

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

Final decision reasons paper

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Associated documents

Publication date	Reference	Title
20 November 2024	[2024] NZCC 27	Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024
21 October 2024	978-1-991287-98-4	Amendments to input methodologies for electricity distribution businesses – wash-up amounts – draft decision reasons paper
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

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Chapter 1 Amendments

Purpose of this paper

- 1.1 This paper sets out and explains our final decision on 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 For each of these changes, we describe:
 - 1.2.1 the current requirements;
 - 1.2.2 the amendment;
 - 1.2.3 what we heard in submissions; and
 - 1.2.4 how the amendment is likely to promote the IM amendments framework outcomes, as defined in Chapter 3.

Correcting errors in the EDB revenue wash-up

- 1.3 As written, the transitional arrangements for the revenue washup provided in the EDB IMs do not function as intended.
- 1.4 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.
- 1.5 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

- 1.6 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
- 1.7 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.
- 1.8 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.

Amendments

- 1.9 We are amending the EDB IMs to include the WAB 2024 term. Including this term allows 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.
- 1.10 Alongside these changes, we have added an additional clause consolidating and explicitly stating what cost of capital estimates apply when making time value of money adjustments.⁴

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 Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024.

What we heard in submissions

- 1.11 We received five submissions on our proposed IM amendments. Four of those submissions were fully supportive of the proposed amendments and the demonstration model published alongside the draft decision.⁵ The fifth, from Vector, was supportive of the intent of the amendments, and provided some additional drafting it considered improved the clarity of the amendments.⁶
- 1.12 In its submission on our draft decision Vector considered that we should define the “wash-up draw down amount” for the years before 2026. We agree with Vector that this would improve the clarity of the amendments, and we have implemented this change in our final decision. We have made minor adjustments to Vector’s proposed wording to ensure that the “wash-up draw down amount” includes Aurora.
- 1.13 We received one cross submission on our draft decision, from Orion.⁷ Orion agreed with Vector’s submission and considered that either of Vectors proposed amendments would improve the clarity of the provisions.

Our reasoning

- 1.14 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.⁸
- 1.15 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.
- 1.16 The 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.

⁵ Orion [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Wellington Electricity [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Electricity Networks Aotearoa [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Aurora Energy [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024).

⁶ Vector [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (4 November 2024).

⁷ Orion “Cross-submission on EDB IM Amendments (Wash-up Amounts)” (13 November 2024).

⁸ Note that while these amendments allow EDBs to drawdown wash-up balances after two years they do not impose a requirement to do so.

Reducing the volatility of the revenue path

- 1.17 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

- 1.18 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.

Amendments

- 1.19 Our final decision is to change the limit on the wash-up drawdown amount available to include the wash-up drawdown amount from the year prior.⁹ 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.
- 1.20 We are also making 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.

What we heard in submissions

- 1.21 We received five submissions in response to our proposed amendment.¹⁰ They were all supportive of the amendment and did not offer alternatives.

Our reasoning

- 1.22 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.

⁹ 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

¹⁰ Orion [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Wellington Electricity [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Electricity Networks Aotearoa [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Aurora Energy [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (31 October 2024); Vector [“Submission on EDB IM Amendments \(Wash-up Amounts\)”](#) (4 November 2024).

- 1.23 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.
- 1.24 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

- 2.1 The 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 On 21 October we released our draft decision, seeking submissions from stakeholders on our proposed amendments. Submissions closed on 1 November 2024, and cross submissions closed on 13 November 2024.
- 2.4 We received five submissions and one cross submission on our draft decision. We have taken these into consideration when making our final decision.
- 2.5 The amendments have been assessed in accordance with the decision-making framework outlined in Chapter 3.

Relationship to other consultation processes

- 2.6 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.
- 2.7 We have chosen to fast-track the draft and final decisions on these wash-up amendments (while still allowing for consultation) so that the 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

- 2.8 Alongside this paper we have published an Electricity Distribution Services Input Methodologies (Wash-up Amounts) Amendment Determination 2024.

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 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 making the 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.¹¹

¹¹ *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289 at [213].

- 3.5 However, some uncertainty remains inevitable.¹² 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”,¹³ and “there is a continuum between complete certainty at one end and complete flexibility at the other”.¹⁴
- 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.¹⁵
- 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.

¹² *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289 at [214].

¹³ *Commerce Commission v Vector Ltd* [2012] NZCA 220, [2012] 2 NZLR 525 at [34].

¹⁴ *Commerce Commission v Vector Ltd* [2012] NZCA 220, [2012] 2 NZLR 525 at [60].

¹⁵ 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.¹⁶
- 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.¹⁷ 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.¹⁸
- 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.

¹⁶ 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].

¹⁷ The next statutory Part 4 IM review is due to be completed by 2030.

¹⁸ 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.¹⁹

The decision-making framework we have applied

- 3.23 In deciding whether to make IM amendments as part of the DPP4 price-quality path setting processes, we used a decision-making framework that we have developed over time to support our decision-making under Part 4 of the Act.²⁰ 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 amendment we considered 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).
- 3.25 We also took into account the following where they were relevant and where taking them into account did not compromise our achievement of the s 52A purpose of Part 4:

¹⁹ 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.

²⁰ See [“Commerce Commission: Part 4 Input Methodologies Review 2023 Framework paper” \(13 October 2022\)](#), para X20-X21.

- 3.25.1 whether there were 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;²¹ 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.

²¹ [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 \(21 December 2022\)](#).