

## Input methodologies issue suggestion template

### *For use by external stakeholders*

The purpose of this form is to provide a template for stakeholders to raise issues for us to consider in the course of the input methodologies (IMs) review, most of which we are required to complete by December 2023 (IM Review 2023). Please complete all sections of the form so that we can understand your input methodologies issue as well as possible.

Completed forms should be sent to [im.review@comcom.govt.nz](mailto:im.review@comcom.govt.nz), with 'Process and Issues/Draft Framework submission – [your submitter name]' in the subject line of the email.

We intend to publish suggestions we receive unless you make a clear and explicit request that we do not do so due to confidentiality or commercial sensitivity. We will consider any such requests on their merits.

You may add additional attachments to your email if you wish to provide more details on your suggested issue. Supporting material that you attach to your submission template should be clearly cross-referenced in the template. 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.

The protection of confidential information is something the Commission takes seriously. To continue to protect confidential submissions, we require you to upload your submission via the template form. This process requires you to provide (if necessary) both a confidential and non-confidential/public version of your submission and to clearly identify the confidential and non-confidential/public versions.

When including commercially sensitive or confidential information in your submission, we offer the following guidance:

- Please provide a clearly labelled confidential version and public version. We intend to publish all public versions on our website.
- 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.
- Please note that all submissions we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we do not publish unless good reason existed under the Official Information Act 1982 to withhold it. We would normally consult with you before any disclosure is made of the information you provided.

#### Your details

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## Issue details

Does your IM issue relate to information disclosure (ID) or the setting of price-quality paths (PQ) or both? [IMs relevant to PQ](#)

Affected sector or sectors: [EDB and Transpower](#)

Topic: [Incentive mechanisms to improve expenditure efficiency](#)

Relevant clause/schedule reference: Part 4 Commerce Act (1986) (topic is treated under Chapter 5 of the Input Methodologies Review Process and Issues Paper, especially paras 5.76 onwards)

## Issue description

### At a high level (in a few words), what is the issue about?

We recommend the Input Methodologies review consider measures to increase flexibility between operating expenses (opex) and capex expenses (capex). In our response to the Commerce Commission's Open Letter last year we recommended the Commission explore an option for achieving this through review of a total expenditure (totex) model to better achieve the purposes of Part 4 of the Commerce Act (1986) and to support decarbonisation objectives.

### What are the full details of your issue? Where possible, please describe how us considering and addressing this issue further in IM review would promote the section 52A purpose of Part 4 of the Act and the IM purpose in section 52R of the Act.<sup>1</sup>

We recommend that the Input Methodologies Review prioritise increasing flexibility between opex and capex expenditure. The total expenditure (totex) model used in other jurisdictions, such as by the Office of Gas and Electricity Markets (Ofgem) and the Water Services Regulation Authority (Ofwat) in the United Kingdom presents a model the Commission may wish to review in examining how incentives may be refined to better achieve the S.52A and 52R purposes of Part 4 of the Commerce Act. Specifically, the introduction of greater opex-capex flexibility could help remove barriers and promote better decision making in the industry for: (a) innovation and investment in assets; (b) improving efficiency and providing services that reflect consumer demands; (c) sharing efficiency gains through lower prices for consumers; and (d) the achievement of decarbonisation objectives and other prescribed policy outcomes.

### What is the specific problem that your issue causes?

Increased flexibility in the use of opex and capex can address what is sometimes referred to as "capital bias" (a tendency to reduce opex rather than capex, even if total cost to deliver services may increase as a result). This can in turn lead to industry investment decisions that are not always in the best interests of consumers or which are not optimal for achieving important policy objectives such as decarbonisation. Examples of this include capital investment in legacy/less competitive technologies, or a tendency to build and control owned assets rather than exploring outsourcing models and new technologies that can deliver significantly better on consumer price, reliability, resilience, security and decarbonisation objectives.

<sup>1</sup> References to sections in this form are to sections in the Commerce Act 1986 and these are described in detail in our IM review decision framework paper.

Over the coming years, the pace of innovation will continue to accelerate as smart grids, distributed energy resources, and other new technologies continue to evolve and grow. Additionally, all industries will need to increase their agility to continue to respond to new resiliency and security challenges. Improved opex-capex flexibility can offer regulators, consumers and industry a more flexible framework for harnessing the benefits of new technologies to deliver on policy outcomes in the energy sector. For regulators this approach can allow them to focus more on how industry participants are delivering on specified outcomes and on setting an appropriate total cost allowance rather than setting and tracking expenditure category allowances for industry inputs.

## Suggested solution

### How could we address the issue?

AWS welcomes the inclusion in Chapter 5 of the Process and Issues paper of a proposal to consider incentives for better achieving the purposes of Part 4 of the Act, and for achieving decarbonisation objectives. In particular, we welcome the discussion on opportunities for improving flexibility between opex and capex, and explicit reference in the report to considering the totex model (para 5.117).

As noted in our submission to the Commerce Commission's Open Letter of May 2021, we would like to reiterate our perspective that the IM Review 2023 should examine the potential for introducing greater flexibility between opex and capex, and specifically explore the opportunity to introduce the totex model in New Zealand (NZ). AWS recommends that the Commerce Commission should pursue this as a high priority issue in the review process. We believe such review will provide important information on regulatory mechanisms for increasing opex-capex flexibility and thereby incentivising behaviours to better achieve the purposes of Part 4 of the Commerce Act.

NZ has the opportunity to draw on implementation experiences and lessons from other jurisdictions and sectors regarding the design and progressive roll out of models to improve opex-capex flexibility so that it is calibrated to achieve the Part 4 purposes of the Act. As an example, we recommend the Commerce Commission reviews the roll out and impact of the totex model in the energy and water utilities sectors in the United Kingdom (UK) overseen by the Office of Gas and Electricity Markets (Ofgem) and the Water Services Regulation Authority (Ofwat) to inform the design of a possible model in NZ. Under these UK models, the regulators have set maximum allowed revenues for the industry participants they regulate by determining allowances for the expected efficient total expenditure (totex) required by those businesses, and have removed the separate allowances for opex and capex.

**If you are suggesting a solution, where possible please tell us how you think it aligns with the overarching objectives of the IM review, as set out in our draft framework paper?<sup>2</sup> The overarching objectives for the IM review are:**

- **promoting the Part 4 purpose in section 52A more effectively;**
- **promoting the IM purpose in section 52R more effectively (without detrimentally affecting the promotion of the section 52A purpose); and**
- **significantly reducing compliance costs, other regulatory costs, or complexity (without detrimentally affecting the promotion of the section 52A purpose).**

Incentivising more flexibility between opex and capex, such as through a totex model, can provide an important regulatory tool for incentivising efficiency and innovation investment in support of important policy outcomes such as decarbonisation, consumer value for money, security and resilience. The model can support greater flexibility by the industry to decide on the most efficient and effective means for delivering against those important outcomes.

<sup>2</sup> [Commerce Commission "2023 input methodologies review" webpage, scroll down to "Draft framework paper" \(20 May 2020\)](#), p. X18.

Improvements in opex-capex flexibility can have a greater impact than simply improving efficiencies. Also, It can also contribute concretely to removing barriers and promoting better decision making in the industry for a range of important purposes of Part 4, particularly: (a) innovation and investment in assets; (b) for improving efficiency and providing services that reflect consumer demands; (c) sharing efficiency gains through lower prices for consumers. The adoption of new technologies through more flexible expenditure could also support the achievement of decarbonisation objectives.

**If you suggested a solution above, what practical implementation matters should we also consider?**

Adoption of a model to improve opex-capex flexibility should include learnings from other regulatory environments such as learnings on the effective design and roll out of such models. This should include, in particular, developing an understanding of the impacts and learnings from the application of the totex model from the UK (Ofgem and Ofwat) experiences. Implementation of a new mechanism, such as the totex model, does not need to be rushed. It can be introduced progressively and NZ has the opportunity to do so based on experiences abroad such as the UK, including the opportunity to review refinements made over time. In the course of the review we suggest that the IM team hear from experts with experience in the design and implementation of the totex model in other jurisdictions, and we would welcome the opportunity to support the IM team in conducting research or reaching out to experts on operation of this model.