

## **Input Methodologies review process paper**

### **Update on fast track amendments**

### **3 July 2015**

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#### **Purpose**

1. The purpose of this paper is to provide parties with an update on the process and timing of the input methodologies review (IM review), with a particular focus on the fast tracking of certain amendments to the input methodologies (IMs) for airport services and customised price-quality paths for electricity distributors.
2. In particular, this paper:
  - 2.1 notifies interested parties that the decision on whether to conduct fast track amendments to electricity distribution services input methodologies for customised price-quality paths (CPP IMs) has been deferred;
  - 2.2 seeks comment from interested persons by **10 July 2015** on further issues raised by parties in submissions on scope and process for fast track amendments for CPP IMs.
  - 2.3 explains the reasons for our decision today to issue an amended Notice of Intention<sup>1</sup> for the IM review to commence a fast track process for considering airport services land valuation input methodology amendments;<sup>2</sup>
  - 2.4 provides an explanation of the scope and process for potential amendments to the airport services IMs<sup>3</sup> relating to land valuation, namely the IMs relating to the application of the market value alternative use (MVAU) valuation methodology for airport land; and
3. The scope and process for the IM review (other than the fast track amendments) remains the same as specified in the original Notice of Intention published 10 June 2015.<sup>4</sup>

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<sup>1</sup> Commerce Commission, "Amended Notice of Intention" (3 July 2015).

<sup>2</sup> We have issued an amended Notice of Intention for the IM review as we consider the decision on whether to conduct the fast track amendments for airport services IMs is a key decision on the process for the review affecting how some potential amendments might be considered within the review. We anticipate issuing further amended Notices of Intention in order to add the review of the EDB IRIS IMs to the IM review and any decisions to consider amendments on a fast-track basis within the review.

<sup>3</sup> Commerce Act (Specified Airport Services Input Methodologies) Determination 2010.

<sup>4</sup> Commerce Commission, "Notice of Intention" (10 June 2015).

## The decision to fast track amendments to the CPP is deferred and further comments sought

4. We have deferred our decision on whether to fast track any amendments to CPP IMs. We will announce a new timeframe for making this decision shortly.
5. The decision to defer allows further time to consider a number of issues raised in submissions on scope and process of CPP fast track amendments. These issues are outside the original scope for CPP fast track proposed in the Notice of Intention on 10 June 2015. We are now considering whether these additional items should be in the scope of any CPP fast track amendments.<sup>5</sup>
6. For example, Powerco, ENA, and WELL raised concerns with WACC where the CPP rate is lower than the DPP rate—an issue we had already proposed considering as part of the IM review.<sup>6</sup> Specifically, Powerco proposes that we fast track a substantial amendment to the IMs, allowing a CPP application to use the current DPP rate in its CPP application, until the DPP WACC is set for the subsequent DPP period, and using that new DPP WACC rate for the balance of the CPP period. Powerco seeks a fast track amendment to this end to facilitate its proposed CPP application proposed for May 2016. If we were to make such an amendment (or some other amendment to address the issue identified by Powerco, ENA and WELL) there may be good reason for it to apply to all CPP applications, including from GPBs. The question at this stage is whether the issue and possible solutions could be appropriately considered and resolved as part of a fast track process. We note WELL’s observation that:

It is important however to acknowledge that fast tracked amendments to the CPP IMs will have implications for suppliers proposing CPPs in 2016 and in subsequent years. It is therefore essential that the Commission's fast tracked process is transparent and adequate time should be given for consultation. The timeframe proposed by the Commission is very tight and should be extended where possible to ensure there is sufficient time for the material items to be properly considered.

7. Given the potential application of any fast track amendment to other suppliers who could make a CPP application, and their consumers, we would therefore welcome views from a range of other parties on whether to fast track consideration of these issues, and the timeframes to do so, by 5pm Friday **10 July 2015**.
8. Comments should be addressed to:

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<sup>5</sup> Powerco “Scope and process for fast track amendments to the CPP input methodology requirements” (23 June 2015); Electricity Networks Association “Submission on scope of CPP fast track amendments for the IM review” (23 June 2015); Wellington Electricity “Submission on scope of CPP fast track amendments for the IM review” (23 June 2015); Maui Development, Letter from Claire Graeme to Keston Ruxton (23 June 2015).

<sup>6</sup> Commerce Commission “Input methodologies review, Invitation to contribute to problem definition” (16 June 2015), paragraphs 185-189.

Keston Ruxton (Manager, Market Assessment and Dairy, Regulation Branch) c/o  
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9. We prefer to receive your comments in both MS Word and PDF file formats. Please include “Comments on CPP fast track” in the subject line of your email.

#### **The fast track amendments within the IM review**

10. The original Notice of Intention published 10 June 2015 announced the commencement of work on a review of input methodologies with the intention of reaching final decisions by December 2016.<sup>7</sup> As part of this announcement, we explained that the Commission would consider whether the review should include potential amendments to specified airport services IMs and CPP IMs on a fast tracked timeframe.<sup>8</sup>
11. We sought submissions on the scope of particular airport services IMs and CPP IMs to be potentially amended on a fast track basis.
12. Fast track amendments will focus on targeted issues for amendment and are considered in a different (faster) timeframe from the overall IM review. The targeted definition of the issues for fast track amendment and faster timeframe apply only to these amendments.
13. We propose to complete any fast track amendments well in advance of the draft decisions on the IM review. This will allow the amended IMs to be considered as part of the overall review.
14. We consider that amendments are amenable to this fast track process where they lead to a final resolution of the targeted issue they seek to address (i.e. the application of the airport services IMs relating to land valuation). These fast track amendments will not include the full review of whether the airport services IMs are operating effectively since that is an important feature of the overall IM review. Resolving these fast track amendments will not complete the IM review for airport services IMs.
15. The fast track amendments will be completed and re-integrated back into the overall IM review process before we release our draft decisions on the IM review in mid Q2 2016. Once re-integrated, the IMs that are subject to fast track amendment will then be considered in the overall IM review. This will enable the Commission to

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<sup>7</sup> As noted in the Commerce Commission, “Cover letter for the Notice of Intention to commence a review of input methodologies” (10 June 2015), at paragraph 6 the date of December 2016 is an indicative end date and once we have conducted the initial stages of the review we will reassess this indicative end date.

<sup>8</sup> Commerce Commission, “Cover Letter for the Notice of Intention to commence a review of input methodologies” (10 June 2015).

consider the IMs in light of the final fast track amendments, rather than considering the fast tracked IM amendments that are still subject to potential change.

16. When we consider the draft decision for the overall IM review we are unlikely to change IMs for the same purpose where these have already been subject to fast track amendments.<sup>9</sup> The main IM review will not review the same issues that the fast track amendments seek to address. For instance, given the scope of today's amended Notice of Intention, during the main IM review we would not be expecting to further review the IMs relating to the application of the MVAU airport land valuation methodology.
17. We received submissions on the proposed airport services fast track amendments from interested persons on 23 June 2015. The relevant submissions on this fast track process are discussed below.
18. The matters we considered in deciding whether to fast track amendments for airport land valuation IMs include the timing need, the specificity, and separability of the potential amendments, and the feasibility of completion on a fast track within the context of the overall IM review.
19. We have decided to fast track amendments for airports services land valuation input methodologies in light of these considerations above. We describe further the reason for this and the scope of the airports fast track amendments below.

#### **Scope and process for the airport services land valuation methodology amendments**

20. We have decided to fast track the consideration of airport services land valuation methodology amendments so that they are available to be used well in advance of the 2017 price-setting events for Auckland and Christchurch airports.<sup>10</sup> The land valuation methodology amendments are scheduled to be made available prior to March 2016 so that MVAU land valuations can be prepared consistent with the input methodologies prior to the commencement of the 2017 price-setting consultation, should airports wish to do so.
21. We have decided not to consider any other amendments to the airport services IMs as part of the fast track process because other amendments are not required well in advance of the commencement of the 2017 price-setting events.<sup>11</sup>

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<sup>9</sup> However, we may need to make consequential amendments to IMs that have been subject to fast track amendments when we consider how they fit with any changes proposed in the overall IM review.

<sup>10</sup> As noted by NZAA, airports are currently not required to prepare land valuations prior to price setting events or to follow the land valuation methodology set out in the airport services IMs. The amendments are made available should airports choose to prepare MVAU land valuations for the 2017 price setting events and they decide to make them consistent with the airport services IMs.

<sup>11</sup> We understand the 2017 price setting event initial pricing proposal is expected to be made available by airports in January 2017. Finalising the IM review amendments by December 2016 and having the draft

22. We received two submissions on the proposed fast tracking of airport issues. BARNZ supported fast tracking the proposal.<sup>12</sup> NZAA noted that it understood the rationale.<sup>13</sup> Submitters did not propose including any other issues in the fast track process for airport services IMs.

*Scope of airports land valuation methodology amendments*

23. The scope of the amendments being considered as part of this fast track process is the application of the MVAU airport land valuation methodology. In particular we will be focusing on:
- 23.1 narrowing the potential range of airport land values that can be derived under the requirements, including removing compliance ambiguities;
  - 23.2 updating the airports land valuation requirements so they align to the current valuation standards and valuation industry practices applying in New Zealand; and
  - 23.3 considering when land valuation methodology amendments will apply.
24. NZAA has submitted that the matters to be considered should be limited to the specific issues we proposed to consider in the cover letter to the original Notice of Intention.<sup>14</sup> We have decided that the scope should not be limited to just those items and that it would be more appropriate to instead limit the scope to the consideration as to how the MVAU airport land valuation methodology is applied, including the framework and underlying assumptions of the MVAU methodology.
25. Consideration of the appropriateness of using a MVAU methodology is not within scope of the fast track. This is open to be considered as part of the main IM review. This allows consideration of the appropriateness of the methodology alongside the other airport services IMs.
26. The application of the MVAU airports land valuation methodology can be separated from the main IM review because it relates to the application of the methodology and is not a consideration of the appropriateness of the methodology.
27. The requirements of the land valuation methodology are generally set out in Schedule A of the airport services IMs. Accordingly, we anticipate that any amendment to the land valuation requirements will focus primarily on Schedule A.

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decisions available from May 2016 is expected to allow sufficient time for any amendments, other than land valuation methodology amendments, to be reflected in the initial pricing proposal.

<sup>12</sup> BARNZ, "Airport services fast track amendment proposal" (23 June 2015), page 1.

<sup>13</sup> NZAA, "Review of input methodologies: Response to fast track proposal" (23 June 2015), paragraph 3.

<sup>14</sup> NZAA, "Review of input methodologies: Response to fast track proposal" (23 June 2015), paragraph 7.

28. Any decision on when the land valuation amendments will apply may not be included in the airport services IMs but instead in the airports information disclosure requirements.<sup>15</sup> Another process will be established if it is decided that the airport information disclosure requirements need to be amended.

#### *Timing*

29. We have decided to bring forward the indicative date for publishing the final decisions and amendments of the fast track issues to the end of February 2016 rather than by 31 March 2016. BARNZ recommended the date for final decision and amendments be brought forward to allow more time for preparation of the valuations by the airports, and subsequent review by airlines, prior to the 2017 price-setting consultation process.<sup>16</sup> NZAA also requested that we consider the resourcing challenges for airports in engaging in this and other matters that are being consulted on in parallel.<sup>17</sup> NZAA suggested that we stagger our processes and minimise overlapping of deadlines where possible.
30. We believe the proposed process allows for sufficient time to consider the airport fast track issues and that bringing forward the final decision and amendments will not limit the ability of interested parties to participate in the consultation.<sup>18</sup> If, during consideration of the issues, we find that further time is required, we may defer the final decision and amendments. However, any decision or amendments made as part of the fast track process will still need to be made in advance of the draft decision on the main IM review. We will notify interested parties if we decide to alter any part of the fast track process.

#### *Process*

31. We have decided to include an industry workshop in the fast track process for considering the airports land valuation methodology amendments. The workshop is to discuss the framework and assumptions underlying the application of the MVAU valuation approach as well as implementation details.
32. The industry workshop will be convened in September 2015, separately from the main IM review forum which is to be held on 29–30 July 2015. The main IM review forum will not cover matters considered as part of the airports fast track process.

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<sup>15</sup> Commerce Commission, "Airport Information Disclosure Determination: Consolidating all amendments as of 1 March 2012" (27 February 2012).

<sup>16</sup> BARNZ, "Airport services fast track amendment proposal" (23 June 2015), page 1.

<sup>17</sup> NZAA, "Review of input methodologies: Response to fast track proposal" (paragraphs 14-15).

<sup>18</sup> The process proposed in the cover letter to the original Notice of Intention listed the consultation as concluding in December 2015 when cross submissions on the draft decision and amendments are due. The amended indicative date for publication of the final decision does not change the end date for consultation.

33. In preparation for the workshop, we may look to engage with interested parties and their experts on a draft framework and agenda for the workshop.
34. Following the industry workshop we intend to issue a draft decision and amendments for the fast tracked issues in November 2015, and a final decision in late February 2016.
35. Table 1 outlines the indicative dates and submission process for the airports fast track process.

**Table 1: Indicative dates for the airports fast tracked process**

<b>Indicative process step</b>	<b>Indicative timeframe</b>
Publication of material for workshop	Early September 2015
Workshop to discuss airport fast tracked issues, including framework for applying the MVAU valuation approach	Late September 2015
Draft decision and amendments	Early November 2015
Submissions on our draft decision and amendments	Early December 2015
Cross-submissions on our draft decision and amendments	Mid December 2015
Final decision and amendments	Late February 2016