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Keston Ruxton  
Manager, Market Assessment and Dairy Regulation Branch  
Commerce Commission  
By email: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

Wellington Electricity  
Lines Limited  
75 The Esplanade  
Petone, PO Box 31049  
Lower Hutt 5040  
New Zealand  
Tel: +64 4 915 6100  
Fax: +64 4 915 6130  
[www.wellington-electricity.co.nz](http://www.wellington-electricity.co.nz)

Dear Keston Ruxton

## **Input methodologies review – Limb 1 of CPP fast track**

### **1. Introduction**

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to respond to the Commerce Commission's (**Commission**) *'Input methodologies review – Proposed amendments to input methodologies for customised price-quality paths – Draft decision for Limb 1 of the CPP fast track'* published 7 September 2015 (**draft decision**).

### **2. Modification or exemption from CPP process or content requirements**

WELL supports the draft decision to allow suppliers to apply for pre-approval to make modifications or seek exemptions to the Customised Price-quality Path (**CPP**) process or content requirements in subparts 1, 4 and 5 of Part 5 of the electricity distribution input Methodologies (**IM**). Allowing pre-approval of modifications or exemptions to the CPP IM process and content requirements will reduce unnecessary transactions costs for both suppliers and the Commission, therefore ultimately reducing the overall costs to consumers. The ability to apply for modifications and exemptions will also ensure suppliers are not deterred from making CPP applications, where it is efficient to do so, due to the IM requirements.

The pre-approval aspect is key to reducing transactions costs. It is important however the pre-approval process does not inadvertently have the effect of bringing forward the transactions costs of meeting the existing process and information requirements, for example by requiring suppliers to demonstrate both the existing and proposed methods. Additionally, the pre-approval process needs to be completed in a timely manner to minimise the need for suppliers to still undertake both the existing and proposed methods in order to ensure they meet the CPP timelines. WELL supports the timeframes proposed by the ENA.

WELL considers the assessment criteria in the draft decision should be accompanied by an assessment of whether the proposed modification or exemption would have net benefit in the long term interest of consumers. This is because while a modification or exemption could be considered to detract from the Commission's and/or stakeholders' assessment to a small degree, this may be more than offset by the cost savings from avoiding unnecessary transactions costs. WELL supports the ENA's proposed drafting in this regard.

Notably, the draft decision does not provide the option to apply for modifications or exemptions to the form of control which is specified in subpart 1 of Part 3 of the IMs and applies to both CPP and DPP. The form of control is a significant factor in the operation of a regulatory determination. WELL considers that a supplier should be able to seek pre-approval for a modification to the form of control. While a supplier already has an ability to apply for an IM variation, pre-approval is not provided for IM variations and the form of control is a major component impacting revenue recovery under a DPP or CPP determination. Such uncertainty over the form of control prior to lodging a CPP proposal could possibly have the potential to deter potential applications.

Similarly, the draft decision does not provide the option to apply for modifications or exemptions to the incentive schemes which are set out in subpart 3 of Part 3 of the IMs and apply to both CPP and DPP. WELL considers suppliers should be able to seek pre-approval for modifications or exemptions to the incentives schemes. There may be certain circumstances where incentives schemes are deemed inappropriate, or appropriate but with modification, given the context of the CPP proposal.

### **3. Alternative methodologies with equivalent effect**

The draft decision proposes that suppliers be able to apply an alternative methodology for forecasting some of the core components of the building blocks in subpart 3 of Part 5 of the IMs, including depreciation, tax, revaluation and the term credit spread differential. It is proposed that no alternative methodology may be applied for, among other things, the cost of capital or the form of control.

In the draft decision, the alternative methodology must however have an equivalent effect as the original methodology. The requirement for equivalent effect is too restrictive because:

- alternative methodologies are unlikely to achieve precisely the same outcome; and
- it will require the supplier to undertake both methodologies to demonstrate equivalence.

WELL recommends the alternative methodology be required to have a materially equivalent effect. The introduction of materially equivalent provides more scope for considering alternative methodologies which may be more appropriate given the suppliers circumstances but which do not result in precisely the same outcomes.

WELL also recommends the Commission allow for pre-approval of alternative methodologies prior to submission of the CPP proposal. Without a pre-approval process there is a real risk the Commission does not approve the proposed alternative methodology and therefore finds the CPP proposal to be non-compliant. This risk creates reputational concerns for suppliers and means that, given the short timeframe for resubmission of a proposal, suppliers would still need to prepare alternative models and drafting and prepare for re-audit, re-certification and re-verification processes in advance of the Commission's decision on compliance.

The absence of a pre-approval process therefore introduces additional transactions costs and increases the compliance risks for suppliers. Further, it is not clear why a pre-approval process is proposed for modifications and exemptions but is not proposed for alternative methodologies. Including a pre-approval process for alternative methodologies would better promote the purposes of IMs in section 52R of the Act and reduce the overall costs and time of preparing a CPP application.

### **4. Proposal complete in all material respects**

WELL supports the draft decision to clarify that a CPP proposal is only required to be compliant in all material respects. This change reduces the risk of non-compliance issues arising over trivial matters.

### **5. Which IMs apply to a CPP proposal**

The Commission is of the view that the IM's applying to a CPP determination should be those applying at the time a CPP application is lodged. The Commission has come to this view based on its interpretation of what is implied by a number of clauses in the Act. As the Commission's interpretation is consistent with its prior belief, the draft decision proposes no IM change.

WELL considers that there is merit in making it clear through the IMs as to which IMs apply at the time of a CPP application. This is because legal drafting can be interpreted in different ways by different parties. Given stakeholders have sought clarity regarding this matter there is clearly a level of ambiguity.

Providing clarity in the IMs regarding which IMs apply to a CPP determination would better promote the purposes of the IMs in section 52R of the Act by providing greater certainty to stakeholders.

Further, consideration should be given to providing a minimum lead in period before changes to the CPP IMs are effective for the purposes of CPP proposals. A situation could arise where an IM is

changed within a short period before the CPP application window. In this circumstance the supplier may have insufficient time to revise the proposal and, depending on the impact of the IM change, undertake re-audit, re-certification, re-verification and potentially additional customer consultation. Therefore a minimum lead in period before CPP IM changes take effect should be considered.

#### **6. General IM review of CPP process and information requirements**

WELL considers that allowing modifications, exemptions and alternative methodologies is an important step to reducing the costs of CPP proposals and ensuring suppliers are not deterred from making CPP applications, where such applications would otherwise be in the long term interests of consumers.

The option for modifications, exceptions and alternative methodologies however should not detract from a broader review of the appropriateness of the existing IM process and content requirements. It would be inefficient for suppliers to apply for modifications, exemptions or alternations to the IMs simply due to practical issues with the existing IMs. WELL therefore encourages the Commission to thoroughly review the CPP IM process and information requirements as part of the full IM review process.

#### **7. Closing**

WELL appreciates the opportunity to contribute to Limb 1 of the CPP fast track input methodology review. Please do not hesitate to contact Megan Willcox, Regulatory Projects Manager, on [MWillcox@welectricity.co.nz](mailto:MWillcox@welectricity.co.nz) if you have any queries.

Yours faithfully



Greg Smith

**CHIEF FINANCIAL OFFICER**