

Input methodologies review process paper

Update on CPP fast track amendments

7 August 2015

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 our decision to fast track certain amendments to the input methodologies (IMs) relating to customised price-quality paths (CPPs).
2. The IMs relating to CPPs are contained in the following determinations:
 - 2.1 *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* (EDB IMs);
 - 2.2 *Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27* (GDB IMs); and
 - 2.3 *Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28* (GTB IMs).
3. Specifically, this paper:
 - 3.1 Explains the reasons for our decision today to issue a second amended Notice of Intention for the IM review to commence a two-limbed fast track process for considering amendments to the IMs for CPPs (CPP fast track);
 - 3.2 Describes the scope of the potential amendments to the IMs that we are considering for each limb of the CPP fast track, and sets out the process and indicative timing for each limb of the CPP fast track.
4. The scope and process for the overall IM review and 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.

The fast track amendments within the overall IM review

5. The original Notice of Intention published on 10 June 2015 announced the commencement of work on a review of IMs with the intention of reaching final decisions by December 2016.¹ As part of that announcement, we explained that the Commission would consider whether the review should include potential amendments to the IMs for airport services and CPPs for electricity distribution services on a fast tracked timeframe.²
6. Fast track amendments fit within the overall IM review in the following manner:
 - 6.1 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.
 - 6.2 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. Fast track amendments will not include the full review of whether the 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.
 - 6.3 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 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.
 - 6.4 When we consider the draft decisions 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.³ The main IM review will not review the same issues that the fast track amendments seek to address.

¹ 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.

² Commerce Commission, "Cover Letter for the Notice of Intention to commence a review of input methodologies" (10 June 2015).

³ 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.

Summary of the process leading to our decision to fast track

7. We sought submissions on the scope of particular airport services IMs and CPP IMs to be potentially amended on a fast track basis in our paper inviting contributions to the possible 'problem definition' for IM-related review areas.⁴
8. We received submissions on the proposed fast track amendments from interested persons on 23 June 2015. The relevant submissions on this CPP fast track process are discussed below. In addition to the original scope of issues proposed for the CPP fast track, some submitters raised a number of additional issues for consideration within the scope of fast track amendments.
9. For example, Powerco Limited (Powerco), Electricity Networks Association (ENA), and Wellington Electricity Lines Limited (WELL) raised concerns with the weighted average cost of capital (WACC) where the CPP WACC is lower than the default price-quality path (DPP) WACC (WACC alignment issue) – an issue we had proposed considering as part of the main IM review. Specifically, Powerco proposed that we fast track a substantial amendment to the IMs, allowing a CPP application to use the current DPP WACC in its CPP application, until the DPP WACC is set for the subsequent DPP period, and using that new DPP WACC for the balance of the CPP period.
10. On 3 July 2015 we issued an amended Notice of Intention for the IM review to commence a fast track process for considering potential amendments to airport services input methodologies relating to land valuation. In the accompanying process paper⁵ we invited views from interested persons on whether to fast track consideration of additional issues raised in submissions, and the timeframes (10 July 2015) to do so.
11. On 10 July 2015 we received further comments from interested persons on the scope of the CPP fast track. The substance of these comments is discussed below.
12. The matters we considered in deciding whether to commence a CPP fast track process include the need for the work to be completed ahead of the main review, 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.

⁴ Commerce Commission, "Input Methodologies Review invitation to contribute to problem definition" (16 June 2015).

⁵ "Input methodologies review – process paper update on fast track amendments – 3 July 2015".

Decision to commence two limbed CPP fast track

13. As outlined on 21 July 2015,⁶ we have decided to commence a two-limbed CPP fast track process for electricity distribution services and gas pipeline services. The two limbs will consider:

Limb 1

- 13.1 Introducing flexibility for suppliers through:
- 13.1.1 modifications or exemptions to the process for preparing, and content of, CPP proposals;
 - 13.1.2 allowing the use of alternative methodologies with equivalent effect (AMWEEs) for the proposal and determination of a CPP;
- 13.2 Accepting CPP applications for consideration if they comply with the process and content IMs “in all material respects”; and
- 13.3 Clarifying which IMs apply if IM amendments are made after a proposal is accepted as complete but before a CPP is determined;

Limb 2

- 13.4 The alignment of the WACC for CPPs with the prevailing WACC for DPPs.
14. The expected time frames for considering each of these limbs differ, but consideration of each limb will be progressed concurrently for electricity distribution services and gas pipeline services. We describe further the reasons for this and the scope of each limb of the CPP fast track below.

Scope, process and timing for the first limb of the CPP fast track

15. We have decided to fast track our consideration of a limited number of potential amendments to CPP IMs as the first limb of the CPP fast track. The amendments are scheduled to be finalised in early November 2015 so that they are available to be applied by suppliers who make a CPP application in May 2016 and beyond.
16. As the fast track process cannot address every issue with the current IMs relating to CPPs, our decision reflects the fact that we have prioritised amendments that were identified by stakeholders as the most important and that will offer the greatest achievable benefits in a fast-tracked time frame.

⁶ “Notification email regarding decision to fast track certain amendments to Input Methodologies” (21 July 2015), see: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/>

Scope of limb one amendments

17. The first limb of the fast track process is limited to considering whether amendments to the EDB IMs, GDB IMs, and GTB IMs should be made to implement the following matters:

Modification or exemption of CPP process or content requirements

- 17.1 The modification or exemption of requirements relating to the process for preparing, and content of, CPP proposals in order to introduce flexibility for suppliers, and the criteria that must be met in order for the modifications or exemptions to apply.⁷
- 17.2 The specification of the information required to be provided by a supplier to meet any criteria set for application of a modification or exemption.
- 17.3 A process to allow for the modification or exemption. Consideration will be given to whether the process should:
- 17.3.1 Comprise of a case-by-case approval given by the Commission in response to a request made by a supplier; and
- 17.3.2 Apply in advance of a CPP proposal being made by a supplier to the Commission under s53Q.

Alternative methodologies with equivalent effect

- 17.4 The modification of some or all of the other relevant IMs that apply for the proposal and determination of a CPP to allow the use of alternative methodologies with an equivalent effect (or materially equivalent effect) in order to introduce flexibility for suppliers, and the criteria that must be met in order for the modifications or exemptions to apply.⁸
- 17.5 The specification of the information required to be provided by a supplier to meet any criteria for application of the modification and demonstrating equivalent effect.
- 17.6 A process to allow for the modification. Consideration will be given to whether the process should:
- 17.6.1 Comprise of a case-by-case approval given by the Commission in response to a request made by a supplier; and
- 17.6.2 Apply in advance of a CPP proposal being made by a supplier to the Commission under s53Q.

⁷ The requirements relating to the process for preparing, and content of, CPP proposals are specified in Part 5 Subparts 1, 4 and 5, and related schedules, of the EDB IMs, Part 5 Subparts 1, 5 and 6, and related schedules, of the GDB IMs, and Part 5 Subparts 1, 5, and 6, and related schedules, of the GTB IMs.

⁸ The input methodologies are contained in Part 5 Subpart 3 of the EDB IMs, Part 5 Subparts 3 and 4 of the GDB IMs, and Part 5 Subparts 3 and 4 of the GTB IMs.

Assessing a CPP proposal that is complete in all material respects

- 17.7 The acceptance by the Commission of CPP proposals as complying with the IMs relating to the process for preparing, and content of, CPP proposals, if the CPP proposal complies with those requirement in all material respects.

Clarifying which IMs apply, and when

- 17.8 Clarification of whether the input methodologies in force at the time a CPP proposal is received by the Commission under s 53Q are the input methodologies that apply to the assessment, consideration and determination of a CPP by the Commission.

Submitters' views on scope of fast track process

18. We received written submissions from WELL, Powerco, ENA, and Maui Development Limited (MDL) expressing broad support for undertaking a CPP fast track that considered simplifications to information requirements and consequent changes to IMs. Powerco and ENA commented specifically on the scope of improvements to information requirements.
19. WELL outlined a list of material areas of concern with the current CPP process that it considered should form the basis of the CPP fast track. This included matters such as enabling CPP applications to be limited to certain matters, and clarifying the Commission's expectations regarding suppliers' consultation requirements.
20. The consideration of whether to introduce an ability for suppliers to apply for a CPP which is limited only to certain elements of the price-quality path raises broad questions about how the DPP and CPP interact, and whether such an approach would better promote the purpose of default/customised price-quality regulation. In our view, those issues are most appropriately considered in the wider context of the full IM review, and do not prevent us from resolving the limb one matters set out in paragraph 17 above.
21. WELL also acknowledged that the Commission's timeframes were very tight and that it is essential that the fast track process is transparent and that adequate time is given for consultation.
22. Powerco submitted that it would be impractical to consider a complete review of the CPP IMs in a fast track process and the Commission could improve the existing CPP IMs through prioritising the matters of greatest materiality by clarifying, amending or deleting particular requirements, or by introducing an exemption mechanism that allows for tailoring to suit the features of the applicant and the available information.⁹
23. ENA submitted that a fast tracked review could be expedited by focussing on priority refinements, with a more comprehensive review included in the full IM review, and

⁹ Powerco "Submission on scope of CPP fast track amendments for the IM review" 23 June 2015.

that one option was to introduce a mechanism that allows a CPP applicant and the Commission to agree certain information amendments in advance of an application.¹⁰ ENA also supported the Commission clarifying, as part of the fast track process, the extent to which amended IMs apply to a CPP submitted during the IM review.

Our decision to fast track limb one

24. We agree with Powerco and ENA that there is insufficient time in a fast track process to consider a line-by-line review of the CPP IMs. We have therefore prioritised amendments in relation to the process for preparing, and content of, CPP proposals that we consider offer the greatest achievable benefits in a fast-tracked time frame. Only the matters specified in paragraph 17 above will be considered in a fast-tracked timeframe.
25. Specifically:
 - 25.1 Our decision to consider a process for modification or exemption of requirements relating to the process for preparing, and content of, CPP proposals is aimed at introducing flexibility for suppliers in areas that suppliers consider to be material to their CPP application. Such a process has the potential to reduce complexity and compliance costs for CPP applicants without materially detracting from the purpose of s52A of the Commerce Act 1986 (the Act).
 - 25.2 Proposed amendments that provide for the ability for a CPP applicant to use alternative methodologies with an equivalent effect in certain situations (and for those alternative methodologies to be applied by the Commission in evaluating and determining the CPP) could also introduce flexibility and lower the time and costs associated with a CPP application without materially detracting from the purpose of s52A of the Act.
26. In addition, given that the IM review will be progressed at a time when suppliers may be considering applying for a CPP, we consider it important that we enhance the certainty available to potential CPP applicants by addressing the issues of whether:
 - 26.1 CPP applications can be accepted by the Commission as complying with the IMs relating to the process for preparing, and content of, CPP proposals if the CPP application meets the requirements “in all material respects”; and
 - 26.2 an IM amendment is required to clarify our view that it is the IMs in place at the time the Commission receives a CPP application that will apply to the determination of a CPP.

¹⁰ Electricity Networks Association “Submission on scope of CPP fast track amendments for the IM review” 23 June 2015.

Timing

27. We have decided to slightly push back (from our proposal of 10 June 2015) the indicative date for publishing final decisions and amendments on the first limb of the CPP fast track to early November 2015. Three submissions on CPP fast track matters commented that the Commission's proposed fast tracking timetable is very tight.¹¹ Primarily submissions proposed different options for refining process steps and options (as discussed below), rather than extending the timing of final decisions for matters (other than where extending the timing of final fast track decisions might be necessary to accommodate the DPP / CPP WACC alignment issue).¹²
28. We believe that the two limbs of the CPP fast track should be progressed on different timelines, due to the differing extent of work associated with each limb and the need for some amendments to be completed before others if any amendments are to be applied by intending CPP applicants.
29. We aim to complete the work on the first limb in time to have the final decision and amendments implemented by early November 2015. This will allow suppliers (should they wish to take up the opportunity) to access the flexibility that we anticipate might result from potential amendments in advance of submitting a CPP proposal in the May 2016 CPP window and beyond.

Process

30. Submissions on CPP fast track matters raised concerns about the process for getting to final fast track decisions, and proposed some different options for refining process steps and options.
31. ENA noted that the timetable we proposed on 10 June 2015 allowed only three weeks (a period they considered insufficient to reach draft decision stage) between the anticipated decision on the scope and process of the fast track (initially anticipated for 3 July 2015) and the draft decision (initially anticipated for release by 27 July 2015 so it would be available prior to the IM Forum). It was also concerned that there was no opportunity for external input between scope definition and draft decision stages.

¹¹ Wellington Electricity Lines Limited "Submission on scope of CPP fast track amendments for the IM review" 23 June 2015, at 1; Powerco, above n 9, at 2; Electricity Networks Association, above n 10, at 2.

¹² Only Powerco (above n 9, at 2) noted "*the timeframe for making a final "fast track" decision could be more flexible and extended to later than October 2015 in order to accommodate the DPP / CPP WACC alignment issue*".

32. ENA suggested that the Commission amend its proposed timetable to remove the IM Forum constraint for the draft decision, and ensure that any scope announcement (prior to the IM Forum) be sufficiently detailed so that it is clear to interested parties at the IM Forum what is in and outside of the fast track process, and the nature of the proposed amendments that are in. It considered that the proposed eight week period between cross submissions on the draft decision and final decision allowed for some slippage in the draft decision deadline, and requested that a consultation step is included for feedback on the draft amendment determination.¹³
33. Separately, Powerco suggested that—upon receipt of submissions and with a better understanding of the topics to be reviewed—it may be useful to have time allocated at the IM Forum to discuss some of the more material fast track issues, or that the draft decision on fast track issues could be released after the Commission has had the opportunity to consider the Forum discussion.¹⁴
34. We have refined our process and altered our anticipated timeframes for key process steps from here to get to final fast track decisions on this first limb of the CPP fast track. We announced our decision to commence a CPP fast track process on 21 July 2015 and outlined the scope of the two limbs at that time. We followed this up by outlining additional detail about the CPP fast track at the IM Forum (29/30 July 2015), and allocating time there for us and others to present on some of those fast tracked issues.
35. We intend to issue a draft decision and amendments for the first limb of the CPP fast track by 7 September 2015.¹⁵ Interested persons will then have three weeks to provide submissions on our draft decision and amendments, followed by a further week for cross-submissions. Pushing back these timeframes allows a four week period between cross submissions on the draft decision and the final decision. We believe that our process allows for sufficient time to consider the first limb of the CPP fast track issues and will not limit the ability of interested parties to participate in the consultation.

¹³ Electricity Networks Association, above n 10, at 2.

¹⁴ Powerco, above n 9, at 2.

¹⁵ This timing also staggers our processes and minimises overlapping of deadlines relating to matters that are outside this limb of the CPP fast track process but within the main IM review.

36. Table 1 outlines the indicative dates and submission process for the first limb of the CPP fast track. We will notify interested parties if we decide to alter any part of the fast track process.

Table 1: Indicative dates for the first limb of the CPP fast track process

Process		Indicative time frame
1.	Draft decision and draft input methodology amendments	7 September 2015
2.	Submissions on our draft decision and draft input methodology amendments	25 September 2015
3.	Cross-submissions on our draft decision and draft input methodology amendments	2 October 2015
4.	Final decision and input methodology amendments	9 November 2015

Scope, process and timing for the second limb of the CPP fast track

Scope of limb two amendments

37. The second limb of the fast track process is limited to considering whether amendments to the EDB IMs, GDB IMs, and GTB IMs should be made so that the WACC for CPPs is aligned with the WACC for DPPs (and any consequential amendments that might result from considering and deciding this issue).
38. The WACC alignment issue was discussed in the problem definition paper (Topic 3: Interactions between the DPP and CPP), which highlighted our initial consideration of this area and discussed a number of potential solutions.

Submitters' views on scope of fast track process

39. In its submission of 23 June 2015, Powerco suggested that a possible solution for suppliers who sought a CPP prior to the next DPP reset would be to allow the CPP applicant to apply the prevailing DPP WACC to its CPP proposal, together with a mechanism that adjusted the CPP to include, for the remaining years of the CPP, the effect of the DPP WACC set for the subsequent DPP period. Powerco noted that a fast track amendment of this nature would facilitate its proposed CPP application targeted for May 2016. This was supported by WELL.

40. Further submissions from MEUG and Powerco received on 10 July 2015 noted that the WACC may have interrelationships with other aspects of DPPs or CPPs, such as inflation assumptions. MEUG opposed the inclusion of the WACC alignment issue as part of the scope for the CPP fast track.¹⁶

Our decision to fast track limb two

41. We have decided only to fast track consideration of the narrow question of whether amendments to the EDB IMs, GDB IMs, and GTB IMs should be made so that the WACC for CPPs is aligned with the WACC for DPPs (and any consequential amendments that might result from considering and deciding this issue, such as ensuring consistency of the inflation expectation within the price-quality path).
42. We have made this decision 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.
43. We are satisfied that:
- 43.1 Consideration of this specifically defined issue can be finalised by the end of February 2016; and
- 43.2 Any amendments to the CPP IMs (including consequential amendments that might result from considering and deciding this issue) can be considered separately from any other significant WACC-related issues in the main IM review.
44. Our view of those points raised by MEUG is that the fast-track consideration is limited to which estimate of WACC (as produced by our cost of capital IM) we should use when setting a CPP. MEUG's points went rather to:
- 44.1 Issues relating to the underlying cost of capital methodology applicable to both the DPP and CPP, including its interaction with other topics, how it treats new vs sunk investment, and how it could be tested in the context of a price quality path determination using insights from Black's simple discounting rule. In our view, those issues need to be considered in the full IM Review, and do not prevent us from resolving the question of DPP/CPP WACC alignment ie, they go equally to both the DPP and CPP WACCs.
- 44.2 The substance of the IM change we would be considering, rather than whether to fast track the process.
- 44.3 The merits of any subsequent CPP application by Powerco, which we will consider on receipt of any application.

¹⁶ Major Energy Users Group "Comment on CPP fast track proposal for the input methodologies review" 10 July 2015.

Timing and process

45. Our consideration of the second limb is expected to be completed by the end of February 2016 when a final decision and any IM amendments will be made. This will allow suppliers to make a CPP application applying the amendments in May 2016 and beyond.
46. Interested parties may make submissions on 21 August 2015 and cross-submissions on 4 September 2015 on the issue of how to align the CPP and DPP WACCs.

Table 2: Indicative dates for the second limb of the CPP fast track process

Process		Indicative time frame
1.	Submissions on CPP/DPP WACC alignment	21 August 2015
2.	Cross-submissions on CPP/DPP WACC alignment	4 September 2015
3.	Draft decision and draft input methodology amendments	2 November 2015
4.	Submissions on our draft decision and draft input methodology amendments	27 November 2015
5.	Cross-submissions on our draft decision and draft input methodology amendments	11 December 2015
6.	Final decision and input methodology amendments	29 February 2016

CPP fast track extends to gas pipeline services

47. In our original Notice of Intention published on 10 June 2015, we suggested that the CPP fast track process would only include potential amendments to the CPP IMs for electricity distribution services. Powerco referred to gas pipeline businesses in its submission in relation to making changes to information and process requirements.
48. We have decided to extend the scope to include potential amendments to the IMs relating to CPPs for gas pipeline services. There are two reasons for this:
 - 48.1 Possible improvements considered for the CPP IMs are likely to apply equally to regulated suppliers of gas pipeline services as well as electricity distribution services. Considering amendments across all sectors subject to default/customised price-quality regulation provides the best opportunity for the Commission to understand the potential impacts on all regulated suppliers, and implement any IM amendments once in a cohesive manner.

- 48.2 The IMs are broadly aligned between these sectors at present and we anticipate there to be similar issues involved in each. Thus there are efficiencies in undertaking work on these sectors together. Although the time frames for considering each of the two limbs of the fast track differ, consideration of each limb will be progressed concurrently for electricity distribution services and gas pipeline services for this reason.