise and targeted to the information of direct relevance to the capex and opex forecasts; and
 - 13.5 ensure that the verifier or the Commission does not focus on benchmarking EDBs. Information for this purpose is not required, as

⁵ CPP workshop transcript, Mr Heaps' remarks at p69, line 28-30.

the CPP option is a *customised* option intended to reflect the circumstances relevant to an individual EDB.

- 14 We are encouraged by some comments at the workshop, which indicate Strata accepts that “one size fits all” requirements are not appropriate, and there are diminishing returns in requiring vast amounts of information.⁶ Some of Mr Heaps’ comments at the workshop on this issue were in our view appropriate (for example, references to requiring only Board-level information; “telling the story” of the business; and restricting the information to major items of capex).⁷

Efficiency of the DPP

- 15 The Commission should not assume that the DPP is not an appropriate starting point for a CPP proposal. If the DPP is robust (and the correct X-factor is set) then the DPP will be a sound base from which to account for specific considerations in the context of a CPP.
- 16 The Commission may be concerned that using the DPP as a starting point will “lock in” and potentially magnify any upside for CPP applicants for whom the DPP guarantees a favourable revenue outcome. There are three responses to this:
- 16.1 that the favourable outcome is but one part of an aggregate set of outcomes that are expected to meet the objectives of section 52A;
- 16.2 that the favourable outcome remains for so long as the EDB in question does not apply for a CPP; and
- 16.3 it is just as likely that an unfavourable outcome will be locked in by using the DPP as a starting point.
- 17 The CPP process needn’t be an overwhelmingly onerous process just because it could be. Nor should the Commission assume (as some of its staff comments at the workshop indicate) that the DPP is not a sound point of departure in assessing an “appropriate” CPP and, by extension, appropriate levels of expenditure. The starting point for a verifier (and the Commission) should in Orion’s view be to use the DPP as a baseline. It should not look to disown DPP outcomes as somehow deficient just because it gets a second chance to look at the issues in the CPP context.

⁶ CPP workshop transcript, Mr Heaps’ remarks at p15, line 26-30; p26, line 2.

⁷ CPP Proposals Workshop transcript, Mr Heaps’ remarks at p61, line 16-18; and Mr Bull’s remarks at p90, line 27.

Response to specific questions

Assigning projects to proposed service categories

Question 1: Examples of projects that cannot be assigned to one of the proposed service categories.

- 18 The context of the discussion at the workshop to which this question relates was about capex categories rather than service categories and our response reflects this. The following example in relation to the purchase of Transpower's spur assets demonstrates a "project" that does not fall within the proposed capex categories is outlined below.
- 18.1 We believe efficiency improvements can be gained by a transfer of ownership of Transpower spur assets to the local distribution network businesses. Many of these spur assets are old and will require replacement or rationalisation in the near future. Significant capital and operations efficiency can be gained by local distribution business integrating these assets into their existing business. The cost to integrate these assets into an electricity business will vary but in many instances will be significant and will be difficult to fund within the DPP regulatory regime using an avoided transmission charge approach. A project of this nature clearly does not fit into any of the proposed capex categories of the CPP:
- (a) Customer connection capex – **no change in customer base**
 - (b) System growth capex – **no growth in demand or energy**
 - (c) Reliability, safety and environment capex – **no change**
 - (d) Asset replacement and renewal capex – **no change to base**
 - (e) Asset relocations capex – **no relocations**
 - (f) Non-system fixed assets capex – **no change**
- 18.2 A spur asset project is simply a shift in the boundary (grid exit point) between the transmission grid and distribution network. For a project like this, it would be a relatively simple exercise for the distributor to produce a customised CPP application to demonstrate the increased asset responsibility and the forecast capital and operations expenditure associated with those assets. Producing a standardised CPP with standardised service, capex and opex

categories for the whole network would not be necessary (or useful) for the Commerce Commission to assess the application.

- 19 We consider that the purchase of spur assets from Transpower is a significant and key project where Orion can improve capital efficiency in the near future. If undertaken the project will deliver significant operational efficiencies which will eventually flow through to the customer. However, we will probably not proceed with this project if we have to undertake a full CPP on the entire business rather than entering a CPP process that allows for ring fencing projects such as this.
- 20 The above is just one example of a potential project for Orion which does not comfortably sit within Strata's proposed service categories. We could provide others, but do not consider that additional examples will add any further value at this stage. We also re-iterate our comments made at the workshop that while these categories are included in the information disclosure requirements we do not consider them appropriate (as we submitted in August 2008).
- 21 In relation to the actual service categories defined in the Strata papers we note Mr Bull's comment at the workshop about these services categories:

"I think if you look at them the very first one which is the provide the network service is the big service that you provide, the other ones are kind of bits and pieces of you know load management services and fault – those other things".⁸

This comment raises concern over the appropriateness of the proposed service categories and their use in a standardised template. The focus should always be on categories which reflect the information already collected by an EDB and which are related to its core business, not on additional small categories created solely for the purpose of a CPP proposal.

Regulated and unregulated services

Question 16: What, if any, unregulated services are captured by the draft information requirements?

- 22 The meaning of electricity line services is set out in section 54C. This has a number of potential conflicts with the proposed service categories.⁹ For

⁸ CPP Proposals Workshop transcript, Mr Bulls' remarks at p59, line 21-24.

⁹ Strata *Draft Qualitative CPP Information Requirements*, page 15.

example, unregulated services that may possibly be captured by the Strata draft information requirements are:

- 22.1 conveying electricity only from a generator to the national grid or from the national grid to a generator (explicitly excluded by section 54C);
 - 22.2 providing load management services. This is arguably a discretionary activity, although many EDBs provide a load management service as part of their Delivery Service Agreements (Use of System Agreements). The extent of this service will vary amongst EDBs;
 - 22.3 third party work such as undergrounding;
 - 22.4 revenue derived from the sale of dedicated assets at a connection point; and
 - 22.5 leasing space in ducts/lines to other network businesses (for example to telecommunications firms).
- 23 The problems relating to the possible unintended capture of unregulated services by the information requirements can, in our view, be resolved by allowing EDBs to use their own service categories, their own project or programme categories and their own asset categories, which are consistent with their own internal planning and forecasting purposes, rather than those prescribed by the Commission. It is these forecasts and underlying assumptions that must be justified for the purpose of the qualitative review, not the categories which are used to describe those assumptions.

Information used for Board decision making

Question 17: What qualitative and quantitative capex, opex, demand and network information about a project is presented to your board when approval is sought for a project?

- 24 The AMP is supported by extensive standards and specifications. The marked up version of changes to the AMP, customer consultation and Orion's pricing methodology disclosure are the core documents that describe the qualitative and quantitative capex, opex, demand and network information to our Board. Project approval is generally on the basis of a "business as usual" approach, where we identify changes to the AMP and review the basis for these changes with the Board.

- 25 Significant projects, and significant changes to the underlying standards and specifications which may be proposed for inclusion in the AMP, or which may have a significant impact over the life cycle of assets, would be discussed by senior management and the Board (and appropriate analysis and modelling undertaken) *prior* to the formal approval or presentation of key changes to the AMP.
- 26 The formal presentation to the Board on the AMP would focus on the following year's budget but will also include long term issues. Discussion will commonly cover issues such as:
 - 26.1 key budget changes from the last AMP;
 - 26.2 overall expenditure forecasts;
 - 26.3 general changes to the plan, including:
 - (a) background and objectives;
 - (b) service levels;
 - (c) risk update;
 - 26.4 lifecycle update;
 - 26.5 network development;
 - 26.6 innovation update; and
 - 26.7 marginal initiatives.
- 27 The Board reviews this information in light of earlier discussions on significant projects and changes to the underlying standards and specifications. This occurs in conjunction with information on customer engagement, pricing methodology disclosure and the Commission report on the previous year's AMP.
- 28 We assume a similar level of information is required for governance decisions at other EDBs. All EDBs are subject to normal accounting and auditing standards, which will be appropriately reflected in their own asset and expenditure categories. Those internal accounting standards will in our view ordinarily be sufficient to give a verifier certainty about the integrity of the information and policies underpinning a CPP proposal.

- 29 A key area of our Board-level discussion in relation to the AMP and the approval of the various projects relates to the trade-offs and inter-relationships between projects. The overall cost of a project is not necessarily a good indicator of the significance of a project and the amount of detailed discussion. For example, installing a zone substation may cost \$4 million but be regarded as “business as usual” (security standard compliance) with only high level justification required, whereas a lower cost program to install ground fault neutralisers (new safety and reliability technology) would require a relatively detailed board paper and presentation/discussion session with the Board. In this example the former project (while more expensive) would be “routine” (ie the various security standards dictate the need for an upgrade). The second project, while less expensive, may carry a higher level of risk which warrants the Board’s closer attention.
- 30 In some cases a “project” may not directly involve capex/opex spend by Orion, but could relate to the overall costs that we face. For example, increased or decreased costs through expenditure by Transpower under a new investment contract may impact on our asset management planning.
- 31 This overall governance aspect of the Board’s approval of the AMP, relating to decisions on which projects should be approved, is fundamental. However, this same exercise of judgment by the Board (and assessment of options) is a key aspect which makes a prescriptive approach to the information requirements, and the use of standardised templates, very difficult to apply.
- 32 In Orion’s view a focus on Board-level information (which we consider is appropriate for the CPP information requirements) will require flexibility on the type of information supporting each project in a CPP proposal. A “one size fits all” approach, such as that in the current Strata draft requirements, is not appropriate. We welcome the recognition at the workshop of the need for flexibility and discretion to ensure the CPP information requirements are fit for purpose.

Materiality

Question 18: What thresholds and criteria determine whether board approval for capex and opex is required for a project or programme? Is this an appropriate basis for determining materiality for a CPP project or programme review?

- 33 We do not consider that there are specific thresholds and criteria that should determine whether board approval for capex and opex is required for a project or programme. A sign-off of the AMP, and all capex and opex is approved by the Orion Board. As stated previously, our Board focuses

on changes to our “business as usual” processes or projects and these may or may not be material from a CPP perspective.

- 34 We believe that the decision to apply for a CPP and the rationale for such a large regulatory decision is of such significance and importance to an EDB that it would need Board approval.
- 35 As part of getting Board approval to apply for a CPP we would need to produce suitable analysis for the Board to review.
- 36 We believe this analysis is a useful starting point for considering what elements need to be reviewed by the verifier and the Commission. The process of assessing materiality for a CPP will depend on the type of CPP application and its drivers, and as such should be discretionary and part of the role of an independent verifier to determine. For example, materiality for the spur asset example above would be significantly different from materiality for a CPP application based on extraordinary aging of assets.

Question 19: In relation to the proposed detailed review by the pre-submission verifier of capex, opex, demand and network information relating to a sample of non- ‘material’ projects, what, if any, criteria do you suggest should apply in determining whether such a review is done? How many non-material projects should be subject to review and how should the verifier select projects?

- 37 We do not consider that it is necessary to pre-determine how many non-material projects the verifier should review in detail. As discussed above and at the workshop, quantifying in number or dollar terms what is considered to be “material” is problematic. Even a “proportional” approach will not work where an EDB has many small programmes or only one or two large programmes.
- 38 In our view a review of the issues driving a CPP application, which we believe would have been outlined to the Board prior to approval to seek a CPP, is the key area on which the independent verifier should focus its review. The Commission should be prepared to rely on the independent verifier’s judgment and expertise as to the level of further verification required (noting that the level of detail for non-material projects may be limited).

Question 20: How many capex projects or programmes are comprised within 30% of your capex forecast for the next 5 years and how many opex projects or programmes are comprised within 30% of your opex forecast for the next 5 years?

- 39 This is not a simple question to answer. As discussed at the workshop, this issue is dependent on the definition of “projects” or “programmes”. For

example, our 2010 asset management plan has identified 89 projects (as Orion describes them) for implementation over the next 5 years. However, these projects only account for 32% (approximately) of our capex spend over that 5 year period.

- 40 The remainder and majority of our capex spend is defined not as projects but under categories such as Replacements, Customer Connections, Network Extensions, Underground Conversions and Contingency. Of this group, the largest single category of "Replacements" account for approximately 29% of our capex spend over the next 5 years.
- 41 In our asset management plan we further break down the "Replacement" category not by project but by asset category. For example: 66kV overhead, 33kV overhead, 11kV overhead, 400V overhead, 66kV underground, 33kV underground, 11kV underground, 400V underground, Metering Protection, Pilots, Control, Systems, Ripple Injection, Switchgear, Transformers, Substations, Property. In the first year for which the AMP applies the replacement budget is further broken down into projects, however this is done only for a single year.
- 42 The difficulty of defining capex spend by project is further complicated by the fact that expenditure by categories such as Replacements, Customer Connections, Transpower spur assets, Network Extensions, Underground Conversions and Contingency occur annually. When taken over a five year period these "business as usual" categories will swamp individual projects, which usually have expenditure occurring over just one or two years.
- 43 Bearing in mind the issues in relation to the definition of "projects" outlined above, Orion would have two "projects" (purchase of Transpower spur assets; and replacement of switchgear) that together would exceed 30% of our forecast capex expenditure for the next 5 years.
- 44 As a further indication of the difficulties involved in the specification of definitions if our category "Replacements" is classed as one single project rather than the 17 individual assets categories being treated as separate projects then this single group will account for 29% of our forecast capex expenditure for the next 5 years.
- 45 In relation to opex, as we indicated at the workshop we do not assign opex to projects. (See our comments in relation to question 22 below).
- 46 The above discussion in our view highlights the difficulty of defining a set number or proportion of projects, as Strata has tried to achieve in its draft requirements.

- 47 Table 1 below provides an indication of the percentage of total capex for each of Orion’s capex categories over the next 5 years. We present this table to illustrate the materiality of the various projects or asset categories within each capex and opex category. The table also illustrates that in our case approximately 30% (26%) capex materiality can be achieved by selecting only the single top project or asset category for the key capex categories. For opex, 35% materiality is achieved by reviewing only 2 of the 22 opex asset categories.
- 48 We believe that materiality is best understood not by a percentage threshold, but in light of the drivers for the CPP application and by determining appropriate projects or asset categories in consultation with the independent verifier, rather than a one size fits all approach.

Table 1

Capex or Opex category (all are listed)	% of total capex	Average % of capex of top project or asset category in each year for the next 5 years	Average % of top 2 opex asset categories for the next 5 years
Extensions/subdivisions (1)	6%		
Connections (1)	10%		
U/G conversions (1)	4%		
Transpower spur assets (one off special)	17%		
Major projects – 31 projects	23%	9%	
Reinforcement – more than 50 projects	10%	3%	
Replacement - 17 asset categories (2)	30%	14%	
OPEX Maintenance - 22 asset categories (3)			35%
Totals	100%	26%	35%

Notes

- (1) Projects cannot be determined in advance as these are customer/council/NZTA¹⁰ driven – historical cost used as a guide for forecast

¹⁰ New Zealand Transport Authority

- (2) Switchgear replacement is the dominant asset category
- (3) 11kV overhead and 400V overhead are the two dominant asset categories

Question 21: What percentage of your capex forecast for the next 5 years do your top 10 capex projects or programmes comprise and what percentage of your opex forecast for the next 5 years do your top 10 opex projects or programmes comprise?

- 49 The same issues which were discussed in our response to question 20 in relation to the definition of “project” also arise under this question.

49.1 Orion’s top 10 “projects” *Transpower spur assets, Replacements-Switchgear, Customer Connections, Network Extensions, Underground Conversions, Replacements-control systems, Replacements-Transformers, Major Urban-Marshland substation, Replacements-Protection, Contingency* would account for 68% of our capex forecast for the next 5 years.

- 50 In relation to opex, and as we indicated at the workshop we do not assign opex to projects. On this point, see our comments in relation to question 22 below.

Question 22: In paragraph 36 of its pre-workshop submission, Orion stated that opex was rarely defined or described in terms of a project or programme. Other than by categorising opex by project or programme, what other means would be reasonable for the Commission to use in targeting a review of proposed opex?

- 51 As we indicated at the workshop, Orion does not assign opex to projects. In general our opex spend is categorised on an assets basis. For example: 66kV OH, transformers, switchgear etc (22 different categories). These categories are further subdivided into scheduled maintenance, non-scheduled maintenance, roadworks, emergency and mains. At an even lower level, scheduled maintenance in the first year for which the AMP applies each of the 22 individual asset classes is further split into projects for that one year.

- 52 We endorse Mr Heaps’ comment at the workshop in relation to capital expenditure. We think the comment below applies equally to opex, and ultimately the intent of the requirements should be to:

enable the assessor to get a view as to whether the capital expenditures are appropriate, whether the policies and procedures are appropriate, and then whether

*the business is actually applying those policies and procedures when it develops its plans.*¹¹

53 Consistent with this approach, we would expect an independent verifier could look at the categories contained in the detailed budget that lies behind the financial reporting, and then use these categories (which the individual business has determined are appropriate) in its assessment.

54 As the Commission's adviser Mr Seipolt observed:

*"The best regulatory outcome is usually not for the businesses to actually internally adopt the cost categorisation that the Regulator may want for its services. Most businesses that I'm aware of would, to be efficient and to act prudently, would need to adopt their own practises, activity codes, that are pertinent to the way they carry out their business to best achieve the outcomes they're now seeking to achieve."*¹²

55 In other (more costly) regulatory regimes, where a full building block review is carried out on a regular basis, it may be appropriate for the businesses to create some sort of allocative table that will take their cost categorisation systems and translate the out-turn costs into the appropriate regulatory format. That is not the case in New Zealand, and the Commission should not assume that such a large-scale requirement is an appropriate starting point for our CPP regime.

56 As indicated at the workshop, the information requirements are not geared towards any benchmarking exercise between businesses. We therefore consider that it is unnecessary to impose a standardised template on either capex or opex expenditure.

Quality

Question 23: In the Commission's presentation at the workshop, it was stated that the Commission would determine information requirements where variation to DPP quality standards was sought under a CPP (lines 16-19 of page 10 of day 1 transcript). Information requirements could vary based on the overall justification for the proposal but may include independent engineering reviews, forecast impact of renewal programs, details of consumer preference etc. Please provide your views on the appropriate amount, degree of prescription and type of information which should be provided to support a proposal where a variation to DPP quality standards is sought.

¹¹ CPP Workshop transcript, page 73, lines 19 – 22.

¹² Workshop transcript, Mr Seipolt's comment at p68, line 5.

- 57 Once again we consider that it is inappropriate to attempt to prescribe any form of standardised template. Rather, it should be left to the applicant to provide information on quality standards which supports the drivers for the proposal.
- 58 We consider that it may be useful for the Commission to provide examples of the type of information required to allow it to approve a change in quality standards. We would expect that these examples would focus on conventional quality measures (SAIDI/SAIFI), rather than any broader concept of “service levels”. We recognise that EDB’s may wish to introduce different measures if the appropriate incentives were available. Guidance from the independent verifier *prior to the proposal* being submitted on whether the quality information being provided is likely to be sufficient would greatly assist this process.
- 59 We believe that justification for a variation to DPP quality standards is likely to be complex and impact on an EDB’s entire business. Key issues that may need to be considered are customer consultation (including customers who are willing to accept lower standards, or pay a premium for higher standards); when assets should be replaced and what they are replaced with; security of supply standards; network configuration; preventative maintenance programs; fault response – operations and contractor arrangements. The information required in each case would differ and it should not be assumed in the information template that a particular set of service level measures will always be appropriate.
- 60 A concern about any move from a DPP to a CPP for quality reasons (although this issue is equally relevant to changes relating to price) is that any change will probably exceed the length of any one regulatory period (or if the process is not aligned with a regulatory period the end of the 5 year CPP period). Quality changes are likely to be changed on a long term basis: they will take time to achieve, they impact on the entire business and any new quality standards will need to be maintained.
- 61 Clearly a return to the DPP at the end of the regulatory period will be problematic, as would having to reapply for a CPP on a regular basis. We look forward to seeing the Commission develop its thinking in relation to the transition across regulatory periods of CPPs.

Pre-submission verification

Question 28: At the workshop Orion queried the fate of a pre-submission verification report where the Commission defers consideration of the CPP proposal in question to later in the regulatory period (day 1 transcript, page 105, lines 27-29). What approach do you consider the Commission should take to verification of the proposal upon the Commission

undertaking its full assessment of the CPP proposal after the delay? How should the Commission treat the pre-submission verification report if material circumstances of the applicant's business have changed?

- 62 This issue will only become a problem if the Commission chooses not to consider a proposal in the year that it is received. However should the Commission need to adopt this approach then any delay has the potential to have a detrimental effect on the EDBs and impact on any long term benefits that consumers may have obtained as a result of the CPP.
- 63 There a number of potential problems that EDBs could face if the Commission defers consideration of the CPP proposal in question to later in the regulatory period or to the next regulatory period:
 - 63.1 an EDB may default back to an unsuitable DPP if a re-application for a CPP is deferred;
 - 63.2 necessary infrastructure projects may have to be deferred or less efficient alternatives may be required;
 - 63.3 increased costs to reproduce outdated material will be incurred; and
 - 63.4 breaches of price and quality paths may occur.
- 64 These potential outcomes need to be avoided if possible. In this respect we submit that:
 - 64.1 irrespective of the legislative ability of the Commission to limit the number of applications to a maximum of four per year, we believe the Commission should use its best endeavours to consider all proposals in the year they are made;
 - 64.2 the Commission should consider including in its enforcement guidelines information how it will deal with breaches that are a result of the Commission deferring consideration of the CPP proposal in question to later in the regulatory period or to the next regulatory period;
 - 64.3 the Commission has a choice in the level of reliance that it chooses to place on the independent verifier's report. Where the Commission chooses to set this level will have a significant impact on the work load and number of applications that the Commission will be able to process; and

- 64.4 the legislation provides the Commission with criteria on how to prioritise CPP applications. Additional detailed guidance from the Commission on how it will apply the prioritisation criteria (which are very broad) would be of assistance.
- 64.5 if a CPP applicant is able to engage and seek guidance from an approved independent verifier *prior to the CPP proposal* being submitted. This guidance should provide confidence that the applicant has met the requirements of s 52T(1)(d) or provide an indication of further information that will be required. This could prevent non-compliant applications imposing unnecessary workloads on the Commission, and provide the opportunity for an EDB to acquire the necessary data in a timely manner or to withdraw from the process before the Commission is directly involved.

Evaluation criteria

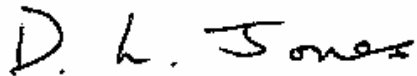
Question 29: What changes, if any, do you consider are required to the evaluation criteria proposed by Farrier Swier for capex and/or opex (and discussed at the workshop). Please provide reasons for your answer.

- 65 We consider the evaluation criteria suggested in the Farrier Swier report to be a useful starting point, however it provides little guidance on how the Commission would actually evaluate a proposal against these criteria. We also consider that it lacks a focus on the key drivers for the CPP proposal. The issue of a focus on key drivers for a CPP was a recurring theme from the workshop and one which we consider the Commission should develop further.
- 66 Along with the evaluation criteria the Farrier Swier report suggested areas of additional guidance should be provided, such as detailed expectations of a prudent service provider. The development by the Commission of the additional detail to support the evaluation criteria is needed before we can comment in any further detail.

Concluding remarks

- 67 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

A handwritten signature in black ink that reads "D. L. Jones". The letters are cursive and somewhat stylized.

Dennis Jones
Industry Developments Manager