

Input methodologies review draft decisions

Topic paper 2: CPP requirements

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Associated documents

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16 June 2016	978-1-869455-09-5	Input methodologies review draft decisions: Introduction and process paper
16 June 2016	978-1-869455-10-1	Input methodologies review draft decisions: Framework for the IM review
16 June 2016	978-1-869455-11-8	Input methodologies review draft decisions: Topic paper 1 – Form of control and RAB indexation for EDBs, GPBs and Transpower
16 June 2016	978-1-869455-12-5	Input methodologies review draft decisions: Topic paper 3 – The future impact of emerging technologies in the energy sector
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22 June 2016 (expected)	978-1-869455-16-3	Input methodologies review draft decisions: Report on the IM review
22 June 2016 (expected)	1178-2560	Draft amendments to <i>Electricity Distribution Services Input Methodologies Determination 2012</i> [2012] NZCC 26
22 June 2016 (expected)	1178-2560	Draft amendments to <i>Gas Distribution Services Input Methodologies Determination 2012</i> [2012] NZCC 27
22 June 2016 (expected)	1178-2560	Draft amendments to <i>Gas Transmission Services Input Methodologies Determination 2012</i> [2012] NZCC 28
22 June 2016 (expected)	1178-2560	Draft amendments to <i>Commerce Act (Specified Airport Services Input Methodologies) Determination 2010</i> (Decision 709, 22 December 2010)
22 June 2016 (expected)	1178-2560	Draft amendments to <i>Transpower Input Methodologies Determination 2012</i> [2012] NZCC 17

Commerce Commission
Wellington, New Zealand

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Executive summary

Purpose of this paper

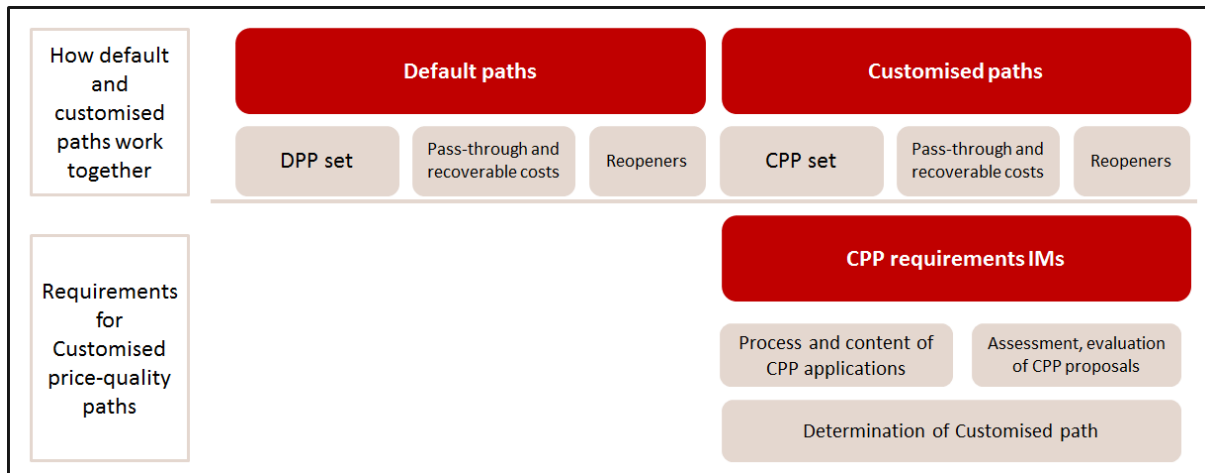
- X1. The purpose of this paper is to set out:
- X1.1. our views on the default/customised price-quality regime – including how default and customised paths work together, and proposed changes to areas where improvements might be made; and
 - X1.2. proposed changes to the detailed requirements for customised price-quality paths (**CPP**) set out in the input methodologies (**CPP requirements**).
- X2. This paper relates to electricity distribution businesses (**EDBs**) and gas pipeline businesses (**GPBs**) that are subject to price/quality regulation.
- X3. At this stage, we have not considered changes to the CPP information requirements specific to gas distribution or transmission businesses.¹

Overview of the CPP requirements topic

- X4. The review of the input methodologies (**IMs**) has provided us with an opportunity to consider what improvements can be made to how we implement the default/customised price-quality regime, as well as the specific requirements for CPPs. In particular, we have considered:
- X4.1. How default price-quality paths (**DPPs**) and CPPs work together — when setting the initial IMs in 2010, we did not have practical experience of how the two mechanisms would interact.
 - X4.2. Specific improvements to the CPP requirements — utilising experience with the first CPP proposal, and taking account of developments in information disclosure since the IMs were set in 2010.
- X5. Figure X1 illustrates the two different levels of this review and the components involved.

¹ As noted at paragraph 40 of this paper, we have not yet reached draft decisions on the CPP information requirements for gas pipeline businesses. This work remains within the IM review and we will continue to liaise with stakeholders in order to establish an appropriate timeline for this work. We will update interested parties on our timing for this work in our anticipated September 2016 process update.

Figure X1: Overview of the components of the review of CPP requirements topic



X6. This paper follows consultation on this topic:

X6.1. Topic 8 of our IM review problem definition paper in June 2015.

X6.2. CPP fast track amendments in November 2015.

X6.3. Emerging views paper in February 2016 on opportunities to improve the way DPPs and CPPs work together.

X6.4. Technical workshop on CPP information requirements in April 2016.

Summary of changes proposed as part of the CPP requirements topic

X7. The changes proposed as part of this topic are in the context of our view that fundamentally the underlying intent of our IMs for the DPP/ CPP regime remains sound. We consider the IM changes proposed to be improvements aimed at giving better effect to this intent.

X8. Accordingly, the majority of our proposed changes are to reduce cost and complexity, and improve the certainty provided by how we specify the IMs.

X9. A summary of the proposed changes in the series of tables X1-X5 that follow. Note, the change to align the DPP and CPP weighted average cost of capital (**WACC**) is explained in the cost of capital topic paper and included in Table X1 for summary purposes only.²

² Commerce Commission "Input methodologies review draft decisions: Topic paper 4 – Cost of capital issues" (16 June 2016).

Table X1: Summary of proposed changes in relation to how DPP and CPP work together

Topic	Proposed change	Outcome of the proposed change	Chapter
Quality-only CPP	Option for EDBs to apply for a quality-only CPP removed and replaced by a quality-only DPP reopener.	Cost and complexity – suppliers are able to apply for a variation to their quality standards without the full cost of the CPP process. This also accounts for practical difficulties in assessing and evaluating 'single-issue' CPPs.	Chapter 3
Pass-through costs	Pass-through costs may be specified in advance for the forthcoming DPP period as part of the DPP reset process – no longer restricted to specifying these costs during the affected regulatory period.	Cost and complexity – allows a greater number of pass-through costs to be specified through a DPP or CPP determination where the cost is outside of the control of the supplier, instead of requiring a change to the IMs.	Chapter 3
Prudently incurred expenditure	Allowing the recovery of prudently incurred costs, in response to an urgent project, between when a CPP is applied for and determined.	Promotion of the purpose of Part 4 – creates incentives to invest where urgent work is needed while the Commission is assessing a CPP proposal.	Chapter 3
CPP contingent projects	Allowing the CPP to be reopened for contingent and unforeseen projects, for EDBs and GDBs.	Promotion of the purpose of Part 4 – provides incentives for suppliers to innovate and invest by allowing a mechanism for the consideration of large incremental expenditure (to be approved where appropriate) in addition to the expenditure originally provided for in a CPP.	Chapter 3
Difference in DPP and CPP WACC rates	A single WACC should apply to all suppliers on DPPs and CPPs for the duration of each DPP regulatory period.	Promotion of the purpose of Part 4 – removing the separate WACC for CPPs so we do not dis-incentivise CPPs where they are in the long-term benefit of consumers.	Topic paper 4 – Cost of capital issues

Table X2: Summary of proposed changes to information requirements for EDBs

Topic	Proposed change	Outcome of the proposed change	Chapter
Modifications and exemptions	Exemption and modification provisions (completed November 2015 as part of IM review) will specify scale as an explicit consideration for the approval of exemption and modification requests. This change will also apply to GPBs.	Certainty – now clear that Commission considers scale an important consideration in allowing CPP applicants to reduce the cost of preparing CPP application by applying for modifications and exemptions to the existing requirements.	Chapter 5
Duplication	Removing the need to duplicate information between documents, by aligning Schedules D and E with the relevant information disclosure requirements.	Cost and complexity – applicants able to rely more on already existing information when making a CPP proposal.	Chapter 5
Deliverability	Including new requirements for a deliverability plan for the proposed expenditure; and improving the way in which applicants demonstrate the deliverability of their proposed expenditure with existing requirements.	Certainty – deliverability expectations now clearer for applicants upfront.	Chapter 5
Asset disaggregation	Simplifying the requirement for forecasting capex projects disaggregated by asset type.	Cost and complexity – applicants not required to spend time allocating asset forecasts at a more detailed level.	Chapter 5
Related party transactions and capital contributions	Changing the requirements for related party transactions and capital contributions to an aggregate level of capex, rather than a project level.	Cost and complexity – applicants not required to spend time allocating related party transactions at a more detailed level.	Chapter 5
Disaggregation of service categories	Removing the requirement for expenditure to be disaggregated by service categories.	Cost and complexity – applicants not required to spend time allocating expenditure at a more detailed level.	Chapter 5

Table X3: Summary of proposed changes to verification requirements

Topic	Proposed change	Outcome of the proposed change	Chapter
Role and purpose	Adding a new section to the verifier's terms of reference in Schedule G of the IMs that defines the verifier's role, purpose, and obligations.	Certainty – both applicant and verifier have more information upfront on the verifier's role in the verification process.	Chapter 6
High level summary	Requiring the CPP applicant to provide us with a high level summary of their application by the time the verifier is engaged.	Cost and complexity – contributes towards a more efficient process by allowing us information upfront to better prepare for the type of CPP proposal being developed.	Chapter 6
Communication protocol	Amending the tripartite deed requirements in Schedule F5 to include a communication protocol that sets out the roles and obligations of the parties during the verification process regarding communication, and to allow meeting minutes to be used as the evidential basis for any verifier technical opinions.	Certainty – provides certainty to applicant that they can have confidence that they can engage openly with knowledge Commission will not view draft material.	Chapter 6
Flexibility in number of projects assessed	Allowing the verifier greater flexibility in the number of projects that are verified, the extent of their verification, and the content of the CPP proposal that we review.	Cost and complexity – applicants not required to allocate expenditure into a specific number of projects where they may not have them.	Chapter 6
Non-standard depreciation	Removing the obligation for the verifier to consider non-standard depreciation.	Cost and complexity – verifier no longer required to assess an area where its expert opinion adds little value.	Chapter 6
Removal of independent engineer	Removing requirement for an independent engineer, and allowing suppliers to prepare the quality standard variation report themselves, subject to verification by the verifier (EDBs only).	Cost and complexity – removing need for separate roles where a verifier is likely to be able to provide an appropriate opinion on any quality standard variation.	Chapter 6

Table X4: Summary of proposed changes to audit requirements

Topic	Proposed change	Outcome of the proposed change	Chapter
Audit report	Clarifying the requirement for the auditor to provide a report setting out the auditor's opinion on specified matters.	Certainty – now clear the auditor must provide a report as part of the audit process where previous this was ambiguous.	Chapter 7
Clarified role – historical v forecast data	Differentiating the role of the auditor with respect to <i>historical</i> financial information and <i>forecast</i> financial information.	Certainty – now clear the specific type of assurance the auditor is expected to provide in respect of different types of information.	Chapter 7
Spreadsheets	Removing ambiguity around quantitative information provided in spreadsheets.	Certainty – now clear the specific type of assurance the auditor is expected to provide in respect of different types of information.	Chapter 7
Clarified role – proper records	Clarifying the requirement on the auditor to provide a view in respect of proper records being kept.	Certainty – the scope of audit requirements is now more clear.	Chapter 7

Table X5: Summary of proposed changes to consumer consultation requirements

Topic	Proposed change	Outcome of the proposed change	Chapter
Price-quality impact of alternative investment options	Amending the consumer consultation IMs to require CPP applicants to notify consumers of the price and quality (EDBs) impact of any alternative investment options in their CPP proposal.	Certainty – applicants have more information upfront on our expectations for the consumer consultation process.	Chapter 8
Verifier's view	In support of the change proposed above, we propose amending the verifier Terms of Reference in Schedule G of the IMs to require the verifier to report on the extent and effectiveness of the applicant's consultation.	Cost and complexity – contributes towards a more efficient process by allowing assessment of applicant's consumer consultation earlier in the process.	Chapter 8

Relationship with the draft decision package

X10. This topic paper forms part of our package of draft decisions papers on the IM review. As part of the package of papers, we have also published:

X10.1. a summary paper of our draft decisions;

X10.2. an introduction and process paper which provides an explanation of how the papers in our draft decisions package fit together; and

X10.3. a framework paper which explains the framework we have applied in reaching our draft decisions on the IM review.

Invitation to make submissions

X11. We invite submissions on this paper by **5pm on 28 July 2016**. We then invite cross submissions by **5pm on 11 August 2016**.

X12. Please address submissions and cross submissions to:

Keston Ruxton
Manager, Input Methodologies Review
Regulation Branch
im.review@comcom.govt.nz

X13. Please clearly indicate within your submission which aspects of this paper it relates to.

Chapter 1: Introduction

Purpose of this paper

1. The purpose of this paper is twofold. It sets out:
 - 1.1 our views on the default/customised price-quality regime – including how default and customised paths work together, and areas where improvements might be made; and
 - 1.2 proposed changes to improve the requirements for customised price-quality paths set out in the input methodologies.
2. In respect of the CPP requirements, it explains:
 - 2.1 the problems we have identified within this topic area;
 - 2.2 our proposed solutions to these problems;
 - 2.3 the reasons for our proposed solutions; and
 - 2.4 how we have taken stakeholders' submissions into account in considering the above.

Where this paper fits in to our package of papers on our draft decisions

3. This topic paper forms part of our package of draft decision papers on the input methodology review. For an overview of the package of papers and an explanation of how they fit together, see the Introduction and process paper published as part of our draft decision package.³
4. To the extent our proposed solutions involve changes to the IMs, this paper explains how we propose to change our existing IM decisions to account for our proposed solutions to problems within this topic area.
5. Our proposed drafting changes to the IMs, including any resulting from this topic area, are shown in the draft determinations, which we expect to publish on 22 June 2016.

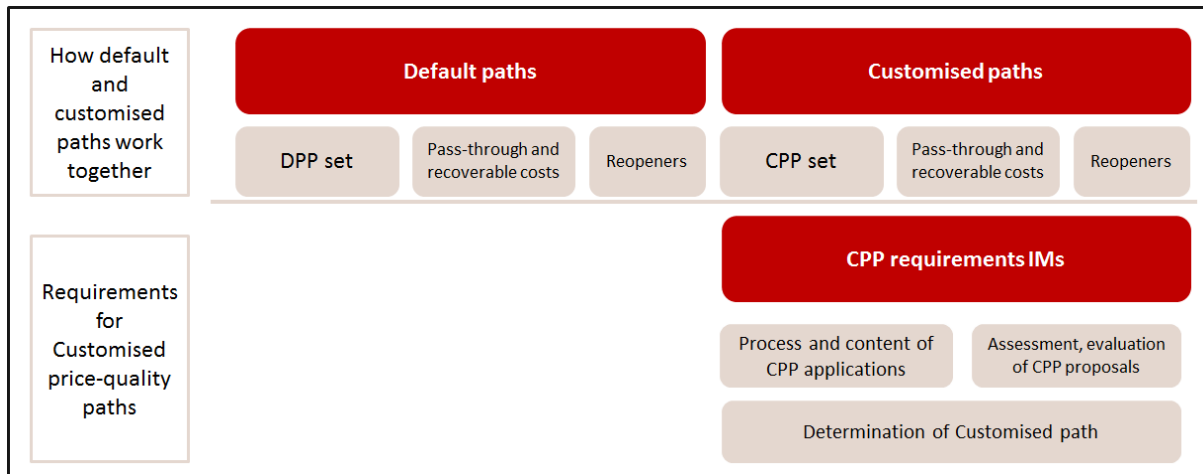
³ Commerce Commission "Input methodologies review draft decisions: Introduction and process paper" (16 June 2016).

6. The framework we have applied in reaching our draft decisions on the IM review is set out in a separate paper, published alongside this paper.⁴ The framework paper explains that we have only proposed changing the current IMs where this appears likely to:
 - 6.1 promote the Part 4 purpose in s 52A more effectively;
 - 6.2 promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); or
 - 6.3 significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).
7. The framework paper also describes key economic principles that can provide guidance as to how we might best promote the Part 4 purpose.

Introduction to this topic

8. While Part 4 (**Part 4**) of the Commerce Act 1986 (the **Act**) specifies at a high level how the regime functions, it also gives significant discretion as to how we design and set the DPP and CPP mechanisms.
 - 8.1 The DPP is the low-cost arm of DPP/ CPP regulation. We are required to set a low-cost default path for all suppliers.
 - 8.2 The CPP offers suppliers the opportunity to come to us for a more tailored price-quality path that better meets their individual circumstances.
9. This topic considers both a regime level view of how default and customised paths work together, and the specific IM requirements for customised paths. Figure 1.1 illustrates the two different levels of this review and the different components involved.

⁴ Commerce Commission “Input methodologies review draft decisions: Framework for the IM review” (16 June 2016).

Figure 1.1: Overview of the components of the default customised price-quality regime

10. This paper follows consultation on this topic:
- 10.1 Topic 8 of our IM review problem definition paper in June 2015⁵;
 - 10.2 CPP fast track amendments in November 2015⁶;
 - 10.3 Emerging views paper in February 2016 on opportunities to improve the way DPPs and CPPs work together;⁷ and
 - 10.4 Technical workshop on CPP information requirements in April 2016.
11. Note, the CPP fast track amendment process originally considered issues relating to the differences in WACC between DPP and CPP. They were discontinued as part of the fast track process in October 2015 to be considered alongside other cost of capital issues as part of the main IM review. This paper includes the proposed changes for this issue in summary form as it is an important feature of the total package of improvements to how DPP and CPP work together. The cost of capital paper provides detailed discussion of the specific issue and our proposed solution.⁸

Structure of this paper

12. The first part of the paper sets out the context for the default/customised price-quality regime (Chapter 2), and the opportunities for improvements we have taken as part of the review (Chapter 3).

⁵ Commerce Commission "Invitation to contribute to problem definition" (16 June 2015).

⁶ Commerce Commission "Amendments to input methodologies for customised price-quality paths – Final reasons paper for Limb 1 of the CPP fast track" (12 November 2015).

⁷ Commerce Commission "Emerging views on opportunities to improve the way default and customised price-quality paths work together" (29 February 2016).

⁸ Commerce Commission "Input methodologies review draft decisions: Topic paper 4 – Cost of capital issues" (16 June 2016).

13. In the second part of the paper, the specific CPP discussions are part of a broader, iterative, longer term set of refinements we are considering for the DPP/ CPP regime. Importantly, not all of these refinements will come through IM changes, but should also occur through the processes by which we engage with prospective and actual CPP applicants.
14. We do, however, propose some IM changes that are designed to improve the CPP process, by increasing clarity and removing unnecessary cost and complexity. We focus on each of the key requirements of a CPP proposal in individual chapters:
 - 14.1 evaluation of proposals (Chapter 4);
 - 14.2 information requirements (Chapter 5);
 - 14.3 verification requirements (Chapter 6);
 - 14.4 audit requirements (Chapter 7); and
 - 14.5 consumer consultation requirements (Chapter 8).
15. There are two attachments to this paper:
 - 15.1 Attachment A – sets out the high level process of CPP preparation and evaluation;
 - 15.2 Attachment B – explains, in respect of each CPP requirement IM decision, whether/how it is changing and why/why not.

Who does this paper apply to?

16. This paper applies to:
 - 16.1 electricity distribution businesses (**EDBs**) that are subject to price-quality regulation; and
 - 16.2 gas pipeline businesses (**GPBs**), although at this stage, we are not proposing to make any changes to the detailed information requirements for either gas distribution businesses (**GDBs**) or gas transmission businesses (**GTBs**).⁹

Invitation to make submissions

17. We invite submissions on this paper by **5pm on 28 July 2016**. We then invite cross submissions by **5pm on 11 August 2016**.

⁹ We have not yet reached draft decisions on the CPP information requirements IMs for gas pipeline businesses. Further discussion on this matter is found at para 40.

18. Please address submissions and cross submissions to:

Keston Ruxton
Manager, Input Methodologies Review
Regulation Branch
im.review@comcom.govt.nz
19. Please clearly indicate within your submission which aspects of this paper it relates to.
20. The Introduction and process paper contains further details about the submissions process. This includes:¹⁰
 - 20.1 explaining that material provided outside of the indicated timeframes without an extension might not be considered in reaching our final decisions;
 - 20.2 providing guidance on requesting an extension to the submissions timeframes;
 - 20.3 noting that we prefer submissions on our draft decisions in a file format suitable for word processing, rather than the PDF file format; and
 - 20.4 providing guidance on making confidential submissions.

¹⁰ Commerce Commission “Input methodologies review draft decisions: Introduction and process paper” (16 June 2016), chapter 5.

Chapter 2: Overview of the default/customised price-quality regime

Purpose of this chapter

21. This chapter provides an overview of the default/customised price-quality regime (DPP/ CPP regime), and summarises, at a high level, our view of the current regulatory settings, including changes proposed as part of the IM review.

Structure of this chapter

22. This chapter is split into two sections:
- 22.1 overview and evolution of the DPP/ CPP regime; and
 - 22.2 overview of the current regulatory settings and proposed IM changes.

Overview and evolution of the default/customised price-quality regime

23. This section illustrates how the default/customised regime has evolved over time, and can continue to evolve given the discretion afforded to us under Part 4.

The legislative context for DPP/ CPP regulation

24. Electricity distributors, gas distributors, and gas transmission businesses are subject to default/customised price-quality regulation under Part 4.¹¹
25. The purpose of default/customised price-quality regulation is:¹²
- To provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances.
26. There are also a number of other key statutory considerations specific to default and customised paths that we must take account of when setting default paths and the requirements for customised paths. These are set out in the table overleaf.

¹¹ Some electricity distributors are exempt from default/customised price-quality regulation where they meet the requirements set out in s 54G of the Act.

¹² Commerce Act 1986, s 53K.

Table 2.1: Key statutory characteristics of DPPs and CPPs

DPP (as set)	DPP pass-through/ recoverable costs	DPP reopener (reconsideration)	CPP (as set)	CPP pass-through/ recoverable costs	CPP reopener (reconsideration)
<ul style="list-style-type: none"> • Relatively low-cost. • Commerce Commission (CC) bears the cost of determination (passed on to industry through general levies). • Section 53P limitations on how the CC sets a DPP – eg, restriction on benchmarking. • IMs must specify key inputs, eg, asset valuation, cost of capital. • 4-5 year regulatory period. 	<ul style="list-style-type: none"> • Costs that can be passed through to prices must be specified in the IMs. 	<ul style="list-style-type: none"> • Circumstances in which DPPs can be reconsidered within a regulatory period must be specified in the IMs. • Only affects path for the remainder of the DPP period. • Should accommodate issues affecting multiple suppliers (4+) that arise after the DPP is set (per High Court in Wellington International Airport Ltd & Ors v CC). • Potentially supplier, CC, or consumer initiated. • We bear the cost of reconsidering the DPP (passed onto industry through levies). 	<ul style="list-style-type: none"> • IMs must set out relevant scrutiny requirements and key inputs. • New regulatory period can be 3-5 years. • Only suppliers can apply and only once during a DPP period. • Cannot withdraw CPP proposal once submitted. • CC can agree with supplier on IM variations. • Applicant bears the cost of determining CPP. • CPP can extend across two DPP periods. 	<ul style="list-style-type: none"> • Costs that can be passed through to prices must be specified in the IMs. 	<ul style="list-style-type: none"> • Circumstances in which CPPs can be reconsidered within a regulatory period must be specified in the IMs. • Only affects path for the remainder of the CPP period. • Changes will only affect path for the remainder of the CPP period. • Potentially supplier, CC, or consumer initiated.

27. Within the bounds of Part 4, taking into account the statutory considerations above, there remains significant discretion for how we give effect to default and customised paths. This discretion includes how we set the IMs that underpin default/customised regulation, but also includes a number of other processes outside the IMs. For example:
- 27.1 periodic resets of default paths;
 - 27.2 mid-period reconsideration of price paths triggered by reopener provisions; and
 - 27.3 general engagement and guidance in reset processes and during the regulatory period.

Our approach to setting default paths has evolved over time

28. To set a default path we must set starting prices for each supplier based on the range of circumstances that we consider appropriate for default paths,¹³ noting that suppliers have the option to apply for a customised path where the default path does not meet their particular circumstances.
29. Over time both our approach to setting starting prices and the range of circumstances we have considered in setting default paths has changed. For example:
- 29.1 When we first set the IMs for default paths, we determined that a fairly simple ‘banded return on investment’ approach would likely be an appropriate low-cost approach to setting starting prices.¹⁴ However, we subsequently decided that the greater accuracy offered under a ‘building blocks’ approach was likely to better promote the s 52A purpose, when we reset the 2010-2015 DPP for EDBs after setting the IMs.¹⁵
 - 29.2 Since we first set the default path for EDBs in 2009 we have increased the range of supplier-specific circumstances taken into account in subsequent default paths, while maintaining the relatively low-cost purpose of the DPP. These include reopeners for catastrophic and change events, and an expanded range of recoverable and pass-through costs.¹⁶

¹³ That is, taking into account the low-cost purpose of DPP/CPD regulation and the outcomes sought more broadly under the purpose of Part 4.

¹⁴ A banded approach sets prices based on whether the supplier’s return on investment falls within a band of return values considered to be appropriate.

¹⁵ A building block approach to setting prices relies on an estimation of different costs faced by a supplier to keep network running, and uses these different components to forecast the revenue and prices that an efficient supplier would require.

¹⁶ We initially only allowed a DPP to be reopened for either an error, or misleading information.

Lessons from setting the first customised path

30. Setting a customised path more naturally lends itself to a more intensive and complex process when compared to the default path.¹⁷ To support this process we are required to set the requirements for customised path applications as IMs.
31. When we originally set the CPP requirement IMs in 2010, our aim was to adopt a cost-effective approach, which still allowed us to apply an appropriate level of scrutiny to effectively assess the CPP proposal. Some of the areas we considered at the time included:¹⁸
 - 31.1 building on information that is required under information disclosure obligations;
 - 31.2 targeting the provision of more detailed information on proposed expenditure which is expected to be material to the proposal;
 - 31.3 only requiring information on proposed expenditure that is consistent with the level of detail that would be expected to already be held in a well-run, well-governed business (except for certain verification and audit requirements);
 - 31.4 focusing on requiring information that would be required for all CPP proposals;
 - 31.5 allowing some flexibility in how the applicant engages with consumers prior to submitting a proposal; and
 - 31.6 including audit and verification requirements, only where audit and verification will add value.
32. While we set the CPP requirements with these considerations in mind, we acknowledged that there would be need for refinements to the requirements as our experience with CPPs grew and the regime developed.¹⁹
33. To date we have only set one CPP, which was for Orion New Zealand Limited (Orion), in 2013. Following Orion's CPP, we asked for feedback on the determination

¹⁷ Act requires us to specify verification, consumer consultation, and information requirements, and step change in expenditure is more suited to a higher level of scrutiny etc.

¹⁸ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), at 9.2.5.

¹⁹ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), at 9.2.8.

process.²⁰ This feedback has informed our problem definitions and the CPP changes that are proposed in this topic paper.²¹

We intend to continue to refine the regime over time

34. As highlighted by the changes proposed in this paper, there are opportunities for improvement in the DPP/ CPP regime. While we consider the proposed changes go some way to improving the regime, we do not consider final changes as part of the IM review will eliminate the need for future changes.
35. This is in part because some issues and solutions lie outside of the IMs, but also because we do not consider that there is a single optimal solution for the DPP/ CPP regime that will hold true over time.
36. As we continue to reset DPPs and receive CPP proposals we will identify further opportunities for improvement and continue to refine solutions to issues. Longer term we also expect scope for change to suit a landscape where we have better knowledge of performance and are able to rely more on existing information.
37. In the short term, we intend to continue to evolve the regime by increasing consideration of supplier-specific circumstances in the default path where possible, and reducing the cost and complexity of the CPP process.

Areas for further work

38. We have also identified the following areas for further investigation:
 - 38.1 the materiality of scale effects for smaller suppliers; and
 - 38.2 upfront engagement and the use of flexibility in the CPP process.
39. We discuss each of these areas of focus in more detail in Chapter 4.
40. In addition, we have not yet reached draft decisions on the CPP information requirements IMs for GPBs. This work remains within the IM review and we will continue to liaise with stakeholders in order to establish an appropriate timeline for this work. We will update interested parties on our timing for this work in our anticipated September 2016 process update. As noted in our 29 February 2016 process update paper the reasons why we are not currently proposing draft decisions on these IMs are:²²
 - 40.1 there are no GDBs contemplating a CPP application in the near future;

²⁰ A summary of this feedback, as well as individual submissions, is available at: <http://www.comcom.govt.nz/regulated-industries/electricity/cpp/orion-cpp/>.

²¹ Commerce Commission "Input methodologies review invitation to contribute to problem definition" (16 June 2015) at paras 416-435; and [Commerce Commission "Summary of feedback on Orion customised price-quality path process" \(4 August 2014\)](#).

²² Commerce Commission "Input methodologies review - Process update paper" (29 February 2016) at paras 59-65.

- 40.2 the GTB will be in a better position to engage following the ownership changes; and
- 40.3 the modification and exemptions provisions will allow for flexibility if needed.

Overview of the current regulatory settings and proposed IM changes

- 41. In presenting our draft decisions for the IM review, we think it is useful to explain how we have approached the review of the CPP requirements, and provide a summary of our findings to help illustrate where we currently sit in the development of the DPP/ CPP regime.

The intent of the IMs underlying the default/customised regime remains sound

- 42. The review of the IMs has provided us with an opportunity to consider what improvements can be made to the DPP/ CPP regime.
- 43. In particular, we have considered:
 - 43.1 how DPPs and CPPs complement each other. When setting the initial IMs in 2010, we did not have the experience of how these would work together in practice; and
 - 43.2 specific improvements we can make to the CPP regime, based on our experience in processing the first CPP proposal, and how we have implemented other regulatory instruments under Part 4 (eg, information disclosure) since setting the initial IMs in 2010.
- 44. To provide context for the changes proposed, we consider it important to provide our view of the package of IMs underlying the DPP/ CPP regime.
- 45. Our view is that fundamentally the IMs for DPPs and CPPs are sound, and our proposed changes are incremental improvements aimed at giving better effect to our intent since setting the IMs in 2010.
- 46. For default paths, we consider the current building blocks approach and range of supplier-specific circumstances we are able to take account of strikes an appropriate balance between its low-cost intent and the outcomes sought by Part 4. We set out our views on how our approach to setting default paths meets the purpose of Part 4 in our Main Policy paper for the 2015-2020 default price-quality paths for electricity distributors.²³
- 47. For customised paths, we consider that they remain a viable alternative for suppliers who consider the default path does not meet their particular circumstances. This is illustrated in setting a customised path for Orion in 2013.

²³ Commerce Commission “Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020 – Main policy paper” (28 November 2015).

48. The Orion experience was potentially the most difficult first-up test the CPP regime could have had – a catastrophic event requiring a substantial network rebuild. Despite time pressures and teething issues with the CPP process, we were able to successfully set a path for Orion.
49. We have confidence that future CPP processes will benefit from this experience to run more smoothly, and while we could face a CPP under similar circumstances in the future, we do not expect that a typical CPP proposal would face these issues to the same extent.

Summary of proposed IM changes

50. Table 2.2 presents, at a high level, the package of IM changes proposed for the DPP/ CPP regime.
51. Note that the table is intended to be a summary only and the individual changes are discussed in more detail in the chapters that follow. The exception is the change to remove the separate WACC for CPPs which is explained in the cost of capital topic paper.²⁴

Table 2.2: Summary of package of IM changes proposed for the default/customised regime

How DPP and CPP work together	
Quality-only CPP	Option for EDBs to apply for a quality-only CPP removed and replaced by a quality-only DPP reopener.
Pass-through costs	Pass-through costs may be specified in advance for the forthcoming DPP period as part of the DPP reset process – no longer restricted to specifying these costs during the affected regulatory period.
Prudently incurred expenditure	Allowing the recovery of prudently incurred costs, in response to an urgent project, between when a CPP is applied for and determined.
CPP contingent projects	Allowing the CPP to be reopened for contingent and unforeseen projects, for EDBs and GDBs.
Difference in DPP and CPP WACC rates	A single WACC should apply to all suppliers for the duration of each DPP regulatory period. We have removed the CPP WACC and will reopen CPPs that straddle DPP regulatory periods to take account of the new DPP WACC rate. The reopener is applied mechanically for the sole purpose of taking account of the change in WACC.

²⁴ Commerce Commission “Input methodologies review draft decisions: Topic paper 4 – Cost of capital issues” (16 June 2016).

Information requirements for EDBs	
Modifications and exemptions	Exemption and modification provisions (completed November 2015 as part of IM review) will specify scale as an explicit consideration for us to approve exemption and modification requests. This change will also apply to GPBs.
Duplication	Removing the need to duplicate information between documents, by aligning Schedules D and E with the relevant information disclosure requirements.
Deliverability	Including new requirements for a deliverability plan for the proposed expenditure; and Improving the way in which applicants demonstrate the deliverability of their proposed expenditure with existing requirements.
Asset disaggregation	Simplifying the requirement for forecasting capex projects disaggregated by asset type.
Related party transactions	Changing the requirements for related party transactions to an aggregate level of capex, rather than a project level.
Disaggregation of service categories	Removing the requirement for expenditure to be disaggregated by service categories.
Verifier	
Role and purpose	Adding a new section to the verifier's terms of reference in Schedule G of the IMs that defines the verifier's role, purpose, and obligations.
High level summary	Requiring the CPP applicant to provide us with a high level summary of their application by the time the verifier is engaged.
Communication protocol	Amending the tripartite deed requirements in Schedule F5 to include a communication protocol that sets out the roles and obligations of the parties during the verification process regarding communication, and to allow meeting minutes to be used as the evidential basis for any verifier technical opinions.
Flexibility in number of projects assessed	Allowing the verifier greater flexibility in the number of projects that are verified, the extent of their verification, and the content of the CPP proposal that we review.
Non-standard depreciation	Removing the obligation for the verifier to consider non-standard depreciation.
Removal of independent engineer	Removing requirement for an independent engineer, and allowing suppliers to prepare the quality standard variation report themselves, subject to verification by the verifier (EDBs only).
Audit	
Audit report	Clarifying the requirement for the auditor to provide a report setting out the auditor's opinion on specified matters.
Clarified role – historical v forecast data	Differentiating the role of the auditor with respect to <i>historical</i> financial information and <i>forecast</i> financial information.
Spreadsheets	Removing ambiguity around quantitative information provided in spreadsheets.
Clarified role – proper records	Clarifying the requirement on the auditor to provide a view in respect of proper records being kept.

Consumer consultation	
Price-quality impact of alternative investment options	Amending the consumer consultation IMs to require CPP applicants to notify consumers of the price and quality (EDBs) impact of any alternative investment options in their CPP proposal.
Verifier's view	In support of the change proposed above, we propose amending the verifier Terms of Reference in Schedule G of the IMs to require the verifier to report on the extent and effectiveness of the applicant's consultation.

52. The majority of these proposed changes are to reduce cost and complexity, and to improve the certainty provided by how we specify the IMs.
53. There are also a number of other areas of work outside the IMs discussed in this paper that can be considered improvements to the default/customised regime that are not represented in Table 2.2. These include:
- 53.1 greater tailoring for individual suppliers when setting default paths; and
 - 53.2 upfront engagement and additional guidance for intending CPP applicants.

Chapter 3: Improvements to the way the DPP and CPP work together

Purpose of chapter

54. This chapter picks up on our emerging views on opportunities to improve the way default and customised price-quality paths work together paper and sets out our proposed IM changes to flow on from those emerging views.²⁵

Structure of this chapter

55. This chapter starts by explaining the background to our work on how the DPP and CPP work together. It sets out the emerging views we published in February 2016 on potential improvements to the way the DPP and CPP work together to accommodate supplier-specific circumstances. It then addresses the feedback that we received from stakeholders on those emerging views and sets out our response and introduces our proposed changes to the IMs.

Early emerging views

56. In our problem definition paper, Topic 8 focussed on exploring opportunities to reduce the cost involved in making and assessing a CPP application.²⁶
57. That topic chapter noted a range of options for reducing the cost of better tailoring the price-quality path, including opportunities to reduce the CPP application and assessment requirements, where this could be achieved without compromising our ability to appropriately assess the application. Our proposed decisions on these opportunities are set out in the second part of this paper (Chapters 4-8).
58. Topic 8 of the problem definition paper also touched on the possibility, raised by suppliers, of introducing 'single-issue' CPPs, which would be reduced in scope compared to a regular CPP where customisation is only sought in respect of one part of the supplier's DPP.
59. Rather than considering this suggestion in isolation, we thought it appropriate to step back and consider the range of options that currently exist for tailoring default/customised price-quality paths, and their effectiveness, before considering new mechanisms, such as single-issue CPPs that might provide for factors other than our existing quality-only CPP option.

Emerging views paper

60. On 29 February 2016 we published an emerging views paper on opportunities to improve the way default and customised price-quality paths, including the path change mechanisms within them (ie, pass-through costs, recoverable costs, and reopeners), work together to promote the long-term benefit of consumers.

²⁵ Commerce Commission "Emerging views on opportunities to improve the way default and customised price-quality paths work together" (29 February 2016).

²⁶ Commerce Commission "Input methodologies review invitation to contribute to problem definition" (16 June 2015).

61. In that paper we explained how promoting the long-term benefit of consumers in this context involves striking the right balance of scrutiny in our design and implementation of the DPP, CPP, and the path change mechanisms within them. This is because:
- 61.1 greater scrutiny can impose higher costs on both us and regulated suppliers, which can ultimately be passed on to consumers; but
 - 61.2 greater scrutiny can also benefit consumers by ensuring that regulated suppliers deliver services at more cost reflective price levels for the quality demanded.
62. This recognition of the costs and benefits of scrutiny, together with our experience of having now set a CPP and set and reset DPPs, informs the proportionate scrutiny principle.²⁷ The configuration of the DPP, CPP, and the path change mechanisms within them, should generally aim to accommodate suppliers' circumstances at a level of cost and scrutiny that is commensurate with the materiality of the proposed changes to prices or quality experienced by consumers, within the constraints of the DPP/ CPP regime. Changes that would lead to material increases in prices or a material change in the quality of service should attract greater scrutiny.
63. There are also a number of other factors we will take into account when considering the appropriate level of scrutiny that include:
- 63.1 The level of confidence we already have that the proposed tailoring delivers long-term benefits to consumers. This could be increased by:
 - 63.1.1 the extent to which the supplier's previous forecasts were fit for purpose;²⁸
 - 63.1.2 scrutiny already applied – for example through summary and analysis, or under a previous CPP;
 - 63.1.3 the extent to which a forecast departs from historical trends; and
 - 63.1.4 the level of control the supplier has over a cost.²⁹

²⁷ As well as being consistent with promoting the long term benefit of consumers in a cost effective manner, it is also consistent with Treasury's regulatory good practice principle of proportionality. That is, "the burden of rules and their enforcement should be proportional to the benefits that are expected to result", see: <http://www.treasury.govt.nz/regulation/bpr/bpregpa-feb15.pdf>, at p. 80.

²⁸ Forecasts will never be completely accurate. However, a supplier's ability to justify the difference between actuals and forecasts will contribute to our assessment of whether that forecast was fit for purpose.

²⁹ Where outside the control of a supplier, little is gained from scrutiny, as the supplier does not have the opportunity to affect that cost – hence, it may be appropriate to recover ex-post, or to provide ex ante for it to be recovered (eg, through a pass-through cost mechanism).

Developing our emerging views

64. With this approach to scrutiny in mind, we considered opportunities to provide for greater supplier-specific tailoring in the DPP or price change mechanisms, while still providing an appropriate level of scrutiny, within the legislative bounds of the regime.³⁰ We presented eight emerging views on how we thought the DPP and CPP could be improved to better accommodate supplier-specific circumstances and deliver greater long-term benefits to consumers:
- 64.1 Taking a more tailored approach to setting the DPP where this can be done without significantly increasing cost.
 - 64.2 'Single-issue' CPPs are not appropriate.
 - 64.3 Expanding the role of DPP reopeners.
 - 64.4 The quality-only CPP option should be replaced with a DPP reopener.
 - 64.5 Considering a CPP reopener for contingent and unforeseen projects.
 - 64.6 Considering approval of costs incurred prior to CPP approval.
 - 64.7 Providing for the expansion of the range of pass-through costs that can be added when setting the DPP.
 - 64.8 Applying a proportionate scrutiny principle in continuing to refine the CPP requirements and in assessing CPP proposals.
65. Submissions were generally supportive of our views, though some argued that they did not go far enough.
66. We set out our draft decisions in relation to the emerging views in the sections below, along with consideration of relevant submissions.

A more tailored approach to setting the DPP where this can be done without significantly increasing cost

67. We expressed the emerging view that we would look to take a more tailored approach to setting the DPP where it could be done without significantly increasing cost.
68. Suppliers generally agreed with this view. Vector and Wellington Electricity submitted that we should not exclude the possibility that it may be appropriate to tailor a DPP for a subset of EDBs in some circumstances.³¹

³⁰ Such as the need to ensure that DPP mechanism is low-cost.

³¹ Comments on the emerging views paper are available at: <http://comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/interactions-between-dpps-and-cpps-and-the-requirements-for-cpps/>.

69. We agree that in some circumstances it may be appropriate to treat some groups of suppliers differently under a DPP. For example, it may be appropriate to rely more on the capital and operating forecasts of a subset of smaller EDBs where we have increased confidence in the data (ie, summary and analysis supporting those forecasts is available).
70. We have recently signalled that, as part of the 2017 DPP reset for GPBs, we are considering an approach where we use supplier’s forecasts as a starting point for setting expenditure allowances.³²
71. We will continue to look for opportunities to tailor the DPP, where it can be achieved without significantly increasing costs. At this stage, we consider that the DPP IMs offer sufficient flexibility to allow this, and therefore no changes are needed.

‘Single-issue’ CPPs are not appropriate

72. Our emerging view was that single-issue CPPs are problematic due to:³³
- 72.1 problems with DPP/ CPP regulatory period alignment;
 - 72.2 asymmetry between suppliers and consumers – suppliers could apply to tailor unfavourable elements of a DPP, but consumers could not apply to tailor overly favourable elements;
 - 72.3 interdependencies of inputs with other aspects of the path; and
 - 72.4 suppliers using their one CPP opportunity for the regulatory period to tailor a single parameter.
73. Submissions generally agreed with our view. However some suppliers thought there would still be a place for single-issue CPPs unless there were satisfactory reopener provisions available to compensate for not providing the option of a single-issue CPP.
74. Having considered submissions, nothing has been presented to change our emerging view.
75. We still consider that single-issue CPPs are problematic and there are other mechanisms (such as the DPP quality standard reopener) that we can develop to address some issues instead. In some cases, however, a CPP will be the appropriate mechanism to address the issue, and while we consider that it is appropriate for all

³² Commerce Commission “Default price-quality paths for gas pipeline services from 1 October 2017 – process and issues paper” (29 February 2016), para 3.2.

³³ This is discussed in more detail in our emerging views paper: Commerce Commission “Emerging views on opportunities to improve the way default and customised price-quality paths work together” (29 February 2016).

CPPs to be full scope, we will look to adjust the depth of our scrutiny in line with the proportionate scrutiny principle.³⁴

76. We continue to hold the view that CPPs should always be full scope. By ‘full scope’, we mean that the scope of the application will encompass all inputs needed to set the price-quality path. This means that all inputs are potentially subject to scrutiny. Accordingly, we do not consider single-issue CPPs to be appropriate, and, as such we propose to remove the provisions in the IMs that allow EDBs to apply for a quality-only CPP (although we propose replacing that option with a new DPP reopener).³⁵

Expanding the role of DPP reopeners

77. Our emerging view explained that we were open to expanding the range of circumstances in which we make DPP reopeners available.
78. Specifically, we expressed the view that we thought that new reopener provisions could be appropriate to adjust the quality standards in certain circumstances (replacing the option for a quality-only CPP), and to adjust constant price revenue growth (**CPRG**), early in the DPP period, where new evidence could be provided that the CPRG forecast was inappropriate (for suppliers under a weighted average price cap).
79. Suppliers were generally supportive of expanding the scope of reopener provisions provided for in the IMs, and adding CPRG and quality standard reopeners.
80. A number of suppliers submitted that we should introduce DPP contingent and unforeseen project reopeners.³⁶ Others expressed concern that the Commission would have the ability to initiate a reopener, which would create regulatory uncertainty.
81. We address the following reopeners in turn:
- 81.1 contingent and unforeseen projects for EDBs;
 - 81.2 contingent and unforeseen projects for GTBs;
 - 81.3 quality standard for EDBs; and
 - 81.4 constant price revenue growth.

³⁴ The principle that the level of scrutiny applied should generally be commensurate with the price and quality impact on consumers of the tailoring being sought.

³⁵ We discuss in more detail under the ‘Quality standards for EDBs’ sub-section of the following section on DPP reopeners.

³⁶ The IMs for gas transmission currently provide for a CPP reopener for contingent and unforeseen projects. This allows the customised path to be reopened to build in incremental expenditure for major projects which were not foreseeable at the time the CPP was set, or which were foreseeable, but the timing, scope or cost of the project was uncertain at the time the CPP was set.

82. For completeness, we note that we are also proposing to introduce several other reopeners:
- 82.1 expanded error;
 - 82.2 workability;
 - 82.3 major transactions; and
 - 82.4 DPP/CPP WACC alignment.
83. These reopeners are not linked to our emerging views and are therefore discussed in the Report on the IM review or the topic paper they relate to.³⁷ We provide a summary of these at the end of this sub-section.

Contingent and unforeseen projects for electricity distribution businesses

84. A number of electricity distribution businesses suggested including contingent and unforeseen project reopeners under the DPP.³⁸
85. Generally, we do not consider that reopeners for incremental capex are appropriate. This is because:
- 85.1 we may not have thoroughly scrutinised the base DPP expenditure, so will not know the extent to which the incremental expenditure is already accommodated in the DPP;
 - 85.2 capex is likely to be strongly linked with other inputs such as opex. As such, it would be difficult to adjust in isolation; and
 - 85.3 capex projects are likely to have a significant impact on the price and quality observed by consumers. Therefore they will require a level of scrutiny which we consider is not appropriate under a relatively low-cost DPP mechanism.

Contingent and unforeseen projects for gas transmission

86. Maui Development Limited (MDL) submitted that we should introduce DPP contingent and unforeseen project reopeners for gas transmission businesses along with greater tailoring of the base DPP.
87. They suggest that gas transmission could be distinguished from electricity and gas distribution on the basis that there would be only a single supplier in the industry. They submitted that for a single supplier, the appropriate or proportionate depth of scrutiny could be applied both under a DPP reopener or a CPP.

³⁷ We expect to publish the Report on the IM review on 22 June 2016.

³⁸ See comments from Wellington Electricity Lines Limited, Orion New Zealand Limited, the Electricity Networks Association and PwC, available at: <http://comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/interactions-between-dpps-and-cpps-and-the-requirements-for-cpps/>.

88. We disagree. MDL is effectively requesting that we move to a regime where a DPP will accommodate almost any need for tailoring of a supplier's path.
89. If a project of the magnitude that MDL suggests could be accommodated under a DPP reopener, it would still require significant scrutiny – necessitating information, consumer consultation and verification requirements – which are expressly required to be provided for under a CPP.
90. There is also the issue of who pays for the tailoring under each mechanism. The Commission's costs of considering a DPP reopener are funded through general gas levies which are paid for by both gas distribution and transmission businesses. Under a CPP however the Commission's costs must be billed back to the applicant.³⁹

Quality standards for EDBs

91. Suppliers were generally supportive of expanding the scope of reopener provisions provided for in the IMs by adding a quality standard reopener under a DPP.
92. However a number of submitters expressed concern at our suggestion in the emerging view paper that the Commission would have the ability to initiate a reopener as well as the supplier. Suppliers were concerned that this would create material regulatory uncertainty.
93. There is a natural tension with this issue between offering regulatory certainty over the period, and reducing asymmetry – that is, allowing suppliers to reopen the path to tailor unfavourable elements, without allowing the Commission or consumers the ability to reopen the path to better tailor overly favourable elements.
94. With regards to quality, we consider it appropriate to only allow the path to be reopened on application from a supplier. This is consistent with our proposal to replace the quality-only CPP with a reopener (CPPs can only be initiated by the supplier). We consider that the circumstances in which the Commission would be likely to need to reopen the quality path will be covered by the new "expanded error" reopener that we are proposing.⁴⁰
95. Accordingly, under the proposed quality standard reopener, we may, based on an application from a supplier, reopen the DPP path to vary the quality standards applying to an EDB where:
- 95.1 a supplier can demonstrate that the quality standards set under the DPP do not reflect the realistically achievable performance of the EDB over the regulatory period; and
- 95.2 the EDB submits a quality standard variation proposal that complies with the requirements that will be set out in the IM.

³⁹ Refer section 53Y(1).

⁴⁰ Introduced below at para 103, and explained in more detail in the Report on the IM review.

96. These requirements will be similar to those currently required for a quality-only CPP, which include justifications for the variation, estimations of its effect, and the provision of an engineer's report supporting the variation. However, consistent with a DPP, the extent of upfront requirements needed to support a DPP quality standard reopener will be less than for the existing quality-only CPP.
97. We propose requiring the supplier to provide evidence of the consumer consultation it has undertaken in respect of the proposed standards and the results of that consultation. We are not proposing to prescribe what consultation is necessary to justify a reopener. We consider that this is appropriate given that we have the ability to request further information or consultation before we reopen the path, and that there is a natural incentive for the supplier to provide this information to support their quality variation proposal.
98. Given that the basis for the quality standard variation will be a report from an independent registered engineer, we do not consider that audit or certification will be necessary in all cases. However, we are retaining our ability to require audit or certification of the information before reopening the path if we consider it appropriate.

CPRG

99. In the emerging views paper we identified CPRG as an input that could potentially be adjusted independently of others, and reopened in certain circumstances under a DPP.
100. Suppliers were supportive, though thought our suggestion of allowing the Commission to initiate this reopener would create material regulatory uncertainty.
101. We have considered the possibility of introducing a CPRG reopener, for early in the period. Although we consider that CPRG could potentially be an input that is appropriate for tailoring, separately from the other inputs, we do not consider that there is an obvious need to introduce such a reopener. This is because:
- 101.1 The issue it was designed to address (ie, where new information comes to light early in the DPP period which demonstrates that the CPRG forecast is inappropriate) would largely be fixed by changing the form of control to a revenue cap for EDBs.⁴¹
- 101.2 Our draft decisions on form of control means that only GDBs would be subject to a weighted average price cap, following the next reset. We are not aware of any significant issues specifically related CPRG forecasting for GDBs.

⁴¹ Commerce Commission "Input methodologies review draft decisions: Topic paper 1 – Risk allocation under price-quality paths" (16 June 2016).

Expanded error

102. We propose expanding the current error provision to address the situation where the price-quality path was set on the basis of any type of error. This could include such cases as the data used was incorrect, or the data was correct, but was applied incorrectly. At present, the error provisions are limited to incorrect data and cannot be used to fix cases where, for example, the data was incorrectly or mistakenly applied.⁴²

Workability

103. We propose to introduce a mechanism that will allow us and suppliers to apply the “next closest alternative” approach where an IM becomes unworkable. In the limited circumstances where making the IM workable would involve a change to an existing DPP (or the same occurs because a provision in the relevant s 52P determination becomes unworkable) the reopener would allow us to reopen the path where necessary, to enable suppliers to be able to implement the alternative approach.⁴³

Major transactions

104. The purpose of this change is to provide for a DPP reopener to address the consequences of a major transaction which makes the price path unworkable.^{44,45}

DPP/CPP WACC alignment

105. As discussed in Topic paper 4 – Cost of capital issues, we are proposing changes to align the CPP and DPP WACC rates for suppliers on a CPP. To implement this we are proposing a reopener of a CPP where there is a DPP WACC change.

Replacing the quality-only CPP option with a DPP reopener

106. As discussed above, we expressed the emerging view that the quality-only CPP option should be replaced with a DPP reopener.
107. Submissions agreed with this proposal, provided the quality standard reopener could achieve the same effect as a quality-only CPP.
108. Details of the proposed quality standard reopener are outlined above under sub-section ‘Quality standards for EDBs’.

⁴² This proposed change applies to both DPP and CPPs, and is discussed in more detail in the Report on the IM review at decision RP01.

⁴³ This proposed change applies to both DPP and CPPs, and is discussed in more detail the Report on the IM review at decision RP01.

⁴⁴ This would use the definition of Major Transaction set out in the amalgamations provisions. There would be no materiality threshold.

⁴⁵ This proposed change applies to both DPPs and CPPs, and is discussed in more detail in the Report on the IM review at decision RP01.

Introducing a CPP reopener for contingent and unforeseen projects

109. We expressed the view that we were open to introducing CPP reopeners for contingent and unforeseen projects, for gas and electricity distribution businesses.⁴⁶
110. Submissions were supportive, although a number of suppliers suggested that these reopeners should also be available under a DPP as well.
111. As set out above, we do not consider that it is appropriate to provide for contingent and unforeseen project reopeners under a DPP.
112. However, we propose to introduce contingent and unforeseen project CPP reopeners for gas and electricity distribution. We consider that this is appropriate under a CPP as we have already scrutinised the underlying expenditure when we set the initial CPP. This means that we can build on incremental expenditure for projects where timing, cost and scope were not known at the time we set the CPP, without concerns that the project may be already provided for in the path.⁴⁷

Allowing contingent and unforeseen projects to include opex

113. Under the GTB IMs, contingent and unforeseen projects are currently defined by reference to the need for major capital expenditure. Consistent with our consideration of ‘non-transmission solutions’ when we evaluate a major capex project for Transpower under the terms of the Transpower Capex IM Determination, we consider that the same contingent and unforeseen project provisions should apply where major operating expenditure is required as well.
114. This change should remove any incentives for a supplier to inefficiently class projects as capital expenditure for the purposes of allowing a reopener, even though incurring operating expenditure may be a more appropriate option in the circumstances.
115. We have drafted the new contingent and unforeseen project provisions in the draft IM determinations for EDBs and GDBs to allow for this and we also propose expanding the existing provisions for GTBs to include operating expenditure.

⁴⁶ The IMs for gas transmission currently provide for a CPP reopener for contingent and unforeseen projects. This allows the customised path to be reopened to build in incremental expenditure for major projects which were not foreseeable at the time the CPP was set, or which were foreseeable, but the timing, scope or cost of the project was uncertain at the time the CPP was set.

⁴⁷ More details on how this reopener works can be found in our original 2010 IM reasons paper: Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), paras 9.5.25 - 9.5.37.

Approval of costs incurred prior to CPP approval

116. We expressed the view that we are open to considering ways in which additional net costs (over and above those provided for in a DPP determination), prudently incurred in response to an urgent project after a CPP has been submitted but prior to the beginning of the CPP period, can be recovered during a CPP period.
117. Submissions were supportive, though a number of suppliers requested that we should also allow for the recovery of prudently incurred expenditure, in response to an urgent project, that is incurred before a CPP is submitted.
118. We do not consider it appropriate to extend the recovery of costs to costs incurred prior to the CPP submission. We consider that this would remove the incentive for applicants to submit a proposal in a timely manner. Further, we consider that it is desirable to minimise the level of controllable expenditure that is approved ex-post.
119. We consider that the best way to implement this policy is through using a new recoverable cost allowance. This cost will allow suppliers to recover prudently incurred costs in response to an urgent project where:
- 119.1 the costs are incurred between the submission of a CPP application and the determination of a CPP;
 - 119.2 the CPP is accepted for consideration by the Commission; and
 - 119.3 the Commission approves the cost by specifying it in the CPP determination.
120. We would retain the discretion to decline the recovery of pre-determination costs that were not considered to be consistent with the “investment case” submitted and approved as part of a CPP application.

Expanding the range of pass-through costs that can be added when setting the DPP

121. We expressed the view that we should widen the criteria-based pass-through costs,⁴⁸ which can currently only be specified during the regulatory period, to also be able to be specified in a DPP or CPP determination at the time the DPP or CPP is determined. We also suggested that we would provide for adding any type of cost, which meets the pass-through cost criteria in the IMs, to potentially be specified as a pass-through cost in a DPP determination, rather than just levies.
122. Submissions were supportive of this proposed change.
123. Accordingly, in our draft amended IM determinations, we have redrafted these provisions to implement these proposed changes.

⁴⁸ The current IMs also provide the opportunity for us to specify new pass-through costs during a regulatory period in circumstances where a levy or other cost meets the criteria for a pass-through cost, set out in the IMs (criteria-based pass-through costs).

Costs of preparing a CPP

124. Some suppliers have suggested that we widen the definition of recoverable costs to include certain additional costs associated with preparing a CPP application, such as costs of consumer consultation, costs of developing a financial model, consultant reports and project management.^{49,50}
125. We do not consider that it is appropriate to introduce these proposed recoverable costs. While we consider that it is appropriate that some of the costs of applying for a CPP can be recovered from consumers, we consider that having the supplier bear some of the cost of preparing a CPP application creates appropriate incentives for the supplier to minimise the costs of preparing a CPP.
126. We also note that, following the introduction of an incremental rolling incentive scheme (**IRIS**) that applies to suppliers subject to a DPP, the impact of any temporary costs not directly recoverable from consumers, will be shared between consumers and suppliers. Under the current IRIS rules suppliers only bear about 34% of these temporary costs.⁵¹

We have applied the proportionate scrutiny principle in continuing to refine the CPP requirements and in assessing CPP proposals

127. We presented the view that there are opportunities for us to be more targeted in the depth of scrutiny we apply when assessing a CPP proposal informed by:
- 127.1 the proportionate scrutiny principle (ie, the level of scrutiny applied should be commensurate with the price and quality impact on consumers of the tailoring being sought);⁵² and
- 127.2 the extent to which we have confidence in the supplier's own forecasts.⁵³

⁴⁹ See: ENA "Feedback on Orion customised price-quality path process" (14 April 2014), Orion Limited "Feedback on Orion customised price-quality path process" (14 April 2014), and PwC "Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015).

⁵⁰ We currently allow audit, verification and independent engineer fees to be recovered.

⁵¹ Commerce Commission "Further amendments to input methodologies for electricity distributors subject to price-quality regulation - Incremental Rolling Incentive Scheme" (25 November 2015).

⁵² Commerce Commission "Input Methodologies Review – Emerging views on opportunities to improve the way default and customised price-quality paths work together" 29 February 2016, para 35.

⁵³ Our level of confidence in each input will depend on the extent to which that input has already been scrutinised when we set the base DPP, or through summary and analysis. For example, if a supplier is seeking a CPP to accommodate a large, one-off, item of project expenditure, it might appropriate for the verifier and ourselves to apply a lower level of scrutiny to business-as-usual expenditure, and for scrutiny to be focused on the increment being sought.

128. We explained that the proportionate scrutiny principle has also guided our approach to the proposed changes to reduce unnecessary cost and complexity in the CPP requirements by:
- 128.1 making improvements to the scope and specificity of the information requirements for CPPs;
 - 128.2 clarifying the roles of the independent verifier, auditor and independent engineer, consistent with s 52R; and
 - 128.3 clarifying our consumer consultation expectations, also consistent with s 52R.
129. Submissions were generally supportive of this view, though there were a number of requests for clarification as to how the proportionate scrutiny principle would work in practice. There were a number of suggestions by submitters that are dealt with in turn below.
130. We conclude this section with our views on the aims and benefits of applying the proportionate scrutiny principle to CPPs.

Case by case negotiation of information requirements

131. Orion suggested that the IMs could usefully include a process for suppliers to engage with the Commission on which items within a CPP would and would not need detailed scrutiny (in accordance with the proportionate scrutiny principle).⁵⁴ The supplier could then tailor their proposal accordingly and only incur significant costs in preparing those aspects of the application that are most material.
132. Conversely though, Vector submitted that while the proportionate scrutiny principle could reduce barriers of cost and complexity for parties seeking a CPP, it is still important that when setting the process to strike the right balance between prescription and the ability of the Commission to exercise discretion.⁵⁵ Vector commented that if there was inconsistency in the level of scrutiny applied to individual cases, this will lead to a lessening of confidence in the process.
133. We considered the possibility of introducing a process which would allow us to, on a case by case basis, agree to reduce the information requirements for non-material aspects of a proposal. This could operate in a similar way to the exemption and modification provisions introduced as part of the CPP fast track amendments.
134. However, bearing in mind Vector's submission and the need to promote certainty under s 52R, we consider that it is appropriate to retain the full set of base information requirements (that is information required for all expenditure categories

⁵⁴ Orion "Submission on emerging views on opportunities to improve the way default and customised price-quality paths work together" (23 March 2016), para 15.

⁵⁵ Vector "Emerging views on customised and default price paths" (24 March 2016), para 9.

– not the detailed information that needs to be provided for the identified projects). This is because we consider:

- 134.1 this information should, generally, be relatively easy to compile (does not contribute significantly to cost); and
 - 134.2 this information is likely to be valuable to our assessment of the proposal and will be crucial if we need to determine revenues that differ from the CPP proposal. Given the limited time available to determine a CPP, we consider that it is beneficial to have this information up front, rather than to request it during the assessment process.
135. We also consider that it is appropriate to apply the modification and exemption provisions,⁵⁶ in line with the proportionate scrutiny principle, on a case by case basis, as intended – where it will not materially detract from our ability to assess a proposal.⁵⁷

Rolling over information requirements for subsequent CPP applications

136. Vector requested that we provide for a CPP rollover mechanism – where a supplier already subject to a CPP wishes to apply for a second or subsequent CPP on substantially similar grounds.⁵⁸ They suggest that in these cases the supplier would not need to replicate the original application. Rather, the application would focus only on updating the information supplied in the original application.
137. Where scrutiny has already been applied through a previous CPP, we think it is appropriate to consider using the exemptions and modification provisions to reduce the scrutiny requirements,⁵⁹ to the extent that it doesn't materially detract from our ability to assess a proposal.
138. For example, where historical information, which is required as part of a CPP proposal, has already been audited under a previous CPP, we may consider exempting an applicant from those audit requirements for the same information in a subsequent CPP application.
139. We consider this to be a practical approach to the issue, taking advantage of our existing provisions that allow for flexibility.

⁵⁶ These allow suppliers to agree with the Commission to exemptions and modifications from the requirements for a CPP proposal application, where it will not detract, in more than a minor way, from the Commission's ability to evaluate and determine a CPP proposal, or the ability of interested persons to consider a provide views on the proposal.

⁵⁷ For example where specific information requirement is not readily available, but adds little to our assessment of the proposal.

⁵⁸ Vector "Emerging views on customised and default price paths" (24 March 2016), para 10.

⁵⁹ The IM requirements for information, consumer consultation, audit and verification, as well as how we assess an application.

140. We recognise the potential benefits in doing sequential CPPs and may look to develop a more specific process in the future. When we have more experience in setting CPPs we will be in a better position to assess the extent to which a prior CPP can give us greater confidence in a supplier's forecasts for a subsequent CPP (and the extent to which we can relax the requirements as a result).
141. Some stakeholders have suggested that we develop IMs to govern the process for how we will treat a supplier who is transitioning from a CPP back onto a DPP.⁶⁰
142. As explained in our paper on Orion's transition to the 2015-2020 DPP,⁶¹ we do not consider that it is necessary to include a prescriptive process for the transition from CPPs to DPPs in the IMs.
143. We consider a better transition option is to address this as part of our engagement process outside of the IMs, which provides flexibility to consider the specific supplier's circumstances at the time of the transition.⁶²

Aims and benefits of a proportionate scrutiny principle

144. When considering the appropriate mechanism for tailoring an aspect of a CPP, the level of scrutiny that is appropriate for that tailoring will be a key factor.
145. Where the benefits of scrutiny (that is the benefits received by consumers due to a path which results in a level of revenue that is more commensurate with the level of quality demanded) are outweighed by the regulatory costs of the scrutiny, then a lower level will likely be more appropriate. This is more likely to be the case for small suppliers where they do not have the scale to spread the regulatory costs, and therefore the cost of scrutiny may itself have a potentially material price effect. We discuss the possible challenges faced by smaller suppliers in applying for a CPP and our proposed approach in Chapter 4.
146. We consider that there are opportunities to apply the proportionate scrutiny principle when setting the requirements for, and assessing, the different elements of a CPP ie, we will focus our assessment on the more material parts of a proposal, including:
- 146.1 the scope and specificity of information requirements;
- 146.2 verification and audit requirements;
- 146.3 consumer consultation expectations; and

⁶⁰ Orion (Orion New Zealand Limited "Submission on the IM Review" 21 August 2015, paragraph 37), ENA (Electricity Networks Association "Response to the Commerce Commission's Input Methodologies review paper" 21 August 2015, paragraph 124).

⁶¹ Commerce Commission "Orion's transition to the 2015-2020 DPP – Key considerations and possible approaches" (14 March 2016).

⁶² Refer paragraphs 28-35 of: Commerce Commission "Orion's transition to the 2015-2020 DPP – Key considerations and possible approaches" (14 March 2016).

- 146.4 our evaluation of the CPP proposal to satisfy the evaluation criteria.
147. We have looked to apply the proportionate scrutiny principle to CPPs, where possible, through our design of the CPP requirements and our proposed changes.
148. Exercising our discretion and judgement, particularly in relation to the flexibility provided for under our modifications and/or exemptions provisions (introduced in the fast track part of this review) will be an ongoing requirement.

Chapter 4: Evaluation of CPP proposals

Purpose of this chapter

149. The purpose of this chapter is to explain and clarify our approach to evaluating CPPs, including how the CPP requirements support that approach. It also introduces the changes we are making to the CPP requirements.

Structure of this chapter

150. This chapter begins by setting out our high level objectives for CPPs. It then explains how we evaluate CPP proposals, and how the CPP requirements, set out in the IMs, support that evaluation. Finally, it introduces the changes that we are proposing to make to the CPP requirements to better achieve our objectives and better support our evaluation and determination of CPP proposals. We also explain our proposed changes to address the possible challenges that a smaller supplier might face when applying for a CPP.

Objectives for CPPs

151. This section sets out our current and forward-looking high level objectives in respect of CPPs.
152. We consider that CPPs should be used where they can better promote the long-term benefits of consumers than a DPP.
153. When a supplier applies for a CPP we have the opportunity to set a more tailored price-quality path than under a DPP.⁶³ This allows us to better match the path to the supplier's specific circumstances and better promote long-term benefits for consumers.
154. In applying scrutiny to the tailoring proposed and developing or approving comprehensive capex and opex forecasts, we ensure that the CPP applicant is able to make efficient expenditures to provide a level of quality that reflects consumer demands, while also being limited in its ability to extract excessive profits, consistent with the s 52A purpose.
155. Our aim is to make the CPP application process as cost-effective and straightforward as possible, while still ensuring that we are able to evaluate and determine a CPP in the statutory timeframes, at an appropriate level of scrutiny (in line with the proportionate scrutiny principle, discussed above in para 62).

⁶³ By "tailored" we mean a price-quality path that better takes into account the supplier's specific circumstances. Greater tailoring can better promote the long-term benefit of consumers where it ensures that the price-quality path provides for efficient investment and rewards superior performance with greater profits, but not to the point that those profits are excessive.

156. To support a CPP regime that gives effect to these objectives:
- 156.1 We understand a degree of flexibility is desirable in the format and level of information suppliers are required to supply. We have already introduced a level of flexibility as part of the CPP fast track amendments.⁶⁴ These IM amendments were aimed at improving the cost-effectiveness of preparation, assessment and determination of CPP applications by allowing:
 - 156.1.1 modifications or exemptions to the process for preparing, and content of, CPP proposals;
 - 156.1.2 the use of alternative methodologies with equivalent effect (**AMWEEs**) for certain elements of CPP proposals; and
 - 156.1.3 allowing us to accept CPP applications for consideration if they comply with the process and content IMs “in all material respects”.
 - 156.2 We consider it important that we provide clarity as to the role and purpose of the verifier, auditor, and our expectations for consumer consultation.
 - 156.3 We will focus our evaluation, where possible, on the drivers and most material elements of proposals (in line with the proportionate scrutiny principle).
 - 156.4 We are making a change to ensure there are no perverse incentives created through a misalignment between the DPP and CPP WACC rates (our proposed solution to the DPP CPP WACC misalignment issue is discussed in Topic paper 4 – Cost of capital issues).
157. Apart from making improvements to the CPP requirements as part of the IM review, there are opportunities for us to make it more likely suppliers will apply for a CPP where that results in greater benefits to consumers, including through:
- 157.1 Clarifying for suppliers the opportunities for tailoring provided by the CPP option and other available tailoring mechanisms, through ongoing engagement;
 - 157.2 Building on the lessons learned during the Orion CPP process, and improving our internal processes for the next CPP application we receive; and
 - 157.3 Through improving and encouraging upfront engagement with suppliers considering and preparing CPP proposals.

⁶⁴ Commerce Commission “Input methodologies review: Amendments to input methodologies for customised price-quality paths – Final reasons paper for limb 1 of the CPP fast track” (12 November 2015).

How we assess CPP proposals

158. This section explains our approach to how we evaluate CPP proposals. Our approach is not set out in the IM requirements for CPP proposals – rather the IM requirements support our evaluation of a CPP proposal using this approach.

High level components of a CPP proposal

159. At any time after a DPP is set,⁶⁵ a supplier that is (or is likely to be) subject to a DPP may make a proposal to the Commission for a CPP.⁶⁶

160. We have broad discretion under Part 4, as to exactly how we determine a CPP and we may determine any CPP that we consider appropriate, applying the relevant IMs.⁶⁷ This means that once we have received a CPP proposal there are two steps we must undertake:

160.1 evaluating the applicant's proposal; and

160.2 determining a customised path that we consider to be appropriate. This may be the path proposed by the supplier, or a higher or lower path, if we consider that the proposal is not appropriate.^{68, 69}

161. We consider that the use of a building blocks approach to determining expenditure, with a greater emphasis on supplier-specific costs than under a DPP, continues to be necessary to determine a CPP that is appropriately tailored to the supplier's specific circumstances.

162. A proposal to support a building blocks approach for determining a CPP broadly is comprised of three parts:

162.1 Price path information – this comprises the financial information – such as information on cost allocation, valuation, depreciation, tax, forecast opex, forecast commissioned assets and other income – that is used to create the price path. The compilation of this information is primarily governed by the input methodologies.

162.2 Proposed expenditure information – this comprises forecasts of capital expenditure and operating expenditure and information on policies, strategies, assumptions, data, processes used to develop these forecasts. Higher forecast levels of capital and/or operating expenditure will typically be the driver of a CPP application, and as such, will require specific focus when evaluating a CPP.

⁶⁵ Within the application windows specified in a 52P determination, and not in the final year of a DPP.

⁶⁶ Commerce Act 1986, s 53(Q)(1).

⁶⁷ Unless a variation to the IMs has been agreed with the supplier, under section 53V(2)(c) of the Act.

⁶⁸ Commerce Act 1986, s 53V.

⁶⁹ This will involve determining and explaining what we consider to be an appropriate level of expenditure that meets the expenditure objective.

162.3 Quality variation information – where a quality standard variation is proposed, information to justify the variation must also be provided.

Assessment of expenditure

163. A key component of our evaluation of a CPP proposal is the assessment of the applicant’s expenditure forecasts.
164. Expenditure will often be the driver of a CPP application, and as such, will require specific focus when evaluating a CPP to ensure the path provides for a level of expenditure that allows the supplier to meet consumer demands at an efficient cost.⁷⁰ Forecasting appropriate levels of expenditure will require the exercise of judgement by both the supplier as well as the Commission.
165. We consider the approach to assessing expenditure that we set out in the 2010 IM reasons paper is still broadly appropriate. This section clarifies some elements of our approach, particularly in light of our experience in evaluating Orion’s CPP application, and explains how it links with the proportionate scrutiny principle.⁷¹

What we are trying to establish when assessing expenditure

166. Broadly, we need to be satisfied that the proposed expenditure is consistent with what would, and could, be delivered by a prudent supplier – the right expenditure, at the right time, at the right cost. Ensuring the CPP applicant recovers the costs that a prudent supplier would incur to efficiently provide the regulated services at a quality that consumers demand is consistent with s 52A(1)(a), (b) and (d).⁷²
167. To establish if the proposed expenditure under a CPP is consistent with this objective, we consider it appropriate to use a predominantly top-down assessment approach. This requires us to obtain assurance that the proposed expenditure is appropriate to meet consumer demands,⁷³ (including quality) and regulatory requirements, (outside of Part 4 regulation) that the supplier must meet.⁷⁴
168. Our assessment will consider whether:
- 168.1 the proposed investments align with the service outcomes;

⁷⁰ In line with s 52A(1)(b) of the Commerce Act 1986.

⁷¹ Explained above under sub-section ‘We should apply a proportionate scrutiny principle in continuing to refine the CPP requirements and in assessing CPP proposals’.

⁷² Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), p. iv.

⁷³ Meeting consumer demands means that the supplier will deliver appropriate service (quality) standards, to meet expected demand.

⁷⁴ Suppliers must also be able to meet any regulatory requirements outside Part 4 – such as health and safety regulations.

- 168.2 the projects can be delivered at the right time, within the bounds of the planning uncertainties;⁷⁵
- 168.3 the processes for delivering the expenditure are efficient; and
- 168.4 the supplier has adequate strategies for accessing the necessary resource to undertake an increased level of expenditure.⁷⁶

Our approach

169. While we consider that it is appropriate to obtain assurance that the proposed expenditure is consistent with the efficient costs that would be incurred by a prudent supplier facing the same circumstances as the applicant, this does not mean that we will undertake a detailed assessment of the supplier's entire spending programme. Rather we will undertake a "top-down" approach to assessing expenditure supported with a limited "bottom-up" review of selected projects and programmes.
170. The top-down approach initially focuses on the supplier's policies, strategies and processes. This provides us with an understanding of how the business says that it will manage its assets to deliver the services required by consumers. We assess the supplier's policies, strategies and processes to ensure that, if they are implemented in practice, they will produce appropriate expenditure forecasts.
171. We then assess whether the development of the proposed expenditure forecast has been consistent with the policies strategies and processes. We would do this by sampling a subset of projects and programmes. This assures us that high level policies strategies and processes are being implemented consistently and that the right investments are being proposed.
172. A further step in our top-down approach is to assess the appropriateness of the input assumptions used by the business when forecasting expenditure. We would also expect to consider the level of confidence that can be placed on any data used by the supplier when forecasting expenditure. This will include consideration of the source, reliability and quality of the information together with the reasonableness of any assumptions made to fill data gaps.
173. As is discussed further below, a key aspect of our expenditure assessment approach is the use of a pre-application verification of proposed expenditure by an approved independent verifier. The independent verifier is responsible for selecting the sample of projects and programmes, and focuses on the most material projects, in line with the proportionate scrutiny principle. This pre-application verification process is intended to promote certainty for suppliers as to how their expenditure is likely to be assessed, as well as to assist us to make the most effective use of the tight statutory

⁷⁵ For the purposes this paper references to projects may also include programmes, which are defined in the IMs as a group of related projects with a common purpose.

⁷⁶ We would not consider it appropriate to increase prices to consumers if the investments are unlikely to occur due to resource constraints.

timeframes for evaluating CPP proposals, by highlighting which areas of a proposal we should focus on.

174. We will supplement our top-down assessment with a limited bottom-up review of areas highlighted by the verifier. We expect this review will complement, rather than repeat, the verifier's assessment. For example, where the verifier's final report identifies that the applicant does not appear to have followed its own planning standards for network or asset replacement, it would highlight this was an area that we needed to review.
175. We, rather than the verifier, are required to determine the appropriate level of expenditure. Therefore, we would also expect to review the models used to prepare the forecasts, and consider if the outputs and conclusions from the models are reasonable.

Proportionate scrutiny/materiality

176. We expect that in applying this top-down approach, we will require a higher level of assurance for more material elements of a proposal, in terms of the potential impact on price and quality. This is consistent with the proportionate scrutiny principle which provides that the scrutiny that an element of a CPP proposal receives should be commensurate with the potential impact of that element on price and quality.
177. The more material elements of a proposal may or may not be a small number of large individual projects. It is possible that the material elements will be formed by one or more programmes made up of several smaller work parcels.
178. As discussed in the verification chapter, the proportionate scrutiny principle is also applied by the verifier as part of their choice of projects that require more specific information on and which have a greater level of scrutiny applied.

Evaluation of price path information

179. In addition to assessing the applicant's expenditure forecasts, our evaluation involves ensuring that IM-compliant financial information relating to key 'building blocks' components is used appropriately to calculate the proposed price-quality path.
180. The way the price path is compiled is defined by the various building block IMs, and the process is largely mechanistic. As noted in our 2010 reasons paper, this promotes certainty and predictability of processes for both suppliers and the Commission.
181. However, there are some areas where the IMs provide flexibility for particular cases, which requires us to exercise our judgement. There are also instances where suppliers may propose variations to the building block IMs under s 53V(2)(c) of the Act, and we will assess these proposals in order to determine an appropriate price-quality path.
182. Our assessment of the price path typically involves a number of steps, such as conducting high level reasonableness checks that forecast information is consistent with the disclosure of past financial data (or, if not, that the applicant has

satisfactorily explained why). We would also seek to establish that expenditure forecasts have the appropriate effect on building block elements such as the regulatory asset base (**RAB**), depreciation and revaluations, and we would assess the overall profile of the price path to understand whether ‘in-period’ smoothing of revenues via the price path ‘X-factor’ is desirable.

Evaluation of quality standard variation information

183. Suppliers may request a quality standard variation to either decrease, or in some circumstances increase, their quality standards. Where a CPP applicant applies for a quality standard variation as part of a CPP, we will also evaluate the proposed variation. At the highest level we will consider the extent to which the proposed quality standard reflects the realistically achievable performance of the EDB.
184. As part of our evaluation of a proposed quality standard variation we are likely to focus on:
- 184.1 the extent that the quality standard variation and the cost (trade-off) is supported by consumers (and if not, why not);
 - 184.2 the components of reliability that are driving the change in quality performance;⁷⁷
 - 184.3 any historical reasons for the deterioration in the drivers;
 - 184.4 an assessment of whether the applicant made prudent historical decision to manage any deterioration;
 - 184.5 the extent to which the proposed quality standards align with the level of investment proposed in the proposal; and
 - 184.6 statistical analysis of past SAIDI and SAIFI performance.

CPP requirements that support our evaluation using this approach

185. This section explains the CPP requirements that support our evaluation of a CPP proposal in line with the approach discussed above, and how they should be designed to ensure we are able to evaluate and determine a CPP that delivers long-term benefits to consumers.

Supplier must provide a proposal

186. A supplier is required to supply us with a proposal which sets out their proposed expenditure and must contain certain information that supports the expenditure. This proposal must be fit for purpose – that is it must allow us to undertake an assessment of the proposed expenditure and determine an appropriate customised price-quality path.

⁷⁷ For example: failure rates due to vegetation, equipment failure, or human error.

187. A proposal that is fit for purpose will clearly demonstrate that the expenditure forecast represents the efficient costs that the supplier needs to incur to meet the services required by the consumers. To do this a fit for purpose proposal will have:

187.1 Appropriate scope and specificity of information (specifying information requirements helps ensure this);

187.2 Information that we have confidence in and can rely on (this is assisted by requiring the supplier to have the proposal independently verified and audited); and

187.3 Evidence of how the supplier has determined the services required by consumers (as specified in the consumer consultation requirements).

188. We discuss each of the above requirements below.

Information requirements – appropriate scope and specificity of information

189. The CPP information requirements should ensure that we have sufficient information to be able to assess the applicant’s proposal and minimise the need to seek additional information after it has been submitted, and set an appropriate level of expenditure.

190. We consider that there is a place for both flexibility and prescription in the IM requirements.

190.1 Prescription helps us ensure that we have the information we need in a CPP proposal to determine a path in the short statutory time frame.

190.2 However, flexibility can be used to focus the information required on the elements of the proposal that are most material (such as those driving the application or that have the greatest potential impact on price and quality). It can also allow suppliers to provide information in a timely and cost-effective way that aligns with their existing business practices.

191. The following paragraphs explain how we provide for both flexibility and prescription in our information requirements.

Base information – prescription

192. While the level of scrutiny that we apply to some elements may vary depending on the level of assurance we attain at a high level, and the materiality/impact of the element on price and quality, we consider that the base information requirements should be the same for all expenditure elements of a CPP proposal (this does not include the detailed information required for specific projects that are selected by the verifier).

193. It will not always be possible to determine what elements of a CPP proposal will require specific focus until we receive a completed application. Given this it is

appropriate that all base information is required to be provided with a proposal to enable a top-down assessment to be undertaken.

Modifications and exemptions – flexibility

194. While we consider that it is generally preferable to have prescriptive information requirements to ensure we are able to determine a CPP in the statutory timeframes in some circumstances added flexibility is appropriate.
195. The exemption and modification provisions that we introduced as part of the CPP fast track process, allow us to agree with an applicant to modify or remove specific information requirements, provided it does not detract from our ability to assess a CPP proposal in a way that is more than minor.
196. We will use these provisions, where appropriate, to further reduce the cost and complexity of the information requirements, in line with the proportionate scrutiny principle, for example, where a supplier can provide the same information in a different format which better aligns with their existing business practices. If the provision of the information in that way does not impair our ability to evaluate the proposal, we are likely to agree to a modification to the information requirements to allow this.
197. We also consider that it will be appropriate to use the modification and exemption provisions to take account of supplier scale (discussed below in para 204).

Detailed information – flexibility

198. We already also provide for flexibility in the more specific detailed information which we require from a sample of “identified” projects in order to ensure that high level policies and strategies are implemented (discussed at paras 323-328). This information is required from a sample of material/high impact projects selected by the verifier, rather than all projects. The selection of projects will depend on the specific proposal. We consider that the verifier is in the best position to decide how this flexibility should be exercised to ensure that a fair sample is taken that will allow the verifier to gain sufficient assurance.
199. In our 2010 IM reasons paper we stated that the expenditure information required in a CPP proposal was likely to be analogous to that typically supplied to a supplier’s Board. On reflection, the provision of more detailed information will likely be necessary in order to appropriately determine the appropriate level of expenditure proposed in a CPP.

The relevance of supplier scale

200. In our 2010 IM decisions we also stated that we considered that the same information requirements should be set for suppliers of all sizes, as the same type of supporting information for proposed expenditure is relevant to all suppliers. We also said that we expected to apply the same degree of scrutiny to all proposals, regardless of size.

201. In theory, if a supplier was proposing a major increase in expenditure under a CPP we would ideally want to undertake a detailed review of that expenditure, regardless of the supplier's size – and only apply a reduced level of scrutiny if the expenditure under consideration is relatively low. If the CPP proposes to impose a material impact on consumer prices then, it is appropriate that the supplier would have to fully justify the increase. Consumers should be entitled to the same level of scrutiny irrespective of the size of the regulated supplier.
202. However, in practice, many of the costs associated with preparing, verifying and evaluating a CPP might not reduce significantly for a smaller supplier. Therefore, for smaller suppliers, the cost of applying for a CPP, could be significantly high compared to the supplier's total revenue, and subsequently the cost of applying for a CPP will have a material impact on the price path (as some of the costs of applying for a CPP can be passed directly on to consumers). In these cases the regulatory cost of higher scrutiny on a per consumer basis may well outweigh the benefit of that scrutiny to the consumer (through determining a "better", more robustly scrutinised, price-quality path).⁷⁸
203. On reflection, we acknowledge the increased burden that a CPP could potentially be for small suppliers.
204. We consider that it may be appropriate in some circumstances to take account of the supplier's size when exercising our judgement in applying the modification and exemption provisions introduced as part of the CPP fast track.⁷⁹ For example, where a small business simply did not hold the information required, or it was completely unrelated to their proposal. Accordingly, we propose that we expressly specify in the IMs that the scale of the business and materiality of the CPP proposal on consumers will be factors that we will consider when deciding on whether to approve an exemption or modification.
205. We also consider that the scale of the supplier could be taken into account by the verifier in exercising their judgement in choosing identified projects for detailed review and for which more detailed information must be provided (discussed further below in Chapter 6).
206. Looking forward, we will also continue to assess the ongoing viability of CPPs as the regime develops – including whether they are viable for smaller businesses (there could be a role here for summary and analysis to determine this).

⁷⁸ The example of Centralines coming in for a CPP demonstrates the extreme end of the scale. If the CPP preparation, verification and evaluation cost were \$1 million (possibly a conservative estimate), this would be a regulatory cost of \$120 per consumer, across Centralines' 8,500 strong consumer base.

⁷⁹ Commerce Commission "Input methodologies review: Amendments to input methodologies for customised price-quality paths – Final reasons paper for limb 1 of the CPP fast track" (12 November 2015).

Information that we can rely on – verification and audit

207. In order to ensure that we can evaluate and determine an appropriate customised price-quality path, we need to be able to rely on the information contained in a CPP proposal. As already discussed, we have a limited statutory timeframe in which we are able to do this.
208. The use of an independent verifier and auditor helps us ensure that we can rely on the information provided as part of a CPP proposal, so we can focus our evaluation on the key drivers of a CPP proposal.

Verification

209. We have a verifier to help support our assessment by ensuring that we can rely on the forecast capital expenditure, and operating expenditure included in the proposal that we receive from an applicant.
210. The key tasks assigned to the verifier are to:
- 210.1 provide an assessment of whether the CPP applicant’s policies, strategies, and procedures are appropriate such that services will be provided efficiently and align with consumer demands;
 - 210.2 ascertain whether these policies, strategies, and procedures have been applied in practice;
 - 210.3 review the material aspects of the proposed CPP to ensure that it is sufficiently complete in content and that it supports the expenditure objective,⁸⁰ prior to the Commission review; and
 - 210.4 assess and report on the reasonableness of the assumptions made or practices used in developing the information that supports the CPP application, and to then report on any aspects that may warrant an in depth review by the Commission.
211. The verifier also has a role in selecting a sample of “identified” projects for which more detailed information is required (as discussed in Chapter 6).

Audit

212. The auditor has a similar role to the verifier, but with a focus on providing us confidence in the quality of financial and quantitative information. The auditor’s role is to ensure that financial and quantitative information provided is robust, reliable, and in compliance with applicable IMs.

⁸⁰ The expenditure objective is one of the evaluation criteria discussed in paras 221-223.

Consumer consultation

213. Setting a price-quality path that reflects consumer demands is an important consideration in determining a CPP that delivers long-term benefits to consumers.
214. Accordingly, we require that suppliers notify consumers of their proposed CPP application, and provide an opportunity for consumers to comment. This consultation should be meaningful and the supplier should, where possible, use it to support its proposed expenditure. This is particularly important when a supplier is proposing expenditure that will have a material impact on the price paid for services by consumers, or there is likely to be a significant change in the service quality experienced by consumers, or both.
215. The current consumer consultation IMs require suppliers to inform and engage with consumers on the implications of the CPP proposal for consumers. We have previously seen that consumer consultation has been undertaken at a relatively high level, often with a starting presumption that consumers demand the current level of service, and survey questions that do not allow consumers to provide informed views on the trade-off between price and quality.
216. To support a CPP proposal, which by its nature is likely to include some step change in expenditure and/or service, we would expect that affected consumers will have been supplied with sufficient information on the likely outcomes for a range of investment scenarios. As a minimum, the information should allow consumers to make informed choices on relevant price and quality trade-offs.
217. We acknowledge that the supplier may have a better understanding of the need for network investment than its consumers, which is why we do not require consumer agreement. Rather, we will take the extent of consumer support into account when assessing the proposal, along with the supplier's explanation of this support (or opposition).

The CPP submission timeline – how the process comes together

218. All of these components come together as part of the CPP process. We have published a diagram at Attachment A which sets out a high level, indicative timeline, to illustrate how the process is intended to work in practice.

Summary of improvements to the CPP requirements

219. This section summarises the changes that we are proposing to make to the CPP requirements that support our evaluation of CPP proposals, which are explained in greater detail in the following chapters.
220. We consider that the intent of the CPP requirements IMs is generally still sound. However we are proposing to make a number of amendments to provide greater clarity and certainty, and to reduce the cost and complexity of the CPP process, in line with the IM review framework.

Evaluation criteria

221. We have reviewed the CPP evaluation criteria set out in the IMs and consider that it supports our approach to evaluating CPP proposals outlined above.
222. We are not proposing any changes to the evaluation criteria as set out in the current IMs.
223. We have also provided additional clarification as to how we intend to evaluate CPP proposals against these criteria.

Information requirements

224. At a high level, the changes we are proposing to the CPP information requirements are mostly intended to reduce the complexity and compliance costs of the CPP information requirements, and to focus these requirements on what is most material to price and quality.⁸¹ Where possible, our intent is for the information required in CPP applications to leverage off existing regulatory disclosures under ID, including AMPs. At this stage, our proposals relate to EDBs only, as we are deferring consideration of changes to the detailed information requirements for GPBs.
225. We are proposing the following changes to Schedules D and E:
- 225.1 To reduce the cost and complexity of preparing a CPP proposal we are:
- 225.1.1 removing the need to duplicate information between documents, by aligning Schedules D and E with the relevant information disclosure requirements;
- 225.1.2 removing superfluous information;
- 225.1.3 aligning the expenditure tables in Schedule E with the ID requirements, where appropriate;
- 225.1.4 removing the requirements for forecasting capex projects disaggregated by asset type; and
- 225.1.5 changing the requirements for related party transactions to an aggregate level of capex, rather than a project level.
- 225.2 To ensure we have the necessary information to be able to effectively evaluate a CPP proposal we are:
- 225.2.1 including new requirements for a deliverability plan for the proposed expenditure; and

⁸¹ This approach is consistent with the proportionate scrutiny principle set out at para 62.

225.2.2 requiring both real and nominal prices to be included in the forecast tables.

226. We also propose clarifying that the information presented in the financial spreadsheets referred to in the IMs does not need to be duplicated.

227. These proposed changes are discussed in more detail in Chapter 5.

Verifier

228. The changes we are proposing to the verifier requirements clarify the verifier's role, and simplify the way suppliers and the Commission engage with the verifier.

229. The specific changes we propose are:

229.1 adding a new section to the verifier's Terms of Reference that defines the verifier's role, purpose, and obligations;

229.2 removing the obligation for the verifier to consider non-standard depreciation;

229.3 requiring the CPP applicant to provide us with a high level summary of their application;

229.4 amending the tripartite deed requirements to include a communication protocol setting out the roles and obligations of the parties during the verification process regarding communication;

229.5 allowing the verifier greater flexibility in the number of projects that are verified, the extent of their verification, and the content of the CPP proposal that we review; and

229.6 removing the requirement for an independent engineer, and allowing suppliers to prepare the quality standard variation report themselves, subject to verification by the verifier (EDBs only).

230. These proposed changes are discussed in more detail in Chapter 6.

Audit

231. We propose to expressly require the auditor to provide an audit report, clarify the audit standards and quantitative accuracy, and align the scope of audit requirements with the information requirements

232. This proposed change is discussed in more detail in Chapter 7.

Consumer consultation

233. Where possible, we expect that meaningful consultation with consumers should require the consideration of price/quality trade-offs by consumers. We are proposing

to expressly require this as part of an applicant's consumer consultation requirements.

234. This proposed change is discussed in more detail in Chapter 8.

Chapter 5: Information requirements

Purpose of this chapter

235. This chapter explains the problems we have identified with the information requirements for CPP proposals, and our proposed solutions in response to them.
236. These problems and proposed solutions relate only to the EDB CPP IMs, because we are deferring consideration of changes to the detailed information requirements for GDBs and GTBs.⁸²

Structure of this chapter

237. The first section of this chapter summarises the changes we are proposing to the CPP information requirements. The remaining sections focus on specific problems we have identified with the information requirements, and our proposed solutions to those problems. The problems are:
- 237.1 the misalignment of CPP information requirements and information disclosure (**ID**) requirements;
 - 237.2 applicants are not required to demonstrate that they are able to deliver their proposed expenditure at a business-wide level;
 - 237.3 duplication of price path information within the application;
 - 237.4 inappropriate disaggregation of certain information; and
 - 237.5 insufficient flexibility for suppliers providing the information, particularly for smaller suppliers.

Summary of proposed changes

238. At a high level, we consider that the intent behind the information requirements which we set out in 2010 remains relevant.⁸³ The intent behind the information requirements is for the applicant to provide the information that will allow us to test whether the CPP application meets our evaluation criteria and is consistent with all the relevant IMs.
239. The changes we are proposing are intended to reduce the cost and complexity of the CPP information requirements, and to focus these requirements on what are most material to price and quality. Our aim is for the information required in CPP applications to, where possible, better leverage off existing regulatory disclosures under ID, including AMPs.

⁸² Commerce Commission “Input methodologies review – Process update paper” (29 February 2016), paras 59-66.

⁸³ Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), para 9.3.14-15.

Changes discussed in this chapter

240. We are proposing the following changes to address the problems we have identified through reviewing the CPP information requirements IMs, namely:
- 240.1 removing the need to duplicate information between documents, by aligning Schedules D and E with the relevant information disclosure requirements;
 - 240.2 including new requirements for a deliverability plan for the proposed expenditure;
 - 240.3 simplifying the requirement for forecasting capex projects disaggregated by asset type;
 - 240.4 changing the requirements for related party transactions to an aggregate level of capex, rather than a project level;
 - 240.5 removing the requirement for expenditure to be disaggregated by service categories; and
 - 240.6 improving the way in which applicants demonstrate the deliverability of their proposed expenditure.
241. We have clarified that our interpretation of the existing IMs means that information presented in the financial spreadsheets does not need to be duplicated.⁸⁴

Other changes

242. For consistency, and to improve ease of use, we also propose:
- 242.1 changing the information requirements in Schedule D that relate to quality of service to bring these requirements in line with the disclosures required under ID;⁸⁵ and
 - 242.2 requiring expenditure forecast tables in Schedule E to be disclosed in real terms as well as in nominal terms.⁸⁶

Misalignment of qualitative CPP information requirements and ID requirements

243. Qualitative information allows the supplier to provide context, reasoning, and justification for the quantitative data used in its proposal.⁸⁷ The requirements for the qualitative information are set out in Schedule D of the IM Determination.

⁸⁴ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, clauses 5.4.7 and 5.4.8.

⁸⁵ *Electricity Distribution Services Default Price-Quality Path Determination 2015* [2014] NZCC 33, clause 9 and schedules 4A, 4B and 5B; Commerce Commission *“Electricity Distribution Information Disclosure Determination 2012 (consolidated in 2015) – 24 March 2015*, clause 2.6.2.

⁸⁶ While forecasts in nominal terms are appropriate for setting the price path, forecasts in real terms are more appropriate for engineering assessment purposes.

244. Schedule D's structure currently allows for a narrative of the applicant's governance and management practices in relation to asset management and information on the policies, assumptions, data, planning standards and processes used to develop the different categories of expenditure.

Problem definition

245. Currently the information requirements in Schedule D are not aligned with the requirements for AMPs. For example, information provided in the AMPs is required to be recast and re-grouped in order to comply with the CPP IMs. This creates an unnecessary compliance burden for applicants, with limited benefit in terms of scrutiny.
246. In feedback on the Orion process, the Electricity Networks Association (ENA) submitted that:

We suggest that the CPP application process could be significantly simplified if the information requirements for a CPP proposal were better aligned to the information each business already has available for its operations, planning and compliance activities. This could include removing the compulsory status of some of the IM requirements, and linking the proposal content better to existing regulatory information, in particular AMPs.⁸⁸

247. PwC, submitting on behalf of 20 EBDs on our Problem Definition paper, made a similar comment:⁸⁹

[W]e consider that the CPP IMs should... enable EDBs to use their Asset Management Plans as the basis for their CPP applications. The key factors supporting the application should already be present in the AMP and the CPP application should build on this information incrementally in support of the proposed CPP price path and quality standards.

248. However, as Geoff Brown noted at our 19 April 2016 CPP workshop, the depth of information required for a CPP application goes beyond that required for AMPs.⁹⁰
249. In other words, the information we require to evaluate a CPP application is wider in scope than an asset management plan (**AMP**), which is focussed on asset management planning.

⁸⁷ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), para K3.7.

⁸⁸ ENA "Feedback on Orion customised price quality path process" (August 2014) para 33. Orion raised the same issue, Orion, "Feedback on Orion customised price quality path process" (August 2014) para 43, as did other submitters, Vector, "Feedback on Orion customised price quality path process" (August 2014) para 12; Powerco "Feedback on Orion customised price quality path process" (August 2014), para 20.

⁸⁹ PwC "Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015), para 121.

⁹⁰ Minutes from the workshop will be published alongside our determinations on 22 June 2016.

Proposed solution

250. Our proposed solution is to follow an ‘AMP-plus’ approach to Schedule D. To implement the AMP-plus approach, we propose amending Schedule D to:
- 250.1 align its structure with the AMP requirements in Schedule A of the ID requirements; and
 - 250.2 require additional information over and above the AMP requirements where it is necessary to justify the expenditure proposed in the CPP.
251. This proposal was developed after discussions with stakeholders at our CPP workshop on 19 April 2016, and is based in part on a structure the ENA proposed.⁹¹
252. The proposal we presented at the 19 April workshop set out Schedule D so the information on strategies, policies, assumptions, data, planning standards, and process used to develop each of the categories of expenditure was presented in one clause. Feedback from stakeholders at the workshop was that our proposed method of presentation did not allow applicants to easily engage with the requirements and may not reduce complexity.
253. Following the workshop, ENA proposed a structure that was more in line with Attachment A of the ID Determination. ENA considers that the revised presentation would make the CPP process more accessible to smaller suppliers.
254. The structure proposed by the ENA is an improvement over the current structure in terms of reducing cost and complexity. However, we consider that the scope of the information we presented at the CPP workshop is necessary for us to properly scrutinise an applicant’s CPP proposal.
255. The scope of the information we propose requiring is set out in the table below.

Table 5.1: Scope of Schedule D requirements

Information we require	Reason for inclusion
Information on policies on governance and descriptions of systems, management of information and data, treatment of risks and uncertainties.	To give us an understanding that the expenditure forecast is prepared using good practice asset management principles and methodologies expected of a prudent supplier.
An overview of any internal challenge, review and approval process applied before the forecasts were finalised for inclusion in the CPP proposal.	Different business units prepare parts of the expenditure plan. This can result in duplication of expenditure items or resource requirements. A robust challenge process at a business-wide level can remedy this.

⁹¹ PwC on behalf of ENA “CPP IM Reducing Cost and Complexity - Schedule D” (6 May 2016).

Key assumptions and information on data and models used to prepare the forecast.	To ensure that the inputs used to prepare the forecasts are sound, and that the investments are made at the right time. This includes the reliance we can place on data used and how data deficiencies have been addressed.
Strategies, policies, rationale for policies and planning standards.	To ensure that the relevant strategies are in place and that they are appropriate and sufficiently robust to ensure that the services will be provided efficiently.
The process or approach used to develop the forecasts.	To assess the validity of the forecasts.
Detailed information on projects.	To ensure that the forecast expenditure is consistent with the applicant's strategies, policies and processes.
Forecasts of consumer connections, distributed generation, electricity volumes carried, and maximum demand.	To provide the background necessary for an informed assessment of the application.
A high level description of all network development projects included in the forecast.	For confirming completeness with the demand forecasts.
A description of how the business support and system operations and network support operations are organised, and the extent that these operations are shared with unregulated business activities and the extent to which the cost of these activities are capitalised.	To provide an insight into the relevance of existing costs and how they are split between opex and capex, and between regulated and unregulated business activities.
A description of any anticipated changes to this information over the forecast period.	To provide a high level understanding of the reasons for increases in the forecast expenditure over the forecast period, particularly if they are step changes.
A detailed description of the drivers for opex programmes and explanation of the basis for determining the forecast increased or new expenditure requirement.	To assess the reasonableness of opex expenditure forecasts.
Information that demonstrates the deliverability of the applicant's work volumes represented by a CPP expenditure forecast (to the extent that these are higher than current levels).	To show that they have considered delivering the work volumes in the CPP, where these are higher than current levels. This is to avoid setting revenue based on expenditure that an applicant does not have the capacity to deliver.

256. As these changes draw an explicit link between Schedule D of the IMs and Appendix A of the ID Determination, adopting this AMP-plus approach will also have the following flow-on effects:
- 256.1 we will have to reconsider and potentially amend the IM Schedule D when we review the ID Determination (increasing our resource requirement at that time);
 - 256.2 there will be a degree of uncertainty for a prospective CPP applicant during any period when we review the ID Determination; and
 - 256.3 the completeness assessment of a CPP will not be mechanistic, and may require a greater degree of communication between the applicant and the Commission during this phase of assessing a CPP proposal.⁹²

Deliverability is not considered at an aggregate level

257. The current CPP information requirements require suppliers to explain the deliverability of each opex and capex category and identified programme.⁹³ This requirement was included in the current IMs to ensure that the applicant is able to demonstrate that it is not constrained in its ability to carry out the work in the timeframes proposed.⁹⁴

Problem definition

258. The current CPP information requirements do not require the supplier to report on deliverability at a whole-of-business level. While each category or programme of expenditure may be deliverable, when taken as a whole the proposal may not be.
259. There is a significant risk that expenditure is approved for work that is both prudent and efficient, yet due to insufficient resources is not delivered. The result of non-delivery is that consumers pay for beneficial outcomes that are not realised.

Proposed solution

260. Our proposed solution to this problem is to require applicants to report on deliverability in a single deliverability report. This proposed report will require a deliverability risk assessment that takes account of:
- 260.1 consenting;
 - 260.2 accommodating a step change in workload above historical levels;

⁹² The applicant could reduce this by thorough cross-referencing and presenting the AMP in manner suitable for assessing completeness.

⁹³ Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26, Schs D7(1)(b), D7(2)(b), D12(1)(b), and D12(2)(a)(ii).

⁹⁴ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), para 9.5.12.

260.3 alignment of resource schedules where shared resources are utilised for different opex and capex-related tasks;

260.4 the extent of outsourcing required; and

260.5 contractor and skilled personnel availability and ability.

261. We expect that CPP applicants will have fully assessed the deliverability of the proposed work-plan required to achieve the objective(s) set out in their CPP application. Accordingly, the provision of this information should not require the applicant to create any additional information.

Duplication of price path information within the application

262. The current information requirements require CPP applicants to include annual dollar amounts (in nominal terms) for the applicant's proposed building blocks allowable revenue (BBAR) for each year of the proposed CPP regulatory period. The IMs also require the applicant to provide all the supporting information used to calculate the proposed BBAR amounts.

Problem definition

263. The current CPP requirements are not explicit about whether the spreadsheets are part of the CPP proposal. This omission led Orion to duplicate the information, increasing the cost of preparing its application.

264. The IMs state that the applicant must provide the calculations for BBAR and maximum allowable revenue (MAR) in spreadsheet form.⁹⁵ However, the IMs do not explicitly state that these spreadsheets form part of the CPP proposal.⁹⁶

265. In feedback on the Orion process, the ENA indicated that the IMs are not flexible enough, and prevent information in the price path model from forming part of the CPP application. Therefore, Orion needed to replicate all of the outputs for each of the building blocks.⁹⁷

⁹⁵ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, cls 5.4.7- 5.4.8.

⁹⁶ Commerce Commission "Electricity and gas input methodologies determination amendments (No.2) 2012, Reasons paper" (15 November 2012), paragraph K2.8 states that the Commission intends to develop a revenue model template that is consistent with the IMs, which a supplier may use in preparing its proposal. The spreadsheet model will not be part of the IM. However, this note is referring to the Commission's revenue model.

⁹⁷ Electricity Network Association "Feedback on setting Orion's customised price-quality path" (14 April 2014), Attachment 1, Section 3.

Proposed solutions

266. Our proposed solution to this problem is to clarify that the information included in the spreadsheets does form part of the CPP proposal. This does not require a change to the IMs. Applicants will have the option of relying on information provided elsewhere, provided the following usability criteria are met. Applicants must:
- 266.1 include clear cross-references to the information in the CPP proposal;
 - 266.2 provide clear references to the IM requirements they are fulfilling in the spreadsheet and the CPP proposal;
 - 266.3 use the technical terms and labels described in the IMs;
 - 266.4 clearly identify and explain all of the source inputs and outputs in separate worksheets and in their required formats;
 - 266.5 produce all of the intermediate outputs set out in the IMs; and
 - 266.6 demonstrate the links and interdependencies between source inputs, intermediate calculations, and outputs in a transparent and auditable manner.
267. Making these criteria clear and transparent should avoid, or significantly reduce, the need for us to request further information from the applicant. It should also help to ensure that the supplier's information can be more readily assessed and used by us.

Unnecessary disaggregation of quantitative information

268. The current CPP IMs require several kinds of information to be provided on a disaggregated basis.

Problem definition

269. Specifically, we are concerned with suppliers needing to provide:
- 269.1 forecasts of capex disaggregated by asset type, for the purposes of asset valuation and regulatory tax;⁹⁸
 - 269.2 expenditure forecasts disaggregated by service categories;
 - 269.3 opex disaggregated into controllable and uncontrollable opex;⁹⁹ and
 - 269.4 related party transaction information that must be disclosed by forecast capex programmes and projects.¹⁰⁰

⁹⁸ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, cl 5.4.12.

⁹⁹ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, cl 5.4.30(3); Schedule D16; Schedule E, Table 3(b).

270. Across all these elements of the information requirements, the level of disaggregation imposes additional cost, with little benefit in terms of determining the price path.

Disaggregating capex by asset type

271. Forecasting on an asset type basis adds complexity to CPP proposals, and increases the cost to applicants. However this level of disaggregation is consistent with the requirements under ID regulation, but this is ex-post. Those requirements are necessary for ex-post reporting of commissioned assets. Since the CPP information requirements work on an ex-ante basis, the value of forecasting to such detail is questionable given its complexity.

272. Orion suggests that:

In addition, the IMs require material to be presented in a specific way that did not align with processes and information sources we hold. For example:

The asset valuation and regulatory tax IMs which are components of the price path require a great deal of disaggregation of forecast data which creates model complexity and it is questionable whether this is necessary.¹⁰¹

273. The ENA echoes this, suggesting that the Commission:

Reduces the level of disaggregation inherent in the forecasting methods for the regulatory asset base and regulatory tax allowance/adjustments. These are currently based on the ID methods, which are relatively precise (given they are prepared ex post). We question whether this is necessary or appropriate for ex ante forecasts, and a more simple/aggregated forecasting approach may be reasonable (i.e. generate sensible forecasts) and, importantly, is likely to be less costly to prepare and support. We note that the DPP methods are extremely aggregated, and we do not consider this level of aggregation is a reasonable approach for a CPP.¹⁰²

274. We are proposing a breakdown by a subgroup of assets that is included in the forecasts provided under Schedules 11(a)(iii) and 11(a)(iv) of ID.¹⁰³
275. We consider that the general categories we are proposing will still provide a reasonable estimate of forecast depreciation and tax for the purpose of determining the price path.
276. Given the variability in timing of projects, the value of more detailed forecasting is questionable. For example, a supplier cannot forecast exactly when it will

¹⁰⁰ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, Sch E, Table 4 and Table 5.

¹⁰¹ Orion "Orion feedback on customised price quality path process 14 April 2014" (August 2014), para 41.

¹⁰² ENA "ENA feedback on Orion customised price quality path process" (August 2014), para 6.1 (b).

¹⁰³ *Electricity Distribution Information Disclosure Determination 2012* [2012] NZCC 22, Schedules 11(a)(iii)-(iv).

commission a given power transformer, and using an estimate will not make the resulting calculations any more accurate.¹⁰⁴

277. In coming to this proposed solution, we also considered the following alternatives:
- 277.1 using the DPP approach of assuming a 45 year asset life to estimate the value of depreciation of forecast commissioned assets;
 - 277.2 disaggregating by asset type at an aggregate value of commissioned assets level rather than at a project level; and
 - 277.3 disaggregating by asset expenditure categories at aggregate value of commissioned assets level.¹⁰⁵

Controllable and uncontrollable opex

278. Disaggregation of opex forecasts as controllable and uncontrollable was originally included in the information requirements to make allowance for IRIS. However, our approach to IRIS has changed, and this type of disaggregation is no longer required.
279. We propose removing the requirement on suppliers to disaggregate based on service categories or into controllable and uncontrollable opex. These proposed changes bring the CPP information requirements in line with the requirements under ID, eliminating the need to recast information in an unnecessary way.

Related party transactions

280. Forecasts on a project-by-project basis are appropriate in other instances, but it is not feasible to forecast related party transactions on this basis. It is not possible to forecast who will deliver which projects if the projects are awarded via competitive tendering.¹⁰⁶ Tenders are called after a project is set-up and scoped and would normally be at the time of implementation, not several years in advance.
281. We propose removing the requirement to disaggregate forecasts project-by-project, and instead to require forecasts on an aggregated basis across the business.

Capital contributions

282. Stakeholders have submitted that it may not be practical to forecast capital contributions at an asset level as currently required and that it is more practical to forecast capital contributions at an aggregate level. The proposed changes to information requirements in Schedule E has simplified the information requirements for forecast capital contributions by netting them off against forecast total values of the capex expenditure categories.

¹⁰⁴ However, we note that, at a macro level, a supplier should be able to forecast the increased number and capacity of its transformer assets and how the utilisation will change over time.

¹⁰⁵ These alternatives were discussed at our CPP information requirements workshop (held 19 April).

¹⁰⁶ The exception is if there is a long term service agreement with the related party.

Insufficient flexibility in providing information

283. As mentioned in Chapter 4 there is significant diversity in the size of price-quality regulated EDBs, which has practical implications for the viability of CPP applications specific to the information requirements.¹⁰⁷

Problem definition

284. The IMs specify the provision of expenditure information, policies, procedures, and strategies at scope and depth that may exceed the levels of information that a prudent supplier for that size would maintain.
285. In such cases, the supplier will either incur costs to create the information, or will decide that the compliance cost outweighs the benefits that might be expected to accrue from a CPP application.
286. Requiring suppliers to create expenditure information, policies, procedures, or strategies solely to apply for a CPP is unlikely to benefit our evaluation of the proposed expenditure. If the supplier's investment decision has been made independent of some of the information required for a CPP application, creating and including this information is not likely to improve the scrutiny we can apply, or to benefit consumers.
287. PwC, submitting on behalf of 20 EDBs (including several smaller price-quality regulated EDBs), commented in submissions on the problem definition for the IMs review:

In order to make the CPP a more viable option we suggest that the CPP IM should be less prescriptive. The IM should allow an applicant to present their case for an alternative price path and quality standards using information which is directly relevant to their application, and is based on information retained by the EDB which supports the EDB's own planning and operating practices. While we understand the need for the Commission to receive comprehensive information in support of a CPP proposal, we consider the IMs can be substantially improved by allowing EDBs more flexibility in how they compile this information. This is not inconsistent with the expectation that well run EDBs will have sufficient information available in support of their application.¹⁰⁸

288. However, in contrast to PwC's observation, we are commonly asked to be more specific about the information we require.
289. Accordingly, there is clearly a trade-off between the certainty provided through greater specificity, and allowing for greater flexibility where the applicant proposes the appropriate level of information.

¹⁰⁷ Other issues related to supplier scale and CPP applications, not limited to the information requirements are discussed in Chapter 4.

¹⁰⁸ PwC "Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015).

Proposed solutions

290. We consider that greater flexibility for suppliers, in particular smaller ones, is warranted. The extent of the flexibility we propose providing depends on the specific circumstances of an application.
291. Where an applicant has not relied on a particular policy, procedure, or strategy in preparing its CPP application, we do not expect the applicant to create these for completeness sake. The current IMs do not require this.
292. Where an applicant has relied on a particular policy, procedure, or strategy in justifying its expenditure, but that policy is not formally documented, we require the applicant to provide an explanation. For example, if the CPP application includes an increase in capex to support an increase in security and reliability to part of its network (eg, inner CBD), and this was driven by a change to the applicant's planning criteria, we would require that policy to be provided with the CPP application. However, if there was no policy underpinning this decision, we would likely question the basis on which the applicant decided to change the level of security.
293. Therefore, regardless of the size of the supplier's business, we expect applications will provide sufficient supporting justification commensurate with the materiality of the expenditure.
294. We consider that the Limb 1 CPP fast track amendments that introduced provisions, which allow for exemptions and modifications from the CPP information requirements, will also help mitigate the challenges facing smaller suppliers.¹⁰⁹
295. To make this intent clear, we propose amending the IMs to expressly specify that we will consider the scale of businesses when deciding whether to approve an exemption or modification.

¹⁰⁹ Commerce Commission "Input methodologies review: Amendments to input methodologies for customised price-quality paths – Final reasons paper for limb 1 of the CPP fast track" (12 November 2015).

Chapter 6: Verification requirements

Purpose of this chapter

296. This chapter explains the problems we have identified with the verification requirements for CPP proposals, and our proposed solutions in response to them.¹¹⁰

Structure of this chapter

297. The first section of this chapter summarises the changes we are proposing to the CPP verification requirements. The next section addresses the common problems we have identified with the verifier's role and purpose.

298. The subsequent sections focus on specific problems we have identified with the verifier requirements, and our proposed solutions to them. These problems relate to:

298.1 the way the applicant and the verifier communicate;

298.2 the number of projects the verifier scrutinises;

298.3 the role of the independent engineer; and

298.4 the verification of non-standard depreciation.

299. The final section responds to other issues raised by stakeholders, where we consider no change to the IMs is required. These issues are:

299.1 the way the verifier is selected and engaged; and

299.2 the time available for verification.

Summary of proposed changes

300. We consider that the intent behind the verifier requirements set out in 2010 remains appropriate.¹¹¹ The pre-application verification process is intended to promote certainty for suppliers as to how their expenditure is likely to be assessed, as well as to assist us to make the most effective use of the tight statutory timeframes for evaluating CPP proposals, through the verifier highlighting which areas of a proposal we should focus on.

301. The changes we are proposing to the verifier requirements clarify the verifier's role, and simplify the way suppliers and the Commission engage with the verifier. The overall intent of these changes is to provide greater certainty for suppliers – consistent with the s 52R purpose – while at the same time reducing the cost and complexity of CPP proposals.

¹¹⁰ Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26, cl 5.5.2 and Schedule F.

¹¹¹ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), paras 9.5.13 and 9.6.3.

302. The specific changes we propose are:
- 302.1 adding a new section to the verifier's Terms of Reference in Schedule G of the IMs that defines the verifier's role, purpose, and obligations;
 - 302.2 requiring the CPP applicant to provide us with a high level summary of their application by the time the verifier is engaged;
 - 302.3 amending the tripartite deed requirements in Schedule F5 to include a communication protocol that sets out the roles and obligations of the parties during the verification process regarding communication, and to allow meeting minutes to be used as the evidential basis for any verifier technical opinions;
 - 302.4 allowing the verifier greater flexibility in the number of projects that are verified, the extent of their verification, and the content of the CPP proposal that we review;
 - 302.5 removing the obligation for the verifier to consider non-standard depreciation; and
 - 302.6 removing requirement for an independent engineer, and allowing suppliers to prepare the quality standard variation report themselves, subject to verification by the verifier (EDBs only).

Verifier's purpose and role

303. A common problem across the issues stakeholders have identified with the current verifier requirements is that the purpose of the verifier and their role is not clear.
304. The way we explained the purpose of the verifier IMs in 2010 had two key limbs:
- 304.1 ensuring we can rely on the information supporting the CPP; and
 - 304.2 an intention to avoid duplication of effort by highlighting the key issues we should focus on during our assessment.
305. We explained the reliability point in our 2010 IMs reasons paper saying:

It is also important that the Commission is able to rely on information contained in a CPP proposal. Therefore, the Commission considers that the proposal should be verified in some way before it is submitted to the Commission. The key considerations when selecting the appropriate form of verification are how critical the information is to the decision and the amenability of the information to the different types of verification [including] independent

opinions on information by a subject matter expert (referred to as ‘independent verification’).¹¹²

306. In addition, we explained that:

A key aspect of the Commission’s expenditure approach is the use of pre-submission verification (prescribed by the Commission) of proposed expenditure by an independent verifier. This should promote certainty for suppliers as to how their expenditure will be assessed, as well as assist the Commission in managing the tight statutory timeframes for assessment. Suppliers have an opportunity to rectify any concerns raised by the verifier before it applies for a CPP and the process should allow the Commission to focus on the most important aspects of the CPP proposal during its assessment period.¹¹³

307. We also stated that where possible, we would not seek to duplicate the effort expended in the verification of a CPP proposal:

The Commission will need to undertake its own assessment of the proposal in order to make a s 52P determination as is required under the Act. In doing so, to the extent practicable, the Commission will seek to avoid duplication of effort and to rely on the professional opinion expressed by the verifier.¹¹⁴

Problem definition

308. Our experience with the Orion CPP suggests that we have not made it entirely clear that the intent behind the verifier role is to ‘frontload’ as much of the work as possible in preparing and reviewing the CPP. This lack of clarity in intent led to issues during the Orion CPP process. For example, we expected that the verifier would assess the reliability of the input data used to form the expenditure forecast, and the key assumptions made by Orion. Equally, that the verifier would have understood and assessed the extent to which the proposed expenditure was required to meet service level requirements and quality demanded by customers.

309. Submissions on the Orion CPP process show the importance of frontloading and avoiding duplication, with several submissions questioning the necessity of the verification process where there was a duplication of effort by the Commission.¹¹⁵

¹¹² Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), para 9.6.3.

¹¹³ Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), para 9.5.13.

¹¹⁴ Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), para 9.6.14.

¹¹⁵ ENA “Feedback on Orion customised price-quality path process” (14 April 2014), para 20; Powerco “Feedback on Orion customised price-quality path process” (14 April 2014), para 25. We note that Orion described the role of the verifier as a “valuable” one, while at the same time expressing concern about the duplication of effort, Orion “Feedback on Orion customised price-quality path process” (14 April 2014), paras 19-20.

310. For example, Vector submitted:¹¹⁶

In practice, it seems that the IM requirement for a verifier has resulted in duplication of effort, unnecessary expense and confused expectations. We therefore question the need for a verifier as specified in the IMs; although the verifier role may be worth retaining if the verifier was also utilised throughout in the process to assist the Commission in reviewing the CPP application.

311. Another reason that frontloading is important is because potentially we may evaluate four (or more) EDB CPP proposals in any one year, and these must be considered within 150 working days. Understanding resource requirements and the nature of the proposal(s) will be crucial to us planning a cost-effective evaluation process.

312. Orion observed that there was some confusion about whether we should have had sight of the draft version of its application provided to the verifier. In addition, the verifier for Orion's proposal considered we would have liked some advance notice of the proposal, so we could have planned our evaluation around the likely contents of what was going to come in, but he considered the draft to be confidential.¹¹⁷

Proposed solution

313. Our proposed solution to the lack of clarity about the purpose and role of the verifier is to add an additional section to the verifier's Terms of Reference (Schedule G2 of the IMs) that clearly sets out expectations for the verifier's role.

314. The proposed new schedule of the IMs will explain that the role of the verifier is to:

314.1 provide an assessment of whether the CPP applicant's policies, strategies, and procedures are appropriate such that services will be provided efficiently and align with consumer demands;

314.2 ascertain whether these policies, strategies, and procedures have been applied in practice;

314.3 review the material aspects of the proposed CPP to ensure that it is sufficiently complete in content and that it supports the applicant's expenditure objective, prior to the Commission review;

314.4 assess and report on the reliance that can be placed on input data and the reasonableness of the assumptions made or practices used in developing the information that supports the CPP application, and to then report on any aspects that may warrant an in depth review by the Commission (particularly

¹¹⁶ Vector "Feedback on Orion customised price-quality path process" (14 April 2014), para 13.

¹¹⁷ Orion's submission on the problem definition paper "Submission on the IM review" (21 August 2015), para 62; Denis Jones (Orion) "Cost-effectiveness of the rules and processes for CPP application" (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), pp 252.

if the content is material to the nature of the proposal and likely to be central to the Commission’s decision-making); and

- 314.5 to report on the extent and effectiveness of the supplier’s consultation with consumers.
315. The proposed schedule will also allow for the CPP applicant to engage with the verifier, where necessary, during the development phase of the CPP proposal in order to ensure that the proposal meets the necessary evidential requirements of the IMs. For example, where the verifier identifies that the applicant does not appear to have followed its own planning standards for network or asset replacement, it would highlight this area to the applicant. This type of engagement should not adversely affect the verifier’s ability to remain independent.
316. In addition, we propose that the applicant provide us with a high level proposal summary when it engages the verifier, sufficient to enable our preliminary resource planning. The high level proposal summary would contain such information as:
- 316.1 the reasons for the CPP proposal and information pertaining to its priority;
- 316.2 the likely anticipated change/effect on consumers;
- 316.3 the supplier's proposed approach to engaging with consumers on the proposal;
- 316.4 the scope and indicative dollar value of the proposal (eg, capex, opex and reliability changes); and
- 316.5 the likely nature and number of projects, and the rationale for seeking the CPP.

Communication between the applicant and verifier

Problem definition

317. In the Orion CPP, we required that the verifier’s conclusions in the verification reports were supported by a verifiable paper trail. Geoff Brown Associates (GBA) – the verifier for Orion – stated that this requirement created an onerous “paper trail” of information. GBA stated that the technical judgements made by the verifier need to be recognised as such, without reference to detailed supporting information.¹¹⁸
318. However we are concerned that we may need to make reference to conversations between the applicant and the verifier during the consultation process, and that doing so in a transparent way may be difficult in the absence of a written record.

¹¹⁸ Geoff Brown (Geoff Brown Associates) “Cost-effectiveness of the rules and processes for CPP application” (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), pp 254.

Proposed solution

319. The verifier and applicant need to have the ability to have open technical discussions to resolve issues on an informal basis. We acknowledge that requiring documentation of every verifier opinion is costly and onerous. However, we do need to reference these discussions if they have been used to form verifier opinions.
320. We expect that, in most cases, the verifier will form its views and technical judgements on documented information and data. Providing references to support technical judgements is expected for an expert witness report, and we expect this level of diligence from the verifier.
321. We propose amending the tripartite deed requirements in Schedule F5 of the IMs to include a communication protocol that sets out the roles and obligations of the parties during the verification process regarding communication and to allow meeting minutes to be used as the evidential basis for any verifier technical opinions.
322. The main reason for this change is that will result in a more efficient and cost-effective verification process.

Number of projects the verifier scrutinises*Problem definition*

323. Submitting on the Orion CPP, stakeholders suggested that the IMs should allow the verifier to pre-select sample projects for review, rather than have the sample projects selected later in the process. This would allow sufficient evidence on the pre-selected projects to be prepared in advance, making the process more efficient.¹¹⁹
324. Orion also pointed to the fact that had there been a smaller number of projects to require detailed review, the cost of the application would have been reduced. In Orion's case, projects had to be artificially constructed and defended to meet the requirements.¹²⁰
325. Stakeholders have also commented that the reference to "identified programmes" in the IMs is excessive, and does not reflect the capex and opex budgets of small networks. These smaller networks may not be sufficiently resourced to meet this task.¹²¹ Additionally, MDL commented that some businesses simply will not have this many projects in total.¹²²

Proposed solution

326. Our proposed solution is to allow a level of flexibility in the number of identified projects that are verified in detail as part of verification process. We will do this by

¹¹⁹ Orion "Feedback on Orion customised price-quality path process" (14 April 2014), para 30(d).

¹²⁰ Orion "Feedback on Orion customised price-quality path process" (14 April 2014), paras 25-28.

¹²¹ ENA "Feedback on Orion customised price-quality path process" (14 April 2014), paras 13-14.

¹²² MDL, Untitled submission on problem definition paper" (21 May 2015), para 12.

allowing the verifier to judge on a case by case basis the appropriate number of identified projects for which more detailed information must be provided (also forming part of the CPP proposal), and which will be verified in greater depth. The current number of identified projects required will remain as the maximum.

327. Specifically, we propose introducing the following criteria in the IMs that will guide the verifier when selecting a lesser number of projects. The verifier will consider:
- 327.1 whether the number of identified projects is sufficient to provide a view on the extent to which the proposed expenditure is consistent with the applicant's policies and strategies;
 - 327.2 whether the issue the CPP intends to resolve can be adequately represented with the number of projects;
 - 327.3 the extent to which the proposed projects in the proposal reasonably reflects the information from previous Asset Management Plans of the business if this is relevant;¹²³
 - 327.4 the best interests of consumers; and
 - 327.5 our ability to test the proposal against the expenditure objective.
328. This change will directly reduce the cost and complexity of CPP applications for the verifier, the applicant, and the Commission, and be consistent with the proportionate scrutiny principle, by allowing the verifier's detailed assessment to be targeted at the projects that most affect the price, quality, and investment aspects of the applicant's business.

Role of the independent engineer

Problem definition

329. The independent engineer preparing the report on network quality (for EDBs seeking a quality standard variation) adds unnecessary cost, and this role could be performed by the applicant.
330. The IMs require the applicant to engage an independent third-party (other than the verifier) to report on a proposed quality standard variation. Stakeholders have suggested this is a task that could be performed by the verifier.¹²⁴

¹²³ For example, where a number of projects are proposed in a CPP proposal that had not been previously signalled in a AMP, the verifier is more likely to require these projects to be reviewed in detail.

¹²⁴ ENA "Feedback on Orion customised price-quality path process" (14 April 2014), para 21-23; Dennis Jones (Orion) "Cost-effectiveness of the rules and processes for CPP application" (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), p. 247.

Proposed solution

331. We propose allowing the applicant to prepare its own quality standard variation report, and to have the verifier assess the report.
332. This change will eliminate the need for an independent engineer, which will reduce compliance costs. However it will still ensure that the report is subject to appropriate independent scrutiny, of the kind that the verifier is well placed to provide.
333. The proposal to merge the roles of the verifier and the independent engineer is not appropriate as an alternative solution. Applicants are likely to have access to the right kind of expertise to prepare the quality standard variation report. However, it would be a departure from the verifier's independent status for them to prepare and then verify their own report.

Verification of non-standard depreciation*Problem definition*

334. The verifier is required to produce an independent report on the CPP proposal based on the terms of reference in Schedule G of the IMs. Feedback on the scope of the verifier's report indicates that some of the material the IMs require should be excluded from the report.
335. Stakeholders have said that non-standard depreciation and cost allocation should not be included in the report. Their view is that these issues fit more comfortably within the Commission's review than within the verifier's.¹²⁵ Additionally, Orion has said that insurance costs should not be within the scope of the verifier's report.¹²⁶

Proposed solution

336. Our proposed solution is remove non-standard depreciation from the verifier's terms of reference, but to retain the requirements related to cost allocation and insurance.
337. Our main reason for this proposed change is that the verifier would likely need to engage specialist economic advice to assess non-standard depreciation, which adds cost and complexity to the process. We agree with submissions that the review of non-standard depreciation is better suited to our own review rather than the verifier's review.
338. However, we propose retaining the cost allocation requirements, as cost allocation may involve matters the verifier is in a better position to assess, such as capitalisation of overheads and related party costs.

¹²⁵ ENA "Feedback on Orion customised price-quality path process" (14 April 2014), Attachment 1, p. 16.

¹²⁶ Dennis Jones (Orion) "Cost-effectiveness of the rules and processes for CPP application" (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), p. 246.

339. Insurance costs should be assessed by the verifier as these costs are CPP opex – a key aspect of a CPP proposal. A specialist insurance report will form a component aspect of a CPP report. The verifier is better placed than the Commission to comment on:

339.1 level of cost versus risk that the applicant is exposing certain assets to, and

339.2 balance between self-insurance and external insurance has been adequately made.

Other issues raised by stakeholders

340. This section responds to a number of issues raised by stakeholders where we consider no changes to the information requirements are required.

Selection and engagement of the verifier

341. The CPP IMs require the applicant to engage the verifier using the process set out in Schedule F of the IM Determinations. Specific problems with the engagement process have focussed on how the verifier is approved, and on the tripartite deed between the verifier, the applicant, and the Commission.

342. Suppliers have submitted that the current process to select and approve the verifier is complex and time-consuming. Stakeholders have suggested that we could reduce the time and cost involved by providing a pre-approved list of verifiers, and through the use of a template deed.

343. Orion described selecting and obtaining approval for the verifier as “unduly onerous” when submitting on the problem definition paper for the IM review. It stated that the time spent on this process could have been better used elsewhere.¹²⁷

344. Orion previously submitted the approval process could benefit from being “streamlined”, possibly by the use of a pre-approved verifier list.¹²⁸ They also commented that the small number of potential verifiers in New Zealand posed a practical issue for CPP applicants.¹²⁹ This sentiment was echoed by the ENA in its feedback on the Orion process, who characterised the process as “complex”.¹³⁰

345. Regarding the tripartite deed, Orion suggested at the IMs forum that the preparation of a standard deed could reduce the time taken to develop and agreed the deed.¹³¹

¹²⁷ Orion's submission on the problem definition paper “Submission on the IM review” (21 August 2015), para 66.

¹²⁸ Orion “Feedback on Orion customised price-quality path process” (14 April 2014), para 24.

¹²⁹ Orion “Feedback on Orion customised price-quality path process” (14 April 2014), para 21.

¹³⁰ ENA “Feedback on Orion customised price-quality path process” (14 April 2014), para 18.

¹³¹ Dennis Jones (Orion) “Cost-effectiveness of the rules and processes for CPP application” (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), pp 245-246.

346. While we agree with the issues highlighted by Orion and other submitters, we consider that differences in circumstance (when compared with the Orion CPP) and changes elsewhere in the IMs will mitigate these problems in future. We remain open to the changes outside the IMs that submitters have suggested, specifically:
- 346.1 introducing a template tripartite deed; and
- 346.2 introducing a pre-approved verifier list in future, should this problem persist.
347. The issues Orion faced in approving the verifier were to some extent a result of the challenging circumstances of their application, and the fact that it was the first CPP application. Furthermore, the removal of the timing constraints imposed by the CPP WACC Determination allows for better pre-application engagement between the Commission and suppliers.
348. We are open to developing a template or “benchmark” tripartite deed. The deed used in the Orion process could form the basis of this, but the specifics of any template require input from stakeholders.
349. Regarding a pre-approved list of verifiers, our view is that the cost of engaging the verifier would be largely the same if the Commission was responsible for engaging or pre-approving the verifier. Additionally, allowing the applicant to appoint their own verifier has advantages:
- 349.1 the applicant can take comfort that the verifier is independent from perceived influence by the Commission; and
- 349.2 the applicant is better placed than we are to judge the experience and qualifications relevant to its industry.
350. Nevertheless, should the issue of finding an appropriate verifier persist in future CPP applications, we are open to introducing a pre-approved list.

Time available for verification

351. For EDBs, the time allowed for the verifier to carry out their work is limited by the timing of the CPP WACC Determination in September and the CPP application windows in February and May. This leads to a compressed timeframe for the verifier to prepare their report, consequently reducing the quality of the CPP application.
352. Our proposal to eliminate the difference between the CPP WACC and the DPP WACC resolves this problem. With the need for the CPP WACC Determination removed, applicants, the verifier, and the Commission will have a wider time frame for both pre-application engagement and for the verification process. This change will help not only with this specific issue, but with many of the problems outlined in previous sections.

Chapter 7: Audit requirements

Purpose of this chapter

353. This chapter explains our proposed solutions to the problems we have identified with the audit requirements for CPP proposals.

Structure of this chapter

354. This chapter begins with a summary of our proposed changes to the audit requirements for CPP proposals. Following this, we review the policy intent of the audit requirements. The following sections then identify specific problems with implementing that intent, and set out our proposed solutions for each.

Summary of proposed changes

355. The changes we are proposing to make are intended to provide greater certainty for CPP applicants around our expectations for the audit requirements, consistent with s 52R. These are:

355.1 clarifying the requirement for the auditor to provide a report setting out the auditor's opinion on specified matters;

355.2 differentiating the role of the auditor with respect to historical financial information and forecast financial information;

355.3 removing ambiguity around quantitative information provided in spreadsheets; and

355.4 clarifying the requirement on the auditor to provide a view in respect of proper records being kept.

Policy intent of the audit requirements

356. We rely on the information provided by CPP applicants in assessing CPP proposals and making CPP determinations. In order to make appropriate and cost-effective CPP determinations we need to have confidence in the information provided by applicants.¹³²

357. One of the means by which we gain confidence over the quality of financial and quantitative information provided by CPP applicants is to require the information to be subject to examination by independent auditors (ie, audit).

358. The policy intent behind the audit IM requirements relating to CPPs is to require CPP applicants to ensure financial and quantitative information provided is robust, reliable, and in compliance with applicable IMs.

¹³² Verification provides a complementary, but distinct role to audit. A key task of the verifier is to provide an assessment of whether the CPP applicant's policies, strategies, and procedures are appropriate such that services will be provided efficiently and align with consumer demands. Auditors are not qualified to form opinions on such matters.

359. Overall, we consider that the audit IM requirements relating to CPPs are fundamentally fit for purpose, but that they require clarifications and refinements to better meet their intent. In particular, references to professional standards, and terminology can be clarified to better align with the audit profession and our expectations of their role.
360. Our review of the IMs and submissions on the Orion CPP process have identified three problems related to the audit requirements. Specifically:
- 360.1 an audit must be conducted, but no audit report is required to be provided by the auditor;
 - 360.2 audit standards and quantitative accuracy are confusing; and
 - 360.3 audit requirements extend beyond information requirements.

An audit must be conducted, but no audit report is required to be provided by the auditor

Problem definition

361. A report setting out the opinion of the auditor is a key part of the application package that we rely on when considering a CPP proposal. Being clear about the requirement for this report is important to ensure applicants and auditors know what the work of the auditor must culminate in.
362. At present the audit IMs state that CPP proposals must be audited by an auditor, but do not explicitly require the auditor to provide a report setting out the auditor's view on specified matters contained in the IMs, as part of that audit (albeit that a different clause, clause 5.1.4, requires the supplier to provide one as part of the CPP application).
363. Accordingly, the need for a formal view to be provided by the auditor (in order for us to have confidence in the CPP proposal information), and the output required from the auditor under the IMs, is not being made as clear as it could be.

Proposed solution

364. The preferred solution is to stipulate in clause 5.5.3 of the EDB IMs, and clause 5.6.3 of the GDB and GTB IMs that the auditor must provide a report setting out the auditor's opinion on specified matters set out in those clauses. This will:
- 364.1 more easily enable us to assess the reliability of the financial and quantitative information provided in the CPP proposal;
 - 364.2 make it clear to stakeholders and auditors what output is required under the IMs; and
 - 364.3 improve the link between those IMs and clauses 5.1.1(2)(a) and 5.1.4.

Audit standards and quantitative accuracy are confusing

Problem definition

365. The role of the auditor can vary depending on the nature of that information and the type of engagement sought. The professional standards that govern auditors reflect these differences:¹³³
- 365.1 Where a high standard of comfort is required over the reliability of historical financial information, an audit may be required involving the application of appropriate audit engagement standards. This is typical in cases where an organisation wishes to issue its financial statements publicly and therefore seeks an opinion as to their fair presentation.
- 365.2 There are other engagements that may be undertaken involving a lesser standard of comfort, which may be performed under applicable assurance engagement standards. These engagements may include, for example, a review of an organisation's procurement practices.
366. A CPP proposal contains a range of information. However, the current audit IMs refer only to an audit, which has been interpreted to mean a high standard of assessment that does not allow the flexibility in approach that audit professionals are accustomed to.
367. Orion highlighted this problem, particularly with respect to what is required under the IMs in relation to historical information and forecast information. Orion stated that:¹³⁴
- ...there are limits to the extent that [forecast] information can be or should be audited. We suggest the focus of the audit should be on verifying actual/historical information and ensuring that the historical and forecast information has been prepared consistent with the IMs.
368. The problem also manifests in relation to audit IMs that require a professional opinion as to whether quantitative information provided in spreadsheets is 'accurately presented':
- 368.1 First, the expression "accurately presented" is arguably not appropriate with respect to forecast quantitative information, as there is no way for the auditor to know ex-ante whether the information is indeed "accurate". This underlies the concerns of auditors as they are being required to provide an opinion that a forecast is accurate, when in fact this cannot be known at the time the opinion is provided (ie, before the fact).

¹³³ Auditing and Assurance Standards as issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board (NZAuASB).

¹³⁴ Orion New Zealand Ltd "Feedback on setting Orion's customised price-quality path", 14 April 2014, p. 6.

- 368.2 Second, the expression “accurately presented” is unclear as to what dimension it is focusing on. For example, it is not clear whether the IM is requiring accurate presentation in terms of the underlying substantive information, or the presentation of that information (given there may be different ways to present the information), or both.
369. A high audit standard applied to forecast financial information is problematic, as the accuracy of forecast information cannot be known by an auditor *ex-ante*, and the information cannot be verified back to source documentation (as this can only happen *ex-post*).

Proposed solution

370. Our proposed solution is that the audit IMs in respect of CPPs be modified to differentiate the role of the auditor with respect to historical financial information and forecast financial information by linking to existing audit engagement standards and assurance engagement standards under the Financial Reporting Act 2013 (or other standards where appropriate).¹³⁵
371. We also propose to remove ambiguity around assessing quantitative information provided in spreadsheets by removing the expression “accurately presented” from the audit IM requirements relating to CPPs.
372. The effect of these changes will result in the following:
- 372.1 historical financial information will be audited in accordance with applicable audit engagement standards issued under the Financial Reporting Act 2013 (or applicable successor);
 - 372.2 forecast financial information will be examined in accordance with applicable assurance engagement standards issued under the Financial Reporting Act 2013 (or applicable successor), or other appropriate standards;
 - 372.3 quantitative historical information provided in spreadsheets will be properly compiled on the basis of the relevant underlying source documentation; and
 - 372.4 quantitative forecast information provided in spreadsheets will be properly compiled on the basis of relevant and reasonable disclosed assumptions.
373. Our main reason for these changes is to provide a greater level of certainty to CPP applicants (and their auditors) in relation to the audit standards we expect to be applied to a CPP proposal.

¹³⁵ Where historical financial information is concerned, requiring an audit of this information under the IMs is appropriate – as the events giving rise to this information, and the associated amounts, can be verified. An auditor can (and should) audit the veracity of historical financial information in CPP proposals against source information held by the applicant in accordance with relevant audit engagement standards, and provide an opinion on whether the CPP proposal information complies with the IMs.

Audit requirements extend beyond information requirements

Problem definition

374. In order to gain confidence in the information provided by a CPP applicant, the policy intent of the IMs is to require the auditor to provide an opinion on whether proper records have been kept by the applicant on which the CPP proposal information has been based.
375. The IMs set out a requirement for an auditor to audit a CPP proposal as to whether or not proper records have been kept to enable the complete and accurate compilation of information by the applicant.
376. However, this requirement does not reflect the fact that some information required under the IMs may not be traditionally produced by applicants for business or regulatory purposes, meaning it may need to be created or developed from other information that is actually produced and kept by the applicant.
377. Accordingly, given that the information may need to be created, the references to “proper records” and “complete and accurate compilation of information” can cause confusion and difficulty for applicants and auditors in terms of complying with the IMs.

Proposed solution

378. We propose to add exemptions and modifications to record-keeping under the IMs relating to information requirements. This change will allow a degree of flexibility in determining whether information may need to be created or developed from other information that is actually produced and kept by the applicant.
379. Our proposed solution is to align the scope of audit requirements to the information requirements, ie, the auditor is required to provide their opinion as to “whether proper records have been kept to enable the compilation of information required for a CPP proposal”.
380. Our main reason for this change is to provide clarity on the scope of audit requirements.

Chapter 8: Consumer consultation requirements

Purpose of this chapter

381. This chapter explains our proposed solutions to the problem we have identified with the consumer consultation requirements for CPP proposals.

Structure of this chapter

382. This chapter begins with a summary of our proposed changes to the consumer consultation requirements. Following this, we review the policy intent of the consumer consultation requirements. We then discuss the lack of clarity in those requirements, and set out our proposed solutions to this problem.

Summary of proposed changes

383. We are proposing two changes to the IMs to provide greater certainty about our expectations for consumer consultation, consistent with s 52R:

383.1 amending the consumer consultation IMs to require CPP applicants to notify consumers of the price and quality impact of any alternative investment options in its CPP proposal; and

383.2 in support of the change proposed above, we propose amending the verifier Terms of Reference in Schedule G of the IMs to require the verifier to report on the extent and effectiveness of the applicant's consultation.

Intent of the consumer consultation requirements

384. Having reviewed the consumer consultation requirements for CPP proposals, we consider that the intent behind them remains appropriate.

385. The current consumer consultation requirements require suppliers to inform and engage with consumers on the implications of the CPP proposal for consumers. This means the proposal is more likely to reflect the service quality that consumers demand and are willing to pay for.

386. In our 2010 IMs reasons paper, we stated:

The requirement relating to consumer consultation is one of 'adequate notification', by which the Commission means that the process, the medium used and the information provided must be sufficient to enable consumers to engage. This will likely differ according to the specific consumer base and the nature of the CPP proposal, and the supplier has discretion as to how it engages with its consumers.

387. Some suppliers sought clarification of what is considered 'adequate'. The Commission has intentionally left it broad to allow suppliers to exercise some

discretion as to the proposed channel of communication, given the nature of their consumer base.¹³⁶

388. Under Part 4, we must ensure that suppliers have incentives to supply services at a quality consumers demand.¹³⁷ The requirement that suppliers consult with consumers on a CPP application is a clear means of promoting this outcome.

389. A similar sentiment was expressed by the Major Electricity Users Group (MEUG) in submissions on our CPP emerging views paper:

...the long term benefits to consumers and the economy as a whole are, in the view of MEUG, likely to be higher if we can lift the level of engagement between monopoly service providers and end consumers and steer the response by the monopolies to that engagement towards that found in service-based sectors...

390. That may require more costs for both EDB and consumers in the CPP process but the benefits for both suppliers and consumers, may be commensurately higher and/or achieved earlier.¹³⁸

391. We consider that the way in which the IMs implement this intent could provide greater certainty for suppliers, while at the same time reducing the cost and complexity of CPP applications for suppliers as well.

There is a lack of clarity about our expectations concerning consumer consultation

Issues identified by stakeholders

392. In both feedback on the Orion CPP process, and submissions on the IM review, stakeholders have identified the following issues related to the consumer consultation requirements:

392.1 a lack of clarity about what we expect from consumer consultation;

392.2 duplication between Orion's consultation and our consultation process; and

392.3 a lack of time for adequate consultation due to the relative timing of the CPP WACC Determination and the CPP application windows for EDBs.

393. The ENA said that in the Orion process, the Commission expected a more comprehensive consultation than specified in the IMs. The ENA suggested that a review of consultation IMs was required.¹³⁹

¹³⁶ Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), paras 9.6.16 and 9.6.17.

¹³⁷ Commerce Act 1986, s 52A(1)(b).

¹³⁸ MEUG "Submission on emerging views on opportunities to improve the way default and customised price-quality paths work together" (24 March 2016), p. 2.

¹³⁹ ENA "Feedback on Orion customised price-quality path process" (14 April 2014), para 26.

394. Orion has said that the CPP IMs do not specifically require the applicant to consult on options and the impacts different options would have on price and quality. Orion recommended that the CPP IMs set out clearly what is required in this regard.¹⁴⁰ Other submitters have expressed similar views.¹⁴¹
395. Submissions further argued that this lack of clarity was one cause of the excessive cost of the CPP application process.
396. Powerco have further stated that there are challenges with consumer consultation, particularly for residential consumers such as a lack of knowledge, complexity of options, negative perceptions about the wider industry and price of electricity, unrealistic expectations amongst consumers, and widespread consumer apathy.¹⁴²
397. On the other hand, Vector noted in its feedback on the Orion CPP process that “it is appropriate for the IMs to require consultation to be carried out but to not be prescriptive of the form of the consultation – the regulated supplier should be able to judge the best mechanisms for gaining the views of their consumers”. Vector suggested that pre-engagement with the supplier could help ensure the consultation process will meet the needs to both parties.¹⁴³
398. Orion questioned whether the Commission was best placed to present the CPP proposal to consumers, and whether this duplication was necessary.¹⁴⁴ The ENA echoed this view, further suggesting that any overlap should be avoided, as it may confuse consumers, and impose unnecessary cost.¹⁴⁵
399. In addition, the timing of the WACC determination for CPP applications by EDBs (at the end of September) relative to the windows for EDBs to apply for a CPP (in February and May) limits the timeframe in which applicants can consult with

¹⁴⁰ Orion “Feedback on Orion customised price-quality path process” (14 April 2014), para 34. Orion reiterated this point during its presentation to the IM Review Forum and its submission on the problem definition paper, Dennis Jones (Industry Developments Manager (Commercial), Orion) “Cost-effectiveness of the rules and processes for CPP application” (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), pp. 247-248; Orion’s submission on the problem definition paper “Submission on the IM review” (21 August 2015), para 70.

¹⁴¹ PwC “Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015), para 115 and 122; MDL, Untitled submission on problem definition paper” (21 May 2015), p 12; Powerco “Feedback on Orion customised price-quality path process” (14 April 2014), para 9; Wellington Electricity’s submission “Input methodologies review – Problem definition” (21 August 2015), p. 9.

¹⁴² Powerco “Feedback on Orion customised price-quality path process” (14 April 2014), para 15.

¹⁴³ Vector “Feedback on Orion customised price-quality path process” (14 April 2014), para 5.

¹⁴⁴ Orion “Feedback on Orion customised price-quality path process” (14 April 2014), para 38.

¹⁴⁵ ENA “Feedback on Orion customised price-quality path process” (14 April 2014), para 26(d). See also: Powerco “Feedback on Orion customised price-quality path process” (14 April 2014), para 11. A similar point was raised during the IM review forum, Lynne Taylor (PwC) “Cost-effectiveness of the rules and processes for CPP application” (presentation at the Commerce Commission input methodologies review forum, Wellington, 29 July 2015), p. 269.

consumers. Stakeholders have said that this timeframe is not sufficient for adequate consultation.¹⁴⁶

400. This last issue has been resolved by a proposed change to the cost of capital IMs, aligning the CPP WACC with the underlying DPP WACC.¹⁴⁷

Problem definition

401. The problem with the current consumer consultation IMs is that they lack clarity about our expectations. In particular, that they do not specify that suppliers must consult on the price and quality impacts of any alternative investments the supplier proposes in its CPP. We consider that conclusions drawn from consumer consultation that has not clearly presented price/quality trade-offs are likely to be unreliable.
402. Consistent with the expenditure objective in our CPP evaluation criteria, we expect that a prudent supplier has weighed up the price/quality trade-offs when it considers various investment alternatives, where relevant, and would inform affected consumers of these trade-offs and provide an opportunity for affected consumers to comment.
403. However, in practice, the IMs do not explicitly set out this expectation, as we are not prescriptive about the content and form of consumer consultation, requiring only “adequate notification”.¹⁴⁸ This is consistent with our view that suppliers are best placed to judge the best manner of engaging with their particular customer base.
404. However, the lack of prescription in the IMs appears to have resulted in a lack of certainty about our expectations for consumer consultation.
405. We agree with stakeholders that greater certainty of applicants’ consumer consultation obligations is warranted. To provide this, we propose the solutions below.

Proposed solution

406. We propose to amend the IMs to explicitly require applicants to consult with consumers on the price/quality impact of any proposed investment alternatives. Further, in the case of EDBs, we propose explicitly requiring applicants to consult on the price/quality trade-offs made in arriving at their proposed investment alternatives.
407. Our main reason for this change is to provide greater clarity about our expectations for CPP consultation.

¹⁴⁶ Genesis “Feedback on Orion customised price-quality path process” (14 April 2014), pp 1-2; Orion “Feedback on Orion customised price-quality path process” (14 April 2014), para 36; Powerco “Feedback on Orion customised price-quality path process” (14 April 2014), para 10.

¹⁴⁷ Commerce Commission “Input methodologies review draft decisions: Topic paper 4 – Cost of capital issues” (16 June 2016).

¹⁴⁸ Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26, cl 5.5.1(1).

408. We consider that this change is sufficient, and are not proposing to include any further prescriptive requirements for consumer consultation. We consider that any further requirements might limit supplier's ability to tailor its consultation to the circumstances of its customers and of their applications, or cause additional consultation costs that might provide little additional benefit.
409. The reason we are proposing treating EDBs and GPBs differently regarding quality trade-offs is that gas network quality (however measured) is not as directly linked to investment behaviour as electricity network quality.
410. We are also proposing to add a requirement to the verifiers' Terms of Reference to support the change to the consultation requirements. This proposed change will require the verifier to report on the extent and effectiveness of the supplier's consultation with consumers.

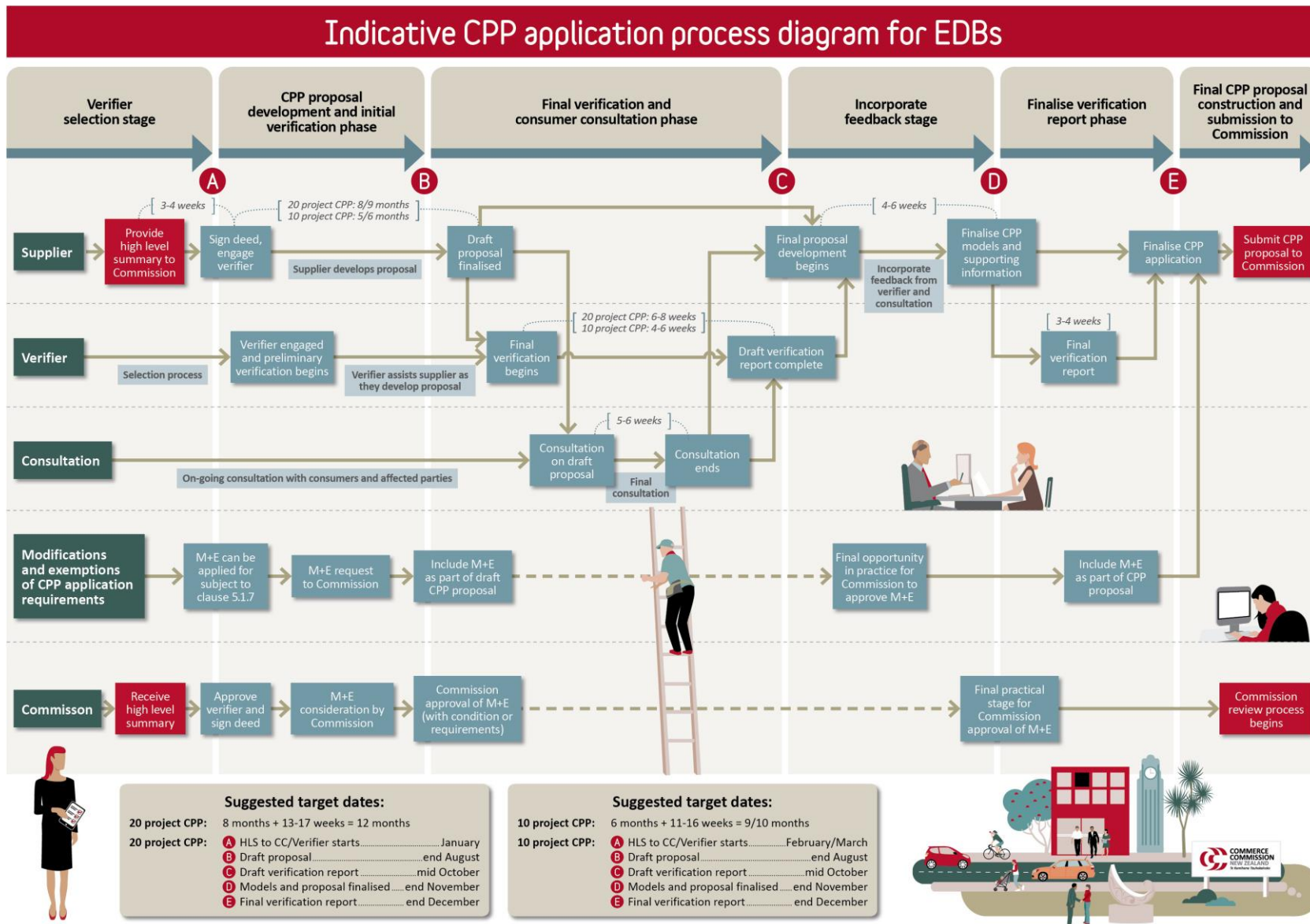
Attachment A: Indicative CPP application process diagram

Purpose of this attachment

411. This attachment contains an indicative diagram of the CPP application process that illustrates how the different components of the application process set out in the CPP IMs interact.
412. It is intended to be an aid for stakeholders to better understand how the CPP application process works in practice. In particular we think the diagram is a useful starting point for intending CPP applicants and a prompt for early discussion and engagement between the CPP applicant and the Commission.

Key considerations in using the diagram

413. Readers should note:
 - 413.1 The timeframes provided in the diagram are indicative only, intended to be a guide at the early stages of a supplier's consideration of a CPP proposal in the absence of other information. We anticipate the stages of the process may vary in length depending on the nature of different proposals and the business practices of the particular applicant.
 - 413.2 For simplicity we have represented the CPP application process from the viewpoint of an electricity distribution business. We expect the diagram to also be a useful starting point for gas pipeline businesses (GPBs) but note that in the absence of a specified CPP application window for GPBs, there might be some nuances in the process that this diagram does not take account of.
 - 413.3 We have used the following acronyms: HLS ('high level summary' – see Schedule F5 of EDB IM determination), CC ('Commerce Commission'), CPP ('customised price-quality path'), M+E ('modifications and exemptions' – see clause 5.1.7 of EDB IM determination), EDBs ('electricity distribution businesses').



Attachment B: Summary of the review of CPP IMs

Purpose of this attachment

414. The purpose of this attachment is to:

414.1 Present the draft results of our review of the CPP requirements IMs for electricity lines services and gas pipeline services in accordance with our decision-making framework; and

414.2 Summarise our draft decisions on whether to change the CPP requirements IMs, and explain our reasons for changing or not changing them.

415. In doing so, this attachment performs, in respect of the CPP requirements IMs, the role that the report on the review performs in respect of all other areas of the IMs.¹⁴⁹

Relationship with the Report on the IM review

416. The Report on the IM review is a separate paper that records our draft decisions on whether to change each of the existing IM decisions as a result of the IM review. For those existing IM decisions we have decided to change, it explains how and why. It also explains our reasons for not changing those decisions we propose not to change as part of the IM review.

417. As noted in the Report on the IM review, for some areas of the IMs, extracting the existing IM decisions was straightforward (for instance, for those chapters of the 2010 IM reasons papers that began with IM overview tables summarising decisions we made in that area).¹⁵⁰ In other areas, including for the CPP requirements IMs, we have extracted the existing decisions from descriptions in the text of the relevant reasons papers.

Why we have presented our draft decisions in respect of the CPP IMs separately

418. Rather than being included in the Report on the IM review, our draft decisions on the CPP requirements IMs are instead covered by this attachment, so that all information about our draft decisions regarding the CPP requirements is in one place.

¹⁴⁹ We expect to publish the Report on the IM Review on 22 June 2016.

¹⁵⁰ For example, for EDB and GPB cost allocation policy and implementation decisions, refer to Commerce Commission "Input methodologies (electricity distribution and gas pipeline services): Reasons paper" (22 December 2010), p. 55-56.

Structure and format of this attachment

419. We have structured the decisions relating to the CPP requirements IMs as follows:
 - 419.1 Content of CPP applications;
 - 419.2 Process relating to CPP proposals;
 - 419.3 Assessing and evaluating CPP proposals; and
 - 419.4 Determining a CPP.
420. As in the Report on the IM review, we have assigned each existing decision with a unique code (eg, CP01) and presented each existing decision in the same tabular format.
421. For each existing decision, this attachment indicates whether or not we propose to change it (either at a policy level, or in terms of the implementation of the decision).
422. For those existing decisions that we do propose changing, it summarises how and why, referring back to the body of this paper or other papers for more information.
423. It also presents those existing decisions that, having considered them in light of our framework, submissions on the IM review so far, and all other relevant information before us, we do not propose changing.

Review of existing decisions relating to the content of CPP applications

Price path information

Decision CP01 Price path information	Original 2010 decision CPP application must contain sufficient information to support a building blocks analysis necessary to determine a price path. Building block information to be provided in spreadsheets. See section 9.2 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

424. We do not propose to change to this decision or the way it is implemented.
425. We have clarified in this paper that our interpretation of the existing IMs is that the quantitative information required in the spreadsheets and repeated in narrative can be provided in the spreadsheets with appropriate cross referencing to the narrative.
426. Further details are set out in Chapter 5 – Information requirements.

Expenditure information – qualitative

Decision CP02 Expenditure information – qualitative	Original 2010 decision CPP application must include information on capex, opex, demand and network in qualitative form as specified in Schedule D. See section 9.5 and Appendix K3 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

427. We propose an implementation change to this decision as it applies to EDBs. We have yet to consider whether a change is required for GPBs at this stage.¹⁵¹

¹⁵¹ We have not yet reached draft decisions on the CPP information requirements IMs for gas pipeline businesses. Further discussion on this matter is found at para 40.

428. We propose to:

428.1 better align the information requirements set out in Schedule D of the IMs with Attachment A of the information disclosure Determination; and

428.2 remove some of the complexity created by the level of disaggregation.

429. We consider that these changes will reduce the cost and complexity of applying for a CPP. Further details are set out in Chapter 5 – Information requirements.

Expenditure information – quantitative

Decision CP03 Expenditure information – quantitative	Original 2010 decision CPP application must include information on capex, opex, demand and network in quantitative form. This information is quantitative and must be provided in spreadsheet format contained in schedule E. See section 9.5 and Appendix K3 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

430. We propose an implementation change to this decision as it applies to EDBs. We have yet to consider whether a change is required for GPBs at this stage. ¹⁵²

431. We propose to:

431.1 align the capex and opex categories in the CPP requirements IMs with those defined in the ID Determination;

431.2 align the CPP information requirements with information disclosure requirements, by asking for forecasts in real and nominal terms and ask for demand forecasts in tabular form;

431.3 align the CPP information requirements with information disclosure requirements, by removing the assignment of projects and programmes to service categories;

431.4 remove the requirement to disaggregate opex into controllable and uncontrollable categories; and

¹⁵² We have not yet reached draft decisions on the CPP information requirements IMs for gas pipeline businesses. Further discussion on this matter is found at para 40.

431.5 refine the requirements for forecasts on related party transactions so these will be at an aggregate level rather than by project.

432. We consider that these changes will reduce the cost and complexity of applying for a CPP and clarify these areas of the CPP requirements IMs. Further details are set out in Chapter 5 – Information requirements.

Period of information required

Decision CP04 Period of information required	Original 2010 decision CPP applicant must specify the period of the CPP that is sought and provide information sufficient to cover a 5 year CPP period and the preceding years for which ID information is not yet available. Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

433. We do not propose any change to this decision or the way it is implemented.

Detail on material projects and programmes

Decision CP05 Detail on material projects and programmes	Original 2010 decision CPP application must include detailed information on the most material projects and programmes relating to the CPP proposal. See section 9.5 and Appendix K3 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

434. We propose an implementation change for this decision as it applies to EDBs and GPBs.

435. We propose to allow a level of flexibility in the number of identified projects for which more in depth information is required, forming part of the CPP proposal (these projects are then able to be verified in greater detailed). The verifier will judge on a case by case basis the appropriate number of “identified projects”.

436. We consider that these changes will reduce the cost and complexity of applying for a CPP and ensure that the verifier is able to focus the detailed verification on the most material projects in a CPP proposal.

437. Further details are set out in Chapter 6 – Verification requirements.

Information relevant to prices

Decision CP06 Information relevant to prices	<p>Original 2010 decision</p> <p>CPP application must contain information on proposed new pass-through costs, and proposed recoverable costs relating to costs of making CPP application.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

438. We do not propose any change to this decision or the way it is implemented.

439. We note that we are expanding the range of pass through and recoverable costs for CPPs, as discussed in Chapter 3 – Improvements to the way the DPP and CPP work together.

Verification

Decision CP07 Verification report	<p>Original 2010 decision</p> <p>CPP application must include a verification report, all information provided to the verifier, and the verifier's certificate of approval.</p> <p>See section 9.6 and Appendix K4 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

440. We do not propose any change to this decision or the way it is implemented.

441. We note that we have proposed changes to the verification process, set out in below in CP21.

Audit and assurance

Decision CP08 Audit and assurance report	<p>Original 2010 decision</p> <p>CPP application must include an audit report signed by the auditor.</p> <p>See section 9.6 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

442. We do not propose any change to this decision or the way it is implemented.
443. We note that we have proposed changes to the audit process, set out in below in CP22.

Consumer consultation

Decision CP09 Consumer consultation evidence	<p>Original 2010 decision</p> <p>CPP application must provide evidence of consumer consultation.</p> <p>See section 9.6 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

444. We do not propose any change to this decision or the way it is implemented.
445. We note that we have proposed changes to the consumer consultation process, set out in below in CP23.

Certification

Decision CP10 Certification	<p>Original 2010 decision</p> <p>CPP application must include the certificates recording Director's certification.</p> <p>See section 9.6 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

446. We do not propose any change to this decision or the way it is implemented.
447. We note that we have proposed changes to the certification process, set out in below in CP24.

Modifications and exemptions of CPP application requirements

Decision CP11 Modification or exemption of CPP application requirements (2015 decision)	<p>Original 2015 decision (as part of IM review fast track)</p> <p>CPP application must include information relating to all approved modifications and exemptions, including evidence any conditions of the approval have been met, and an indication of where the exemptions and modifications have been applied.</p> <p>Input methodologies review – Amendments to input methodologies for customised price-quality paths – Final reasons paper for Limb 1 of the CPP fast track (12 November 2015)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

448. We do not propose any change to this decision or the way it is implemented.

Information regarding quality

Decision CP12 Information regarding quality	<p>Original 2010 decision</p> <p>If sought, a CPP application must include information to support a quality standard variation, including reasons for the change and an engineer's report (EDBs only).</p> <p>See section 9.3 and Appendix K2 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB

We are not proposing any changes to this decision

449. We do not propose change to this decision or the way it is implemented.

Cost allocation information

Decision CP13 Cost allocation information	<p>Original 2010 decision</p> <p>CPP application must include information on the allocation of operating costs and RAB values.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

450. We do not propose any change to this decision or the way it is implemented.

Asset valuation information

Decision CP14 Asset valuation information	<p>Original 2010 decision</p> <p>CPP application must include information on RAB roll forward, depreciation, revaluations, commissioned assets, asset disposals, and works under construction.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We propose implementation and policy changes for this decision

451. We propose changes in policy and implementation as it applies to EDBs.

452. We propose to:

452.1 group projects and programmes by asset categories and simplify the calculation of depreciation for forecast commissioned assets; and

452.2 amend the depreciation information requirements to reflect that depreciation is calculated using asset expenditure category which is a more aggregated category than asset types.

453. We consider that these changes will reduce the cost and complexity of applying for a CPP. Further details are set out in Chapter 5 – Information requirements.

Tax information

Decision CP15 Tax information	Original 2010 decision CPP application must include information on regulatory tax allowance, tax losses, permanent differences, amortisation of initial differences in asset values, deferred tax, temporary differences, and regulatory tax asset value. Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

454. We do not propose any change to this decision or the way it is implemented.

Information relevant to alternative methodologies

Decision CP16 Information relevant to alternative methodologies	Original 2015 decision (as part of IM review fast track) CPP application must include information demonstrating alternative methodologies have equivalent effect. Input methodologies review – Amendments to input methodologies for customised price-quality paths – Final reasons paper for Limb 1 of the CPP fast track (12 November 2015)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

455. We do not propose any change to this decision or the way it is implemented.

Cost of capital information

Decision CP17 Cost of capital information	Original 2010 decision CPP application must include information regarding WACC. Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

456. We do not propose any change to this decision or the way it is implemented.

Gas pricing methodology to be submitted with CPP proposals – GDBs and GTBs

Decision CP18 Gas pricing methodology to be submitted with CPP proposal – GDBs and GTBs	Original 2010 decision GPB will be required to submit a pricing methodology as part of its CPP proposal if it has been identified through the most recent information disclosure summary and analysis as being required to do so, were it to apply for a CPP. See section 9.3 and Appendix I of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	GDB/GTB

We are not proposing any changes to this decision

457. We do not propose any change to this decision or the way it is implemented.

Review of existing decisions relating to processes for CPP proposals

General matters

Decision CP19 General matters	Original 2010 decision A supplier may seek a CPP by submitting a CPP application that complies with the requirements specified in the IMs. CPP application must include the reasons for the proposal, information on priority of the proposal, and duration of the CPP period sought. Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

458. We do not propose any change to this decision or the way it is implemented.

Quality-only CPP

Decision CP20 Quality-only CPP	Original 2010 decision A supplier may seek a quality-only CPP which doesn't require verification. The quality only CPP must be reviewed by an independent engineer (EDBs only). See section 9 and Appendix K2 of the 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB

We propose changes in policy and implementation

459. We propose a policy change to remove the option for EDBs to apply for a quality-only CPP.

460. We consider that we will be able to achieve a materially equivalent outcome to a quality-only CPP using a DPP reopener and we consider that this is a more appropriate mechanism for this type of change to the quality path.

461. Further details on our proposed decision to remove quality-only CPPs and introduce a quality standard variation reopener are set out in Chapter 3 – Improvements to the way the DPP and CPP work together.

Verification requirements

Decision CP21 Verification requirements	<p>Original 2010 decision</p> <p>A verifier must be engaged and all proposals must be verified, except quality-only proposals. Applicant must provide verifier with necessary information to verify the proposal.</p> <p>See section 9.6 and Appendix K4 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This original decision applies to (sectors):	EDB/GDB/GTB

We propose implementation changes for this decision

462. We propose implementation changes for this decision as it applies to EDBs and GPBs.
463. Our proposed changes aim to clarify the role of the verifier, improve the verification process and allow a degree of flexibility in the verification process.
464. We propose to:
- 464.1 add a new section to the verifier’s Terms of Reference in Schedule G of the IMs that defines the verifier’s role, purpose, and obligations;
 - 464.2 require the CPP applicant to provide us with a high-level summary of their application by the time the verifier is engaged;
 - 464.3 amend the tripartite deed requirements in Schedule F5 to include a communication protocol that sets out the roles and obligations of the parties during the verification process regarding communication, and to allow meeting minutes to be used as the evidential basis for any verifier technical opinions;
 - 464.4 allow the verifier greater flexibility in the number of identified projects that are selected;
 - 464.5 remove the obligation for the verifier to consider non-standard depreciation; and
 - 464.6 remove the requirement for an independent engineer to provide a report on a quality standard variation, and instead allowing suppliers to prepare the report themselves, subject to verification by the verifier (EDB IMs only).
465. Further details are set out in Chapter 6 – Verification requirements.

Audit and assurance requirements

Decision CP22 Audit and assurance requirements	Original 2010 decision An auditor must be engaged and the CPP proposal must be audited. See section 9.6 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This original decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

466. We propose an implementation change to this decision as it applies to EDBs and GPBs.
467. Our proposed changes would more clearly distinguish the auditor's role in respect of historical and forecast information, and better align the IM requirements with industry standards for audit under the Financial Reporting Act 2013.
468. We propose to:
- 468.1 modify the audit requirements to differentiate the role of the auditor with respect to historical financial information and forecast financial information; and
 - 468.2 clarify that the auditor needs to provide a report as part of the audit.
469. Further details are set out in Chapter 7 – Audit requirements.

Consumer consultation requirements

Decision CP23 Consumer consultation requirements	<p>Original 2010 decision</p> <p>A CPP applicant must consult with its consumers. Consumer feedback is particularly relevant where different price/quality trade-offs are available. Our requirement is that there should be adequate notification and promotion of consumer engagement. The applicant must report on the extent that consumer feedback has been taken into consideration but the Commission notes that consumer agreement to the proposed CPP is not required.</p> <p>See section 9.6 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This original decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

470. We propose an implementation change for this decision as it applies to EDB and GPBs.
471. We propose to:
- 471.1 require CPP applicants to notify consumers of the price and quality impact of any alternative investment options in their CPP proposal;
 - 471.2 require the verifier to report on the extent and effectiveness of the applicant's consultation; and
 - 471.3 require the applicant to provide us with its planned consultation strategy early in the CPP process
472. Further details are set out in Chapter 8 – Consumer consultation requirements.

Certification requirements

Decision CP24 Certification requirements	<p>Original 2010 decision</p> <p>The Commission requires certification of the information in a proposal.</p> <p>See section 9.6 of 2010 EDB-GPB IM reasons paper:</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This original decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

473. We do not propose any change to this decision or the way it is implemented.

Reconsideration of a CPP

Decision CP25 Reconsideration of a CPP	Original 2010 decision CPP may be re-opened following catastrophic events, change events, errors, and conditions for reconsideration, and process for amending price-quality path after reconsideration. The CPP may also be reopened to provide for contingent or unforeseen projects for Gas Transmission businesses. See section 8.4 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We propose an implementation change for this decision

474. We have proposed to expand the range of circumstances under which we may reconsider a CPP:
- 474.1 Expanding the existing error provisions.
 - 474.2 Introducing a major transactions reopener.
 - 474.3 Introducing a reopener so we can align the DPP and CPP.¹⁵³
 - 474.4 Introducing a reopener for where the path becomes unworkable.
 - 474.5 Introducing contingent and unforeseen project reopeners for EDBs and GDBs.
475. These changes are set out, along with the changes to the DPP reconsideration provisions, in the Report on the IM review.¹⁵⁴

¹⁵³ The reasons for this reopener are explained in Topic paper 4 – Cost of capital issues.

¹⁵⁴ We expect to publish the Report on the IM Review on 22 June 2016. Our proposal to introduce contingent and unforeseen project reopeners for EDBs and GDBs is also explained in Chapter 3 - Improvements to the way the DPP and CPP work together.

Modification or exemption of CPP application requirements

CP26 Modification or exemption of CPP application requirements (2015 decision)	Original 2015 decision (as part of IM review fast track) Commission may approve modification and exemption to the content of a CPP application; information required in a CPP proposal; and consumer consultation, verification, and audit and certification requirements for CPP proposals. Input methodologies review – Amendments to input methodologies for customised price-quality paths – Final reasons paper for Limb 1 of the CPP fast track (12 November 2015)
This decision applies to (sectors):	EDB/ GDB/GTB

We propose an implementation change for this decision

476. We propose a change to the way this decision is implemented for EDBs.
477. We propose to make the scale of a supplier an explicit consideration when deciding on requests for modifications and exemptions.
478. Further details are in the Chapters 4 – Evaluation of CPP proposals; and 5 – information requirements.

Review of existing decisions relating to processes for assessing and evaluating CPP proposals

Evaluation criteria

Decision CP27 Evaluation criteria	Original 2010 decision Commission must assess all CPP proposals against the evaluation criteria specified in the IMs. See section 9.4 of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

479. We do not propose any change to this decision or the way it is implemented.

480. Further details set out in Chapter 4 – Evaluation of proposals.

Review of existing decisions relating to processes for determining a CPP

Determination of annual allowable revenues

Decision CP28 Determination of annual allowable revenues	Original 2010 decision Allowable revenue amounts by reference to building blocks components and a 'CPI-X' smoothing requirement. see section 9.3 and Appendix K of 2010 EDB-GPB IM reasons paper: Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)
This original decision applies to (sectors):	EDB/GDB/GTB

We propose implementation changes for this decision

481. We propose to amend the GDB CPP IMs to codify the approach to claw-back that we used in making Orion's 2013 CPP determination.¹⁵⁵ In particular, we propose:
- 481.1 reflecting that the claw-back can be for historical over-recovery and under-recovery of revenue; and
 - 481.2 that the present value of claw-back amounts would be used if adjusting for claw-back in the BBAR calculation.
482. In addition, to give effect to the proposed change from a lagged revenue cap to a pure revenue cap for GTBs,¹⁵⁶ we propose removing references to the ΔQ factor in the revenue-setting formula in the GTB CPP IMs.

¹⁵⁵ ENA and PwC have previously submitted that the wording of the formula that adjusts BBAR for any applicable claw-back could be clarified to reflect that the claw-back can be for historical over-recovery and under-recovery of revenue. See ENA and PwC "Review of Input Methodologies" (14 February 2014), para 31.

¹⁵⁶ See Commerce Commission "Input methodologies review draft decisions: Topic paper 1 – Form of control and RAB indexation for EDBs, GPBs and Transpower" (16 June 2016); and the Report on the IM review, under existing decision SP02.

Cost allocation and asset valuation

Decision CP29 Cost allocation and asset valuation	<p>Original 2010 decision</p> <p>Allocation of forecast operating costs and calculation of rolled-forward asset values must largely follow rules applying to information disclosure.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

483. We do not propose any changes to this existing decision in this paper. However, we note that this existing decision would be affected by changes we are proposing to existing decisions on cost allocation and asset valuation. These changes are discussed in the Report on the IM review at Chapter 4 – Cost allocation decisions we propose changing, and Chapter 5 – Asset valuation changes we propose changing.

Treatment of taxation

Decision CP30 Treatment of taxation	<p>Original 2010 decision</p> <p>Regulatory tax allowance is calculated using the modified deferred tax method for EDBs and GDBs and a tax payable method for GTBs.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

484. We do not propose any changes to this existing decision in this paper. However, we note that this existing decision would be affected by changes we are proposing to existing decisions on taxation. These changes are discussed in the Report on the IM review at Chapter 6 – Treatment of taxation decisions we propose changing.

Cost of capital

Decision CP31 Cost of capital	<p>Original 2010 decision</p> <p>Method of determining cost of capital uses the simplified Brennan-Lally model.</p> <p>Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

485. We do not propose any changes to this existing decision in this paper. However, we note that this existing decision would be affected by changes we are proposing to existing decisions on the cost of capital. These changes are discussed in the Report on the IM review at Chapter 7 – Cost of capital decisions we propose changing.

Alternative methodologies with equivalent effect

Decision CP32 Alternative methodologies with equivalent effect (2015 decision)	<p>Original 2015 decision (as part of IM review fast track)</p> <p>Alternative building block methodologies for cost allocation and asset valuation, treatment of taxation and the TCSD may be applied where they produce an equivalent effect.</p> <p>Input methodologies review – Amendments to input methodologies for customised price-quality paths – Final reasons paper for Limb 1 of the CPP fast track (12 November 2015)</p>
This decision applies to (sectors):	EDB/GDB/GTB

We are not proposing any changes to this decision

486. We do not propose to change to this decision or the way it is implemented.