



ISSN 1178-2560
Decision Series
Project no. 14.09/12683

Public version

Electricity Distribution Input Methodology Amendments Determination 2014

[2014] NZCC 31

Input methodology amendments made under s52X of the Commerce Act 1986 to the input methodologies applicable to electricity distribution businesses contained in Decision [2012] NZCC 26.

Date of Decision: 27 November 2014

The Commission: Dr M Berry

S Begg

P Duignan

Dr S Gale

Regulation Branch, Commerce Commission

Wellington, NEW ZEALAND

27 November 2014

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Electricity Distribution Input Methodology Amendments 2014

Pursuant to Part 4 of the Commerce Act 1986 (the Act) the Commerce Commission makes the following determination:

1. DETERMINATION AMENDED

This determination amends the *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26*, as previously amended (the **EDB IM Determination**).

2. COMMENCEMENT

- 2.1 This determination comes into force on the date on which notice of the determination is given in the New Zealand Gazette in accordance with section 52W of the Commerce Act 1986.
- 2.2 Changes made to input methodologies by this determination do not apply to any default or customised price-quality path applying at the date this determination comes into force.

3. INTERPRETATION

- 3.1 Terms in bold type have the meaning given to those terms in the **EDB IM Determination**. Terms in bold type used in this determination that are defined in the Act, but not this determination, have the same meaning as in the Act.
- 3.2 Nothing in this determination limits the **Commission's** authority to amend any Determination in accordance with the Act.

4. EDB IM AMENDMENTS

- 4.1 In the **EDB IM Determination** amend clause 1.1.4(2) as follows:
 - (a) replace the reference to "clause 4.3.3(6)" in the definition of 'amortisation of revaluations' with "clause 4.3.3(5)";
 - (b) delete paragraph (b) of the definition of 'initial differences in asset values' and renumber paragraph (c) accordingly; and
 - (c) insert the following new definitions in alphabetical order:

"2013-15 NPV wash-up allowance means the amount specified in the **DPP determination for the regulatory period** commencing 1 April 2015 for Alpine Energy Limited, Centralines Limited, and Top Energy Limited reflecting the impact of the capped alternative rate of change for those suppliers in the *Electricity Distribution Services Default Price-Quality Path Determination 2012 [2012] NZCC 35*;

“capex wash-up adjustment means the amount that is the difference between the revenues for a **DPP regulatory period** using the actual values of **commissioned assets** for a prior **regulatory period** and the revenues using forecast **commissioned assets** applied by the **Commission** when setting prices, and is calculated in accordance with clause 3.1.3(8);

“catastrophic event allowance means the amount determined by the **Commission** for—

- “(a) additional net costs (over and above those provided for in a **DPP determination or CPP determination**) prudently incurred by an EDB in responding to a **catastrophic event**, other than costs that are foregone revenue;
- “(b) **recoverable costs and pass-through costs** the EDB was permitted to recover under the applicable **DPP determination or CPP determination through prices**, but did not recover due to a **catastrophic event**; and
- “(c) the impact of a **catastrophic event** on any **quality incentive adjustment**,

“incurred in or relating to the period between a **catastrophic event** and the effective date of an amendment to the **DPP** or **CPP** following reconsideration of the **price-quality path** under clause 4.5.4(1)(c) or clause 5.6.4(2)(a);

“distributed generation allowance means any positive allowance for costs incurred and amounts payable, or negative allowance for amounts receivable, in relation to avoided transmission charges arising from distributed generation, including embedded or notionally embedded generation, made in accordance with—

- “(a) Schedule 6.4 of Part 6 of the Electricity Industry Participation Code; or
- “(b) the Electricity Industry Act 2010;

“distribution prices means the portion of **prices** excluding **pass-through prices**;

“energy efficiency and demand side management incentive allowance means an allowance for foregone revenue attributable to energy efficiency or demand side management initiatives, projects, or activities as allowed by the **Commission** in a **DPP determination or CPP determination**;

“extended reserves allowance means an amount determined by the **Commission** as a positive allowance for costs incurred and amounts payable, or a negative allowance for amounts receivable, in accordance with

requirements in the Electricity Industry Participation Code 2010 relating to extended reserves made under the Electricity Industry Act 2010;

“incentive rate means the incremental rate of change used to calculate the **quality incentive adjustment**, as specified in a **DPP determination or CPP determination**;

“pass-through prices means the portion of **prices** attributable to **pass-through costs** and **recoverable costs**;

“quality incentive adjustment means an amount to provide incentives for a **non-exempt EDB** to maintain or improve its quality of supply in accordance with s 53M(2) of the **Act**, and is a function of—

- “(a) a **non-exempt EDB**’s performance above or below the quality targets, up to the caps or collars specified in relation to the quality targets;
- “(b) **revenue at risk**; and
- “(c) **incentive rate**,

“calculated in accordance with the method specified in a **DPP determination or CPP determination**;

“reconsideration event allowance means the positive or negative amount determined by the **Commission**—

- “(a) for additional net costs (over and above those provided for in a **DPP** or **CPP**) prudently incurred by an **EDB** as a result of a **change event** in the period between the **change event** and the effective date of an amendment to the **DPP** or **CPP** under clause 4.5.4(1)(f) or clause 5.6.4(2)(c);
- “(b) to mitigate the effect of an **error** or provision of false or misleading information on the relevant **DPP** or **CPP** under clauses 4.5.4(1)(d), 4.5.4(1)(e), 5.6.4(2)(b), or 5.6.4(4); and
- “(c) for the impact of a **change event**, **error**, or provision of false or misleading information under clause 4.5.4(1)(e) or 5.6.4(4), on any **quality incentive adjustment**;

“revenue at risk means the maximum financial reward or penalty arising under a **quality incentive adjustment**, as specified in a **DPP determination or CPP Determination**;

“transmission asset wash-up adjustment means a negative amount corresponding to the present value of revenues allowed in a **DPP** or **CPP** for additional **capital expenditure** and additional **operating expenditure**

associated with a transmission asset forecast to be purchased in **disclosure years** preceding the **regulatory period** but were not completed, as specified in a **DPP determination or CPP determination**;”.

4.2 In the **EDB IM Determination** replace clause 2.3.4(2) with the following:

- “(2) For the purpose of subclause (1), 'notional deductible interest' means the amount determined in accordance with the formula—

$$\frac{((\text{regulatory investment value} \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance})}{\sqrt{1 + \text{cost of debt}}}.$$

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$\sqrt{1 + \text{cost of debt}}.$

4.3 In the **EDB IM Determination** amend clause 3.1.1(1) as follows:

- (a) delete “and” from the end of paragraph (d);
 - (b) replace the full stop at the end of paragraph (e) with “; and”; and
 - (c) insert new paragraph (f) as follows:
- “(f) the sum of relevant **pass-through costs** and **recoverable costs** passed through to **prices** is separately demonstrated.”.

4.4 In the **EDB IM Determination** replace clause 3.1.1(2) with the following:

- “(2) Allowable notional revenue means, in respect of a 12 month period, a function of—
- “(a) relevant **CPIs**;
 - “(b) the X factor applicable to the **EDB**; and
 - “(c) **distribution prices** in the preceding 12 month period multiplied by quantities.”.

4.5 In the **EDB IM Determination** replace clause 3.1.1(3) with the following:

- “(3) Notional revenue means, in respect of a 12 month period, **distribution prices** in that period multiplied by quantities.”.

4.6 In the **EDB IM Determination** amend clause 3.1.3(1) as follows:

- (a) replace subclause (1)(b) with the following:
- “(b) a charge payable to **Transpower** for **electricity lines services** provided to a **non-exempt EDB** in respect of the transmission system in accordance with the transmission pricing methodology **Transpower**

uses to determine the prices it charges for its services, as specified in the Electricity Industry Participation Code, including any such charges on-charged at cost by a third party to a **non-exempt EDB** that does not have a transmission agreement with **Transpower** for the relevant point of supply;”;

- (b) amend subclause (1)(c) by deleting “, subject to the requirement specified in subclause (2)”;
- (c) replace subclause (1)(f) with the following:
 - “(f) **a distributed generation allowance;**”;
- (d) at the end of subclause (1)(k), delete “or”;
- (e) at the end of subclause (1)(l), replace the “.” with a “;”; and
- (f) insert the following new paragraphs in alphanumeric order:
 - “(m) **an energy efficiency and demand side management incentive allowance**, subject to the requirement specified in subclause (2);
 - “(n) **a catastrophic event allowance**, as specified in a **DPP determination or CPP determination**;
 - “(o) **an extended reserves allowance**, subject to the requirements specified in subclauses (2) and (7);
 - “(p) **a quality incentive adjustment**;
 - “(q) the amount calculated for a **non-exempt EDB** in accordance with the following formula for each **disclosure year** other than the first in a **DPP regulatory period** for which the starting prices were determined by the Commission under s 53P(3)(b)–

$$\left(\frac{\text{capex wash-up adjustment}}{l - 1} \right) \times (1 + r)^{y+0.5}$$

where–

- l* is the number of **disclosure years in the DPP regulatory period**;
- r* is the **cost of debt** applying to the **DPP regulatory period**; and
- y* is the number of **disclosure years** preceding the **disclosure year** in question in the **DPP regulatory period**;
- “(r) an amount calculated for a **non-exempt EDB** if the acquisition of the transmission asset is not completed prior to the commencement of a **regulatory period** in accordance with the terms of any contract

setting out the terms and condition of sale, in accordance with the following formula for a **disclosure year** in a **regulatory period** other than the first **disclosure year**—

$$\left(\frac{\text{transmission asset wash-up adjustment}}{l - 1} \right) \times (1 + r)^{y+0.5}$$

where—

l is the number of **disclosure years** in the **regulatory period**;

r is the **cost of debt** applying to the **regulatory period**; and

y is the number of **disclosure years** preceding the **disclosure year** in question in the **regulatory period**;

“(s) the **2013-15 NPV wash-up allowance**; or

“(t) a **reconsideration event allowance**, as specified in a **DPP determination** or **CPP determination**.”.

4.7 In the **EDB IM Determination** insert new clause 3.1.3(7) as follows:

- “(7) For the purpose of giving approval under subclause (2) in respect of an **extended reserves allowance**, the **Commission** will have regard to any policy intent stated by the Electricity Authority as to whether—
- “(a) some or all compensation payments to be made by an **EDB** under the extended reserves regime would be expected to constitute negative **recoverable costs** and be passed-through to **consumers** via corresponding reductions in **prices**; and
 - “(b) revenues that an **EDB** may receive under the extended reserves regime would be expected to be treated as unregulated income.”.

4.8 In the **EDB IM Determination** insert new clauses 3.1.3(8) and 3.1.3(9) as follows:

- “(8) For the purpose of clause 3.1.3(1)(q), the ‘capex wash-up adjustment’ is an amount equal to the present value of the difference in the series of building block allowable revenues before tax for the **DPP regulatory period** in question, subject to clause (9), from adopting—
- “(a) the sum of **value of commissioned assets** for each **disclosure year** that follows the **base year** in the preceding **DPP regulatory period**,
- “instead of—
- “(b) the **forecast aggregate value of commissioned assets** determined by the **Commission** in respect of each of those **disclosure years** when determining prices in accordance with s 53P(3)(b).

“(9) For the purpose of subclause (8)–

- “(a) the present value must be determined by discounting the building block allowable revenues before tax to the end of the preceding **DPP regulatory period** using a discount rate equal to the **WACC** applied by the **Commission** in setting prices for the **DPP regulatory period** in question;
- “(b) the series of building block allowable revenues before tax for the **DPP regulatory period** are those used to reset starting prices based on the current and projected profitability of each **EDB** and must-
 - “(i) be calculated using the same methodology that was applied by the **Commission** in setting starting prices for the **EDB** for the **DPP**, subject to subparagraphs (ii) and (iii);
 - “(ii) for the purpose of subparagraph (i), adopt the sum of **depreciation** calculated under Part 2 in respect of each **disclosure year** that follows the **base year** in the preceding **DPP regulatory period** for assets having a **commissioning date** in any of those **disclosure years**; and
 - “(iii) for the purpose of subparagraph (i), adopt the same values for all other inputs to the calculation of building block allowable revenues before tax;
- “(c) where building block allowable revenues before tax from adopting the sum of **value of commissioned assets** exceed the building block allowable revenues before tax from using the **forecast aggregate value of commissioned assets** then the difference is a positive amount of capex wash-up adjustment;
- “(d) where building block allowable revenues before tax from adopting the sum of **value of commissioned assets** is less than the building block allowable revenues before tax from using the **forecast aggregate value of commissioned assets** then the difference is a negative amount of capex wash-up adjustment; and
- (e) where a **CPP** applies in respect of a **disclosure year** during the **DPP regulatory period** then the amount of capex wash-up adjustment for that **disclosure year** and each subsequent **disclosure year** of the **DPP regulatory period** will be specified by the **Commission** in the relevant **CPP determination**, taking account the partial recovery of the capex wash-up adjustment in prior **disclosure years** of that **DPP regulatory period**.”.

4.9 In the **EDB IM Determination** amend clause 4.3.1(4) by deleting “– term credit spread differential allowance” where it appears.

4.10 In the **EDB IM Determination** replace clause 4.3.3(2) with the following:

"(2) For the purpose of subclause (1), 'notional deductible interest' means the amount determined in accordance with the formula—

$((\text{opening investment value} \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance})$

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$\sqrt{(1 + \text{cost of debt})}.$

4.11 In the **EDB IM Determination** replace clause 4.3.3(3) with the following:

"(3) For the purpose of subclause (1), 'amortisation of initial differences in asset values' is determined in accordance with Part 2 as of the **base year**."

4.12 In the **EDB IM Determination** delete clause 4.3.3(5) and renumber clause 4.3.3(6) accordingly.

4.13 In the **EDB IM Determination** replace clause 5.3.16(2) with the following:

"(2) For the purpose of subclause (1), 'notional deductible interest' means the amount determined in accordance with the formula—

$((\text{regulatory investment value} + \text{RAB proportionate investment}) \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance}$

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$\sqrt{(1 + \text{cost of debt})}.$

Sue Begg, Deputy Chair

Dated at Wellington this 27th day of November 2014.

COMMERCE COMMISSION