Reconsideration of customised price-quality paths of Powerco Limited and Wellington Electricity Lines Limited following change to weighted average cost of capital

Final decision

Date: 31 March 2020
## Associated documents

<table>
<thead>
<tr>
<th>Publication date</th>
<th>Reference</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 December 2016</td>
<td>978-1-869455-48-4</td>
<td>Input methodologies review decisions – Topic paper 4: Cost of capital issues</td>
</tr>
<tr>
<td>28 March 2018</td>
<td>978-1-869456-32-0</td>
<td>Powerco’s customised price-quality path – Final decision</td>
</tr>
<tr>
<td>28 March 2018</td>
<td>978-1-869456-33-7</td>
<td>Wellington Electricity’s customised price-quality path – Final Decision</td>
</tr>
<tr>
<td>5 March 2020</td>
<td>978-1-869457-97-6</td>
<td>Reconsideration of customised price-quality paths of Powerco Limited and Wellington Electricity Lines Limited following change to weighted average cost of capital - consultation paper</td>
</tr>
</tbody>
</table>

Regulation Branch, Commerce Commission
Wellington, New Zealand
Executive Summary

We have decided to amend two customised price-quality path determinations

X1 This paper sets out our decision under section 52Q of the Commerce Act 1986 (Act) to amend:

X1.1 the Wellington Electricity Lines Limited Electricity Distribution Customised Price-Quality Path Determination 2018 [2018] NZCC 6 (Wellington Electricity CPP); and


X2 We have made these amendments after:

X2.1 reconsidering the Powerco CPP and the Wellington Electricity CPP under clause 5.6.7(1)(a) and (2)(e) of the Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26 (EDB IMs). This clause lets us reconsider a CPP after we have determined and published the weighted average cost of capital (WACC) for a new default price-quality path (DPP) regulatory period (WACC change). The purpose and policy intent of this clause, combined with clause 5.6.8(5) of the EDB IMs, is to remove the perverse incentive for an EDB to apply (or not to apply) for a CPP because of a material difference in the CPP and DPP WACC rates;¹ and

X2.2 under section 52Q(1) of the Act, consulting and taking account of submissions and cross-submissions on our draft amendment determinations.²

The amendments align the CPPs’ allowable revenue with a recent WACC change

X3 On 25 September 2019, we determined and published a WACC change for the DPP that will apply for the period 1 April 2020 to 31 March 2025 (DPP3).³

---

When a WACC change triggers our reconsideration of a CPP, clause 5.6.8(5)(a) of the EDB IMs requires us to determine for the remaining disclosure years of the CPP regulatory period:

X4.1 the series of maximum allowable revenue (MAR) after tax; and

X4.2 any consequential changes to the forecast net allowable revenue (FNAR).

Our amendment determinations provide for the requirements of clause 5.6.8(5)(a) of the EDB IMs by, for the CPPs’ remaining disclosure years, amending the MAR after tax and making consequential changes to the FNAR.

Additionally, after reconsidering a CPP and determining that it should be amended, under clause 5.6.8(1) of the EDB IMs, we may amend either or both of the CPP’s price path or quality standards and quality incentive measures. As we explain later in this paper, CPP amendments we propose to make under clause 5.6.8(1) must comply with the requirements of clause 5.6.8(2) and (3)(a) of the EDB IMs.

After considering submissions and cross-submissions on our draft decision paper, we have decided:

X7.1 to apply clause 5.6.8(1) of the EDB IMs and amend the CPPs to align the actual net allowable revenue (ANAR) for the CPPs’ remaining disclosure years with the WACC change. This includes making other minor consequential changes to the CPPs to provide for the amended ANAR; and

X7.2 these amendments, along with the amendments required under clause 5.6.8(5)(a) of the EDB IMs, are reasonably necessary under clause 5.6.8(3)(a) to take account of the change in costs arising from the DPP3 WACC change.

In amending the CPPs under clause 5.6.8(1) and (5)(a), we have also complied with the requirements of clause 5.6.8(2) and (5)(b) of the EDB IMs.

As detailed in this paper, this approach to the amendment determinations:

X9.1 gives effect to the policy intent of clause 5.6.7(1)(a) and (2)(e) and clause 5.6.8(5)(a) of the EDB IMs by ensuring:

X9.1.1 the allowable revenues under the CPPs reflect a WACC change applying to the relevant disclosure years; and

X9.1.2 there is no incentive to apply or not apply for a CPP based on a difference between the CPP and DPP WACC rates; and

In this cost of capital determination, we reduced the vanilla WACC for EDBs in DPP3, and for Transpower New Zealand Limited under its 2020-2025 individual price-quality path, from 7.19% to 4.57%.

See paragraph 2.9 and chapter 5 of this paper.

See chapter 5 of this paper.

Above n 1.
X9.2 aligns the CPPs’ allowable revenues with the DPP3 WACC change within the CPPs’ regulatory periods in a single, simple amendment; and

X9.3 goes no further than permitted by the constraints under clause 5.6.8(2), (3), and (5)(b) of the EDB IMs.

X10 Our amendment determinations will come into effect on 31 March 2020.

After considering submissions, we have decided not to proceed with our proposed three-part solution for dealing with the problem relating to clause 5.6.8(5)(a) of the EDB IMs

X11 We explained in our draft decision paper that, after a WACC change reconsideration under the EDB IMs, clause 5.6.8(5)(a) does not provide for us to make consequential changes to a CPP’s ANAR to reflect the WACC change. We said this was problematic because, if a CPP’s ANAR does not reflect a WACC change, this can lead to the relevant electricity distribution business’s (EDB) prices not reflecting that WACC change.

X12 Our draft decision paper sought interested parties’ views on the first part of our proposed three-part solution for dealing with the impact of this problem.8

X13 We are grateful to interested parties for the time and effort they put into engaging with us and submitting on our draft decision paper.9 After having regard to submissions and cross-submissions, and for the reasons summarised in paragraph X9 above and detailed further in this paper, we have decided not to proceed with our proposed three-part solution.

X14 This paper outlines the submissions and cross-submissions we received, our consideration and analysis of those submissions and cross-submissions, and the reasons for our decision on the amendment determinations.

Accompanying material

X15 Alongside this paper, we have published on our website our final reconsideration models and final amendment determinations to the Powerco CPP and Wellington Electricity CPP, which, as noted above, will come into effect on 31 March 2020.

---

7 See draft decision paper, above n 2, at chapter 4.
8 The first part of our proposed solution was to reduce the FNAR for the remaining disclosure years of the Wellington Electricity CPP and Powerco CPP to the before-tax MAR value that would reflect the DPP3 WACC change. For more details, see our draft decision paper, above n 2, at chapter 5.
1. **Introduction**

*We have amended two CPP determinations*

1.1. Under clause 5.6.7(1) and (2)(e) of the EDB IMs, we may reconsider a CPP after we have determined and published a WACC change. As outlined above, the purpose and policy intent of clauses 5.6.7(1), (2)(e), and 5.6.8(5) of the EDB IMs is to remove the perverse incentive for an EDB to apply (or not apply) for a CPP because of a material difference in the CPP and DPP WACC rates.\(^{10}\)

1.2. Under the relevant definition in clause 5.6.7(4) of the EDB IMs, a ‘WACC change’ occurred on 25 September 2019, because:

1.2.1. we determined and published the 67<sup>th</sup> percentile estimate of WACC for the DPP that will apply for DPP3;\(^{11}\) and

1.2.2. DPP3 will overlap with the regulatory periods of:

(a) the Wellington Electricity CPP;\(^{12}\) and

(b) the Powerco CPP.\(^{13}\)

1.3. When a WACC change triggers our reconsideration of a CPP, clause 5.6.8(5)(a) of the EDB IMs requires us to determine for the remaining disclosure years of the CPP regulatory period:

1.3.1. the series of MAR after tax; and

1.3.2. any consequential changes to the FNAR.

1.4. In determining the matters under clause 5.6.8(5)(a), we must use the components set out in clause 5.6.8(5)(b) of the EDB IMs.

1.5. Additionally, after reconsidering a CPP and determining that it should be amended, under clause 5.6.8(1) of the EDB IMs, we may amend either or both of the CPP’s price path or quality standards and quality incentive measures. Under clause 5.6.8(2) and (3)(a) of the EDB IMs, in determining any such amendment, we must, respectively:\(^{14}\)

1.5.1. take into account the expenditure objective;\(^{15}\) and

1.5.2. not amend the price path more than is reasonably necessary to take account of a change in costs net of any insurance or compensatory entitlements.

---

\(^{10}\) Above n 1.

\(^{11}\) Above n 2.

\(^{12}\) The Wellington Electricity CPP’s regulatory period is from 1 April 2018 to 31 March 2021.

\(^{13}\) The Powerco CPP’s regulatory period is from 1 April 2018 to 31 March 2023.

\(^{14}\) The requirements under clause 5.6.8(2) and (3)(a) of the EDB IMs also apply to amendments to the MAR after tax and FNAR under clause 5.6.8(5)(a) of the EDB IMs.

\(^{15}\) Under clause 1.1.4(2) of the EDB IMs, ‘expenditure objective’ means “objective that capital expenditure and operating expenditure reflect the efficient costs that a prudent non-exempt EDB would require to-(a) meet or manage the expected demand for electricity distribution services, at appropriate service standards, during the CPP regulatory period and over the longer term; and (b) comply with applicable regulatory obligations associated with those services”. 
1.6. Under clause 5.6.7(1)(a) and (2)(e) of the EDB IMs, we have reconsidered the Wellington Electricity CPP and the Powerco CPP. Under section 52Q of the Act:

1.6.1. as required by clause 5.6.8(5)(a) of the EDB IMs, we have amended the MAR after tax and FNAR for the remaining disclosure years of the two CPP determinations; and

1.6.2. we have applied clause 5.6.8(1) of the EDB IMs and aligned the ANAR for the CPPs’ remaining disclosure years with the DPP3 WACC change. As we explain in chapter 6 of this paper, this involves making other minor consequential changes to the CPPs to:

(a) provide for the amended ANAR; and

(b) comply with the requirements for ANAR under clause 3.1.3(13)(h) and (i) of the EDB IMs.

1.7. As outlined in chapter 5 of this paper, in amending the CPPs under clause 5.6.8(1) and (5)(a), we have complied with the requirements of clause 5.6.8(2), (3)(a), and (5)(b) of the EDB IMs.

1.8. We consider the amendment determinations give effect to the purpose and policy intent of the EDB IM provisions specified above by ensuring:

1.8.1. the allowable revenues for the remaining disclosure years of the Powerco CPP and Wellington Electricity CPP reflect the WACC change; and

1.8.2. there is no incentive to apply or not apply for a CPP based on a difference between the CPP and DPP WACC rates.

After considering submissions, we have decided to adopt a simpler and more appropriate approach rather than proceeding with the three-part solution proposed in our draft decision paper

1.9. Our draft decision paper detailed a problem we identified in clause 5.6.8(5)(a) of the EDB IMs that affects the allowable revenue under the Wellington Electricity CPP and the Powerco CPP.

1.10. The problem is that, following a WACC change reconsideration under the EDB IMs, clause 5.6.8(5)(a) does not permit us to make consequential changes to a CPP’s ANAR to reflect the WACC change. Under the EDB IMs and the CPPs, the ANAR for a disclosure year forms part of an EDB’s forecast allowable revenue for a subsequent disclosure year, which is the basis on which the EDB sets its prices.\(^\text{17}\) As we explained in chapter 4 of our draft decision paper, if ANAR does not reflect a WACC change, this results in a forecast allowable revenue that also does not reflect the WACC change, which in turn can result in prices that do not reflect the WACC change.

---

\(^{16}\) This paper explains our justification under clause 5.6.8(1) of the EDB IMs for determining that the CPPs should be amended, and why our amendment determinations comply with clause 5.6.8(2) and (3)(a) of the EDB IMs, at chapter 5.

\(^{17}\) Clause 3.1.1(1) of the EDB IMs.
1.11. Our draft decision paper put forward a three-part solution to this problem and sought interested parties’ views on the first part of the proposed solution.\textsuperscript{18} Consistent with clause 5.6.8(5)(a) of the EDB IMs, the first part of our proposed solution was to amend the FNAR of the remaining disclosure years:

1.11.1. under Schedule 1.3 of the Wellington Electricity CPP; and
1.11.2. under Schedule 1.3 of the Powerco CPP.

1.12. We received submissions on our draft decision paper from each of Powerco Limited (Powerco), Wellington Electricity Lines Limited (Wellington Electricity), and the Electricity Networks Association (ENA). Powerco and Wellington Electricity also submitted cross-submissions on matters raised in each other’s submissions. As summarised at chapter 3 of this paper, all submitters expressed the view in their submissions and cross-submissions that our proposed solution was unnecessarily complex, time-consuming, and administratively burdensome.

1.13. Submitters instead advocated that we take a simpler, timelier approach. Of the alternative approaches submitters put forward, we consider that an approach recommended by both Powerco and Wellington Electricity – applying clause 5.6.8(1) of the EDB IMs to amend the CPPs’ ANAR to reflect the WACC change – is the most appropriate. This is because the recommended alternative approach would give full effect to the DPP3 WACC change within each CPP’s regulatory period. Consistent with section 52R of the Act, this would best promote regulatory certainty and predictability under our CPP regulatory regime.\textsuperscript{19}

1.14. Coupled with the amendments required under clause 5.6.8(5) of the EDB IMs, applying the recommended alternative approach would align the allowable revenues for the CPPs’ remaining disclosure years with the WACC change. As we discuss in chapter 4 of this paper, this would give effect to the policy intent of the WACC change provisions noted above within the CPPs’ regulatory periods. We have accordingly adopted this approach instead of proceeding with the three-part solution proposed in our draft decision paper.

1.15. The next chapter summarises the reconsideration framework under our regulatory regime. The following chapters then outline submitters’ views, our consideration and analysis of the submissions and cross-submissions, and the reasons behind our decision.

2. Reconsideration framework

The statutory framework for reconsidering and amending a CPP after a WACC change

2.1. This chapter sets out the statutory context and legal framework under which we may reconsider and amend a CPP after a WACC change.

\textsuperscript{18} Our draft decision paper also signalled the second and third parts of our proposed solution and outlined our intention of consulting on the second and third parts at the appropriate points in time.

\textsuperscript{19} Section 52R of the Act states that the purpose of the input methodologies is to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of goods or services under Part 4 of the Act.
2.2. CPPs are determined on an *ex-ante* basis and apply for a regulatory period of 5 years, though we may set a shorter period than 5 years if we consider doing so would better meet the purpose of Part 4 under section 52A of the Act. In any event, we may not set a regulatory period of less than 3 years.

2.3. Once determined, a CPP may not be reconsidered (or reopened) within a regulatory period except in limited circumstances, which include the identified circumstances in which they may be reconsidered under the input methodologies made under section 52T(1)(c)(ii) of the Act.

2.4. As required under section 52T(1)(c)(iii) of the Act, we determined input methodologies identifying the circumstances in which a CPP may be reconsidered within a regulatory period in Subpart 6 of Part 5 of the EDB IMs.

2.5. Under clause 5.6.7(1) and (2)(e) of the EDB IMs, one of the circumstances under which we may reconsider a CPP is if there has been a WACC change (WACC change reopener).

2.6. When the WACC change reopener applies, clause 5.6.8(5)(a) of the EDB IMs requires us to determine for the remaining disclosure years of the CPP regulatory period:

- the series of MAR after tax; and
- any consequential changes to the FNAR.

2.7. In determining the series of MAR after tax and any consequential changes to the FNAR arising from the WACC change, we must use the components set out in clause 5.6.8(5)(b) of the EDB IMs.

2.8. After reconsidering a CPP and determining that it should be amended, clause 5.6.8(1) of the EDB Ms lets us amend either or both of the CPP’s price path or quality standards and quality incentive measures. As Powerco and Wellington Electricity advocated in their submissions, in this context, we view:

- clause 5.6.8(5)(a) as specifying the CPP amendments we must make under a WACC change reopener; and
- clause 5.6.8(1) as enabling us to make additional amendments to give effect to the WACC change.

2.9. Our scope for amending a CPP under a WACC change reopener is not unconstrained. In determining such amendments, clause 5.6.8(2), (3)(a), and (5)(b) of the EDB IMs requires us to, respectively:

- take into account the expenditure objective in determining the extent of any amendment to the price path;

---

20 Section 53W(1) of the Act.
21 Section 53W(2) of the Act.
22 Sections 52T(1)(c)(ii) and 53ZB of the Act.
23 Clause 5.6.8 of the EDB IMs is set out in full at Attachment A.
24 Powerco submission, at Attachment 2, page 5; and Wellington Electricity submission, at page 5.
2.9.2. not amend the price path more than is reasonably necessary to take account of a change in costs net of any insurance or compensatory entitlements; and

2.9.3. in amending the MAR after tax and FNAR for the remaining disclosure years of the CPP, use specified components.

2.10. These EDB IM provisions therefore work together and ensure that:

2.10.1. we can make all necessary amendments to a CPP to give effect to the policy intent behind the WACC change reopener described below; and

2.10.2. amendments we make to a CPP’s price path:

   (a) properly take account of the expenditure objective;

   (b) do not amend the price path more than is reasonably necessary to take account of a change in costs; and

   (c) in the case of changes to the MAR after tax and FNAR, reflect the components specified in clause 5.6.8(5)(b) of the EDB IMs.

**Our policy intent behind the WACC change reopener**

2.11. In our decisions resulting from the 2016 review of the input methodologies, we outlined the problem the WACC change reopener sought to address:

Divergence between the revised WACC that applied to CPPs and a supplier’s WACC under a DPP may create perverse incentives for a supplier to either apply or not apply, for a CPP.

2.12. In terms of resolving the identified problem, we explained that aligning the CPP WACC with the DPP WACC:

[would] significantly limit the incentive problems that can occur when application of a CPP coincides with significant differences between the CPP and DPP WACC rate. Fluctuations in interest rates [for example] will, therefore, no longer be a significant consideration in whether a supplier applies for a CPP or not....

...We consider the most practical approach that minimises the risk of applications that are not in the long-term interests of consumers is to apply DPP WACCs to CPPs.

3. **Submitters advocated a simpler approach than that proposed in our draft decision paper**

All submitters understood the need to align ANAR with the WACC change, but disagreed with the three-part solution proposed in our draft decision paper

3.1. All submitters recognised that, alongside the changes required under clause 5.6.8(5)(a) of the EDB IMs, amending ANAR is a necessary step to give effect to a WACC change. Powerco and Wellington Electricity both understood that.

---

25 Documents relating to our process, consultation, decisions and determinations from the 2015/16 review of the input methodologies are available at: https://comcom.govt.nz/regulated-industries/input-methodologies/projects/201516-im-review.

26 Above n 1, at para 607.

27 Above n 1, at paras 616 and 622.

28 Powerco submission, at page 1; and Wellington Electricity submission, at page 2.
unaddressed, the WACC change reopener provisions would produce unintended windfall gains arising from the wash-up mechanism under the EDB IMs.

3.2. However, all submitters disagreed with the three-part solution proposed in our draft decision paper:

3.2.1. the ENA considered our proposal to be a complex approach to achieving alignment between the DPP and CPP WACC rates;\(^{29}\)

3.2.2. Powerco considered our proposal “an adequate workaround to achieve the [desired] outcome, but it comes at a significant cost”, noting that “[t]here are a number of secondary impacts – some predictable and some not – which will impact our customers and us”;\(^ {30}\) and

3.2.3. Wellington Electricity submitted our proposal “to ‘work around’ the error in the [EDB IMs] does not address the underlying error and creates perverse outcomes for all stakeholders.”\(^ {31}\)

3.3. In their submissions, Powerco and Wellington Electricity detailed their views on the likely implications of our proposed three-part solution, which:

3.3.1. according to Powerco, included:\(^ {32}\)

(a) Powerco “bear[ing] the cost (potentially millions) of the mismatch between actual and forecast CPI hard-coded in the estimation of ...ANAR [for the 2020/21 disclosure year]”;\(^ {32}\)

(b) “reduc[ing] the coherence and elegance of the [FNAR] and [ANAR] mechanisms as they have been, and are expected to apply”;\(^ {32}\)

(c) “requir[ing] adjustments to Powerco[’s allowable revenue in the transition to DPP3 and again at the following DPP reset]... solely attributable [to the three-part solution]. This reduces regulatory certainty because adjustments will be needed”;\(^ {32}\)

(d) “creat[ing] an administrative burden on the Commission and Powerco for several years and across two regulatory resets”;\(^ {32}\) and

(e) creating “a mismatch between the trigger and amount of revenue forgone in relation to the 20% limit on the revenue reduction percentage”;\(^ {32}\)

3.3.2. according to Wellington Electricity, included:\(^ {33}\)

(a) “…price volatility for customers [including estimated] ...annual distribution price fluctuations of between 3% and 17%”;

(b) “…cash flow volatility for [Wellington Electricity] and Powerco. Both [Wellington Electricity] and Powerco would receive revenue that does not reflect their underlying costs”; and

\(^{29}\) ENA submission, at page 1.

\(^{30}\) Powerco submission, at page 1.

\(^{31}\) Wellington Electricity submission, at page 1.

\(^{32}\) Powerco submission, at Attachment 1, pages 2 to 4.

\(^{33}\) Wellington Electricity submission, at pages 1 to 4.
Submitters advocated simpler alternative approaches, including amending ANAR under clause 5.6.8(1) of the EDB IMs

3.4. Submitters put forward two main alternative approaches to our proposed three-part solution:

3.4.1. applying clause 5.6.8(1) of the EDB IMs and, under section 52Q of the Act, amending the ANAR for the CPPs’ remaining disclosure years to reflect the WACC change (first alternative approach);\(^{34}\) and

3.4.2. amending clause 5.6.8(5)(a) of the EDB IMs to enable amendments to CPPs’ ANAR, and, applying the amended clause 5.6.8(5)(a) to the Powerco CPP and Wellington Electricity CPPs (second alternative approach).\(^{35}\)

3.5. Submitters gave several reasons in support of each of the two main alternative approaches, including:

3.5.1. regarding the first alternative approach:

(a) Powerco considered this to be the simplest way forward, enabling us to make all changes reasonably necessary to achieve the outcome all stakeholders expected from the WACC change reopener, and consequently promoting regulatory certainty;\(^ {36}\)

(b) Powerco submitted that the scheme of clause 5.6.8(1), (3), and (5) of the EDB IMs makes sense: “as we are discovering, regulation is complex and having a general power to make all changes reasonably necessary (but no more) is a useful part of the framework and an important part of delivering on regulatory certainty and predictability, giving the Commission and the EDB the ability to deliver the outcome stakeholders expect from the reconsideration”;\(^ {37}\)

(c) in Powerco’s view, implementing the first alternative approach would be consistent with the fact that, “[as] a practical matter, not all the CPP...changes needed to deliver on a reconsideration could be identified upfront in the [EDB] IMs. And indeed, for most of the reconsideration triggers, none of the CPP...changes were signalled ahead of time[,] and all...the work is done under the [clause 5.6.8(1) and (3)] general power provisions”;\(^ {38}\) and

(d) Wellington Electricity supported both main alternative approaches, stating that “[t]he amendments are simple, cost efficient, unlikely to have unexpected outcomes and are similar to what the Commission would

---

\(^{34}\) Wellington Electricity submission, at page 5; and Powerco submission, at page 5.

\(^{35}\) Wellington Electricity submission, at page 5; Powerco submission, at pages 6 and 7; and ENA submission, at pages 1 and 2.

\(^{36}\) Powerco submission, at page 5.

\(^{37}\) Ibid.

\(^{38}\) Ibid.
have originally drafted had they been aware of the error [in clause 5.6.8(5)(a)]. 39

3.5.2. regarding the second alternative approach:

(a) the ENA “strongly recommend[ed we]...consider an [EDB] IM amendment to address the issue, to ensure the intended policy can be readily implemented in amending the CPPs,” 40

(b) the ENA considered that “[m]aking an [EDB] IM amendment to correct an error would not be seen as undermining confidence and certainty in the regime. To the contrary, fixing an error in the drafting of the [EDB] IMs to ensure the policy intent is being achieved would add certainty and confidence in the regime”, 41

(c) in Wellington Electricity’s view, “[a]llowing for corrections to [the] drafting error [in clause 5.6.8(5)(a)] now, in order to achieve the policy intent [of the WACC change reopener], will not undermine regulatory certainty. We would suggest that the opposite is true...”; 42

(d) Wellington Electricity noted that “[t]he [EDB] IMs will have to be changed at some stage to correct the error. [We] believe the change should be made now to maintain consistency of the wash-up calculation over...time. If the change to the [EDB] IMs is made now, temporary work arounds in the Powerco CPP...and potentially [Wellington Electricity]’s DPP3 determination...can be avoided”; 43

(e) both Wellington Electricity and Powerco submitted there are other instances under the Act in which we can amend the EDB IMs outside of the seven-year review cycle under section 52Y of the Act; 44

(f) in Powerco’s view, this approach would be “in the nature of [an] error correction, not a change to the substantive nature of the price-quality [path]”; 45 and

(g) Powerco did not see this “as creating the regulatory rules as they are applied[,] but [rather, as] an essential part of the reconsideration exercise – delivering on the changes needed to give the outcome of the reconsideration that stakeholders expect.” In this respect, Powerco reiterated that “[r]egulatory certainty and credibility comes from delivering on the outcome stakeholders expect from the reconsideration.” 46

39 Wellington Electricity submission, at page 5.
40 ENA submission, at page 1.
41 ENA submission, at pages 1 and 2.
42 Ibid.
43 Wellington Electricity submission, at page 7.
44 Wellington Electricity submission, at page 5; Powerco submission, at page 6.
45 Powerco submission, at page 6.
46 Ibid, at page 7.
3.6. Wellington Electricity submitted there were several advantages that applied to both alternative approaches:\(^{47}\)

3.6.1. they would avoid consumer price shocks and maintain price stability;

3.6.2. they would maintain the intent and form of the CPPs’ revenue cap under the EDB IMs;

3.6.3. they would deliver a pragmatic and sensible outcome consistent with how the WACC change reopener would have worked without the problem in clause 5.6.8(5)(a) of the EDB IMs;

3.6.4. they would maintain certainty in and the credibility of the regulatory framework by giving effect to the WACC change reopener’s policy intent and avoiding price volatility;

3.6.5. they would avoid regulatory complexity and maintain the relationship between FNAR and underlying costs; and

3.6.6. they would address the problem with clause 5.6.8(5)(a) within the CPPs’ regulatory periods.

Submitters’ cross-submissions endorsed arguments made in submissions favouring alternative approaches

3.7. In their cross-submissions, Powerco and Wellington Electricity reiterated points raised in submissions in favour of us adopting one of the two alternative approaches advocated by both CPP parties over the three-part solution proposed in our decision paper.

3.8. Powerco reiterated the need for an approach that is pragmatic and easy to understand and implement, noting that both CPP parties’ submissions highlighted the confusion and other potential negative effects of our proposed three-part solution. Powerco emphasised that taking a simpler, more practical approach now would deliver value to customers in the longer term.\(^ {48}\)

3.9. In its cross-submission, Wellington Electricity endorsed the implications and effects Powerco identified in its submission as arising from our proposed three-part solution and affecting Powerco and its stakeholders. Wellington Electricity considered that some of these implications and effects were unique to Powerco, but others were relevant to Wellington Electricity and additional to the issues raised in its submission.\(^ {49}\) Wellington Electricity further underlined the uncertainty and vulnerability to unintended outcomes that it considered was inherent in our proposed three-part solution.\(^ {50}\)

3.10. The next chapter sets out our analysis of the points raised in the submissions and cross-submissions, along with our decision on how we will proceed.

---

\(^{47}\) Wellington Electricity submission, at pages 6 and 7.

\(^{48}\) Powerco cross-submission, at page 1.

\(^{49}\) Wellington Electricity cross-submission, at page 1.

\(^{50}\) Wellington Electricity cross-submission, at page 2.
4. We have adopted submitters’ first alternative approach

We consider submitters’ first alternative approach provides a simpler, timelier, and more effective solution than that proposed in our draft decision paper.

4.1. We agree with the views expressed in submissions and cross-submissions that the first alternative approach provides a simpler, timelier, and more effective solution than that proposed in our draft decision paper. Specifically, by giving full effect to the DPP3 WACC change within each CPP’s regulatory period, the first alternative approach would best promote regulatory certainty and predictability under our CPP regulatory regime – consistent with section 52R of the Act.\(^{51}\)

4.2. Under clause 5.6.8(1) of the EDB IMs, the first alternative approach would amend the ANAR for the CPPs’ remaining disclosure years. Combined with the required amendments to the MAR after tax and FNAR under clause 5.6.8(5)(a) of the EDB IMs, this would serve to apply the DPP3 WACC change to the allowable revenues under the CPPs, within the CPPs’ regulatory periods.

4.3. We agree with and adopt Powerco’s view that:

4.3.1. applying the first alternative approach (as above) would give effect to the WACC change reopener’s policy intent, deliver the outcome stakeholders expected, and consequently promote regulatory certainty;\(^{52}\)

4.3.2. in the context of a WACC change reopener, applying clause 5.6.8(1) of the EDB IMs in the manner submitters proposed\(^{53}\) would promote regulatory certainty and predictability by delivering the outcome stakeholders expect from the reconsideration;\(^{54}\)

4.3.3. applying clause 5.6.8(1) here would be consistent with the fact that, for reasons of practicality, the EDB IMs in most cases do not prescribe the changes that can or must be made to a CPP under a CPP reconsideration.\(^{55}\) In such cases, any changes to a CPP are therefore made under clause 5.6.8(1);\(^{56}\) and

4.3.4. clause 5.6.8(3) of the EDB IMs constrains our scope for amending a CPP under clause 5.6.8(1).\(^{57}\)

4.4. We likewise agree with Wellington Electricity’s submission and cross-submission that, compared with our proposed three-part solution, the first alternative approach

\(^{51}\) Above n 19.

\(^{52}\) Powerco submission, at page 5.

\(^{53}\) That is, in a manner that complies with clause 5.6.8(2) and (3)(a) of the EDB IMs.

\(^{54}\) Powerco submission, at page 5, and, Powerco cross-submission, at page 1.

\(^{55}\) For example, for a reconsideration triggered by a change event (clause 5.6.7(1) and (2)(b)), an error event (clause 5.6.7(1) and (2)(c)), or a major transaction (clause 5.6.7(1) and (2)(d)), the EDB IMs do not specify the amendments that can or must be made to a CPP.

\(^{56}\) Powerco submission, at page 5.

\(^{57}\) Ibid, at pages 5 and 6. We note too that after reconsidering a CPP, but before amending the CPP:

- clause 5.6.8(1) itself requires us to first determine that the CPP should be amended; and
- clause 5.6.8(2) requires that, in determining the extent of any amendment to a CPP’s price path, we must take account of the expenditure objective.

Our analysis showing how we have applied these two requirements in this case is set out at chapter 5 of this paper.
is simpler, more cost efficient, less prone to unexpected outcomes, and closer to what we originally intended under the EDB IMs.\textsuperscript{58}

4.5. For these reasons, we consider that adopting and applying the first alternative approach would enhance the regulatory certainty and predictability of the CPP regime, as sought by section 52R of the Act. Additionally, consistent with clause 5.6.8(3)(a) of the EDB IMs, the CPP amendments under clause 5.6.8(1) are reasonably necessary to take account of the change in costs arising from the DPP3 WACC change.

4.6. We consider that, consistent with the desired outcomes under section 52A(1)(b) and (d) of the Act,\textsuperscript{59} the first alternative approach would, by aligning the allowable revenue under the CPPs with the DPP3 WACC change:

4.6.1. reduce incentives to apply for a CPP when it is not in consumers’ long-term interests (ie, to seek higher revenue allowances based on differences in the applicable WACC rate)\textsuperscript{60}—which also gives effect to the policy intent behind the WACC change reopener;\textsuperscript{61}

4.6.2. direct incentives towards improving efficiency and providing services at a quality that reflects consumer demands, rather than pursuing higher revenue allowances from a higher WACC rate when costs have not changed;\textsuperscript{62} and

4.6.3. limit the ability to extract excessive profits by aligning allowable revenues under the CPPs with the lower DPP3 WACC rate.\textsuperscript{63}

\textbf{We prefer the first alternative approach to the second alternative approach}

4.7. We acknowledge the view all submitters expressed that, by amending clause 5.6.8(5)(a) of the EDB IMs, the second alternative approach would involve directly fixing the problem with that provision.

4.8. We agree with:

4.8.1. all submitters’ view that, rather than undermine regulatory certainty, fixing the problem with clause 5.6.8(5)(a) under this approach would promote

\textsuperscript{58} Wellington Electricity submission, at page 5, and, Wellington Electricity cross-submission at pages 1 and 2.

\textsuperscript{59} Under section 52A(1) of the Act, the purpose of Part 4 of the Act is to promote the long-term benefit of consumers in markets referred to in section 52 of the Act by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services— (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and (d) are limited in their ability to extract excessive profits.

\textsuperscript{60} This is consistent with section 52A(1)(d) of the Act, because it limits EDBs’ abilities to extract excessive profits by taking advantage of a higher WACC rate under a CPP when costs have not changed.

\textsuperscript{61} Above n 1.

\textsuperscript{62} This is consistent with section 52A(1)(b) of the Act.

\textsuperscript{63} This is consistent with section 52A(1)(d) of the Act.
regulatory certainty by enabling the WACC change reopener to deliver its policy intent; and

4.8.2. the submission from Wellington Electricity and Powerco that there are other contexts under the Act in which we can amend the EDB IMs outside the seven-year review cycle under section 52Y of the Act.

4.9. We prefer the first of the two alternative approaches primarily for practical reasons. In particular, under the second alternative approach, amending the FNAR, ANAR, and MAR after tax for the two CPPs’ remaining disclosure years before the 2020/21 disclosure year would require us to:

4.9.1. under section 52X of the Act, amend clause 5.6.8(5)(a) of the EDB IMs; and

4.9.2. apply the amended clause 5.6.8(5)(a) of the EDB IMs to amend the FNAR, ANAR, and MAR after tax for the two CPPs’ remaining disclosure years.

4.10. Amending the EDB IMs under section 52X would require consultation with interested persons. To ensure that we give effect to the WACC change reopener’s policy intent, we consider it necessary to align the CPP parties’ allowable revenue for the 2020/21 disclosure year with the DPP3 WACC change before that disclosure year starts (1 April 2020). We consider that amending the EDB IMs prior to the 2020/21 disclosure year would not give interested persons a reasonable opportunity to give their views on any draft EDB IMs we propose under the second alternative approach. By contrast, implementing the first alternative approach only requires us to:

4.10.1. analyse and apply clause 5.6.8(1), (2), and (3)(a) of the EDB IMs; and

4.10.2. provided the amendments comply with clause 5.6.8(2) and (3)(a), under section 52Q of the Act, amend the ANAR for the CPPs’ remaining disclosure years.

4.11. We consider the above steps under the first alternative approach are achievable before the start of the 2020/21 disclosure year.

4.12. For the reasons set out in this chapter, we have decided to adopt and implement the first alternative approach instead of the three-part solution proposed in our draft decision paper.

5. In amending the CPPs, we have complied with clause 5.6.8(1), (2), (3)(a) and (5)(b) of the EDB IMs

Under clause 5.6.8(1) of the EDB IMs, we have determined that the CPPs’ ANAR should be amended to reflect the DPP3 WACC change

5.1. After reconsidering a CPP, but before amending the CPP, clause 5.6.8(1) requires us to first determine that the CPP should be amended.

5.2. Under clause 5.6.8(1), we consider that the CPP should be amended in line with the first alternative approach. This is because applying clause applying clause 5.6.8(5)(a)

---

64 Above n 1, and, Wellington Electricity’s cross-submission, at page 2.
65 Above n 1.
66 As required under section 52V(2)(b) of the Act.
of the EDB IMs would not, by itself, properly give effect to the policy intent of the WACC change reopener. We adopt the view put forward in submissions and cross-submissions that the first alternative approach, combined with the required amendments under clause 5.6.8(5)(a), would better achieve this.

5.3. Similarly:

5.3.1. for the reasons set out above at paragraph 4.6, implementing the first alternative approach would promote the desired outcomes under section 52A(1)(b) and (d) of the Act by aligning the allowable revenue under the CPPs with the DPP3 WACC change; and

5.3.2. applying the EDB IMs in line with the first alternative approach would promote the purpose of the EDB IMs under section 52R of the Act by giving certainty to EDBs and stakeholders concerning the effect of a WACC change on a CPP.

Our amendment determinations comply with clause 5.6.8(2), (3)(a), and (5)(b) of the EDB IMs

5.4. Applying clause 5.6.8(2) and (3)(a), respectively, our amendments to the two CPPs’ MAR after tax and FNAR under clause 5.6.8(5) and the ANAR under clause 5.6.8(1):

5.4.1. clause 5.6.8(2): take account of the expenditure objective by ensuring the allowable revenue for the remaining disclosure years of the two CPPs reflects the DPP3 WACC change. In practical terms, this aligns the two CPPs’ WACC rate with the lower DPP3 WACC rate, resolving unintended windfall effects. Similarly, amending the two price paths in the manner proposed would encourage the CPP parties to make capital and operating expenditure decisions that reflect the efficient costs that a prudent non-exempt EDB would make to meet or manage the expected demand for electricity distribution services, at appropriate service standards, during the CPPs’ regulatory periods; and

5.4.2. clause 5.6.8(3)(a): do not amend either of the two price paths more than is reasonably necessary to take account of the CPP parties’ change in costs. Rather, by aligning the CPPs’ WACC rate with the DPP3 WACC rate, the amendments ensure the CPP parties do not benefit from a WACC rate that is higher than the DPP3 WACC rate, reflecting, ex ante, the estimated change in the CPP parties’ capital costs.

5.5. The final reconsideration models published on our website alongside this paper demonstrate our application of the components listed in clause 5.6.8(5)(b) of the EDB IMs to, under clause 5.6.8(5)(a), determine the series of MAR after tax and the consequential changes to the FNAR for the remaining disclosure years of the two CPPs.
6. Amending ANAR involves making other minor consequential changes to the CPPs

To amend ANAR for the CPPs’ remaining disclosure years, we must amend the FNAR for the first disclosure year of each CPP’s regulatory period

6.1. Clause 3.1.3(13)(h) and (i) of the EDB IMs defines a CPP’s ANAR as, respectively:

- for the first disclosure year of a regulatory period, the FNAR for that disclosure year as specified under clause 3.1.1(6); and

- for each disclosure year of the regulatory period after the first disclosure year, an amount calculated under a CPP by applying-
  
  (a) the ANAR for the preceding disclosure year;
  
  (b) the CPI in place of the forecast CPI to the extent that forecast CPI was applied in setting prices for the disclosure year under with clause 3.1.1(7); and
  
  (c) the X factor that was used when the FNAR was originally determined for the disclosure year under clause 3.1.1(7).

6.2. Under these provisions, ANAR for a CPP’s second disclosure year onwards draws on the FNAR for the first disclosure year\(^{67}\) (applying CPI and the X factor) of the regulatory period. This means that amending ANAR in a way that gives effect to the DPP3 WACC change and complies with the EDB IMs requires us to amend each CPP’s FNAR for the first disclosure year. Putting this another way:

- combining the amended FNAR for the first disclosure year\(^ {68}\) with CPI and the X factor enables the calculation of ANAR for the second disclosure year, consistent with clause 3.1.3(13)(i) of the EDB IMs; and

- this in turn enables the calculation of ANAR for the following disclosure year onwards, which, like ANAR for the second disclosure year, relies on ANAR for the preceding disclosure year (applying CPI and the X factor) under clause 3.1.3(13)(i).

6.3. As outlined below, providing for the approach immediately above entails making several other minor consequential CPP amendments to:

- accommodate amending the FNAR for the first disclosure year of each CPP; and

- ensure that there are no other implications for, or changes to, other provisions under each CPP.

**Amending the FNAR for the first disclosure year of each CPP’s regulatory period involves making minor adjustments to other CPP provisions relating to ANAR**

6.4. In amending the FNAR for the first disclosure year of each CPP’s regulatory period:

---

\(^{67}\) Under clause 3.1.3(13)(h) of the EDB IMs, the ANAR for the first disclosure year of the regulatory period is the FNAR for that disclosure year.

\(^{68}\) Ibid.
clause 3.1.1(6) of the EDB IMs requires us to specify the FNAR at the start of a regulatory period in a CPP. However, under clause 5.6.8(1) of the EDB IMs, to give effect to a WACC change, we consider we may also amend a CPP to specify an additional FNAR value for the first disclosure year to calculate the ANAR for disclosure years after the WACC change;

the additional FNAR value we have specified for the first disclosure year of each CPP relies on a CPI figure that will not exist when our amendment determinations take effect on 31 March 2020. We have accordingly specified a formula in each CPP that will produce the additional FNAR value, and enable ANAR to be calculated in respect of a disclosure year following the WACC change (or in Powerco’s case, multiple disclosure years), once the CPI data becomes available;

we have ensured the additional FNAR value specified for the first disclosure year of each CPP will not affect price path compliance for disclosure years that will have ended at the time of our amendment determinations (ie, the 2018/19 and 2019/20 disclosure years). We have done this by providing that the additional FNAR value specified for the first disclosure year of each CPP only enables the calculation of ANAR:

(a) under the Powerco CPP and the Wellington Electricity CPP, for the 2020/21 disclosure year; and
(b) under the Powerco CPP, for the 2021/22 and 2022/23 disclosure years.

To provide for the above matters under paragraph 6.4 in our amendment determinations, we have:

amended each CPP’s definition of “forecast net allowable revenue” so that the 2018/19 disclosure year (ie, the first disclosure year of the regulatory period) has an additional FNAR value for the purpose of calculating ANAR for the 2020/21 disclosure year for both CPP parties;

---

69 At the start of the regulatory period of each CPP, we specified an FNAR value for the first disclosure year in the Powerco CPP and Wellington Electricity CPP.

70 This is consistent with the paragraph (a) definition of ‘price’ under section 52C of the Act, which is:

price—
(a) means any 1 or more of individual prices, aggregate prices, or revenues (whether in the form of specific numbers, or in the form of formulas by which specific numbers are derived); and

71 The formula produces the additional FNAR value for the first disclosure year by:

• taking the new FNAR value for the third disclosure year; and
• adjusting that new FNAR value by:
  o the actual CPI that applied for the second and third disclosure years; and
  o the rate of change.

The formula for the new FNAR value for the first disclosure year effectively back-calculates the FNAR such that when it is used to generate the time series of ANAR values for the first, second, and third disclosure years, the third disclosure year ANAR value is equal to the third year FNAR value. We consider that having equality between the third disclosure year FNAR and ANAR values gives effect to our policy intent that the allowable revenues under the CPPs reflect the WACC change.

72 The CPPs refer to this as the first ‘assessment period’, which is defined in clause 4.2 of each CPP.
6.5.2. for all other purposes under each CPP, retained the original FNAR value for each CPP’s 2018/19 disclosure year as specified under clause 3.1.1(6) of the EDB IMs at the start of each CPP’s regulatory period;

6.5.3. in Schedule 1.5 of each CPP, specified:

(a) the formula for calculating the additional FNAR value for the 2018/19 disclosure year to be used for calculating ANAR for the remaining disclosure years of each CPP; and

(b) how the additional FNAR value for the 2018/19 disclosure year fits into the formula for calculating ANAR for the remaining disclosure years of each CPP.

The other minor consequential CPP changes comply with clause 5.6.8(1), (2), and (3)(a) of the EDB IMs

6.6. After reconsidering the CPPs under the WACC change reopener and determining to amend the CPPs, we have made the other minor consequential CPP changes described at paragraph 6.5 above under clause 5.6.8(1) of the EDB IMs.

6.7. These other minor consequential changes are necessary to properly amend the ANAR for the CPPs’ remaining disclosure years to reflect the DPP3 WACC change. We therefore consider that:

6.7.1. making these consequential changes is necessary and consistent with giving effect to the WACC change reopener;

6.7.2. the same basis justifying us determining under clause 5.6.8(1) to amend the ANAR (set out paragraph 5.2 above) therefore applies to these consequential changes; and

6.7.3. for the same reasons as those set out at paragraph 5.4, the consequential changes comply with clause 5.6.8(2) and (3)(a) of the EDB IMs.

---

73 Schedule 1.5 of the CPPs sets the framework for calculating wash-up amounts for assessment periods under a CPP.

74 Under paragraph (3) of Schedule 1.5 of the CPP, this formula for calculating the additional FNAR value for the 2018/19 disclosure year must provide for the relevant CPI figure and X factor.
Attachment A: clause 5.6.8 of the EDB IMs

5.6.8 Amending price-quality path after reconsideration

(1) Where, after reconsidering a CPP, the Commission determines that the CPP should be amended, the Commission may amend either or both of the price path or the quality standards and quality incentive measures specified in the CPP determination, subject to subclause (3).

(2) In determining the extent of any amendment to the price path, the Commission must take into account the expenditure objective.

(3) The Commission must not amend the-

(a) price path more than is reasonably necessary to take account of the change in costs net of any insurance or compensatory entitlements; and

(b) quality standards or quality incentive measures more than are reasonably necessary to reflect the Commission’s decision on a quality standard variation or mitigate the effect of-

(i) the catastrophic event;

(ii) the change event;

(iii) the error event;

(iv) the major transaction;

(v) the provision of false or misleading information;

(vi) the contingent project;

(vii) the unforeseen project; or

(viii) the WACC change,

as the case may be.

(4) Where the Commission’s reconsideration of the price-quality path was-

(a) triggered by a catastrophic event, in determining the extent of the amendment to the price-quality path, the Commission will consider the extent to which an EDB has demonstrated that it has reviewed its capital expenditure and operating expenditure plans for the remainder of the regulatory period and made such substitutions as is possible without adversely affecting its ability to meet its quality standards;

(b) pursuant to the occurrence of an unforeseen project-

(i) the Commission need not amend the CPP unless the amount of required capex and opex determined by the Commission exceeds 10% of the value of the EDB’s annual revenue in the relevant disclosure year for the purpose of clause 5.6.6(2);

(ii) any such amendment may not take effect until the disclosure year in which assets constructed as part of the relevant unforeseen project are forecast to be commissioned; and

(c) pursuant to the occurrence of a trigger event, any amendment to the CPP may not take effect until the disclosure year in which assets constructed as part of the relevant contingent project are forecast to be commissioned.
(5) Where the Commission’s reconsideration of the price-quality path was triggered by a WACC change, the Commission will for the remaining disclosure years of the CPP regulatory period after the WACC change:

(a) determine the series of maximum allowable revenue after tax in accordance with clause 5.3.4(7) and determine any consequential changes to the forecast net allowable revenue for the remaining disclosure years of the CPP regulatory period; and

(b) for the purpose of (a), use-

(i) the building blocks allowable revenue before tax calculated in accordance with clause 5.3.2(1);

(ii) the revised WACC in clause 5.3.22(2), including where the WACC is used for present value calculations, and for timing factors in clause 5.3.2(4);

(iii) the forecast CPI for DPP revaluation for the new DPP regulatory period referred to in clause 5.6.7(4)(b), to calculate a revised revaluation rate in accordance with the method in clause 5.3.10(4);

(iv) the cost of debt for the new DPP regulatory period referred to in clause 5.6.7(4)(b), to calculate a revised notional deductible interest as specified in clause 5.3.16(2);

(v) subject to (ii) to (iv), the same input values as applied by the Commission in initially determining the CPP for all other input values in the calculation of building blocks allowable revenue before tax; and

(vi) a revised forecast regulatory taxable income to apply the changes in building blocks allowable revenue before tax resulting from (i) to (iii) in a revised forecast regulatory tax allowance.