unison
The Powerlines People

21 October 2024

Commerce Commission
Te Komihana Tauhokohoko
Attn: Ben Woodham

By email: infrastructure.regulation@comcom.govt.nz

Tēnā koe Ben

CROSS SUBMISSION PROPOSED AMENDMENTS TO THE INPUT METHODOLOGIES – INSURANCE ENTITLEMENTS

The complexity justifies optionality

1 We support the robust policy intent of the Commission's proposed amendments and urgency of resolution.

2 The submissions filed clarify the **likely harm** to distributors and their consumers of:
  a. the existing Input Methodologies (**IM**) approach;
  b. a rigid approach to foreseeable scenarios;
  c. undermining incentives to:
    i. hold efficient levels of insurance; and
    ii. mitigate risks for the benefit of consumers;
  d. impractical regulatory burden; and
  e. inequitable reductions of future revenues.

3 The purpose of this submission is to demonstrate that **optionality** (enabling a non-exempt EDB to adopt the Commission's proposal, or the ENA's retention factor proposal) **achieves a materially better Part 4 outcome**, as we submitted on 4 October 2024. It provides a regulatory safeguard to enable non-exempt EDBs to protect their consumers from an adverse regulatory outcome (also discussed in our previous submission).

4 As both the Commission's proposals and the ENA's are net present value neutral, we encourage pragmatism driven by the greatest identifiable harm. Regulatory treatment that creates a significant cash-flow deficit for an EDB who, in a workably competitive market, would be insulated from that outcome by their insurance entitlement is an unjustifiable and significantly harmful impact.

5 The amendments should '*mitigate the impact on the distributors and consumers to the extent practicable*'.[1] The Commission's approach, ENA and Transpower's alternative solutions do not appear to mitigate the impact equitably in all circumstances. We acknowledge that simplicity will be warranted in some circumstances. We agree with ENA that the proposals do not need to complicate reporting for price-quality exempt EDBs and we support Orion's submission.

Balancing the key economic principles

6 The Commission's proposal or the ENA's retention factor proposal resolve non-exempt EDBs circumstances differently depending on the nature and scale of an event and / or the entitlements. This is demonstrated when assessed against the Commission's key economic principles promoting Part 4 set out in the Input Methodologies Review 2023 Framework paper,[2] included in **Appendix One**.

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[1] *Input Methodology amendments for electricity distribution services*, Default price-quality paths, 27 November 2014, at [12.16].
[2] *Part 4, Input Methodologies Review 2023*, Framework paper, 13 October 2022.

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7 To restore incentives to invest in insurance, at a minimum, the amendments must **provide certainty for non-exempt EDBs** that the regulatory treatment will:

  a. equitably respond to foreseeable scenarios by **resolving cashflow** for distributors (consistent with a workably competitive market);
  b. implement a **proportionate regulatory burden** commensurate with the risks facing consumers and the non-exempt EDB; and
  c. improve the **pathway to rectify** adverse regulatory treatment.

8 We acknowledge the complex nature of insured events and compensatory entitlements and subsequent short to medium term impacts on price-quality path revenue entitlements, including IRIS. This warrants the Commission holding **further discussions or a workshop** with submitters to ensure that the final decision best meets the policy intent.

Optionality and amending the catastrophic event criteria are required

9 The Commission's reasons paper implementing the High Court's decision to include a catastrophic event mechanism emphasises the *"strong reason to ensure distributors make suitable preparations*[3]*"*. This includes:

  a. implementing efficient levels of insurance to protect the consumer from shouldering the full burden of an event; and
  b. a non-exempt EDB being unable to act in the long-term interests of consumers because of a material cashflow deficient (and financeability constraint) impacting the ability to invest.

10 As introduced above, the Commission's objective of the catastrophic event mechanism as described in 2014 is sound:[4]

> *[12.16] We would expect as a general rule that reconsiderations of this type would mitigate the impact on the distributors and consumers to the extent practicable, and in doing so would need to compensate for inaccurate revenue allowances prior to the start of any reconsidered price path. [Emphasis added]*

11 Optionality minimises the potential harm of an insured event impacting a non-exempt EDB adversely. This is aligned to the Commission's Framework Paper on the IM Review 2023, for the reasons below. The Commission has continued to apply its key economic principles throughout the EDB IM Reviews, and we consider the reasons equally apply to the existing IMs in force.

12 Transpower's regime is sufficiently distinct to warrant separate consideration. This is supported by: the diversification of their portfolio (with assets spread across Aotearoa); and the likely significance of insurance or compensatory payments received in a regulatory period compared to their revenue entitlements.

Options available in Information Disclosures and Default Price-Quality Path Compliance

13 Optionality is utilised in the existing regulatory treatments below, either in respect of the actual treatment applied or how it is used to address cashflow (based on the circumstances of the non-exempt EDB):

  a. The cost allocation methodologies of:
    i. ABAA or OVABAA; and
    ii. the allocator types – where a causal relationship cannot be established a proxy cost allocator can be used.
  b. The revaluation of physical asset lives in certain circumstances (a choice available for Airports).
  c. The approach to customer/capital contributions (balancing cashflow demands and the impact on consumer prices).
  d. The draw down of wash-up amounts (balancing cashflow demands and the impact on consumer prices).

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[3] *Input Methodology amendments for electricity distribution services*, Default price-quality paths, 27 November 2014, at [12.13].
[4] *Input Methodology amendments for electricity distribution services*, Default price-quality paths, 27 November 2014, at [12.16].

Amend the catastrophic event criteria to meet the policy intent

14 As referenced in ENA's submission, it was decided that including a catastrophic event reopener within the DPP (rectifying unjustifiably rigid regulatory treatment) achieves a materially better Part 4 outcome because it may avoid a customised price-quality path.

15 As ENA emphasise, the reasoning of the High Court[5] justifies amendment of the catastrophic event criteria to be considered in 'gross' as opposed to 'net of insurance and compensatory entitlements'. We support the ENA's conclusion that this is consistent with the Commission's view that *"the IM amendments would not re-open within the regulatory period"* because the allowable revenue remains the same.[6] The Commission's discretion within an application process provides adequate comfort a non-exempt EDB cannot unfairly gain from an allowance or reopener event. The goal is merely 'opening the door' for the Commission's fair consideration of the on-going applicability of a DPP in the circumstances consistent with the intention:

> *[1907] We acknowledge the Commission's in principle point, that a DPP – as a low (at least in theory) cost and to an extent one size fits all type of regulatory control – is less susceptible to being "reconsidered" by reference to an event affecting one or a small number of individual suppliers. At the same time, given the definitions of change event and catastrophic event, the trigger level is an objective one.* ***Establishing that the trigger level has been met would provide a basis for considering the on-going applicability of a DPP*** *to the supplier or suppliers in question. Furthermore, we would have thought that what would appear to be the Commission's principal concern, namely that an adjusted DPP might end up being higher than was appropriate because a DPP does not necessarily involve an assessment of forecasts of efficient expenditure, could – in what we take to be the reasonably unusual circumstances which constitute either of the material legislative or regulatory change or catastrophic trigger events – be addressed in the particular situation. Our essential point of difference with the Commission, and where we agree with Vector, is that given the nature of the trigger events (being quite beyond the control of the affected supplier or suppliers and objectively defined and measurable),* ***providing for automatic reopening is materially better than invoking the CPP pathway.***
>
> *[Emphasis added]*

16 As above, we encourage and look forward to further work with the Commission alongside other submitters to ensure a balanced regulatory outcome for all stakeholders into DPP4.

Nāku noa, nā

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Appendix One: Applying the key economic principles promoting Part 4 against optionality

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[5] *Wellington International Airport Ltd & Others v Commerce Commission* [2013] NZHC 3289, at [1907].

[6] *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*, 3 September 2024, at [3.18].

Appendix One: Applying the key economic principles promoting Part 4 against optionality

Commission's Framework Paper	Why optionality is a materially better way to promote Part 4
Ex ante FCM	
4.9.2 Providing appropriate compensation to suppliers for the risks they are required to manage either: (A) through an ex-ante allowance to suppliers for bearing the risk (through either the WACC and/or cashflows), the cost of which ultimately falls on consumers;[118] (B) by providing for ex-post compensation of **actual costs incurred** when the risk eventuates – although ex-post regulatory assessments of business performance that affect subsequent prices have their own risks in that they may detract from incentives to invest, so should be carefully considered; or (C) **through a combination of the above, provided there is no double counting, and where it would promote the section 52A Part 4 purpose** to do so; and…	The **risk of harm**, either because of: (a) disproportionate regulatory burden; or (b) unfair allocation of risk to non-exempt EDBs **undermining incentives to invest** in the long-term interests of consumers because of: • short to medium term reductions in revenue; and • unaltered quality demands from consumers. We consider that the circumstances of an event may alter the harm the pendulum swings to. Optionality addresses that concern.[7]
4.10 As a result of applying the FCM principle each regulatory period when setting PQ paths: 4.10.1 suppliers **have the opportunity to earn a normal return** on their efficient investments, consistent with section 52A(1)(a) and (d); 4.10.2 suppliers are rewarded for superior performance, consistent with section 52A(1)(b); and 4.10.3 **efficiency gains are shared with consumers** when the price path is reset (or via the IRIS mechanism), consistent with section 52A(1)(c).	While smaller values may not impact a normal return on efficient investment for a non-exempt EDB over a price-path, material sums will. How material the impact of insurance proceeds for non-exempt EDBs will vary with the nature and scale of events, timing of expenditure, and recognition of insurance proceeds received. Returning all or most proceeds to consumers distorts the perception of efficiency gains as consumers benefit in the short- term while the EDB faces increased financing and quality risks.
Allocation of risk	
4.12 Our risk allocation principle is that, ideally, risks should be allocated to suppliers or consumers depending on which are best placed to manage them. **Workably competitive markets tend to manage risks efficiently** by allocating identified risks to the party considered best placed to manage them.[119] 4.13 **Applying this principle** in the context of Part 4 regulation tends **to promote the section 52A(1)(a)-(d) outcomes** for the long-term benefit of consumers in a manner	**Incentives to invest are critical after an insured event**. Netting off insurance proceeds is consistent with outcomes achieved in a competitive market. Significant administration cost or adverse consequences in later price-paths, however, is not. This includes, where relevant, potentially unnecessary GAAP

[7] Noting that the Commission may need to consider how non-exempt EDBs address the values of gains or losses on disposals for the purpose of minimising the risk of double counting discussed in ENA's submission (pg 3, bullet 4).

Commission's Framework Paper	Why optionality is a materially better way to promote Part 4
similar to the way those outcomes are promoted in workably competitive markets.[120] … 4.15 In considering the application of this principle we are also taking into account practical impacts of risk allocation. **For example, during the Orion CPP we allowed for full cost recovery of Orion's immediate expenditure post-Canterbury earthquakes as we did not want to disincentivise this important expenditure**. In summary, this is not an overriding principle, and **we consider the overall impact** in promoting the section 52A purpose statement of a potential allocation of risk. 4.16 Regulated suppliers have various **risk management tools** at their disposal, **including insurance**, investment in network strengthening/resilience, hedging, contracting arrangements, and delaying certain decisions, like when to make large investments. Some of these tools may have associated costs to suppliers.	divergence if financeability or another significant factor cannot justify generating subsequent inconsistencies. Optionality enables a **proportionate response** considering the external factors and financial circumstances of the non-exempt EDB for the benefit of consumers long-term interests.
4.33.4 Regarding Unison's request to reconsider the risk allocation principle to better accommodate **intertemporal equity**: in promoting the section 52A purpose and the long-term benefit of consumers, if we considered tomorrow's consumers were better placed to manage risks than today's consumers, or vice versa, **then that may be a factor we could take into account** when applying that economic principle.	Survey feedback and customer engagement following Cyclone Gabrielle highlighted the resilience demanded by our consumers after experiencing that event, including their willingness to pay more to improve resilience of the network. Unison's circumstances illustrate that returning most insurance proceeds to consumers would impact Unison's ability to deliver in the long-term interests of consumers and return its network to its previous state or improve its resilience. We do not consider tomorrow's consumers are better placed to manage the resulting risks given the increasing climate change driven events expected and the demands of today's consumers. In a small event, however, with less material expenditure associated (in particular, operating expenditure as opposed to capital expenditure), returning proceeds to consumers may achieve an acceptable economic outcome.
Certainty and financeability	
4.27…The Part 4 regime was intended to **provide greater certainty over time**,[126] and we accept that wholesale rejection of principles we have consistently applied may affect this certainty.	**Optionality provides** non-exempt EDBs **certainty** that regulation can appropriately flex to promote the s 52A Part 4 outcomes. Optionality must currently exist with the regime because it achieves a materially better Part 4 outcome; the large range of foreseeable scenarios justifies that outcome.

Commission's Framework Paper	Why optionality is a materially better way to promote Part 4
4.33.5 We do not consider that introducing a new economic principle in the form of a financeability test would further help us in applying the Part 4 purpose. However, we **may take financeability into account** to the extent doing so is consistent with promoting the Part 4 purpose in a particular context.	Financeability is relevant to considering the **cashflow available to invest in replacement of damaged and destroyed assets** after an insured event. A small event, however, may not impact financeability.