



**Submission on the draft Default Price-  
Quality Path determination 2015**

**31 October 2014**

## **CONTENTS**

Introduction.....	3
General comments.....	3
Quality standards and incentives .....	3
Pass-through and recoverable costs .....	5
Price restructures .....	6
Major transactions .....	7
Energy efficiency incentives .....	7
Approval processes.....	8

## **Introduction**

1. This submission responds to the Commerce Commission's (Commission) consultation on its draft default price-quality path determination from 1 April 2015, dated 20 October 2014.
2. Vector has reviewed and endorses the submission by the Electricity Networks Association on this topic.
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## **General comments**

4. Overall, Vector is pleased with a clear majority of the changes the Commission has made to the determination, particularly those that relate to the quality standards and the pass-through balance. It is clear from the current draft that the Commission has carefully considered the points made by submitters and the recommendations for change. We appreciate the Commission's efforts in this regard.
5. Attached to this submission is a marked-up version of the draft DPP determination. We found this to be a more efficient way of providing comments on certain aspects of the drafting, particularly relating to price restructures. Where we thought the changes were not self-explanatory, we have added comments explaining them. We would be happy to talk the Commission through our suggested changes.

## **Quality standards and incentives**

6. The current proposals make considerable improvements to the Commission's previous draft (dated 18 June 2014). In particular, Vector supports the Commission's revised proposals to:
  - a) Retain the "two-out-of-three" compliance rule, and the improved certainty around compliance and enforcement that this brings.
  - b) Keep the quality standard (i.e. the reliability limit) at one standard deviation above the mean.

- c) "De-link" compliance and the reward/penalty incentive payment by measuring compliance separately from the revenue incentive.
  - d) Remove the pro-rata compliance breach adjustment.
  - e) Normalise SAIDI and SAIFI independently of each other.
7. The Commission's revised approach more appropriately reflects the underlying intention of the Act – where there are incentives to innovate and invest, and promoting outcomes that are consistent with long-term benefits of consumers. This is because the suppliers will continue to be measured against a quality standard that accounts for natural variability by applying a multi-year assessment. At the same time, suppliers will have incentives to improve the performance of their network. Our significant remaining concern regards the substitution of a boundary value for major event days.
  8. The Commission's new proposal is to determine the SAIDI and SAIFI unplanned boundaries using the 23<sup>rd</sup> highest daily unplanned SAIDI and SAIFI values from the ten year reference data set. In our view, the revised methodology using the 23<sup>rd</sup> highest daily value seems somewhat oversimplified. However, when applied to Vector's reference dataset the results are not unreasonable in terms of consistency of result from year to year. If the Commission is uncomfortable with other alternative boundary value methodologies (such as that put forward by the ENA) then Vector will support using this particular methodology for the next reset.
  9. That said, we wish to reiterate our view that where EDBs experience a major event the SAIDI and / or SAIFI values for those days ought to be removed altogether or substituted with the average from the reference dataset (after normalisation) – not substituted with the boundary value. This is because the purpose of a reliability limit is to ensure that the underlying integrity and average historical benchmark of a supplier's network performance is not degraded by major events on the network, which are beyond the control of EDBs or are uneconomical to build networks to withstand. Therefore, the removal of MEDs (as recommended by the IEEE) is desirable and will better reveal trends in daily network performance that would otherwise be hidden.
  10. Replacing values on MEDs with the boundary value effectively distorts the overall network reliability trends. Though the boundary value is much less than the actual (pre-normalised) SAIDI or SAIFI value on a MED, it nevertheless reintroduces data that skews overall reliability data towards the reliability limit. This makes it difficult to accurately assess the real underlying (i.e. non-major event day) performance of the network.

## **Pass-through and recoverable costs**

### *Pass-through balance*

11. Vector welcomes the Commission's adoption of our recommended approach to remove the pass-through and recoverable cost price compliance requirements from the calculation of notional revenue and allowable notional revenue. The Commission has done this through the new "Pass-through Balance" (PTB) approach.
12. We appreciate the Commission's willingness to address and remove the recovery risks associated with these costs. We consider that the proposed changes are consistent with the principle that suppliers should be able to fully recover their pass-through and recoverable costs. We particularly welcome the intention to carry over any "overs" or "unders" from the previous assessment period.
13. The Commission has sought views on whether EDBs would find it difficult to disaggregate pass-through prices from distribution prices. We do not anticipate this disaggregation will cause any undue difficulties for Vector. The disaggregation will require small changes, at our next price reset, to the existing transmission portion of prices, which are already published. We are already consulting with retailers on this proposal. We note it would be advantageous to change the requirements of Schedule 8 of the Electricity Distribution Information Disclosure Determination 2012 to align with the DPP pass through and distribution split (rather than retaining the current transmission-distribution split).
14. While we support the Commission's proposal for a PTB approach, we note that paragraph 4.13.2 of the consultation paper seems to mis-understand a point made in an earlier submission by Vector. In the earlier submission we raised concerns that the ascertainable approach may cause serious cash-flow issues if the Electricity Authority amended the transmission pricing methodology.<sup>1</sup> For clarity, these concerns related to the ascertainable approach, not the ENA's proposed revenue wash-up.

### *Pass-through of Electricity Authority Levies*

15. The Commission acknowledges the unexpected increase of Electricity Authority (Authority) levies over the period 1 July 2014 – 30 June 2015. This

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<sup>1</sup> Vector Limited, *Submission to the Commerce Commission on the Default Price-Quality Paths from 1 April 2015: Process and Issues Paper*, 30 April 2014, paragraph 50.

“unexpected increase” is not an immaterial sum. It is a 170% increase in the Authority’s Registry and Consumer operations levy and was not consulted on in its 2014/15 appropriation consultation paper.

16. The effect of this increase is that Vector will under-recover approximately \$300,000 over the July – March months of the current pricing year. Other EDBs will under-recover at a similar rate. While the amount is relatively small in the context of total revenues, we believe it is important to maintain the principle that pass-through and recoverable costs are recovered in full and not more than in full.
17. As the Commission notes, currently the DPP determination does not allow EDBs to recover un-recovered levies in a subsequent regulatory period. The Commission invites submissions on this issue.
18. Vector considers that this could be addressed by amending the PTB requirements such that the PTB can apply to the Authority’s *Registry and Consumer operations* levy that was charged in the 2014/15 regulatory year (but not to any other pass-through and recoverable cost in that year).
19. Paragraph 8.6 of the draft DPP determination provides that the PTB for assessment period *t-1* must be *nil* for the first assessment year of the regulatory period. However, for all other assessment years any remaining balance from a previous assessment year can be recovered in assessment period *t*. In our view it would be reasonably straightforward to amend this clause to enable recovery of the excess amount levied under the Authority’s *Registry and Consumer operations* levy.
20. If the Commission implements the proposed PTB for the next DPP Vector **recommends** that an exception be made in clause 8.6 allowing EDBs to recover the difference (adjusted for the time value of money) between the Authority’s actual *Registry and consumer operations* levy and the value for this levy that was consulted on in the 2015 year. We consider that this would be consistent with the principle that EDBs should be allowed to fully recover their pass-through and recoverable costs.

### **Price restructures**

21. The Commission is proposing changes to the treatment of price restructures. Vector agrees that quantity estimates made by EDBs should be demonstrably reasonable. We also agree it is reasonable to include in the compliance

statement details of any forecast of quantities and an explanation of the reasons for any difference between forecast and actual quantities.

22. We make detailed comments and mark-ups on the price restructure clauses in the attached draft determination.

### **Major transactions**

23. Vector considers that the revised approach for managing major transactions closes the gap previously identified relating to transactions between a non-exempt EDB and an exempt EDB.
24. However, for quality standards, we are not convinced that an allocation based on ICPs in each network is sensible as the ICPs being transferred may not be representative of the ICPs in either the purchaser's or the seller's network (the proposed definition of SAIDI<sub>other,t</sub> is ambiguous as to which EDB's figures are to be used). In our view, it would be preferable to identify the historical performance of the transferred asset(s) and this should be possible to do as part of the transaction process.
25. We also consider that the draft formulae for adjusting quality standards following a transaction with Transpower do not work properly. The formula in schedule 4B clause 2 seems to mean the new SAIDI target is an unweighted average of the SAIDI for the purchasing EDB and the SAIDI value of the transferred assets – this is very unlikely to be appropriate.
26. We welcome the ability to propose an alternative approach to calculating revenues and costs for a particular transaction as this will ensure the Commission's proposal does not need to be applied in circumstances where it may be unsuitable.
27. However, this ability to propose an alternative seems to be limited to price only. Vector **recommends** the DPP provides an ability to propose an alternative method of calculating revised quality standards following a particular major transaction, subject to Commission approval.

### **Energy efficiency incentives**

28. The Commission has amended the clauses relating to approval of an energy efficiency and demand incentive allowance and has invited comments on the revised clauses.

29. We recommend some further changes (and set out our reasoning) in the attached marked-up determination.

### **Approval processes**

30. The Commission proposes to require approval for a number of items within the DPP, e.g. energy efficiency and demand incentive allowance and extended reserves allowance.
31. However, the DPP is generally silent on the Commission's approval process (while specifying requirements for EDBs to meet). In our view this is not the correct balance of requirements and creates inappropriate and unnecessary uncertainty regarding how and, crucially, when decisions on approval applications will be made.
32. Vector **recommends** the DPP determination sets out timing and processes for the Commission to provide approvals, where Commission approval is required under the DPP.