



# Disclosure of Pricing Methodology for Pricing as at 1st April 2013

**Prepared By:**

Buller Electricity Limited

Robertson Street

Westport

Date: 31 March 2013

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## TABLE OF CONTENTS

1. INTRODUCTION.....	1
2. RECOVERY OF COSTS – COST REFLECTIVE PRICES .....	3
2.2. COST ESTIMATION.....	4
2.3. COST EFFICIENCY .....	5
3. COSTING PRINCIPLES .....	7
3.1. ELECTRICITY AUTHORITY PRINCIPLES .....	7
3.2. SATISFYING THESE PRINCIPLES IN BEL’S PRICING .....	8
4. RECOVERY OF LINE CHARGES .....	12
4.1. NETWORK COMPONENTS.....	12
4.2. LINE LOSSES.....	13
4.3. REVENUE REQUIREMENTS .....	13
4.4. PRICE AND MANNER OF CALCULATIONS.....	13
4.5. FIXED CHARGES.....	13
4.6. METERING AND LOAD CONTROL EQUIPMENT .....	14
4.7. LOAD GROUPS.....	14
4.7.1. LOAD GROUP ONE.....	16
4.7.2. LOAD GROUP LOW USER .....	15
4.7.3. LOAD GROUP TWO .....	16
4.7.4. LOAD GROUP THREE .....	17
4.7.5. LOAD GROUP FOUR .....	17
4.7.6. LOAD GROUP FIVE .....	17
4.8. TOTAL REVENUE REQUIREMENTS .....	18
5. TRANSMISSION PRICING.....	19
6. NOTE TO CONSUMERS.....	20

## 1. INTRODUCTION

This publication sets out the methodology used to determine charges to connected consumers for access to, and use of, the Buller Electricity Limited (BEL) distribution network. Line charges recover costs associated with the use of Transpower's National Grid and the costs of operating and maintaining BEL's network together with a provision to provide a rate of return on the investment in the distribution network (i.e. the cost of ownership). For most electricity consumers, these line charges are a part of their retail tariff, and represent the price for conveying electricity from the generating stations to the consumers' installations. In practice:

- BEL's line charges are paid by electricity retailers operating in the Buller network region, using, *inter alia*, the load group aggregate metering information supplied by these retailers for each consumer Installation Control Point (ICP); and
- In deriving their retail tariff, the majority of retailers repackage BEL's line charges together with their own retail energy charges.

Pricing Methodologies are a requirement of the Electricity Distribution Information Disclosure Determination 2012<sup>1</sup> determined pursuant to Part 4 of the Commerce Act 1986. Whilst in many respects similar, the 2012 Determination supersedes the previous requirement to disclose pricing methodologies pursuant to the Electricity Distribution (Information Disclosure) Requirements 2008 (which themselves adopted Requirements 22 and 23 of the Electricity Information Disclosure Requirements 2004). Additional regulatory guidance for BEL in preparing its pricing methodology comes from Distribution Pricing Principles and Information Disclosure Guidelines<sup>2</sup>, and the Electricity (Low Fixed Charge Tariff option for Domestic Consumers) Regulations 2004.

In the Determination (Clauses 2.4.1 to 2.4.5), BEL must disclose its pricing methodology, including:

- Target revenue information (where applicable);
- Discussion of the extent of consistency of the pricing methodology with the pricing principles;

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<sup>1</sup> Commerce Commission Decision No. NZCC 22

<sup>2</sup> Prepared by the Electricity Commission (now Electricity Authority) in February 2010

- Pricing strategies;
- Approach to pricing for non-standard contracts and distributed generation; and
- Disclosure of consumer consultation on price and quality.

The Commerce Commission notes that pricing disclosures help interested persons to understand how prices are set, and to compare prices for different consumer groups. Pricing and related disclosures help interested persons consider whether the prices set by suppliers (such as BEL) promote efficiency, and whether suppliers are sharing the benefits of efficiency gains with consumers. Given this, the information herein, describes BEL's:

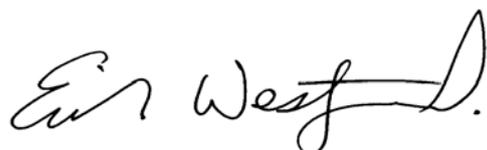
- Line Pricing Methodology used to determine prices charged as at 1st April 2013 for the supply of line function services;
- Approach to the allocation of costs, revenues and assets from 1 April 2013; and
- Costs and revenues attributable to load groups and the methodology used to allocate indirect costs between load groups from 1st April 2013.

The transmission cost recovery is spread equally over all consumers as no single consumer can be identified as having a marked effect on the maximum demand that drives the transmission charges. The Buller network maintains an evening peak which suggests no large industrial loads affect the maximum demand.

Appropriate details and any departure from the methodology published in the guidelines are set out below.

The information in this publication was prepared by Buller Electricity Limited after making all reasonable enquiries and to the best of the knowledge of the company complies with the 2012 Determination.

All charges shown in the Electricity Price Schedule are exclusive of goods and services tax.



Erik Westergaard  
Chief Executive Officer  
Buller Electricity

## 2. RECOVERY OF COSTS – COST REFLECTIVE PRICES

As a consumer-owned EDB, BEL is exempt from the price/quality regime administered by the Commerce Commission. However, BEL has determined that it is in its interests, and in the interests of its consumer owners, to align its pricing methodology to that of its non-exempt peers.

It is therefore integral to BEL's pricing methodology that a 'building blocks' approach is used to determine the appropriate level of costs<sup>3</sup> to be recovered – this being the target Revenue Requirement for the year. Prices are then determined to deliver this revenue requirement based on:

- Strategic considerations (e.g. for maximising the efficient utilisation of the network, and managing revenue volatility risks) as to the mix of fixed and variable tariff components; and
- Estimates of the number of consumers and their demand for/consumption of electricity for the period.

Whether actual revenue will be close to target revenue for the year is determined as a function of prices, the actual number of consumers, actual demand, and actual volumes of electricity delivered over the distribution system.

### 2.1. REVENUE REQUIREMENTS

The revenue requirement for BEL's line business is based on the recovery of the following costs:

- Operations and Maintenance;
- Administration and Overheads;
- Pass-through and Recoverable Costs (e.g. Transmission);
- Depreciation of Network Assets;

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<sup>3</sup> In order for prices to be cost reflective, these are costs that will necessarily be incurred in providing the distribution service.

- Cost of Capital (Return on Investment); and
- Taxation.

Note: BEL has used the Commerce Commission's estimation of the Vanilla WACC (at the 75% percentile of the WACC range) which the Commission uses for pricing purposes with non-exempt EDBs. As such, the corporate tax shield provided by debt capital has been ignored. BEL needs to determine its revenue requirement through a cash flow allowance for levered tax liabilities<sup>4</sup>.

## 2.2. COST ESTIMATION

The major cost elements and their associated value for the 2013-2014 revenue requirement are estimated to be:

<b>Element</b>	<b>\$000</b>
Operations and Maintenance	1,650
Administration and Overheads	1,385
Pass-through and Recoverable Costs	1,540
Depreciation of Network Assets	1,020
Taxation	500
Cost of Capital	2,055
<b>Total Revenue Requirement</b>	<b>8,150</b>

- Operations and maintenance are the direct costs associated with maintaining the system assets, and includes the management of designing and running the line business and the management of the computerised load control system and geographical information system.
- Transmission charges, together with some industry levies and Local Authority rates are recognised as pass-through and recoverable costs.

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<sup>4</sup> In determining its levered tax liability, BEL has adopted the regulatory leverage of 44% and the cost of debt corresponding to the Vanilla WACC

- The cost of network assets is returned over time as depreciation, with the amount of depreciation being affected by the useful life of the assets.
- Also aligned with the investment in network assets is a return on capital. In theory, this should enable an appropriate return to financiers and shareholders that are funding the investment in assets.
- Taxation is covered in the cost recoveries to ensure that the return on capital is in pre-tax terms.
- Administration and overhead costs include the other indirect costs necessarily incurred in providing the distribution service.

BEL has two subsidiaries—a wholly owned contracting business and an electricity retail business approximately 70% owned by BEL. BEL applies a cost allocation methodology for allocating indirect costs amongst its network and non-network business units, and also applies a transfer pricing methodology to account for services acquired by BEL from its contracting subsidiary. In calculating line charges, forecasts incorporating the transfer pricing (but eliminating intra-group profit margins) are used.

The above cost estimates were based on BEL's December 2012 preliminary forecasts for the 2013-2014 financial year. At this time, BEL forecast that its actual revenue for 2012-2013 from line charges and capital contributions would be \$7,575,000. The revenue requirement for 2013-2014 therefore represents an 8% increase in revenue from 2012-2013. This large increase in the revenue requirement arises as a consequence of a large increase in transmission charges and a need to move line charges to a more efficient level.

BEL has in the recent past only increased its prices for increases in Transpower's transmission charges and/or has increased its prices to a level less than sufficient to recover the building blocks revenue requirement. BEL has done so in a conscious bid to avoid price shocks to its consumers, and in order to incentivise cost efficiencies and place downwards pressure on its costs.

### **2.3. COST EFFICIENCY**

BEL seeks to ensure that its consumers receive value-for-money from the services it provides. In this respect, BEL has no intention of making its consumers pay for inefficient service delivery. BEL's current approach is to use published industry statistics, and the building blocks approach applicable to non-exempt EDBs, to guide BEL to more efficient outcomes. This is an on-going process. To keep some

downwards pressure on costs, BEL has used a WACC of 6.92%. This is lower than the WACC used by BEL's non-exempt peers in their building blocks calculations.

BEL's two subsidiaries provide additional scale to its business. As mentioned previously, a measure of indirect costs are allocated to these businesses in order to reduce the overall level of costs to be recovered from BEL's network consumers through lines charges.

### **2.3.1. Policies or Methodologies for determining Capital Contributions (Clauses 2.4.6 to 2.4.8)**

In addition to the lines charge revenue BEL receives from customer groups BEL also receives capital contributions from customers that require new or upgraded power supply to their properties. Capital contributions are required for upgrades or extensions for which the revenue from standard line charges would be insufficient to make them economic.

As the requirement for a capital contribution can only be determined once details of the connection are known, BEL does not have a schedule of charges. However, as there is a high degree of consistency in prices for similar categories of connection, the level of capital contribution is transparent to customers.

Accordingly, BEL considers that the capital contribution methodology applied is consistent with the pricing principles.

### **2.3.2. Policies Related to Discretionary Discounts and Rebates (Clauses 2.4.24 and 2.4.25)**

BEL does not have in place specific policies regarding discretionary discounts or rebates. Any decision to provide a discount or make a rebate will be determined by the BEL Board following input from management and the shareholder.

### 3. COSTING PRINCIPLES

Through the adoption of the building blocks approach and benchmarks for cost efficiency, BEL is confident that its aggregate revenue will quickly (i.e. within 2 years) revert to an efficient cost reflective revenue requirement. Once this is achieved, BEL will have a basis for determining whether its prices are sufficiently cost reflective at a customer load group and locational level. Any decision to significantly rebalance load group prices or introduce locational prices of any nature will first be discussed with BEL's shareholders, as they are the consumer representatives.

#### 3.1. PRICING STRATEGY

BEL's does not have a formal pricing strategy. However, BEL has commenced a shift to an increased fixed component to line charges for larger customers to reduce BEL's exposure to volumetric risk.

In addition BEL is commencing work on understanding the extent and magnitude of cross-subsidies now occurring with current line charges. The purpose of this work is to better understand the implications of cross subsidies and then develop options for managing the issues associated with them.

#### 3.2. ELECTRICITY AUTHORITY PRINCIPLES

The core distribution pricing principles espoused by the Electricity Authority are:

- *Prices to signal the economic costs of service provision, by:*
  - *being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulation;*
  - *having regard, to the extent practicable, to the level of available service capacity; and*
  - *signalling, to the extent practicable, the impact of additional usage on future investment costs.*
- *Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable.*

- *Provided that prices satisfy the first point above, prices should be responsive to the requirements and circumstances of stakeholders in order to:*
  - *discourage uneconomic bypass;*
  - *allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or non-standard arrangements for services; and*
  - *where network economics warrant, and to the extent practicable, encourage investment in transmission and distribution alternatives (e.g. distributed generation or demand response) and technology innovation.*
- *Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders*
- *Development of prices should have regard to the impact of transaction costs on retailers, consumers and other stakeholders and should be economically equivalent across retailers*

### **3.3. SATISFYING THESE PRINCIPLES IN BEL'S PRICING**

The Information Disclosure requirements for 2012 require that every disclosure under clause 2.4.1 must-

*“Demonstrate the extent to which the pricing methodology is consistent with the pricing principles and explain the reasons for any inconsistency between the pricing methodology and the pricing principles.”*

BEL acknowledges that that the Pricing Principles were introduced with a view to achieving voluntary compliance and therefore sets out below how BEL's Pricing Methodology achieves those objectives.

1. *Prices are to signal the economic costs of service provision, by:*
  - a. *being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislative and other regulations;*

BEL believes that this methodology demonstrates that the revenue for each network tariff group falls within the bounds of the stand-alone and avoidable costs and hence are subsidy-free.

- b. having regard, to the extent practicable, to the level of available service capacity; and*
- c. signalling, to the extent practicable, the impact of additional usage on future investment costs.*

BEL's prices signal capacity constraints in the following manner.

**Controlled Load** - BEL has a day and night price signal which incentivises movement of controllable load away from periods of high usage (congested periods that might give rise to a need for future investment). BEL's prices provide to certain customer groups, a signal that there is an opportunity for consumers to receive a lower price for service by allowing their load to be shifted in periods of high demand on the network.

**Demand (kW)** - The demand charge provides a strong price signal by incentivising large commercial and industrial consumers to reduce their demand at high network congestion periods by curtailing their loads. Any growth in the demand results in higher charges in the future to the consumer.

**Power Factor Charge** - BEL does not have significant issues with power factor on its network. However, in the event that prices signal are required to assist in the management of power factor issues then a power factor charge will be developed and charged to consumers whose load gives rise to a need for power factor correction to be implemented.

- 2. *Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable.*

BEL addresses the need for prices that have regard to the ability of consumers to respond by establishing variable consumption tariffs that are based on the consumers actual energy use.

3. *Provided that prices satisfy (1) above, prices should be responsive to the requirements and circumstances of stakeholders in order to:*
  - a. *discourage uneconomic bypass;*
  - b. *allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or nonstandard arrangements for services; and*
  - c. *where network economics warrant, and to the extent practicable, encourage investment in transmission and distribution alternatives (e.g. distributed generation or demand response) and technology innovation.*

When prices are above the standalone cost, a situation is created where the possibility of efficient bypass of the existing infrastructure is created. BEL's prices are below the stand alone costs, thereby discouraging bypassing the network. In addition, while BEL uses standard tariffs, it may negotiate connection costs with customers requiring non-standard connections or with non-standard loads. To date this has not been required. BEL believes that this approach will allow it to make price and service trade-offs with customers to better match their circumstances.

BEL supports the connection of embedded generation on our network and is currently negotiating a service contract with a new generator.

4. *Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders.*

All prices are developed in a systematic approach that broadly reflects the consumer profile and connection characteristics. All of these prices are published in public documents and thus the delivery of standard prices is transparent.

Prices have been escalated on a uniform basis relative to BEL's identified revenue requirement which has been developed in a manner consistent with that which would apply for a firm subject to a DPP Determination except for consumers falling into the low fixed charge user category which have had their fixed charge component capped. Aside from the low fixed charge consumer group there has not been any reweighting between tariffs, demonstrating that price setting is stable from year to year.

5. *Development of prices should have regard to the impact of transaction costs on retailers, consumers and other stakeholders and should be economically equivalent across retailers.*

BEL attempts to minimise possible transaction costs arising from its network tariffs, by limiting the complexity of tariff structures and the number of charging parameters within each tariff.

BEL applies the same tariff structure to all retailers.

BEL has not introduced any new tariffs or tariff structures in the 2013/14 disclosure year, therefore no transaction costs were incurred by stakeholders in this regard.

### **3.4. CONSUMER CONSULTATION ON PRICE AND QUALITY**

BEL addresses the requirement for consultation with consumers in a number of ways including:

- Regular meetings with and reporting to the Buller Electric Power Trust – who own BEL on behalf of consumers.
- Independent surveys of consumers to assist with the preparation on the annual AMP – including surveys of representative groups such as Federated Farmers and Grey Power; and
- Periodic meetings with major customers.

## 4. RECOVERY OF LINE CHARGES

The total line charge is allocated across seven load groups and line charges are derived based on load groups use of the various network components and their capacity requirements.

As per the Government Policy Statement, Buller Electricity Limited does not differentiate in pricing by geographic location for load groups even though the cost of supply for rural and remote rural feeders is higher than urban areas. This means that rural consumers benefit from a cross subsidy.

As noted above, BEL is undertaking work on identifying the extent of cross-subsidies and will revisit the issue in the future

### 4.1. NETWORK COMPONENTS

Network related expenditure comprises costs that are applicable to the meshed and dedicated networks as follows:

- Operations and Maintenance
- Administration
- Depreciation
- Transmission Costs
- Tax
- Return on Investment

The Network components are grouped into the following components

- 400V Lines General
- 400V Lines Dedicated
- Distribution Transformers
- 11kV Lines General

- 11kV Lines Dedicated
- Zone Substations
- Subtransmission Lines
- Dedicated Network

400V and 11kV refer to the voltage level at which the Consumer receives supply indicating which component in the network the consumer uses.

#### **4.2. LINE LOSSES**

The cost of distribution line losses between the Grid Exit Point and the Consumers premises are treated as an electricity supply business cost and are included in the variable energy charge of the energy trader.

Loss adjustment factors reflect the total losses incurred via the various components of the distribution network when electricity is conveyed across the network.

#### **4.3. REVENUE REQUIREMENTS**

All costs identified in Sections 4.1 and 4.2 above aggregate to the distribution business total costs equating to the company's total revenue requirements.

#### **4.4. PRICE AND MANNER OF CALCULATIONS**

The revenue requirement is divided amongst the total number of separately metered installations to be recovered by using a fixed and variable line charge. The variable charge is dependent on the amount of energy consumed.

#### **4.5. FIXED CHARGES**

The fixed line charge applies to all separately metered installations. For low user domestic consumers the amount is controlled by regulation. Buller Electricity Limited applies different amounts to standard domestic and low user fixed charges to encourage consumers eligible for low fixed charges to apply to the energy retailer for the low fixed charge tariff.

Large commercial consumers attract fixed charges in the form of lagged maximum demand charges to reflect the costs imposed on the distribution network by those demands. Buller Electricity Limited has a kW capacity charge for commercial and industrial customers in load groups 4, 5, and 6. A fixed daily charge is applied to all other commercial consumers.

#### 4.6. METERING AND LOAD CONTROL EQUIPMENT

Buller Electricity Limited sold its metering and ripple control relays to TrustPower, the incumbent energy retailer. Buller Electricity Limited retained the operational services for load control and charges the network users for this service. The revenue from these services is included in the line charge revenue.

#### 4.7. LOAD GROUPS

Installations have been grouped into seven load groups for pricing according to their assessed kVA capacity or maximum power loadings. The groups reflect the significant cost differences between low and high voltage supply. Separate pricing options are set out in a pricing schedule which changes from time to time.

Revenue requirements are split between fixed and variable line charges. The Table below indicates the usage of each load group and the number of consumers connected to the network in each group.<sup>5</sup> Buller Electricity Limited allocates costs to load groups by their designated share of the use of the assets.

The following statistics, as at 1st April 2011<sup>6</sup>, are formulated to allocate costs:

	Low User Group	Load Group 1	Load Group 2	Load Group 3	Load Group 4	Load Group 5	Total
GWhs	7.85	13.91	10.22	4.37	3.13	19.18	58.66
No. of Connections	1,833	2,089	559	79	9	10	4579
Share of Assets	13%	24%	17%	7%	5%	33%	100%

Costs are then allocated to the load groups as below, using the share of assets allocation.

<sup>5</sup> As there is only one customer in Load Group 6, for the purpose of this disclosure information relating to this load group has been added to Load Group 5.

<sup>6</sup> Historical allocations have been maintained to reduce year-to-year price shocks. BEL intends to revisit these allocations over a five year time frame.

	Low User Group (\$000)	Load Group 1 (\$000)	Load Group 2 (\$000)	Load Group 3 (\$000)	Load Group 4 (\$000)	Load Group 5 (\$000)	Total (\$000)
Operations and Maintenance	\$215	\$396	\$281	\$116	\$99	\$545	\$1,650
Line Business Administration	\$180	\$332	\$235	\$97	\$83	\$457	\$1,385
Depreciation of System Assets	\$133	\$245	\$173	\$71	\$61	\$337	\$1,020
Transmission Costs	\$200	\$370	\$262	\$108	\$92	\$508	\$1,540
Taxation	\$65	\$120	\$85	\$35	\$30	\$165	\$500
Cost of Capital	\$267	\$493	\$349	\$144	\$123	\$678	\$2,055
<b>Total Cost Recovery</b>	<b>\$1,060</b>	<b>\$1,956</b>	<b>\$1,386</b>	<b>\$571</b>	<b>\$489</b>	<b>\$2,690</b>	<b>\$8,150</b>

Each load group has a revenue requirement derived from this table that is detailed in the data below.

#### 4.7.1. LOAD GROUP LOW USER

Domestic consumers living permanently at the premises and using less than 8,000 kWh of energy in any one year may be eligible (at the retailers discretion) for low user rates.

	Revenue (\$000)	No Consumers
Fixed Charge	100	1,833
Variable Charge	960	

#### 4.7.2. LOAD GROUP ONE

Up to 15 kVA capacity loads supplied at 400V sharing the use of the low voltage urban and rural meshed network and all other assets. This load group comprises all domestic and low consumption business consumers.

	Revenue (\$000)	No Consumers
Fixed Charge	862	2,089
Variable Charge	1,094	

#### 4.7.3. LOAD GROUP TWO

Over 15 kVA supplied from the general 400V system sharing the use of the low voltage circuits and network assets. The group comprises farm and business consumers (including streetlighting) with maximum power demands between 15kVA and 99kVA.

	Revenue (\$000)	No Consumers
Fixed Charge	230	559
Variable Charge	1,156	

#### 4.7.4. LOAD GROUP THREE

Over 15kVA supplied at 400V with dedicated supply feeders. This group is mainly non domestic installations between 15 and 99kVA.

	Revenue (\$000)	No Consumers
Fixed Charge	130	79
Variable Charge	441	

#### 4.7.5. LOAD GROUP FOUR

Over 100 kVA supplied from the general 11 kV system taking supply at 400V. This group is medium to large commercial/industrial consumers. The pricing structure has a power demand component.

	Revenue (\$000)	No Consumers
Fixed Charge	94	9
Variable Charge	395	

#### 4.7.6. LOAD GROUP FIVE

Over 200 kVA with dedicated 11kV supply feeders. These are industrial consumers who take supply at high voltage and have dedicated transformers to supply them. The pricing structure has a power demand component and has maximum loadings over 200 kVA.

	Revenue (\$000)	No Consumers
Fixed Charge	189	10
Variable Charge	2581	

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#### 4.8. TOTAL REVENUE REQUIREMENTS

Total revenue requirements are summarised below.

Summary of Charges	\$000
Total Fixed Charges	1,605
Total Variable Charges	6,545
Total Revenue	8,150

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## 5. TRANSMISSION PRICING

Transpower's pricing structure at each of the two grid exit points is a fixed charge per annum. The maximum demand entitlement is applied to each of the two substations which are based on the peak loadings that Buller Electricity Limited imposes on each of the Grid connection points.

The company's policy for allocating transmission charges to each load group is as follows:

- As all consumers share the common use of the Grid, transmission charges including the connection, capacity and network charges reflect the average costs incurred and have been allocated across all consumers.
- Transmission costs for the Load Groups are recovered by a variable unit charge of 2.65 cents per kWh with no fixed component and total costs of the two points of supply are averaged over the 7 load groups.

## 6. NOTE TO CONSUMERS

All energy retailers using the Buller Electricity Limited network pay the same line charges. However pricing options may differ between energy retailers which may have an effect on the final charge the consumer pays.



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## IN ACCORDANCE WITH THE COMMERCE ACT

### Electricity Distribution Information Disclosure Determination 2012

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#### Certification for year beginning Disclosure 2013

We, **FRANCIS THOMAS DOOLEY** and **SHARON PATRICIA ROCHE**, being directors of Buller Electricity Limited certify that, having made all reasonable enquiry, to the best of our knowledge-

- a) the following attached information of Buller Electricity Limited prepared for the purposes of clause 2.4.1 of the Electricity Distribution Information Disclosure Determination 2012 in all material respects complies with that determination.
- b) the prospective financial or nonfinancial information included in the attached information has been measured on a basis consistent with regulatory requirements or recognised industry standards.

.....  
Director

.....  
Director

Dated: 6 June 2013  
.....