

10 June 2015

Cover letter for the Notice of Intention to commence a review of input methodologies

1. Today the Commission has issued a notice of intention to commence the review of input methodologies (IMs) under section 52Y of the Commerce Act 1986.
2. This letter provides an explanation of the IM review's:
 - 2.1 scope and timing;
 - 2.2 process including the initial problem definition phase which involves an invitation paper, forum and submissions from interested parties; and
 - 2.3 approach including the approach to IM amendments (current s 52X amendment processes and fast tracked amendments within the review).
3. This letter also calls for submissions from parties on the scope of potentially fast tracked amendments.

Scope and timing of the review

4. Section 52Y(1) requires the Commission to review each IM no later than seven years after the date of publication. We consider that it is open to us to conduct the review within the seven year timeframe (as long as it is completed for each IM no later than 7 years after publication).
5. The Commission has decided at this time to review all the IMs except the Transpower Capital Expenditure Input Methodology determination (the Capex IM). We consider it appropriate to defer the review of the Capex IM. The Capex IM was originally determined in January 2012, separately from the other IMs, has recently been amended, and does not substantially drive decisions in relation to the other IMs.

6. Our aim is to complete the review of the IMs within the scope of the review by December 2016. We have engaged with stakeholders on this indicative end date. At this stage we think this timeframe is realistic, and preferable to a longer process extending into 2017. However, once we have conducted the initial stages of the review process we will reassess this indicative end date and provide further updates on our process. One option we will consider is whether IMs for electricity distribution services (and possibly gas pipeline services) may require a later end date for the review.

IM review process

7. Our intention is to take a tailored, fit for purpose approach to reviewing the IMs. We want the issues to drive the process. Our aim is to develop a process that properly addresses the issues and our review requirements while managing costs and time commitments for all parties.
8. Having considered submissions to our open letter, we believe that a phase of problem definition is required before we can further develop our process for the review, and begin to consider potential solutions. We are starting this problem definition phase today.
9. At the end of this phase we expect to have a much clearer picture of any problems that the review should focus on. This will allow us to further develop our process for the remainder of the review.
10. While our review will be comprehensive and consider all aspects of the IMs, having a clear and common understanding of the problems that require particular focus should also put all parties in a much better position to begin to identify and evaluate potential solutions to those problems as we move into the next phase of the review.
11. Stakeholder input is vital to shaping this first problem definition phase and, ultimately, the review. To promote the sharing of ideas and get the best outcome from the review, we intend to publish a paper that is an invitation to contribute to the problem definition phase and to hold a forum, prior to submissions and cross-submissions being received on that paper. Further details on the Invitation paper and Forum are set out below.

Approach to the review and IM amendments

12. There are two sets of circumstances where we may amend IMs that are subject to this review prior to December 2016.

Current s 52X amendment processes

13. First, we have already issued notices of intention (under section 52X of the Act) to work on amendments to the input methodologies for the following matters:

- 13.1 The appropriate WACC percentile estimates to publish for airports information disclosure; and
- 13.2 The operation of the Incremental Rolling Incentive Scheme (IRIS).

Fast tracked amendments within the review process

14. Second, in submissions on the Commission's open letter regarding the review of input methodologies (dated 27 February 2015)¹ and the proposal to include airports WACC percentile in the review (also 27 February 2015)², and discussions with the Commission, parties have put forward reasons why it would be useful to make amendments to particular IMs earlier than December 2016 as follows:

- 14.1 Amendments to simplify requirements in the electricity distribution services IMs to make a supplier's preparation, and our assessment and evaluation, of a customised price quality path (CPP) proposal more cost-effective. It is necessary for any amendments to these IMs to be in place for applicants seeking a CPP in the February and May 2016 application windows; and
- 14.2 Amendments to specific IMs for airports services, such as land valuation rules, so that the outcomes of applying those rules are available in time to be used for the 2017 airport price setting events.

¹ Commerce Commission "Open letter on our proposed scope, timing and focus for the review of input methodologies", 27 February 2015, **(the open letter)**.

² Commerce Commission "Further work on the cost of capital input methodologies for airports – Proposal to consider the WACC percentile for airports as part of the input methodologies review", 27 February 2015, **(the WACC percentile for airports paper)**.

Approach to review

15. The Commission has considered whether any IM amendments between now and December 2016 should be made as part of the review, or under section 52X. With one exception for the electricity distribution services IRIS IMs, we believe it is preferable to include these amendments within the review.³ This is in order to:
- 15.1 Ensure clarity regarding the IMs that are subject to review. We believe this is best achieved if we conduct a single review process, with one starting point, rather than attempting concurrent review and s 52X amendment processes for the same IMs, or to make fine distinctions between which IMs are subject to review and which are not; and
- 15.2 Allow for a comprehensive and coherent review of related IMs, including consideration of any interlinkages between IMs.⁴ To allow for this broader consideration we propose to complete any fast tracked amendments well in advance of the draft decision(s) on the IM review. This will allow the amended IMs to be considered as part of the overall review.

Process for IM amendment processes begun prior to this review

16. We consulted on our proposal to consider the WACC percentile for airports as part of IM review in the WACC percentile for airports paper issued on 27 February 2015. We have decided to discontinue this section 52X amendment proposal for airports WACC percentile and review the WACC percentile as part of the IM review. We consider that this should provide sufficient time for any changes to be considered by Auckland and Christchurch airports prior to their price reset events in July 2017. A decision has been issued today on this s 52X amendment, that there is no change to the IMs for airports WACC percentile as part of that process.⁵
17. The potential amendments to IMs for IRIS for gas pipeline services will now be considered as part of this review of input methodologies. We consider that this is appropriate as the consideration of these changes is not close to completion. A decision was made yesterday that there is no change to the IMs for gas pipeline services as part of that amendment process.⁶

³ We discuss this exception further in paragraph 18 below.

⁴ A number of submitters on the open letter, dated 27 February 2015 expressed the view that the IMs should not be considered in isolation and there are benefits in considering them at the same time.

⁵ Airport Services (Weighted Average Cost of Capital percentile) Input Methodology Amendments Determination [2015] NZCC 16.

⁶ Gas Pipeline Services (Incremental Rolling Incentive Scheme) Input Methodology Determination [2015] NZCC 15.

18. The potential amendments to IMs for IRIS for electricity distribution services will still continue to be considered as a s 52X amendment with the intention to reach a final decision on any amendment to these IMs by the end of this year. We believe this is appropriate as decisions on the electricity distribution services IRIS IM amendment proposals are beyond the final substantive consultation and are near completion. When these amendments have been completed the IRIS IMs will be added to this review of the electricity distribution services IMs.

Process to consider the fast tracking amendments within review

19. At this stage we see some merit in fast tracking amendments described in paragraph 14 and will make a final decision on whether to consider these potential amendments on a fast tracked process by 3 July 2015.
20. We will be seeking information from interested parties in the next month in order to define the scope of the particular IMs to be potentially amended on a fast track process. Further details for the processes to define these fast tracked amendments and invitations to submit on the proposed scope of the fast tracked amendments are provided in the Attachment to this letter.
21. If we decide to proceed with any fast tracking we will notify all interested parties of the description of the IMs being fast tracked for amendment, and the process and timeframes for the amendment of these IMs.

Invitation paper

22. We aim to publish an **Input Methodology Review: Invitation to contribute to problem definition (invitation paper)** on 15 June 2015. This paper will set out our understanding of the topics we have so far identified as potentially being the most significant for the review. It will also call for submissions.⁷
23. We want stakeholders to play a key role in defining the topics and problems to be addressed by the review. In many cases, suppliers, consumers and other interested parties are better placed than us to do so.

⁷ This is the same as the preliminary issues paper referred to in our email update dated 7 May 2015.

24. We intend to include sufficient substance in the paper in order to allow stakeholders to prepare submissions to help us:
 - 24.1 identify the relevant focus topics to the IM review;
 - 24.2 define the specific problems that flow from the focus topics identified, and understand whether/how the IMs are relevant to those problems;
 - 24.3 further develop the process for the next phase of the review.
25. We will allow plenty of time to prepare submissions on the invitation paper (10 weeks) in order to give parties time to think thoroughly about problem definition. The forum will also help stakeholders prepare their submissions.

Forum

26. We intend to hold a forum in Wellington on 29 and 30 July 2015. The aim is to give stakeholders an opportunity to present the issues as they see them, to us and to other interested parties at an early stage. It will allow discussion of the issues in a relatively informal setting with parties. In our view, this will have a number of benefits:
 - 26.1 It will allow as many material issues as possible to be identified and shared broadly with all interested parties early in the process;
 - 26.2 It will assist in more quickly defining the underlying problem that potential changes to any particular IM are intended to address;
 - 26.3 It will allow parties and their expert advisors to explore these issues with other parties as well as ourselves prior to making formal written submissions;
 - 26.4 This may assist parties to develop their submissions, by allowing them to test the clarity of expression and to anticipate possible questions and counter-perspectives. All parties will eventually benefit from receiving well-developed written submissions; and
 - 26.5 It will inform our process and allow us to re-assess the end date for the review.

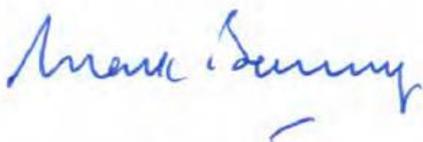
27. We see the forum as being different from a conference (as referenced in section 52V of the Act). As described above, the intention is for the forum to allow open discussion and exchange of information between all parties. This will happen before submissions are made on the invitation paper. This contrasts with a conference where Commissioners lead the questioning of submissions (and are typically held after submissions are made). Commissioners will attend the forum but principally as observers. Commission staff will participate in the forum. We will provide more details on the format and agenda prior to the forum.
28. To achieve the forum's aim, it is necessary to prepare effectively in advance of it. This will help produce high quality presentations and discussions. We encourage parties to consider the issues in our upcoming paper, and continue developing their thinking on these or other issues they find relevant from their experience with the IMs. We also encourage all parties to consider engaging expert advisers now to assist in their preparation for the forum.

Next steps

29. We will issue the invitation paper in the next week and ask that parties consider:
- 29.1 The problem definitions presented in the invitation paper;
- 29.2 How to prepare for the forum, including engaging of experts and how parties wish to be involved by presenting at the forum.
30. Any comments on the forum or questions about the review should be addressed to:

Keston Ruxton
Manager Market Assessment and Dairy
Regulation Branch
c/o regulation.branch@comcom.govt.nz

Yours sincerely



Dr Mark Berry
Chairman
Commerce Commission

Attachment – Process for considering the fast tracking of amendments within the review

CPP requirements amendment proposal

Background and proposed scope

1. Our observations and feedback from suppliers on the process to set Orion’s customised price-quality path in 2013 highlighted a number of areas for improvement in the CPP input methodologies. Consistent with our letter summarising feedback on the Orion process, we consider it prudent to make improvements to the electricity distribution services CPP process for future applicants based on our experience setting the first customised price-quality path and applying the relevant input methodologies for the first time.⁸
2. To make these improvements, we propose fast-tracking some amendments to the CPP process to be completed by the end of October 2015. This timing would allow us to make some important but simple improvements in time for any applicants preparing to submit a CPP application in 2016, prior to the completion of the main IM review.⁹
3. The proposed amendments are aimed at making a supplier’s preparation, and our assessment and evaluation, of a customised price quality path (CPP) proposal clearer and more cost-effective to benefit both suppliers and consumers. For example, we may consider simplifications to the information requirements for submitting a CPP proposal, and consequent changes to how we will evaluate and determine a CPP. These changes are intended to provide more flexibility around content and process requirements so as to align with existing business practices, or better suit the needs of applicants.
4. We also intend to explore options to address concerns raised about the potential for uncertainty over which rules a CPP application must be prepared and submitted under during the IM review process.¹⁰
5. Note that the fast track amendment process will not review all CPP IMs. To be achievable prior to receiving any CPP applications in 2016, the fast track process will only target issues that clearly need addressing for suppliers of electricity distribution services intending to submit a CPP application in 2016. Other potential

⁸ Commerce Commission “Summary of feedback on Orion customised price-quality path process” 4 August 2014.

⁹ In 2016, suppliers of electricity distribution services may submit a CPP in normal circumstances in either the February or May application windows. A supplier may submit a CPP under catastrophic event provisions at any time.

¹⁰ For example, Aurora “Submission in response to the Commerce Commission’s open letter on our proposed scope, timing and focus for the review of input methodologies” (received 31 March 2015), page 2.

improvements to the CPP IMs for both electricity distribution services and gas pipeline services will still be able to be considered in the main part of the IM review.

Proposed process

6. We intend to provide more detail on the proposed improvements and how we could implement them in the invitation paper for publication on 15 June 2015.
7. Following this we intend to confirm whether to proceed with any CPP fast tracked amendments, the specific scope of these amendments, and the timing and process of this work by 3 July 2015.
8. At this stage, we envisage making a draft decision in late July and a final decision by the end of October 2015.

Overview of indicative dates and submission process

9. The indicative dates for the proposed CPP fast track process are summarised in Table 1 below.

Table 1: Indicative dates for the proposed CPP IMs fast track review

Process step	Indicative timeframe
Parties submit views on specific scope of CPP fast tracked amendments to Commission	23 June 2015
Our decision on scope and process for any fast track CPP amendments	3 July 2015
Draft decision on fast track amendments to CPP requirement IMs	27 July 2015 ¹¹
Submissions on draft decision on fast track amendments to CPP requirement IMs	25 August 2015
Cross-submissions on draft decision	2 September 2015
Final decision on fast track amendments to CPP requirement IMs	30 October 2015

10. We encourage any supplier considering submitting a CPP application in 2016 to contact us directly in advance of the submission date on the scope and process of

¹¹ This date is immediately prior to the IM forum on the main IM review scheduled for 29 and 30 July 2015. Our intention is that this would allow any discussion of CPP requirements at the IM forum to be focussed on issues for the main IM review. Our proposal is that the specific changes proposed in our draft decision (fast track amendment) would be known at that point and our intention is that they would not be discussed at the IM forum. These dates are indicative however, and we will update parties on the focus of the discussion of CPP requirements closer to the date of the IM forum.

the CPP fast track amendments, as well as any written submission they may provide by 23 June 2015.

11. All parties who wish to submit their views to us on the proposed scope and process for CPP fast track amendments should provide a written submission by 5pm 23 June 2015 and address their correspondence on this matter to the attention of:

Keston Ruxton
Manager Market Assessment and Dairy
Regulation Branch
c/o regulation.branch@comcom.govt.nz

12. Please include "Submission on scope of CPP fast track amendments for the IM review" in the subject line of your email.

Airports services fast track amendment proposal

Background and proposed scope

13. We are also considering if certain amendments to the Airport IMs should be fast tracked so that the outcome of applying those IMs is available to be used well in advance of the 2017 price resetting events. This attachment sets out and invites submissions on our rationale for considering fast tracking amendments to the Airport IMs, the proposed scope of items to be fast tracked and the proposed process for fast tracking.
14. In response to our February 2015 open letter we received submissions from BARNZ and Christchurch Airport which indicated that it might be desirable for certain issues with the Airport IMs to be resolved well in advance of December 2016 if they were to have an impact on the 2017 price setting events.¹² Early resolution of issues would mean that the outcome of applying certain IMs, such as an updated market value alternative use (MVAU) value for airport land, can be included in the airports' pricing consultation processes.
15. We will not review all Airport IMs as part of this fast tracked amendment process. The fast tracked amendments are only proposed for those issues that would be helpful and can reasonably be resolved well in advance of December 2016.
16. We propose including in the airports fast track process amendments to the Airport land valuation methodology set out in Schedule A of the Airport IMs.¹³
17. We invite submissions on whether this methodology should be included in the airports fast track process, and whether there are any other issues that should also be included. In deciding whether additional issues are to be included in the airports fast tracked process we will have consideration of:
 - 17.1 the reason for fast tracking the issue;
 - 17.2 the ability for the issue to be adequately resolved prior to consideration of other issues being considered as part of the main IM review process; and
 - 17.3 the likelihood the issue can feasibly be completed within the proposed fast track process.

¹² BARNZ "Review of input methodologies" (23 March 2015), page 1 and Christchurch International Airport Limited "Input methodologies review" (20 March 2015), paragraph 4.

¹³ The requirements in Schedule A of the Airport IMs are referred to in respect of land valuations and land revaluations in the body of the IMs in clauses 3.2(1)(b), 3.7(2), 3.7(5), 3.9(4)(a), 3.10(2)(b)(iii) and 3.11(3), 3.11(6)(a)(i) and 3.11(6)(d)(i).

18. Issues not included in the airports fast track process will still be able to be considered as part of the main IM review.
19. The specific issues we are proposing to consider in the proposed fast tracked airport land valuation methodology amendments include:
 - 19.1 narrowing the resulting range of airport land values derived under the requirements by valuers who may be called upon by interested parties to apply the requirements;
 - 19.2 removing compliance ambiguities that may give rise to materially differing values under the requirements; and
 - 19.3 updating the practical implementation of the airports land valuation requirements to align them to the current valuation standards and valuation industry practices applying in New Zealand.
20. We also invite submissions on the scope of the proposed fast tracked airports land valuation methodology amendments. Submissions on the scope of this fast tracked issue will assist us in establishing the terms of reference for our expert valuer, proposed to be appointed in Q2 2015.

Proposed process

21. Our intention is to make a decision on whether to fast track any airport IM issues by 3 July 2015. If we decide to fast track any issues we will also at the same time decide the scope of the issues to be fast tracked and the process the fast track will follow.
22. We see merit in including in any airports fast tracked process an industry workshop. The workshop would look to address, amongst other things, a framework for applying the MVAU valuation approach.¹⁴
23. The proposed industry workshop would be convened separately from the main IM review forum and have an agenda limited to discussion of the fast tracked issues.
24. Following the industry workshop we would aim to issue a draft decision and proposed amendments on the fast tracked issues in Q4 2015, and a final decision in March 2016.

¹⁴ We propose a framework be established to address matters such as the credibility and demand forecast requirements for alternative use scenarios.

Overview of indicative dates and submission process

25. Table 2 outlines our proposed indicative dates and submission process for the proposed airports fast track issues.

Table 2: Proposed indicative dates for the airports fast tracked issues

Proposed process step	Indicative timeframe
Submissions on scope for fast tracking airport issues	23 June 2015
Our decision on fast tracking airport issues including scope of issues to be addressed and process	3 July 2015
Publication of material for workshop	Q3 2015
Workshop to discuss airport fast tracked issues, including framework for applying the MVAU valuation approach ¹⁵	Q3 2015
Draft decision and amendments	Q4 2015
Submissions on our draft decision and amendments	Q4 2015
Cross-submissions on our draft decision and amendments	Q4 2015
Final decision and amendments	By 31 March 2016

26. We ask for your early submissions on the proposed fast tracking of amendments to address specific issues with the Airport IMs. In particular, we request submissions on:
- 26.1 what issues should be included in an airport fast tracked process and the reasons for including them in a fast tracked process;
 - 26.2 what should be covered in the Airports land valuation methodology amendments if it is a fast tracked issue; and
 - 26.3 the proposed dates and submission process for the fast tracking as set out in Table 2.

¹⁵ The preparation of the valuation framework for discussion at the industry workshop may include prior discussions with the valuers of interested parties to help us develop the proposal and the agenda for discussion. This would be aimed at having a focused agenda and a complete as possible framework for discussion at the workshop. This would not preclude alternative approaches from being discussed at the workshop.

27. Submissions on this Airport IM fast track proposal are due by **5pm 23 June 2015**. Please address these to:

Keston Ruxton
Manager Market Assessment and Dairy
Regulation Branch
c/o regulation.branch@comcom.govt.nz

28. Please include “Submissions on airport fast track for the IM review” in the subject line of your email.

Format of all submissions and requests for confidentiality

29. We prefer to receive your comments in both MS Word and PDF file formats.
30. We encourage full disclosure of submissions so that all information can be tested in an open and transparent manner. However, if it is necessary to include confidential material in a submission we offer the following guidance:¹⁶
- 30.1 Both confidential and public versions of the submission should be provided; and
- 30.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
31. We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be ‘locked’. This is because we intend to publish all submissions and cross-submissions on our website. Where relevant, please provide both an ‘unlocked’ electronic copy of your submission, and a clearly labelled ‘public version’.

¹⁶ You can also request that we make orders under s 100 of the Act in respect of information that should not be made public. Any request for a s 100 order must be made when the relevant information is supplied to us, and must identify the reasons why the relevant information should not be made public. We will provide further information on s 100 orders if requested by parties. A benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any s 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.