

Proposed amendments to input methodologies for electricity distribution businesses, gas pipeline businesses and Transpower relating to insurance entitlements, other compensatory entitlements, and other regulated income

Draft reasons paper

Date of publication: 3 September 2024



Associated documents

Publication date	Reference	Title
20 May 2024		Notice of Intention - Potential amendments to Input Methodologies for Electricity Distribution Services, Gas Distribution Services, Gas Transmission Services and Transpower
28 September 2012	NZCC 26	Electricity Distribution Services Input Methodologies Determination 2012
28 September 2012	NZCC 28	Gas Transmission Services Input Methodologies Determination 2012 [2012]
28 September 2012	NZCC 27	Gas Distribution Services Input Methodologies Determination 2012 [2012];
29 June 2012	NZCC 17	Transpower Input Methodologies Determination [2012]

Commerce Commission
Wellington, NEW ZEALAND

Contents

Glossary.....	2
Executive summary.....	3
IM amendments we are proposing	3
Transpower IPP amendments we are proposing.....	4
Chapter 1 Introduction.....	5
Purpose of paper	5
Structure of paper	6
Application dates for proposed amendments	6
Materials released alongside this paper	7
How you can provide your views	8
Chapter 2 Decision-making framework	10
Purpose of this chapter.....	10
Framework for considering the scope of potential IM amendments.....	10
The decision-making framework we have applied	13
Chapter 3 Proposed amendments to the IMs.....	15
Purpose of this chapter.....	15
Summary of proposed IM amendments.....	15
Summary of proposed amendments to IPP for RCP3 and draft IPP for RCP4.....	16
Current requirements – insurance entitlements and compensatory entitlements	17
Attachment A: proposed amendment to the draft IPP for RCP4	23

Glossary

Acronym	
Capex IM	Transpower Capital Expenditure Input Methodologies
DPP	Default price-quality path
DPP3	Default price-quality path for the third regulatory period (1 April 2020 – 31 March 2025)
DPP4	Default price-quality path for the fourth regulatory period (1 April 2025 – 31 March 2029)
the Act	Commerce Act 1986
EDB	Electricity Distribution Businesses
GAAP	Generally accepted accounting practice
GDB	Gas Distribution Business
GPB	Gas Pipeline Business
GTB	Gas Transmission Business
ID	Information Disclosure
IMs	Input Methodologies
IRIS	Incremental Rolling Incentive Scheme
ORI	Other regulated income
Part 4	Part 4 of the Commerce Act 1986

Executive summary

- X1 This paper proposes amendments to the current input methodologies (**IMs**) for DPPs, CPPs, IPPs, and ID, in relation to the treatment of insurance entitlements and other compensatory entitlements.
- X2 The proposed amendments would apply to the IMs:
- X2.1 for electricity distribution services, gas transmission services, gas distribution services, and Transpower; and
 - X2.2 that currently apply, and as amended by the IM amendments from the recent Part 4 IM Review.¹
- X3 This paper also proposes a related amendment to the Transpower IPP determination for RCP3 and the draft Transpower IPP determination for RCP4, as part of giving effect to the same policy change.
- X4 We seek the views of interested parties on the proposed amendments by 20 September 2024.

IM amendments we are proposing

- X5 The current IMs treat insurance entitlements and some other compensatory entitlements as ‘other regulated income’ (**ORI**) which must be returned to consumers via wash-up rules for EDBs, GTBs and Transpower. This means that regulated suppliers are not able to retain and use the cash proceeds from insurance and similar entitlements if they are recognised as ORI.
- X6 The proposed amendments are intended to treat these entitlements in respect of capex the same way as capital contributions under the EDB and GPB IMs, reducing the cost of relevant asset repairs or replacement. The amendments also net off insurance entitlements for opex that arises from damaged assets (including destroyed assets) and third-party liability claims from the definition of operating expenditure and are as follows:
- X6.1 define and apply new terms in the IMs: ‘insurance entitlements’, ‘compensatory entitlements’, and ‘third-party liability entitlements’;

¹ Our final decisions and IM amendment determinations for the Part 4 IM Review 2023 are available at: <https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-electricity-gas-and-airports/input-methodologies-projects/2023-input-methodologies-review?target=documents&root=337609>.

- X6.2 specify that capex entitlements relating to asset damage are offset against asset remediation costs;
- X6.3 specify that opex entitlements relating to asset damage and third-party liability claims are excluded from the definition of operating expenditure; and
- X6.4 exclude insurance entitlements, and compensatory entitlements and third-party liability entitlements from the definition of 'other regulated income' (EDBs and GPBs only).

Transpower IPP amendments we are proposing

- X7 We propose to exclude insurance entitlements and third-party liability entitlements, as defined in the proposed amendments to the Transpower IMs, from the definition of ORI in:
 - X7.1 the Transpower Individual Price-Quality Path Determination 2020 [2019] NZCC 19 (**IPP for RCP3**); and
 - X7.2 the [Draft] Transpower Individual Price-Quality Path Determination 2025 [2024] NZCC XX (**draft IPP for RCP4**).

Chapter 1 Introduction

Purpose of paper

- 1.1 This paper outlines our draft decision and invites submissions on how we propose to amend the IMs for EDBs, GPBs and Transpower contained in the following determinations:
 - 1.1.1 Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26;
 - 1.1.2 Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28;
 - 1.1.3 Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27]; and
 - 1.1.4 Transpower Input Methodologies Determination [2012] NZCC 17.
- 1.2 This paper outlines our related draft decision and invites submissions on how we propose to make a related amendment to the IPP for RCP3 and the draft IPP for RCP4.
- 1.3 The proposed amendments have been assessed in accordance with the decision-making framework outlined in Chapter 2.
- 1.4 In accordance with s 52V of the Commerce Act 1986 (**Act**), we published a notice of intention relating to the proposed IM amendments set out in this paper on 20 May 2024.²
- 1.5 This Chapter sets out:
 - 1.5.1 the structure of this paper;
 - 1.5.2 when the proposed amendments to the IMs, the IPP for RCP3, and the draft IPP for RCP4, are intended to apply;
 - 1.5.3 what materials have been released alongside this paper; and
 - 1.5.4 how you can provide your views.

² [Commerce Commission, "Notice of Intention – Potential amendments to Input Methodologies for Electricity Distribution Services, Gas Distribution Services, Gas Transmission Services and Transpower" \(20 May 2024\).](#)

Structure of paper

- 1.6 Chapter 2 of this paper outlines our framework for considering the scope of potential IM amendments and the decision-making framework we have applied in proposing the IM amendments and amendments to the IPP for RCP3 and the draft IPP for RCP4.
- 1.7 Chapter 3 of this paper describes our proposed changes to the IMs, the IPP for RCP3, and the draft IPP for RCP4. It sets out:
- 1.7.1 the current requirements;
 - 1.7.2 the proposed amendments and why we are proposing these changes; and
 - 1.7.3 how the proposed amendments meet the decision-making framework.

Application dates for proposed amendments

- 1.8 Section 52W of the Act requires us to publish, by way of notice in the *Gazette*, a brief description of any IM amendment and the goods and services to which it applies, the reasons for determining that IM amendment and how we are making it publicly available.³
- 1.9 If, after taking account of submissions on our consultation, we decide to finalise our proposed amendments to the IMs, the IPP for RCP3, and the draft IPP for RCP4, we propose that those amendments come into force immediately after that final decision, and apply as summarised below:
- 1.9.1 the proposed IM amendments would apply:
 - 1.9.1.1 to the current IMs, immediately after our final decision;⁴ and
 - 1.9.1.2 to the IMs as amended by the amendments from the Part 4 IM Review, immediately after those amendments apply;
 - 1.9.2 the proposed amendment to the IPP for RCP3 would apply immediately after our final decision; and
 - 1.9.3 the proposed amendment to the IPP for RCP4 would apply for that IPP that commences on or after 1 April 2025.

³ Section 52W(1)(b) states that IM amendments are secondary legislation which means that the publication requirements for secondary legislation in the Legislation Act 2019 apply.

⁴ We outline in Chapter 3 our view that, consistent with s 53ZB(1) of the Act, making and applying the IM amendments as summarised above would not reopen within the current regulatory period any price-quality (PQ) path.

- 1.10 We provide some further information on the application dates for the proposed IM amendments in the draft IM amendment determinations, as follows:
- 1.10.1 Except for the amendments listed in clause 4.2 of each draft IM amendment determination, the IM amendments apply on the date each amendment determination comes into force under clause 4.1 of the relevant draft IM amendment determination (ie, the day after notice is published in the Gazette).
 - 1.10.2 The amendments listed in clause 4.2 of each draft IM amendment determination comprise most of the amendments we are proposing. Clause 4.2 specifies various application dates for these amendments to reflect our draft decision to (a) amend the IMs that apply now (eg, for RCP3 for Transpower) and (b) amend the IMs being amended by the IM amendments from the Part 4 IM Review, some of which are still to apply (eg, in most cases, the IM Review amendments to the IMs for information disclosure regulation in Part 2 of the principal IM determinations apply from the commencement of disclosure year 2026).
 - 1.10.3 In the case of the draft Transpower and EDB IM amendment determinations, we have added provisions that would revoke certain of the amendments that are not needed once all IM amendments from the Part 4 IM Review apply (eg, clauses 4.6 and 4.7 of the draft Transpower IM amendment determination).

Materials released alongside this paper

- 1.11 Alongside this paper, we have published a:
- 1.11.1 draft Electricity Distribution Input Methodologies Amendments Determination;
 - 1.11.2 draft Gas Distribution Services Input Methodologies Amendments Determination;
 - 1.11.3 draft Gas Transmission Services Input Methodologies Amendments Determination;
 - 1.11.4 draft Transpower Input Methodologies Amendments Determination; and
 - 1.11.5 draft amendment determination to the IPP for RCP3.
- 1.12 A draft amendment to the draft IPP for RCP4 is set out at Attachment A of this paper.

How you can provide your views

Submissions on this paper

- 1.13 We welcome your views on the matters raised in this paper and our draft amendments that give effect to our draft decisions, within the following timeframes:
- 1.13.1 submissions by 5pm on **Friday, 20 September 2024**; and
 - 1.13.2 cross-submissions by 5pm on **Monday, 7 October 2024**.
- 1.14 We consulted on the draft IPP for RCP4 from 29 May to 15 July 2024.⁵ This paper only proposes discrete amendments to the definition of ‘other regulated income’ in the draft IPP for RCP4 that we have identified since that consultation, at Attachment A of this paper. This paper does not seek views on matters we have already consulted on which are not affected by the discrete amendments proposed in this paper.

Address for submissions

- 1.15 Please email submissions to infrastructure.regulation@comcom.govt.nz with “Insurance IM amendments” in the subject line of the email.
- 1.16 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

- 1.17 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.⁶ We offer the following guidance:
- 1.17.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential.
 - 1.17.2 Where commercial sensitivity is asserted, submitters must explain why publication of the information would be likely to unreasonably prejudice

⁵ Copies of our draft decision paper for Transpower’s IPP for RCP4 and the draft IPP for RCP4 can be found on our [website](#).

⁶ Parties can also request that we make orders under s 100 of the Act prohibiting the publication or communication of any confidential information. If we receive a request, we will exercise our judgement in deciding whether or not an order is appropriate and any order we make will apply for a limited time as specified in the order. We will provide further information on these orders if requested by parties.

their commercial position or that of another person who is the subject of the information.

- 1.17.3 Both confidential and public versions of the submission should be provided.
 - 1.17.4 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.
- 1.18 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 2 Decision-making framework

Purpose of this chapter

- 2.1 This chapter describes:
 - 2.1.1 our framework for considering the scope of potential IM amendments, which is relevant in considering what IMs it may be appropriate to amend outside of the statutory IM review cycle in s 52Y of the Act;
 - 2.1.2 the decision-making framework we have applied in proposing the IM amendments and amendments to the IPP for RCP3 and draft IPP for RCP4.

Framework for considering the scope of potential IM amendments

- 2.2 Our framework considers:
 - 2.2.1 the statutory context;
 - 2.2.2 our specific powers to amend IMs; and
 - 2.2.3 what we must take account of when amending IMs outside of the statutory IM review cycle under s 52Y.

Statutory context

- 2.3 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.
- 2.4 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, para [213].

- 2.5 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
- 2.6 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.
- 2.7 However, as recognised in ss 52X and 52Y, these rules, processes and requirements may change over time.
- 2.8 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 PQ 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
- 2.9 When considering IM amendments, we must therefore be mindful that this may have a detrimental effect on:
- 2.9.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with s 52A(1)(a); and
- 2.9.2 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.
- 2.10 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.
- 2.11 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.

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

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

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

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

- 2.12 Section 52A governs all 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
- 2.13 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.
- 2.14 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 IMs statutory review cycle

- 2.15 This section considers the circumstances in which IMs may be amended and what must be taken into account when making amendments to IMs outside of the statutory review cycle.
- 2.16 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.
- 2.17 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. Additionally, 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).
- 2.18 On the other hand, it is important that the IMs are fit-for-purpose going into a DPP reset, particularly as under s 53ZB(1) IM amendments made after a PQ path is determined (other than in limited circumstances) will not affect the PQ path until the next reset.¹⁴
- 2.19 Leading up to a DPP 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 able to be

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, para [165].

¹³ The next statutory Part 4 IM review is due in 2030.

¹⁴ Under s 53ZB(2) a PQ path must be reset by us with a new PQ path made by amending the PQ 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 PQ path being set had the changed IM applied at the time the PQ path was set.

workable and effective in promoting the outcomes in s 52A, as we have done in this case.

Amendments outside of the statutory IM review cycle

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

2.20.1 those that support incremental improvements to PQ paths; and

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

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

2.22 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

IM amendments

2.23 In deciding whether to propose IM amendments as part of the DPP4 and RCP4 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.

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

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

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

¹⁵ An example of this was the re-consideration of the Part 4 WACC percentile decision in 2014. The compelling reason for this 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.

¹⁶ See, for example, [Commerce Commission, Part 4 Input Methodologies Review 2023 Framework paper \(13 October 2022\)](#), para X20-X21.

- 2.24.3 significantly reduce compliance costs, other regulatory costs, or complexity (without detrimentally affecting the promotion of the s 52A purpose).
- 2.25 We may 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:
- 2.25.1 whether there are alternative ways to address the identified issues with the relevant IM that do not involve changing the IMs;
- 2.25.2 the permissive considerations under s 5ZN of the Climate Change Response Act 2002;¹⁷ and
- 2.25.3 other Part 4 provisions, namely:
- (A) the purpose of ID (s 53A);
- (B) the purpose of default/customised price-quality regulation (DPP/CPP regulation) (s 53K);
- (C) requirements relating to energy efficiency (s 54Q);
- (D) decisions made under the Electricity Industry Act 2010 (s 54V); and
- (E) decisions under the Gas Act 1992 (s 55I).
- 2.26 We refer to the outcomes specified in paragraph 2.24 as the ‘IM amendments framework outcomes’ in this paper.

Amendments to the IPP for RCP3 and draft IPP for RCP4

- 2.27 Our discretion as to whether we amend the IPP for RCP3 and draft IPP for RCP4 is driven by whether such an amendment would promote the s 52A purpose of Part 4.
- 2.28 We may also take into account the s 52R IM purpose as well as the other matters listed at paragraph 2.25, where they are relevant and where taking them into account does not compromise our achievement of the s 52A purpose of Part 4.

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 \(21 December 2022\)](#).

Chapter 3 Proposed amendments to the IMs

Purpose of this chapter

- 3.1 This chapter describes our proposed changes to the IMs. Most of the proposed amendments are the same or similar for EDBs, GPBs and Transpower.
- 3.2 We also describe a related change to the definition of ‘other regulated income,’ which for Transpower sits in the IPP determination rather than in the Transpower IMs.
- 3.3 We summarise the proposed changes below, and then for each of the changes, we explain in more detail:
 - 3.3.1 our current requirements;
 - 3.3.2 our proposed amendments; and
 - 3.3.3 how the proposed amendments are likely to promote an IM amendments framework outcome, as defined in Chapter 2, para 2.24.

Summary of proposed IM amendments

- 3.4 We propose amending the IMs as follows:
 - 3.4.1 for EDBs and GPBs, to treat capex insurance entitlements and compensatory entitlements in respect of assets that have been damaged or destroyed like capital contributions, and net them off the cost of assets where they are applied to the remediation of assets;
 - 3.4.2 for Transpower, to treat capex insurance entitlements in respect of assets that have been damaged or destroyed like capital contributions, and net them off the cost of assets where they are applied to the remediation of assets;
 - 3.4.3 for EDBs and GPBs, to offset opex insurance and opex compensatory entitlements arising from asset damage and third-party liabilities against the corresponding operating expenditure in the year or years of remediation or third-party compensation spend, with any entitlement exceeding the corresponding spend to be treated as ORI;
 - 3.4.4 for Transpower, to offset opex insurance entitlements arising from asset damage and third-party liabilities against operating expenditure in year or years of remediation or third-party compensation spend, with any entitlement exceeding the corresponding spend to be treated as ORI;

3.4.5 for EDBs and GPBs, to exclude ‘insurance entitlements’, ‘compensatory entitlements’ and ‘third-party liability entitlements’ from the definition of ORI; and

3.4.6 for all PQ-regulated suppliers, to make a consequential amendment replacing undefined references to ‘insurance entitlements’ and ‘compensatory requirements’ in certain of the IMs for reconsidering a PQ path with the equivalent defined terms proposed for the amendments summarised above.

3.5 The regulatory accounting outcomes of our proposed changes are summarised in Table 1.

Table 1: Regulatory accounting outcomes under proposed changes

Type of insurance/entitlement	Use of Entitlements	Treated as		Consistent with GAAP?
		Capex	Opex	
Asset cover	Used to replace assets	asset cost offset		No
Asset cover	No asset replacement	ORI		Yes
Opex cover from asset damage	Used for consequential opex		opex offset	No
3rd party liability from asset damage	Paid to 3rd party		opex offset	No
Other 3rd party liability	Paid to 3rd party		opex offset	No
Business interruption	Used to recover loss of profits		ORI	Yes
Other insurance	Used to meet insured costs		ORI	Yes
EDBs/GPBs only				
Compensatory entitlement	Used to replace assets	asset cost offset		No
Compensatory entitlement	Used for consequential opex		opex offset	No

3.6 Our focus is on changes that deliver the above regulatory accounting outcomes and which we consider align with our decision-making framework. We may, however, consider further such changes suggested in our consultation process where we consider them to be consistent with that framework.

Summary of proposed amendments to IPP for RCP3 and draft IPP for RCP4

3.7 For Transpower we propose to exclude ‘insurance entitlements’ and ‘third-party liability entitlements’ (as defined in the proposed amendments to the Transpower IMs) from the definition of ORI in Transpower’s IPP Determination. This is because the definition of ORI is included there rather than in the Transpower IMs. We set out the proposed change to:

3.7.1 the IPP for RCP3, in a draft amendment determination to that IPP; and

3.7.2 the draft IPP for RCP4, in Attachment A.

- 3.8 We have not proposed an exclusion for ‘compensatory entitlements’ for Transpower, as Transpower has a discretion to treat these as a reduction in asset costs or as income under the Transpower IMs.

Current requirements – insurance entitlements and compensatory entitlements

- 3.9 The current IMs, and those IMs that will apply as a result of the IM review completed in 2023, treat insurance entitlements as ‘other regulated income.’ Capex entitlements do not fall within the definition of ‘capital contributions’, as applies to EDBs and GPBs, because their purpose is to compensate businesses for damage to assets. They are not payments for the purposes of asset construction, acquisition or enhancement.
- 3.10 ORI is included in forecast revenue in setting price paths and in actual revenue for the revenue wash-up calculation (applicable to EDBs, GTBs and Transpower), which means that any surplus over the forecast amount must be returned to consumers as a (negative) recoverable cost. This means that regulated suppliers are not able to retain and use the cash proceeds from insurance and similar entitlements if they are recognised as ORI.
- 3.11 There may be grants or other compensatory payments intended to facilitate reinstatement or construction of assets, which under the existing definitions must also be treated as ORI and passed on to consumers if they do not meet the definition of ‘capital contributions’. This treatment may deter third parties from making payments to assist with asset remediation, and otherwise act as a disincentive to remediation investment. There is no requirement for Transpower to treat compensatory payments as ORI, as the Transpower IMs allow Transpower the discretion to recognise such payments as an offset against the cost of assets or as income.
- 3.12 The treatment of insurance entitlements as ORI under the IMs also means that they are not netted off additional remediation costs for IRIS calculation purposes in a catastrophic event situation. They are, however, required to be netted off in calculating the price path impact of catastrophic event remediation costs and in calculating a catastrophic event allowance.
- 3.13 This means that we are only able to compensate suppliers via the catastrophic event reopener for the IRIS impacts of additional costs that are not covered by insurance. From a policy perspective, this disadvantages suppliers who have taken out insurance cover.
- 3.14 Suppliers may also face opex IRIS penalties for consequential opex arising from damaged assets or from payments in respect of third-party liability claims where that opex is covered by insurance.

- 3.15 In respect of routine remediation expenditure arising from damage to assets or third-party liability events, insured suppliers will not enjoy the immediate benefit of the cashflow provided by asset or third-party liability insurance cover, as this must be passed on to consumers via the revenue wash-up.
- 3.16 Supplier asset damage could subsequently give rise to third-party liability costs. Furthermore, we consider there is no policy reason to distinguish damage to a third party's assets that arises from damage to a supplier's assets, and similar entitlements arising from direct causes of liability such as damage to a third party's assets or other third-party costs that might occur, for example, as a result of a regulated supplier carrying out lines services work. We have therefore proposed changes to the treatment of third-party liability entitlements generally. This will mean that suppliers are not exposed to opex IRIS penalties arising from the settlement of unforecast third-party liability claims, whether arising from damage to third-party assets or any other cause.

Proposed IM amendments

- 3.17 The proposed IM amendments are as follows:
- 3.17.1 First, we propose new definitions for 'insurance entitlements' and 'third-party liability entitlements' (for EDBs, GPBs, and Transpower), and 'compensatory entitlements' (for EDBs and GPBs).
- 3.17.2 Secondly, we propose that, for EDBs and GPBs, 'insurance entitlements' and 'compensatory entitlements' in respect of damaged or destroyed assets are treated as if they were like capital contributions and are netted off commissioned asset costs.
- 3.17.2.1 For Transpower, we propose that only insurance entitlements be treated as if they were like capital contributions and are netted off commissioned asset costs. This is because, unlike the IMs for the other regulated services, the Transpower IMs are silent on the accounting treatment of capital contributions from third parties. While clause D4(1)(i) of Schedule D4 of the Transpower Capex IM provides for how financial contributions are treated as part of the major capex investment test, no explicit provision is made for how they are accounted for outside of this assessment. In our recent Part 4 IM Review, we decided not to amend the Transpower IMs in respect of the

treatment of contributions from third parties that are not insurance entitlements;¹⁸

- 3.17.2.2 Where insurance entitlements are netted off asset costs, we propose that:
- 3.17.2.2.1 EDBs and GPBs treat any subsequent adjustments after the asset's commissioning date, for example due to a change in the estimated value of entitlements, as separate assets or negative assets; and
- 3.17.2.2.2 Transpower's chooses whether to treat any subsequent adjustments after the asset's commissioning date as a part of that asset or as a separate asset or negative asset.
- 3.17.2.3 The above approach is consistent with the current treatment of subsequent expenditure on an asset in accordance with clause 2.2.11(4)(b) of the EDB/GPB IMs and clause 2.2.7(4)(b) of the Transpower IMs, respectively.
- 3.17.2.4 If insurance entitlements are not netted off the cost of asset remediation or replacement, then we propose that they must continue to be treated as ORI.
- 3.17.3 Thirdly, we propose that insurance entitlements and third-party liability entitlements in respect of insured operational costs that arise from damaged or destroyed assets or third-party liability claims for EDBs, GPBs and Transpower are netted off in the definition of 'operating expenditure' for the year in which the remediation or third-party liability costs are incurred.
- 3.17.3.1 This may give rise to the need for a restatement of operating expenditure where estimates of insurance entitlements and third-party liability entitlements are adjusted after they are first recognised.
- 3.17.3.2 We also considered an alternative solution for insured operational costs, to deduct the insurance and third-party liability entitlements from actual opex included in the calculations of IRIS incentive amounts in Part 3 of the IMs. This

¹⁸ [Commerce Commission "Transpower investment topic paper, Part 4 Input Methodologies Review 2023 - Final decision" \(13 December 2023\)](#), pages 137-139.

would be similar to the Part 3 partitioning of the treatment of operating lease payments, which are added to the definition of 'operating expenditure' for IRIS purposes only. In this case, however, the insurance entitlements adjustment would only be applied against actual opex to reduce the overspend taken into account for the opex IRIS calculations.

3.17.3.3 On balance, our preferred solution is to propose that insurance entitlements and third-party liability entitlements be netted off in the definition of 'operating expenditure' as outlined in our draft amendment determinations.

3.17.3.4 We do not propose to change the treatment of insurance for non-asset related cover other than third-party liability cover (for example, business interruption insurance), which will continue to be included in ORI.

3.17.3.5 Where insurance entitlements for asset damage are not used for remediation, we propose that they continue to be treated as ORI.

3.17.4 Fourthly, we propose to make a consequential amendment to the IMs for all PQ-regulated suppliers to replace undefined references to 'insurance entitlements' and 'compensatory requirements' in certain of the IMs for reconsidering a PQ path with the equivalent defined terms proposed for the above amendments.

3.18 Consistent with s 53ZB(1) of the Act, we consider that making and applying the IM amendments as proposed in the draft IM amendment determination would not reopen current regulatory period any existing PQ path within the (ie, DPP3 for gas transmission and distribution services, RCP3 for Transpower, and DPP3 for EDBs). This reflects that in each case, the IM amendments would not reopen within the regulatory period, the allowable revenue for the remaining years of the regulatory period.

3.19 For the same reason, we consider that the proposed amendment to the IPP for RCP3 and draft IPP for RCP4 would not reopen within relevant regulatory period the PQ path for Transpower.

How the proposed amendments are likely to promote an IM amendments framework outcome

3.20 We acknowledge that the IM amendments proposed for the draft decision affect elements of a foundational building block of the regime. Under normal circumstances, we would be hesitant to make changes to fundamental IMs outside of the statutory IM review cycle. However, as explained below, the changes are

necessary for us to continue to apply our regulatory framework consistently and will enable us to promote the Part 4 purpose more effectively.

- 3.21 The current IMs' treatment of insurance entitlements as ORI means that suppliers may not be compensated for the IRIS costs of additional remediation expenditure in a catastrophic event situation, although insurance entitlements are taken into account for assessing costs that can be recovered through a catastrophic event reopener. This disadvantages suppliers that have taken out insurance cover compared to those suppliers that have not.
- 3.22 For routine remediation expenditure and third-party liability costs, under the current IMs, insured suppliers do not get the benefit of the cashflow provided by asset insurance cover, as this must be passed on to consumers via the revenue wash-up.
- 3.23 Unforeseen damage to supplier assets could also subsequently give rise to third-party liability costs. We do not consider there is a policy reason to distinguish damage to a third party's assets that arises from damage to a supplier's assets, and similar entitlements arising from direct causes of liability such as damage to a third party's assets or other third-party costs that might occur, for example, as a result of a regulated supplier carrying out lines services work. The current treatment of these as ORI exposes suppliers to IRIS costs in relation to the settlement of third-party liabilities and may disincentivise suppliers from taking out third-party liability insurance cover.
- 3.24 Where compensatory entitlements other than insurance must be passed on to consumers as ORI, this may deter third parties from making payments to assist with asset remediation, and otherwise act as a disincentive to remediation investment.
- 3.25 For the reasons outlined above, the proposed IM changes will promote the s 52A(1)(a) limb of the Part 4 purpose more effectively by improving incentives to innovate and to invest, including in replacement, upgraded, and new assets. The proposed changes will also promote s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose) by giving clarity about what is meant by insurance entitlements and other compensatory entitlements and how they should be accounted for.
- 3.26 We consider the reasons outlined above are compelling enough to justify making these changes outside of the normal statutory IM review cycle, because they would promote the Part 4 purpose and support incremental improvements to PQ paths.
- 3.27 The proposed changes will place some additional compliance obligations on EDBs, GPBs and Transpower in calculating asset values, operational expenditure and ORI for revenue forecasting and for ID reporting. However, we consider that the likely

long-term benefits to consumers would sufficiently outweigh any increase in compliance costs, other regulatory costs or complexity.

How the proposed amendment to the IPP for RCP3 and draft IPP for RCP4 aligns with our decision-making framework

- 3.28 The proposed amendment to the IPP for RCP3 and draft IPP for RCP4 would give effect to the same policy change for Transpower as outlined above for the IM amendments proposed for PQ-regulated suppliers.
- 3.29 We therefore consider the proposed amendment to the IPP for RCP3 and draft IPP for RCP4 would have the same effect in terms of promoting the s 52A(1)(a) limb of the Part 4 purpose more effectively, for the reasons outlined above.

Attachment A: proposed amendment to the draft IPP for RCP4

Our proposed amendment to the definition of ‘other regulated income’ in clause 7.1 of the draft IPP for RCP4 is marked-up,¹⁹ as follows:

other regulated income	<p>means income associated with the supply of electricity transmission services, excluding:</p> <ul style="list-style-type: none"> (a) actual transmission revenue; (b) income associated with electricity transmission services performed by Transpower as system operator; (c) income associated with new investment contracts; and (d) investment-related income; (e) <u>any insurance entitlement that has been applied to reduce the value of a commissioned asset under clause 2.2.10(1)(j) of the Transpower IM;</u> (f) <u>any insurance entitlement that has been netted off in calculating an operating cost; and</u> (g) <u>any third-party liability entitlement that has been netted off in calculating an operating cost;</u>
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¹⁹ Copies of our draft decision paper for Transpower’s IPP for RCP4 and the draft IPP for RCP4 can be found on our [website](#).