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Proposed amendments to input methodologies for electricity distribution businesses – wash-up amounts

Draft decision reasons paper

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Associated documents

Publication date	Reference	Title
21 October 2024	978-1-991287-91-5	[Draft] Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024
11 September 2024		Notice of Intention, amended and reissued 11 September 2024 - Potential amendments to Input Methodologies for Electricity Distribution and Transmission Services
3 September 2024	978-1-991287-69-4	[Draft] Electricity Distribution Services Input Methodologies (treatment of insurance entitlements) Amendment Determination 2024
3 September 2024	978-1-991287-68-7	[Draft] Transpower Input Methodologies (treatment of insurance entitlements) Amendment Determination 2024
28 September 2012	[2012] NZCC 26	Electricity Distribution Services Input Methodologies Determination 2012
2 July 2024		Notice of Intention – Potential amendments to Input Methodologies for Electricity Distribution and Transmission Services
29 June 2012	[2012] NZCC 17	Transpower Input Methodologies Determination

Commerce Commission
Wellington, New Zealand

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Chapter 1 Proposed amendments

Purpose of this paper

1.1 This paper sets out and explains proposed amendments to the input methodologies (IMs) for electricity distribution businesses (EDBs) that relate to:

1.1.1 wash-up balances for EDBs subject to the default price quality path (DPP) or customised price quality paths (CPPs); and

1.1.2 the limit on wash-up drawdown amounts.

1.2 This paper outlines our draft decisions and invites submissions on the proposed amendments. The proposed amendments relate to:

1.2.1 correcting errors in the EDB revenue wash-up; and

1.2.2 reducing the volatility of the revenue path.

1.3 For each of these proposed changes, we describe:

1.3.1 the current requirements;

1.3.2 the proposed amendment; and

1.3.3 how the proposed amendment is likely to promote an IM amendments framework outcomes, as defined in Chapter 3.

Correcting errors in the EDB revenue wash-up

1.4 As written, the transitional arrangements for the revenue washup provided in the EDB IMs do not function as intended.

1.5 There is no wash-up account balance (WAB) 2024 term, only a WAB 2025 term. This means that any washup balance accrued in 2024 cannot be drawn down in 2026 as intended and instead would have to be drawn down in 2027 along with the 2025 WAB. This three-year lag between accrual and drawdown creates additional volatility with the revenue washup.

1.6 Additionally, the time value of money adjustments used to roll-forward the wash-up balance in present value terms between DPP periods were not clearly defined, leading to potential ambiguities in what the adjustments should be.

Current requirements

1.7 During the 2023 IM Review we made changes to the way the EDB revenue washup operates.[1] The intent of these changes was to improve the function of the washup by providing "a one big bucket approach to all mechanisms that true-up for forecast versus actual differences" and "a wash-up account that tracks accruals, balances, time-value-of-money and drawdowns".[2]

1.8 To implement these changes, transitional arrangements were created, which were intended to provide EDBs the ability to drawdown balances accrued in DPP3 in the first two years of DPP4. However, the transitional arrangements provided in the 2023 IM Review did not include a WAB 2024 term.

1.9 This means that, as specified, any washup accrual that occurs in disclosure year 2024 (DY2024), does not get acknowledged by the washup mechanism until DY2025 when it is included in the WAB for 2025. As a consequence of this, EDBs are unable to draw down the WAB for 2024 in DY2026 as originally intended.

Proposed amendments

1.10 We are proposing to amend the EDB IMs to include the WAB 2024 term. Including this term would allow EDBs to draw down their accrued washup balance in DY2026 as intended. This drafting is based on a submission (made as part of the DPP4 process) from Electricity Networks Aotearoa (ENA).[3] We have modified the ENA proposal, to better integrate it with the other proposed changes.

1.11 Alongside this change, we have added an additional clause consolidating and explicitly stating what cost of capital estimates apply when making time value of money adjustments.[4]

Our reasoning

1.12 When specifying the transitional arrangements in the 2023 IM Review, our intent was to provide EDBs with the ability to drawdown wash-up balances accrued in DY2024 and DY2025 with a two-year lag.[5]

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1 Commerce Commission "Part 4 IM Review 2023 - Final decision - Risks and Incentives topic paper" (13 December 2023), Attachment D.

2 Commerce Commission "Part 4 IM Review 2023 - Final decision - Risks and Incentives topic paper" (13 December 2023), Attachment D, paragraph D87.

3 The wash-up account balance 2024 term was proposed by the ENA, in their submission on the DPP4 draft decision, where they identified the issue, see: Electricity Networks Aotearoa (ENA) "Submission on EDB DPP4 draft decisions" (12 July 2024), pp. 5 and 17.

4 See cl 3.1.4(12) of Attachment A of the [Draft] Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024.

5 Note that while these amendments allow EDBs to drawdown wash-up balances after two years they do not impose a requirement to do so.

1.13 As noted, the lack of a WAB 2024 term in the provisions prevents EDBs drawing down any wash-up balance accrued in 2024 until DY2027, rather than DY2026 as intended. This change promotes the IM amendments framework outcomes (particularly the s 52R IM purpose) by correcting a technical error.

1.14 The proposed change to add a clause specifying the cost of capital estimate to be used in making the time value of money adjustment promotes the IM amendments framework outcomes (particularly the s 52R IM purpose) by improving certainty.

Reducing the volatility of the revenue path

1.15 The two-year lag between the accrual and drawdown of a wash-up balance can cause volatility in wash-up balances. Wash-up balances can "swing" above and below zero as the EDB attempts to drawdown its available balance as fast as possible. This volatility may flow into prices, creating swings in the prices experienced by consumers.

Current requirements

1.16 As currently specified, due to the timing of various disclosures, there is an unavoidable two-year lag between accrual of a wash-up balance and the ability for an EDB to draw down that balance.

Proposed Amendments

1.17 We are proposing that the limit on the wash-up drawdown amount available be amended to include the wash-up drawdown amount from the year prior.[6] This change should reduce the volatility in the wash-up balance by allowing for a more accurate representation of the amount available for an EDB to draw down each year.

1.18 We are also proposing to make a time value of money adjustment to both the WAB term two-years prior and the prior wash-up accrual term one year in the wash-up drawdown limit.

Our reasoning

1.19 The addition of the prior year's drawdown term and the time value of money adjustments will promote the IM amendments framework outcomes (particularly the s 52A Part 4 purpose) by reducing the volatility associated with the wash-up, which reduces volatility in prices.

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[6] This approach adapts a proposal made by the ENA. See Electricity Networks Aotearoa (ENA) "Submission on EDB DPP4 draft decisions" (12 July 2024), p. 18

1.20 EDBs have more up-to-date knowledge about amounts drawn down than is currently acknowledged by the wash-up provisions in the IMs. By using this information, we can reduce over (or under) drawdown of WABs, which in turn helps reduce price volatility.

1.21 With these changes in place, only the wash-up accrual for the year prior would not be accounted for in the current year's WAB (because the necessary information is not available when prices are set) minimising as much possible the 'swinging' effect.

Chapter 2 Process and how to make a submission

2.1 The proposed amendments to the EDB IMs described in this paper are made in accordance with s 52X of the Act.

2.2 In accordance with s 52V of the Act, we published on 2 July 2024 a Notice of Intention relating to the proposed IM amendments set out in this paper, which we amended and reissued on 11 September 2024 to include further possible amendments.

2.3 The proposed amendments have been assessed in accordance with the decision-making framework outlined in Chapter 2.

2.4 Following submissions and cross-submissions, we intend to issue a final decision on these amendments by the end of November 2024.

Relationship to other consultation processes

2.5 As noted in the Notice of Intention, we also intend to consult on separate amendments to the EDB and Transpower IMs, related to the workability of price-path-reopeners.

2.6 We have chosen to fast-track the draft and final decisions on these wash-up amendments (while still allowing for consultation) so that that any resulting amendments are in place in time for EDBs to determine their prices for the regulatory year beginning 1 April 2025.

Materials published alongside this paper

2.7 Alongside this paper we have published a [Draft] Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024. We have also published a demonstration model that sets out how the wash-up account will operate in the transition between DPP3 and DPP4, to aid with stakeholder understanding of the proposed changes.

How you can provide your views

Submissions on this paper

2.8 We seek your views on the matters raised in this paper and our draft amendments that give effect to our draft decisions. We have allowed two weeks for submissions and one week for cross-submissions as follows:

2.8.1 submissions are due by 5pm on **Friday 1 November 2024**; and

2.8.2 cross-submissions are due by 5pm on **Wednesday 13 November 2024**.

Address for submissions

2.9 Please email submissions to infrastructure.regulation@comcom.govt.nz with "EDB IM wash-up amendments" in the subject line of your email.

2.10 We prefer submissions in both a format suitable for word processing (such as a Microsoft Word document), as well as a 'locked' format (such as a PDF) for publication on our website.

Confidential submissions

2.11 While we encourage public submissions so that all information can be tested in an open and transparent manner, we recognise that there may be cases where parties that make submissions wish to provide information in confidence. We offer the following guidance:

2.11.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is considered to be confidential.

2.11.2 Where commercial sensitivity is asserted, submitters must explain why publication of the information would be likely to unreasonably prejudice their commercial position or that of another person who is the subject of the information.

2.11.3 Both confidential and public versions of the submission should be provided.

2.11.4 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

2.12 Parties can also request that we make orders under section 100 of the Commerce Act 1986 in respect of information that should not be made public. Any request for a section 100 order must be made when the relevant information is supplied to us and must identify the reasons why the relevant information should not be made public. We will provide further information on section 100 orders if requested by parties. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any section 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.

2.13 Please note that all submissions and cross-submission we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we do not publish unless good reasons existed under the Official Information Act 1982 to withhold it. We would normally consult with the party that has provided the information before any disclosure is made.

2.14 We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public' version.

Chapter 3 Decision making framework

Purpose and structure of this chapter

3.1 This chapter sets out the framework we have applied in reaching our draft decision. In doing so, it explains:

3.1.1 our framework for considering potential IM amendments, which is relevant in considering what IMs may be appropriate to amend outside of the statutory IM review cycle under s 52Y of the Act; and

3.1.2 the decision-making framework we have applied in proposing the potential amendments.

Framework for considering the scope of potential IM amendments

3.2 Our framework considers:

3.2.1 the statutory context;

3.2.2 our specific powers to amend IMs; and

3.2.3 what we must take account of when amending IMs outside of the statutory IM review cycle under s 52Y of the Act.

Statutory context

3.3 When considering amendments to IMs, we must consider the purpose of IMs and the purpose of Part 4. This section discusses the tensions between making changes to improve the regime and the certainty intended by the IMs.

3.4 The purpose of IMs, set out in s 52R of the Act, 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. To that end, s 52T(2)(a) requires all IMs, as far as is reasonably practicable, to set out relevant matters in sufficient detail so that each affected supplier is reasonably able to estimate the material effects of the methodology on the supplier. In that way, the IMs constrain our evaluative judgements in subsequent regulatory decisions and increase predictability.[7]

[7] *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289 at [213].

3.5 However, some uncertainty remains inevitable.[8] As the Court of Appeal observed (in relation to a judicial review against decisions made in the IMs under Part 4) "certainty is a relative rather than an absolute value",[9] and "there is a continuum between complete certainty at one end and complete flexibility at the other".[10]

3.6 The s 52R purpose is primarily promoted by having the rules, processes and requirements set upfront prior to being applied by regulated suppliers or ourselves.

3.7 However, as recognised in ss 52X and 52Y, these rules, processes and requirements may change over time.

3.8 The power to amend an IM must be used to promote the policy and objectives of Part 4 of the Act as ascertained by reading it as a whole. It is clear that Parliament saw the promotion of certainty as being important to the achievement of the purposes of price-quality regulation. While this is to an extent implicitly inherent in s 52A (for example, providing suppliers with incentives to invest in accordance with s 52A(1)(a)), it is also expressed in s 52R in relation to the purpose of IMs, but also in other aspects of the regime, such as the restrictions on reopening DPPs during their regulatory periods.[11]

3.9 When considering IM amendments, we must therefore be mindful that this may have a detrimental effect on:

3.9.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with s 52A(1)(a); and

3.9.2 the role that the IMs play in promoting certainty for suppliers and consumers in relation to the rules, requirements, and processes in advance of being applied by us and suppliers in setting the DPP, CPP or IPP, as applicable.

3.10 At times there will be a tension between making changes to improve the regime and better promote the s 52A purpose on the one hand, and certainty on the other.

3.11 While we will have regard to the s 52R purpose (and the other indications of the importance of promoting certainty), ultimately, we must nevertheless make decisions that we consider promote the s 52A purpose.

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8 *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289 at [214].

9 *Commerce Commission v Vector Ltd* [2012] NZCA 220, [2012] 2 NZLR 525 at [34].

10 *Commerce Commission v Vector Ltd* [2012] NZCA 220, [2012] 2 NZLR 525 at [60].

11 For further discussion see *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289 at [213]-[221].

3.12 Section 52A governs all of our decision-making processes under Part 4, including our IM decisions. The other purpose statements within Part 4 are relevant matters, but they should be applied consistently with s 52A.[12]

3.13 When making our decisions we must only give effect to these other purposes to the extent that doing so does not detract from our overriding obligation to promote the purpose set out in s 52A.

3.14 Therefore, where the promotion of s 52A requires amendment to an IM, s 52R does not prevent us from making a change that is consistent with s 52A.

Amendments inside and outside the IM statutory review cycle

3.15 This section considers the circumstances in which IMs may be amended and what must be taken into account when making amendments to IMs outside the statutory review cycle.

3.16 All IMs must be reviewed at least once every seven years, as mandated by s 52Y.[13] This process is key to delivering on the s 52R certainty purpose of IMs, while at the same time allowing the regime to mature and evolve in response to changing circumstances.

3.17 Given the certainty purpose of the IMs and the scheme set out in the Act to promote this purpose, we must carefully assess what amendments are appropriate to consider outside the statutory IM review cycle. As noted previously, the predictability the IMs provide is key to promoting the s 52A purpose and, in particular, incentives to invest as required under s 52A(1)(a).

3.18 On the other hand, it is important that the IMs are fit-for-purpose going into a price-quality path reset, particularly as under s 53ZB(1) IM amendments made after a price-quality path is determined (other than in limited circumstances) will not affect the price-quality path until the next reset.[14]

3.19 Leading up to a price-quality path reset, we may therefore need to consider which topics are appropriate to consult on as potential s 52X amendments in order to identify changes to the IMs that are necessary to ensure that the DPPs are workable and effective in promoting the outcomes in s 52A.

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12 We note that the High Court, in *Wellington International Airport Ltd & Ors v Commerce Commission* considered that the purpose of IMs, set out in s 52R, is "conceptually subordinate" to the purpose of Part 4 as set out in s 52A when applying the "materially better" test. See *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289 at [165].

13 The next statutory Part 4 IM review is due to be completed by 2030.

14 Under s 53ZB(2) a price-quality path must be reset by us with a new price-quality path made by amending the price-quality path determination if: an IM changes as a result of an appeal under s 52Z; and that changed IM would have resulted in a materially different price-quality path being set had the changed IM applied at the time the price-quality path was set.

Amendments outside the statutory IM review cycle

3.20 We generally focus on two types of amendments outside the statutory IM review cycle:

3.20.1 those that support incremental improvements to price-quality paths; and

3.20.2 those that enhance certainty about – or correct technical errors in – the existing IMs.

3.21 We do not generally consider it appropriate to consider 'fundamental' changes outside of the statutory IM review cycle. Fundamental IMs are generally those that define the fundamental building blocks used to set price-quality paths (listed in s 52T(1)(a)), and that are central to defining the balance of risk and benefits between suppliers and consumers.

3.22 However, we can and will reconsider fundamental building blocks where there is a compelling and urgent rationale for doing so.[15]

The decision-making framework we have applied

3.23 In deciding whether to propose IM amendments as part of the DPP4 price-quality path setting processes, we are using a decision-making framework that we have developed over time to support our decision-making under Part 4 of the Act.[16] This has been consulted on and used as part of prior processes, and helps provide consistency and transparency in our decision-making.

3.24 Specifically, in respect of each potential amendment we will consider whether it would:

3.24.1 promote the Part 4 purpose in s 52A of the Act more effectively;

3.24.2 promote the IMs purpose in s 52R of the Act more effectively (without detrimentally affecting the promotion of the s 52A purpose); and

3.24.3 significantly reduce compliance costs, other regulatory costs, or complexity (without detrimentally affecting the promotion of the s 52A purpose).

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15 An example of this was the re-consideration of the Part 4 WACC percentile decision in 2014. The compelling reason was criticism by the High Court of this decision in the IM merits appeal process, and the urgency was due to the upcoming default price-quality path and individual price-quality resets for EDBs and Transpower New Zealand Limited.

16 See "Commerce Commission: Part 4 Input Methodologies Review 2023 Framework paper" (13 October 2022), para X20-X21.

3.25 We may also take into account the following where they are relevant and where taking them into account does not compromise our achievement of the s 52A purpose of Part 4:

3.25.1 whether there are alternative ways to address the identified issues without changing the IMs;

3.25.2 the permissive considerations under s 5ZN of the Climate Change Response Act 2002;[17] and

3.25.3 other Part 4 provisions, namely:

3.25.3.1 the purpose of ID (s 53A);

3.25.3.2 the purpose of default/customised price-quality regulation (DPP/CPP regulation) (s 53K);

3.25.3.3 requirements relating to energy efficiency (s 54Q); and

3.25.3.4 decisions made under the Electricity Industry Act 2010 (s 54V).

3.26 We refer to the outcomes specified in paragraph 3.24 as the 'IM amendments framework outcomes' in this paper.

[17] Commerce Commission, "Default price-quality paths for gas pipeline businesses from 1 October 2022 – Final reasons paper" (31 May 2022) (Gas DPP3 final decision), at paras 2.24-2.25; Note of clarification – our Part 4 Input Methodologies Review 2023 Framework paper (21 December 2022).