

30 September 2013

Dr Mark Berry
Chair
Commerce Commission
P O Box 2351
Wellington 6140

by email: regulation.branch@comcom.govt.nz

ORION CPP PROPOSAL: DRAFT DETERMINATION

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the Commerce Commission's (**Commission's**) Draft Determination "Orion New Zealand Limited Customised Price-Quality Path Determination 2013, [2013] NZCC XX, (undated draft version)" (the **Draft Determination**) and the accompanying paper "Companion Paper on the Draft Determination and Compliance Requirements for Orion New Zealand Limited's 2014-2019 Customised Price-Quality Path" (the **Companion Paper**). Both the Draft Determination and Companion Paper were released for public consultation on 4 September 2013.
- 2 The Draft Determination is intended to support the Draft Decision,¹ released on 14 August 2013 (the **Draft Decision**). Our submission on the Draft Decision was submitted on 20 September 2013.

Introduction

- 3 The purpose of the Draft Determination is to give effect to the Draft Decision. It is important for the final Determination to accurately and unambiguously capture the CPP Decision and our obligations under the CPP.

¹ Setting the 2014-2019 customised price-quality path for Orion New Zealand Limited: Draft Decision, 14 August 2013

- 4 In this submission, we set out where we consider that the Draft Determination does not fully and accurately capture the Draft Decision, or appears to depart unnecessarily from the DPP determination that currently applies to the other non-exempt EDBs (the **DPP Determination**)². In this submission we propose amendments to the Draft Determination to overcome these issues.

Consistency with DPP Determination

- 5 Paragraphs 1.3 and 1.4 of the Companion Paper state that the Commission has *“endeavoured to align the text of the Draft Determination as much as possible with the form of the EDB DPP Reset Determination”* but that it has *“made minor changes to provide additional clarity”*.
- 6 In general, the CPP Determination should be as consistent as possible with the DPP Determination, other than in respect of the different price paths and quality standards that will apply to us. This is appropriate given that both determinations relate to EDBs.
- 7 We agree with many of the changes to the CPP Determination where they provide greater clarity than the wording used in the DPP Determination. However, the Draft Determination includes many changes to the form and text, relative to the DPP Determination, some of which are more than minor. The Companion Paper does not provide sufficient explanation for the proposed changes made relative to the DPP Determination, and is silent on many of them.
- 8 The Draft Determination proposes changes that introduce inconsistencies with the DPP Determination. It is not appropriate to introduce new approaches to matters which are relevant to both the DPP and CPP, without wider consultation, particularly as the CPP Determination is intended to be an amendment to the DPP Determination. We discuss specific differences in later sections, where we consider the differences are potentially problematic.

Next steps

- 9 The Companion Paper sets out a proposed timetable for making the final CPP Decision and releasing the final CPP Determination. The final Decision may differ from the Draft Decision (as signalled in the Draft Decision). In this submission, we recommend a number of changes to the Draft Determination. Our proposals are not inconsistent with the Draft Decision (save for the proposal we suggest in paragraph 33 below).
- 10 Given the degree of change, we request a further technical consultation on the Commission's next draft of the CPP Determination. This final technical step has been introduced in previous consultations. We would anticipate a short consultation period, around the middle of November, and (as in the past) the consultation material does

² *Electricity Distribution Services Default Price-Quality Path Determination 2012*, 30 November 2012, NZCC 35.

not require the final Decision's values for the price path and quality standards to be included. This step will help to ensure that the final Determination gives effect, as accurately as possible, to the final Decision.

Contents of the Draft Determination

- 11 We support the general structure and contents of the Draft Determination. The overall structure is broadly consistent with the DPP Determination, and it includes the items required to give effect to the Draft Decision.
- 12 The Draft Determination includes the necessary formulae, requirements and values for us to determine compliance with the price path and quality standards in each Assessment Period.
- 13 However, as we discuss in more detail below, there are a number of specific details which need to be altered for the Draft Determination to fully and accurately reflect the Draft Decision. In addition, some elements of the Draft Determination differ from the DPP Determination, and the rationale for this has not been set out. We consider that unless the changes are necessary to give effect to the CPP determination, or provide greater clarity than the DPP Determination does, that the CPP determination should align with the DPP determination.

Determination is a section 52P amendment

- 14 The CPP Determination is an amendment to the 2010 DPP Determination. While this is stated in the Draft Determination, we recommend that it be made clearer that the CPP Determination is a direct amendment to and replacement of the previous DPP Determination. Accordingly, we recommend that the 'Determination version history' box and clauses 1.1, 2.1, and 3.1-3.2 be amended as follows:

Determination version history
This determination amends the <i>Electricity Distribution Services Default Price-Quality Path Determination 2010</i> (Commerce Commission Decision 685, 30 November 2009), as it applies to Orion New Zealand Limited by replacing it with the <i>Orion New Zealand Customised Price-Quality Path Determination 2013</i> in respect of Orion New Zealand Limited.

...

1. Title
 - 1.1 This determination is the Orion New Zealand Limited (Orion) Customised Price-Quality Path Determination 2013.
2. Commencement
 - 2.1 This determination takes effect on 1 April 2014.

3. Application Amendment

3.1 This determination amends the Electricity Distribution Services Default Price-Quality Path Determination 2010 (Commerce Commission Decision 685, 30 November 2009), by replacing it with the Orion CPP Determination in respect of Orion. It sets to set the customised price-quality path for Orion New Zealand Limited (Orion), to commence on 1 April 2014. It and is made under sections 53Q and 53V of the Act.

3.2 This determination applies to Orion.

3.3 The Electricity Distribution Services Default Price-Quality Path Determination 2010 (Commerce Commission Decision 685, 30 November 2009) as amended by NZCC 36 is further amended by omitting clause 3.2.

15 We also suggest that it be recorded in the amendment box at the front of the 2010 DPP Determination that the Orion CPP Determination amends that determination in respect of Orion.

Interpretation

16 There are a number of definitions which are ambiguous and/or do not fully give effect to the Draft Decision. These definitions should be improved and/or corrected.

17 The definition of 'Auditor' in the Draft Determination refers to clause 10.2(d). This should be clause 10.2(e).

18 The definitions of 'Class C Interruptions' and 'System Fixed Assets' in the Draft Determination are written in such a way that Class C Interruptions include interruptions that originate within assets owned by Transpower. We presume this was not the Commission's intention. The definition for Class C Interruptions should be limited to assets owned by Orion. A similar clarification is also required for Class B interruptions. We recommend that this definition be amended as follows:

Class B Interruptions means planned Interruptions by Orion

Class C Interruptions means Unplanned Interruptions originating within the System Fixed Assets of Orion

19 A number of terms are defined in clause 4.2 of the Draft Determination that are not used elsewhere in the document. These terms are:

- Amalgamate
- Input Methodology
- Orion DPP Determination

We recommend that the definitions of these terms be removed from clause 4.2.

20 The Draft Determination includes a number of terms and definitions which are different from those in the DPP Determination. This introduces inconsistencies between the two Determinations, and it is unclear what the rationale is for the changes. The differences include the following:

- 'Assessment Period' has been redefined such that it now excludes the term 'Assessment Date'.
- Some items now refer to different clauses, without changing the underlying definition.
 - For example: in the DPP Determination 'Consumer' is defined as having "*the same meaning as in section 2(1) of the Electricity Act 1992*". The Draft Determination now defines 'Consumer' as having "*the same meaning as clause 1.1.4 of the IM Determination*", and clause 1.1.4 of the IM Determination defines 'Consumer' as "*having the same meaning as defined in s 2(1) of the Electricity Act 1992*".
 - Other examples are: 'Electricity Lines Services', 'Pass-through costs', 'Prices', and 'Recoverable costs'.
 - The revised definitions of 'Pass-through costs' and 'Recoverable costs', in particular, introduce confusion as to whether these items are defined in the same way as in the DPP Determination.
- The 'Annual Compliance Statement' is now called the 'Compliance Statement'.
- The acronym for 'allowable notional revenue' has changed from R_t to ANR_t .
- A reference to a year in the subscripts of the formulae for 'allowable notional revenue' has changed from 20XX/XY to 20XX.
 - For example: Equation 2 in the DPP Determination includes subscripts for '2013/14', while the corresponding Equation 1 in the Draft Determination includes subscripts for '2015'.
- Clauses 4.1 and 4.2 have reversed order.

No explanation has been provided for these differences between the two Determinations. They do not result in greater clarity, and they unnecessarily introduce inconsistencies and the potential for confusion.

Clause 7 – Price path

- 21 In general, we support the continued use of the allowable notional revenue/notional revenue approach to assessing price path compliance. The Draft Determination sets out the necessary formulae, starting prices and rate of change to allow us to determine annual allowable revenues and compliance requirements.
- 22 Compared to the DPP Determination, the reference to “in prices” has been removed from the X-factor clause (clause 8.2 in the DPP Determination; clause 7.2 in the Draft Determination). The reasons for this difference have not been set out.

The use of lagged variables in the formulae for allowable notional revenue and notional revenue

- 23 Clause 7.5 and Schedule 1C of the Draft Determination define the term $Q_{i,t-2}$ by reference to the Assessment Period $t-2$. Schedule 1C also refers to the prices in Assessment Period $t-1$. However, ‘Assessment Period’ is only defined during the CPP regulatory period. Therefore it is not possible to have an ‘Assessment Period $t-2$ ’ if t is either the first or second Assessment Period, nor is it possible to have an ‘Assessment Period $t-1$ ’ if t is the first Assessment Period. We recommend that the definitions of $P_{i,t-1}$ and $Q_{i,t-2}$ in Clause 7.5 and Schedule 1C be amended as follows:

7.5 ...

$Q_{i,t-2}$ is the Quantity corresponding to the i^{th} Price during the Assessment Period $t-2$ 12 month period ending on 31 March two years prior to year t

...

Schedule 1C: Adjustments to allowable notional revenue and notional revenue resulting from a transaction to transfer assets

...

$P_{i,t-1}$ is the i^{th} Price changed by the supplier of the services in the Assessment Period $t-1$ 12 month period ending on 31 March the year prior to year t

$Q_{i,t-2}$ is the Quantity corresponding to the i^{th} Price during the Assessment Period $t-2$ 12 month period ending on 31 March two years prior to year t

Similarly, we recommend that clauses 7.7(b) and 7.7(b)(i) of the Draft Determination be amended as follows:

7.7 If Orion restructures its Prices during an Assessment Period, the Compliance Statement for the Assessment Period must:

...

(b) if there is no Quantity for the ~~Assessment Period~~ 12 month period ending on 31 March two years prior that reasonably relates to a restructured Price, provide information demonstrating that Orion has complied with the price path in clause 7 using alternative Quantities, which must include:

(i) the methodology used to determine the Quantity for the ~~Assessment Period~~ 12 month period ending on 31 March two years prior that corresponds to each restructured Price; and

...

24 Schedule 1C of the Draft Determination sets out the formula for the adjustment to allowable notional revenue in the event of a transaction referred to in clause 9.3 of the Draft Determination. This adjustment includes quantities relevant to the supplier of the services lagged by two years. Paragraph 1 of Schedule 1C states that these same lagged quantities must be used to calculate the corresponding adjustment to notional revenue. However, if the transaction involves us obtaining more customers, these quantities will not match our pricing structure – this makes such a strict adjustment to notional revenue not possible. We propose that a method similar to that used for price restructures be applied in these situations. We recommend that Schedule 1C be amended as follows:

Schedule 1C: Adjustments to allowable notional revenue and notional revenue resulting from a transaction to transfer assets

1. ...

such that allowable notional revenue is adjusted by the amount calculated using Equation 3, ~~and the corresponding adjustment to notional revenue uses the Quantities as used in Equation 3.~~

...

$Q_{i,t-2}$ is the Quantity applied to the supplier of the services corresponding to the i^{th} Price during the ~~Assessment Period~~ 12 month period ending on 31 March two years prior to year t

...

3. The adjustment to notional revenue referred to in clause 9.3 is applied by adjusting the Quantities otherwise used in the calculation of notional revenue under clause 7.5 by:

(a) where Orion acquires assets from another supplier and increases its provision of Electricity Lines Services, an amount that reasonably reflects the increase that would have occurred had the additional services been provided in the 12 month period ending on 31 March two years prior to year t, or

(b) where Orion disposes of assets to another supplier and reduces its provision of Electricity Lines Services, the Quantities as used in Equation 3.

Adjustments to allowable notional revenue and notional revenue resulting from a transaction to transfer assets

25 Schedule 1C includes inconsistent references to increased and reduced services. It refers to “*the provision of any additional Electricity Lines Services*”, “*supplies additional services*”, “*Electricity Lines Services that Orion no longer supplies*” and “*supplies less services*”. These references should be made consistent. We would prefer to use the phrases “*an increase in*” and “*a reduction in*”, as well as always specifying that the services are Electricity Lines Services, as we consider that these terms provide greater clarity. We therefore recommend that Schedule 1C be amended as follows:

Schedule 1C: Adjustments to allowable notional revenue and notional revenue resulting from a transaction to transfer assets

1. Where Orion completes a transaction referred to in clause 9.3, the adjustment for the Assessment Period required under clause 9.3(a) is:

(a) to include allowable notional revenue and notional revenue amounts that are associated with ~~the provision of any additional~~ an increase in the Electricity Lines Services Orion supplies as a result of the transaction; or

(b) to remove allowable notional revenue and notional revenue amounts that are associated with a reduction in the Electricity Lines Services ~~that Orion no longer~~ supplies as a result of the transaction,

...

i is each Price relating to the ~~additional or excluded services~~ increased or reduced Electricity Lines Services for the 12 month period ending on 31 March one year prior to year t;

...

2. For the avoidance of doubt, ANR_t^{adj} is:
- (a) a positive value where Orion acquires assets from another supplier and as a result ~~supplies additional services~~ increases its provision of Electricity Lines Services; and
 - (b) a negative value where Orion disposes of assets to another supplier and as a result ~~supplies less services~~ reduces its provision of Electricity Lines Services.

Determining the values for pass-through and recoverable costs

- 26 Schedule 2 of the Draft Determination sets out a number of adjustments to the determination of pass-through and recoverable costs, but does not appear to actually specify the basis for determining these amounts. We acknowledge that the application of the definitions in the IMs is implied, but we suggest these are explicitly stated, to avoid any ambiguity. We submit that the following opening paragraph be added to Schedule 2:

X Pass-through Costs and Recoverable Costs are those set out in clause 3.1.2 and 3.1.3 of the IM Determination respectively, except as modified by or specified in this Schedule 2.

- 27 We note that this better aligns with the definitions of 'Recoverable costs' and 'Pass through costs' in the DPP Determination. The definitions for these items in clause 4.2 of the Draft Determination introduce uncertainty by referencing different provisions of the IMs. We recommend that this are aligned. (Also refer to paragraph 20 above).
- 28 The Draft Determination introduces ambiguity as to whether we can include, for the purpose of calculating allowable notional revenue, pass-through and recoverable costs recovered in the previous year. Equation 2 in the Draft Determination specifies that in order to calculate allowable notional revenue for a given Assessment Period we must include pass-through and recoverable costs relevant to the previous Assessment Period. However, this is inconsistent with paragraph 1(b) of Schedule 2 which prohibits the inclusion of costs already passed through or recovered from consumers. We therefore submit that paragraph 1 of Schedule 2 be redrafted to address this issue. In this respect we note:
- It may be useful to distinguish between the amounts for pass-through and recoverable costs to be included in the calculation of (i) notional revenue and (ii) allowable notional revenue.
 - Alternatively, it may be useful to specify in paragraph 1 of Schedule 2 the Assessment Period being referenced, and whether this Assessment Period

relates to allowable notional revenue, notional revenue, and/or the K and V terms (pass-through and recoverable costs).

- 29 In addition, paragraph 1 of Schedule 2 of the Draft Determination uses the phrase “may include”, which appears to provide options. However, any pass-through or recoverable costs included in the calculation of notional revenue must also be included in the calculation of allowable notional revenue. We suggest the word “may” be replaced with “must only”. We also suggest the inclusion of an unambiguous requirement to include consistent costs from year to year in schedule 2 with the addition of a paragraph:

X Except for the First Assessment Period, the calculation of allowable notional revenue for an Assessment Period must include an amount for pass through and recoverable costs which is consistent with that included in the calculation of notional revenue in the previous Assessment Period.

The inclusion of only ascertainable pass-through and recoverable costs

- 30 The Draft Determination specifies that a pass-through or recoverable cost must be “ascertainable at the time Orion sets its Prices for that Assessment Period” (paragraph 1(a), Schedule 2). The Draft Decision, in paragraph 5.72, specifically states that forecasts cannot be used. This is a change in approach from the DPP Determination, which allows EDBs to forecast these costs when setting prices. The Draft Decision states that “*the reason for this is to minimise the chances of Orion over- and under-recovering its revenue*” (paragraph 5.72). However, this rationale would equally apply to EDBs under a DPP. The Companion Paper does not set out any reason for why the CPP should differ from the DPP in this regard.
- 31 Many of our recoverable costs are ascertainable at the time prices are set.
- The recoverable cost items set out in paragraph 3 of Schedule 2 of the Draft Determination (ie: CPP proposal related costs and foregone pass-through and recoverable costs from FY11 and FY12) are ascertainable when prices are set. Clause 3.1.3(3) of the IM Determination requires that the value for these items be specified in the CPP Determination, and therefore the amount is ascertainable when we set prices throughout the CPP regulatory period.
 - Recoverable costs for Transpower charges, as specified in clause 3.1.3(1)(b) and (c) of the IM Determination (ie: connection, interconnection and NIA charges), are materially ascertainable when prices are set for a given year. Transpower advises us of the charges in advance to allow us to set our prices based on this information.
 - Avoided transmission costs, of the type included in the above paragraph, as a result of spur asset purchases from Transpower, are materially ascertainable when we set prices for a given year. As with the transmission costs incurred, we can determine the amount avoided when prices are set.

- 32 However, components of our pass-through costs and some of our recoverable costs are only ascertainable as forecasts at the time prices are set.
- Avoided transmission costs related to export and generation credits are not ascertainable in advance. We note that the value of these costs is very small relative to total transmission costs, just 0.3% of recoverable costs.
 - Pass-through costs for local authority rates and industry levies are not fully ascertainable in advance.
- 33 We submit that we should include forecast pass-through or recoverable costs relevant to the Assessment Period, as other non-exempt EDBs are able to under the DPP.
- 34 We submit that we should be able to recover from consumers the pass-through and recoverable costs that we incur in the year in which we incur them. This is a fundamental principle of good regulation and fair pricing.
- 35 The chance of a materially large difference between the forecast and actual values for non-ascertainable items is very small, because:
- as stated above, many of our recoverable costs are ascertainable
 - those that are not make up only a small proportion (less than 5%) of our annual pass-through and recoverable costs
 - we can forecast our non-ascertainable items with a high degree of accuracy. For example, our forecast of local authority rates and industry levies for FY13 were within 2.5% of the actual value for these items (as set out in our FY13 DPP compliance statement)
 - we have always allowed a margin in our pricing to accommodate such variations so that we don't breach our price path. We anticipate continuing with this approach under a CPP.
- 36 If the Commission believes it has a problem with EDBs' actual pass-through and recoverable costs differing from forecasts, we submit that this can be resolved through enforcement processes. We therefore submit that the method proposed in the Draft Determination is not the appropriate way to address this issue.
- 37 We also note that there are transitional issues with having different approaches for the DPP and our CPP which are not addressed in the Draft Determination or the Companion Paper. As the DPP allows forecasts but the CPP does not, then the amount of pass-through and recoverable costs we will be able to include in the first year of the CPP period will be much lower than other years. In addition, at the end of the CPP period, there will be some pass-through and recoverable costs which were incurred in the CPP period but not able to be recovered in that period. When we move back onto the DPP, there will need to be an adjustment to allow us to recover

these as-yet-unrecovered costs. Ensuring that the same pass-through and recoverable cost provisions apply to both DPPs and CPPs avoids these timing issues. Allowing us to forecast these costs avoids all such issues.

38 The Draft Determination approach also introduces inconsistencies with information disclosure, in relation to pass-through and recoverable costs for price path compliance. As proposed, the CPP revenue path will reflect (to some extent) lagged pass-through and recoverable costs, but the information disclosure ROI will be (appropriately) calculated using the pass-through and recoverable costs incurred in the year.

39 We therefore recommend that clause 10.3 and Schedule 2 of the Draft Determination be amended as follows:

Price path compliance

10.3 The Compliance Statement must include any information reasonably necessary to demonstrate whether Orion has complied with the price path set out in clause 7, including but not limited to:

...

- (c) the amounts of Pass-through Costs and Recoverable Costs ~~that were used to calculate allowable notional revenue and notional revenue, including both the forecast amounts when Orion set prices for the Assessment Period and the actual amounts for the Assessment Period~~, and supporting data, information, and calculations used to determine those amounts, including ~~when each Pass-through Cost and Recoverable Cost amount was paid and the period to which those costs relate~~ information relevant to the variance between the forecast and actual amounts;

...

Schedule 2: Determining the amount of Pass-through Costs and Recoverable Costs for an Assessment Period

1. Orion may include a Pass-through Cost or Recoverable Cost to calculate allowable notional revenue or notional revenue for an Assessment Period where the amount:

~~(a) is ascertainable at the time Orion sets its Prices for that Assessment Period;~~

(a) has not already been passed through to, or recovered from, Consumers or other parties by Orion in a previous Assessment Period;

- (b~~e~~) cannot be otherwise recovered from Consumers or other parties, other than through Prices;
- (c~~d~~) cannot be otherwise recovered from Consumers through Prices, otherwise than through Pass-through Costs or Recoverable Costs; and
- (d~~e~~) does not relate to costs that were incurred by Orion prior to the Regulatory Period, except as provided under paragraph 3 of this Schedule.

...

40 However, if the Commission wishes to only allow ascertainable costs to be included, then we submit that changes need to be made to the Draft Determination clauses, as follows.

- For costs where the full amount for the year is not ascertainable when prices are set for that year, we suggest that an alternative approach to that proposed is to lag cost recovery by one year, with the values inflated by the cost of debt for one year. This is a simple approach, and avoids the complexity in the proposed determination which suggests partial year recovery, and the possibility of different pass through costs recovered over different time frames.
- The CPP Determination needs to include specific clauses which set out how we are to include costs which are not ascertainable. The Draft Decision refers to allowing Orion to include them in future years, adjusted for the time value of money – however, the Draft Determination does not include any clauses which implement this decision. As written, the Draft Determination does not appear to allow us to ever recover costs which are not ascertainable when prices are set.

41 Notwithstanding our submission for the amendments stated in paragraph 39 above, if the Commission wishes to only allow ascertainable costs to be included, then we propose the following amendments to clause 10.3 and Schedule 2 of the Draft Determination, in order to implement the changes we recommend in paragraph 40 above:

Price path compliance

10.3 The Compliance Statement must include any information reasonably necessary to demonstrate whether Orion has complied with the price path set out in clause 7, including but not limited to:

...

- (c) the amounts of Pass-through Costs and Recoverable Costs that were used to calculate allowable notional revenue and notional

revenue, and supporting data, information, and calculations used to determine those amounts, ~~including when each Pass-through Cost and Recoverable Cost amount was paid and the period to which those costs relate;~~

...

Schedule 2: Determining the amount of Pass-through Costs and Recoverable Costs for an Assessment Period

1. Orion may include a Pass-through Cost or Recoverable Cost to calculate allowable notional revenue or notional revenue for an Assessment Period where the amount:
 - (a) is either:
 - (i) ascertainable at the time Orion sets its Prices for that Assessment Period; or
 - (ii) is incurred in the year prior to the Assessment Period
 - (b) has not already been passed through to, or recovered from, Consumers or other parties by Orion in a previous Assessment Period;
 - (c) cannot be otherwise recovered from Consumers or other parties, other than through Prices;
 - (d) cannot be otherwise recovered from Consumers through Prices, otherwise than through Pass-through Costs or Recoverable Costs; and
 - (e) does not relate to costs that were incurred by Orion prior to the Regulatory Period, except as provided under paragraph 3 of this Schedule.

2. The value for an item included in paragraph 1(a)(ii) of Schedule 2 is determined using the following formula-

$$\underline{PR_t = PR_{t-1} \times (1 + CoD)}$$

where-

PR_t the value of a given pass-through or recoverable cost in the Assessment Period

PR_{t-1} the value of that same pass-through or recoverable cost in the Assessment Period in which it was incurred

t is the year in which the Assessment Period ends

CoD is 5.89%, which is the cost of debt

...

Recovery of foregone pass-through and recoverable costs from FY11 and FY12

42 Paragraph C128 of the Draft Decision states that the Commission considers that our under-recovery of pass-through costs in FY11 and FY12 of \$7.7m should be recovered in the CPP period as a recoverable cost. As we explained in our answer to the Commission's question #23 on our CPP proposal, this amount includes Transpower connection and interconnection charges, Transpower NIA charges, local authority rates and industry levies. We are unable to distinguish between the different elements of Transpower costs – we under-recovered the recoverable costs relating to Transpower charges, but cannot decompose this into the different elements.

43 However, the Draft Determination specifies this recovery as a recovery of connection and interconnection charges – excluding NIA charges and rates and levies. Specifically, clause 3(c) and paragraph 4 of Schedule 2 of the Draft Determination allow us to include as a recoverable cost Transpower connection and interconnection charges incurred in FY11 and FY12 which we have not already recovered. There are no further clauses which allow the recovery of NIA charges or rates and levies.

44 The requirement to calculate and justify the under recovery adds unnecessary uncertainty in our price setting and preparation of the subsequent compliance statement. All information to determine the amount is available already, and we request that the Determination be simplified to specify the amount that can be claimed as a recoverable cost. We submit that this amount should be \$7.7m as detailed in our CPP assessment material.

45 We submit that paragraphs 3 and 4 of Schedule 2 should be amended as follows:

3. Orion may include as a Recoverable Cost incurred prior to the Regulatory Period any amount that is:

...

- (c) the amount specified in a charge payable by Orion to Transpower, which meets the requirements set out in paragraph 4 of this Schedule

±

...

4. Orion may include as a Recoverable Cost ~~any charge payable to Transpower where the amount:~~
- ~~(a) is a cost to Orion of the type defined in clause 3.1.3(1)(b) of the IM Determination; and~~
 - ~~(b) is a charge by Transpower to Orion relating to:
 - ~~(i) the year ended 31 March 2011; or~~
 - ~~(ii) the year ended 31 March 2012; and~~~~
 - ~~(c) only to the extent that the amount has not already been passed through to, or recovered from, Consumers or other parties by Orion prior to the Regulatory Period.~~

the amount of \$7.7m (in present value (PV) terms as at 1/4/14) which represents the under-recovery of recoverable and pass through costs in the years ending 31 March 2011 and 31 March 2012

Consistent with the above, we also submit that paragraph 5 of Schedule 2 should be deleted (and paragraphs 6 and 7 renumbered accordingly).

The value of, and time period of recovery for, recoverable costs relating to costs incurred prior to the CPP regulatory period

- 46 Clauses 3.1.3(3) of the IM Determination requires that the values for all CPP proposal costs, which are to be included as recoverable costs, must be specified in the DPP Determination. However, while the Draft Determination specifies the values for the verifier, auditor and engineer fees (in paragraph 3 of Schedule 2), it does not include the value for the Commission's fees (as specified in clause 3.1.3(1)(h) and (i) of the IM Determination). We therefore submit that the CPP Determination must include values for these Commission fees.
- 47 Paragraph 4 of Schedule 2 of the Draft Determination specifies that the under-recovery of pass-through and recoverable costs (as discussed above) must be recovered in FY15. The Draft Determination does not specify the period over which CPP proposal costs (as otherwise discussed in paragraph 3(a) and (b) of Schedule 2) should be recovered. We submit that both of these costs should be recovered over the full five years of the CPP period. This will aid the smoothing of prices for consumers, and avoid a larger increase in FY15 followed by a decrease in FY16.
- 48 We submit that the Final Determination states the value of each of these two recoverable cost items, in present value (PV) terms as at 1/4/14, and specify the method used to determine the annual values of recoverable costs.

49 We recommend that paragraph 6 of Schedule 2 of the Draft Determination be amended as shown below. This formula calculates the annual amounts of these recoverable costs, and ensures that the total annual amount increases at the time value of money, and that the PV of the five-year series equals the PV of the previously incurred costs.

6. Any amounts that Orion ~~carries over~~ recovers under paragraphs 3 and 4 of this Schedule must be included as a Recoverable Cost to calculate notional revenue in each of the five Assessment Periods ending in 2015 within the CPP regulatory period. The annual amount to be included should be calculated as follows:

$$RC_t = ((PV_{14} / 5) \times (1 + CoD)^{t-2014}) / TF_{rev}$$

where-

t is the year in which the Assessment Period ends

RC_t is the amount of recoverable costs in the Assessment Period t

PV₁₄ is [\$XX]³, which is the PV at 1/4/14 of the costs which are to be recovered as recoverable costs

CoD is 5.89%, which is the cost of debt for the CPP period, which is used for the time value of money

TF_{rev} is as defined in the IM Determination.

50 The Draft Determination removes the allowance for 2009/10 Commerce Act levies, as included as clause 8.7 of the DPP Determination. This is inappropriate. The DPP Determination, and the Orion DPP Determination (as defined in the Draft Determination)⁴, allows non-exempt EDBs to recover these levies evenly over the five years from FY11 to FY15. We will not have fully recovered these costs before the CPP period begins. We submit that we should be able to include the remaining amount of these levies as a recoverable cost in FY15. We propose an additional clause be added to the Draft Determination, at the end of section 7, which reads as follows:

³ This value will comprise values for: the under-recovery of Transpower costs and pass-through costs from FY11 and FY12, and CPP proposal related costs. We are unable to completely quantify this value, since the Commission has not specified the value of its fees than can be included as recoverable costs.

⁴ *Electricity Distribution Services Default Price-Quality Path Determination 2010*, 30 November 2009, Commerce Commission Decision 685.

2009/10 Commerce Act Levies

X.X If Orion paid Commerce Act Levies during the Pricing Period 1 April 2009 to 31 March 2010 then Orion may include, as a Pass-Through Cost in the Assessment Period ending in 2015, one-fifth of the total amount of those levies.

Consistent with this, we recommend an amendment to paragraph 1(e) of Schedule 2, as follows:

1. Orion may include a Pass-through Cost or Recoverable Cost to calculate allowable notional revenue or notional revenue for an Assessment Period where the amount:

...

- (e) does not relate to costs that were incurred by Orion prior to the Regulatory Period, except as provided under paragraph 3 of this Schedule, or clause 7.X.

The recovery period for avoided transmission costs

- 51 As previously submitted, the intention of clause 3.1.3(5) of the IM Determination was to provide a five-year incentive for avoided transmission charges where an EDB purchases assets from Transpower, but the wording of the IMs does not provide for this. We suggest an addition to Schedule 2 to allow us to recover the intended amount, as follows:

- X IM clause 3.1.3(4) shall not apply, and instead, for the purpose of IM sub-clause (1)(e), an amount is a recoverable cost for a maximum of five years from the date of the transaction in which assets were transferred.

Recoverable cost reductions relating to forecast spur asset purchases

- 52 Paragraph 2 of Schedule 2 of the Draft Determination specifies an amount each year which must be deducted from the total amount of recoverable costs to determine the value for recoverable costs to be used in the calculation of allowable notional revenue and notional revenue. The reason for this deduction is to remove any 'double-count' between the effect of forecast spur asset purchases in the BBAR and the allowable which underpins the price path for avoided transmission charges within recoverable costs.
- 53 In this context, we support the Commission's proposed approach of determining the amount of BBAR which relates to the forecast spur asset purchases, and deducting this amount from any recoverable costs.

- 54 However, the figures in Table J2 of the Draft Decision, which are the basis for the figures specified in paragraph 2 of Schedule 2 of the Draft Determination, appear to include three separate errors, as we set out below. We submit that these errors need to be corrected, and the values in paragraph 2 of Schedule 2 of the Draft Determination be adjusted accordingly.
- 55 The BBAR impact is included for Papanui and Springston through the whole CPP period. This is not consistent with the purpose of this calculation which is to offset the five year recoverable cost allowance provided for in 3.1.3(1) of the IM Determination. The Papanui BBAR should end in FY17, and Springston in FY18, consistent with the timing in Table J1 in the Draft Decision.
- 56 The data in the 'adjust capex' and 'adjust opex' lines in Table J2 are constant over the CPP period. This appears to be inconsistent with the intent of the BBAR analysis, particularly as the BBAR increases over the CPP period as additional acquisitions are made.
- 57 The data in the 'adjust capex' line in Table J2 appears to be too high. We have attempted to recreate these values but have been unable to do so without further explanation.

Transition at the end of the CPP period

- 58 Section 53X of Part 4 of the Commerce Act provides that (in the absence of a further CPP application) we will be subject to the DPP that is applicable to other suppliers at the end of our CPP. However, the Act provides the Commission with full discretion as to how the DPP starting prices will be set for us. These may be either those that apply at the end of the CPP under the CPP price path, or any other starting prices the Commission determines.
- 59 The Draft Determination does not include any guidance on how the Commission will reset our prices at the end of the CPP period. In our view, the Draft Determination should address the options and process by which the Commission will determine the DPP settings at the end of the CPP period.
- 60 In this respect we recommend that the CPP Determination include the following text:

Price-quality path transition at the end of the CPP period

X.X At the end of the CPP period, if Orion does not apply for another CPP Determination, Orion will move back to the DPP applicable to other non-exempt EDBs. Under section 53X of the Act, Orion's starting prices for this DPP are those applicable to Orion at the end of the CPP regulatory period, or any other starting prices which we determine at least four months before the end of the CPP regulatory period.

X.X The Commission will consult with Orion at least 24 months prior to the end of the CPP period regarding Orion's intentions around applying for another CPP Determination, and the implementation of section 53X and Orion's DPP starting prices.

X.X The Commission will determine, at least 12 months prior to the end of the CPP regulatory period, and after consultation with Orion, whether, in the event that Orion does not apply for another CPP Determination, the Commission intends to set starting prices at the end of the CPP regulatory period under s53X(2) by either:

(a) applying the prices that applied at the end of the CPP regulatory period; or

(b) applying different prices.

X.X If option (b) above is to apply, the Commission will consult with Orion as to how those prices will be determined, including the method, application of the DPP Input Methodologies, the information to be used, and the calculations to be applied in determining the starting prices.

X.X The Commission will determine, at least 12 months prior to the end of the CPP regulatory period, and after consultation with Orion, how the DPP quality standards will be set for Orion, including the method, the information to be used, and the calculations to be applied in determining the quality standards.

X.X The Commission will determine the starting prices that will apply to Orion at the end of the CPP period, and the DPP quality standards that will apply to Orion, at least four months prior to the end of the CPP period.

Restructuring of prices and price changes

61 Clauses 7.6 - 7.7, which set out how to assess and demonstrate compliance with the price path when prices are restructured, have been substantially rewritten relative to the DPP Determination. While the rationale for this rewrite has not been set out, these revised requirements are more straight-forward than those in the DPP Determination and we support the change.

62 The Companion Paper states that if our prices change during the year, then we should use weighted average prices to calculate allowable notional revenue (paragraph 3.6). We support this decision. However, the Draft Determination does not include sufficient wording to effect this. Clause 7.5 and Schedule 1B defines allowable notional revenue and notional revenue as a function of prices "during any part of the Assessment Period". We submit that these two clauses should explicitly specify that weighted average prices should be used in the event that prices are changed during the year. We also submit that Schedule 1C be amended to specify that, where

relevant, weighted average prices can be used to derive values for prices to calculate adjustments due to transactions.

Clause 8 – Quality standards

- 63 We support the approach used to assess compliance with the quality standards. This is the same method used in the DPP Determination.
- 64 We support the Draft Determination specifying our quality standards for the CPP period, as opposed to the approach in the DPP Determination of including the formula for calculating them. Explicitly specifying the values is more appropriate in the context of this CPP.
- 65 The Draft Decision and Draft Determination set out a process for adjusting the reliability limits when Transpower spur asset transfers take place. This process will accommodate the impact of transfers, recognising the actual transfer dates. We support this approach. However, the reliability limits that we calculated for our CPP proposal already included asset transfers at forecast dates. Therefore, the reliability limits included in the Draft Determination are not internally consistent with the method for accounting for asset transfers.
- 66 We recommend that the Commission adjusts the reliability limits stated in the Draft Determination to exclude the impact of the forecast spur asset transfers in our CPP quality standards.
- 67 In the two tables below we set out the impact of these forecast spur asset purchases on the reliability limits in our CPP proposal. We recommend that the Commission deduct the values for the 'effect of assets acquired during CPP period' from the reliability limits it included in the Draft Determination. These values are inherent in both of the quality standards that we included in paragraphs 373 and 383 of our submission on the Draft Decision.

Transpower asset purchases - SAIDI	CPP period				
	FY15	FY16	FY17	FY18	FY19
Papanui (66kV assets)	0.0	0.0	0.0	0.0	0.0
Springston (66kV assets)	2.8	2.8	2.8	2.8	2.8
Addington (66kV assets)	0.0	0.0	0.0	0.0	0.0
Middleton (66kV assets)	0.0	0.0	0.0	0.0	0.0
Arthurs Pass (66kV assets)	0.0	0.0	0.0	0.0	0.0
Castle Hill (66kV assets)	0.0	0.1	0.1	0.1	0.1
Hororata (66kV assets)	0.0	0.0	0.1	0.1	0.1
Bromley (66kV and 11kV assets)	0.0	0.0	0.1	0.1	0.1
Islington (33kV assets)	0.0	0.0	0.0	0.0	0.0
Total	2.8	2.9	3.0	3.0	3.0
Effect of assets acquired during CPP period	0.0	0.1	0.2	0.2	0.2

Transpower asset purchases - SAIFI	CPP period				
	FY15	FY16	FY17	FY18	FY19
Papanui (66kV assets)	0.00	0.00	0.00	0.00	0.00
Springston (66kV assets)	0.04	0.04	0.04	0.04	0.04
Addington (66kV assets)	0.00	0.00	0.00	0.00	0.00
Middleton (66kV assets)	0.00	0.00	0.00	0.00	0.00
Arthurs Pass (66kV assets)	0.00	0.00	0.00	0.00	0.00
Castle Hill (66kV assets)	0.00	0.00	0.00	0.00	0.00
Hororata (66kV assets)	0.00	0.00	0.00	0.00	0.00
Bromley (66kV and 11kV assets)	0.00	0.00	0.01	0.01	0.01
Islington (33kV assets)	0.00	0.00	0.00	0.00	0.00
Total	0.04	0.04	0.06	0.06	0.06
Effect of assets acquired during CPP period	0.00	0.00	0.02	0.02	0.02

Clause 9 – Transactions

68 The definition of a large transaction, as specified in clause 9.1 of the Draft Determination, uses a different term for the ‘value’ of assets. The DPP Determination refers to “*the value of the assets of the Non-exempt EDB*” (clause 10.4(a)). In contrast, the Draft Determination refers to “*the Regulatory Investment Value of Orion’s assets*” (clause 9.1(a)). This now explicitly includes the value of any deferred tax, which appears to change the ‘value’ of a given set of assets. We submit that the definition used in the DPP Determination should also be applied to our CPP Determination.

Clause 10 – Compliance Statement

69 Clause 10 of the Draft Determination, regarding the ‘Compliance Statement’, corresponds to clause 11 of the DPP Determination. However clause 10 includes a large number of relatively small wording changes, relative to the DPP Determination. This makes it difficult to determine what the material differences are between the two Determinations.

70 The name of the statement has been changed from ‘Annual Compliance Statement’, as specified in the DPP Determination, to ‘Compliance Statement’. The rationale for the proposed change in term has not been set out.

71 Clause 10.3(d) of the Draft Determination refers to recoverable costs defined in clause 3.1.3(1)(b) of the IM Determination, and clause 10.3(e) of the Draft Determination refers to recoverable costs defined in clause 3.1.3(c) and (e) of the IM Determination. These references appear to be an error. Clause 10.3(d) of the Draft Determination discusses avoided transmission costs, and hence should refer to clause 3.1.3(e) of the IM Determination. Clause 10.3(d) of the Draft Determination should refer to clauses 3.1.3(b) and (c). We recommend that clause 10.3 of the Draft Determination be amended as follows:

10.3 The Compliance Statement must include any information reasonably necessary to demonstrate whether Orion has complied with the price path set out in clause 7, including but not limited to:

...

(d) information relating to any amounts of avoided transmission charges specified as Recoverable Costs (as defined in clause 3.1.3(1)(~~e~~) of the IM Determination), including:

...

(e) information relating to any amounts specified as Recoverable Costs consistent with clauses 3.1.3(1)(~~b~~) and (~~c~~) of the IM Determination, including:

...

Directors' certificate

The Directors' Certificate in Schedule 4 of the Draft Determination omits the word "Customised" from the title of the Final Determination.

Audit report

72 The form of the Auditor's report in Schedule 5 of the Draft Determination is considerably different to the corresponding schedule in the DPP Determination.

73 Schedule 5 of the Draft Determination requires that the Auditor's report be "*addressed to the Directors of Orion and to the Commission as the intended users of the assurance report*". This is different from the Auditor's Report in the DPP Determination, which is addressed to "*the readers of the Annual Compliance Statement of [insert name of Non-exempt EDB]*" (Schedule 3A). There appears to be no reason why the Auditor's report for a Compliance Statement for a CPP should be addressed differently to the Auditor's report for a Compliance Statement for a DPP.

74 Our auditor, Audit New Zealand, has advised that it is comfortable with the proposed approach. While the reasons for the proposed rewrite have not been set out, the proposed rewrite is an improvement over the DPP Determination and we support the changes.

Variations to Applicable Input Methodologies

75 The first sentence in Schedule 6 is missing the word "varied". This needs to be corrected.

Concluding remarks

- 76 Thank you for the opportunity to make this submission.
- 77 Orion does not consider that any part of this submission is confidential.
- 78 If you have any questions please contact David Freeman-Greene (General Manager - Commercial), DDI 03 363 9848, email David.Freeman-Greene@oriongroup.co.nz.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'David Freeman-Greene', with a long horizontal flourish extending to the right.

David Freeman-Greene
General Manager - Commercial