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Powerco's transition to the 2020-2025 default price-quality path

Process and Issues paper

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Purpose

1. On 1 April 2018 Powerco Limited (**Powerco**) began its five-year Customised Price-Quality Path (**CPP**), which is due to end on 31 March 2023. Powerco will transition from its 2018-2023 CPP to the final two years of the 2020-2025 Default Price-Quality Path (**DPP3**).[1]

2. Given the impending expiry of Powerco's CPP, the Commerce Commission (**Commission**) is now looking to set Powerco's price path for the remainder of DPP3. This paper sets out the process we intend to follow in determining Powerco's transition to DPP3 and seeks feedback from interested persons on key issues.[2]

Summary

3. This paper sets out:

    3.1 the legal framework regarding a transition from a CPP to a DPP, i.e., the Commerce Act 1986 (the **Act**);

    3.2 the Commission's previous decisions regarding transitions from a CPP to a DPP;

    3.3 the Commission's proposed timeline for making determinations and the timing of opportunities for interested persons to contribute; and

    3.4 the key issues on which we are inviting written submissions at this stage.

Background

4. There are 16 price-quality regulated electricity distribution businesses (**EDBs**), which includes Powerco. These EDBs are subject to either the DPP or, upon application, a CPP. Currently, only Aurora and Powerco are subject to CPPs.

5. Powerco's CPP ends on 31 March 2023, after which it will revert to DPP3 for the final two years (1 April 2023 – 31 March 2025).

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[1] The time periods for the previous DPPs are 2010-2015 for DPP1, and 2015-2020 for DPP2.

[2] The definition of 'interested persons' is set out in paragraph 2.15 of the Information Disclosure for Electricity Distribution Businesses and Gas Pipeline Businesses: Final Reasons Paper dated 1 October 2012. The paper states that it interprets 'interested persons' to "broadly include (among others) persons who are affected by the way in which regulated services are provided, whether they take an active interest in the performance of suppliers or not." Paragraphs 2.15.1 to 2.15.7 give examples of who this includes.

Legal Framework

Section 52A – Purpose of Part 4

6. Part 4 of the Act provides for the regulation of the price and quality of goods or services in markets where there is little or no competition, and little or no likelihood of a substantial increase in competition.

7. Section 52A sets out the purpose of Part 4 and states:

52A Purpose of Part

(1) The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—

(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and

(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and

(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and

(d) are limited in their ability to extract excessive profits.

8. In deciding whether to roll over the prices that applied at the end of the CPP, or to set different starting prices, the primary consideration will be which option will better promote the objectives in the s 52A purpose.

Section 53K – Purpose of default/customised price-quality regulation

9. Section 53K establishes that "the purpose of default/customised price-quality regulation is 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."

10. This purpose emphasises the desirability of keeping the cost and complexity of a transition low, including in our approach to setting starting prices.

Section 53X – What happens when a customised price-quality path ends

11. What happens when a CPP ends is governed by s 53X of the Act. Section 53X(2) of the Act gives the Commission two options for determining prices for the CPP-to-DPP transition. Section 53X states:

53X What happens when customised price-quality path ends

(1) When the customised price-quality path of a supplier of goods or services ends, the supplier is subject to the default price-quality path that is generally applicable to other suppliers of those goods or services.

(2) The starting prices that apply at the beginning of the default price-quality path are those that applied at the end of the customised price-quality path unless, at least 4 months before the end of the customised price-quality path, the Commission advises the supplier that different starting prices must apply.

(3) The supplier remains subject to the default price-quality path until—

(a) the end of the period for which it applies to other suppliers; or

(b) a new customised price-quality path begins to apply to the supplier.

(4) To avoid doubt, a supplier who is or was subject to a customised price-quality path may apply in accordance with section 53Q for another customised price-quality path

12. Section 53X(1) and 53X(2) contain the most relevant considerations and are explored in more detail below.

Section 53X(1) – Making the supplier subject to the DPP

13. Section 53X(1) establishes that when Powerco's CPP ends it will become subject to the DPP that is "generally applicable" to the other EDBs. In this case, the generally applicable DPP is the DPP3 determination.[3]

14. Under clause 3.3 of the DPP3 determination, the determination does not apply to Powerco until the expiration of Powerco's CPP determination. This means that, when Powerco's CPP determination expires on 31 March 2023, the EDB DPP3 determination will apply to Powerco from 1 April 2023 onwards.

15. However, some amendments to the DPP3 determination may be required to ensure the DPP that is "generally applicable" to the other EDBs is workable for Powerco.[4] Without these amendments, the mechanics of the DPP determination may not effectively regulate Powerco's revenue.

Section 53X(2) – Setting the transitioning supplier's starting prices

16. Section 53X(2) establishes a default position whereby Powerco's CPP prices will be applicable when it transitions to DPP3.[5] However, it also gives the Commission the discretion to apply alternative starting prices provided we give Powerco notice of this at least four months prior to their CPP ending.

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[3] A copy of DPP3 can be found here: https://comcom.govt.nz/__data/assets/pdf_file/0029/191972/2019-NZCC-21-Electricity-distribution-services-default-price-quality-path-determination-2020-27-November-2019.pdf

[4] Any amendments to a DPP determination must be made under s 52Q of the Commerce Act, and we note that s 52Q(1) requires the Commission to consult with interested parties on any material amendments to the DPP determination.

[5] We note that s 53X(2) deals with the starting prices that apply when a CPP ends and the supplier transitions to the DPP, while s 53P(11) deals with the starting prices (and rates of change and quality standards) that apply when a DPP ends and the Commission has not reset the DPP for the next regulatory period. Section 53P(11) has the effect of extending DPP starting prices if the Commission doesn't reset it when a DPP ends,

17. We have previously considered how we should set a transitioning supplier's starting prices under s 53X(2) when Orion New Zealand Limited transitioned from its CPP to the EDB DPP for the last year of the 2015-2020 regulatory period, and when Wellington Electricity Limited transitioned from its CPP to the EDB DPP one year into its four-year 2018-2021 CPP . We set out our key considerations for each of these transitions in our "Previous CPP to DPP decisions" section beginning at paragraph 26 below.

18. Our discretion in setting starting prices under s 53X(2) involves:

    18.1 choosing between rolling over the prices that applied at the end of the CPP or setting different starting prices; and

    18.2 if we choose to set different starting prices, deciding on the prices that apply.

19. In exercising our discretion under s 53X(2), we must do so in the manner we judge best meets the purpose of Part 4 of the Commerce Act (as set out in s 52A) and the purpose of DPP/CPP regulation (as set out in s 53K). However, the s 52A purpose provides the primary objectives and considerations that we must give weight to when exercising our judgement.

20. The factors most relevant to the exercise of our s 53X(2) discretion are:

    20.1 the s 52A(1)(a) outcome relating to incentives to innovate and invest;

    20.2 the s 52A(1)(b) outcome that suppliers are limited in their ability to extract excessive profits; and

    20.3 the s 53 K purpose regarding the desirability of keeping the cost and complexity of the transition low, including our approach to setting starting prices.

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while section 53X(2) establishes that the CPP starting prices will roll over at the end of a CPP, unless the Commission advises differently before the end of that CPP. The relevance of s 53P is discussed in further detail below.

21. However, as previously stated, when deciding whether to roll over the prices that applied at the end of the CPP, or to set different starting prices, the primary consideration will be deciding which option better promotes the objectives in the s 52A purpose. If, for example, rolling over the prices that applied at the end of the CPP would be inconsistent with limiting the supplier's ability to extract excessive profits, this would weigh in favour of setting different starting prices. This could be the case where, for instance, a CPP was required for a temporary spike in expenditure. If the prices that applied at the end of the CPP were rolled over in this instance, the prices would not reflect the lower level of future expenditure and the supplier may extract excessive profits.

Section 53P – Resetting starting prices, rates of change and quality standards

22. If we decide to set different starting prices, s 53P (which sets out the requirements for resetting the DPP at the end of a regulatory period) is a relevant consideration. Section 53P requires that starting prices at the start of a DPP:

    22.1 be either the prices that applied at the end of the preceding regulatory period (s 53P(3)(a)), or based on the current and projected profitability of the supplier (if prices are being reset, s 53P(3)(b));

    22.2 must not seek to recover any excessive profits made during any earlier period (53P(4)); and

    22.3 must not be derived from comparative benchmarking (53P(10)).

23. We have some flexibility in how we set prices based on the current and projected profitability of the supplier. In particular, we are not required to undertake a full 'building blocks' analysis. Nor are we required to accommodate all of a supplier's specific circumstances, given the low-cost nature of DPP regulation.

24. Our view is that it is appropriate for us to apply the section 53P restrictions on setting starting prices when making decisions under section 53X. This is unless particular circumstances lead us to consider that this would be inconsistent with sections 52A or 53K.

25. Price shocks are also a relevant consideration we refer to later in this paper, and we note that s 53P(8)(a) states:

> (8) The Commission may set alternative rates of change for a particular supplier—
>
> (a) as an alternative, in whole or in part, to the starting prices set under subsection (3)(b) if, in the Commission's opinion, this is necessary or desirable to minimise any undue financial hardship to the supplier or to minimise price shock to consumers.

Previous CPP to DPP transitions

26. This section outlines how a transition from a CPP to a DPP might work, and issues that may arise. It is not exhaustive, but it informs discussion on possible approaches we might take based on approaches we have taken in the past. It includes discussion of:

    26.1 Wellington Electricity's transition from its 2018-2021 CPP to DPP3;

    26.2 Orion's transition from its 2014-2019 CPP to DPP2;

    26.3 interactions between the DPPs and CPPs more broadly; and

    26.4 previous discussions on Powerco's transition from its CPP to DPP3.

Wellington Electricity's transition from its 2018-2021 CPP to DPP3

27. When we considered Wellington Electricity's CPP to DPP3 it had four years to run in DPP3. In this case we decided that a Building Blocks Allowable Revenue (BBAR) approach most appropriately met the purposes of the Act.[6] The BBAR approach we applied was the same as the one we applied to other EDBs for DPP3, but we used updated figures, including information from Wellington Electricity's most recent information disclosure at the time.

28. In making this decision, we exercised our discretion under s 53X, while being guided by the purposes in s 52A and s 53K. In particular, we considered that our decision:

    28.1 maintained Wellington Electricity's incentives to invest (s 52A(1)(a);

    28.2 limited its ability to extract excessive profits (s 52A(1)(d);

    28.3 reflected a relatively low-cost approach to the transition (s 53K); and

    28.4 was consistent with s 53P.[7]

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[6] Our final reasons paper for Wellington Electricity's transition from CPP to DPP can be found here: comcom.govt.nz/__data/assets/pdf_file/0034/228886/Wellington-ElectricityE28099s-transition-to-the-2020-2025-DPP-final-decision-Reasons-paper-26-November-2020.pdf

[7] Our reasoning is explained further in paragraphs 3.5-3.14, ibid

Orion's transition from its 2014-2019 CPP to DPP

29. Orion had only one year to run in the 2015-2020 DPP2, and we decided to use a less complex, lower-cost approach than BBAR to meet the purposes of the Act. Our final decision was to set Orion's starting prices the same as the allowable prices that applied at the end of its CPP, excluding claw-back (its allowable claw-back amount was calculated to be fully recovered over the five-year CPP period), with a CPI adjustment.[8]

30. We acknowledged that a full BBAR approach had merit, but decided that considerations of efficiency, complexity, and cost were best served by a lower-cost modified roll-over approach for a 1-year price-quality path.[9] A roll-over approach continues the price-quality path at the end of a CPP into the subsequent beginning of a DPP. It was, in effect, an extension of Orion's CPP prices for another year.

31. We also indicated we had flexibility to take a case-by-case approach for other CPP-to-DPP transitions in future. Transitions should depend on the particular circumstances facing an EDB and its consumers.

32. In our CPP-to-DPP determination for Orion, we explained the considerations for our discretion under s 53X when deciding how to set starting prices. These considerations were:[10]

    32.1 to best meet the purposes set out in s 52A (main purpose) and s 53K;

    32.2 the length of the DPP period still left to run when an EDB transitions;

    32.3 that the price-quality path regime should work as effectively as possible so that the costs and complexity of the process for coming off a CPP and onto a DPP are no greater than necessary; and

    32.4 that the transition from a CPP to a DPP under s 53X reflects a move from the individually-tailored approach of a CPP to a more generic, relatively low-cost, DPP. As such, it may not be appropriate to accommodate all of an EDB's specific circumstances.

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8 comcom.govt.nz/__data/assets/pdf_file/0021/63255/Orions-transition-to-the-2015-2020-DPP-Final-report-7-October-2016.PDF

9 see paragraphs 2.4 to 2.7, ibid. In Orion's case, we exercised our discretion to notify other prices that applied, rather than simply rolling-over CPP prices. This was to remove the claw-back applied under the CPP, and to apply a CPI adjustment.

10 ibid

Interactions between the DPPs and CPPs more broadly

33. As part of determining DPP3, we set quality standards for Powerco but did not set its starting prices (this is also what occurred for Wellington Electricity). Instead, we said we would address Powerco's transition to DPP3 closer to the end of its CPP.[11]

34. We considered setting binding starting prices or setting indicative prices that would be formalised later. However, we decided that the DPP3 reset was too far in advance of Powerco's transition to reliably forecast starting prices.

35. As discussed in paragraph 16, s 53X(2) also means we must set starting prices – if different from end-of-CPP prices – at least 4 months before the end of a CPP. Orion's and Wellington Electricity's transitions from their CPPs to DPPs provide useful precedents on how this can occur.

Previous discussions on Powerco's transition from its CPP to DPP3

36. In our final determination of Powerco's 2018-2023 CPP in 2017, we discussed what we expected to happen when it transitioned to DPP3. We here draw attention to factors we previously discussed and, where relevant, if what has happened since has affected those factors. These factors were:

    36.1 Powerco's Regulated Asset Base (RAB);

    36.2 the WACC that applies; and

    36.3 operating and capital expenditure, both during the CPP period and forecasts for the DPP period.

37. For Powerco's CPP, we allowed for an initial 4.5% increase in maximum allowable revenue (MAR), which would then be indexed to inflation for the remaining years of its 2018-2023 CPP.[12] Further price-path changes during the CPP period were also expected. This was due to an expected re-opening (which led to a decrease in MAR from the WACC being reset in 2019 for DPP3)[13] and a different MAR in our draft decision that Powerco used for pricing while awaiting our final MAR decision.[14]

[11] Attachment I, comcom.govt.nz/__data/assets/pdf_file/0020/191810/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2020-Final-decision-Reasons-paper-27-November-2019.PDF

[12] Paragraph 39, comcom.govt.nz/__data/assets/pdf_file/0028/78715/Final-decision-on-Powercos-2018-2023-customised-price-quality-path-28-March-2018.PDF

[13] comcom.govt.nz/__data/assets/pdf_file/0022/213772/2020-NZCC-4-Powerco-Limited-electricity-distribution-customised-price-quality-path-Allowable-revenue-amendments-determination-2020-31-March-2020.pdf

[14] Paragraph 512, comcom.govt.nz/__data/assets/pdf_file/0028/78715/Final-decision-on-Powercos-2018-2023-customised-price-quality-path-28-March-2018.PDF

Powerco's Regulated Asset Base (RAB)

38. One particular factor is Powerco's RAB. Its RAB was expected to grow during its CPP period, such that its RAB in subsequent pricing periods would be greater than during its CPP.[15]

39. Powerco's RAB has grown by $461 million (to $2,054 million) in the three full years of the five that we have CPP data for.[16] This is generally in line with our expectations and is at this stage (with two years still left to run in the CPP) 10% less than we allowed for.

The WACC that applies

40. The WACC that would apply to Powerco during the DPP3 period was not known at the time we set Powerco's CPP. Given the significant impact of the WACC (and cost of debt) on the MAR, this gave rise to significant future uncertainty.

41. However, the WACC is no longer a source of material uncertainty. As noted above in paragraph 37, in 2019, once the WACC was determined, we applied a reopener to Powerco's (and Wellington Electricity's) CPPs to flow-through the impact of the DPP WACC to the CPP allowable revenues.

Operating and capital expenditure, both during the CPP period and forecasts for the DPP period

42. We approved $447 million of operating expenditure (opex) for Powerco's CPP. At three years into its CPP, Powerco has spent $268 million on CPP opex, which is $21 million less than forecast by this stage.[17] Regarding the Incremental Rolling Incentive Scheme (IRIS), actual over- or under-spend of this amount will have to be shared with its customers in the subsequent pricing period.[18]

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[15] Paragraph 516, ibid

[16] comcom.govt.nz/__data/assets/pdf_file/0019/105256/Powerco-2021.pdf

[17] powerco.co.nz/-/media/project/powerco/powerco-documents/who-we-are---pricing-and-disclosures/disclosures/electricity-disclosures/3-electricity-customised-price-quality-path/2021/fy21-annual-delivery-report-quantitative-data-1-april-2020-31-march-2021.pdf

[18] Paragraph 386, comcom.govt.nz/__data/assets/pdf_file/0028/78715/Final-decision-on-Powercos-2018-2023-customised-price-quality-path-28-March-2018.PDF

43. Three years into its CPP, Powerco has spent $565 million on CPP capital expenditure (capex) – $18 million more than forecast by this stage. A retention factor of 15% was determined for Powerco's CPP capex IRIS. Since then, a retention factor of 23.5% was determined for other EDBs under the DPP capex IRIS. We may consider whether to determine an intermediate retention factor for Powerco to reflect a five-year regulatory period with three years at a 15% retention factor and the final two years at 23.5%. Powerco's CPP opex IRIS is calculated in the same way as the DPP opex IRIS.

44. We continue tracking how Powerco has performed on delivering its proposed capex and opex via its annual delivery report.[19]

45. Efficiency improvements for various opex include:

    45.1 A backlog of maintenance issues: this was meant to improve under the CPP with a more proactive asset management approach. We would expect, over the longer term, cost savings to occur in the maintenance portfolio;

    45.2 A reduction in reactive maintenance is expected over time; and[20]

    45.3 A reduction in ICT opex.[21]

46. We also discussed linking Powerco's delivery of its project to its ability to increase prices. The relevant paragraph is quoted below:

> We considered linking delivery of this investment to Powerco's ability to increase prices. For instance, we could have limited Powerco's ability to increase future prices and/or clawed back price increases where the proposed investment did not in fact occur. We decided against this in the case of Powerco only because we had not previously signalled this to the industry and potential CPP applicants. However, we may consider such an approach in future and that may require future IM amendments.[22]

Proposed process and timeline for determining Powerco's DPP3

47. In determining Powerco's DPP3 we will:

    47.1 invite written submissions on key issues identified later in this paper; and

    47.2 release a draft decision and invite written submissions and cross submissions on it.

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[19] Available at: powerco.co.nz/who-we-are/pricing-and-disclosures/electricity-disclosures

[20] Paragraphs 439 and 441, comcom.govt.nz/__data/assets/pdf_file/0028/78715/Final-decision-on-Powercos-2018-2023-customised-price-quality-path-28-March-2018.PDF

[21] Paragraph 444, ibid

[22] Paragraph 612, ibid

Indicative timeline

48. Table 1 below sets out the process we intend to follow and the indicative dates for completion. We have based this process on the requirements of the Act, the timing of relevant information disclosures by Powerco, and feedback on our previous DPP processes.

Table 1 – Intended process

Indicative date	Publication/event
May	Commission releases this Process and Issues Paper
June	Submissions due on issues raised in Process and Issues Paper (three weeks)
July	Commission releases Draft Decision (together with draft models)
August	Submissions due on Draft Decision (four weeks)
Early-September	Cross-submissions due on Draft Decision (two weeks)
End-October	Commission releases Final Decision

Key issues for Powerco's DPP3

49. We are considering the advantages and disadvantages of a default roll-over approach versus a different – potentially BBAR (like in DPP3) or modified roll-over – approach for Powerco's transition. We detail, above, our earlier decisions for Wellington Electricity (BBAR) and Orion's (modified roll-over) CPP-to-DPP transitions. We also discussed, above, factors we earlier expected to emerge from Powerco's CPP-to-DPP transition.

50. We are seeking your feedback on the following key issues relevant to our determination of Powerco's DPP3:

    50.1 whether a different approach (potentially based on the method used for the BBAR for other EDBs on the DPP) is justified over a roll-over approach;[23]

    50.2 price-shocks and revenue smoothing;

    50.3 if we take a BBAR approach, the appropriate length of the historical reference period for capex and opex forecasts;

    50.4 if we take a roll-over approach, how to address incentives to improve performance and efficiency during the regulatory period (i.e., Incremental Rolling Incentive Scheme); and

[23] Section 53P(3) of the Act states that starting prices must be either: "a) the prices that applied at the end of the preceding regulatory period; or b) prices, determined by the Commission, that are based on the current and projected profitability of each supplier."

50.5 price inflators and forecasts to apply.

51. We do not intend to consult on quality standards and quality incentives. We determined Powerco's quality standards for DPP3 alongside all other EDBs subject to DPP3 in 2019.[24] As mentioned in paragraph 37, the WACC applying to EDBs in DPP3 has already been determined.

Whether a different (potentially BBAR) approach is justified over a roll-over approach

52. The legal framework (above) sets out our considerations of different approaches to best meet the purposes of Part 4 of the Act.

53. A roll-over approach would, in effect, extend Powerco's CPP revenue allowance for two years. It is a relatively low-cost and straightforward exercise.

54. A disadvantage of a roll-over approach is that it can significantly over- or under-collect revenue after transitioning off a CPP.

55. A BBAR approach is higher cost as a one-off exercise. However, as a regime it is a lower-cost approach that meets our main s 52A purpose, while still being guided by s 53K. Its main advantage is that it takes account of an EDB's circumstances following major changes due to a CPP. The more specific, significant, and complex the circumstances for an EDB at the time of transition, the better a BBAR approach suits an EDB's current and forecast expenditure than a roll-over approach.

Price shocks and revenue smoothing

56. Powerco's RAB has grown during its CPP.[25] This means that following its five-year CPP period, Powerco will have a higher RAB in subsequent periods, which (all else equal) would result in an increase in MAR with a BBAR approach.

57. Under a BBAR approach, if this increase were significant enough to cause a price shock for consumers, we may consider smoothing the increase over the remaining years of the DPP period, guided by s 53P(8)(a) as discussed in paragraph 25.

58. Conversely, under a roll-over approach, real price shocks are likely to be limited. However, this might only defer (and potentially worsen) price shocks at the end of DPP3 moving into DPP4. Additionally, this might mean Powerco does not have an existing expectation of a normal return after accounting for its efficient operating costs.

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[24] Paragraph I23, comcom.govt.nz/__data/assets/pdf_file/0020/191810/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2020-Final-decision-Reasons-paper-27-November-2019.PDF

[25] Discussed in paragraph 39 above.

[25] Discussed in paragraph 39 above.

Appropriate length of historical reference period for capex and opex with a BBAR approach

59. The approach we have taken to forecasting opex growth trends and to scrutinising capex requirements has used historic reference periods. For opex, this data informs our analysis of trend factors like network growth. For capex, it is used when analysing capex forecasts from the EDB's asset management plan.

60. In DPP3 we generally used a dataset extending back to the commencement of Part 4 information disclosure, about 10 years ago. We are considering whether the historical data we use for preparing our forecasts of Powerco's capex and opex should extend back to the same starting date as used for DPP3 or extend back by the same number (10) of years. We wish to ensure forecast expenditure is not unreasonably volatile, and reflect the range of comparable historic data available through information disclosure.

61. A shorter reference period than this might be more relevant for expected capex and opex, especially if including new assets as part of CPP projects. However, a shorter reference period might include CPP expenditure that is not expected to continue in the future. Alternatively, for opex, these one-off costs could be addressed through a 'step-change' within a base-step-trend methodology.

The Incremental Rolling Incentives Scheme and a roll-over approach

62. The intent of the IRIS is to incentivise savings being shared between an EDB and its customers. It means any over- or under-spend against Powerco's capex and opex allowances is shared.

63. We have previously noted it is not clear how a roll-over approach could be implemented for a price path that contains an IRIS mechanism. However, we also noted that we do have discretion under s 53X(2) to choose between a roll-over or setting different starting prices for transitions to best meet the Part 4 purpose.[26]

Price inflators and forecasts to apply on a roll-over approach

64. The DPP3 has input price inflators, which are several years old now, that are applied to EDBs' capex and opex:

    64.1 average year-on-year Consumers Price Index (CPI);[27]

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[26] Paragraph 3.12 of the Wellington CPP-to-DPP Reasons Paper, comcom.govt.nz/__data/assets/pdf_file/0034/228886/Wellington-ElectricityE28099s-transition-to-the-2020-2025-DPP-final-decision-Reasons-paper-26-November-2020.pdf

[27] Paragraph 3.38 of the Wellington CPP-to-DPP Reasons Paper states we may reconsider updating this forecast when we next review the IMs, ibid

64.2 March quarter CPI;[28]

64.3 blend of All-Industries Labour Cost Index (LCI) and Producers Price Index (PPI); and

64.4 All-Industries Capital Goods Price Index (CGPI).[29]

65. Higher inflation now means that these older, lower DPP3 price inflators might not allow for appropriate cost recovery.

66. It is a requirement under s 53X(1) that an EDB transitioning onto a DPP should be on the same DPP that applies to other EDBs already on the DPP.[30] This means that Powerco would still have to be on the same DPP as the other EDBs.

Table 2 – Key Issues for different approaches

Key issue	Which approach the key issue arises for
Justification for cost/suitability	Both a BBAR and a roll-over issue
Price shocks	Both a BBAR and a roll-over issue
Historical reference period	BBAR issue
Incremental Rolling Incentives Scheme	Roll-over issue
Price inflators	Roll-over issue

We require further information before deciding on an approach

67. We invite Powerco to provide evidence, such as expected costs, to explain how its preferred approach for the two years remaining on DPP3 would be consistent with s 52A. Before we decide an approach, we would need to be satisfied that Powerco would:

67.1 continue to have sufficient incentives to innovate and invest;

67.2 continue to have incentives to improve efficiency and provide services at a quality reflecting consumer demands;

[28] This index and nominal WACC comprise our specification for real WACC.

[29] In paragraph 3.34 of the Wellington CPP-to-DPP Reasons Paper, we noted we considered updating the LCI, PPI, and CGPI, but decided not to.

[30] Section 53X(1) states: "When the customised price-quality path of a supplier of goods or services ends, the supplier is subject to the default price-quality path that is generally applicable to other suppliers of those goods or services."

67.3 share its efficiency gains with consumers, including through lower prices; and

67.4 be limited in its ability to extract excessive profits during this time.

68. We are seeking feedback from other interested persons on the key issues identified above. We will also consider information available through information disclosure (such as Powerco's asset management plan), or if necessary, information obtained under s 53ZD of the Act.

How you can provide your views

69. You are invited to provide your written views on this Process and Issues Paper no later than **5pm Thursday, 16 June 2022**. Please address your responses to:

Robert Cahn (Electricity Distribution Manager)

c/o infrastructure.regulation@comcom.govt.nz

70. Please include "Powerco CPP-to-DPP Process and Issues" in the subject line. We prefer responses to be provided in a file format suitable for word processing in addition to PDF file format.

Requests for confidentiality

71. While we discourage requests for non-disclosure of submissions so that all information can be tested in an open and transparent manner, we recognise there may be cases where interested persons that make submissions wish to provide information in confidence. We offer the following guidance:

71.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential;

71.2 Both confidential and public versions of the submission should be provided;

71.3 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission; and

71.4 We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.