

# **Amendment to Electricity Distribution Services Input Methodologies Determination and Electricity Distribution Services Default Price-Quality Path Determination 2020**

**Correction to definition of discount – companion paper**

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## Associated documents

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26 November 2019	ISBN 978-1-869456-71-6	Amendments to electricity distribution services input methodologies determination – Reasons paper
26 November 2019	[2019] NZCC 20	Electricity Distribution Services Input Methodologies Amendments Determination (No. 2)
27 November 2019	ISBN 978-1-869457-68-6	Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision – Reasons Paper
27 November 2019	[2019] NZCC 21	Electricity Distribution Services Default Price-Quality Path Determination 2020
27 February 2020	ISBN 978-1-869457-95-2	[DRAFT] Electricity Distribution Services Default Price-Quality Path (Definition of discount) Amendments Determination 2020
27 February 2020	ISBN 978-1-869457-96-9	[DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2020
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30 March 2020	[2020] NZCC 2	Electricity Distribution Services Input Methodologies Amendments Determination 2020
30 March 2020	[2020] NZCC 3	Electricity Distribution Services Default Price-Quality Path (Definition of discount) Amendments Determination 2020

Commerce Commission  
Wellington, New Zealand

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## Chapter 1 Introduction

### Purpose of this paper

- 1.1 This paper discusses an error in the Electricity Distribution Services Input Methodologies 2012 (EDB IMs) related to the definition of discounts, and the amendment we have implemented to correct it. It also discusses a consequential amendment to the Electricity Distribution Services Default Price-Quality Path Determination 2020 (EDB DPP3 determination), which allows the EDB IM amendment to apply for the default price-quality path for 2020-2025 regulatory period (DPP3).

### Summary

- 1.2 The issue relates to how ‘discount’ is defined in clause 3.1.1(11) of the specification of price IMs.<sup>1</sup> This clause required (among other things) that any discount must have ‘applied when the forecast net allowable revenue was determined’.<sup>2</sup> This determination occurred on 27 November 2019 when DPP3 was determined.<sup>3</sup>
- 1.3 The previous drafting meant electricity distribution businesses (distributors) subject to DPP3 could not include any discounts not offered before 27 November 2019 in their calculations of “forecast revenue from prices” when demonstrating compliance with the price path. This effectively removed a price-quality regulated distributor’s ability to offer new discounts or alter their terms in a way that could have been included in the calculation of their revenue cap.
- 1.4 We have amended the EDB IMs and made a consequential EDB DPP3 determination amendment to resolve this error.

### Structure of this paper

- 1.5 The second chapter sets out the frameworks we apply:
- 1.5.1 when considering the scope of an IM amendment process; and
  - 1.5.2 in deciding whether to make IM amendments within the scope of that amendment process.

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<sup>1</sup> The latest consolidated version of the EDB IMs can be accessed at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-29-January-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-29-January-2020.pdf).

<sup>2</sup> [Commerce Commission Electricity Distribution Services Input Methodologies Determination 2012 \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), clause 3.1.1(11)(1)(c).

<sup>3</sup> [Commerce Commission Electricity Distribution Services Default Price-Quality Path Determination 2020 \[2019\] NZCC 21 \(27 November 2019\)](#), Schedule 1.4.

- 1.6 The third chapter explains the definition of discounts issue we have identified and discusses our solution, applying the framework from Chapter 2, and responding to comments raised in submissions on our draft decision.
- 1.7 Alongside this paper, we have also published an EDB IM amendments determination and an amendment to the EDB DPP3 determination.<sup>4</sup>

### **Process we have followed**

- 1.8 We issued a notice of intention to consider amending the IMs under section 52V(1) of the Act on 11 February 2020. This was followed by a draft decision (and accompanying draft IM and DPP determinations), published on 27 February 2020.
- 1.9 Submissions on the draft decision were received on 12 March 2020. Cross-submissions were due by 19 March 2020 (however we received no cross-submissions).
- 1.10 All of these documents are available on our website at:  
<https://comcom.govt.nz/regulated-industries/input-methodologies/projects/amendments-necessary-to-implement-the-2020-electricity-distribution-default-price-quality-path>

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<sup>4</sup> Commerce Commission *Electricity Distribution Service Input Methodologies Amendments Determination 2020* [2020] NZCC 2; Commerce Commission *Electricity Distribution Services Default Price-Quality Path (Definition of discount) Amendments Determination 2020* [2020] NZCC 3.

## Chapter 2 Framework

### Purpose of this chapter

- 2.1 This chapter summarises the framework we have applied in reaching our decision. In doing so, it explains:
- 2.1.1 the approach we take when considering the scope of an IM amendment process;
  - 2.1.2 how we consider what IM amendments to make within that process; and
  - 2.1.3 the effect of a change to the EDB IMs on the DPP3 determination.
- 2.2 How we have applied this framework to the current issue is explained in the following chapter.
- 2.3 None of the submissions we received on the draft decision raised issues with these frameworks. As such, we have applied them in the same way we did for the draft decision.

### Framework for considering whether to amend IMs

- 2.4 To aid us in making decisions about the scope of IM amendments in a way that is consistent with the Commerce Act 1986 (the Act), we have developed a decision-making framework over the 2016 input methodologies (IM) review and 2019 pre-DPP3 reset process.<sup>5</sup>
- 2.5 We may amend an IM at any time, provided that, where the change is material, we follow the consultation process set out in section 52V of the Act.<sup>6</sup> However, in deciding whether to exercise our power to consult on amendments to the IMs, we must also have regard to section 52A of the Act as the central purpose of Part 4, as well as the purpose of IMs (section 52R of the Act).
- 2.6 While it is important to ensure the IMs are error-free and appropriate for the forthcoming DPP regulatory period, we must be mindful that being overly willing to entertain amendments may have an unduly detrimental effect on:
- 2.6.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with section 52A(1) of the Act; and

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<sup>5</sup> A fuller explanation of this framework can be found in: [Commerce Commission “Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons Paper” \(26 November 2019\) Chapter 2.](#)

<sup>6</sup> [Commerce Act 1986](#), section 52X.

- 2.6.2 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 (for example, in setting the DPP).
- 2.7 As such, the approach we have taken in the past to amendments that are outside of a section 52Y IM review process is to consider amendments that either:
- 2.7.1 support implementation of incremental improvements to the way the DPP is set; or
- 2.7.2 enhance certainty about the rules and correct for technical errors ahead of the DPP reset.<sup>7</sup>
- 2.8 Conversely, it is not generally appropriate to consider fundamental changes to the IMs outside of a section 52Y IM review process. By fundamental changes, we primarily mean significant changes to the IMs listed in s 52T(1)(a) of the Act – being the cost of capital, valuation of assets, allocation of common costs, and treatment of taxation. These IMs provide the foundational building blocks used to set price-quality paths. While we might consider such amendments in exceptional circumstances, we consider that they will normally be more appropriately considered as part of the next s 52Y review of the IMs.

### **Framework for considering IM amendments**

- 2.9 In deciding whether to make potential IM amendments within the scope of an amendments process, we apply a decision-making framework that we have developed over time to support our decision making under Part 4 of the Act.<sup>8</sup> This has been consulted on and used as part of prior processes, and helps provide consistency and transparency in our decision making.
- 2.10 Specifically, we consider whether candidate IM amendments would promote the following outcomes:
- 2.10.1 promoting the Part 4 purpose in s 52A of the Act more effectively than the current IM;
- 2.10.2 promoting the IM purpose in s 52R of the Act more effectively (without detrimentally affecting the promotion of the s 52A purpose); or

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<sup>7</sup> [Commerce Commission “Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons Paper” \(26 November 2019\)](#), para 2.11.

<sup>8</sup> [See Commerce Commission “Input methodologies review decisions: Framework for the IM review” \(20 December 2016\)](#), para 59.

- 2.10.3 significantly reducing compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

### **Relationship of IM amendment to the DPP**

- 2.11 To allow the IM amendment in this case to apply for DPP3, we must also make an amendment under s 52Q to the section 52P DPP3 determination. This is because the DPP3 determination specifies the IMs that apply to the DPP which (until this amendment) only captured IMs in effect as of 27 November 2019.<sup>9</sup>

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<sup>9</sup> [Commerce Commission Electricity Distribution Services Default Price-Quality Path Determination 2020 \[2019\] NZCC 21 \(27 November 2019\)](#) – see the definition of “IM determination” in clause 4.2 and clause 6.



## Chapter 3 Amendment to definition of discounts

### Purpose of this chapter

- 3.1 This chapter explains the error we have identified in the EDB IMs, and then analyses our solution in light of the framework discussed in Chapter 2, and responds to submissions on our draft decision.

### Problem definition

- 3.2 Under the previous EDB IMs, non-exempt distributors<sup>10</sup> could not include (or in other words ‘net off’) the value of any discounts made after a default price-quality path (DPP) or customised price-quality path (CPP) is determined when complying with that DPP or CPP. This means non-exempt distributors would have to have either:
- 3.2.1 avoided offering any new discounts when setting their prices; or
  - 3.2.2 risked non-compliance with the price path.
- 3.3 We considered these outcomes are undesirable as they:
- 3.3.1 did not achieve the intent of the original IM provision – to distinguish between discretionary discounts (which are treated as dividends) and non-discretionary discounts (treated as reductions in revenue);
  - 3.3.2 did not promote outcomes consistent with section 52A(1)(c), in that distributors are limited in their ability to use discounts to share the benefits of gains in efficiency; and
  - 3.3.3 limited our ability to assess whether the section 52A(1)(d) outcome is being met, as the exclusion of certain discounts offered in practice but not included in disclosures affects the calculation of a distributor’s profitability.

### Prices are defined to include certain kinds of discounts

- 3.4 The error was caused by clause 3.1.1(11)(c) of the EDB IMs, which stated (among other requirements) that:<sup>11</sup>

(11) ‘discount’ means a discount to charges payable for the **supply of electricity distribution services...**

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<sup>10</sup> By “non-exempt distributions”, we mean distributors that are not exempt from default/customised price-quality regulation under section 54G of the Act.

<sup>11</sup> [Commerce Commission Electricity Distribution Services Input Methodologies Determination 2012 \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), clause 3.1.1(11)(1)(c).

(c) that applied when the **forecast net allowable revenue** was determined.

3.5 The definition of ‘discount’ is referenced in the definition of ‘prices’ in clause 3.1.1(9) of the IMs:<sup>12</sup>

(9) ‘Prices’ means-

- (a) individual tariffs, fees or charges; or
- (b) individual components thereof,

in nominal terms exclusive of **GST** for the **supply** of an **electricity distribution service**, and must include a discount taken up by **consumers**.

3.6 The revenue cap that non-exempt distributors must comply with is defined in terms of “forecast revenue from prices”, the definition of which is given in clause 3.1.1(3) of the EDB IMs:<sup>13</sup>

(3) For the purpose of this subpart, ‘forecast revenue from prices’ for a **disclosure year** means the forecast revenue used by an **EDB** to set **prices**, where forecast revenue is the total of each **price** multiplied by each forecast **quantity**.

3.7 Finally, the revenue cap that non-exempt distributors must comply with is also defined in terms of “actual revenue from prices”, which is referred to in clause 3.1.3(13)(f) of the EDB IMs.<sup>14</sup>

3.8 Applying these definitions if discounts are ignored, ‘prices’ will be higher, and as a result ‘forecast revenue from prices’ and ‘actual revenue from prices’ will also be higher.

### **Forecast net allowable revenue for the regulatory period has already been determined**

3.9 ‘Forecast net allowable revenue’, the term that was previously relevant for determining the time by which a non-exempt distributor must have offered a discount that qualifies for inclusion in prices, is defined in clauses 3.1.1(6) and 3.1.1(7) of the EDB IMs:<sup>15</sup>

(6) For the purpose of this subpart, ‘forecast net allowable revenue’ for the first **disclosure year** of a **DPP** or **CPP regulatory period** will be specified by the **Commission** at the start of the **regulatory period** in a **DPP determination** or **CPP determination**.

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<sup>12</sup> Ibid. clause 3.1.1(9).

<sup>13</sup> Ibid. clause 3.1.1(3).

<sup>14</sup> Ibid. clause 3.1.3(13)(f).

<sup>15</sup> Ibid. clauses 3.1.1(6) and (7).

(7) For each **disclosure year** of the **DPP** or **CPP regulatory period** after the first **disclosure year**, 'forecast net allowable revenue' is calculated by applying-

- (a) the **forecast net allowable revenue** for the preceding **disclosure year**;
- (b) the **forecast CPI**, as specified in subclause (8); and
- (c) any X factor applicable to the **EDB**.

3.10 We made the DPP3 determination referenced in these definitions on 27 November 2019. Schedule 1.4 of the DPP3 determination specifies 'forecast net allowable revenue' for each distributor for each year of the regulatory period.<sup>16</sup> Because of this, under the previous definition of 'discount' only discounts to prices that were offered on or before 27 November 2019 could be recognised when calculating 'forecast revenue from prices'.

3.11 Because 'forecast net allowable revenue' is determined based on forecast CPI, we were able to determine the values for each assessment period of the regulatory period at the outset of the period, not just the values for the first assessment period. This means that, if we did not amend the definition of 'discount', this problem would persist for all assessment periods of the DPP3 period, not only the first assessment period.

### Views raised in submissions

3.12 Submissions from all parties were supportive of the problem as we defined it.<sup>17</sup>

### Solution

3.13 To remedy this situation, we have amended clause 3.1.1(11)(c) to require that discounts are "included in the individual tariffs, fees or charges (or individual components thereof) used to calculate forecast revenue from prices for the disclosure year that those individual tariffs, fees, or charges apply to", in place of when "forecast net allowable revenue was determined". We have changed the wording of this amendment relative to the draft decision, in response to submissions on our draft decision, discussed further below at paragraphs 3.28 to 3.30.

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<sup>16</sup> [Commerce Commission \*Electricity Distribution Services Default Price-Quality Path Determination 2020\* \[2019\] NZCC 21 \(27 November 2019\)](#), schedule 1.4.

<sup>17</sup> [ENA "Submission on discount error correction draft decision" \(12 March 2020\)](#); [Centralines "Submission on discount error correction draft decision" \(12 March 2020\)](#); [Network Tasman "Submission on discount error correction draft decision" \(12 March 2020\)](#); [The Lines Company "Submission on discount error correction draft decision" \(12 March 2020\)](#); [Top Energy "Submission on discount error correction draft decision" \(12 March 2020\)](#).

- 3.14 We have also amended the definition of “IM determination” in clause 1.4 of the EDB DPP3 determination to include the IM amendments determination that gives effect to the change in paragraph 3.13.

### **Analysis of solution**

- 3.15 This section analyses the amendment in light of the framework set out in Chapter 2, considering:
- 3.15.1 whether this is an appropriate use of our IM amendment powers;
  - 3.15.2 whether this change meets the criteria we apply when considering whether to make an amendment to the IMs; and
  - 3.15.3 submissions on the draft decision.

### **Whether to consider an IM amendment**

- 3.16 We considered this amendment an appropriate use of our amendment powers. The issue related to the correction of a technical error – drafting that is not achieving the intent of the IM provision – and does not affect fundamental aspects of the IMs. We have not identified any other aspects of the IMs that are affected by this issue or the amendment, and so considered that we could make this change in isolation.
- 3.17 Additionally, we considered it appropriate to consider the amendment now, rather than waiting for the next review of IMs under section 52Y. To be effective during DPP3, an IM amendment needed to be in place prior to 1 April 2020.

### **Whether to make an IM amendment**

- 3.18 In this section, we assess the amendment against the three criteria we apply when considering changes to the IMs:
- 3.18.1 promoting the Part 4 purpose in s 52A of the Act more effectively than the current IM;
  - 3.18.2 promoting the IM purpose in s 52R of the Act more effectively (without detrimentally affecting the promotion of the s 52A purpose); and
  - 3.18.3 significantly reducing compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

*Policy intent of the discount provisions in the IMs*

- 3.19 The original requirement in the EDB IMs for discounts to be ‘posted’ to qualify as a reduction in revenue was intended to distinguish them from ‘discretionary discounts’. The key difference between the two is that ‘posted discounts’ have the characteristics of prices, in that they are ‘locked in’ once tariffs are set, and consumers are able to respond to them.<sup>18</sup>
- 3.20 Discretionary discounts, on the other hand, may be offered, varied, or removed after the fact, and are more akin of the payment of a dividend to consumer-shareholders. Preserving the distinction between these two situations is important, as it allows more accurate reporting and analysis of distributor profitability. As such, this issue is relevant to the assessment of whether the outcome in section 52A(1)(d) of the Act is being met.
- 3.21 The original EDB IMs published in 2010 required discounts to be “offered by an **EDB** in a published tariff schedule”.<sup>19</sup>
- 3.22 The definition of ‘posted discounts’ was changed as a result of the 2016 IM review to the drafting that we have now amended. This was done because the inclusion of the word “posted” in the definition meant that it could not encompass non-standard contracts, which are not generally published. The (now amended) requirement was included as a substitute for this.<sup>20</sup>
- 3.23 The amendment to the IMs we have made preserves this approach, specifically:
- 3.23.1 distributors still have the ability to offer non-discretionary discounts to their consumers and for these to be netted off revenues; but
  - 3.23.2 qualifying discounts are fixed at a certain point in time, so that consumers can respond to them.
- 3.24 We consider that by enabling distributors to offer discounts, and for these discounts to be properly accounted for in the distributor’s revenue path, the amendment we have made better promotes the original purpose of the IM.

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<sup>18</sup> [Commerce Commission “Input Methodologies \(Electricity Distribution and Gas Pipeline Services\) – Reasons Paper” \(22 December 2010\)](#), paras G2.40-G2.47.

<sup>19</sup> [Commerce Commission \*Electricity Distribution Services Input Methodologies Determination 2012\* \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), Appendix Part 4, clause 3.1.1(5)(b).

<sup>20</sup> [Commerce Commission “Input methodologies review decisions – Report on the IM review” \(20 December 2016\)](#), para 273.2.3 and footnote 81.

### *Certainty for consumers and EDBs*

- 3.25 The statutory purpose of IMs is “to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation... of goods or services”.<sup>21</sup>
- 3.26 We consider the amendment we have made better promotes certainty for suppliers and consumers. Under the previous IMs, the intent of the provision conflicted with the way it was drafted. The amendment remedies this, and therefore gives distributors better certainty about how the rules should be applied.

### *Cost and complexity*

- 3.27 The amendments to the EDB IMs and DPP3 determinations we have made are relatively straightforward (both involve a single change to a single definition). A ‘do nothing’ option may have required distributors to change the approach they take to pricing, increasing cost. Furthermore, it would have involved continued discussions between distributors and us, increasing the complexity of complying with the IMs and the DPP3 determination.

### **Response to issues raised in submissions**

- 3.28 As stated above, submissions were supportive of our proposal to amend the IMs. However, in its submission, Network Tasman raised an issue related to the timing implications of the draft definition we proposed:

Forecast revenue from prices (which included posted discounts) for a particular regulatory year is calculated **prior** to the beginning of regulatory year in question. The forthcoming DPP determination requires non-exempt distributors to provide the Commission with an annual price setting compliance statement **before** the beginning of each regulatory year that demonstrates that forecast revenue from prices does not exceed forecast allowable revenue.

Under the current definition of discounts, the discounts that must be used for each non-exempt distributor’s are those that applied before the beginning of the regulatory year for which the annual price setting compliance statement relates to (i.e. the year prior to the regulatory year in question).<sup>22</sup>

- 3.29 We agree with Network Tasman’s point, and so we have changed our amended definition to read:

(11) 'discount' means a discount to charges payable for the **supply of electricity distribution services...**

(c) that is included in the individual tariffs, fees, or charges (or individual components thereof) used to calculate **forecast revenue from prices** for the **disclosure year** that those individual tariffs, fees, or charges apply to.

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<sup>21</sup> [Commerce Act 1986](#), section 52R.

<sup>22</sup> [Network Tasman “Submission on discount error correction draft decision” \(12 March 2020\)](#), p. 2.

- 3.30 This definition makes it clear that the relevant disclosure year is the (forthcoming) disclosure year in which prices and discounts to them will apply, rather than the (present) disclosure year in which the calculation of forecast revenue from prices is undertaken.