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# Input Methodologies review, Framework for the IM review

Submission to the Commerce Commission

Final

From the Electricity Networks Association

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# 1. Introduction

1. The Electricity Networks Association (ENA) appreciates the opportunity to make a submission to Commerce Commission (Commission) on the consultation paper **Input methodologies review draft decisions – Framework for the IM review, 16 June 2016 (Framework paper)**.
2. The ENA represents all of New Zealand's 26 electricity distribution businesses (EDBs) or lines companies, who provide critical infrastructure to NZ residential and business customers. Apart from a small number of major industrial users connected directly to the national grid and embedded networks (which are themselves connected to an EDB network), electricity consumers are connected to a distribution network operated by an ENA member, distributing power to consumers through regional networks of overhead wires and underground cables. Together, EDB networks total 150,000 km of lines. Some of the largest distribution network companies are at least partially publicly listed or privately owned, or owned by local government, but most are owned by consumer or community trusts.

# 2. Submission summary

3. The ENA recommends that:
  - The "policy intent" should be clearly defined as the core economic principles identified in the Framework paper, plus the rationale for decisions as set out in the Input Methodology (**IM**) Reasons Paper.
  - The Commission confirms that any change to an IM should be consistent with the core economic principles.
  - The Commission confirms that a change to a core economic principle will be subject to a very high evidentiary and economic threshold.
  - The Commission develops a final Reasons Paper for this IM review, which does not unintentionally undermine the original IM Reasons Paper.
  - The Commission initiate a process to ensure the Reasons for its IM decisions are internally consistent and are consistent with the original Reasons Papers except where an explicit decision to change the approach has been made.
  - The Commission clarifies the status of the 2010 Reasons Paper will have when the new IMs are published.

## 3. Assessment of the Framework paper

### 3.1. Overview of consultation paper

4. The Framework paper<sup>1</sup> states that the Commission considered the following questions when considering potential changes to the IMs:
  - Is the policy intent behind the IM still relevant and appropriate?
  - Is the current IM achieving that intent?
  - Could the current IM achieve the policy intent better?
  - Could the current IM achieve the policy intent as effectively, but in a way that better promotes section 52R of the Commerce Act 1986 or reduces complexity or compliance costs?
  - Do changes to other IMs require any consequential changes to the IM in question for internal consistency or effectiveness reasons?
5. The Framework paper indicates that the Commission has proposed changing the IMs only where the change appears likely to:
  - Better promote the Part 4 purpose.
  - Better promote the purpose of IMs.
  - Significantly reduce compliance costs, other regulatory costs or complexity, without undermining points (a) and (b).
6. The Framework paper goes on to explain that the intention is to only make those changes that will likely promote factors (a)-(c). It notes that deciding whether to make a change requires the Commission to exercise judgement and that the “pros of making a change must outweigh the cons”.
7. The Framework paper considers there are “three key economic principles which are relevant to the Part 4 regime”:
  - Real financial capital maintenance (FCM); suppliers have an ex ante expectation of maintaining their financial capital in real terms.
  - Risk is allocated to the parties who are best placed to manage the risk.
  - FCM is applied recognising the asymmetric consequences for consumers of over-investment versus under-investment.
8. The Framework paper does not consider “that these or any other economic principles amount to a regulatory compact”.

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<sup>1</sup> For the material in this section, see Framework paper pages 4-5.

## 3.2. ENA's previous submission

9. In our previous submission the ENA's recommendations regarding the IM review framework included:<sup>2</sup>
  - The "policy intent" should be clearly defined as the core economic principles relied upon by the Commission when the IMs were determined and, in relation to a specific IM under consideration, the reasons in support as set out in the relevant Reasons Paper. The core economic principles should be clearly specified up front by the Commission as part of the IM review.
  - Any change to an IM should be consistent with the core economic principles (e.g. the expectation of earning at least normal returns over the life time of an asset (expected NPV=0)).
  - A change to a core economic principle should require a very high evidentiary and economic threshold.

## 3.3. Comments on the Framework paper

10. The Framework paper provides useful information and description of the decision-making process regarding the IMs, but does not deliver the certainty that electricity distribution businesses (**EDBs**) are seeking.

### Policy intent and economic principles

11. The Framework paper defines 'policy intent' as 'what was the IM attempting to achieve, either on its own or as part of the IMs as a package?' This is a reasonable definition but EDBs are looking for a clear statement of what the policy intent is. If the policy intent is unclear or subjective then it will be challenging to reach a consensus on whether the IMs are delivering that policy intent or whether a better approach is available.
12. The Framework paper does not provide a clear re-statement of the policy intent, although several of the IM topic papers state a policy intent in relation to particular issues.<sup>3</sup> The ENA requests that a clear restatement of the policy intent underpinning the IMs as a whole is included in the final IMs Reasons Paper. We remain of the view that the policy intent is the core economic principles relied upon by the Commission when the IMs were determined (and now specified in the Framework paper) and the reasons in support as set out in the relevant Reasons Paper. It does not seem that the Commission disagrees with this but confirmation would be helpful.

### Regulatory compact

13. The Framework paper goes to some length to argue the economic principles do not amount to a regulatory compact. We submit this position is overly concerned with legal interpretation. Whether it is termed a "compact" or not, suppliers regulated under Part 4 receive a low return on their expenditure. This is only likely to be viable or attractive for investors over the longer-term if they have confidence they will be able to fully recover their investments. EDBs have reasonable

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<sup>2</sup> ENA, Response to the Commerce Commission's Input Methodologies review paper: Invitation to contribute to the problem definition, 21 August 2015, paragraph 6.

<sup>3</sup> For example, Form of control and RAB indexation Topic paper, paragraph 215.1.

expectations of this outcome, whether it is called a regulatory compact or not. To put it another way, if there is no regulatory compact, what is there? On what basis should EDBs have the confidence to invest if there is no compact?

14. The ENA considers that it would be helpful for investor confidence and certainty if the Commission expressed a stronger commitment to the economic principles that underpin the IMs.

### When IMs will be changed

15. Our underlying concern remains that the IMs can and are being changed frequently, which undermines certainty and confidence for investors, suppliers and consumers. For example, since December 2010 the IMs that apply to EDBs have been amended 10 times.<sup>4</sup>
16. The Framework paper discusses the rationale and process the Commission will use when amending the IMs. This is helpful but does not address our concerns. We are seeking some assurances that the IMs will remain stable over time. A statement that they will be amended only when pros outweigh cons (where the assessment of both pros and cons will be necessarily subjective) does little to provide any such assurance. The ENA would support a statement that substantive (i.e. non-error correcting) changes to the IMs are only made, outside of the statutory 7-year review process, where the change meets a clear materiality threshold for changing the IMs.

## 3.4. Recommendations

17. The ENA recommends that:
  - The "policy intent" should be clearly defined as the core economic principles identified in the Framework paper, plus the rationale for decisions as set out in the IM Reasons Paper.
  - The Commission confirm that any change to an IM should be consistent with the core economic principles.
  - The Commission confirm that a change to a core economic principle will be subject to a very high evidentiary and economic threshold.

# 4. Status of Reasons Papers

## 4.1. Discussion

18. Various topic papers contain some discussion and material that is contrary to the discussions in the 2010 IM Reasons Paper. For example, the CPP Topic paper contains some criteria for evaluating CPPs that are inconsistent with those in the current IMs – it is not clear what the status of these additional criteria are.
19. This contrary discussion does not reflect a change in policy intent or implementation, but seems to reflect just a lack of understanding. It is important that the final IMs published at the end of this review are supported by clear, credible and consistent documentation of the Reasons for the

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<sup>4</sup> This is a count of the amendments listed at: *Commerce Commission, Input Methodologies review draft decisions – Introduction and process paper*, 16 June 2016, pages 30-33.

decisions. This could either be in the form of a new, comprehensive, Reasons Paper or a paper setting out updates and changes to the Reasons. In either case the Reasons need to be internally consistent and they should also be consistent with the original Reasons Papers except where an explicit decision to change the approach has been made.

## 4.2. Recommendations

20. The ENA recommends that:

- The Commission develops a final Reasons Paper for this IM review, which does not unintentionally undermine the original IM Reasons Paper.
- The Commission initiate a process to ensure the Reasons for its IM decisions are internally consistent and are consistent with the original Reasons Papers except where an explicit decision to change the approach has been made.
- The Commission clarifies the status of the 2010 Reasons Paper will have when the new IMs are published.

## 5. Appendix

The Electricity Networks Association makes this submission along with the explicit support of its members, listed below.

Alpine Energy  
Aurora Energy  
Buller Electricity  
Counties Power  
Eastland Network  
Electra  
EA Networks  
Horizon Energy Distribution  
Mainpower NZ  
Marlborough Lines  
Nelson Electricity  
Network Tasman  
Network Waitaki  
Northpower  
Orion New Zealand  
Powerco  
PowerNet  
Scanpower  
The Lines Company  
Top Energy  
Unison Networks  
Vector  
Waipa Networks  
WEL Networks  
Wellington Electricity Lines  
Westpower