

14 August 2018

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Dear Matthew

### **Cross-submission on recent customised price-quality path processes**

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on submissions of 12 other parties on the Commerce Commission open letter 'Requesting feedback on recent customised price-quality paths applying to Powerco and Wellington Electricity' dated 3<sup>rd</sup> July 2018 (the "CC open-letter").<sup>1</sup>
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. This cross submission has 10 section headings, including an overview and 9 headings that match the tables in Attachment A of the Commission's open letter:
  - Overview of submissions – some EDB receptive to more rigorous CPP process
  - Table A – Consideration of alternatives – broad consensus
  - Table B – Use of cost benefit analysis – some EDB receptive to greater role for CBA
  - Table C – Long term pricing impact – uncertainty is not a valid objection
  - Table D – Calculating revenue and pricing changes – discussion needs to move off 'averages'
  - Table E – Delivery and accountability of CPP commitments – qualified support
  - Table F – Link between price and quality – EDB trade-offs need to be revealed
  - Table G – Consumer consultation – no quantification of consumer preferences
  - Table H – Verification – open question
  - Table I – Defining and applying proportionate scrutiny – no change warranted.

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<sup>1</sup> <http://www.comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/wellington-electricitys-2018-2021-cpp/>

## Overview of submissions – some EDB receptive to more rigorous CPP process

4. Most of the submissions focused on a subset of the 9 CPP topics in Attachment A of the Commission's open letter ('consideration of alternatives', 'use of CBA', 'long term pricing impact', and 'link between price and quality').
5. MEUG (with its advisor NZIER), Fonterra, Mercury and the Electricity Retailers Association (ERANZ) with its advisor TDB, support change in the CPP process including the use of CBA methodology and clearer disclosure of the long-term price impacts and price quality trade-offs. These submitters reiterated and reinforced arguments for change in the CPP process made in their submissions on the Powerco CPP proposal and draft decision.
6. The underlying theme of these submission is that CPP proposals should include fuller and more granular quantification of the costs and benefits of CPP proposals and that these should be transparently compared to consumer preferences for service and reliability. Arguments against fuller and more granular quantification such as the cost and complexity of this analysis invite scepticism as CPP applicants need this type of information to make good quality investment decisions. The changes proposed by the Commission go toward, but do not fully meet, the suggestions of these submitters.
7. Four EDB (Aurora, Powerco, Wellington Electricity Lines Limited (WELL) and Vector) and the Electricity Networks Association (ENA) have made submissions on the issues in Attachment A of the Commission's open letter. Four of the five submitters argue against a change to the IMs but suggest the Commission should provide 'guidance' to CPP applicants. Vector the fifth submitter does mention IMs but its submission also talks about guidance. However, the comments by ENA and EDB submitters about the scope and timing for more rigorous quantification of the CPP benefits and price impacts differ:
  - The ENA seems to be the most conservative of the EDB submitters. It objects strongly to CBA of CPP proposals, cautions that asset health measures needed to analyse price quality trade-offs are not available and argues against a prescriptive approach to estimating future price impacts.
  - Aurora, Powerco and WELL make broadly similar comments about the practical difficulties of 'accurately estimating' CPP proposal costs and benefits, long term price impacts, long term revenue changes and price quality trade-offs but indicate these will improve over time and suggest Commission guidance rather than a change to the IMs would encourage progress on these issues.
  - Vector is critical of the lack of explanation of the trade-off between prices and service reliability in the recent CPP decisions and its submission implies that a more granular explanation of the price reliability trade-off could and should be provided. Vector comments that:
    - EDB are continuously making decisions on trade-offs between reliability and price limits based on a range of models including 'deterministically planned networks with system security criteria that allow very little energy risk' and 'probability-based system planning allowing for more risk complemented with other management strategies'
    - the Commission has missed an opportunity to guide EDB and other stakeholders about how price and reliability trade-offs should be considered within existing regulations.
8. In summary these submissions show unmet expectations from some consumers and electricity retailers for a more detailed quantification of the business case for CPP investment and price increases, with some EDB arguing that such quantification either

cannot be delivered now or would not be in the interest of consumers. The following sections briefly compare the individual aspects of the CPP.

#### **Table A – Consideration of alternatives – broad consensus**

9. MEUG suggested two approaches to the consideration of alternatives in its previous submission<sup>2</sup> This suggestion balances the need to encourage EDB to behave as if they were operating in a workably competitive market with the concerns EDB have raised. Specifically, EDB submitters wanted an approach for considering alternatives that is:
  - pragmatic and can be applied to both DPP and CPP investment decisions (Powerco)
  - can be adjusted to recognise the differences in reliability standards applying to EDB and third parties (WELL)
  - can be accommodated as an add-on to the development of asset management plans (Aurora) or as a standalone.

#### **Table B – Use of cost benefit analysis – some EDB receptive to greater role for CBA**

10. MEUG (with supporting advice from NZIER) and ERANZ (with supporting advice from TDB) argue that the benefits and costs of CPP proposals should be quantified, compared to the costs and benefits of a genuine counterfactual and tested against the customer's willingness to pay for the change in reliability. Fonterra also supports the use of CBA.
11. The capacity to quantify costs of changes in reliability and compare these to actual consumer preferences for reliability is the core of the argument by both MEUG and ERANZ that quantification of cost and benefit assessment can be applied to CPP proposals so that the investment decisions are more likely to be in line with consumer preferences.
12. EDB submitter views on the CBA range from costly with no benefit (ENA) through to a potential method in the 'basket of techniques' used for CPP assessment and preparation (Powerco). All submitters except Vector argue that:
  - applying CBA to a CPP overall is very difficult and has limited benefits
  - CBA is well suited to some investments, but other techniques are more appropriate for other investments (without specifying either the alternative techniques or the selection criteria).
13. Vector does not comment explicitly on the use of CBA but the comments in its submission that EDB are continuously making choice between reliability and compliance with price caps hint that these trade-off decisions are made frequently and their benefits in terms of reliability gains can be quantified and compared with their cost to the EDB.
14. Overall, the submissions by EDB seem to acknowledge that the discussion of the role of CBA techniques in assessing CPP proposals should now move from a binary 'yes/no' to a discussion about which parts of a CPP proposal can be assessed using CBA. MEUG argues that this discussion should also explicitly compare the alternative assessment techniques EDB want to CBA and consider how obstacles to applying CBA might be removed in the future.

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<sup>2</sup> Refer MMEUG submission to CC, 31 July 2018 page 3, URL, <https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-lines-price-quality-paths/electricity-lines-customised-price-quality-path/wellington-electricitys-20182021-cpp?target=documents&root=89568>

### Table C – Long term pricing impact – uncertainty is not a valid objection

15. Submitters agree in principle that the EDB should consult on the long-term price impacts of CPP proposal but several of the EDB submitters have raised concerns about the uncertainty around long term price forecasts.
16. The TDB advice included in the ERANZ submission points out that the uncertainty about the long-term price forecasts is common to all the elements of the CPP. Shortening the horizon for the price forecast does not reduce this uncertainty but simply conceals the expected impact as the Commission has pointed out in its open letter.

### Table D – Calculating revenue and pricing changes – discussion needs to move off averages

17. Submitters agree in principle that the EDB should consult on the long-term price impacts of a CPP proposal but several of the EDB submitters have raised concerns about the usefulness to individual customers of average price changes over a large group of diverse consumers.
18. The NZIER advice suggested that EDB pricing methodologies and cost to serve models could be used to forecast the allocation of CPP costs to the main EDB pricing plans. This would address the EDB problem of averages that are not relevant to individual consumers as well allowing small business and commercial users to get a clearer indication of how they may be affected by the CPP.

### Table E – Delivery and accountability of CPP commitments – qualified support

19. Some EDB submitters have argued against additional reporting claiming the existing requirements are sufficient (Aurora) or that an overly prescriptive approach could discourage innovation (ENA). Other EDB submitters have supported delivery accountability reporting and additional quality measures either with caveats (WELL) or for both DPP and CPP frameworks (Powerco). All EDB submitters (except Vector<sup>3</sup>) had some aversion to application of additional quality measures for CPP proposals ranging from ‘inappropriate’ (Aurora), through to ‘may be instances’ of relevance (WELL), to ‘agreement in principle subject to consultation’ (Powerco).
20. MEUG agrees successful CPP applicants should be accountable to their stakeholders for delivering changes in service quality and line charges approved under the CPP proposal but remains ambivalent about the reporting requirements<sup>4</sup>. The question of ‘additional quality’ measures is secondary to:
  - improved quantification of the price quality trade-off proposed in CPP
  - the recognition in CPP approval decisions of relative consumer preferences for choices such as ‘planned versus unplanned outages’ and ‘more frequent but shorter’ versus ‘less frequent but longer’ outages.

Accordingly, the case for additional quality measures should be considered as part of the ‘link between price and quality’ (the next section of the Commission’s open letter).

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<sup>3</sup> The Vector submission did not comment directly on this issue but did argue that a CPP should use a different lens to assess price quality trade-offs to other Part 4 decisions.

<sup>4</sup> Refer MMEUG submission to CC, 31 July 2018 page 4, URL, <https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-lines-price-quality-paths/electricity-lines-customised-price-quality-path/wellington-electricitys-20182021-cpp?target=documents&root=89568>

### Table F – Link between price and quality – EDB trade-offs need to be revealed

21. The Commission's open letter notes the importance of:
  - understanding the impact of investment on asset quality outcomes to enable EDB to prioritise their expenditure and for consumers to make their preferences clear
  - asset management is a priority for the Commission and asset criticality could inform the assessment of how different investment options affect different quality outcomes.
22. All EDB submitters except Vector have argued that the current measures of asset health and the effect of investment on network reliability are not sufficiently well developed to assess a trade-off between price and service quality. Vector's submission states that EDB continuously make this type of decision. Vector's statement suggests that EDB can calculate a price service quality trade-off at least for marginal investments. Similarly, the Commission's decision to approve a lower level of investment than proposed by Powerco but increase Powerco's service quality targets implies the Commission also formed a view on the contribution of investment to reliability.
23. MEUG supports the rapid development and application of efficient improvements in the assessment of asset reliability. But we struggle to form a view on the current capability of CPP applicants to assess investment reliability trade-offs or the time required for new assessment tools such as asset criticality measures to materially improve the capacity and willingness of CPP applicants to transparently disclose investment service quality trade-offs. MEUG suggests that both would-be CPP applicants and the Commission need to adopt a two-stage strategy:
  - make better use of existing asset health indicators and asset management plans to present genuine counterfactuals as part of CPP proposals and explicitly comment on the implications of the forecast asset health at the end of the CPP period for the likely requirement for network investment after the CPP period
  - encourage adoption of frameworks such as asset criticality only where they are expected to be efficient and effective.

### Table G – Consumer consultation – no quantification of consumer preferences

24. Both the Commission's open letter and all the submissions that comment on consultation frame the task as defining high-level principles or process steps for a qualitative discussion with a group of (usually mass-market) customers. At best the specification of the task considers how to engage uninterested customers and recognise differences in service quality and service expectations in different parts of the network.
25. There has been no detailed discussion of how to:
  - deepen and broaden the willingness to pay and willingness to avoid outage research commissioned by Powerco as part of its CPP application
  - incorporate and weight the findings from this type of research in the CPP approval decision made by the Commission.
26. The willingness to pay and willingness to avoid outage research was the closest the Powerco CPP consultation process came to quantifying consumer preferences for both price reliability trade-offs and preferences between frequency and duration of outages. The lack of any substantive discussion of the role of this type of research in future CPP proposal processes raises the prospect that future CPP proposals will rely even more heavily on qualitative assessments of consumer preferences than the Powerco decision and may not have the benefit of any quantitative assessment of consumer preferences.

**Table H – Verification – open to question**

27. For MEUG the rationale for and net contribution of the verifier is an open question. (MEUG has not changed the view in its previous submission).

**Table I – Defining and applying proportionate scrutiny – no change warranted**

28. The definition of proportionate scrutiny has not been sufficiently tested to warrant change. (MEUG has not changed the view in its previous submission).

Yours sincerely

John Harbord  
MEUG Chair