Attachment H Other matters

H1 Purpose of the attachment

H2 This attachment explains the rationale for decisions related to other policy matters relevant to the DPP4 reset. It provides background analysis to those decisions and responds to stakeholder submissions on each topic area.

H3 It covers:

H3.1 regulatory period length;

H3.2 Aurora Energy's CPP/DPP transition;

H3.3 CPP application deadlines; and

H3.4 asset transfers.

Final decision on Regulatory period length

X1 Retain the current five-year regulatory period length

Nature of the decision

H4 Section 53M(4) of the Commerce Act (the Act) specifies a five-year duration for a default price-quality path (DPP) as a default. However, s 53M(5) gives us the discretion to set a regulatory period shorter than five years (but no less than four years) if it aligns better with the purpose of Part 4.

H5 Recognising the forecasting challenges in the DPP due to heightened uncertainty, along with potential heightened requirements for decarbonisation investment, we have considered whether the long-term benefit of consumers would be improved by having a four-year regulatory period.

Final decision

H6 Our final decision is to retain a five-year regulatory period. This is unchanged from our draft decision.

What we heard from stakeholders

H7 In submissions on our draft decision, stakeholders acknowledged that while there are inherent uncertainties associated with any regulatory period, the benefits of providing regulatory certainty outweigh these concerns.[1]

H8 Submitters such as Vector and MEUG agreed that a five-year regulatory period offers a better balance by providing continuity and avoiding the administrative costs associated with more frequent resets.[2] Wellington Electricity also expressed the view that a shorter regulatory period does not present a better solution for addressing issues like investment uncertainty and capex step changes, compared to using mechanisms like reopeners.[3]

H9 Additionally, Unison considered that a longer regulatory period enhances the deliverability of projects by providing greater confidence in the funding and planning of projects over a five-year span, thereby enabling a commitment to a longer-term work profile.[4]

H10 Alpine acknowledged that there might be merit in considering shorter regulatory periods in the future, particularly as a way to mitigate forecasting challenges or future uncertainties that cannot be easily addressed within the current regulatory regime.[5]

Analysis

H11 We considered whether there might be value in reducing the regulatory period to better address significant contextual uncertainty affecting all EDBs during the regulatory timeframe.

[1] Submissions by Orion, MEUG and ENA on the Commerce Commission "EDB DPP4 draft decision" (12 July 2024).

[2] Vector "Submission on EDB DPP4 draft decision" (12 July 2024), p. 2; and Major Electricity Users' Group "Submission on EDB DPP4 draft decision" (12 July 2024), p. 5.

[3] Wellington Electricity "Submission on EDB DPP4 draft decision" (12 July 2024), p. 52.

[4] Unison "Submission on EDB DPP4 draft decision" (12 July 2024), p. 21.

[5] Alpine "Submission on EDB DPP4 draft decision" (12 July 2024), p. 20.

H12 Stakeholders felt that reducing the period length was unwarranted and would add further cost and complications to the regime to reduce the regulatory period. They expressed concerns that altering the duration of the regulatory period would significantly increase uncertainty within the regulatory framework. This heightened uncertainty could disrupt the ability to manage and execute projects efficiently, both in terms of cost and implementation.

H13 They noted that if the regulatory period is shortened, the amount of 'in period' information available for evaluation could be reduced to as little as two years. This reduction would complicate the ability to draw meaningful conclusions about the effectiveness of actions taken during the current DPP period, thereby hindering the process of informing and improving future DPPs. They emphasized that stability is crucial, suggesting that a minimum of three years of experience within the DPP framework is necessary to effectively inform any potential changes to the DPP structure.[6]

H14 We consider the following factors support retaining a five-year regulatory period:

H14.1 altering the regulatory period heightens the interest rate hedging risk, a primary concern for EDBs. Opting for a lengthier reset period offers greater certainty in managing this risk, as it remains locked in for an extended duration. Securing capital for long-term capex projects would become challenging for EDBs, as creditors would face increased uncertainty regarding the settings four, eight, or nine years into the future;

H14.2 we have increased the availability of reopeners as part of the recent IM review, which may be a more appropriate tool to address increased uncertainty for individual EDBs; and

H14.3 more frequent DPP resets would increase compliance costs. Further, as noted in submissions, the shorter regulatory cycle would reduce the time available to make any changes to our performance monitoring regime under ID, build up a timeseries of information, and to make changes to DPP settings as a result.

H15 We note a shorter regulatory period works to reduce the strength of efficiency incentives under the IRIS mechanism, with EDBs retaining any gains for a shorter period before they are passed on to consumers.

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[6] Submissions by Alpine, Horizon, Aurora, ENA, MEUG, Orion, The Lines Company, Unison and Wellington Electricity on the Commerce Commission "DPP4 Issues paper" (19 December 2023).

H16 Our decision better promotes the overarching objectives in s52A of the Act and aligns with the relatively low-cost way of setting price-quality paths set out in s 53K of the Act.

Final decision for Aurora Energy's CPP/DPP transition

X2 Include Aurora in the DPP4 expenditure and revenue setting process

Nature of the decision

H17 With Aurora's CPP ending on 31 March 2026, we may need to determine prices for a CPP to DPP transition and we considered whether we should include Aurora in the DPP determination.

Final decision

H18 Our final decision is to include Aurora in the DPP4 expenditure and revenue setting process.

H19 This involves setting indicative opex, capex, and revenue forecasts as part of this DPP4 reset process, then under s 53X finalising Aurora's revenue path in 2025 prior to the transition, taking account of the most recent information available at the time.

How the decision is aligned to the decision-making framework for the DPP

H20 Section 53X (2) of the Act gives us two options for determining prices for the CPP-DPP transition:

H20.1 rolling over the starting prices which applied at the end of the CPP period; or

H20.2 determining different starting prices that will apply, after giving the supplier four months' notice.

What we heard from stakeholders

H21 We only received two submissions in response to our draft decisions from Aurora and Powerco restating their support for the proposed approach.[7] Aurora reiterated that it is happy with the Commission working closely with Aurora Energy ahead of the transition from CPP to DPP and the 2025 AMP being the starting point for assessing forecast capex.

Analysis

H22 Similar to Wellington Electricity in DPP3, Aurora's CPP only coincides with the DPP4 for a single year. This implies that assessing its revenue requirements for the DPP4 period presents only minor additional challenges compared to other EDBs on the DPP. With Wellington Electricity, we did not set starting prices for when it transitioned in 2020, but provided guidance on how we would set the starting price in 2020 and set indicative opex and capex allowances.[8,9]

H23 With Powerco's CPP to DPP transition in 2023 we decided to set starting prices closer to the time it would transition because the DPP3 reset was taking place too far in advance of Powerco's transition.[10] We did not give indicative prices in the DPP3 reset as we could not reliably forecast what its starting prices should be in the year starting 1 April 2023. Closer to the transition in 2022 we used a BBAR approach to establish initial prices, taking into consideration both current and projected profitability. This method closely mirrored the approach used for other EDBs under DPP3, but it incorporated information from Powerco's latest disclosures for a more comprehensive assessment.

[7] Aurora "Submission on EDB DPP4 draft decision" (12 July 2024), p. 7; Powerco "Submission on EDB DPP4 draft decision" (12 July 2024), p. 34.

[8] Commerce Commission "Wellington Electricity Lines Limited's transition to the 2020-2025 default price-quality path Reasons paper" (26 November 2020).

[9] The price path for DPP4 will apply to distributors as a 'revenue cap'. A revenue cap limits the maximum revenues a distributor can earn, rather than the maximum prices that it can charge. For this reason, while the terminology in the Act refers to a 'price path' and to 'starting prices', in this paper we have generally referred to 'allowable revenues' a distributor can earn. For consistency with the decision framing in DPP3 and our statutory requirements we have referred to "starting prices" here.

[10] Commerce Commission "Powerco Limited's transition to the 2020-2025 default price-quality path Reasons paper" (18 August 2022).

H24 Much like the CPPs of Powerco and Orion, Aurora's CPP experienced a notable increase in opex and capex levels. When determining opex and capex allowances, it is crucial to determine whether these increases are a temporary consequence of the CPP or indicate a permanent rise in baseline expenditure. We will be engaging closely with Aurora in advance of deciding how we will set its prices, when finalising Aurora's revenue path in 2025 prior to the transition taking place 1 April 2026.[11]

H25 Aurora previously submitted on the issues paper:[12]

H25.1 supporting our stance to include Aurora in the DPP4 reset. Aurora emphasized that this inclusion would offer it greater certainty for robust financial planning. This, in turn, enables strategic preparations, including reopener applications for projects where regulatory allowances might pose uncertainties;

H25.2 seeking clarification on whether the finalisation process solely entails updating financial model inputs for Aurora's last CPP year or if the Commission is considering other modelling adjustments. Additionally, it is interested in understanding if the Commission plans to utilise Aurora Energy's 2025 AMP to enhance expenditure assumptions for future growth projects that might be uncertain during the preparation of the 2024 AMP; and

H25.3 invited the Commission to engage with Aurora directly regarding setting allowances to clarify how the process works so that it has more certainty.

H26 We do not consider that the process will necessarily just be updating financial model inputs. We consider some adjustment of the expenditure assessment framework particularly for capex may be required, dependent on the extent of change forecasted in Aurora's 2025 AMP.

[11] We have made a representative -$3.5 million adjustment to Aurora's indicative opex allowance to reflect the end of its CPP. We have not made any adjustment to capex allowances, pending the disclosure of Aurora's 2025 AMP.

[12] Aurora Energy "DPP4 Issues paper submission" (19 December 2023), p. 5.

Alternative considered

H27 Following the issues paper Unison proposed that the Commission enhance clarity during the transition from CPP to DPP by issuing a framework.[13] Unison suggested a framework that covers alignment with standard DPP processes, timing, approach, EDB-specific considerations, and criteria for assessing expenditure allowances, incentives, and quality standards. It also stated that greater clarity is needed on the processes for CPPs ending early or later in a DPP period.

H28 While we saw merit in creating a framework and how it could improve certainty, we do not see the need to implement one yet. In our experience with Powerco and in previous transitions the approach we used worked well and was flexible enough to cater to the EDB's circumstances. The goal is to transition seamlessly from the CPP without compromising the implementation of network improvements or future growth initiatives. We consider our approach has been demonstrated to work well.

Conclusions

H29 In making our decision, we are exercising discretion granted by s 53X when Aurora transitions, and we are guided by the principles outlined in s 52A and s 53K. his approach underscores our commitment to a transition strategy that is both effective and cost-conscious and promotes the long-term benefit of consumers.

Final decision for CPP application windows

X3 Retain the CPP application timings set for DPP3

Nature of the decision

H30 Setting the date each year for when EDBs must submit CPP applications is one of the statutory requirements for the DPP determination.[14]

[13] Unison "DPP4 Issues paper submission"(19 December 2023), p. 20.

[14] Section 53O(e) of the Commerce Act 1986.

Final decision

H31 Our decision is to keep the final application date for CPPs as 190 working days before the commencement of the upcoming pricing year for the first four years of DPP4. In the final year of the DPP period, we have set a final application date of 29 March, as there is a statutory prohibition on CPP applications in the final year of the DPP period.[15] The dates are set out in table H1 below:

Table H1 Proposed CPP application deadlines

CPP beginning	Final date for application
1 April 2026	11 June 2025
1 April 2027	9 June 2026
1 April 2028	15 June 2027
1 April 2029	12 June 2028
1 April 2030	29 Mar 2029

H32 If an EDB wants to be informed of its final CPP starting prices in time to notify retailers of price adjustments, the CPP application would need to be submitted earlier than the final date mentioned above. Based on a 190 working day timeline, our estimation for the deadline by which an EDB would need to apply for a CPP with a four-month notice period are outlined in Table H2 below.

Table H2 CPP application with four-month notice period[16]

CPP beginning	CPP final decision date	Approximate application date
1 April 2026	28 November 2025	27 February 2025
1 April 2027	30 November 2026	27 February 2026
1 April 2028	30 November 2027	2 March 2027
1 April 2029	30 November 2028	3 March 2028
1 April 2030	30 November 2029	6 March 2029

[15] Commerce Act 1986, s 53Q(3)

[16] These dates assume a 190 working-day consideration period, are for guidance only, and are not part of the DPP determination.

What we heard from stakeholders

H33 The submissions we received expressed support for the retention of the CPP application timings set for DPP3.[17] Submitters saw no compelling reasons to modify the application windows.

H34 Alpine submitted in support of our draft decision and encouraged an approach which accounts for the differing application complexities, noting that it would be the interests of consumers, applicants, and the Commission.[18]

Analysis

H35 Consistent with Section 53T of the Act, we have established a final application date 190 working days before the commencement of the upcoming pricing year for the initial four years of the DPP period in DPP3.

H36 The 190-working day lead time was based on the CPP assessment timeframes set out in the Act:

H36.1 the Commission has 150-working days to assess a CPP and determine starting prices and quality standard;[19]

H36.2 and by agreement with the supplier, may apply a 30-working day extension;[20] and

H36.3 process of preliminary assessment of a CPP proposal, as contemplated by s 53S of the Act. Which allows 40 working days to assess whether a CPP proposal complies with the relevant input methodologies (IMs).[21]

H37 If an EDB wants to know its final CPP starting prices early enough to give notice of price changes to retailers, it needs to submit its CPP application earlier than the current 190 working day timeline.

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[17] Submissions by Aurora, ENA, Orion, Powerco and Wellington Electricity on the Commerce Commission "EDB DPP4 draft decision" (12 July 2024).

[18] Alpine "Submission on EDB DPP4 draft decision" (12 July 2024), p. 20.

[19] Commerce Act 1986, s 53T(2).

[20] Commerce Act 1986, s 53U. This option to extend remains available; however, may result in a final decision date after 1 April the following year.

[21] Commerce Act 1986, s 53S.

H38 During the DPP3 regulatory period, we only received one CPP application from Aurora Energy on 12 June 2020, which was the last day for applications for a price path starting from 1 April 2021. Notably, Aurora's price-quality path was finalised on 31 March 2021, resulting in the first year of pricing being based on the draft decision, with wash-ups applying for differences in value.

Final decisions for Asset Transfers

Decisions R1.5 and QS11

Nature of the decision

H39 Under our DPP3 approach there is a requirement for transferring and receiving EDBs to agree a reasonable allocation of revenues and quality parameters.

H40 Our asset transfer provisions do not provide a de minimis threshold (revenue or quality) for this requirement.

H41 EDBs consider that our asset transfer provisions could lead to administrative complexity and unnecessary compliance costs for EDBs when relatively small asset transfers take place, which may have a limited impact on quality metrics or allowable revenue.

Final decision

H42 Our final decision is to:

H42.1 require EDBs to determine a reasonable reallocation of revenue following an asset transfer (**decision R1.5**);

H42.2 retain the requirement for reasonable reallocation of quality parameters following a transfer of more than 0.5% of ICPs of the smallest non-exempt EDB that is party to the transaction (**decision QS11**). This is a change from our draft decision, which did not include a de minimis threshold for this requirement; and

H42.3 remove the requirement for a non-exempt EDB to "agree" transfer values with an exempt EDB.

How the decision is aligned to the decision-making framework for the DPP

H43 Our decision simplifies the DPP's transfer arrangements and reduces EDBs' compliance costs in a way that does not detract from promoting the s 52A purpose. This is consistent with the purpose of DPP regulation under s 53K, providing a relatively low-cost way of setting price-quality paths and reducing unnecessary complexity and compliance costs.

What we heard from stakeholders

H44 We received one submission on our draft decision. Aurora submitted that while it supported the requirement for reasonable allocation of SAIDI and SAIFI, it considered a de minimis threshold needs to be introduced. Citing its experience in the November 2022 transfer of 144 connections on its network, it considered that "there has been little benefit to consumers in us incurring the costs of undertaking these adjustments."[22]

H45 We received cross-submissions from ENA and Powerco in support of Aurora's request to introduce a minimum threshold.

H46 ENA submitted that they see significant value in the introduction of a minimum threshold for adjustments to revenue and quality paths following a transfer.[23] Powerco submitted that "Implementing a de minimis threshold is a sensible approach that will prevent EDBs and consumers from incurring unnecessary costs for adjustments with minimal impact on quality standards and allowable revenue".[24]

Analysis conducted

H47 There are three types of transaction provisions which exist within the DPP and IMs that are dealt with differently:

H47.1 Amalgamation or merger: When two non-exempt EDBs merge or amalgamate, their price-quality paths are aggregated consistent with the IMs.

[22] Aurora Energy "Submission on EDB DPP4 draft decisions" (12 July 2024), p. 14

[23] Electricity Networks Aotearoa (ENA) "Cross-submission on EDB DPP4 draft decisions" (2 August 2024), p. 3.

[24] Powerco "Cross-submission on EDB DPP4 draft decisions" (2 August 2024), p. 3.

H47.2 Major transaction: If a transaction affects more than 10% of a EDB's opening regulatory asset base (RAB), it is a ‘major transaction’. The Commission may reopen and amend the EDB’s price-quality path under the IMs.

H47.3 Transfers: Where a non-exempt EDB is party to transaction that is not an amalgamation or merger and affects 10% (or less) of the EDB's opening RAB, this is a "transfer. The EDB must make specific adjustments to revenue and quality standards and incentives under the DPP determination, applying a principles-based approach.

R1.5 Require EDBs to determine a reasonable reallocation of revenue following an asset transfer.

H48 Our final decision is to require EDBs to determine a reasonable reallocation of revenue following an asset transfer without introducing a minimum financial threshold. This decision reflects our view that while asset transfers can have material implications for revenue, calculating these impacts is typically less complex than reallocating quality metrics (eg, using revenue received from transferred ICPs, or an average revenue per user amount).

H49 We recognize that not setting a minimum threshold maintains the existing compliance burden, even for small asset transfers. In such cases, adjustments to forecast net allowable revenue and wash-up amounts will still be required.

H50 However, if we make no reduction to revenue remaining customers would continue to pay for assets the EDB no longer owns, which would be inconsistent with the outcomes in s 52A(1)(d) of the Act, to limit suppliers’ ability to extract excessive profits.

H51 Our approach is based on the principle that, in aggregate, consumers should not be worse off due to a transaction. While we remain mindful of administrative burden, we consider calculating the revenue impact to be less complex than reallocating quality metrics. We believe that maintaining flexibility without a fixed threshold ensures that all transactions, regardless of size, are assessed based on a case-by-case basis.

H52 Since low value asset transfers by EDBs has not been frequent and even transactions with small RAB implications can be material in revenue terms, we do not consider a threshold for revenue adjustments necessary at this time. Nonetheless, it may be worthwhile to reassess this approach in future if asset transfers become more recurrent and as the landscape evolves.

QS11: Retain the requirement for reasonable reallocation of quality parameters following a transfer of more than 0.5% of ICPs of the smallest non-exempt EDB that is party to the transaction.

H53 Our final decision is to retain the requirement for reasonable reallocation of quality parameters following an asset transfer but with a threshold. This requirement does not apply if the transfer is less than 0.5% of ICPs of the smallest non-exempt EDB that is party to the transfer. We have added a minimum threshold to our draft decision to help reduce EDBs' cost of compliance where a transfer is not material.

H54 When a non-exempt EDB engages in a transaction above the threshold, an adjustment needs to be made to both quality standards and quality incentives parameters.

H55 The non-exempt EDB will determine an allocation for each of the parameters of the quality standards (eg, boundary values, reliability limits) and quality incentives (eg, targets and caps), where the transaction is with another non-exempt EDB these values will need to be agreed.

H56 We note that when demonstrating whether adjustments to quality standards were reasonable, we would look to the ICP weighted sums of SAIDI and SAIFI before and after the transactions, rather than the absolute amount of SAIDI and SAIDI.

H57 We consider that unpicking the historical interruptions associated with a specific subset of ICPs may be complex, particularly where only part of a feeder may have been transferred. We consider that the implementation of a de minimis threshold, set at 0.5% of ICPs of the smallest non-exempt EDB who are a party to the transfer, will prevent EDBs and the Commission from incurring unnecessary compliance costs for transfers that will have a minimal impact on quality standard and incentives.

We have removed requirement for a non-exempt EDB and an exempt EDB to agree transfer values

H58 The asset transfer provisions also require that the other party in a transfer agree to the proposed allocations. However, since exempt EDBs are not subject to our price-quality regulation they are not obligated or incentivised to participate. This can create challenges for non-exempt EDBs in obtaining compliance and engagement from exempt EDBs, risking unintentional non-compliance.

H59 We have decided to remove the requirement for an exempt EDB to agree, so that the non-exempt EDB will no longer be exposed to the risk the exempt EDB party does not participate in a recalculation.