

20 March 2015

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**SUBMISSION ON THE PROPOSAL TO IMPLEMENT FURTHER AMENDMENTS TO
INPUT METHODOLOGIES (IRIS)**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the Commerce Commission (the **Commission**) proposal to implement further changes to the input methodologies related to the Incremental Rolling Incentive Scheme (the paper).
- 2 Orion's submission should be read in conjunction with (and is intended to be complementary to) the submission filed by the ENA on this issue.

General comments

- 3 Orion agrees that the proposed amended determination should preserve the existing CPP IRIS provisions for Orion. These current provisions can which can be described as 'asymmetric', apply only to the operating expenditure and cover the five years from 1 April 2014 to 31 March 2019. The amended determination allows the net IRIS balances to be included as recoverable costs in the years following the CPP.
- 4 In relation to the main body of the determination, overall we consider that the approach is overly complex as a result of the variety of possible combinations due to the various time frames and DPP/CPP transitional arrangements. We find the formulae relating to non-standard situations, such as transitioning between DPP and CPP, complicated and we are not clear that we fully understand the purpose of each adjustment term.

- 5 The Commission has indicated they will assist distributors to comply with the calculations by providing Excel templates that are tailored to the situation that distributors are in. While we consider that the provision of spreadsheets is useful and support the Commission's provision of these, we do not consider that the provision of spreadsheets as an alternative to the Commission being able to explain, and EDB's being able to understand, the methodology that is being proposed is appropriate.
- 6 Following on from the previous point, rather than call the formulae 'roll-over adjustment term X' and 'savings adjustment term Y', it would be useful if the Commission described their respective purpose in addition to providing the formula. There are a lot of adjustment terms and it would be helpful to understand what each is trying to achieve. In para 2.13 of the paper the Commission recognises that the formulae are not intuitive and states that they combine to ensure the recoverable costs are consistent with the intention of the IRIS scheme.
- 7 While the Commission has determined formula for most of the adjustment terms, it is unable to determine a formula for the baseline adjustment term. This baseline adjustment term is used in arguably the most important cases of the transition to/from a CPP. The inability to specify a mathematical term appears to be due to the inherent discontinuity between the DPP opex forecast and the CPP opex forecast, which is a result of the different forecasting methods and assumptions.
- 8 Because it cannot derive a mathematical solution to the problem the Commission proposes to determine the relevant adjustment amount using a four step process outlined in paragraphs 3.10.1 to 3.10.4 of the paper. We cannot see how the four steps in paragraphs 3.10 are related to the non-recurrent differences in the penultimate year as referenced in paragraph 3.9 or clause 3.3.7(2) of the draft determination.
- 9 This method articulated in clause 3.3.7(2) of the draft IMs states that the Commission will determine what constitutes a non-recurring difference but does not explain the process that will be followed in order to achieve this outcome other than to have "regard to the views of interested persons".
- 10 We believe that the proposed approach set out in clause 3.3.7 is flawed. It is inappropriate as it will allow the Commission complete discretion in determining the value of the baseline adjustment term. We believe that this does not meet with the intent of the IMs to provide certainty.

- 11 In addition, we consider that interested persons may not be in a position to determine what is a recurring or non-recurring cost and have a potential bias in relation to the proportion of non-recurring to recurring costs in order to increase/decrease the amount of the baseline adjustment term, and therefore the recoverable cost.
- 12 We recommend that:
 - 12.1 the Commission does not implement the amendment at this time and thereby avoids locking in a flawed IRIS scheme;
 - 12.2 considers this issue further as part of the wider IM review;
 - 12.3 does not include any IRIS IM in a section 52P determination until this issue is resolved.
- 13 Should the Commission persist with the its proposed approach (which we do not support) then we recommend that the Commission includes an IM which sets out the basis on which it will determine whether an amount is non-recurring or recurring.

Clarification on approach to resetting of prices

- 14 We also suggest that the Commission clarifies its position in relation to the resetting of prices at the end of a DPP/ CPP.
- 15 At the end of a DPP the starting prices must be set under s53P(3) (a) or (b), while at the end of a CPP the starting prices for the next regulatory period are set under s53X if the EDB is transitioning to a DPP.¹
- 16 While we acknowledge that the Commission has provided options in the IRIS scheme for all the various scenarios for setting starting prices, we note that previously the Commission has not been inclined to roll over prices.
- 17 We therefore seek clarification of the Commission's position in relation to the resetting of prices at the end of a DPP/ CPP. We are concerned that should the Commission interpret s53X in the same way as it has indicated it will deal with s53P then this will effectively rule out rolling over prices as a valid option.

¹ Alternatively they would be set as part of the CPP proposal should the EDB seek a further CPP.

- 18 The Commission has previously indicated, at least in relation to a DPP reset and s53P, that to inform its choice on whether to roll over the prices that previously applied, or adjust starting prices based on the current and projected profitability of each distributor it will calculate starting prices that would apply if starting prices are adjusted based on the current and projected profitability.

"When setting starting prices, we can either roll over the prices that previously applied, or adjust starting prices based on the current and projected profitability of each distributor, ie, using either s 53P(3)(a) or (b) of the Act. We are interested in your views on the approach we should use to set starting prices for the next regulatory period.

*In our view, it is generally not possible to make a decision on the approach to use until we have calculated the starting prices that would apply if starting prices are adjusted based on the current and projected profitability of each distributor. By carrying out this calculation, and determining the materiality of differences between the alternative starting prices, we will be able to make an informed decision."*²

- 19 We believe that should the Commission adopt the approach of calculating starting prices that would apply based on the current and projected profitability to inform its decision on the choice of starting prices, then the Commission will have to choose to apply these prices rather than roll over the existing prices.
- 20 Given the Commission's previous statements in relation to resetting the starting prices at the end of a DPP using section 53P(3)(b), with prices determined based on the current and projected profitability of each supplier, we would like the Commission to confirm that all the proposed IRIS scenarios based on the rolling over of prices, whether under section 53P(3)(a) or 53X have practical application.
- 21 We consider that the option to roll over the prices under s53X when at the end of a CPP period is a valid option particularly when moving onto the final year of a DPP.

Suitability of applying an IRIS scheme to a CPP

² Paragraphs 2.4 and 2.5 Commission's default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper released by the Commission on 21 March 2014

- 22 In our CPP proposal we proposed the controllable opex in the IRIS scheme required under a CPP be set to zero dollars. In addition, in our 12 November 2013 submission responding to the Commission's consultation on the "proposed approach to the specification of controllable opex" we indicated that we did not consider it appropriate to apply an IRIS scheme to Orion's CPP.
- 23 We will not re-iterate the detail of our concerns in this submission but note that we remain of the opinion that in the case of a catastrophic CPP it is inappropriate to apply an IRIS scheme.

Concluding remarks

- 24 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 signature is written in a cursive, slightly slanted style.

Dennis Jones
Industry Developments Manager