Submission to the Commerce Commission

on

Input methodologies review: draft decisions papers

Made on behalf of 17 Electricity Distribution Businesses

PwC submission on behalf of a group of 17 electricity distributors

4 August 2016

Table of contents

Introduction 2
Summary 4
Framework for the IM review 11
Form of control and RAB indexation 13
CPP requirements 20
Emerging technology in the energy sector 36
Cost of capital issues 43
Related party transactions 51
Report on the IM review 54
Appendix A: ACAM revenue threshold 56

Introduction

Overview

1. This submission responds to the following consultation papers published by the Commerce Commission (Commission):

    - 'Input methodologies review draft decisions – Framework for the IM review' (IM Framework paper)
    - 'Input methodologies review draft decisions – Topic paper 1 – Form of control and RAB indexation for distributors, GPBs and Transpower' (Form of control paper)
    - 'Input methodologies review draft decisions – Topic paper 2 – CPP requirements' (CPP requirements paper)
    - 'Input methodologies review draft decisions – Topic paper 3 – The future impact of emerging technologies in the energy sector' (Emerging technologies paper)
    - 'Input methodologies review draft decisions – Topic paper 4 – Cost of capital issues' (WACC paper)
    - 'Input methodologies review draft decisions – Topic paper 7 – Related party transactions' (Related party transactions paper)
    - 'Input methodologies review draft decisions – Report on the IM review' (IM report).

2. This submission also responds to aspects of the consultation paper on implementing the IMs for Gas Pipeline Businesses (GPBs) and two letters from the Electricity Authority (Authority) to the Commission that were published as part of the consultation material:

    - Possible implications for efficient distribution pricing of a decision to change the form of control for electricity distribution businesses, 30 May 2016 (EA's form of control letter)
    - Implications of regulatory treatment of cash flows for emerging technology, 1 June 2016 (EA's emerging technology letter).

3. This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 17 Electricity Distribution Businesses (EDBs or distributors):

    - Alpine Energy Limited
    - Aurora Energy Limited
    - EA Networks
    - Eastland Network Limited
    - Electricity Invercargill Limited
    - Electra Limited
    - MainPower New Zealand Limited
    - Marlborough Lines Limited
    - Nelson Electricity Limited

- Network Tasman Limited
- Network Waitaki Limited
- OtagoNet Joint Venture
- The Lines Company Limited
- The Power Company Limited
- Top Energy Limited
- Waipa Networks Limited
- Westpower Limited.

4. Together these businesses supply 24% of electricity consumers, maintain 40% of total distribution network length and service 68% of the total network supply area in New Zealand. They include both consumer owned and non-consumer owned businesses, and urban and rural networks located in both the North and South Islands.

5. The distributors which support this submission also support the submission made by the Electricity Networks Association (ENA). The purpose of this submission is to highlight topics of particular interest to the 17 distributors listed above.

6. We trust this submission provides useful input to your consultation on the consultation papers. We would be happy to answer any questions you may have regarding this submission.

7. The primary contact for this submission is:

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Summary

8. The following points summarise our views on matters raised in the consultation papers. They are discussed more fully in the body of this submission.

Overall comments

9. The distributors which support this submission broadly welcome the package of input methodology (IM) improvements put forward in the consultation material. For the most part, the Commission has assessed the issues carefully and developed well-reasoned proposals. We particularly support the view that there are no grounds to further regulate investments by electricity distributors in emerging technologies. We are also supportive of improvements to the form of control and the intention to reduce the cost and complexity of the customised price-quality path (CPP) requirements.

10. We consider there is scope for further improvements to the CPP requirements, by reducing cost and complexity and improving certainty, and the cost of capital IM by adopting a trailing average approach to establishing the cost of debt parameters. We also consider that the range of wash-ups proposed to be applied under a revenue cap is excessive and we have some concern about the proposed next closest alternative (NCA) provision.

11. This submission highlights those areas we support and provides our reasoning where we consider an alternative approach may be better than what the draft decisions propose.

Framework for the IM review

12. The distributors which support this submission are concerned that the Commission has set out a generally reasonable process and approach for changing the IMs, but has claimed for itself the ability to change that approach at, effectively, any time it wants to. This is not consistent with the purpose of input methodologies – to provide certainty.

13. The distributors which support this submission submit that the Commission should commit to not making substantive changes to the IMs between seven-yearly reviews except in exceptional circumstances and should confirm that a very high threshold would be applied before any change to the core economic principles is made.

Form of control

14. The distributors which support this submission support the draft decision to not make an adjustment to the asset beta for regulatory differences, such as the form of control.

15. The distributors which support this submission also support changing the form of control to a ‘pure’ revenue cap for distributors. The primary reasons for this support are that a revenue cap removes the exposure of suppliers to the risk of error in regulatory volume forecasts when price resets are made and makes it easier for distributors to make price restructures.

16. We recognise the Authority has raised concerns regarding the application of a revenue cap. However, we do not believe any weight should be given to these concerns as they are heavily theoretical and do not reflect actual business practices by distributors. For example, the concerns it raises about distributors needing to be under a price cap to reform their prices are based on a short-term view of incentives. The Authority has overlooked the reality that even distributors that are not subject to price cap incentives (ie distributors that are exempt from price control) are reforming their prices. The Authority has also misunderstood some of the evidence.

17. There are too many wash-up requirements proposed as part of the revenue cap. A straightforward wash-up of the difference between allowed and realised revenues is desirable. The extra wash-ups

proposed seem to be duplicatory and the complexity of applying all of these simultaneously will be costly for distributors to manage. We are not convinced any further wash-up is justified at this time.

18. In particular, we do not agree with a cap on wash-up amounts, which would prevent recovery of some losses resulting from catastrophic events. This is inconsistent with the intent of a pure revenue cap. There is no principled reason why small variations in revenue should be washed up but large negative revenue shocks should not be.

19. We also disagree that a constraint on voluntary undercharging is necessary. The Commission should assess whether large under-recovered amounts are built up and it can then take action if required.

20. We are also not convinced that regulatory tools to address price shocks are necessary. Distributors already take steps to manage price shocks on their networks and this is another area where it would be better to wait and assess whether there is a problem before creating a further wash-up.

21. We do not agree with the proposal in the Gas DPP IMs paper that the pricing compliance report could be provided after prices are set but before they take effect (which implies a deadline of around March each year for the price compliance statement). Preparing two separate DPP compliance statements rather than one and securing audit and certification of both will increase costs. In February and March each year distributors are focused on disclosing pricing methodologies and asset management plans as well as managing year-end financial and tax responsibilities. It will also be difficult for distributors to secure auditor time in February and March each year. To add a further compliance burden at this time is not helpful.

RAB indexation

22. The consultation material has provided a helpful explanation of the policy intent behind the current approach to regulatory asset base (RAB) indexation. The distributors which support this submission are not opposed to continued indexation of the asset base but are concerned that the practice of setting a real return when distributors issue nominal debt makes it unlikely that distributors' revenues will reflect their actual cost of debt. This impacts distributors' expectation of earning a normal return.

Interaction between DPPs and CPPs

23. We support the proposal to improve the way DPPs and CPPs work together, including expanding the scope of DPP reopeners. We consider this provides a more cost effective process for specifying fit for purpose price-quality paths than relying on a CPP application to remedy a DPP decision. In this respect we submit:

    - If a quality standard variation is approved it should apply retrospectively back to the start of the DPP regulatory period.
    - If a weighted average price cap is retained as the form of control, a constant price revenue growth reopener should be introduced.
    - The capex wash up recoverable cost allowance should also be applied for CPPs, this will strengthen the urgent project allowance proposal.
    - Additional and abnormal costs incurred by a supplier in making a CPP application are also able to be recovered.

Assessing CPPs

24. The criteria for evaluating a CPP application are specified in the IMs. The consultation papers introduce a number of new criteria, without apparent recognition of the existing IMs. These additional criteria introduce cost and complexity because it is not clear what status they have. This outcome is contrary to the stated objective of the IM review to reduce cost and complexity.

25. The distributors which support this submission remain concerned at the potential for unnecessary overlap between the Commission's assessment and the verifier's assessment of a CPP proposal. We are disappointed that this has not been resolved in the Draft Decisions, for example:

    - The Commission intends to undertake a detailed review of the same models which will have been reviewed by the verifier.
    - There is no indication that the Commission intends to retain the verifier once the CPP application has been received.

26. We support the intention to clarify the communication protocols between the verifier and the applicant, in order to maintain open and frank dialogue between the parties during the verification phase.

27. In addition, we support the publication of a benchmark tripartite agreement for engagement of the verifier, which would reduce the costs of applying for a CPP for all parties. This would not need to form part of the IMs and could be modified with agreement of the three parties to accommodate particular circumstances.

28. We do not support the proposal for the applicant to provide the Commission with a summary of its proposal at the time the verifier is engaged, and an updated summary at the time the verifier's report is prepared. This proposal adds undue cost, and subjects the applicant to Commission scrutiny too early in the process, while the proposal is still being developed. The Commission has access to other information to help it plan its assessment, and the verification process is expressly designed to assist the Commission to target its assessment work.

29. The distributors which support this submission support the proposed changes to the verifier's terms of reference in principle. However we submit that the drafting requires substantial review as it introduces ambiguity, inconsistencies with the remainder of the CPP IMs, terms which are not defined, and as drafted, exceeds the intended scope of the terms of reference.

30. The core capability of the verifier should be aligned to assessing forecast opex and capex, associated policies and procedures, the quality standards and the demand for electricity distribution services which underpins the proposed expenditure. Accordingly we generally consider that any of the regulatory methodologies applied in deriving the CPP price path should fall outside of the verifier's terms of reference. This includes:

    - Non-standard depreciation.
    - Cost allocation, which is better assessed by the auditor because of their familiarity with it, and the CPP cost allocation methodology is tied to the most recent (audited) disclosures of the distributor.
    - Any other aspect of the price path, including calculations, models and supporting information.

31. We agree that the verifier should review any quality standard variation proposal, and the role for the independent engineer in this instance can be removed. However the CPP IM requirements for quality standard variations, including the verifier's assessment of them, require comprehensive review as they are no longer fit for purpose given the recent development of the DPP quality standards.

32. We support the proposal to introduce more flexibility in selecting identified projects and programmes for detailed review by the verifier. However we consider the draft guidance can be substantially improved.

33. More clarification of the role of the auditor for CPP proposals is supported. However:

- The auditor's report will need to designate between the opinion itself and the explanatory information to be included in the audit report.
- The appropriate assurance standards will be SAE3100 and ISAE (NZ) 3000 Revised.
- In accordance with these standards the auditor will not offer an opinion on the reasonableness of the disclosed assumptions for forecast information, rather they will state that the prospective financial information is properly prepared on the basis of the assumptions, and whether supporting evidence supports the assumptions underpinning the forecasts.

CPP consultation

34. Further clarification as to the Commission's expectations for consumer consultation is also supported, and we are pleased that as a result it will be less likely the Commission will undertake its own targeted consultation, as it did after Orion submitted its proposal.

35. However we suggest the Commission provides more clarity as to its expectations for consultation on investment alternatives – given the potential for multiple alternatives at multiple locations on a network. We suggest that the consultation on alternatives should be focussed on the key reasons for a CPP proposal, as per the information required in response to Clause 5.4.2 Reasons for the proposal.

36. We also submit that the verifier's assessment of the distributor's consultation should not extend to making judgements about the suitability or otherwise of the proposed price path or price-quality trade-offs, which we consider is a role for the Commission, not the verifier.

CPP building blocks

37. We support the draft decision to remove the CPP WACC, and apply the prevailing DPP WACC for CPP price paths. This proposal:
    - Removes potential incentives and disincentives to apply for CPPs which may arise from changes in the regulatory WACC within a DPP regulatory period.
    - Removes a timing constraint leading up to a CPP application being made.
    - Is a simple solution, which reduces cost and complexity of applying for a CPP.

38. Further, the proposed reopener process to accommodate a change in DPP WACC during a CPP regulatory period is expected to be straight forward, given the CPP building block model outputs can be readily recalculated by updating the WACC and CPI parameters.

39. However we question whether the necessary adjustments to incorporate the impact of the new WACC, and CPI revaluation rate have been fully considered in the Draft Decisions. We also note that a CPP application made in the February window, 14 months prior to a DPP Determination coming into effect, will not have the DPP WACC information available to it at that time. We address these points more fully in the body of our submission.

40. The Draft Decision proposes more aggregated asset categories for capex information. We support this proposal to reduce cost and complexity. However the Draft Decision fails to reflect this change in the CPP building block methods, which compromises the intended outcome. Part 5, subpart 3 of the CPP IMs must be revised to reflect this proposed new approach. The key adjustments required are in the asset valuation and treatment of taxation sections.

CPP information requirements

41. The distributors which support this submission strongly support changes to the IMs which reduce the cost and complexity of them. Currently CPPs are not a viable option for many non-exempt distributors because of the resources required to prepare a CPP application which fully meets the IM requirements. In this respect we support the proposals to:

    - Apply the proportionate scrutiny principle.
    - Allow more flexibility in how distributors prepare their proposals.
    - Leverage relevant information which is already published for information disclosures, including AMPs.
    - Reduce the level of disaggregation of information.

42. However we consider further improvements can be made to the CPP information requirements in the Draft Decisions on these topics. We also submit that further improvements should be made by:

    - Better aligning the quality standard variation requirements to the DPP.
    - Aligning Schedule B and C templates to information disclosure.
    - Providing more flexibility in Schedule E, Table 9 and the supporting information requirements in Schedule D for unit cost escalators.

Emerging technology in the energy sector

43. The distributors which support this submission support the Commission's view that distributor investments in emerging technologies should not be further regulated at this time. We agree that the regulatory regime should not discourage suppliers or others from using new technology and new business models for their and consumers' benefit.

44. We also agree it is helpful to take precautionary steps now to minimise the risk of harm to consumers in future. As such, we support the proposed ability to reduce asset lives by up to 15% where the assets are at risk of stranding due to technology change. However, as proposed and drafted this would only apply to non-exempt distributors and would seem to only be applied through the DPP. We consider that this option to reduce asset lives must also be available to exempt distributors and should be applied through information disclosure. Additionally, we are not convinced there is a need for a 15% cap – as the asset life reduction is only applied where the Commission agrees, there is no need for a cap. We also support further consideration of the ENA's proposed alternative to apply lower total asset lives to new investments.

45. We further agree with the Commission's definition of the regulated service and that the tools provided to the Commission under Part 4 of the Commerce Act 1986 were not designed to, and cannot, deliver changes to industry structures. If structural changes are deemed necessary they should be progressed by policy makers and Parliament.

46. We agree with the Commission that the proposal by the Electricity Retailers Association of New Zealand (ERANZ) for ring-fencing transactions between distributors and distributor-owned emerging technology initiatives should not be considered further. The proposal would create transaction costs and is likely to discourage investment by distributors in emerging technologies.

47. The EA's emerging technology letter raises concerns about potential competition impacts of distributor-led investment in emerging technologies. We do not believe these concerns have any basis. We consider it is likely that distributor involvement will promote efficient investment in emerging technologies. There is no evidence of a problem to warrant regulatory intervention at this stage.

48. The distributors which support this submission are concerned by the comment in the consultation paper that distributors may ultimately fail to recover their investments in certain circumstances. Distributors have invested in their networks in the expectation of cost recovery and if this is not forthcoming, or is not supported by the regulator, future investment incentives will be affected. The Commission's statement appears inconsistent with the Part 4 Purpose and the Commission's FCM principle.

49. The distributors which support this submission are comfortable with the intention of requiring more disclosure about the reasons why proxy cost allocators are used. However, we do not agree that this should be by way of certification by the Chief Financial Officer – an added declaration will create complexity. A better approach is to include the information within disclosures for certification by directors, as for other disclosures.

50. We agree that the avoidable cost allocation methodology (ACAM) materiality thresholds should be set at a level where the effect of applying ACAM is not expected to generally affect regulated revenues by more than 2%. However, we have reviewed the Commission's analysis regarding the effect of the 20% ACAM threshold and do not consider it to be robust (e.g. it treats capital contributions incorrectly, uses inconsistent total revenue data from different companies and makes assumptions regarding cost allocators that are not correct – in particular it is not plausible that distributors would allocate operating costs to the regulated business under ABAA on the basis of the industry average percentage of regulatory revenue to total revenue).

51. Our own analysis, which corrects for the errors in the Commission's analysis and is described in detail in Appendix A, suggests that the ACAM revenue threshold does not enable any distributor to increase regulated revenues by as much as 2% and therefore there are no grounds to reduce the ACAM threshold. As such, the ACAM revenue threshold should not be reduced.

Cost of capital issues

52. The distributors which support this submission support the continued use of the current high-level approach to determining the WACC – that is, the approach which averages the costs of debt and equity, and estimates the latter using the SBL-CAPM formula. We support the draft decisions to not apply a 'split cost of capital', a 'dual WACC' for the purposes of a CPP, or Black's Simple Discount Rule as a cross-check.

53. We support re-estimating the asset beta with updated data. We continue to support the use of a wide sample of comparators for this purpose, however more weight should be given to the daily estimates, and an average taken over daily, weekly and four-weekly estimates.

54. We support the consistency in approach to determining the TAMRP value, between electricity distribution and other regulated industries such as telecommunications. However, some details of the approach used to determine the TAMRP estimate can be improved, for example:

    - Mean values are more relevant than median values.
    - We do not support rounding the estimate to the nearest 0.5%.

55. We consider that the use of a three month averaging period is preferable to one month for determining the risk-free rate and debt premium. However we remain of the view that an averaging period of around five years is more suitable, and that a 'trailing average' approach is superior to a 'prevailing rate' approach.

56. We agree with the decision not to annually update the risk-free rate or cost of debt.

57. The distributors which support this submission support the draft decision to remove the reduced weighting on bonds which are issued by a company owned by the Crown or a local authority for the purpose of determining the debt premium. We support the use of the Nelson-Siegel-Svensson (NSS)

curve for this purpose, and in general support moves to reduce the degree of judgement required in implementing the cost of capital IM.

58. We support an alternative approach to the term credit spread differential (TCSD), where the cost of debt is estimated with respect to bonds which reflect the average tenor of distributor-issued bonds.

59. If this approach is not adopted, then we support the retention of the TCSD allowance. The additional premium incurred in issuing debt of longer than five years tenor is a legitimate expense that should be able to be recovered. We support the proposed simplifications of the method for implementing the TCSD, although there are some details of the method which we submit should be reconsidered.

60. The distributors which support this submission support a process where the estimate of debt issuance costs is updated on the basis of recent data from distributors. We are comfortable with the allowance for swap costs being included within the debt issuance costs allowance, rather than the TCSD. However, we disagree with the draft decision to exclude the costs of standby bank facilities from the estimate of debt issuance costs because these are reasonable costs associated with efficient debt practices.

Related party transactions

61. The distributors which support this submission support the Commission considering reforms to the related party transaction requirements in the IMs over a longer timeframe, provided this ensures the related party rules in information disclosure and the IMs can be reviewed in parallel and made to be consistent. We agree that the definition and interpretation problems with the current requirements (eg aligning the IM and information disclosure requirements and addressing the use of the term 'directly attributable cost') should be reviewed.

62. We are not convinced that the trends identified in the paper regarding increased values of related party transactions and variations in avoidable cost of transmission (ACOT) payments are evidence of a problem. More work may be needed to fully understand why related party transactions are increasing. However, the concerns raised regarding ACOT seem to be based on a misunderstanding of the nature of ACOT payments.

63. The related party transactions paper asks a series of questions about the nature and rationale of company organisations that give rise to related party transactions. It may be helpful to hold a workshop to discuss these matters. The information requested will vary between suppliers and may involve some confidential data.

Report on the IM review

64. The distributors which support this submission have some concerns regarding the proposed next closest alternative (NCA) provision, partly because it will be an additional set of decisions to be aware of and partly because the level of scrutiny over these decisions will be limited. If this is progressed, more clarity should be provided on how the provision will be used and it should be subject to consultation.

65. Otherwise, we support the ENA submission in relation to the detailed IM changes proposed in this paper that are not discussed in any of the Topic papers; these are generally not controversial. Where proposed IM changes discussed in the IM report are also discussed in the Topic papers, we refer the Commission to the section of this submission that responds to the relevant Topic paper.

Framework for the IM review

Background

66. The IM framework paper describes:

    - The approach the Commission has taken in reaching its draft decisions, which was:

        i. to consider each IM and consider whether it is currently achieving the right thing in the right way

        ii. to consider whether changing an IM would better promote the Part 4 purpose, the purpose of IMs or significantly reduce compliance costs or complexity.

    - Three key economic principles that the Commission has used as guidance to how it can best promote the Part 4 purpose, which are:

        i. that regulated firms have an ex ante expectation of achieving financial capital maintenance (FCM) in real terms

        ii. that risk is allocated to the party best placed to manage the risk

        iii. that the asymmetric consequences of under-investment compared to over-investment are recognised.

67. The Commission disagrees that these economic principles are a regulatory compact and argues that they are subordinate to the Part 4 purpose. The Commission also does not consider there should be any materiality threshold for applying the IMs.

68. In mid-2015 the Commission published draft frameworks for reviewing the IMs. The IM framework paper discusses these and notes that it will develop a wider framework for future IM reviews later.

Discussion

69. It is helpful for the Commission to describe its approach to reviewing the IMs and the key principles it applies to such reviews. We support the completion of the wider IM review framework in the near future.

70. At a high level the questions the IM framework paper says were asked are relevant and useful questions to ask (eg “Is the policy intent behind the IM still relevant and appropriate?”). However, unavoidably, the answers to such questions are likely to be subjective and the distributors which support this submission are looking for more certainty regarding when an IM will and will not be changed.

71. In our previous submission, we considered that:

    - When errors are identified they should be corrected as soon as possible and updated versions of the IMs should be provided.

    - Other than for error correction, the Commission should strive to avoid making changes to the IMs between the 7-yearly statutory reviews.

72. Importantly, we do not expect substantive policy changes to occur within the 7-year windows, including in advance of price resets. While there is much in the framework we support, the risk of substantive ad-hoc amendments to the IMs remains a concern. This is because the approach in the IM framework paper essentially says that any time the Commission judges that changing an IM would better promote the Part 4 purpose it can make the change.

73. The IM framework paper also suggests that the Commission will not be constrained by the economic principles. The economic principles are important and well regarded. However, the IM framework paper is careful to point out that they can be overridden if the Commission considers that a different approach would deliver the Part 4 Purpose more effectively.

74. The distributors which support this submission are concerned that the Commission has set out a generally reasonable process and approach, but has claimed for itself the ability to change that approach at, effectively, any time it wants to. This is not consistent with the purpose of the IMs – to provide certainty.

75. The distributors which support this submission submit that the Commission should commit to not making substantive changes to the IMs between seven-yearly reviews except in exceptional circumstances and should confirm that a very high threshold would be applied before any change to the core economic principles is made.

Form of control and RAB indexation

Introduction

76. The Form of control paper sets out the Commission's draft decisions in relation to the form of control that should be applied to distributors (as well as Gas Pipeline Businesses and Transpower) and in relation to whether the RAB should be subject to revaluations at the rate of inflation, termed 'indexation'.

77. The form of control applies directly to distributors that are subject to default/customised price-quality regulation. However, it is also relevant for exempt distributors as they can (and some do) set prices to mirror the requirements of price-quality regulation.

78. The draft decision for electricity distributors is that a revenue cap with wash-ups should apply and distributors' RABs should continue to be indexed at the rate of inflation.

79. The EA's form of control letter raises concerns regarding the implications of a revenue cap on distributors' incentives to price efficiently and suggests the Authority may regulate distribution prices further if a revenue cap is applied to distributors.

Principles of form of control

Comments on Commission draft decision

80. The distributors which support this submission support the draft decision to not make an adjustment to the asset beta for regulatory differences, such as the form of control.[1] We agree there is insufficient empirical evidence to support making such an adjustment or to identify what the adjustment should be.

81. The distributors which support this submission support changing the form of control to a 'pure' revenue cap.

82. We agree a revenue cap will remove the exposure of suppliers to the risk of error in regulatory volume forecasts when price resets are made. This is important because any error in the Commission's forecast will mean suppliers earn either more or less than their price-quality path revenue requirement, leading to windfall gains and losses that do not provide any useful incentive effect. Importantly, this risk differs from the standard risk faced by all businesses that revenues will vary from expectations over time. We consider that the variances between actual and forecast revenues identified by the Commission indicate this is a material problem.

83. We agree with the Commission that the quantity forecasting risk may reduce if tariff structures change, because forecasting kWh supplied is probably more challenging than forecasting other metrics used to bill electricity lines services (such as capacity or peak demand). However, the Commission will still be required to forecast volumes of capacity or peak demand over time and the risk of error would remain under a WAPC.

84. A move to a revenue cap will also improve the ability of distributors to reform their tariff structures as the compliance risk of such changes will be reduced. The compliance risk associated with changing price structures has been a material barrier to pricing reform by distributors reforming their tariffs.

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[1] Form of control paper, paragraph 19.

85. The distributors which support this submission also agree with the Commission that even under a revenue cap suppliers still have incentives to price efficiently, otherwise they risk long-term disconnections resulting from inefficient prices that drive consumers to consider other options.

Comments on Electricity Authority paper

86. The Authority has a different perspective on the form of control, as set out in the EA form of control letter. This section considers and responds to the views expressed by the Authority.

87. The Authority considers that:[2]

- “a revenue cap might reduce distributors’ incentives to adopt efficient pricing structures” (the Authority seems to disagree with the Australian Energy Regulator’s (AER) recent conclusions that a price cap is unlikely to drive efficient prices in reality).
- A revenue cap could “lead to inertia and encourage distributors to continue to rely on consumption-based pricing”.
- “a revenue cap could provide incentives for distributors to set inefficiently high prices for price-responsive services and/or customers” as a means of driving down costs
- If a revenue cap were to be introduced, the Authority may be more likely to scrutinise and regulate distribution pricing structures.
- Efficient prices may emerge under a WAPC.
- Quantity forecasting risk is something businesses should be able to manage.

88. We consider that the Authority has taken an overly theoretical approach to this question and has also misunderstood some of the evidence.

89. We agree with the AER’s conclusions that the theoretical benefits of WAPCs would only be realised if the following assumptions were true:[3]

- The objective of DNSPs[4] is to maximise profit.
- DNSPs must have the expertise and ability to estimate the price sensitivity of different services and adjust prices accordingly.
- The necessary metering technology must be in place to provide cost-reflective tariffs.
- DNSPs must be able to set profit-motivated prices and be free from outside influence to do so.
- Retailers must pass through the price signals to consumers.
- Consumers must know of price changes when they happen.
- Consumers must understand and be able to respond to the price signals.

90. The AER has concluded that the majority of these assumptions do not hold for the majority of DNSPs in the Australian National Electricity Market (NEM).

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[2] EA’s form of control letter.

[3] Australian Energy Regulator, Stage 1 Framework and approach paper: Ausgrid, Endeavour Energy and Essential Energy, March 2013, pages 74-75.

[4] The term for Australian electricity distributors.

91. The Authority has suggested these conclusions are not relevant in the New Zealand context. We consider that they are relevant, as discussed below.

92. Firstly, the Authority argues the conclusions of the AER related to New South Wales DNSPs which are state owned, and thus less likely to act commercially than some New Zealand distributors. This overlooks the nature of the AER's conclusions. While these conclusions were first reached in regulatory consultation papers relating to NSW DNSPs, the conclusions clearly applied to all of the Australian National Electricity Market:[5]

> "The AER agrees there is an incentive for efficient pricing under [a WAPC]. However, the AER considers that the same incentives and improvements are not evident across all NEM DNSPs subject to WAPCs, especially in regard to the previous regulatory period. Appendix B provides analysis of pricing trends by Essential Energy, Endeavour Energy **and the Victorian DNSPs** under the WAPC. The AER found that the improvements demonstrated by Ausgrid in the current regulatory period were not evident across the other DNSPs subject to the WAPC." [emphasis added]

93. As can be seen from this quote, the AER's analysis included Victorian DNSPs, which are all privately owned. The AER has also, more recently, used similar logic to justify applying a revenue cap to Victorian DNSPs.[6]

94. The Authority is concerned that if a revenue cap was applied to distributors, some distributors might choose not to change their pricing structures as any losses due to volumes being lower than forecast would be able to be recovered in future years. We agree this might be the short-term incentive. However, in the longer term such an approach would be unsustainable as volumetric charges would increase to levels that would threaten the distributor's business model. The distributors which support this submission are in the business of owning long-life assets that will deliver services over many years and are not short-term focused organisations. It is reasonable to expect distributors to act in a manner that is rational over the long-term.

95. The Authority raises a concern that a revenue cap incentivises firms to set extremely high prices for price responsive services or consumers to induce those consumers to reduce demand or exit altogether and thus reduce costs. The Authority is not aware of any instances of this situation occurring.[7] The distributors which support this submission do not believe any company would act in the way the Authority suggests. Setting such high prices for an asset or consumer that they may disconnect would be to price in a way that is likely to invite consumer complaint and media or political scrutiny. In the longer term, driving down usage or consumers is not in any distributor's interests. Setting prices in this way would also require considerable data and analytics expertise that is not present within many, if any, distributors and would require significant management effort for what would at best be fairly marginal gains. Pricing in this way would also be inconsistent with the Authority's pricing principles, which all distributors are required to have regard to.

96. The AER has also considered this risk and concluded that, even if it is a valid concern, it would most likely lead to more efficient tariffs:[8]

> "The incentive for distributors to decrease costs through pricing is therefore likely to result in higher prices for peak demand. This would require a shift towards peak energy/capacity

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[5] AER, Preliminary positions: Framework and Approach Paper Ausgrid, Essential Energy and Endeavour Energy, page 85.

[6] For example: AER, Final Framework and approach for Victorian Electricity Distributors Regulatory control period commencing 1 January 2016, 24 October 2014.

[7] EA's form of control letter, pages 2-4.

[8] AER, Final framework and approach for the Victorian Electricity Distributors Regulatory control period commencing 1 January 2016, 24 October 2014, page 80-81.

based tariffs. In the current environment where tariffs largely consist of flat energy/capacity tariffs we consider that a shift towards peak energy/capacity prices will result in increases in pricing efficiency, regardless of the form of control.[9] That is, the recent scenario of rising peak demand and falling energy consumption is a strong driver of a need to reform tariffs under both a revenue cap and a WAPC."

97. The Authority suggests that it may be more likely to scrutinise or regulate distribution prices if a revenue cap was applied. We assume the Authority would not do this without undertaking more detailed analysis of whether prices under a revenue cap were more inefficient. Based on the evidence and analysis discussed in this submission, we do not consider the Authority could reasonably reach a conclusion that revenue caps would necessarily lead to less efficient pricing.

98. In particular, we note that price caps of one form or another have applied to New Zealand electricity distributors for more than a decade and the Authority still believes that distribution prices are not as efficient as they could be. This evidence does not support a claim that a WAPC will drive efficient pricing as it has not achieved this yet. Meanwhile it is clear that, as identified by the Commission, the risk of revenue losses and compliance breaches resulting from price restructures is a constraint on pricing reform.

Conclusion

99. We consider that the real and practical benefit of removing the compliance risk associated with price restructures and avoiding the volume forecast error risk outweighs the theoretical concerns regarding price efficiency under a WAPC. A revenue cap is likely to be a materially better form of control for distributors than a WAPC.

Implementation of form of control

Overview of implementation detail

100. The Form of control paper proposes that the revenue cap would include a wash-up mechanism to allow for over and under-recoveries to be adjusted for in subsequent years. The objective is to ensure distributors can earn their revenue requirement but not more or less.

101. The revenue cap wash-up mechanism that is proposed contains a number of components. Wwe comment on each in the table below.

Proposed wash-up mechanism	**Comment**
Distributors set their prices such that forecast revenues are no more than allowable revenues in each year	We agree that distributors should set prices such that forecast revenues are no higher than allowable revenues and the difference between actual and permitted revenues should be washed-up
A time value of money adjustment on any wash-up amount to ensure the revenue requirement is achieved in real terms	We support a time value of money adjustment. However, we are not convinced the other proposed caps, collars and constraints are necessary
A constraint on average price increases, which will limit the percentage increase that can be applied in any one year	The constraint on average price increases would be a percentage limit on the average price increase that could be applied in any one year under a revenue cap. This has been designed by the Commission for gas transmission businesses, which have a few very large

[9] AER, Stage 1 NSW framework and approach Ausgrid, Endeavour Energy and Essential Energy, 1 July 2014–30 June 2019, March 2013, p. 48.

Proposed wash-up mechanism	Comment
	consumers whose exit could cause price shocks for other consumers. It is not clear this is relevant or necessary for electricity distributors, who all have a large proportion of smaller consumers.
A cap and collar on the wash-up ("drawdown") amount, which seeks to restrict price volatility caused by the wash-up and smooth price changes over time	The cap and collar on the drawdown amount is proposed as a restriction on the amount of the wash-up that can be recovered in any one year, defined as a percentage of allowable revenues (net of pass-through and recoverable costs). We expect this would help to smooth price changes between years. However, it is not clear that price shocks would be a problem under a revenue cap. The distributors which support this submission are generally concerned to avoid price shocks for their consumers and routinely smooth changes themselves already without regulatory direction. We recommend waiting to assess whether price shocks are a material problem before introducing caps and collars. Also, care will need to be taken in setting the limits. If the cap and collar are too narrow, and a supplier consistently over- or under-recovers then it could take several years before a large over- or under-recovery is fully washed up. It is even conceivable that a full wash-up may never be achieved. Also, we question why it is necessary to have a limit on average price increases *as well as* a cap and collar on the drawdown amount. They seem to achieve largely similar outcomes.
A cap on the accumulation of voluntary undercharging, which sets a percentage of voluntary undercharging that cannot be washed up in future	The Commission proposes to measure the degree of voluntary undercharging by assessing the difference between forecast revenue and allowable revenue for each year when the distributor sets its prices. The cap on accumulation of voluntary undercharging would then be a specified percentage of allowable revenues. The percentage is to be specified in the DPP determination. We consider the cap on the accumulation of voluntary under-charging is not consistent with the principles of a revenue cap – that each supplier should be able to earn their revenue requirement. However, we acknowledge the concern that ongoing under-charging could build up a very large balance that a distributor may seek to drawdown in future. The distributors which support this submission do not support this cap at the present time. We recommend the Commission implement the revenue cap and then assess the scale of wash-up balances that are built up through under-charging. The Commission will then be able to intervene, if necessary, with a targeted mechanism. We think the intent to apply the wash-up to every difference between allowable and forecast revenue is problematic. It will not always be the case that a distributor who voluntarily under-charges in one year does not intend to recover it the following year. For example, a distributor could be seeking to smooth price rebalancing or the recovery of pass-through and recoverable costs and as part of the smoothing chooses to recover less than their revenue requirement in one year but will seek to regain this in the next year or two.

Proposed wash-up mechanism	Comment
A cap on the wash-up amount, which is intended to prevent full recovery of losses following a catastrophic event	The distributors which support this submission strongly oppose the proposed cap on the wash-up amount. The Commission's stated intent, to ensure suppliers bear some of the risk if a major catastrophic event (or other negative demand event) occurs, is inconsistent with the intent of a revenue cap – where the regulated supplier's revenue requirement is always met. There is no principled reason for suppliers to be subject to revenue risk resulting from major shocks but insulated from revenue risk resulting from minor and moderate shocks.
A requirement for each supplier to maintain a wash-up account to retain wash-up and charging information	Given the complexity and inter-relatedness of the wash-up mechanisms, we understand why the Commission has proposed that distributors are required to maintain a wash-up account to account for the different wash-up elements. However, the wash-up account will create complexity of its own and costs for distributors to manage. If fewer wash-ups were applied, as we recommend, this would also reduce the cost and complexity of the wash-up account.

102. This is clearly a complex set of arrangements. The distributors which support this submission would prefer simplified regulation wherever possible and question whether all of these features are required. It is clear the introduction of a revenue cap including all of these features would cause cost and complexity when setting prices.

Timing of wash-ups

103. The draft decision proposes to delay the wash-ups by two years so the full wash-up amount is known before prices are set to recover it. We understand the reasoning for this but submit that a partial wash-up in the year after the year in which the balance is created is a better approach. By the time prices are set for the following year approximately 8-9 months of actual revenue data will be available, including for the coldest months of the year. As such distributors will have a good idea of the size of any over- or under-recovery that would occur. It would be reasonable for distributors to re-estimate their revenues and carry out a wash-up based on the difference between that estimate and allowable revenues. A full wash-up can then be undertaken the following year for any differences between actual and re-estimated revenues. This would provide for faster corrections of any over or under-recovery and may also reduce the size of the wash-ups and thus reduce the risk of price shocks.

Disclosure of connection information

104. We note the Commission's intention to require further disclosure of information regarding the connection of new consumers. The design of the new requirements must be such that it is made low cost for distributors to provide the necessary information.

Incentives for new connections

105. The Form of control paper considers that there is no need for an incentive for distributors to connect new consumers efficiently. We disagree. Without such an incentive distributors may not be able to recover the costs of new connections where the connection costs were not included in DPP forecasts. This could result in sub-optimal new connections and/or a failure of some distributors to achieve a real return. We support the ENA's proposals in this respect.

Timing of the price compliance report

106. In preparing this submission we have reviewed the current consultation paper on the application of the IMs to the DPPs of gas pipeline businesses.[10] This consultation discusses some details of how the Commission proposes to apply a pure revenue cap to gas transmission businesses.

107. One proposal in the Gas DPP IMs paper is that the pricing compliance report could be provided after prices are set but before they take effect. This could imply a deadline of around March each year for the price compliance statement of electricity distributors. This implies there would be two separate compliance statements each year – one for price in or around March and one for quality in June. We do not agree with this proposal as it will increase cost and complexity for all distributors, (eg: for distributors to prepare two separate DPP compliance statements rather than one and secure audit and certification of both will increase their costs). In February and March each year distributors are generally focused on disclosing pricing methodologies and asset management plans as well as managing year-end financial and tax responsibilities. It will also be difficult for distributors to secure auditor time in February and March each year. To add a further compliance burden at this time is not helpful.

RAB indexation

108. The draft decision paper provides a helpful explanation and worked example of the basis for applying revaluations to distributors' asset bases. The draft decision clearly sets out the objective of delivering electricity distributors and gas pipeline companies with a real return on capital over the regulatory period.

109. We appreciate the logic put forward in support of the current approach to RAB indexation. However, this is undermined by the application of a different approach to Transpower. We cannot see any principled justification for the regulatory regime to provide Transpower with a nominal return while it provides distributors with a real return.

110. We also consider the Form of control paper too readily dismisses the bankruptcy risk for distributors associated with the issuance of nominal debt. While the bankruptcy risk may be small, the broader problem is that the practice of targeting a real return makes it unlikely distributors' revenues will reflect their actual cost of debt, as the debt payments will be required in nominal terms. This is a problem in itself, irrespective of how likely the bankruptcy risk is, because it compromises the ability of distributors to earn normal returns, or just as importantly the expectation of earning normal returns.

[10] "Default price-quality paths for gas pipeline services from 1 October 2017, Implementation matters arising from proposed input methodologies changes".

CPP requirements

Cost and complexity

111. The distributors which support this submission have previously supported a comprehensive review of the CPP IMs, in particular to reduce the cost and complexity inherent in the current requirements. We therefore support the intention of the draft decision to make the CPP more cost effective for all parties, and reduce the complexity and improve certainty for the CPP application process. We also support the parallel process of introducing opportunities for more supplier specific circumstances to be included in DPPs. Taken together, such refinements should in principle improve the workability of the DPP/CPP regime, and we hope, reduce the associated implementation and administration costs.

112. In the remainder of this section we comment on the key changes proposed.

Reopeners

113. There are a number of changes proposed to reopeners for DPPs and CPPs. We agree that DPPs and CPPs should be able to be reopened under certain circumstances. We support the proposal to expand the scope of DPP reopeners. We consider this provides a more cost effective process for specifying fit for purpose price-quality paths than relying on a CPP application to remedy a DPP decision.

114. The following table addresses each of the proposed changes to reopeners, in turn.

Proposed Change	Comment
DPP able to be re-opened for a quality standard variation on application by the distributor. Quality only CPP application removed	We support this change. While the existing CPP quality only application provisions have merit in principle, there is some ambiguity as to how they would be applied in practice. A DPP reopener is expected to be more straight-forward and therefore a lower cost solution for achieving fit for purpose quality standards for non-exempt distributors. If a quality standard variation is approved, we submit that it should apply retrospectively, ie: from the beginning of the DPP regulatory period. This recognises that there will be some delay in determining the modified quality standards, to allow for the application to be prepared and then considered by the Commission. We note that the quality standard variation proposal requirements included in the draft determinations have been largely sourced from the existing CPP IMs. We consider they can be improved and support the ENA's submission on the draft determination in this respect.
CPP able to be reopened for contingent and unforeseen projects	We support this change because we consider that it is reasonable for allowances to be added to a CPP price path, if information about significant and additional projects becomes available during a regulatory period. This provision is subject to approval by the Commission and is to include both capex and opex. We note that a CPP application must include detailed justification for forecast expenditure for a seven year period. It may not be possible to provide the sufficient evidence for the

Proposed Change	Comment
	entire forecast period, particularly where the timing or scope of a project is uncertain, and may be dependent on factors outside an distributor's control. This new provision appropriately recognises this uncertainty.
CPP reopened when DPP WACC changes	We support this change. Refer to our commentary on the CPP WACC below.
Error reopener expanded	We support the draft decision to reopen a DPP or CPP where there was an error in the determination. We consider the current error reopener provisions are too narrow, and currently there is little other remedy available in these circumstances.
Major transaction reopener	We support the draft decision to allow for a DPP or CPP to be reopened, at the Commission's discretion, to address the unforeseen consequences of a major transaction (using the same definition as in the 2015 DPP Determination). This is a pragmatic provision, recognising that it is not possible to fully anticipate the consequences of future transactions on regulated businesses when making regulatory determinations. We agree that, in this event, the extent of modification to the price path or quality standards should be limited to the extent necessary to maintain the original policy intent, and respond only to the impact of the transaction on the distributor.
Reopen a DPP or a CPP when a Next Closest Alternative (NCA) approach has a non-equivalent effect	This proposal has merit as a pragmatic solution for rare circumstances where an existing price-quality path determination becomes unworkable. However we have some concerns which are discussed in our comments on the IM report.
Reopen when a requirement of a 52P DPP or CPP Determination, and the application of s52Q results in a non-equivalent effect	We support this proposal which is a pragmatic solution for rare circumstances where an existing price-quality path determination is amended under section 52Q.
DPPs are not to be reopened for constant price revenue growth (CPRG) assumptions	We agree that this decision is consistent with the draft decision to implement revenue caps, rather than weighted average price caps for DPPs. However, should a weighted average price cap be retained, we submit that a CPRG reopener is required for DPPs, given the materiality of this assumption to price paths, the difficulty in forecasting it, and the variances between forecast and actual CRPG experienced in the last DPP regulatory period.

115. In addition, it is proposed that some of the DPP/CPP pass-through and recoverable cost provisions are modified. We comment on each of these proposals in the following table:

Proposed Change	Comment
Additional pass through costs may be specified in advance of a regulatory period	We support this change which provides more flexibility for accommodating costs which are outside of the control of distributors. These can be specified at the time a new DPP or CPP determination is made, and thus will be subject to consultation.
Urgent project allowance for costs incurred in the period between a CPP application and determination Capex wash up recoverable cost	This proposed change recognises that there is a substantial delay before a CPP determination can be implemented. The pre application requirements of an distributor (preparation of the CPP proposal, consultation, verification, audit and certification) can be expected to take at least 12 months. It is likely that there will be another 12 months before the CPP determination comes into effect, allowing for the application windows, the Commission's assessment period and the publication date requirements. We therefore consider that it is reasonable for an distributor to be able to recover the costs of urgent work, above those allowed for in the DPP price path, incurred during this application period. We note that it is proposed that the urgent project allowance excludes any costs which are treated as commissioned assets. We support this exclusion on the condition that the capex wash up recoverable cost, which was introduced for DPPs prior to the 2015 DPP Determination, is extended to CPPs. This adjusts for the difference between forecast and actual commissioned assets in the year immediately prior to the new (DPP or CPP) price path taking effect. We submit that the rationale for introducing this wash-up for DPPs applies equally to CPPs.
Recovery of additional CPP costs has not been permitted	While the CPP IM allows for the recovery of some costs of preparing a CPP application, there are substantial abnormal costs which are expected to be incurred by distributors which are not able to be recovered (and for which there is no provision in DPP price paths). As previously submitted, where a CPP determination is made, it will be deemed to be in the long term interests of consumers, consistent with the s 52A Purpose Statement. We address this further below.

Recovery of additional costs

116. The distributors which support this submission continue to believe that the costs of preparing a CPP proposal are prohibitive for many non-exempt distributors (even with the proposed refinements to the information requirements). If a CPP determination is made, which will be deemed to be in the long term interests of consumers, then those costs to the distributor which are not business as usual costs, such as advisor costs and CPP specific consultation costs, should be able to be recovered.

117. Smaller distributors in particular do not have teams which are geared up to manage complex regulatory projects. This is efficient and is reflected in lower business as usual operating costs. A successful CPP application does require considerable targeted effort due to the large amount of information to be collated together, and the pre application processes which must be managed. These

are legitimate activities, which are in effect prescribed by the IMs. The costs of these additional external costs should therefore be able to be recovered through prices via a CPP Determination.

CPP Processes

Assessment of expenditure

118. CPP requirements paper includes commentary on the way in which the Commission expects to assess the proposed expenditure included in a CPP proposal. Paragraph 168 sets out the topics that the Commission intends to consider, as follows:

- The alignment of investment with service outcomes.
- That projects can be delivered within the bounds of planning uncertainty.
- That the processes for delivering the expenditure are efficient.
- That the supplier has strategies for accessing the necessary resource to undertake the expenditure.

119. We are concerned by these proposals which appear to ignore the fact that evaluation criteria for the Commission are already specified in the IM at Part 5, subpart 2, clause 5.2.1. These evaluation criteria specify how expenditure is to be evaluated, how information is to be evaluated, and how quality standards are to be evaluated. We find it particularly unhelpful for additional criteria to be included in the Topic Paper, without recognition of the existing criteria, particularly as it is unclear what the status of these new criteria is. In our view, this additional commentary adds to the complexity of understanding the CPP requirements.

Top down evaluation

120. The discussion on pages 43-44 of CPP requirements paper states that the Commission's approach to assessing proposed CPP expenditure is a top down approach supported by bottom up review of selected projects and programmes. This is described as follows:

- Assessing policies, strategies and processes initially, to ensure that if they are implemented in practice, they will produce appropriate expenditure forecasts.
- Assessing whether the expenditure forecast has been developed consistent with the policies, strategies and processes – by investigating a sample of projects and programmes (which is the main responsibility of the verifier).
- Assessing the appropriateness of the input assumptions used when forecasting expenditure.
- A bottom up review of areas highlighted by the verifier to complement, not repeat the verifier's own review.
- An additional review of the models used to prepare the forecasts, to consider if the outputs and conclusions from the models are appropriate.

121. We have previously requested clarification of the role of the verifier once the CPP application has been submitted. We have been concerned at the potential for unnecessary overlap between the Commission's assessment and the verifier's assessment – requiring the applicant to explain its proposal, processes etc to two different sets of assessors. Along with the ENA, we have previously submitted that the verifier should be retained by the Commission after an application has been submitted, to ensure this duplication of effort is minimised. The process which is summarised in the preceding paragraph suggests that our concerns have not been addressed, and that it is likely that the Commission will repeat much of what the verifier does, in undertaking its own assessments of policies, procedures, inputs and models.

122. We are disappointed that the Commission has not taken the opportunity to significantly improve the assessment process by making the best use of knowledge gained by each of the parties involved. We recommend the verifier is retained to assist the Commission in its assessment of a CPP application.

Evaluation of a quality standard variation

123. CPP requirements paper sets out how the Commission plans to evaluate a quality standard variation proposal. Similar to comments made above, this does not appear to be aligned with the CPP IMs. Paragraph 184 suggests that the Commission is likely to focus on:

- The support of consumers, including the cost trade-off.
- Components of reliability that are driving change.
- Historical reasons for deterioration in drivers.
- Whether the applicant made prudent historical decisions to manage deterioration.
- The extent to which the proposed quality standards align with investment in the CPP proposal.
- Statistical analysis of past SAIDI and SAIFI performance.

124. Only some of these topics are included in the information requirements for a CPP proposal or the evaluation criteria for a CPP proposal. For example, the CPP IM includes no criteria or information requirements which align with the proposed assessment of historical reasons for deterioration in drivers or whether the applicant has made prudent historical decisions to manage deterioration.

125. Further the references to the information what must be included in a CPP proposal in support of a quality standard variation (at clause 5.4.5), or in Schedule G have not been updated to reflect the most recent DPP Determination's specification of the quality standards.

126. Accordingly we submit that all of the CPP IM requirements which relate to quality standards (and service levels) require a comprehensive review to remove ambiguity, errors, and inconsistencies with the rest of the IMs to ensure they are fit for purpose.

Verification

127. There are two primary objectives for the verification role

- To assist the applicant to prepare a CPP application which is robust and of a good standard, by reviewing and commenting on a draft CPP proposal, which the applicant is then able to respond to before finalising its application.
- To assist the Commission in completing its evaluation of the CPP application once submitted, by identifying in the verification report those topics in the CPP application for further consideration by the Commission.

128. For this reason, the verifier acts under a tripartite arrangement, with obligations to the applicant and the Commission. We consider that the commentary in CPP requirements paper (for example at paragraphs 209 – 211) and the draft decisions, have primarily focussed on the second objective, at the expense of the first.

129. Further the amendments to Schedule G of the IMs, which set out the verifier's terms of reference have significantly expanded the scope of the verification. We submit that this extended scope is well beyond that intended in the original IM Determination, as set out in paragraphs 9.6.10 – 9.6.15 of the 2010 IM Reasons Paper and is in some cases inconsistent with the evaluation criteria for a CPP.

130. We note that the 2010 IM Reasons Paper explicitly recognised the limited scope of the verification.

K4.7 The verifier must consider those aspects of the CPP proposal that are relevant to its Terms of Reference and may not consider material relevant to other parts of the CPP proposal.[11]

131. We submit that the additional content in Schedule G2 has not been drafted in a way which is consistent with the criteria against which a CPP application is to be assessed (as specified in section 5.2.1 of the IMs), or the components of the CPP which the verifier is tasked with reviewing, which is predominantly the expenditure forecasts. We question whether this is intentional (as it does not appear to align entirely with CPP requirements paper) and may be an unintended outcome of the drafting.

132. Paragraph 314 of CPP requirements paper describes the proposed key changes to the role of the verifier. We comment on each one in the following table.

Proposed role of the verifier	Comment
Provide an assessment of whether policies, strategies and procedures are appropriate such that the services will be provided efficiently and align with consumer demands	This proposal unnecessarily introduces new assessment criteria which increases cost and complexity. The existing **expenditure objective** (IMs clause 1.1.4) provides the appropriate criterion for this purpose. We note that there was considerable discussion in 2010 about the CPP evaluation criteria when the IMs were first established. We have not seen anything in the IM review consultation material to date which suggests that these are no longer appropriate. We therefore submit that any changes to the CPP IM assessment process and requirements must be consistent with clause 5.2.1 of the IMs – and importantly should not indirectly or informally expand the criteria against which a CPP is to be evaluated.
Ascertain whether policies, strategies and procedures have been applied in practice	A CPP application is largely about forecasts. The Commission ultimately must approve *ex ante*, a price path and quality standards. We therefore question why this new requirement is backward looking. While historical expenditure does form part of the CPP application, and current practice is of relevance to expected future practice, we consider that a better focus would be for the verifier to consider whether the applicant's policies, strategies and procedures support its CPP forecasts.
Review material aspects of the CPP proposal to ensure it is sufficiently complete in content and supports the applicant's expenditure objective, prior to the Commission's review	We submit that this requirement is too broad. It potentially incorporates aspects of the CPP proposal which are outside the verifier's scope (such as the price path). The verifier does not need to verify whether an entire CPP proposal is complete. This role resides with the Commission once an application has been made, and is assessed by the auditor and directors prior to the application being submitted. It is reasonable for the verifier to consider whether the applicant has sufficient evidence to support its expenditure forecasts and whether the CPP proposal contains the prescribed information of relevance to these forecasts.

[11] IM Reasons Paper, page 644

Proposed role of the verifier	Comment
	In addition the term **applicant's expenditure objective** is confusing given the **expenditure objective** term defined in IM clause 1.1.4.
Assess the input data and assumptions or practices used in developing the information that supports the CPP application, and report on any aspects that may warrant in depth review by the Commission	Again this is too broad. The verifier should not be forming a view on the input data and assumptions which fall outside its scope of work, for example in relation Building Block Allowable Revenue (BBAR) and Maximum Allowable Revenue (MAR).
Report on the extent and effectiveness of the consultation with consumers	We support this extension to the verifier's scope of work, and comment further on this below. However we consider that the verifier should focus primarily on the effectiveness of the consultation material and the ways in which the applicant engaged with its consumers. We do not consider the verifier should or could be expected to comment on the CPP proposal represented in the consultation such as any price-quality-trade-offs proposed by the applicant.

Communication with verifier

133. It is essential that the applicant and the verifier are able to engage freely during the development phase of a CPP proposal, as indicated in paragraph 315 of CPP requirements paper. The verification role is expected to contribute to a quality CPP proposal being submitted, by providing feedback to the applicant during this phase.

134. We support the proposal to clarify the communication protocols between the verifier and the applicant during the verification process. We agree that it is reasonable to require the verifier to maintain a written record of the substantive information relied on when forming its views, as represented in its verification report.

135. We also agree that this information should not be made available to the Commission prior to the CPP proposal being submitted, recognising that some of the material relied on by the verifier may already be in the public domain (such as an AMP), or may become public during the CPP development phase (such as evidence supporting consumer consultation).

136. We consider that it is important to maintain an open and frank dialogue between the verifier and applicant during the verification phase – as this will ensure the objectives of the verification are best achieved. It is important that this dialogue occurs without direct oversight of the Commission during this phase, as the Commission's oversight commences once the application has been submitted. Further, we consider that the Commission's interests are adequately accommodated via the tripartite deed.

Summary for Commission

137. It is proposed that the applicant provide the Commission with a high level CPP proposal summary when it engages the verifier, for preliminary resource planning. We question the cost/benefit of this proposal, particularly given the proposed content of this summary, as set out in the Draft Determination. We consider that this proposal adds undue cost and complexity to the CPP process – contrary to the objective of the IM review. This is because the proposed summary:

- Is too detailed, and thus introduces an additional and substantial (given its proposed scope) document which must be prepared, approved and submitted by the applicant during the period when the applicant should be focussing on preparing the best proposal it can.
- Comes too early in the CPP applicant's development phase.
- Requires the applicant to refine and resubmit it as the CPP proposal develops and puts the applicant in the position of having to explain any subsequent changes to the Commission.
- Is unnecessary, as the Commission will have access to other information, and the ability to engage more informally with the applicant in the lead up to the CPP proposal being submitted. In particular the applicant will be publishing an AMP or AMP update, annual disclosures and CPP consultation material in the 12 months prior to a CPP application being made. Further, once the applicant triggers a verification engagement process, the Commission is involved and is able to open dialogue with the applicant about its proposal.
- Unduly duplicates the verification role, as it is the verifier which is tasked with reviewing the draft proposal and recommending to the Commission where it should focus its efforts.
- Is inconsistent with the intent of the proposed communication protocol for the verifier.

Identified projects

138. We note that the current CPP IM includes substantial prescription as to the number and scope of the capex and opex projects or programmes included in the CPP proposal, which are to be investigated in detail. We consider this contributes to undue cost and complexity, and support the proposal to introduce some flexibility in this respect. In particular we:

    - Support the proposal for the verifier to determine the appropriate number of projects to be investigated, and to cap this at 20.
    - Support the intent to provide guidance to the verifier for the selection of identified projects and programmes in Schedule G (the verifier's terms of reference). However we consider that the draft guidance (included in the Draft Determinations) needs to be improved because:

        i. it is not consistent with the evaluation criteria for a CPP as set out in Part 5, subpart 2 of the IMs

        ii. it duplicates other guidance already included in Schedule G

        iii. it introduces new terminology where suitable terms exist elsewhere in the CPP IMs.

139. We note that the proportionate scrutiny principle is valid in this respect, and is of particular interest to smaller non-exempt distributors. We consider that the verifier should select a sufficient number, but not an excessive number, of projects or programmes in order to fulfil its obligations as set out in the terms of reference.

Independent engineer

140. We support the proposal for the verifier to review any quality standard variation proposal, and for this to be prepared by the applicant. The CPP IMs currently assign this review role to an independent engineer. We consider that it is more cost effective for the verifier to take on this role because it is likely that the quality standards will reflect in some way the proposed expenditure forecasts. These forecasts will comprise a significant part of the verifier's review.

141. We note that a CPP applicant may choose to engage an independent engineer to prepare or review aspects of its CPP proposal, including a quality standard variation.

142. As noted above, the draft determination requires comprehensive review in this respect. For example in the verifier's terms of reference there is inadequate recognition of the specific focus necessary to review the proposed quality standard variation, in addition to the existing requirements for reviewing service levels.

Other topics for verification

143. We generally consider that any of the regulatory methodologies applied in deriving the CPP price path should fall outside of the verifier's terms of reference. The core capability of the verifier should be aligned to assessing opex and capex, associated policies and procedures, the quality standards and the demand for electricity distribution services which underpins the proposed expenditure.

144. Limiting the terms of reference to these core areas, will help ensure the verifier has the appropriate skill set needed, and that an adequate pool of verifiers is available in the event that multiple CPP applications are being prepared at once. If the terms of reference are too broad, both of these outcomes may be compromised.

145. Accordingly we consider that:

    - non-standard depreciation should be removed from the terms of reference – as is proposed
    - the application of the cost allocation IM – which applies to the RAB and opex should be excluded from the terms of reference. It is already included in the scope of the audit, and auditors have experience with the practical application of this methodology through annual regulatory financial disclosure audits.

146. In addition, for CPP purposes the cost and asset allocations are to be aligned to those that applied in the most recent disclosure year – which will have been audited. It will add unnecessary cost if the verifier is required to understand the allocations already made and audited, and confirm that the methodology has been applied to the forecasts. The auditor is also required to do this.

147. We also disagree with the rationale in CPP requirements paper that the cost allocation methods should be included in the verifier's terms of reference because it will involve capitalisation of overheads and related party costs. This is incorrect. The application of the cost allocation rules to CPPs (which is about ring fencing regulated from unregulated services) is independent of the methods which determine the value of regulated services.

Engaging the verifier

148. The distributors which support this submission, support the publication of an indicative template or benchmark agreement for the tripartite deed for the verifier. The nature of this deed is complex – given its three way obligations, and a benchmark agreement would assist distributors to manage their application costs. The relevant parties could amend the benchmark agreement as necessary to meet their particular circumstances. It does not seem sensible for every CPP applicant to start afresh for something which is a standard requirement. We note that this agreement would not need to form part of the CPP IM.

149. Page 75 of CPP requirements paper suggests that the CPP WACC constraint impacts on the engagement of the verifier. We do not agree. However we agree that the timing of the CPP WACC determination is a constraint to the pre application processes of the CPP applicant, which include completing verification, audit, consultation and finalising the CPP proposal itself. This is because the September publication date for the CPP WACC Determination significantly compresses the time available for these tasks. We therefore support the removal of this constraint. We have commented on the DPP/CPP WACC decision further below.

Audit

150. The distributors which support this submission support clarification of the role of the auditor in the CPP application process. We recognise that there are benefits for a range of stakeholders including the Commission, of an independent audit of the quantitative information included in a CPP application, and compliance with the IMs. In this respect we support the proposed amendment to:

    - Provide more clarity about the form of the auditor's report.
    - Recognise the appropriate audit standards to be applied.
    - Recognise that the assurance that can be given over historical and forecast information differs.
    - Focus on compilation of information from underlying records, but recognises that the information may not have been retained by the applicant in the form required for a CPP application.

151. In clarifying the requirement for the auditor to provide a report setting out the auditor's opinion on specified matters, we note that the specified matters set out in the clauses are not sufficiently complete to provide clear guidance on the requirements.

152. The clauses state for example that the auditor must state whether or not "the information has been prepared in all material respects in accordance with the input methodologies set out in this determination, and that it has been audited in accordance with applicable auditing standards...". The auditing standards used should be stated, but should not be included within the opinion. We suggest the clause separates the opinion requirement from the requirement that the assurance standards which the auditor complied with are stated.

153. We note certain matters that should be addressed within an auditors' report based on the applicable standards have not been specifically outlined in the amended IM. The Commission should consider whether excluding these would counter the clarity objectives. The specific matters include but are not limited to:

    - The assurance standards that should be used in providing assurance over CPPs.
    - The work done by the auditor.
    - The scope and limitations of the assurance engagement.
    - The existence of any relationship (other than that of auditor) which the auditor has with, or any interest which the auditor has in, the distributor or any of its subsidiaries.
    - Whether the auditor has obtained sufficient recorded evidence and explanations that he or she required and, if not, the information and explanations not obtained.

154. Differentiating the role of the auditor with respect to historical financial information and forecast financial information will clarify the type of engagement and assurances sought. We note however that the linkage to audit and assurance engagements standards issued under the Financial Reporting Act 2013 is not appropriate. The standards issued under the Financial Reporting Act 2013 are only applicable to audits of financial statements and would not be relevant to the audit of either the historical financial information or forecast financial information included in a CPP proposal.

155. We consider the appropriate standards to be:

    - For historical financial information:

        i. Standards on Assurance Engagements 3100: Compliance Engagements (SAE3100)

ii. International Standard on Assurance Engagements (New Zealand) 3000 (ISAE (NZ) 3000 Revised): Assurance Engagements Other than Audits or Reviews of Historical Financial Information

iii. or their successor standards

- For forecast financial information

i. International Standard on Assurance Engagements (New Zealand) 3000 (ISAE (NZ) 3000 Revised): Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

ii. International Standard on Assurance Engagements 3400: The Examination of Prospective Financial Information

iii. or their successor standards.

Additional guidance for auditing spreadsheets

156. It is appropriate to address the ambiguity around assessing quantitative information provided in spreadsheets by removing the expression "accurately presented". The reference to "the quantitative historical information being properly compiled on the basis of the relevant underlying source documentation" however adds further ambiguity as it is unclear against what this should be assessed. This implies that the Commission requires an audit of that information to source documentation although it only refers to the information being properly compiled.

157. Compilation of historical information engagements are not assurance engagements. An opinion on whether, '*as far as appears from an examination, the information used in preparation of the spreadsheets has been properly extracted from the distributor's accounting and other records, sourced from its financial and non-financial systems*' should provide sufficient assurance that the information used in compilation of the spreadsheets is appropriate

158. In relation to the requirement to state whether "quantitative forecast information provided in the spreadsheets has been properly compiled on the basis of relevant and reasonable disclosed assumptions", it is unclear whether the auditor is required to opine on whether the spreadsheets were compiled based on disclosed assumptions as well as that the disclosed assumptions are relevant and reasonable.

159. We note ISAE 3400: The Examination of Prospective Financial Information requires only negative assurance as to whether the assumptions are reasonable as well as an opinion on whether the prospective financial information is properly prepared on the basis of the assumptions. Such a report would more appropriately:

    - State whether, based on the examination of the evidence supporting the assumptions, anything has come to the auditor's attention which causes the auditor to believe that the assumptions do not provide a reasonable basis for the prospective financial information.

    - Express an opinion as to whether the prospective financial information is properly prepared on the basis of the assumptions.

160. We consider this is appropriate for assurance over the prospective information in a CPP proposal.

161. Finally, we note that removing the reference to "complete and accurate compilation of information" and the inclusion of exemptions and modifications to record-keeping under the IMs relating to information requirements should provide sufficient flexibility to allow the auditor to conclude on whether proper records have been kept to enable the compilation of information required.

Consultation

162. It is proposed that the CPP consultation requirements are amended to ensure that consultation includes notification of alternative investment options and associated price-quality trade-offs. The distributors which support this submission acknowledge the benefits of CPP applicants fully understanding the Commission's consultation expectations in advance of a CPP application.

163. We do not consider that it is realistic that a supplier would provide, via its consumer consultation, information about all alternative investment options. Given the nature of distributor networks, which are comprised of many asset components, and which cover diverse geographies, there are likely to be multiple projects – both opex and capex, which underpin a CPP proposal. In principle there will be multiple options/alternatives to each of these, all of which could impact on the price and quality outcomes for consumers.

164. While we support the proposal that the consumer consultation requirements are not overly prescriptive, allowing the applicant to determine how best to engage with its consumers, we consider it is important that the Commission clarify its expectations about consultation on investment alternatives. In our view, this should be focussed on those investments which are primarily driving the case for a CPP application.

165. While we support in principle the extension of the verifier's terms of reference to include consideration of the extent and effectiveness of the applicant's consultation, we have noted our concerns with the scope of this role above.

166. The distributors which support this submission also note that when Orion applied for its CPP. It undertook a consultation process in accordance with the CPP IMs. Once the CPP application had been submitted and accepted for consideration by the Commission, the Commission also undertook its own consultation process. This included direct engagement with Orion's consumers, on a range of matters, including price-quality trade-offs. We have previously questioned whether this dual consultation approach is effective. We note the summary paper has not responded to this point.

167. We submit that the proposed clarifications to the scope of consultation to be undertaken by the applicant mean it is less likely that additional consumer consultation by the Commission would be necessary. We note that there is substantial consultation undertaken by the Commission with all stakeholders following receipt of a CPP application, including consultation over particular issues, the draft decision and the draft determination.

CPP Building Blocks

CPP WACC

168. One of the most significant changes in the CPP IM draft decision is the removal of the CPP WACC, and the proposal to apply the prevailing DPP WACC for CPP price paths.

169. Where a CPP regulatory period crosses two DPP regulatory periods:

    - The CPP price path is to be determined using the DPP WACC applying at the start of the CPP regulatory period.
    - The CPP price path is to be re-opened when a new DPP WACC is determined, and adjusted for the change in WACC and underlying CPI assumptions from the date the new DPP WACC applies.

170. The distributors which support this submission agree with the proposed change because:

    - It removes potential incentives and disincentives to apply for CPPs which may arise from changes in the WACC within a DPP regulatory period.

- It removes timing constraints leading up to a CPP application being made, because the WACC to be used in the CPP application will be known further in advance than under the current IMs (where the CPP WACC Determination is made in September each year). This applies for all years except where a CPP application is lodged in the first year of a DPP regulatory period, as the DPP WACC determination will be made the preceding September.
- It is a simple solution, which reduces cost and complexity of applying for a CPP.
- The reopener process is expected to be straight forward, given the CPP building block model outputs can be readily recalculated by updating the WACC and CPI parameters.

171. We question whether the necessary adjustments to incorporate the impact of the new WACC, and CPI revaluation rate have been fully considered. For example, the notional deductible interest in the forecast regulatory tax allowance reflects the cost of debt component of the cost of capital, which is expected to change when a new DPP WACC is determined.

172. We also note that a CPP application made in the February window, 14 months prior to a DPP Determination coming into effect, will not have the DPP WACC information available to it at that time. This is because the DPP WACC Determination in this instance will be made in the September of that year. We suggest this situation is recognised in the IMs, and that the CPP proposal is prepared using the prevailing DPP WACC at the time the application is submitted. The CPP price path can be updated following the September WACC determination, and prior to the CPP determination which must be made by the end of November.

Depreciation and tax depreciation building blocks

173. It is proposed that in order to reduce cost and complexity in making a CPP application, the level of disaggregation of some information is reduced. One of the suggestions is that capex forecasts are no longer required to be prepared at a sub asset category level (ie: in accordance with the asset categories set out in Schedule A of the existing IMs), and that a more aggregated set of asset categories (as per the proposed new Table A.2 of Schedule A) are applied. We support this proposal which we consider is consistent with the forecast nature of the information which is central to a CPP application.

174. However the Draft Decision is silent on how these proposed new asset categories are to be reflected in the CPP BBAR calculations. This may be an oversight. As it stands, distributors will also have to prepare capex forecasts at the sub asset category level in order to be able to calculate the depreciation and tax depreciation building blocks. This undermines the objective of reducing complexity of CPPs.

175. Accordingly we propose that the CPP BBAR methods, which are contained in Part 5, Subpart 3 of the CPP IMs are revised to reflect the proposed new capex categorisation approach. This will affect both the asset valuation and treatment of taxation methods. Further clarification will be required as to how the categorisation is to apply to assets commissioned in the current period, the assessment period, and the CPP regulatory period for the purpose of the CPP proposal, and BBAR/MAR model.

Changes proposed to information requirements

176. We acknowledge and support the intent to reduce cost and complexity for CPP applications by:

- Focussing on information which is most material to price and quality.
- Better leveraging existing ID disclosures.
- Applying the proportionate scrutiny principle.
- Addressing anomalies, duplication, errors and some poorly prescribed information requirements in the current CPP IMs.
- Reducing the level of disaggregation of required information in some areas.

Proportionate scrutiny and flexibility

177. We welcome the proposal to adopt the proportionate scrutiny principle, and suggest that this may be particularly useful for smaller distributors, with fewer projects or programmes, and smaller networks. However, small suppliers making a CPP application need to be confident that this will occur in practice and that it will save them significant costs, otherwise they may not be sure enough about the costs and complexity to their business to make a CPP application.

178. We also support the recognition of the benefits from allowing more flexibility for suppliers to prepare a CPP proposal largely based on the information they have at hand without preparing substantial new supporting material. We acknowledge that some distributors may not have every policy, procedure or strategy comprehensively documented. We also acknowledge that the Commission requires adequate justification for the CPP proposal. We therefore support an approach which allows an distributor to justify its proposal using the evidence and rationale it has relied on, rather than creating evidence to fulfil a CPP IM compliance obligation.

179. We note the CPP fast track amendments introduced last year have assisted in this regard.

AMP plus approach

180. We support the proposal to recognise the information about capex, opex, demand, service standards, risk management and deliverability already included in an distributor's AMP. We consider that specifying the CPP IM requirements for the information to be presented in support of the expenditure proposal in this way will greatly assist distributors in understanding the requirements and responding to them – in a cost effective way.

181. We note the concerns raised at paragraph 256 of CPP requirements paper due to the link between the IDD and the CPP IMs. We consider these are entirely manageable as it is unlikely that any changes to the ID requirements for AMPs will be contrary to the objective of Schedule D. We note that the similar linkages with the IDD are also proposed for Schedule E, and already exist in many other aspects of the CPP IM such as the starting values for the components of the BBAR forecasts.

Schedule D requirements

182. Schedule D of the IMs sets out the qualitative information to be provided in a CPP proposal in support of an distributor's capex and opex plan. We support the proposal to specify these requirements as incremental to the AMP, and to ensure the definitions are consistent with those in the current IDD. We also support the proposal to include sufficient information to explain how the expenditure plan at an aggregate level is planned to be delivered during the CPP period.

Information supporting the BBAR outputs

183. We note the proposed clarification in paragraphs 262-266 of CPP requirements paper regarding how information supporting the CPP BBAR information is to be included in the proposal. Recognising that the price path model forms part of the CPP proposal is a helpful solution to the duplication issue identified. However we consider that this clarification should be included in the CPP IMs, not just in supporting documentation. We suggest that this clarification is included in Subpart 4, Section 3, clause 5.4.7.

Level of disaggregation of information

184. As previously submitted, we consider that the level of disaggregation of information as specified in the CPP IMs is too onerous, and not consistent with the forecast nature of most of the information which is relevant to determining a CPP. We support efforts to reduce cost and complexity by examining areas for reducing the level of disaggregation in the information to be provided. We agree with the areas identified in CPP requirements paper for this objective (including asset categorisation, service categorisation, controllable/uncontrollable opex, capital contributions and related party transaction information), but suggest further improvements can be made to the Draft Decisions to better meet these objectives.

185. For example the related party transaction provisions are too onerous, and we suggest the verifier should use a sampling approach to verify how related party arrangements have been established in the past, and are currently arranged by the distributor.

Schedule E information

186. The Schedule E templates are proposed to be modified significantly, and importantly, to be aligned more closely with the templates for forecast information currently included in the IDD, and published by distributors in support of their AMPs. We support closer alignment with IDD and AMP information formats.

187. However, we submit that there are a number of drafting errors and ambiguities which need to be resolved in the draft Schedule E templates and in clause 5.4.30 of the IMs, which includes the instructions for completing the schedules. We support the ENA's submission on the Draft Determinations in this regard.

Information requirements unchanged

188. There remain significant components of the CPP IM information requirements which are to be retained. The distributors which support this submission suggest that additional changes should be introduced to assist in reducing the cost and complexity of CPPs, and to correct ambiguities and errors.

189. In particular we note:

- Information on proposed quality standard variations (clause 5.4.5) can be improved, to reflect the changes which have been introduced in the recent distributor DPP Determination, remove references to earlier DPP quality standard terms, and reflect the fact that alternative methods may have different properties.

- Schedule B templates can be removed and replaced with templates which align with Schedules 5d, 5e, 5f, and 5g of the IDD, which will reduce the number of schedules required to be included in a CPP, and remove inconsistency between the CPP information and the ID information.

  This is particularly important for cost allocation information for a CPP, because the CPP cost allocation method is linked to the method applied in the last disclosure year prior to a CPP application being made. We note that Table B1 of Schedule B is no longer necessary, as the allocation of the initial RAB value has been superseded by subsequent closing RAB allocations.

- Schedule C templates should also be aligned with the IDD cost allocation schedules noted above to reduce cost and unnecessary complexity.

  In addition, we submit that Schedule C templates (which apply when assets are divested in the period between the last disclosure year of the current period and the CPP application date) should only be required where the asset divestment is material to the business. This requires an amendment to clause 5.3.6(4).

  Further, Table 8 in Schedule E also replicates some of the information included in Schedule C, and can be removed.

- The information required to be supplied in support of unit costs and expenditure escalators, as set out in Schedule D has not been updated to reflect other changes to the IMs – for example the term **base year** is now used in the incremental rolling incentive scheme (IRIS) IMs and has a different meaning to that inferred by Schedule D.

In addition, Schedule D14 along with the quantitative information to be supplied in Schedule E Table 9, does not provide sufficient flexibility to accommodate different approaches to establishing nominal cost estimates for capex and opex projects and programmes. It should be adjusted to accommodate the range of approaches which may be adopted by CPP applicants for this purpose, and to better align with the corresponding Schedule D requirements.

Emerging technology in the energy sector

Introduction

190. The Emerging technologies paper provides a considered and detailed assessment of the likely effect of emerging technologies in the energy sector.

191. The distributors which support this submission agree the technological innovations within the energy sector have the potential to create significant change for consumers and businesses. We also agree that there remains a great deal of uncertainty regarding the nature of the change and when and where it will occur.

192. Possible outcomes include:

    - Reduced demand for electricity lines services as consumers supply a larger proportion of their load through on-site generation.
    - Increased number of parties disconnecting from the grid or network entirely.
    - Changes to patterns of demand, possibly becoming more peaky.
    - Alternatively, potential for increased demand for electric vehicle charging.
    - A 'smart' use of new technologies enabling network companies to smooth demand on their networks and thus reduce peaks.

193. The list of possible outcomes above, which is certainly not exhaustive, indicates the level of uncertainty regarding the nature of the change that will occur.

194. Given the uncertainty we support the Commission's views that:

    - The regulatory regime should not discourage suppliers or others from using new technology and new business models for their and consumers' benefit.
    - It is helpful to take precautionary steps now to minimise the risk of harm to consumers in future.

195. The Emerging technologies paper identifies potential problems with the current IMs in relation to emerging technology trends. These are:

    - The risk that demand for electricity lines services will reduce to the extent that distributors may not be fully able to recover the cost of their investments (the 'Partial capital recovery risk'); the draft decisions paper proposes an adjustment to asset lives in relation to this risk that can be applied for when price-quality paths are set.
    - The risk that incentives for distributors in relation to emerging technology may not drive efficient outcomes; the draft decisions paper does not propose any IM adjustments relating to this issue.
    - The cost allocation IMs may not be optimal; the draft decisions paper proposes some adjustments to the cost allocation IMs in response.

196. We discuss these issues below.

Partial capital recovery risk

197. We agree it seems likely that the majority of consumers will continue to be connected to the network and use electricity lines services for the foreseeable future. However, the distributors which support this submission also agree there is a risk that emerging technology will lead to such substantial reductions in demand and/or disconnections that it may become difficult for distributors to recover the costs of their investments, because remaining consumers may be unable to bear the costs.

198. In response to this risk, the draft decisions paper proposes a precautionary approach that would allow some bringing-forward of cost recovery in order to reduce the risk of future consumers facing very large bills. The proposal is that distributors would be able to apply, at a price reset, for a reduction in the lives of certain assets (chosen by the distributor). The Commission would consider the applications and could reduce the asset lives by up to 15%.

199. The distributors which support this submission support the principle behind this draft decision. We have some recommendations to make it work better.

200. As proposed it seems this draft decision would only be of assistance to distributors that are subject to price control. As we understand it exempt distributors would not be able to apply for shorter asset lives (although they could still seek to apply shortened asset lives through information disclosure where an independent engineer's approval is obtained).

201. The exclusion of exempt distributors from this approach is problematic. Exempt distributors face the same risk of asset stranding as non-exempt distributors. While in theory, as they are not price controlled, they could increase prices to effectively recover the cost of their investments early, their information disclosures will then suggest they are earning higher ROIs, possibly at the level that might invite criticism and regulatory or political scrutiny.

202. The distributors which support this submission recommend that the ability to apply for reduced asset lives is made available to all distributors and is a process that is applied through information disclosure rather than price/quality regulation. The Commission's approval could be sought at any time and if an adjustment is approved it would be reflected from the next set of disclosures published after the approval is made.

203. We also support further consideration of the ENA's proposal to apply shorter assets lives to new investments.

204. The distributors which support this submission question whether a 15% cap is appropriate or, in fact, necessary. As the draft decision involves Commission approval of the application it is not clear why the IM needs to set such a low limit on the asset life reduction. For example, if a distributor can demonstrate a need to reduce an asset's life by, say, 40% and can convince the Commission this is justified and in the long-term interest of consumers, why should the IMs prevent this? The FCM principle would still be achieved.

205. The draft decisions documentation indicates that the ability to reduce asset lives by 15% is something that can only be applied once. This may be overly restrictive. A distributor may need to reduce an asset's life by 15% at one DPP reset but by the following reset the risk of stranding of that asset may have increased considerably. There are benefits in enabling a distributor to seek a further reduction in the asset's life of up to 15% (or any other limit that is applied).

206. If shortened asset lives are approved as part of setting a price-quality path, it is not clear what asset lives would be reported for information disclosure purposes. If the information disclosure lives are not changed, this could distort disclosures relating to the return on investment.

207. The emerging technology paper acknowledges that this proposal:[12]

> "is only modest and partial. It likely does not fully mitigate the downside risk. This is intentional. Distributors ultimately bear the risk of economic network stranding… They are therefore best placed, and have the strongest incentive, to manage this risk, for example through pricing… We would expect distributors to act if they genuinely see their risk increasing."

208. The distributors which support this submission agree that where patterns of electricity usage change as a result of new technologies, it is reasonable to expect distributors to take steps to manage any resulting risk. However, we do not believe a regulator should raise the prospect that economic network stranding may occur. Distributors have invested in their networks in the expectation of cost recovery and if this is not forthcoming, or is not supported by the regulator, future investment incentives will be affected. The Commission's position appears inconsistent with the Part 4 Purpose and FCM principle.

Regulatory treatment of emerging technologies

The draft decision is correct regarding distributor investment in emerging technologies

209. The distributors which support this submission agree that the Commission regulates services, not assets or technologies, and only regulates companies to the extent they are involved in supplying the regulated service. We support the Commission's technology agnostic approach to the application of Part 4.

210. We also agree with the Commission's interpretation of the definition of electricity lines services. To argue that only assets that are 'lines' can be classified as part of the regulated service would narrow the scale of the regulated activity to an unworkable extent. It would also prevent innovation by distributors who may seek to provide services through alternative means.

211. The distributors which support this submission agree that the tools provided to the Commission under Part 4 were not designed to, and cannot, deliver changes to industry structures. If structural changes are deemed necessary they should be progressed by policy makers and Parliament. We note the Commission has monitoring and influencing roles through ID requirements that can assist in identifying any particular problem.

212. The distributors which support this submission agree there does not appear to be any need for revenue allocation rules at this time. Where revenue is received in relation to emerging technologies and that revenue is a payment for the supply of electricity lines services, it should be recorded as regulated revenue (eg as other regulated income). However, distributors are also likely to receive revenue from the supply of unregulated services using emerging technologies. These revenues are not, and should not be seen as, payments for the regulated service and are therefore unregulated revenues.[13]

ERANZ proposal

213. We agree with the Commission that the proposal by ERANZ to require transactions between distributors and suppliers of services using emerging technologies to be at arm's-length should not be introduced within the IMs. It is clear the ERANZ proposal would create transaction costs by requiring all distributors to put in place new arm's-length transaction arrangements and this is likely to discourage innovation and investment by distributors in the field of emerging technologies.

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[12] Emerging technology paper, paragraph 93.

[13] Example: Where a distributor installs a battery at a consumers' premises, the consumer may pay a fee for the services they receive from the battery (eg reduced usage at peak times and therefore lower bills, more security of supply for them). These revenues are unregulated as they do not relate to a regulated service. Also, under the cost allocation IM a portion of the battery sits within the RAB, relating to the network services provided by the battery (e.g. voltage support). As a portion of the battery asset sits within the RAB, a return on that portion of the battery will be recovered through regulated revenues.

214. Meanwhile the benefits of the ERANZ proposal are uncertain. The markets for emerging technologies are still nascent and it is not clear what kind of business model or product offering will be most successful. Retailers' closer relationship with the consumer may prove decisive. Alternatively, large global technology companies may be able to leverage their brand and scale to an extent that New Zealand firms cannot compete with. In the face of these other advantages, any cost sharing between regulated and unregulated business activities may not be very material. We agree that "the benefits are conditional on the creation of a workably competitive market that does not fully exist today".[14]

215. The distributors which support this submission consider that the draft decision is consistent with the requirements of section 52T (3) of the Act and the underlying policy intent. Distributors and their consumers should be able to benefit from scale economies when providing new services and this should not be unduly deterred.

216. Importantly, we agree that regulatory intervention is risky given the current uncertainty regarding market change and direction. Regulators should only intervene where there is a clear market failure such that markets are not able to produce an efficient outcome. At present, there is no evidence of such a market failure.

Electricity Authority letter

217. The EA's emerging technology letter also raises concerns regarding the competition impacts of distribution investments in emerging technologies. The letter discusses arrangements the Authority put in place regarding Transpower's demand response programme. We are not convinced this is an entirely analogous situation – demand response providers tend to be large organisations whereas emerging technologies can more easily be adopted by any scale of consumer.

218. The Authority states that it wants "to make sure we have the optimal regulatory settings to:

- Promote efficient investment in emerging technologies, including batteries, across the electricity sector, to achieve long-term benefits for consumers.
- Facilitate competition in wholesale and ancillary services markets by removing barriers to entry and providing a level playing field for participation."[15]

219. We consider that distributor involvement is likely to promote efficient investment in emerging technologies. Distributors can invest in these technologies to deliver network services and/or to deliver unregulated services. Where they are used to supply both, the cost allocation IM would apply. There is no evidence of a problem to warrant regulatory intervention at this stage.

220. It is not clear to what extent small-scale emerging technologies will be used in wholesale and ancillary services markets. Nor is it clear that distributor investment in emerging technologies would create barriers to entry in these markets.

Conclusion

221. Distributor investment in emerging technologies is likely to promote the development of new markets as distributor investment can assist emerging technologies reach a scale that otherwise would be delayed or not achieved. To introduce regulation that prevents this is likely to not be in the long-term interest of consumers. We therefore support the draft decision to not make any such intervention at this time.

[14] Emerging technologies paper, paragraph 172.

[15] EA emerging technology letter, page 2.

Cost allocation adjustments

222. This section considers the two adjustments to the cost allocation IMs proposed in the draft decision:

- The reduction of the revenue materiality threshold for applying the avoidable cost allocation methodology (ACAM).
- The tightening of requirements relating to the use of causal and proxy allocators.

Adjustments to ACAM revenue threshold

223. Under the current IMs, suppliers are able to apply ACAM to their expenses and asset values where it can be shown that unregulated business activities are not very material to the overall business. One threshold is that ACAM can be applied where unregulated revenues are less than 20% of total revenues.

224. The draft decision proposes to reduce this threshold to 10%. Thus any businesses whose revenues from unregulated services are greater than 10% of total revenues will have to apply the accounting based allocation approach (ABAA) unless they can meet the opex and capex ACAM thresholds. The Commission's analysis suggests this change would affect three distributors.

225. The rationale in the draft decision for making this change is based on the Commission's assessment of when unregulated business activities become material. The Commission considers that it is only appropriate to apply ACAM where the unregulated businesses are not material in relation to the overall corporate Group. Material, in terms of ACAM, has been interpreted as meaning a 1%-2% impact on regulated revenues. We are comfortable with the position that the ACAM threshold should seek to ensure that where ACAM is applied the effect on regulated revenues should generally not be more than 2%.

226. We have reviewed the analysis in the Emerging technologies paper and we consider that it is problematic in several ways, both in terms of the conceptual approach and the presence of errors in the analysis. Our re-working of the analysis suggests that the existing 20% threshold should be retained. The existing revenue threshold would not have an effect on revenues of more than 2%.

227. The conceptual problems we have with the analysis in the Emerging technologies paper are:

- Only a single year of data has been assessed (2015) and the 2015 year may have been unusual for one or more distributors. In fact, 2015 saw some unusually bad storms affect a number of distributors and this will have affected their operating costs in that year.
- The paper assumes that if an distributor applied ABAA to opex on the basis of the revenue threshold it would use revenue as an allocator. We do not believe this is a robust assumption – distributors use a variety of cost allocators.
- The paper assumes that the revenue allocator the distributor would apply would be the industry average split between regulated and unregulated revenue (which the Commission calculates as 33% in 2010 and 39% in 2015)[16] rather than the distributor's own balance of regulated and unregulated revenues. This is certainly not a robust assumption – using an industry average rather than company specific data would be unlikely to be a suitable allocator of company specific costs.
- Where distributors do apply ACAM, the paper assumes each distributor would allocate 100% of shared operating costs to the regulated business. While this is one possible outcome, and is perhaps worth considering as an 'extreme' scenario, disclosures

[16] Note we are not entirely sure how these percentages were calculated.

demonstrate that some distributors who apply ACAM allocate a portion of shared costs to the unregulated businesses.

228. The errors we have identified in the analysis are:

- Total revenue, which is sourced from annual reports, is extracted on an inconsistent basis across the distributors. For some distributors (eg Northpower) total revenue of the Parent company is used while for others (eg Vector) total revenue of the Group is used. It is not entirely clear whether Parent or Group revenue should be used, but this should be consistent (our analysis in Appendix A uses Group revenue as this is less subject to judgement).
- Unregulated revenue is calculated as the difference between total and regulated revenues. Total revenue is taken from financial accounts and regulated revenue is taken from regulatory accounts. This causes the following problems:
    i. It treats capital contributions inconsistently. Under GAAP these are recorded as income while under the IMs they are netted off the asset value. Thus the value of contributions is part of the recorded "unregulated revenue", which is incorrect as these contributions will mostly relate to the regulated business.
    ii. Some distributors have different financial and regulatory years but it does not appear that any adjustment has been made to account for this.
    iii. All non-electricity distribution revenue is treated as unregulated revenue, which is inconsistent with the IMs. Clause 2.1.2(2)(a) of the IMs determines the ACAM revenue threshold as being met where total unregulated revenues are less than 20% of total regulated revenues. Both Vector and Powerco have substantial regulated gas businesses and the revenues from these should be counted as regulated rather than unregulated revenues for this purpose.

229. Reflecting the problems identified above we have applied a corrected analysis for both 2014 and 2015. Our analysis:

- Does not use total revenue as an input. Instead it uses regulatory revenues from information disclosures (which are net of contributions) and unregulated revenues from financial reports.[17]
- For those distributors with a June-ending financial year, determines unregulated revenues for the 2015 regulatory year as being equal to 75% of revenue from the 2015 financial year plus 25% of revenue from the 2014 financial year. An equivalent approach is applied to determine unregulated revenues for the 2014 regulatory year.
- Adds Vector's and Powerco's gas network regulated revenues to their regulated revenues for the purposes of calculating whether they meet the ACAM revenue materiality threshold.
- Assumes that where distributors did apply ACAM using a revenue allocator they would use their own company's balance between regulated revenue and unregulated revenue rather than the industry average.

230. The results of this analysis are shown in Appendix A.

231. On the basis of our analysis, there were 9 distributors in 2014 and 10 distributors in 2015 who were able to apply ACAM on the basis of the 20% revenue materiality threshold.[18] Only four of these

[17] Some judgements have been applied regarding whether certain line items in Notes to the Financial Statements were regulated or unregulated revenue.

distributors reported any shared operating costs in either year. For these four distributors, the effect of applying ACAM using each distributor's own regulated/unregulated revenue split is less than 1%. As a result, we do not consider that there are grounds to tighten the ACAM materiality threshold.

Adjustments to requirements regarding proxy and causal allocators

232. Under the current IMs, where ACAM is applied, suppliers are required to use causal allocators, or proxy allocators where causal allocators are not available. Analysis presented in the emerging technologies paper raises concerns about the use of proxy allocators.

233. The Emerging technologies paper proposes to "make it clear that the use of proxy allocators must be justified".[19] Distributors will need to better demonstrate that a causal relationship cannot be established and the proxy cost allocator selected is appropriate. The Commission also indicates that it will give more attention to these matters in future.

234. This will involve requiring additional information (presumably through information disclosure) about the allocators chosen. The proposal is that the Chief Financial Officer of each distributor that uses a proxy allocator will need to sign and provide a declaration that "no causal allocator was available and that their selected proxy allocator was appropriate".[20] The distributors which support this submission consider that disclosing the basis for selecting an allocator is reasonable. However, we do not agree that this should be required as part of a separate declaration – it can be included within ID and subject to the standard directors' certification of the disclosures.

235. We note that the concerns expressed in the draft decision appear to be based on two facts: that more proxy than causal allocators are used and that proxy allocators allocate more costs to the regulated businesses than causal allocators.

236. We expect that fewer causal allocators than proxy allocators are being used due to the difficulty in identifying a clear, measurable, causal allocator. There will always be judgement applied when choosing allocators, this is unavoidable and we suggest it will be very difficult to demonstrate conclusively that an allocator is entirely accurate.

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[18] Note that our analysis excluded four distributors for whom relevant data was not obtained.

[19] Emerging technologies paper, paragraph 129.

[20] Emerging technologies paper, paragraph 131.

Cost of capital issues

237. In this section we comment on the draft decisions set out in the WACC paper. We firstly discuss the overall approach to determining the regulatory WACC value and then discuss each parameter in turn.

238. We provide our comments on the proposed changes to the CPP WACC earlier in this submission.

General approach to estimating WACC

239. We support the continued use of a high-level approach to determining the WACC – that is, the approach which averages the costs of debt and equity, and estimates the latter using the SBL-CAPM formula.

240. The distributors which support this submission agree with the WACC paper that an alternative to the SBL-CAPM would not lead to better estimates of WACC.[21] We remain of the view that there is little evidence, of a substantive nature, which suggests that the rationale for the 2010 decision to use the SBL-CAPM no longer applies. As the WACC paper notes, neither the Black CAPM or the Fama-French model are well-used amongst practitioners and regulators, while there is little evidence of the Black CAPM having any superiority over the SBL-CAPM, and the Fama-French model involves additional complexity and data requirements.[22]

241. We support the draft decisions to not apply either a 'split cost of capital' as previously proposed by MEUG, or a 'dual WACC' approach for the purposes of a CPP. We agree that that the disadvantages of either approach – namely, the additional practical complexity, and the potential to reduce incentives for investment – are likely to be significant. As we stated in our submission on the Commission's November 2015 update paper on WACC (the WACC update paper), the general view of UK regulators is that a single WACC is "*conceptually superior and more practical*".[23]

242. We also support the draft decision to not apply Black's Simple Discount Rule as a cross-check. We consider that it would introduce significant additional complexity to the regulatory regime, and provide little overall benefit. Furthermore, it has not been demonstrated how it could work in practice within the regulatory framework. We agree with the WACC paper that there are a number of challenges that would need to be overcome before it could be used in practice in a regulatory setting.[24]

Asset beta

243. We support updating the estimate of the asset beta using updated data. We support the use of the same sample of comparators, with adjustments for de-listings and new listings of similar firms.

244. We also continue to support the use of a wide sample of comparators, as opposed to the narrower sample of six comparators proposed by Contact Energy.[25] We agree with the WACC paper that Contact's preferred sample is too small to be relied upon to estimate a beta in this context, and we consider that the benefits of 'better average comparability' are outweighed by the costs of the smaller sample size.

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[21] WACC paper, paragraph 532.

[22] WACC paper, paragraphs 527-531.

[23] PwC, Submission to the Commerce Commission on Input methodologies review: Update paper on the cost of capital topic, 5 February 2016, paragraph 29.

[24] WACC paper, paragraph 649.

[25] WACC paper, paragraph 308.

245. In this respect we support the approach to focus attention on beta estimates from the last 10 years. This is consistent with the approach used in 2010, and we consider that this reflects a reasonable balance between obtaining a large sample size and ensuring the estimate is sufficiently up-to-date.

246. We support the proposal for estimating four-weekly, rather than monthly betas and for the estimation of weekly and four-weekly betas by averaging the results from different reference days. This is a pragmatic way of minimising any possible estimation error due to the choice of reference day.

247. However, we submit that more weight should be given to the daily estimates, and an average be taken over daily, weekly and four-weekly estimates. While daily estimates may be more 'noisy',[26] they have not been shown to be biased,[27] and we consider that the 10-year average should mitigate any practical impact of the noise. The rationale for using both weekly and four-weekly estimates are that neither is theoretically preferable – we continue to submit that averaging daily, weekly and four-weekly observations is a better, less biased, way of implementing this policy intent.

248. We support the draft decision to not make an adjustment to the asset beta as a result of the draft decision to change the form of control for distributors. We remain of the view that there is no compelling empirical evidence to justify such an adjustment.

Tax-adjusted market risk premium

249. The distributors which support this submission support consistency in determining the TAMRP value for electricity distribution and other regulated industries such as telecommunications. The TAMRP is not sector-specific, and therefore it is logical to use the same approach for different regulated sectors.

250. However, we remain of the view that details of the approach used to determine the TAMRP estimate, as initially used in the recent UCLL/UBA decision and now in the WACC paper, could be improved. In particular:

- The proposed approach relies on the use of median values (from different estimation methods). However, we consider that that mean values are more relevant than median values. Means incorporate information from all of the methods, and importantly are not overly impacted by the value of one method. We submit that means should be the primary basis for determining the overall TAMRP estimate.

- We do not support rounding the estimate to the nearest 0.5%. We consider that the estimates are sufficiently robust that the mean values can be rounded to the nearest 0.1%. We understand that there is a limited degree of precision with at least some of the methods used, and that this is the rationale for rounding to a relatively high unit of measure. However, we consider that the averaging over multiple methods mitigates this problem. Furthermore, we do not consider that there is less precision in the TAMRP that there is in the estimates of other WACC parameters that are rounded to a lower unit of measure.

- We note that the ENA submission on this topic[28] stated that the 'Surveys' and 'Siegel version 1' method are not as robust as the other methods and should not be used, based on advice and analysis from CEG. We recommend that the Commission reconsider the specific methods used to address CEG's comments.

[26] WACC paper, paragraph 296.

[27] WACC paper, paragraph 296.1.

[28] Supra n34.

Risk-free rate and debt premium

Time period for averaging bond yields

251. The WACC paper proposes to retain the current 'prevailing rate' approach, as opposed to adopting a 'trailing average' approach to the estimating the debt premium. It also proposes to extend the period over which bond yields are averaged from one month to three months.

252. We consider that the use of a three month averaging period is preferable to one month. However we remain of the view that an averaging period of around five years would be preferable. In general, we consider that the trailing average approach is superior to the prevailing rate approach, for the reasons set out below.

253. Lastly, we support the use of the same averaging period for estimating the risk-free rate and debt premium. We do not support the 'hybrid' approach discussed in the WACC paper, where only the debt premium uses a trailing average approach, because it is inherently inconsistent.

Efficient financing practices

254. The distributors which support this submission submit that the cost of debt estimates in the regulatory WACC should seek to estimate the efficient financing practices of distributors.

255. As we explained in our submission on the WACC update paper,[29] distributors raise and manage their funding requirements over a number of years, often using a combination of debt types. They do not, and are not practically able to, refinance all of their debt during a one (or three) month window. Furthermore, distributors which access international debt markets typically rely on access to these markets during what is considered 'issuance efficiency' windows.

256. We submit that averaging bond yields over around five years is consistent with best treasury management practice, and importantly is reflective of actual distributor treasury practice.

257. The WACC paper appears to accept that distributors do, and should, issue debt on a rolling basis. But it seems to suggest that distributors can then use interest rate swaps to fully hedge against the rates in the proposed three-month window.[30] While this is possible, it is not efficient or best practice. As we explained in our submission on the WACC update paper, best practice and prudent interest rate management is typically demonstrated by firms making a number of small hedging decisions over time, rather than a heavy concentration of hedging decisions in a short space of time.

258. Furthermore, a concentration of hedging in a predictable window of time is imprudent, as the New Zealand capital markets could anticipate it, potentially leading to pre-emptive, artificial price behaviour by the market.[31]

259. We therefore submit that the continued use of the prevailing rate approach leaves distributors exposed to a significant risk of misalignment between the regulatory debt premium and their actual and efficient weighted average cost of debt, which they are unable to effectively manage.

Stability of estimates

260. The experience to date of the prevailing rate approach is that it has generated regulatory WACC estimates which have exhibited significant volatility over time. We consider this degree of volatility was not fully anticipated at the time the IM decisions were originally determined in 2010. The volatility has meant that individual estimates of the risk-free rate or debt premium can be artificially above or below what might be representative of an underlying level at that time. This has introduced

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[29] Supra n23, paragraphs 77-79.

[30] WACC paper, paragraph 98.

[31] Supra n23, paragraph 81.

regulatory uncertainty, and made regulated revenue targets difficult to estimate and manage for exempt and non-exempt distributors.

261. The use of a trailing average of five years or longer would significantly reduce volatility in WACC estimates over time, and reduce the uncertainty around future WACC estimates at specific points in time. In our submission on the WACC update paper, we showed risk-free rate estimates since 2010 under a trailing average approach (for a number of different averaging periods).

262. The WACC paper states that distributors can mitigate the impact of volatility by hedging against the three-month window.[32] But as we discussed above, this is not treasury best practice and creates additional costs and risks which cannot be managed. This compromises the economic principles underpinning the IMs.

263. The WACC paper also states that the regulator can mitigate the impact of WACC volatility by setting alternative rates of changes, and hence managing one-off price changes.[33] We disagree with this assertion. Setting an alternative rate of price change does not change the NPV impact on an distributor's revenue.

Regulatory precedent

264. The use of a trailing average method for estimating the risk-free rate and debt premium is consistent with recent regulatory precedent which was not available when the IMs were first determined in 2010. This was discussed at length in the WACC update paper, but is not mentioned in the WACC paper.

265. The Australian Energy Regulator (AER), Economic Regulatory Authority of Western Australia (ERAWA), Essential Services Commission of South Australia (ESCOSA), Ofgem and Ofwat all use the trailing average approach, while New South Wales' Independent Pricing and Regulatory Tribunal (IPART) uses a hybrid approach. 10 years is the most common period over which an average is taken.[34] Many of these regulators have changed their approach since the IMs were initially determined. This is a valid and compelling trigger for reconsideration of the IM approach at this time.

266. The primary reason for the AER changing to the trailing average approach is that it better reflects efficient financing arrangements. The AER stated that the trailing average method "*performs well in terms of minimising the potential difference between the return on debt allowance and the expected return on debt of the benchmark efficient entity*" and "*is capable of providing the benchmark efficient entity with a staggered debt portfolio with a reasonable opportunity to recover at least the efficient debt financing costs.*" Reducing volatility over time was stated as a secondary reason.[35]

Disadvantages of trailing averages noted in WACC paper

267. The WACC paper notes these benefits of a trailing average approach, but then asserts that they are outweighed by a number of disadvantages.[36]

268. We agree that a disadvantage of the trailing average approach is that it reduces the extent to which the WACC estimate reflects current market conditions, and hence that it alters the incentives for new investment. In our submission on the WACC update paper, we discussed in detail the trade-off

[32] WACC paper, paragraph 122.1.

[33] WACC paper, paragraph 122.2.

[34] Commerce Commission, Input methodologies review: Update paper on the cost of capital topic, 30 November 2015, paragraph 3.23; Cambridge Economic Policy Associates Ltd, International comparison of regulatory precedent on the weighted average cost of capital: Final report, a report for the New Zealand Commerce Commission, December 2015, pages 10-11.

[35] Australian Energy Regulator, Better Regulation – Explanatory Statement: Rate of Return Guideline, December 2013, page 109.

[36] WACC paper, paragraphs 135-136.

between using a WACC which reflects up-to-date information and a WACC which reflects best practice treasury management and averages out short term fluctuations.[37] In our view, the benefits of the trailing average approach outweigh this potential disadvantage.

269. We disagree with the assertions in the WACC paper that there are significant implementation difficulties with a change to a trailing average approach. In particular:

- We do not agree that this change would have a "*significant one-off regulatory cost … in terms of administrative costs of implementing the change*".[38] Calculating an average over five years should not be more difficult than calculating one over three months, and this change appears no more administratively complex than many of the other changes to the IMs that have already been made or are part of the draft decisions. It is unclear to us what is considered so administratively complex about this change.

- We do not agree that this change would have a "*significant one-off regulatory cost … in terms of … the impact on the conditional regulatory predictability that the IMs are intended to promote*".[39] Under the current method, the risk-free rate and debt premium are very difficult to predict. The distributors which support this submission consider that a change to a trailing average approach will significantly increase regulatory predictability. While we appreciate that any change to the IMs could have a negative impact on regulatory predictability, and we support the Commission being cautious in changing the IMs (refer to regulatory framework section), we consider the increase in predictability of the method outweighs any potential erosion of industry trust in the overall stability of the IMs over time.

- We agree that this change could be subject to debate[40] – indeed, there has already been considerable debate through this IM Review process. However, we do not consider that this is a reasonable justification for not making a change to the IMs if it otherwise better promotes the Part 4 Purpose. The implication is that only changes which are either minor or which all industry participants support should be made, and we consider that this would be unduly restrictive on the IMs going forward.

  The Commission has stood behind its original IM decisions, including through appeals. It has also made a number of changes to the IMs since 2010, including some significant amendments. We support changes to the IMs where they would better promote the purpose of Part 4.

  We also note that there are other IM changes proposed, such as the form of control for distributors, and the alignment of the CPP and DPP WACCs which are not insignificant changes. These have been made following experience with the existing IMs since 2010 and the desire to address unforeseen consequences or difficulties with them.

  We also note it is common for overseas regulators to make changes to their regulatory frameworks over time, including significant changes. As we noted above, a number of Australian and UK regulators have recently adopted the trailing average approach.

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[37] Supra n23, paragraphs 71-74.

[38] WACC paper, paragraph 135.5.

[39] WACC paper, paragraph 135.5.

[40] WACC paper, paragraph 135.6.

Furthermore, Ofgem and Ofwat have introduced regulatory changes over the last decade which are far more substantial than adopting a trailing average.[41]

- In contrast, we agree that annually updating the price path would be a significant administrative burden.[42] As we state below, we support the draft decision to not annually update either the risk-free rate or debt premium.

270. We do not consider that any of the implementation difficulties noted in the WACC paper are a reasonable justification for not adopting a trailing average approach.

Annual indexation

271. We support the decision not to annually update the risk-free rate or cost of debt. As we stated in our submission on the WACC update paper, the current approach provides for NPV=0 ex-ante, and this is exactly how incentive regulation is intended to work.[43] We agree with the WACC paper that this annual indexation would not provide material benefits to consumers.

Term of the bonds used, and the TCSD

272. The cost of debt is currently estimated with respect to bonds with a term to maturity of five years. Where distributors issue debt with longer terms than five years, the additional costs involved are compensated for through the TCSD allowance.

273. Clearly, if issuing debt of terms longer than five years is the most efficient financing method, then distributors should be fully compensated for that. However, we remain of the view that the TCSD is only a second-best approach for achieving this outcome.

274. We submit that a preferable approach is to estimate the cost of debt with respect to bonds which reflect the average tenor of distributor-issued. This was the approach which we, on behalf of the ENA, proposed at the time the IMs were initially determined.[44] We do not accept that the term of either the risk-free rate or the debt premium should necessarily be matched to the length of the regulatory period.

275. However, if this approach is not adopted, then we support the retention of the TCSD allowance. The additional premium incurred in issuing debt of longer than five years is a legitimate expense that should be able to be recovered.

276. The TCSD has proven to be complex for distributors to implement in practice. We therefore support simplification of the method for implementing it, as proposed in the WACC paper, in order to reduce the administrative burden on distributors.

277. We consider that the use of a fixed relationship between the 'spread premium value' and the debt term, as determined by the Commission based on historical data, seems a sensible and workable simplification. However, we note the following two potential downsides:

- The proposed method is based on an average relationship using historical data. This is inconsistent with the prevailing rate method used to determine the debt premium itself. We submit that the debt premium and the spread premium value should be estimated

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[41] For example: changing the length of the regulatory period, introducing menu regulation for expenditure allowances, combining the allowances for capex and opex, changing the approach to expenditure efficiency benchmarking.

[42] WACC paper, paragraph 135.7.

[43] Supra n23, paragraphs 90-93.

[44] PricewaterhouseCoopers, Electricity Networks Association: Submission on the Cost of Capital Parameter Estimates in the Commerce Commission's (Draft) Electricity Distribution Services Input Methodologies Determination 2010, August 2010, paras 4.5 & 5.13-5.17.

based on the same set of information. This is another reason why we support the use of a trailing average method to determine the debt premium.

- We note that the ENA submission on the WACC paper suggests that the modelling undertaken to date substantially underestimates the spread premium value, based on analysis undertaken by CEG.[45] We recommend that the Commission's modelling be reconsidered in order to address CEG's specific comments.

278. Lastly, and as discussed in more detail below, we are comfortable with moving the allowance for swap costs out of the TCSD and into the wider debt issuance costs allowance.

Sample of corporate bonds used

279. We support the draft decision, for the purposes of determining the debt premium, to remove the reduced weighting on bonds which are issued by a company owned by the Crown or a local authority.

280. As the WACC paper points out, there are currently few publically traded bonds which are issued by a non-government owned distributor or GPB, and have a BBB+ rating and a remaining term of five years. We support the use of a wider universe of bonds for the calculation of the debt premium.

281. We also agree with the WACC paper that government ownership does not in practice have a significant bearing on traded credit margins (after accounting for the credit rating of the bonds).

Interpolation method between corporate bond yields

282. The WACC paper proposes a more mechanical approach to determining the debt premium than is currently used. It proposes an approach where the NSS curve is used to interpolate between yields of different terms to maturity.

283. In general, we support moves to reduce the degree of judgement required in implementing the IMs. This helps the IMs provide regulatory predictability.

284. Furthermore, we are comfortable with the use of the NSS curve, as described in the WACC paper, for the purposes of determining the debt premium. This seems a sensible, workable, method for making the interpolation process more mechanical.

Other items

285. We support the draft decision to retain New Zealand government bonds as the proxy for the risk-free rate. We remain of the view that there is not sufficient evidence for a change in approach.

286. We support the draft decision to retain BBB+ as the assumed credit rating for an efficient supplier. We agree with the WACC paper that this credit rating remains appropriate for this purpose.[46]

Debt issuance costs

287. We support a process where the estimate of debt issuance costs is updated on the basis of recent data from distributors.

288. However, it is not clear to us that the average issuance costs stated in the WACC paper are appropriate. In particular, the WACC paper states that the average debt issuance cost, from its recent debt survey, is 6-7 bps p.a. But the ENA submission states that CEG undertook a very similar debt survey which yielded an average cost of 24 bps p.a.[47] This difference limits our confidence in the robustness of the data used to derive the WACC paper estimate. As we have previously noted, the

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[45] Supra n**Error! Bookmark not defined.**.

[46] WACC paper, paragraph 252.

[47] Supra n**Error! Bookmark not defined.**.

Commission needs to be as transparent as possible about how it determines its final issuance cost value. Despite the confidentiality of the input data, we suggest that the Commission considers whether it can make some form of data public, so that the method can be satisfactorily assessed by interested parties, and the final estimate fully justified.

289. We are comfortable with the allowance for swap costs being included within the debt issuance costs allowance, rather than the TCSD. However, we note that swap costs are typically influenced by different factors than debt issuance costs, and hence the estimate of these costs needs to be considered separately from that of debt issuance costs.

290. We also support the statement in the WACC paper that "*[g]iven the uncertainty and variability of the various costs, it is prudent to include an additional margin to cover other issues related to debt issuance*".[48]

291. However, we disagree with the draft decision to exclude the costs of standby bank facilities from the estimate of debt issuance costs. We acknowledge that the Commission uses a 'simple' approach to estimating the cost of debt, focusing on just one type of debt (corporate bonds), rather than a 'complex' approach considering the weighted average of a number of types of debt, and we support this approach. However, the current debt premium method only compensates for actual debt funding (estimated via corporate bond rates), yet distributors are required to have committed bank liquidity over and above their actual debt funding level. The simple approach is a useful way of estimating the cost of debt funding, but it excludes the costs of maintaining short-term funding facilities. These are actual costs that are incurred by distributors (including those who use corporate bonds for their funding), and we continue to submit that an allowance for them should be provided for, ideally within the wider debt issuance cost estimate.

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[48] WACC paper, paragraph 246.

Related party transactions

Overall approach

292. The Related party transactions paper notes some potential problems with the treatment of related party transactions under the IMs and also under information disclosure. Given the complexity of the issues, the proposal is to defer decisions on this topic but to still complete them within the timeframe of this IM review (ie by January 2018).

293. The Related party transactions paper poses several questions regarding related party transactions with the aim of helping the Commission to better understand the issues.

294. The distributors which support this submission can accept a delay in concluding the review of the related party IMs. However we do not believe they should be further delayed beyond the timeframe of the current IM review.

Issues identified

295. The potential problems identified in the Related party transactions paper are:

- Interpretation and implementation concerns with the current proposals, including the use of the term 'directly attributable cost', the terms of the directors' certification option and the 17.2% margin contracting option.
- Misalignment between capex related party provisions in the IMs and opex and revenue related party provisions in information disclosure.
- An increasing value of related party transactions within the industry, including payments for avoidable cost of transmission (ACOT).

Interpretation and implementation

296. As we have previously submitted we agree that the term "directly attributable costs" as applied in related party clauses is difficult and that application of the directors' certification option can be challenging in some circumstances. We support a review of these issues. We also consider that the 17.2% margin option may benefit from some clarification.

Alignment between IMs and information disclosure

297. The distributors which support this submission agree the IM and information disclosure related party provisions could be, and should be, better aligned. We refer the Commission to our previous submission on this topic for more detail.[49]

Increasing value of related party transactions

298. The Related party transaction paper appears concerned that the value of related party transactions is increasing. We are less convinced this is a problem. As distributors increasingly seek to diversify, which is a sensible strategy given the risks posed by emerging technologies, increased related party activity is to be expected. As related parties established by distributors will generally have some synergies with the distribution business it is not surprising related parties and distributors would transact.

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[49] PwC, Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition, 21 August 2015.

299. We also consider that limb (b) of the definition of related party in the IMs may be relevant here. This limb essentially states that any part of a regulated supplier that does not supply regulated services is a related party. As distributors have become more familiar with this clause they may have concluded that more of their business activities fell within this bucket. As an example, where a distributor's contracting activity is within a different legal entity it is a related party. Therefore distributors with an in-house contracting activity may also have decided to treat this as a related party under this limb of the definition.

Avoidable cost of transmission

300. The Related party transactions paper raises concerns that avoidable cost of transmission (ACOT) payments have been increasing in recent years and that some of the higher ACOT payments made by distributors are made to distributed generators that are related parties to the distributor. The paper comments that ACOT payments have been increasing at a much higher rate than generation.

301. We submit that the analysis misunderstands the nature of and basis for ACOT payments. ACOT payments are made based on the amount of transmission charge a distributor (in this case) has managed to avoid through the operation of distributed generation at peak times. Transmission charges seek to recover Transpower's full revenue amount. In recent years ACOT has increased because Transpower has invested substantially in its network and has thus passed on significantly higher charges. These charges are then allocated based on each party's contribution to regional coincident peak demand. Where total transmission charges increase, it is to be expected that total ACOT payments would increase as the value of the transmission charge being avoided has increased.

302. There is no particular reason to expect ACOT payments to trend closely with generation volumes (although broadly over the long-term they should be consistent). In recent years growth in electricity demand has slowed, pushing down generation volumes, while most major transmission investments were approved before this trend became apparent.

Questions posed in the consultation paper

303. The Related party transactions paper indicates that the Commission would like to further engage with stakeholders to better understand:[50]

- The commercial rationale for the ownership structures or joint venture structures of related party suppliers to regulated suppliers.
- The types of ownership structures of related party suppliers to regulated suppliers.
- The terms of the contracts being entered into between the relevant parties.
- The mix of business undertaken by the related party suppliers with the regulated suppliers and with other unrelated parties.
- The reasons for the growing value of related party transactions being disclosed.
- Why suppliers use certain related party options.
- The extent to which implementation and compliance issues reflect problems in dealing with the above issues.

304. It may be helpful to hold a workshop to discuss these matters. The information requested will vary between suppliers and may involve some confidential data.

[50] Related party transactions paper, paragraph 74.

305. As an initial response, we note that the disaggregation of corporate enterprises into separate legal entities is common in many industries. It is a way of ensuring particular business units have a clear focus and purpose and can assist with allocating costs between activities.

306. In the electricity distribution sector, many companies have established their contracting business as a separate legal entity. Reasons for this include giving the contracting business a clearer focus (eg to act as a service provider to the distributor) and making it better able to provide services to third parties. Similarly, some distributors have established fibre or other business ventures that provide services to the network business but also to third parties.

307. Some related parties of distributors provide the majority of their services to the network business with only a small portion of sales to third parties. Other related parties are the opposite. This will reflect the relative goals, risk appetites and successes of these enterprises.

Report on the IM review

Overall approach

308. The IM report discusses the non-CPP IMs the Commission has considered changing and lists the IMs it has decided to change and not change. It includes discussion of the IM changes proposed in the Topic papers.

309. The most significant IM change discussed in the IM report that is not discussed in the topic paper is the next closest alternative (NCA) proposal. We discuss this proposal here. The other changes put forward in the IM report that are not covered in the topic papers are generally less material. On those items, we endorse the submission of the ENA.

310. This section also discusses two other changes to the IMs we would like to see but which were not included in the draft decisions.

Next closest alternative

311. The NCA proposal is based on a concern that the IM amendment process is too inflexible to make urgent and non-material amendments when an IM becomes unworkable. The IM amendment process set out in Part 4 includes notification and consultation steps that can take some time to work through.

312. The NCA proposal would mean that:

- Where a provision in an IM becomes unworkable (eg where the IMs refer to codes or standards set by other regulators that may change or cease to be available) the Commission would identify the next closest alternative provision.
- The Commission would then publish a decision that this next closest alternative now applies including a description of the alternative
- This decision would be published alongside the IMs.
- The Commission might consult on the proposed change, but would have discretion not to.
- The intention is that the next closest alternative would have an equivalent effect; but if the effect is not equivalent for price-quality paths, the Commission may reopen the price-quality path. This is only expected in "rare" circumstances.

313. The distributors which support this submission are not opposed to mechanisms that make the IMs work more effectively in a lower-cost way. However, the NCA provision may better provide certainty for suppliers and consumers if there are additional restrictions on its use.

314. We think there is a concern that, once available, the NCA provision could be used for an expanded list of issues. There will always be a level of subjectivity when deciding whether an IM is "unworkable" and whether an alternative approach is "equivalent". For the Commission to have the power to apply alternative approaches after making these judgements creates a risk of increasingly substantive changes being made to the IMs outside the formal and statutory amendment process. The distributors which support this submission would prefer that the NCA provision is only applied following consultation and clear guidance is provided in the IMs about how the Commission will determine whether an IM can be "reasonably applied as intended" and how it would determine what the next closest alternative is.

315. The practice of publishing the next closest alternative alongside the IMs is problematic. We understand the IMs themselves would not change. Thus any distributor completing their disclosure or price-quality path compliance requirements (and their auditors) would need to review both the IMs

and the list of next closest alternatives. This may cause confusion and cost, which an actual IM amendment would avoid. As such, where there is sufficient time to make an IM amendment without causing compliance problems, we consider a proper amendment should be progressed. A NCA should only be progressed when there is certainty that no other alternative approach is feasible.

316. The distributors which support this submission are also uncomfortable that the NCA provision could be used to reopen price-quality paths where the NCA is not fully equivalent with the, now unworkable, IM. We would like to better understand in what circumstances such a change may apply. It does not seem conceivable that the price path or quality standard could become unworkable in this way, so it is not clear why this would be necessary.

IRIS adjustments following transmission asset purchases

317. The current IMs do not provide for any adjustments to the IRIS recoverable cost amounts that are related to the purchase of transmission assets. Where a distributor purchases an asset from Transpower and this purchase is not reflected in the DPP opex and capex forecasts the distributor will be penalised under the IRIS for this 'over-expenditure'. This is not consistent with the intent of the IRIS, which is to provide incentives for efficiencies. Penalising distributors for purchasing transmission assets will make it less likely these transactions will go ahead and will not have any useful incentive effect.

318. The distributors which support this submission recommend the IRIS IMs exclude expenditure associated with a transmission asset purchase from the calculation of the IRIS recoverable cost, unless the purchase was included within the price-quality path expenditure allowances.

Recovery of avoided cost of transmission payments

319. The IMs include a recoverable cost for the 'distributed generation allowance'. This permits payments made by distributors to distributed generators under Part 6 of the Electricity Industry Participation Code 2010 to be treated as recoverable costs.

320. The Authority has recently consulted on proposals to remove the pricing principles from within Part 6 of the Code. This would mean that there would no longer be regulatory requirements for distributors to pay ACOT to distributed generators. However, some distributors may still be contractually required to make such payments on the basis of contracts that have already been entered into, on the basis of the Part 6 requirements.

321. We (and others) have submitted to the Authority on this issue, and it may be that the Authority choses to resolve it. However, in order to address the risk that the Authority fails to resolve the issue we request the Commission extend the definition of the distributed generation allowance to include:

> *(c) agreements entered into between a distributor and a distributed generator that reflected the terms of Schedule 6.4 of Part 6 of the Electricity Industry Participation Code with regard to payments for avoided transmission charges*

Appendix A: ACAM revenue threshold

This Appendix sets out the results of our re-working of the Commission's analysis of the ACAM revenue materiality threshold, as discussed in the Emerging technologies section of this submission.

Methodology

The inputs to this analysis are:

- Regulated electricity revenues, as disclosed by each distributor (column A).
- Other regulated revenues, as disclosed by Powerco and Vector (column B).
- Total unregulated revenues of the Group, as reported in each distributor's annual report, with some judgement applied about whether certain items were regulated or unregulated (column C)[51].
- Operating costs directly attributable (OCDA) and operating costs not directly attributable (OCnDA) as disclosed by each distributor (columns E and F).

Column D assesses which distributors are eligible to apply ACAM under the revenue threshold, by dividing unregulated revenue by regulated revenue (that is, column C divided by A+B). Those shown in green fall below the 20% threshold and are eligible to apply ACAM.

Column G calculates the percentage of each company's revenue that is unregulated.

Columns H and I seek to estimate the percentage impact on regulated revenues if the distributor uses ACAM to allocate its operating costs. We follow the Commission's assumption that under ACAM 100% of opex will be allocated to the regulated business (and therefore the results are conservatively high). We also follow the Commission's assumption that any distributor that did apply ABAA would use revenues as the allocator (this is not correct, but is a simplifying assumption).

Column H replicates the column headed "Operating Cost Impact on Revenue (Current Revenue Split)" in Table B1 of Appendix B of the Emerging technologies paper, but with corrected inputs. It takes each distributor's OCnDA (column F) and divides this by the distributor's total regulated revenue (column A+B) and then multiplies it by 39%, which is the Commission's estimate of the percentage of the total of industry revenue that is unregulated. The purpose of this is to estimate the amount by which each distributor's regulated revenues would increase if they used ACAM rather than ABAA to allocate OCnDA.

Column I carries out the same calculation as column H but replaces the 39% value with the percentage of each distributor's revenue that is unregulated (the value in column G). We consider that this is a much more realistic assessment of how a distributor would use revenue as an allocator than the Column H value.

Discussion

In our view the results in Column I demonstrate the reasonableness of the current ACAM threshold. Our results show that no businesses whose share of unregulated revenues is below the materiality threshold would be likely to increase revenues by more than 1% by applying ACAM. Therefore there is no basis to reduce the current ACAM materiality threshold to 10%..

[51] We note it is somewhat unclear whether Group or Parent revenue should be used. We have used Group unregulated revenues in this analysis.

Results

Table 1: Analysis of ACAM revenue threshold for 2015

2015	A	B	C	D	E	F	G	H	I
EDB	Regulated revenue ($000)	Other Regulated revenue ($000)	Unregulated revenue ($000)	Unregulated revenue/ Regulated revenue	OCDA ($000)	OCnDA ($000)	Individual company revenue split	Operating cost impact on revenue (ComCom 2015 split: 39%)	Operating cost impact on revenue (individual company split)
Buller Electricity	7,692		102,297	1330%	2,717	380	93%	1.93%	4.59%
Northpower	63,779		259,655	407%	13,762	13,588	80%	8.31%	17.10%
Horizon Energy Distribution	31,893		79,271	249%	5,312	4,339	71%	5.31%	9.70%
Westpower	20,833		39,917	192%	9,567	0	66%	0.00%	0.00%
Scanpower	8,492		9,841	116%	1,599	1,418	54%	6.51%	8.97%
Eastland Network	33,555		38,075	113%	7,854	0	53%	0.00%	0.00%
WEL Networks	100,990		91,076	90%	11,052	8,920	47%	3.44%	4.19%
Electra	38,005		23,115	61%	10,629	0	38%	0.00%	0.00%
Vector	616,862	164,008	455,636	58%	77,948	56,245	37%	2.81%	2.65%
Top Energy	39,133		21,784	56%	12,239	5,224	36%	5.21%	4.77%
MainPower New Zealand	53,435		25,477	48%	7,471	4,689	32%	3.42%	2.83%
Unison Networks	139,744		62,647	45%	19,314	17,712	31%	4.94%	3.92%
Network Waitaki	16,754		5,584	33%	3,503	1,303	25%	3.03%	1.94%
The Lines Company	38,456		11,078	29%	8,079	3,203	22%	3.25%	1.86%
Marlborough Lines	35,331		7,979	23%	11,521	965	18%	1.07%	0.50%
Orion New Zealand	274,174		52,509	19%	50,828	0	16%	0.00%	0.00%
Alpine Energy	50,913		9,145	18%	13,822	0	15%	0.00%	0.00%
Network Tasman	42,074		6,026	14%	9,818	0	13%	0.00%	0.00%
EA Networks	41,252		4,786	12%	9,121	0	10%	0.00%	0.00%
Electricity Invercargill	19,964		2,124	11%	4,161	0	10%	0.00%	0.00%
Counties Power	46,467		3,272	7%	7,716	4,125	7%	3.46%	0.58%
Powerco	358,774	50,636	27,835	7%	41,630	29,111	6%	2.77%	0.45%
Centralines	12,304		743	6%	3,477	94	6%	0.30%	0.04%
The Power Company	56,622		1,401	2%	14,414	0	2%	0.00%	0.00%
Aurora Energy	93,463		0	0%	23,608	0	0%	0.00%	0.00%
Nelson Electricity	10,534				1,905	0			
OtagoNet Joint Venture	35,782				8,009	0			
Waipa Networks	22,993				4,811	768			
Wellington Electricity Lines	182,610				25,556	0			

Table 2: Analysis of ACAM revenue threshold for 2014

2014	A	B	C	D	E	F	G	H	I
EDB	Regulated revenue ($000)	Other Regulated revenue ($000)	Unregulated revenue ($000)	Unregulated revenue/ Regulated revenue	OCDA ($000)	OCnDA ($000)	Individual company revenue split	Operating cost impact on revenue (ComCom 2015 split: 39%)	Operating cost impact on revenue (individual company split)
Buller Electricity	7,400		74,786	1011%	2,846	495	91%	2.61%	6.09%
Northpower	60,533		188,066	311%	12,464	13,249	76%	8.54%	16.56%
Horizon Energy Distribution	30,323		74,168	245%	4,943	4,248	71%	5.46%	9.94%
Westpower	19,915		31,123	156%	8,169	0	61%	0.00%	0.00%
Eastland Network	31,855		37,917	119%	7,810	0	54%	0.00%	0.00%
Scanpower	8,032		7,524	94%	1,704	1,303	48%	6.33%	7.85%
Electra	35,781		26,591	74%	7,513	2,678	43%	2.92%	3.19%
WEL Networks	95,981		66,355	69%	18,919	0	41%	0.00%	0.00%
Top Energy	37,136		23,778	64%	8,903	5,581	39%	5.86%	5.87%
Vector	588,136	184,363	461,399	60%	73,487	44,725	37%	2.26%	2.16%
MainPower New Zealand	47,843		26,613	56%	8,102	2,886	36%	2.35%	2.16%
Unison Networks	124,090		59,290	48%	19,918	13,176	32%	4.14%	3.43%
Network Waitaki	13,651		5,454	40%	3,119	802	29%	2.29%	1.68%
Marlborough Lines	32,973		12,384	38%	10,767	0	27%	0.00%	0.00%
The Lines Company	37,101		12,079	33%	8,909	3,826	25%	4.02%	2.53%
Orion New Zealand	210,754		46,378	22%	50,934	0	18%	0.00%	0.00%
The Power Company	53,893		9,653	18%	13,498	0	15%	0.00%	0.00%
Network Tasman	40,122		7,060	18%	8,543	0	15%	0.00%	0.00%
Alpine Energy	42,221		5,669	13%	15,272	0	12%	0.00%	0.00%
EA Networks	37,460		4,391	12%	5,502	2,712	10%	2.82%	0.76%
Electricity Invercargill	17,822		1,835	10%	4,814	0	9%	0.00%	0.00%
Centralines	11,260		803	7%	3,934	392	7%	1.36%	0.23%
Powerco	338,324	47,588	22,057	6%	44,030	29,420	5%	2.97%	0.41%
Counties Power	43,540		1,871	4%	7,181	3,878	4%	3.47%	0.37%
Aurora Energy	85,265		0	0%	22,317	0	0%	0.00%	0.00%
Nelson Electricity	9,863				2,234	0			
OtagoNet Joint Venture	33,249				7,680	0			
Waipa Networks	22,006				4,143	513			
Wellington Electricity Lines	163,772				29,611	0			