In the High Court of New Zealand
Wellington Registry
I Te Kōti Matua o Aotearoa
Te Whanganui-ā-Tara Rohe

CIV-

---

under:	section 52Z of the Commerce Act 1986
in the matter of:	an appeal against the Gas Transmission Services Input Methodologies Amendment Determination (No.2) 2022 and Gas Distribution Services Input Methodologies Amendment Determination (No.2) 2022
between:	**MAJOR GAS USERS' GROUP** an unincorporated association of gas consumers and acquirers having its address for service at Level 5, 90 The Terrace, Wellington
	APPELLANT
and:	**COMMERCE COMMISSION** a Crown entity established under the Commerce Act 1986, of Wellington
	RESPONDENT

NOTICE OF APPEAL

Date: 29 June 2022

Level 5, Wakefield House
90 The Terrace
PO Box 10388
Wellington 6140

Tel +64 4 815 8050

Solicitors: Brigitte Morten (Brigitte.Morten@franksogilvie.co.nz)
Stephen Franks (Stephen.Franks@franksogilvie.co.nz)
Counsel: Matthew Dunning QC (matthew@dunningqc.co.nz)

TO: the Registrar of the High Court at Wellington
AND TO: the Commerce Commission

NOTICE OF APPEAL

1. The appellant gives notice that it is appealing against those parts of the Gas Distribution Services Input Methodologies Amendment Determination (No. 2) 2022; [2022] NZCC [15] and the Gas Transmission Services Input Methodologies Amendment Determination (No. 2) 2022; [2022] NZCC [16] ("**the IM Amendments**"**)** insofar as they respectively amended clause 4.2.2 of the Gas Distribution Services Input Methodologies Determination 2012 ("**GDB IM Determination")** and the Gas Transmission Services Input Methodologies 2012 ("**GTB IM Determination**")(together "**the IMs**") by introducing into each:

    a) cl 4.2.2(4), which allows the Commerce Commission ("**Commission**") to apply an adjustment factor in respect of a Default Price Path (**"DPP**") regulatory period for the purpose of determining the remaining asset life for existing assets and the remaining asset life for additional assets, provided the Commission is satisfied that applying an adjustment factor would better reflect economic asset lives and doing so would better promote the purpose of Part 4 of the Act;

    b) cl 4.2.2(3)(a)(ii) and cl 4.2.2(3)(b)(ii) which provide definition alternatives to give effect to cl 4.2.2(4) for "existing assets" and "additional assets" in cl 4.2.2(2) to determine allowable depreciation by a gas distribution business ("**GDB**") and a gas transmission business **("GTB**") under cl 4.2.2(1). In this notice GDBs and the GTB are referred to generically and each is encompassed with the term Gas Pipeline Business ("**GPB**"); and

    c) other clauses or parts consequential on or intended to apply or to give effect to cl 4.2.2(4), such as clause 2.2.8(5), Schedules 1, 2 and 3 in the GDS DPP3 and Schedules 1, 2 and 4 in the GTS DPP3 and terms with such effects defined in cl 1.1.4(2) including "remaining asset life", "forecast depreciation for existing assets" and "transitional adjusted asset life for existing assets".

2. The provisions described in paragraphs (a) to (c) above are referred to in this Notice as "**the Amendments**" and each is an **"Amendment".**

RELIEF SOUGHT

3. The appellant asks the court to allow the appeal and exercise powers under s 52Z(3) (directly or through directions to the Commission) by way of

amendments or substitutions that are materially better in meeting the purpose of Part 4 of the Commerce Act 1986 (“**the Act**”), the purpose in s 52R of the Act, or both, as follows:

a) *Revoke the Amendments* - By omitting the Amendments; or

b) *Prevent double compensation* - If the Amendments are not revoked, amending them so that the IMs do not provide for or allow the Commission:

   i) to elevate the principle it calls Financial Capital Maintenance (“**FCM**”) to justify the transfer to consumers of potential supplier losses on assets that the Commission thinks are putatively stranded; nor

   ii) to allow suppliers compensation for stranding risk, or for stranding, where the stranding is the crystallisation or maturing of risk that is provided for or reflected in the applicable regulatory WACC; or

c) *Only for future assets* - If the Amendments are not revoked, or if compensation from consumers to a GPB (by way of accelerated depreciation) for the risk or fact of stranding of assets in its regulated asset base is allowed, then:

   i) by confining the compensation to the stranding of additional assets (as defined in the IMs) from time to time, entering the regulated asset base after the effective date of the adjustment factor or equivalent intended to generate the compensation; and

   ii) by respecting the purpose of assuring a normal return on capital as being to incentivise future investment decisions, and not to apply it to assets that are the result of past decisions/sunk costs.

d) *Need to satisfy other purpose criteria* - If the Amendments are not revoked or if the IMs are to allow or provide for compensation from consumers to a GPB for the risk or fact of stranding of assets in its regulated asset base, then qualifying and restricting the Amendments and/or the IMs so that:

   i) the IMs (not a DPP) authorise and specify any adjustment factor in the interests of longer term predictability and certainty to satisfy sections 52R and 52T; and

   ii) any such incentive adjustments apply only to additional assets that need a specific ex ante FCM assurance, in other words, where the criteria require adequate evidence that the investment would not occur without the assurance, to exclude, for example, investment

that must occur to meet DPP service quality standards, or investment required by safety law or regulation.

BACKGROUND

4. The appellant is a person within the meaning given to that term in s 2 of the Act, being an unincorporated association of companies. The appellant gave views on the IM Amendments to the Commission as part of the Commission's process under s 52V preceding their determination. Members of the association are from businesses which are major consumers and acquirers of natural gas. Their businesses will incur significant extra expense under the accelerated depreciation regime instituted by DPP3 in purported application of the Amendments.

5. By virtue of s 55B of the Commerce Act 1986 ("**Act**"), gas pipeline services are regulated under Part 4 of the Act (which provides for regulation of price and quality of goods or services in markets where there is little or no competition).

6. By virtue of s 52T of the Act, the Commission must determine an IM containing the matters set out in that section to apply to regulated gas pipeline services. The IMs which are amended by the IM Amendments are of that kind and the Commission describes them as "fundamental IMs…central to defining the balance of risks and benefits between suppliers and consumers" (Final Reasons Paper, 31 May 2022 – "**DPP3 Final Reasons Paper**", Chapter 2 para 2.19).

7. By virtue of s 52Y the Commission must review each input methodology at intervals of no more than 7 years (commonly referred to as "the statutory review" and the 7 years is referred to as the "statutory review period").

8. The purpose of IMs is stated in s 52R to be "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 this Part".

9. IMs are applied to GPBs in instruments called Default Price-Quality Paths (each a "**DPP**"). DPPs run on a different review cycle from IMs. They must be reset at least every five years, although the Commission can set the regulatory period of a DPP as short as four years if it considers that would better meet the purposes of Part 4 of the Act (s 52M(4) and (5)), which it has done for GPBs. During a regulatory period, a DPP applies the pertinent IMs in their form at the commencement of that period. A review change to an IM during the period of a DPP is therefore not practically effective until the next reset of the DPP.

10. By virtue of s 52Y(3) of the Act, s 52V applies to an IM review and requires the Commission to:

    a) publish a notice of intention to conduct the review;

b) outline the processes that will be followed;

c) set out proposed time frames;

d) publish a draft methodology; and

e) give interested persons a reasonable opportunity to give their views on the draft.

11. The last statutory reviews of gas pipeline business IMs were in 2016, and so statutory review of them is accordingly due. The Commission published on 23 February 2022 notice of its intention to conduct that review and to complete it by 31 December 2023.

12. The Commission may amend an IM outside the statutory review period, but it is acknowledged (DPP3 Final Reasons Paper, Chapter 2) that such amendments should be rare, as frequent changes would be inimical to the requirement of s 52R that IMs promote certainty. In this case it considered that there are "compelling and urgent reasons" (DPP3 Final Reasons Paper para 2.20) for an out of cycle amendment.

13. DPP3 would not apply any changes to the IM arising from the statutory review already under way and expected to be determined in December 2023. Any changes under the statutory review would take effect from 1 October 2026 under what will be DPP4.

14. The Commission published a notice of its intention to make the IM Amendments before the statutory review on 4 February 2022 and published the proposed amendments with a Draft Reasons Paper on 10 February 2022, allowing four weeks for submissions and two weeks for cross-submissions.

15. Among the reasons advanced to justify the Amendments out of cycle is that they will take effect in the regulatory period of DPP3 which begins on 1 October 2022 and runs for four years to 1 October 2026. The Commission has determined to allow GPBs to accelerate depreciation as an additional component of allowable revenue for regulatory purposes. That is to enable suppliers to begin recovering, in advance, losses from economic 'stranding' of GPB assets which the Commission anticipates as natural gas use diminishes and perhaps ends, possibly before the end of the physical useful life of those assets.

16. On 30 May 2022 the Commission published the Amendments so that they would apply in DPP3 published on 31 May 2022.

17. The Amendments enable the Commission to apply adjustments in DPP3 which reduce the deemed economic lives of the assets of GPBs for price control purposes, materially below the deemed physical lives which have until that change generally governed permitted deductions for depreciation of GPB assets in what is called the Regulated Asset Base ("**RAB**"). The reduction in projected

asset lives ranges from 5 to 11 years, a reduction of between 18% and 35% of the expected asset lives.

18. The practical result of the Amendments as applied in DPP3, is that suppliers will be able to transfer to consumers (direct and indirect users of regulated gas pipeline services) some or all of the stranded asset losses that will crystallise for suppliers if and when the use of reticulated natural gas ends earlier than the life expectations for those assets when they were commissioned and/or entered the RAB. Until the Amendments, suppliers were permitted to depreciate assets in the RAB only over a standardised expected physical useful life, assuming that gas pipeline services would be useful indefinitely.

19. The accelerated depreciation allowances may cause a consumer to pay a GPB supplier more or less than the suppliers' actual and fair costs of assets to serve that consumer or generation of consumers at a particular time, depending on:

    a) whether the adjusted deemed economic lives of the assets are shorter, or longer than the actual outcomes. In other words, it will depend on the accuracy of the Commission's expectations of the scale, timing and degree of natural gas demand loss and stranding. If the economic life continues after accelerated depreciation has recovered for the supplier the full RAB value of an asset, consumers thereafter will not be charged for their benefit from the asset;

    b) any effect on connections and gas use, by the timing of tariff increases with accelerated depreciation. The rapidity of stranding may be affected by the degree of inflation in costs to consumers from early compensation for stranding; and

    c) whether the suppliers find economic uses for the assets to replace lost or declining uses for natural gas.

20. Over the four years of the DPP3 regulatory period commencing 1 October 2022, based on the Commission's financial modelling outputs for mitigated and non-mitigated economic stranding risk, the overall additional cost for consumers of accelerated depreciation is $156 million. This is expected to increase the aggregate cost for GPB services for the Appellant group by about $19 million in that regulatory period. Based on the Commission's consumer price bill model, residential households as a consumer group will pay around $50 million more in the four years to October 2026.

21. In determining that it should adopt a mechanism to prescribe for such adjustments, the Commission stated that:

    a) It is acting to uphold a principle of FCM that offers GPBs ex ante assurance of a normal rate of return on their investments;

b) That is to provide the incentives for investment and other activities referred to in s 52A to secure adequate supplier capacity to deliver pipeline services for the long-term benefit of consumers;

c) Government pronouncements and legislation pursuing the goal of New Zealand being carbon-zero by 2050 and by agencies such as the Climate Change Commission and MBIE recommending that energy policies be decided and implemented by government to transition to such goals indicate considerable uncertainty over longer term future gas demand;

d) A significant decline in demand and government mandated phase-out of natural gas, could shorten the economic lives of gas pipeline business assets. If they are truncated to end on or before 2050, FCM will not be delivered to GPBs without adjustments to deemed asset lives;

e) That risk of stranding would discourage continuing investment by suppliers despite what may be a continuing consumer demand for natural gas. Under-investment may undermine the quality and continuity of safe and reliable gas supply in the period until supply is expected to cease;

f) Though under-recoveries of the cost of capital are unlikely through DDP3 and DPP4 (8 or 9 years total), an expectation of future stranding (under-recoveries) threatens current investment incentives: "in terms of preserving incentives to invest and ex ante expectation of FCM, it is the material risk of economic network stranding that matters, not that the event has occurred or its occurrence is knowable" (DPP Final Reasons Paper para 6.12 and Attachment C at C45);

g) Increasing costs to consumers now reduce the revenue that will need to be recovered from consumers in future regulatory periods to maintain FCM; and

h) The pronouncements and the uncertainty provided "compelling and urgent reasons" to act outside the statutory review cycle to enable the adjustments to be made in DPP3, rather than wait for due consideration in the statutory review of the IM.

GROUNDS OF APPEAL

22. The Amendments were premature.

23. The Amendments made the GPB IMs materially worse for the purposes of Part 4 than the IMs before the changes. The GPB IMs would be materially better without the Amendments.

24. Alternatively, there are changes that could make the GPB IMs materially better for the purposes specified in s 52Z(4) even if the Court is not satisfied that the Amendments should be revoked completely.

The Amendments are premature

25. The Amendments were determined in a truncated process relying upon indications of de-carbonisation policy and possible legislative changes that are themselves at this time expressly uncertain, tentative or exploratory and subject to clarification. The consequence of prematurity is unjustified risk that the IMs will promote unintended outcomes which may be inconsistent with the outcomes to be promoted under s 52A of the Act. In particular:

    a) the scheme of the Act does not intend out of cycle IM amendments based on the lack of synchronicity between IM and DPP reviews, and the circumstances are not so “compelling and urgent” as to allow it here when:

        i) there is a mandated periodic review already under way intended for completion by December 2023. That is the appropriate process to elucidate the implications of emerging energy policy, and

        ii) the only present certainty is uncertainty - in the words of Commission Reasons Papers at various places, there is “significant uncertainty”, “considerable uncertainty over possible future scenarios”, “no definitive data”, it is “affected by policy intervention by current and future governments”;

    b) it is too soon to have any sufficient confidence that gas pipeline assets will lose their economic lives at all or to what extent: it is unknown “**if** networks [will] wind down as a result of government policies to phase out fossil fuels” (emphasis added, C63.1, DPP3 Final Reasons Paper);

    c) there is evidence that natural gas may be used for longer and in greater amounts than the Commission expects, or alternative uses may emerge for pipeline assets: it is “credible that networks may have some residual economic value of (as yet) unknown quantum in conveying alternative gases” as that “networks or parts of networks are decommissioned with limited or no residual economic value” (C43, DPP3 Final Reasons Paper);

    d) the Amendments and the Commission statements about how it expects to exercise its powers under them, anticipate and give excess weight to necessarily speculative potential results of current and future government and government agency decision-making; and

    e) acting prematurely without sufficient evidence has led to some pertinent possibilities being excluded from working out the best response to

decarbonisation and the apprehension of stranding risk, including that suppliers and consumers will include in their calculations:

i) the likelihood of changes in government priorities;

ii) the possible effects of a change in government;

iii) the ease of amendment of s 55A so that regulation of gas pipelines can encompass the conveyance of gases other than natural gas, which enable the Commission (on its approach to the implications of the current definitions) to take into account more possibilities of avoiding the stranding of assets.

26. A materially better IM would follow supplier and consumer opportunities to discuss with the Commission in the current IM review, analysis of counterfactuals or of more scenarios, with updated information, on the way in which regulated suppliers and consumers and a workably competitive market might react to policies discouraging the use of natural gas. Waiting for such better information could reduce the net economic costs if the Amendments and DPPs made in reliance on them are applying mistaken expectations of the future, or wrong interpretations of the purpose of Part 4 and the purpose of s 52R, including that:

a) the Commission appears to have acted on a belief (DPP3 Final Reasons Paper para 6.55) that allowing more depreciation in DPP3 "promotes more efficient use of pipeline assets over time because resulting prices are more cost-reflective for both current and future consumers". This is contrary to orthodox expectations that a reduction in demand will shift the demand curve to the left, leading to a reduction, not an increase in prices in competitive markets. Resources will be misallocated if prices are elevated to recognise stranding risk arising from a reduction in demand. In addition the costs to be met by current consumers with accelerated depreciation are largely for the benefit of suppliers with putative benefit for consumers at least 8 years (DPP3 Final Reasons Paper para 6.12) into the future and likely to be mostly later than that, if and as stranding losses actually crystallize;

b) costs incurred to serve current consumers should be attributed and billed to them. In competitive markets costs incurred on assets which become stranded are not transferred to consumers. There appears to be little 'cost-reflection' for current consumers if they are now to bear costs intended to benefit assumed consumers in the future;

c) higher prices to consumers now are likely to incentivise premature reductions in demand, disconnections and reduced new consumer connections. Such consumer decisions may be inefficient both

economically, and in terms of energy efficiency and even in achieving timely least cost de-carbonisation;

d) premature disincentives to consumer decisions to use gas and to consumer decisions to invest in gas using equipment may bring forward stranding. In competitive markets that risk would weigh against a supplier pricing with such an effect, but under the Amendments; and the Commission statements about its intentions on exercise of the Amendment powers, suppliers can be indifferent to that risk. They can reasonably expect to be permitted to recover from the remaining consumers from time to time, the costs of premature end of economic life.

27. The risk or likelihood of promoting outcomes that do not deliver long term benefit for consumers is raised by serious uncertainty about the existence of consumers in the long term. The Amendments involve speculations about a need for continuing investment to benefit future consumers but determine an IM intended to compensate suppliers for losses anticipated on current sunk costs. The Amendments are premature without careful linkage and confining of the mechanism to future investment needed to benefit any long-term consumers in the market for natural gas.

28. The IMs could mitigate many of the above risks and costs of the early implementation of accelerated depreciation by deferring design and application of any adjustments until:

a) the triggering policies and regime are more definite in nature, timing and scope; and

b) the issues have been more thoroughly explored in the current (2023) statutory review of the IMs.

29. A current IM without the power to affect DPP3 with such adjustments would be materially better.

30. Acting prematurely in the current uncertainty around the timing, scale and nature of steps to end the use of natural gas has led to outcomes promoted by the Amendments being inconsistent with the purpose of IMs in s 52R and the requirements of s 52T.

Inconsistency with s 52A purpose

31. The Amendments are inconsistent with the prevailing purpose of s 52A because:

a) they provide the Commission with power to apply DPP3 to offer what is effectively an ex post assurance of financial capital maintenance in relation to existing assets. A materially better IM would carefully

distinguish between existing and future assets in any necessary delivery of FCM;

b) any stranded asset assurance should be confined to achieving relevant elements of the purpose of s 52A(1) against established needs, not hypothesis, in the light of particular circumstances affecting GPBs and their customers. A materially better IM would not propound a standing FCM "principle" in putative contradiction of that section, without careful elucidation of the conditions and exceptions;

c) they are without provisions to limit compensation for stranding losses to avoid 'double compensation'. The market risk premium and asset beta in regulatory WACC for the regulated periods of investment in historic RAB should already fully or partially reflect perceived risks of demand reduction (including stranding from technological, regulatory or other change). Accordingly IM provisions to transfer to consumers (ex post the investment decisions) losses on stranded assets in the historic RAB is compensation for risk for which the regulatory WACC has already provided ex ante. The specific stranding compensation will contribute to excess profit. A materially better IM would confine any incentive to investment decisions to which the stranding circumstances are pertinent and the incentive is demonstrably necessary;

d) they permit stranded asset compensation as incentives to investment for which there are adequate incentives and penalties under price-quality pathway standards, the Gas Act and health and safety regulation;

e) assets will continue to enter the RAB at a deemed 45 year economic life, with the risk of a 2050 horizon for gas pipeline services being dealt with by adjustment under the Amendments, yet if that horizon is more likely than not, an ex ante FCM for a 45 year deemed life is not in consumer interests. Consumers will not benefit from long-term investments after termination, whereas the Amendment will incentivise long–term investments and have consumers pay for them despite benefits curtailed by early termination. A better IM would not put such a high implicit value on an approach which seems to serve a purpose of preserving a particular version of FCM and the Commission's credibility with suppliers, without more assured benefit for consumers;

f) suppliers in competitive markets must bear their stranding losses arising from a reduction in demand. They cannot oblige their customers to bear them. Put simply, a reduction in demand leads to lower prices in competitive markets, not to higher ones. Accordingly the Amendments, by resulting in higher prices, promote an outcome that is **not** "consistent with outcomes produced in competitive markets", contrary to that governing purpose in s 52A(1); and

g) in workably competitive markets, as assets become recognised as being at risk of stranding, or stranded, they are 'implicitly marked to market', reflecting the reduction in expected future cash flows from their reduced useful life. That is the "outcome" produced in competitive markets. For assets held in companies with traded equity it will be seen in share prices. The Amendments enable the generation and preservation of cash flows on assets to negate that outcome produced in competitive markets. Materially better IMs would seek to minimise differences between that outcome and competitive market outcomes.

32. If it is held that the purpose elements in the subparagraphs of s 52A (1) necessitate some protection against stranding losses despite the prima facie inconsistency with competitive market outcomes, (for example for future assets) better IMs would seek to produce the least necessary inconsistency. Any adjustment provision should have conditions which:

i) for s52A(1)(a) purposes, minimise the risk that stranding compensation on RAB is a disincentive "to innovate and to invest", including in "replacement, upgraded, and new assets". The reasoning behind the Amendments asserts that they contain such an incentive, but does not show how. Accelerated depreciation could be such an incentive if it was confined to replacement, upgraded, or new assets, and denied on existing assets;

ii) minimise the risk that stranding compensation on RAB is an inefficient incentive and not justified after consideration of alternative ways to preserve or to provide incentives to innovate, or to invest for paragraph (i) purposes. Denial of assured return on stranded existing assets would be an incentive on their owners to innovate, and upgrade to preserve network revenue;

iii) for paragraph s 52A(1)(b) purposes, minimise the risk that stranding compensation on RAB is a disincentive for improving efficiency, or aligning service quality with consumer demands. Allowing monopoly suppliers to impose such costs on consumers is:

A. an incentive to tolerate premature disconnection and other reductions in demand for suppliers' regulated services, to the extent that suppliers are protected against losses of revenue;

B. a reduction in the pressure of necessity, to find out and serve consumer quality/price preferences, to preserve and extend the economic life of the assets;

iv) for paragraph s 52A(1)(c) purposes minimise the risk that stranding compensation on RAB is a barrier to consumers sharing the benefits

of efficiency gains in the supply of regulated services including through lower prices;

v) recognise that requiring consumers to bear stranding losses may be contrary to that objective. In competitive markets, as demand reduction occurs or is threatened including by changes that create the stranding risk, the supplier of legacy services is compelled to price to compete, i.e. the stranding risk is mitigated somewhat by the lower prices. An efficiency gain results in ensuring continued full utilisation of the assets, because of demand fostered by lower prices. That does enable consumers of the legacy regulated service to share in the lower price benefits of efficiency gains, including from pricing that efficiently. A materially better IM would incentivise suppliers to maximise demand for their potentially stranded assets at marginal cost, without full recovery of the returns expected ex ante, from the historic investment; and

vi) for paragraph 52A(1)(d) purposes minimise the extraction of excessive profit. Allowing the transfer of stranded asset losses to consumers may enable, not limit, suppliers' ability to extract excessive profits. An ex post assured normal return (regulatory WACC) on stranded assets that fails to reflect the normal competitive market reduction in asset value upon recognition of the stranding (or risk of stranding) would deliver economic rent (excess profits) in respect of the difference between RAB value and the workably competitive market's realisable value taking account of the stranding (or stranding risk).

The Amendments do not constitute or properly form part of input methodologies

33. The Amendments are effectively a grant by the Commission of a power to itself, to exercise wide discretions. That misinterprets and misapplies sections 52R and 52T which contemplate an IM being complete in and of itself and stipulate for detail in pursuit of certainty and predictability for suppliers and consumers. The discretions reflect a recognition that it is too soon to know enough about the risks that the Amendments are to address, to allow for any firm and permanent adjustments.

34. The Reasons Paper headed "Amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths" published on 30 May 2022 ("**the IM Reasons Paper**") stated:

a) at para 3.47.5 "In DPP3 this [asset lives adjustment mechanism] will be used to shorten lives, but it is possible it could be used to lengthen lives in subsequent DPPs, depending on the circumstances"

b) In para 3.51 that possibility is elaborated, highlighting the absence of any cap on adjustments, the possibility of multiple adjustments over time, and the intention to apply different adjustment factors to different GPBs, the latter intention illustrated in para 3.54.

35. The absence of anything more than a discretion in the Amendments is the antithesis of the IM requirements. It does not, on its own:

a) Meet the prescription of s 52(1) to be a “methodology for evaluating or determining...depreciation”.

b) set out matters governing “valuation of assets, including depreciation” as required by s 52T(2)(a), or

c) set out how the Commission intends to apply it to particular services to satisfy s 52T(2)(b); or

d) provide sufficient detail to enable an affected supplier to estimate the material effects of the methodology on the supplier to satisfy s 52T(2)(a).

36. Some of that information is set out in Reasons Papers, or in DPP3. That does not satisfy the purposes of Part 4.

37. Where the Amendments depend on the DPPs to provide details that are required to be in the IMs, it is not clear that they are actually “set out” in DPP3 either. Materially better IMs would contain the necessary detail in compliance with s 52T and set out the criteria that will determine any adjustment factor or factors, when and to what assets it will apply.

38. The Amendments are not a methodology in terms of s 52R, because the terms do not promote certainty. On their own and as constituent parts of the IMs they amend, they promote dependence on future exercises of discretion. A materially better IM would remedy the following deficiencies/inconsistencies with the governing purposes of IMs:

a) the Commission’s reasoning and urging to propose changes in the current IM review acknowledges circumstances which effectively render the Amendments unsuitable. The opening phrase of new subclause (4) of Subpart 2 clause 4.2.2 reads “The Commission **may apply an adjustment factor** in respect of a DPP regulatory period for...” (appellant emphasis) signals only a discretion. The Amendments set out no adjustment factors, or the criteria on which they will be calculated. They contain no caps, limits or other constraints to mitigate the uncertainty created by what is effectively the declaration of discretions;

b) because the Amendments promote dependence on future exercises of discretion, DPP period by period, they do not comply with Section 52R that requires that the IM promote certainty “..in relation to the rules,

requirements and processes applying to the regulation..” Unconfined discretion is antithetical to rules-based regulation. The Reasons Papers warn of the possibility of changes in adjustment factors including the possibility that they might even reverse direction, effectively to defer depreciation following a period of acceleration;

c) the DPP Final Reasons Paper in effect concede the arbitrariness and potential unsuitability of the Amendments and the way the adjustment power is used in DPP3. It urges participation in the current (2023) IM review to seek changes if necessary. It effectively warns consumers and suppliers to see as interim, perhaps a first and reversible instalment, the stranding loss compensation announced in DPP3;

d) paragraphs 6.59 and 6.60 of the DPP Final Reasons Paper show why the discretions declared in the Amendments cannot promote certainty. They negate the intent of s 52T(2), which requires predictability for suppliers and consumers; and

e) the DPP Final Reasons Paper signals the possibility of ex post or retrospective changes in permitted recoveries through depreciation, of all or any part of the RAB, not just future assets. That does not exclude the possibility of changes that might prevent FCM. With the reservation of wide discretions to reverse course, or to accelerate, it is unclear whether the FCM principle remains only an ex ante assurance.

39. The Amendments are stated to permit the application of “an adjustment factor in respect of a regulatory period…” but in fact require multiple adjustment factors, differing GPB by GPB in a number of DPPs, to complete the impact of the IMs.

40. The IM Amendments do not satisfy the requirement of s 52T(2)(c) that they must, so far as is reasonably practicable, be consistent with other input methodologies. In particular, they are not consistent with the methodologies in the GPB IMs Subpart 4 of Part 4 for determining the regulatory WACC. The Commission says (DPP Final Reasons Paper para 6.11.3) that stranding risk is not provided for in the cost of capital factor used in their evaluative model. The WACC methodology does not exclude reflection of stranding risks. Without recognition of that (also addressed in clause 31(c) of this Notice) suppliers may get “double” compensation, first, ex ante in a provision for stranding in their regulatory cost of capital, and secondly from recovery of the cost for which they have already had an allowance and which has already been factored into the prices paid by consumers.

RELIEF SOUGHT

The Appellant seeks the following relief:

a) The determination of materially better IMs as outlined in paragraph 2 and elsewhere in this Notice:

b) Costs.

Date: 29 June 2022

____

Stephen Franks
Solicitor for the Appellant