

## **Input methodologies review**

**Process update paper**

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## Associated documents

Publication date	Reference	Title
27 February 2015	Open letter	<a href="#">Open letter on our proposed scope, timing and focus for the review of input methodologies</a>
27 February 2015	ISBN 978-1-869454-31-9	<a href="#">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</a>
9 June 2015	ISSN 1778-2560	<a href="#">Gas Pipeline Services (Incremental Rolling Incentive Scheme) Input Methodology Amendments Determination 2015 [2015] NZCC 15</a>
10 June 2015	ISSN 1778-2560	<a href="#">Airport Services (Weighted Average Cost of Capital percentile) Input Methodology Amendments Determination 2015 [2015] NZCC 16</a>
10 June 2015	Notice of intention	<a href="#">Notice of intention: Input methodologies review</a>
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3 July 2015	Update paper	<a href="#">Input methodologies review process paper: Update on fast track amendments</a>
3 July 2015	Notice of intention	<a href="#">Amended notice of intention: Input methodologies review</a>
7 August 2015	Update paper	<a href="#">Input methodologies review process paper: Update on CPP fast track amendments</a>
7 August 2015	Notice of intention	<a href="#">Amended notice of intention: Input methodologies review</a>
7 September 2015	ISBN 978-1-869454-70-8	<a href="#">Proposed amendments to input methodologies for customised price-quality paths: Draft decision for Limb 1 of the CPP fast track</a>
9 October 2015	Update paper	<a href="#">Input methodologies review process update paper: Second update on CPP fast track amendments</a>
9 October 2015	Notice of intention	<a href="#">Amended notice of intention: Input methodologies review</a>

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## Introduction

### Purpose of this paper

1. The purpose of this paper is to update stakeholders about a number of process matters relating to the input methodologies review (**IM review**). More specifically, it provides:
  - 1.1 An update on the key topics for the review;
  - 1.2 An update on the indicative date for our draft decisions, which we expect will be mid-June 2016;
  - 1.3 An overview of the next steps in the IM review process;
  - 1.4 Details of some additional process steps between now and the draft decisions for selected topic areas; and
  - 1.5 An update on the draft decision-making framework for the review.
2. This paper does not engage with the substance of submissions on our problem definition paper. Rather, it is focused on updating you about the next steps in the process for the IM review, which we have developed following our analysis of your submissions and cross-submissions on our problem definition paper.

### Background to this paper – a recap of the IM review process so far

3. On 27 February 2015, we issued an open letter seeking comment on the timing, approach and possible focus areas for the IM review.<sup>1</sup>
4. Having reviewed your comments on that letter, we issued a notice of intention to commence the current IM review on 10 June 2015.<sup>2</sup>
5. On 16 June 2015, we released an invitation to contribute to the problem definition for the IM review (**problem definition paper**).<sup>3</sup> We held an industry forum on 29–30 July 2015 to give you an opportunity to develop and test your views on the problems for the review prior to making your formal written submissions.

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<sup>1</sup> Commerce Commission “Open letter on our proposed scope, timing and focus for the review of input methodologies” (27 February 2015) (**open letter**).

<sup>2</sup> Commerce Commission “Notice of intention: Input methodologies review” (10 June 2015). That notice of intention was subsequently amended by: Commerce Commission “Amended notice of intention: Input methodologies review” (3 July 2015); Commerce Commission “Amended notice of intention: Input methodologies review” (7 August 2015); and Commerce Commission “Amended notice of intention: Input methodologies review” (9 October 2015) (**notice of intention**).

<sup>3</sup> Commerce Commission “Input methodologies review: Invitation to contribute to problem definition” (16 June 2015).

6. Having now analysed your submissions and cross-submissions on our problem definition paper, we have been able to further develop the process for the review.<sup>4</sup> This paper communicates this updated process.

### Update on the topics for the review

7. Thank you for your participation at the forum, and for your submissions and cross-submissions on our problem definition paper.

### The key topics for the IM review remain largely the same in light of submissions

8. Having considered submissions on the problem definition paper, we consider that the topics identified in the problem definition paper remain key topics for the review with a few minor changes and additions. These are:<sup>5</sup>
- 8.1 Risk allocation mechanisms under price-quality paths, including the form of control for price-quality regulation of electricity distribution businesses (**EDB**) and gas pipeline businesses;
  - 8.2 Cost-effectiveness of the customised price-quality path (**CPP**) requirements, and interactions between default price-quality paths (**DPP**) and CPPs;
  - 8.3 The future impact of emerging technologies in the energy sector;
  - 8.4 Cost of capital issues;
  - 8.5 Reconsidering the weighted average cost of capital (**WACC**) percentile range for airports; and
  - 8.6 Airports profitability assessment.
9. The new key topics we have identified through submissions on the problem definition paper are:
- 9.1 Related party transactions (from the former complexity and compliance costs topic);

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<sup>4</sup> Within the review, a number of specific issues relating to airports and CPPs have been fast tracked. These issues have been progressing at a faster pace to the rest of the review, and we have issued a number of process updates specific to the fast tracked issues since publishing the problem definition paper. Paragraphs 26–28 of this paper provide a recap on how the fast track processes interact with the main review.

<sup>5</sup> As noted in the problem definition paper (para 65): “while there are a number of interrelationships between the topics, for practical reasons, it is useful to split them into separate topics for the purposes of engaging with the problems they each pose as they relate to Part 4 of the Commerce Act 1986 (**Part 4**) and the IMs.” As noted in our open letter, (paragraph 9) we consider there is general desirability in taking a cross-sector approach to reviewing input methodologies by reviewing all IMs at the same time. While the review has a number of focused topic areas (some of which are sector specific), we consider this to be consistent with a cross-sectoral approach to reviewing the IMs, (by reviewing all IMs at the same time and considering alignment issues where appropriate).

9.2 Gas pipeline issues; and

9.3 Consumer engagement.

10. We briefly discuss the new topics identified through submissions below.

### **Related party transactions**

11. In the problem definition paper, we suggested four areas that might particularly benefit from a review for unwarranted complexity and compliance costs: related party transactions, regulatory taxation, cost allocation, and cost definitions.

12. Of those areas, the one that generated significant attention in submissions was related party transactions.<sup>6</sup> We have therefore separated out related party transactions as a key topic for the review in its own right. We intend to look at related party transactions both for opportunities to reduce complexity and compliance costs, and to improve effectiveness of the provisions.

### *Other opportunities to reduce unwarranted complexity and compliance costs*

13. We will continue to consider other opportunities to reduce unwarranted complexity and compliance costs as part of our effectiveness review of all IMs. As noted in the problem definition paper, in order to meet our obligation under s 52Y, we intend to review all IMs within the scope of the notice of intention for effectiveness.<sup>7</sup> This process is ongoing.<sup>8</sup>

### **Gas pipeline issues**

14. We want to work with gas pipeline stakeholders on both the IM review and 2017 gas DPP reset matters. We have decided to consider issues specific to gas pipeline businesses as a separate topic under the IM review. We think this will be an efficient way of addressing both IM issues specific to the gas DPP resets and ensuring the general consistency of the gas pipeline IMs with other sectors.

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<sup>6</sup> See, for example: ENA “Response to the Commerce Commission’s Input Methodologies review paper” (21 August 2015), section 8.3.1; PWC “Submission to the Commerce Commission on input methodologies review: invitation to contribute to problem definition (21 August 2015), para 130–142; Alpine Energy “Submission to Commerce Commission on Input methodologies review invitation to contribute to the problem definition” (21 August 2015), para 6–35.

<sup>7</sup> Problem definition paper, para 34.

<sup>8</sup> Our effectiveness review of all IMs has so far identified some issues not already covered by the key topic areas identified above. These include a number of more detailed implementation matters raised with us since we set the original IMs. Examples of more significant effectiveness issues identified to date include: in the Asset Valuation IMs, the capping of interest during construction of capital assets, asset lives, and the definition of capital contributions; in the Specification of Price IM, recoverable costs involving avoided transmission charges; and in the Cost Allocation IMs, the thresholds for electing cost allocation approaches, and the definitions used for causal and proxy cost and asset allocators.

15. As a first step we will hold a meeting in early December this year. This will allow for timely input into the IM review, and also begin discussions on the lead up to the 2017 gas DPP resets.
16. Further details on this meeting, including how to register your interest, are contained in paragraphs 79–83 of this paper.

### **Consumer engagement**

17. A number of submitters raised issues about the level of engagement from consumers. For example:
  - 17.1 Molly Melhuish asked:<sup>9</sup>

how are small consumers and small-scale energy service providers to be represented in the decision-making processes of the Commerce Commission, the Electricity Authority, and other agencies that influence energy investments and operation – including (importantly) the Smart Grid Forum?
  - 17.2 Contact Energy noted that:<sup>10</sup>

Having read the 25 submissions received by the Commission, we note the stark lack of a consumer advocate in this space. Given that the effect of any changes in the IMs is ultimately born by consumers, we believe a well-funded consumer advocate who can participate in this process is required in order for the regulatory regime to be effective.
18. It seems likely that the problem definition and potential solutions for this topic might lie to a large extent in the wider Part 4 regime, rather than in the IMs specifically.<sup>11</sup> We acknowledge that the IM review may provide some opportunities to promote consumer engagement further; for example, in the context of the requirements for preparing a CPP proposal. However, there are also opportunities outside of this review process for us to improve our engagement with consumers, and for suppliers to engage more fully with consumers to better understand their preferences, including as to the quality of service valued by consumers.

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<sup>9</sup> Molly Melhuish “Cross-Submission, Input Methodologies Review (4 September 2015), p. 1.

<sup>10</sup> Contact Energy “Cross submissions on the Commission’s invitation to contribute to problem definition” (4 September 2015), p. 2.

<sup>11</sup> As noted in the problem definition paper (at figure 1), problems may be defined either as they relate to the IMs, or as they relate to Part 4 regulation more broadly. Likewise, potential solutions to defined problems might lie within or outside the IMs (Discussion draft decision-making framework, Attachment A, para 20).



19. Other regulators have recently sought to increase their level of engagement with consumers, as well as establishing guidance for regulated suppliers in engaging with consumers.<sup>12</sup> We have not reached a view on the appropriateness of such guidance in the Part 4 context, but we intend to consider the general issue of consumer engagement further, and how consumer engagement could be better facilitated.
20. After further consideration, we expect to engage with stakeholders more generally on these issues. At this stage, we are considering largely doing so as a separate process from the IM review process. Once we have further considered how we take forward our work in this area, we will update you and seek your input.

### **Overview of the next steps in the IM review process**

21. Having analysed your submissions and cross-submissions on our problem definition paper, we have decided to further engage with stakeholders on a number of focused topics prior to reaching our draft decisions.<sup>13</sup> This paper goes on to describe the additional engagement steps for these selected topics.
22. The additional engagement we have planned for selected topics does not mean these are the only topics of focus for the review. Rather, they are the topics where we consider further engagement with stakeholders at this stage will assist us in further articulating problem definitions, exploring possible options for addressing problems, and ultimately reaching draft decisions.<sup>14</sup>
23. For other topic areas, at this stage, we have not identified additional engagement steps that might be required before we are able to reach draft decisions. However, we are open to adding additional engagement steps if, as we continue with our analysis, we identify that there would be value in doing so. For example, once we have completed our internal effectiveness review of all IMs, we might identify additional issues that warrant engagement with stakeholders prior to the release of our draft decisions.

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<sup>12</sup> See, for example: Ofwat (UK) "Involving customers in price setting – Ofwat's customer engagement policy statement" (August 2011).

<sup>13</sup> This is consistent with the views of a number of submitters that we should engage in further consultation prior to the draft decisions, including by using expert and stakeholder working groups, workshops and emerging views or discussion papers. See, for example: ENA "Response to the Commerce Commission's Input Methodologies review paper" (21 August 2015), para 43-45; Powerco "Submission on Input methodologies review: Invitation to contribute to problem definition" (21 August 2015), para 81-85; Unison "Submission on Input Methodologies Review Invitation to Contribute to Problem Definition" (24 August 2015), para 49, 69.

<sup>14</sup> This is consistent with the approach we described in the problem definition paper (para 4, 99) of developing a tailored, fit-for-purpose process according to the state of each topic area. It is also consistent with the ENA's submission that the best process going forward will differ by issue (ENA "Response to the Commerce Commission's Input Methodologies review paper" (21 August 2015), para 43).

24. More generally, we have also been engaging with stakeholders on a bilateral basis during October 2015, and anticipate continuing to do so into November 2015 where we consider it will help us to further understand specific issues and comments raised in submissions.
25. As noted in our process update email of 18 September 2015, we are still aiming to complete the IM review by December 2016. Accordingly, we are aiming to reach our draft decisions in mid-June 2016.<sup>15</sup> We consider this timeline to be sufficient to allow us to further engage with stakeholders on the areas identified in this paper and make robust draft decisions. We will continue to evaluate the timing for the review as the review progresses.

### **How the fast track processes interact with the main IM review**

26. Within the IM review, certain topics concerning CPPs and airports are proceeding on a ‘fast track’, ahead of the timeline for the main review. This section provides a reminder and update about how these fast track processes interact with the main review.<sup>16</sup>
27. These fast track amendments focus on targeted issues.<sup>17</sup> The fast track amendments will be completed and re-integrated back into the main IM review process before we release our draft decisions on the IM review in mid-June 2016.
28. When we consider the draft decisions for the main IM review, we do not intend to consider changing IMs for the same purpose where these have already been subject to fast track amendments.<sup>18</sup>

### **IRIS for electricity distribution businesses still to be added to the IM review**

29. As advised on 9 October 2015,<sup>19</sup> we currently plan to re-integrate the Incremental Rolling Incentive Scheme (**IRIS**) IMs for EDBs into the main IM review the day after we publish a final decision on the IM amendments for the EDB IRIS. The final decision on the amendments to the EDB IRIS IMs is expected in late November 2015.

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<sup>15</sup> In selecting this date, we have considered the timing of other consultation processes and regulatory requirements that stakeholders may be engaged in.

<sup>16</sup> As advised on 9 October 2015, the former Limb 2 of the CPP fast track amendments (which concerned the alignment of the WACC for CPPs with the prevailing WACC for DPPs) is no longer following a fast track process. Instead, the WACC alignment issue will be considered as part of the main review on the same timetable as the rest of the cost of capital work. See Commerce Commission “Input methodologies review process update paper: Second update on CPP fast track amendments” (9 October 2015).

<sup>17</sup> See: Commerce Commission “Amended notice of intention: Input methodologies review” (9 October 2015); Commerce Commission “Input methodologies review process update paper: Second update on CPP fast track amendments” (9 October 2015); Commerce Commission “Input Methodologies review process paper: Update on fast track amendments (3 July 2015).

<sup>18</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>19</sup> Commerce Commission “Input methodologies review process update paper: Second update on CPP fast track amendments” (9 October 2015), para 5–6.

### A note about the record for the review

30. Any material provided in the course of the IM review (on any topic or sectoral issue), including in any engagement planned on any topic, will form part of the record for the IM review. We will have a record of all workshops, which will be made available on our website.
31. The record will therefore include any material provided during Commission workshops or other engagements in the course of the IM review, including any material that may cover matters wider than the IMs. For instance, the airports profitability topic may also consider changes to the airports ID determination,<sup>20</sup> and the gas pipeline issues topic may cover preparations for the 2017 gas DPP resets.<sup>21</sup> We consider that this is appropriate for these topics because it is impractical to separate IM review material and material that may be wider than the IMs. It is also beneficial to engage on these topics with a wider view as it is a pragmatic approach to the process and allows consideration of how the IMs are implemented in practice.

### Summary of the process steps through until the draft decisions

32. The planned process steps between now and the draft decisions are set out in table 1. The details of the events listed in table 1 are discussed further, by topic, later in this paper. The table also includes dates relevant to the CPP and airports fast track processes.<sup>22</sup>

**Table 1: Planned process steps through to draft decisions**

Indicative process step	Indicative timeframe
CPP fast track: Final decision and input methodology amendments	9 November 2015
Airports fast track: Draft decision and amendments	Early November 2015
Airports profitability assessment: Confirm venue for workshop 1 and publish agenda and associated papers	Early November 2015
Gas pipeline issues: Publication of the agenda for the meeting	Week beginning 23 November 2015
Emerging technology: Publication of material for workshop	Second half of November 2015

<sup>20</sup> Para 44.

<sup>21</sup> Para 79. For the avoidance of doubt, any decisions regarding changes to ID determinations or the gas DPP resets will be made under s 52Q and s 52P, respectively (as opposed to s 52Y for the review).

<sup>22</sup> The CPP and airports fast track dates have been previously advised in the notice of intention.

Cost of capital issues: Publish a cost of capital update paper	End of November 2015
Airports profitability assessment: Workshop 1	1 December 2015
Airports fast track: Submissions on our draft decision and amendments	Early December 2015
Gas pipeline issues: Meeting held	Week beginning 7 December 2015
Emerging technology: Workshop	14 December 2015
Airports fast track: Cross-submissions on our draft decision and amendments	Mid-December 2015
CPP requirements: Update on the details of the planned workshop	Before end of 2015
Cost of capital issues: Submissions on cost of capital update paper due	End of January 2016
Gas pipeline issues: Written comments from stakeholders due	End of January 2016
CPP requirements: Workshop	February 2016
Airports fast track: Final decision and amendments	Late February 2016
Cost of capital issues: Publish any expert advice sought	Quarter 1 2016
Airports profitability assessment: Workshop 2  Note: we will work with airports stakeholders to confirm a date for this workshop. We then aim to publish an agenda and associated papers at least a week before the workshop.	Between February and April 2016
Draft decisions and reasons published	Mid-June 2016

33. For the risk allocation topic (including form of control), as noted in paragraph 73, we are considering further engagement with stakeholders in light of how this topic interacts with other aspects of the review.

34. We will provide a further process update in February 2016 to confirm the process described above, or notify of any changes.<sup>23</sup>

### Update on the draft decision-making framework for the review

35. Thank you for your submissions on the discussion draft decision-making framework for the IM review (**discussion draft**).<sup>24</sup>
36. We are still analysing these submissions and considering how we take the decision-making framework forward. In the meantime, for the additional process steps described in this paper, we will continue to broadly follow the decision-making approach described in the discussion draft in light of submissions, which we continue to consider.
37. At this stage, we do not intend to seek further views from stakeholders on the decision-making framework prior to the draft decisions. The draft decisions will provide an opportunity for stakeholders to comment on the decision-making framework (updated in light of submissions on the discussion draft) as applied in making the draft decisions, rather than in the abstract.
38. In the problem definition paper and the discussion draft, we explained our preliminary view that we cannot create an IM on a matter not covered by an existing IM.<sup>25</sup> Many submitters challenged this view.<sup>26</sup> Our discussion draft invited submitters to provide examples of any areas where a change to an IM is required that might cross over into creating an IM on a new matter.<sup>27</sup> Two submitters provided some examples of the kinds of matters where an IM on a new matter might be a potential solution.<sup>28</sup>

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<sup>23</sup> This is in addition to any updates relating to specific topics described in the 'Further information on additional process steps planned for specific topics' section of this paper.

<sup>24</sup> Commerce Commission "Developing decision-making frameworks for the current input methodologies review and for considering changes to the input methodologies more generally – discussion draft" (22 July 2015).

<sup>25</sup> Commerce Commission "Developing decision-making frameworks for the current input methodologies review and for considering changes to the input methodologies more generally – discussion draft (22 July 2015), para 23–27; and the problem definition paper, para 44–48.

<sup>26</sup> See, for example: Russell McVeagh "Input methodology review: Advice on legal questions and decision-making framework" (21 August 2015), p. 5–7; Vector "Input methodologies review – Invitation to contribute to problem definition" (21 August 2015), para 13; Transpower "Input methodologies: threshold for changing IMs and the creation of new IMs" (25 June 2015), p. 4–5.

<sup>27</sup> Commerce Commission "Developing decision-making frameworks for the current input methodologies review and for considering changes to the input methodologies more generally – discussion draft (22 July 2015), para 27.

<sup>28</sup> Electricity Trusts of New Zealand Inc "Submission on IM decision-making discussion draft" (21 August 2015), p. 2–3; Board of Airline Representatives of New Zealand "Submission by BARNZ on problem definition paper for the input methodologies review" (21 August 2015), p. 4–5.

39. We remain open to reconsidering our preliminary view if, as the review progresses, we consider that resolution of any identified problem would require an IM on a new matter.<sup>29</sup>

### **Further information on additional process steps planned for specific topics**

40. This section outlines the additional process steps planned for specific topics prior to the draft decisions. As discussed at paragraph 23, for other topic areas, at this stage, we have not identified additional engagement steps that might be required before we are able to reach draft decisions.

### **Airports profitability assessment**

41. This section outlines the indicative stakeholder engagement events relating to airports profitability assessment up until our draft decisions.<sup>30</sup>
42. As a result of our analysis of matters raised in submissions, we have decided to hold two workshops so we can engage with interested parties on a number of focused topics relating to airports.<sup>31</sup>
43. We have contacted airports sector parties that we think might be interested in participating in the workshops. If any other stakeholders are interested in participating, please contact Karen Smith by 6 November 2015 on (04) 924 3863 or [karen.smith@comcom.govt.nz](mailto:karen.smith@comcom.govt.nz).

#### *Airports workshop 1*

44. The first workshop will be focused on the airports profitability assessment and potential approaches we may take when performing our summary and analysis obligations. From this we aim to establish a common understanding of how the airports IM determination can support the potential approaches.
45. If time permits, we will also look to explore with interested parties how issues raised during the problem definition phase in relation to airports may be resolved in the context of the proposed approaches to assessing profitability.

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<sup>29</sup> Including those issues raised by ETNZ and BARNZ referred to in paragraph 38.

<sup>30</sup> The WACC percentile for airports work, and cost of capital issues more generally, are covered under the cost of capital issues section of this paper, rather than here.

<sup>31</sup> We have already held a workshop on the MVAU methodology for valuing airport land as part of the airports fast track process. The material from that workshop is available at: <http://www.comcom.govt.nz/airport-fast-track-processes-for-im-review/>.

46. Workshop 1 is scheduled for 1 December 2015. We have scheduled the workshop for this time so there is sufficient time, prior to the draft decisions, to engage with stakeholders on how the airports IM determination may be amended to support any change to the approach to assessing airports profitability.<sup>32</sup>
47. In early November 2015, we will confirm and communicate the venue for the workshop and publish an agenda and associated papers. It is expected the workshop papers will outline criteria for assessing potential approaches and include a high-level outline of how the proposed approaches would work and our initial thoughts on criteria for assessing them. Stakeholders are invited to ask applicable experts to attend the workshop.

*Airports workshop 2*

48. The second workshop will be focused on seeking interested parties' views on resolving issues raised during the problem definition phase and at workshop 1 through amendments to the airports IM determination and in the context of a proposed approach to assessing airports profitability.
49. The second workshop is scheduled for between February and April 2016. We will confirm and communicate the exact date for the workshop in February 2016.
50. We intend developing a more detailed agenda and proposed papers once we have a proposed approach to the profitability assessment.

*Summary of events for the airports profitability assessment topic*

51. A summary of the event dates relating to the airports profitability assessment topic (other than the airports fast track process) is presented in table 2.

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<sup>32</sup> We will also consider what changes to the ID determination may be necessary to support our proposed approach to the airports profitability assessment. Any amendments to the ID determination will be made as a separate process.

**Table 2: Indicative event dates for the airports profitability assessment topic**

Indicative process step	Indicative timeframe
Confirm venue for workshop 1 and publish agenda and associated papers	Early November 2015
Workshop 1	1 December 2015
Workshop 2  Note: we will work with airports stakeholders to confirm a date for this workshop. We then aim to publish an agenda and associated papers at least a week before the workshop.	Between February and April 2016

### Emerging technology in the energy sector

52. This section outlines the high-level details of a workshop relating to the regulatory treatment of emerging technology in the energy sector that we aim to hold prior to our draft decisions. The focus of this workshop is on the electricity sector rather than the energy sector more broadly.<sup>33</sup>
53. The aim of this workshop will be to test our thinking with stakeholders that have a working knowledge of the relevant rules, in order to build a shared understanding of how the current rules treat the costs and revenues associated with particular ‘non-traditional’ investments by EDBs. The record from this workshop will be publically available. Once our thinking on this topic is more developed, we intend to share it more broadly. Later in the review, interested stakeholders will have an opportunity to comment and express their views on our proposals.
54. We will consider other issues relating to emerging technology as part of the review, but at this stage we do not anticipate that engagement initiatives like the one outlined below are needed to progress them prior to the draft decisions.
55. We envisage that this will be a small workshop to allow for a focused discussion and provide ample opportunity for interaction. We will be contacting the relevant trade associations for them to nominate a small number of representatives to participate in the workshop. If any other stakeholders are interested in participating and have not heard directly from us they may contact Karen Smith on (04) 924 3863 or [karen.smith@comcom.govt.nz](mailto:karen.smith@comcom.govt.nz) by 1 December 2015. We plan to publish a record of the workshop so that all parties will be able to follow the workshop.

<sup>33</sup> The scope of the emerging technology topic for the review continues to include the gas sector given the cross-sector influences. However, we note that, to date, no submitters have raised any emerging gas technology issues directly affecting the gas sector.



*Emerging technology workshop*

56. The workshop will be focused on the regulatory treatment of emerging technologies in the electricity sector. In particular, we intend to focus on revenues and costs associated with ‘non-traditional’ investments on both sides of the point of supply. The objective is to test our thinking and create a common understanding of how the current IMs work in the face of emerging technologies, and determine whether change is needed.
57. Submissions on our problem definition paper were mixed on this issue. Some submissions highlighted the importance of flexibility in the cost allocation rules and asked for clarity on the assets that go into the regulated asset base.<sup>34</sup> Other submissions said that too much flexibility can harm competition and stressed the importance of a level playing field between regulated and non-regulated markets.<sup>35</sup>
58. In order to address this issue, we plan to present at least one case study of a concrete emerging technology investment (we may present different scenarios for variables such as its location on the network, ownership and control), and show how we expect the associated costs and revenues would be treated under the current rules. We envisage that participants may also prepare and present their own case studies, or contribute to discussing other significant types of emerging technology investments that they think will benefit from consideration at the workshop.
59. The workshop will be held on 14 December 2015 at the Royal Society of New Zealand – 11 Turnbull Street, Thorndon, Wellington.
60. We aim to publish the workshop draft agenda and papers in the second half of November 2015. This will include information on the technology investment case study and associated regulatory treatment, which should help participants prepare for the workshop. We anticipate the relevant areas include legal (eg definition of regulated services), business development, engineering and accounting (eg cost allocation).
61. The process beyond the workshop for this topic will be considered in due course and updates provided as required.

*Summary of events for the emerging technology topic*

62. Table 3 presents a summary of the event dates relating to emerging technology discussed above.

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<sup>34</sup> See, for example: Vector “Input methodologies review – Invitation to contribute to problem definition” (21 August 2015), para 10.

<sup>35</sup> See, for example: Contact “Cross submissions on the Commission’s invitation to contribute to problem definition” (4 September 2015), section 1; Mighty River Power “Input Methodologies Review: Cross-submission on invitation to contribute to problem definition” (4 September 2015).

**Table 3: Indicative event dates for the emerging technology topic**

Indicative process step	Indicative timeframe
Publication of material for workshop	Second half of November 2015
Workshop (described above)	14 December 2015
Draft decisions and reasons	Mid-June 2016

**Cost of capital issues**

63. This section outlines the indicative stakeholder engagement events relating to cost of capital up until our draft decisions. This topic now includes the issue of the alignment of the WACC for CPPs with the prevailing WACC for DPPs (the former CPP fast track Limb 2).
64. Having identified the key issues via submissions on our problem definition paper, we plan to publish a cost of capital update paper at the end of November 2015.
65. We expect that the update paper will:
- 65.1 Outline the problem definitions in this area and the focus for the work going forward;
  - 65.2 Provide additional information related to those focus areas;
  - 65.3 Identify those areas in which we plan to seek external expert advice; and
  - 65.4 Provide further details on the process we intend to follow for our cost of capital work.
66. At this stage, we expect the key areas of focus described in the paper to include:
- 66.1 Issues raised in submissions to the problem definition paper relating to the calculation of the cost of debt (eg, the use of prevailing or long-term average rates, the use of annual indexation);
  - 66.2 The use of Black's simple discount rule; and
  - 66.3 The practical calculation of various parameters needed to determine the WACC (eg, asset beta, debt risk premium).
67. The paper will call for submissions. We are particularly interested in submissions with new evidence related to the focus areas identified in the paper that will assist in our decision making. At this stage, we expect that submissions will be due towards the end of January 2016.

68. In the first quarter of 2016, we plan to publish any expert advice sought by the Commission on the areas identified in the update paper. We will provide an update on the process early next year, including whether we expect submissions on expert evidence at the draft decisions stage or prior.
69. Some submitters suggested we hold a workshop on cost of capital issues.<sup>36</sup> While we agree a workshop may have value for working on some practical issues, we consider that a workshop on cost of capital is not required at this stage of the process. However, following consideration of submissions to the update paper and any external expert advice, we may hold a workshop next year, prior to the draft decisions, in order to consider the practical implementation of any options affecting the calculation of the cost of capital.
70. Table 4 presents a summary of the event dates relating to the cost of capital issues discussed above.

**Table 4: Indicative event dates for the cost of capital issues topic**

Indicative process step	Indicative timeframe
Publish a cost of capital update paper	End of November 2015
Submissions on cost of capital update paper due	End of January 2016
Publish any expert advice sought	Early 2016
Draft decisions and reasons	Mid-June 2016

### **WACC percentile for airports**

71. We are still considering our next steps for the WACC percentile for airports topic. One of the options we are considering is seeking expert advice. We intend to discuss the next steps in reconsidering the WACC percentile for airports in bilateral discussions with BARNZ, Air New Zealand, and the regulated airports during November 2016. If any other stakeholders are interested in discussing this, please contact Karen Smith on (04) 924 3863 or [karen.smith@comcom.govt.nz](mailto:karen.smith@comcom.govt.nz) by 18 November 2015.

<sup>36</sup> See, for example: Orion “Submission on the IM review” (21 August 2015), paragraph 1; ENA “Response to the Commerce Commission’s Input Methodologies review paper” (21 August 2015), section 2.1, para 43.

**Risk allocation mechanisms, including the form of control**

72. The form of control was identified as an issue for consideration in submissions on the problem definition paper and will be an area of focus for the review. In making a judgement on the most appropriate form of control for price-quality regulation of electricity distribution businesses and gas pipeline businesses, we will:
- 72.1 Consider specific implementation options, given the spectrum of options that have been identified; and
  - 72.2 Consider the interaction with other topic areas (for example the cost of capital) to ensure the overall balance of risk is appropriate.
73. Given the above, we expect any further engagement with stakeholders in this area to be next year and to focus on specific options for a form of control that can be implemented in a practical and efficient way. It would also follow further consideration on how the form of control interacts with other aspects of the review.
74. We will update you on any further engagement on this topic as part of our February 2015 process update.<sup>37</sup>

**CPP requirements**

75. We anticipate holding a workshop on CPP requirements in February 2016. While we have not yet settled on the workshop content, we anticipate it will be focused at a relatively detailed level, such as considering implementation details relating to potential changes to:
- 75.1 Information requirements for customised price-quality path proposals; and
  - 75.2 The engagement of (and terms of reference for) an independent verifier.
76. Given the technical nature of the anticipated subject matter, we consider a small-group workshop is likely to be most effective. We are seeking nominations for representatives that have strong asset management experience combined with familiarity with existing regulatory information disclosures. If you would like to nominate a representative, or have any questions about the workshop, please contact Dane Gunnell on (04) 924 36 74 or [dane.gunnell@comcom.govt.nz](mailto:dane.gunnell@comcom.govt.nz).

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<sup>37</sup> See paragraph 33.

77. We may also look to engage with interested parties and their representatives on an agenda for the workshop (and the potential materials we might produce to support that). We anticipate the workshop materials could also include an initial view on the interaction between DPPs and CPPs—including single issue CPPs / mini CPPs as raised by some submitters<sup>38</sup>—as useful context for any proposed changes to the information requirements.
78. We will update interested parties as our planning for this workshop develops, at least before the end of 2015.

### Gas pipeline issues

79. We want to engage with gas pipeline stakeholders on both the IM review and the 2017 gas DPP reset, and have decided to consider issues specific to gas pipeline businesses as a separate topic under the IM review.
80. The first meeting we will hold with gas pipeline stakeholders will be in early December this year. This will be focussed on the IM review, but will also be used to start discussions on the gas DPP resets. The meeting will provide an opportunity for gas pipeline stakeholders to:
- 80.1 Provide a gas pipeline perspective on any cross-sector IM issues, for example in relation to the form of control, or how we will treat large capital expenditure projects,<sup>39</sup> and
  - 80.2 Discuss any gas pipeline-specific issues, such as the issues already raised by Maui Development Limited.<sup>40</sup>
81. We have contacted gas pipeline sector stakeholders that we think might be interested in participating in this meeting to seek views on the intended focus of the meeting. If any other stakeholders are interested in participating, please contact Brett Woods on (04) 924 3776 or [brett.woods@comcom.govt.nz](mailto:brett.woods@comcom.govt.nz). We then intend to publish an agenda for this meeting in mid-November, including details of the date and venue.
82. Following the meeting we will allow interested parties to provide written comments highlighting any further issues or perspectives they would like us to take into consideration. At this stage, we intend to allow up to the end of January 2016 to provide us with these comments.

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<sup>38</sup> See, for example: Wellington Electricity “Input methodologies review – problem definition” (21 August 2015), p. 5; ENA “Response to the Commerce Commission’s Input Methodologies review paper” (21 August 2015), p. 33.

<sup>39</sup> This is not the only opportunity for gas pipeline stakeholders to engage on cross-sectoral issues. Gas pipeline stakeholders should also participate in cross-sectoral topics within the review (e.g. WACC, risk allocation mechanisms) as they see fit.

<sup>40</sup> Maui Development Limited, Submission on problem definition paper, (21 May 2015); Maui Development Limited, Cross-submission on problem definition paper, (4 September 2015).

83. Table 5 presents a summary of the event dates relating to gas pipeline issues discussed above.

**Table 5: Indicative dates for the gas pipeline meeting**

Indicative process step	Indicative timeframe
Publication of the agenda for the meeting	Week beginning 23 November 2015
Meeting held	Week beginning 7 December 2015
Written comments from stakeholders due	End of January 2016