

Input methodologies review process update paper

Second update on CPP fast track amendments

9 October 2015

Purpose

1. The purpose of this paper is to update parties regarding the two-limbed fast track process for certain amendments to the customised price-quality path (CPP) input methodologies (IMs). It is being published alongside an amended Notice of Intention that specifies the revised scope of and process for the IM review.¹
2. In part, this paper responds to a letter the Commission received from Powerco on 17 September 2015. In that letter, Powerco advised the Commission that it was deferring its potential CPP application beyond 2016.² This development has prompted us to reconsider our process for the CPP fast track.

Updated process

3. We have decided to continue with Limb 1 of the CPP fast track amendments. However, we have decided not to progress work on Limb 2 of the CPP amendments under a fast track process, and to consider the issues involved as part of the main review instead. We have published this paper to:
 - 3.1 explain our decision to continue with the fast track process for the proposed Limb 1 amendments, which relate to certain aspects of the requirements for preparing, assessing, and determining CPPs;
 - 3.2 explain our decision to discontinue the fast track process for the potential Limb 2 amendments, which consider the alignment of the weighted average cost of capital (WACC) for CPPs with the prevailing WACC for default price-quality paths (DPPs);
 - 3.3 outline the process we have followed leading up to this decision; and
 - 3.4 confirm the status of any substantive submissions parties have already made relating to Limb 2 of the fast track, and the expected new process for making decisions in relation to the WACC alignment issue.

¹ Commerce Commission “Amended Notice of Intention to commence a review of input methodologies”, 9 October 2015 (published alongside this update paper).

² Powerco “Letter regarding Powerco decision to defer its 2016 CPP application”, 17 September 2015 (published alongside this update paper).

Updates on other matters

4. The scope and process for the fast track amendments for considering airport services land valuation IM amendments remains the same as that specified in the amended Notice of Intention published on 3 July 2015 (except that the workshop scheduled to be held in late September was held in early October) and is not affected by this decision.
5. We would also like to advise that we currently plan to include the Incremental Rolling Incentive Scheme (IRIS) IMs for electricity distribution businesses (EDBs) in the main IM review the day after we publish a final decision on the IM amendments for the EDB IRIS.
6. The final decision on the amendments to the EDB IRIS IMs is now expected in November (rather than August as previously advised). At present the EDB IRIS IMs are not part of the main IM review.

Continuation of Limb 1 of the fast track

7. We still intend to complete the Limb 1 amendments by the original 9 November 2015 completion date. These amendments focus on certain aspects of the requirements for preparing, assessing, and determining CPPs. We are continuing to consider these issues on an earlier timetable because there are substantive advantages and process efficiencies in completing this work early.
8. Given that any suppliers applying for a CPP in 2017 are likely to begin preparing their CPP applications before the scheduled December 2016 conclusion of the main IM review, there remains value in providing earlier certainty to any potential applicants regarding the Limb 1 amendments, as they impact on this preparation.
9. Work on the issues covered by Limb 1 is already well advanced. We have already published a draft decision and received submissions in response. It is most efficient to now complete this work, and consistent with submissions which have been generally supportive of the proposed Limb 1 amendments.

Discontinuation of Limb 2 of the fast track

10. We have decided to delay consideration and resolution of the potential incentive problems created by the difference between the DPP and CPP WACCs. Following Powerco's deferral of their application, there is no longer a pressing need to resolve the alignment issue sooner than December 2016.

11. This development changes our assessment of Limb 2 against one of the core matters we laid out in our process update paper on the CPP fast track amendments, specifically the need for the work to be completed ahead of the main IM review.³ As we said in the previous process update paper, part of the reason we decided to fast track this issue was because:

Submitters have told us that the current CPP IM requirements for WACC are creating incentives to apply, or not apply as the case may be, for a CPP in circumstances where it is not in the long-term interests of consumers to do so.⁴

12. While we still consider that the WACC alignment issue was a specific issue capable of being considered separately from the main IM review (the other core consideration when deciding whether to fast track), other issues we are considering in the main IM review are nonetheless potentially relevant.⁵
13. Delaying consideration of the WACC alignment issue, in the absence of a pressing need to resolve it quickly, will allow for a more holistic solution to be proposed and consulted on. This will likely be more effective in terms of ensuring all decisions and incentives are aligned at one point. In our view this is preferable to running the risk that any Limb 2 solution is undone (in part or in whole) by later decisions in the main IM review.
14. In its letter to the Commission, Powerco stated that there is still benefit in fast tracking consideration of the WACC alignment issue. Specifically, Powerco cited the benefits of completing any appeals processes before any CPP applications in 2017.⁶ While we appreciate Powerco's preference for achieving greater certainty sooner, we believe that the benefits of considering the WACC alignment issue alongside other related issues outweigh the certainty benefits of early completion.
15. We have identified a potential implementation issue for CPP applications in the February 2017 application window. As we expect to make our final decision on the IM review in December 2016, there may not be enough time for any decision on WACC to be incorporated into a CPP application.
16. In our view, this would only be a transitional issue. Should any supplier face these circumstances, we would consider and consult on an appropriate transitional solution, such as adding an extra application window between the February and May 2017 windows.

³ Commerce Commission "Input methodologies review process paper – Update on CPP fast track amendments" 7 August 2015. The core considerations are set out in para 12.

⁴ Ibid, para 42.

⁵ As MEUG noted in their submission on the scope of the CPP fast track. MEUG "Comments on CPP fast track" 10 July 2015, para 2.

⁶ Powerco "Letter regarding Powerco decision to defer its 2016 CPP application", 17 September 2015, page 1.

Summary of the process leading to this decision

17. The original Notice of Intention published on 10 June 2015 explained that the Commission would consider whether the IM review should include potential amendments to the IMs for CPPs on a fast tracked timeframe.⁷ The IMs relating to CPPs and affected by this decision are contained in the following determinations:
 - 17.1 *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* (EDB IMs).
 - 17.2 *Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27* (GDB IMs).
 - 17.3 *Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28* (GTB IMs).
18. Submissions on the 10 June Notice of Intention indicated that the difference between the DPP and CPP WACCs was a critical factor in determining whether to apply for a CPP, and was therefore potentially creating incentives that were not in the long-term interests of consumers.
19. The Commission, and interested parties, were aware that Powerco was contemplating applying for a CPP in 2016. At the IM review forum Powerco confirmed that the WACC alignment issue was the most significant factor in its decision-making around whether to make that application.
20. Our Process Update Paper of 7 August confirmed our intention to review some aspects of the CPP input methodologies in advance of the main IM review. This process comprised two “Limbs”, with Limb 1 focusing on certain aspects of the requirements for preparing, assessing, and determining CPPs, and Limb 2 focusing on the WACC alignment issue.⁸
21. We published our draft decision on the Limb 1 amendments on 7 September, and invited submissions in response. We received these submissions on 25 September, and received cross-submissions on 2 October.
22. In a letter on 17 September 2015, Powerco advised the Commission that it was deferring its potential CPP application beyond 2016.⁹ We have also contacted the other potential 2016 CPP applicants that we are aware of, and we are now confident that there will be no CPP applications in 2016. This prompted us to reconsider the fast tracking of the review of aspects of the CPP IMs.

⁷ Commerce Commission, “Cover Letter for the Notice of Intention to commence a review of input methodologies”, 10 June 2015.

⁸ Commerce Commission “Input methodologies review process paper – Update on CPP fast track amendments” 7 August 2015.

⁹ Powerco “Letter regarding Powerco decision to defer its 2016 CPP application”, 17 September 2015.

Status of previous submissions and expected process from here

23. We have already received substantive submissions on the WACC alignment issue as part of our consultation on the scope of the fast track and during the IMs review forum. We wish to reassure parties that these submissions remain on the record, and that we will use them to further our thinking for the main IM review.
24. Further work on the WACC alignment issue will now be carried out on the same timetable as other work related to WACC within the main IM review. We anticipate providing a more detailed process update for energy topics in late October.