
Response to the Commerce Commission

on the

IM Letter on the proposed
scope, timing and focus for the
review of input methodologies

Made on behalf of 20 Electricity Distribution Businesses

*PwC submission on
behalf of group of 20
EDBs*

Final

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Response to the proposed scope, timing and focus of the input methodology review

1. This submission responds to the Commerce Commission's (the Commission's) IM Letter, "IM Letter on our proposed scope timing and focus for the review of input methodologies", released on 27 February 2015 (the IM Letter). This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 20 Electricity Distribution Businesses (EDBs).
 - Alpine Energy Limited
 - Aurora Energy Limited
 - Buller Electricity Limited
 - Eastland Network Limited
 - EA Networks
 - Electra Limited
 - Electricity Invercargill Limited
 - Horizon Energy Distribution Limited
 - MainPower New Zealand Limited
 - Marlborough Lines Limited
 - Nelson Electricity Limited
 - Network Tasman Limited
 - Network Waitaki Limited
 - Northpower Limited
 - OtagoNet Joint Venture
 - The Lines Company Limited
 - The Power Company Limited
 - Top Energy Limited
 - Waipa Networks Limited
 - Westpower Limited.
2. Together these businesses supply 28% of electricity consumers, maintain 46% of total distribution network length and service 72% of the total network supply area in New Zealand. They include both consumer owned and non-consumer owned businesses, and urban and rural networks located in both the North and South Islands.
3. The IM Letter outlines initial thoughts as to how the Commerce Commission (the Commission) may determine the scope, timing and emphasis of the Input Methodology (IM) review. The 20 EDBs which

support this response welcome the opportunity to provide input into the initial scoping of the IM review. In this response we firstly consider the proposed timing of the review, we then consider process matters, and finally we consider the specific components of the IMs which may form the focus of the review. In this final section of our response we have concentrated on those IMs which apply to EDBs.

4. We trust this response provides useful input in considering the forthcoming IM review. We would be happy to answer any questions you may have regarding this response.
5. The primary contact for this submission is:

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Summary

6. The following points summarise our review of the matters raised in the IM Letter, and are explained more fully in the body of this document.

Timing of the review

7. The EDBs which support this submission believe that the most important considerations are that sufficient time is available:
 - a) for the review to be completed within the seven years of publication date as stipulated in section 52Y; and
 - b) to enable the review to adequately consider IM issues and potential amendments and improvements, including consultation, preparing of supporting papers and expert reports, and drafting of the determination amendments.
8. We note that there is never a perfect time for the seven year IM review, given the number of regulatory decisions made across the sectors which are subject to Part 4. We believe that there are practical advantages in reviewing the IMs for each sector at one time, however as the regulatory cycles differ, in practice the IMs will be incorporated into the regulatory decisions for each sector at different times.
9. We consider that using the full seven year review period is more appropriate for the EDB IMs because it:
 - a) ensures as much time as possible is available for the review
 - b) delivers amended IMs well before the next DPP reset
 - c) makes best use of ID information in assessing whether the purpose of Part 4 is met with the current IMs, and
 - d) it is less disruptive for those which may be considering applying for a CPP in response to the recent DPP Determination.

Review process

10. In considering the process for the review, we make the following comments:
 - a) we encourage the Commission to include in the IM review process the outstanding actions which are necessary to correct and improve the Information Disclosure Determination (IDD). The IDD applies to all EDBs, and hence it is an important regulatory mechanism in the context of Part 4.
 - b) the IM Letter does not address the consultation process that the Commission might follow in undertaking the review. We have included our initial thoughts on the review process in the body of this submission.
 - c) the 2011 IM merits reviews are likely to have highlighted areas where the IM determination process could be improved. We encourage the Commission to consider the learning from the merits review process, and factor it into the forthcoming IM reviews.

Scope of the review

11. The EDBs which support this submission believe that the IM review should focus on:
 - a) new evidence, or a change in circumstances which may signal that improvements to the current IMs can be made to 'materially better' meet the Part 4 purpose;
 - b) changes which reduce complexity and hence compliance costs; and

- c) simple fixes which reduce ambiguity or correct errors or unintended consequences in the current IMs.
- 12. We do not support an approach which attempts to focus on discrete elements of IMs without considering wider IM impacts, because of the complexity in the IMs and the interrelationships between them.
- 13. Accordingly, we submit that it will be necessary to undertake the following actions before the focus of the IM review can be determined:
 - a) analyse whether the purpose of Part 4 is being met with the current IMs; and
 - b) analyse whether the information which was relied on in determining the current IMs remains valid, or whether there are developments which now need to be taken into consideration.
- 14. In this respect we submit that the quality of this analysis and hence the IM review will be enhanced if the maximum time permitted in the Act is made available for the review.
- 15. We also encourage the Commission to comprehensively review the CPP IM, as previously indicated, in order to ensure the CPP option is realistically available to all non-exempt EDBs, as a remedy to DPP assumptions which are not fit for purpose for individual EDBs.

Timing of the Review

IM determinations

16. The purpose of IMs is to promote regulatory certainty for suppliers and consumers of regulated services, as per section 52R of Part 4 of the Commerce Act. Section 52Y of Part 4 requires each IM to be reviewed no later than seven years after its publication.
17. The IMs for EDBs were first determined in late 2010 and published on 20 January 2011. For EDBs these comprised:
 - for information disclosure regulation – IMs for cost allocation, asset valuation, treatment of taxation and cost of capital;
 - for both Default Price-Quality Paths (DPPs) and Customised Price-Quality Paths (CPPs) – IMs for the specification of price, amalgamations and incremental rolling incentive scheme (IRIS);
 - for DPPs only – IMs for cost of capital and reconsideration of the DPP; and
 - for CPPs only – IMs for the contents of a CPP application, the Commission's assessment of a CPP proposal, how a CPP is determined, information required in a CPP, customer consultation, verification, audit and certification of a CPP, and catastrophic events and reconsideration of a CPP.
18. Subsequently, in September 2012 additional EDB IMs for DPPs were determined for cost allocation, asset valuation, treatment of taxation, treatment of periods that are not 12 month periods and the availability of information.
19. In addition, since 2010 a number of EDB IM amendments have been introduced including:
 - in June 2012, the asset valuation IMs for CPPs and information disclosure regulation were amended;
 - in November 2012, the IM for how a CPP is determined was amended;
 - in November 2014, the DPP and CPP cost of capital IMs were amended, and the DPP specification of price, reconsideration and IRIS IMs were amended; and
 - in December 2014, the cost of capital IM for information disclosure regulation was amended.

Proposed timing

20. The IM Letter proposes that all IMs (including those for EDBs, Transpower, regulated gas suppliers and regulated airports) are reviewed at the same time, irrespective of when they were first determined. It is suggested that this will enable subsequent reviews to be aligned.
21. It is also proposed that the IM review is completed by December 2016 (the 2017 regulatory year for EDBs), as this will allow any resultant changes to the gas IMs to be incorporated into DPPs for regulated gas suppliers, which are due to be determined by May 2017.

Considerations

22. The EDBs which support this submission believe that the most important considerations are that sufficient time is available:
 - for the review to be completed within the seven years of publication date as stipulated in section 52Y; and

- to enable the review to adequately consider IM issues and potential amendments and improvements, including consultation, preparing of supporting papers and expert reports, and drafting of the determination amendments.
23. There is a large volume of complex material represented by the IMs. We therefore submit that the maximum time available should be used if necessary to complete the review. While we understand the Commission's desire to hasten the IM review for the gas DPPs, we are not persuaded that this objective should outweigh the need for sufficient time for a comprehensive review of the IMs which apply to EDBs.
24. We note that there is never a perfect time for the seven year IM review, given the number of regulatory decisions made across the sectors which are subject to Part 4. We believe that there are practical advantages in reviewing the IMs for each sector at one time, particularly as there is currently a high level of commonality between the sector IMs. However, as the regulatory cycles differ, in practice the IMs will be incorporated into the regulatory decisions for each sector at different times.
25. In Appendix 1, we map out potential IM review timelines, assuming all IMs reviews are completed in the final year of the seven year period stipulated in section 52Y. We also map out an alternative timing, assuming the IMs are amended by the end of calendar year 2016 (the 2017 regulatory year for EDBs), and in the final year of the seven year review period thereafter. This mapping shows there is never one time for a cross sector IM review which suits all regulatory decisions.
26. We observe that for EDBs:
- while the proposed 2017 timing assists with certainty for the next EDB DPP reset (at 2020), a 2018 review, which takes full advantage of the seven year period permitted also provides IMs well in advance of the next reset;
 - the 2012 IDD (and subsequent amendments) are only just delivering information which is relevant to the assessment of whether the purpose of Part 4 is being met. Expediting the IM review reduces the usefulness of the ID regime, as less information will be available at the time of the review; and
 - the proposed 2017 timing is particularly disruptive for any non-exempt EDB which may be considering applying for a CPP, in response to the 2015 DPP Determination. In our view IM changes early in a DPP regulatory period are the most disruptive to the CPP process.

ID regulation

27. All of the EDBs which support this submission are subject to ID regulation, as are all of the businesses which are subject to Part 4. The IM Letter however does not acknowledge the purpose of ID (which is described in section 53A of the Act as '*to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met*'). The 2012 ID determination was the first determination which fully reflected the Part 4 purpose of ID, and therefore the overall purpose of Part 4, as set out in section 52A. Accordingly, it is only since the 2013 regulatory year that comprehensive information has been published which is consistent with the objectives of Part 4.
28. We submit that the ID disclosure dataset is critical to the IM review. Accordingly we believe that there are advantages for EDBs and GPBs in allowing for the full seven year period before any IM amendments are made, as this will maximise the number of years for which IM compliant data is available. This is particularly important for the first IM review as the IDD was delayed two years after the IMs were first determined and hence the information time series is shorter than it could be.

Conclusion on timing

29. Accordingly, we consider that using the full seven year review period is more appropriate for the EDB IMs because it ensures as much time as possible is available for the review, it delivers amended IMs well before the next DPP reset, makes best use of ID information in assessing whether the purpose of Part 4 is met with the current IMs, and it is less disruptive for those which may be considering applying for a CPP in response to the recent DPP Determination.

Review Process

30. The IM Letter acknowledges that the Commission is currently reviewing some aspects of existing IMs including the IRIS IMs, and the cost of capital applying to airports. We also note that the Commission has previously stated that it intends to examine matters which impact future CPP proposals in 2015, however no further details about the scope and timing of that review have been released to date.

Information Disclosure IMs

31. When consulting on the recent amendments to the IDD¹ it was indicated that potential IDD amendments which require an IM amendment were to be deferred until the IM review, as follows:

2.16 We propose to defer matters where an amendment to an input methodologies determination is required. This is because the purpose of input methodologies is to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation.¹¹

and

¹¹ Clause 52Y of the Commerce Act outlines a requirement for the Commission to review the input methodologies at least every 7 years. Proposed amendments to the IMs are to be deferred for consideration as part of the 7 year review unless there is a compelling reason for them to be addressed earlier.²

32. The IM Letter however does not explicitly acknowledge this intent.
33. The EDBs which support this submission encourage the Commission to include in the IM review process the outstanding actions which have been previously signalled, including those elements of the IDD which can be improved. The IDD applies to all EDBs, and hence it is an important regulatory mechanism in the context of Part 4.

Consultation process

34. The IM Letter does not address the consultation process that the Commission might follow in undertaking the review. While we might expect a 'process and issues' consultation step will follow, it may be useful to highlight at this stage some of our thoughts about the review process.
35. In particular we suggest the consultation process should seek to:
- set out the criteria which may be used to determine which alternatives are 'materially better';
 - provide sufficient information during the early consultation rounds so that EDBs are able to understand the impact of the proposal on them (as per section 52T(2)(a)), the alternative approaches which may be adopted, and the reasons for the approach proposed;
 - have a clear and structured process for the use of experts, including consultation on terms of reference, and ensuring expert reports are available in a timely manner;
 - avoid overlapping consultation deadlines, which in practice simply reduces each consultation period;

¹ Commerce Commission, Consultation paper – Proposed amendments to information disclosure for electricity distribution and gas pipelines services, 22 October 2014

² Ibid, page 6

- recognises that while the Commission may have different teams working on different IMs, most regulated suppliers will have one team (or sometimes one person) working on them all; and
- allows sufficient time for determination drafting.

36. We also suggest that the 2011 IM merits reviews are likely to have highlighted areas where the IM determination process could be improved. The EDBs which support this submission were not directly involved in the merits reviews, however we encourage the Commission to consider the learning from that process, and factor it into the forthcoming IM review.

Focus of the Review

Scope of the review

37. The IM Letter acknowledges that the Commission has an obligation to review all of the IMs, once every seven years. We agree that it is appropriate to focus the review on those areas which are likely to have the most significant long term benefit to consumers, consistent with the section 52A purpose of Part 4.
38. We also note that the section 52R purpose of IMs is to promote regulatory certainty. Accordingly we do not support change where it is not a material improvement, other than where simple fixes can be made to reduce ambiguity or remove errors in the current IMs.
39. In our view therefore, the IM changes that should be considered include:
 - new evidence, or a change in circumstances which may signal that improvements to the current IMs can be made to ‘materially better’ meet the Part 4 purpose;
 - changes which reduce complexity and hence compliance costs; and
 - simple fixes which reduce ambiguity or correct errors or unintended consequences in the current IMs.
40. We note that the IM Letter raises discrete parts of individual IMs for possible focus for the review. We are concerned about this discrete approach, which we submit must also consider wider IM impacts, because of the complexity in the IMs and the interrelationships between them. Experience shows that inconsistencies may be introduced into the IMs if a wider review is not also undertaken.
41. For example, the IM Letter raises the topic of disruptive technologies and suggests this may impact on certain elements of the asset valuation IMs. We submit that changes to consumer demand patterns, and the way in which EDBs provide electricity distribution services (which are two possible consequences of new technologies) will be relevant to cost allocation, cost of capital, asset valuation, the form of control, the CPP IM, the IRIS IM and most likely (given the preceding list) the regulatory tax IM.
42. Therefore we do not support an approach which attempts to focus on discrete elements of IMs. Accordingly, we submit that it will be necessary to undertake the following actions before the focus of the IM review can be determined:
 - analyse whether the purpose of Part 4 is being met with the current IMs; and
 - analyse to what extent the information which was relied on in determining the current IMs remains valid, or whether there are developments which now need to be taken into consideration, which were not known or understood at the time each IM was determined.
43. As stated above, we believe that the quality of the IM review will be enhanced if the above tasks are able to take advantage of the maximum time available before the IM review must be completed (ie: to target a January 2018 review deadline).

CPP IMs

44. As we have previously submitted, we do not believe the current CPP IMs are fit for purpose, and we believe that, as signalled in the 2010 IM Reasons Paper, a comprehensive review was required after completion of the first CPP. Ideally this should have occurred immediately after Orion’s CPP was determined in November 2013 and prior to the commencement of the next DPP regulatory period (on 1 April 2015).
45. In particular, having observed the Orion CPP process, the EDBs which support this submission believe that given the current CPP IMs, a CPP is likely to be:

- costly, hence out of reach for some
- complex
- resource intensive, hence distracting and disruptive to the business
- uncertain and risky
- too broad, ie: not able to be targeted to a particular challenge or solution.

46. We encourage the Commission to comprehensively review the CPP IM, as previously indicated, in order to ensure the CPP option is realistically available to all non-exempt EDBs, as a remedy to DPP assumptions which are not fit for purpose for individual EDBs.

Appendix 1 – Impact of IM review timing on regulatory decisions

