

**Proposed amendments to Electricity Distribution Services
Input Methodologies Determination in relation to
accelerated depreciation**

Draft reasons paper

Date of publication: 23 August 2018

Associated documents

Publication date	Reference	Title
23 August 2018	978-1-869456-52-8	[DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018
17 July 2018	N/A	Notice of Intention: Proposed Amendments to Input Methodologies for Electricity Distribution Services
20 December 2016	NZCC 24	Electricity Distribution Services Input Methodologies Amendments Determination 2016
20 December 2016	978-1-869455-47-7	Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector
20 December 2016	978-1-869455-51-4	Input methodologies review decisions: Report on the IM review

Regulation Branch, Commerce Commission
Wellington, NEW ZEALAND

Contents

1. INTRODUCTION	1
2. PROPOSED AMENDMENTS	4
3. HOW YOU CAN PROVIDE YOUR VIEWS	7

1. Introduction

Purpose of paper

- 1.1 This paper invites submissions on how we propose to implement fast-track amendments to input methodologies (**IMs**) for Electricity Distribution Services contained in the *Electricity Distribution Services Input Methodologies Determination* [2012] NZCC (**IM determination**).¹
- 1.2 The proposed amendments relate to implementation changes to the IMs for default price-quality paths (**DPPs**) in respect of the valuation of assets, specifically the accelerated depreciation of existing assets of electricity distribution businesses (**EDBs**).²
- 1.3 We have also proposed consequential changes to the IMs for DPPs and EDB information disclosure (**ID**) in respect of the treatment of taxation.

Proposed amendments outlined in this paper

Why these amendments are required

- 1.4 As part of the IM review in 2016, we introduced a mechanism for EDBs to apply for a discretionary net present value-neutral shortening of their remaining asset lives.³ This mechanism allows EDBs to elect new asset lives based on their assets' expected economic asset lives rather than their physical asset lives.⁴ This mechanism is to take effect at the time of the next DPP reset.⁵
- 1.5 We have identified implementation errors in the IM determination. The proposed amendments aim to clarify the provisions relating to:
 - 1.5.1 the timing for us to receive accelerated depreciation applications from EDBs;
 - 1.5.2 the applicable adjustment factor; and

¹ The principal determination was most recently amended in December 2017 by the *Electricity Distribution Services Input Methodologies Amendments Determination* [2017] NZCC 30. A consolidation of the principal determination and all subsequent amendments was published by us on 3 April 2018.

² See clause 1.1.4(2) of the IM determination for the definition of 'existing assets'.

³ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 84.

⁴ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 84.

⁵ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 86.

- 1.5.3 the applicable remaining asset lives used in calculating ‘adjusted depreciation’.

Why we propose to make these amendments on a fast-track basis

- 1.6 We have proposed these amendments on a fast-track basis to give better effect to our 2016 IM review decision on accelerated depreciation in time for the next EDB DPP commencing 1 April 2020.⁶
- 1.7 We have prioritised these amendments to allow EDBs, which may be considering proposing an adjustment factor for the next EDB DPP reset, to have sufficient time before our draft DPP decision on the 2020 reset in Q2 2019, to:⁷
- 1.7.1 consult with interested persons on their proposed adjustment factor; and
- 1.7.2 if they wish, propose the adjustment factor to us in writing.⁸
- 1.8 Chapter 2 explains our proposed amendments in more detail.

Proposed amendments in accordance with Commerce Act 1986

- 1.9 This paper proposes amendments to the EDB IMs, which were originally determined in accordance with Part 4 of the Commerce Act 1986 (the **Act**) on 22 December 2010.⁹
- 1.10 The amendments proposed in this paper are in accordance with s 52X and s 52V(2)(a) of the Act.
- 1.11 In accordance with sections 52V(1) and 52X of the Commerce Act 1986, we published a notice of intention for these proposed amendments on 17 July 2018.¹⁰

Material released alongside this paper

- 1.12 Alongside this paper, we have published a draft Electricity Distribution Services Input Methodologies Amendments Determination (**draft IM amendments determination**)

⁶ Input methodologies review decisions: Report on the IM review (20 December 2016), para 93-99, and Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 83-95.

⁷ ‘Adjustment factor’ is the term used in the IM determination to implement accelerated depreciation.

⁸ Default price-quality paths for electricity distribution businesses from 1 April 2020: Proposed process (14 June 2018), p. 6.

⁹ A detailed outline of our Part 4 regime, including the role of IMs in Part 4 regulation is outlined in Input methodologies review decisions: Framework for the IM review (20 December 2016), para 16-37.

¹⁰ Notice of Intention: Proposed Amendments to Input Methodologies for Electricity Distribution Services (17 July 2018).

specifying our proposed implementation changes to the IMs for the EDB DPP in respect of the accelerated depreciation of existing assets.¹¹

Invitation to make submissions

1.13 We welcome your views on the drafting of the amendments proposed in the draft IM amendments determination and this draft reasons paper. Submissions are due by **5pm, 6 September 2018**. Cross-submissions on submissions are due by **5pm, 14 September 2018**.

1.14 Chapter 3 explains how you can provide your views in more detail.

¹¹ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018).

2. Proposed amendments

Purpose of this chapter

- 2.1 This chapter sets out the specific matters that we have proposed amending in our draft IM amendments determination in relation to EDB accelerated depreciation, and why we have proposed making these changes.
- 2.2 We have proposed clarifying the provisions relating to:
- 2.2.1 the timing for us to receive accelerated depreciation applications from EDBs;
 - 2.2.2 the applicable adjustment factor; and
 - 2.2.3 the applicable remaining asset lives used in calculating ‘adjusted depreciation’.

Timing for us to receive accelerated depreciation applications from EDBs

Current requirement

- 2.3 Under our IM determination, EDBs may propose, by a notice in writing, an adjustment factor prior to the commencement of the ‘**base year**’,¹² to be applied by us for the DPP commencing 1 April 2020.¹³

Proposed requirement

- 2.4 We propose amending the date for when EDBs may propose an adjustment factor from ‘prior to the commencement of the **base year**’ to ‘not later than 13 months prior to the commencement of the next **DPP regulatory period**’.¹⁴ We propose this change to allow EDBs more time to consult with interested parties on a potential adjustment factor.
- 2.5 We consider that this proposed change will:
- 2.5.1 allow EDBs, which may be considering proposing an adjustment factor for future DPP resets, and in particular the upcoming 2020 DPP reset, to have sufficient time before our draft DPP decisions to:

¹² In clause 1.1.4(2) of the IM determination, ‘base year’ is defined as meaning ‘the **disclosure year** selected by the **Commission**’. We intend to select our ‘base year’ for the DPP commencing 1 April 2020 in our DPP Issues paper, which we are intending to publish in November 2018.

¹³ Clause 4.2.2(3)(d) of the IM determination.

¹⁴ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018), clause 4.5.

- 2.5.1.1 consult with interested persons on their proposed adjustment factor; and
 - 2.5.1.2 if they wish, propose the adjustment factor to us in writing; and
 - 2.5.2 allow us sufficient time to consider an EDB's proposed adjustment factor before making our DPP draft decisions and final decisions.
- 2.6 Our proposed amendments would allow EDBs to propose by not later than 1 March 2019 an adjustment factor for the DPP commencing on 1 April 2020.

Applicable adjustment factor

Current requirement

- 2.7 Our IM determination is silent about the applicable adjustment factor to use for any successful accelerated depreciation applications in the 'gap year' (i.e. the disclosure year between the base year¹⁵ and the first year of the next DPP regulatory period).

Proposed requirement

- 2.8 We propose amending the IM determination by specifying that the adjustment factor for the disclosure year immediately following the base year is '1'.¹⁶ We have proposed this implementation change to clarify our policy intent from the 2016 IM review that any adjustment to the remaining asset lives for existing assets will only apply as a one-off adjustment at the time a DPP is reset, not in the 'gap year' prior to the reset.¹⁷
- 2.9 We have also clarified that the adjustment factor made at the time a DPP is reset will apply for each disclosure year of the applicable¹⁸ new DPP regulatory period.¹⁹ Having that adjustment factor also apply in the 'gap year' would lead to the accelerated depreciation in the 'gap year' reducing the opening regulatory asset base

¹⁵ For the 2010-2015 EDB DPP, we used the disclosure year commencing two years before the start of the DPP regulatory period as the 'base year'. See Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020: Low cost forecasting approaches (28 November 2014), para 2.5.

¹⁶ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018), clause 4.5.

¹⁷ Commerce Commission, Input methodologies review decisions: Report on the IM review (20 December 2016), para 93-99.

¹⁸ See Input methodologies review decisions: Report on the IM review (20 December 2016), para 94.

¹⁹ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018), clause 4.5.

(RAB) at the start of the regulatory period, which would be contrary to our policy intent from the 2016 IM review.²⁰

Applicable remaining asset lives used in calculating ‘adjusted depreciation’

Current requirement

2.10 Our IM determination is silent about the interplay between ‘adjusted depreciation’²¹ and ‘total depreciation’²² when calculating the remaining asset lives for existing assets following a successful adjustment factor application.

Proposed requirement

2.11 We propose amending the IM determination by specifying for a DPP that any remaining asset lives for existing assets used when calculating ‘adjusted depreciation’ for ‘amortisation of revaluations’²³ and ‘depreciation temporary differences’²⁴ must be consistent with the remaining asset lives for existing assets used for calculating ‘total depreciation’.²⁵

2.12 We propose amending the IM determination by specifying for ID and customised price-quality path proposals that any remaining asset lives used when calculating ‘adjusted depreciation’ for ‘amortisation of revaluations’ and ‘depreciation temporary differences’ must be consistent with the remaining asset lives used for calculating ‘total depreciation’.²⁶

2.13 We have proposed these amendments to clarify that any differences between ‘total depreciation’ and ‘adjusted depreciation’ should arise solely from the inclusion (or exclusion) of revaluation amounts. Differences between ‘total depreciation’ and ‘adjusted depreciation’ should not arise from using different remaining asset lives.

²⁰ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 83-95.

²¹ See clause 1.1.4(2) of the IM determination for the definition of ‘adjusted depreciation’.

²² See clause 1.1.4(2) of the IM determination for the definition of ‘total depreciation’.

²³ See clause 1.1.4(2) of the IM determination for the definition of ‘amortisation of revaluations’.

²⁴ See clause 1.1.4(2) of the IM determination for the definition of ‘depreciation temporary differences’.

²⁵ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018), clause 4.1.

²⁶ [DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018 (23 August 2018), clause 4.1.

3. How you can provide your views

Purpose of this chapter

- 3.1 This chapter sets out how you can provide your views on how we propose to implement amendments to the IMs on a fast-track basis in relation to the accelerated depreciation of existing assets of EDBs.

Timeframe for submissions

- 3.2 We welcome your views on the drafting of the amendments proposed in the draft IM amendments determination and this draft reasons paper. Submissions are due by **5pm, 6 September 2018**. Cross-submissions are due by **5pm, 14 September 2018**.
- 3.3 We do not intend to take into account any material that is submitted outside of the timeframes provided. Any party that is concerned about the time to engage with the material should contact us with a request for an extension outlining their specific concerns.

Address for submissions

- 3.4 Submissions and cross-submissions should be addressed to:

Dane Gunnell (Senior Project Manager, Regulation Branch)
c/o regulation.branch@comcom.govt.nz

Format for submissions

- 3.5 We prefer submissions in both MS Word and PDF file formats.
- 3.6 Please include "Submission on EDB IM Accelerated Depreciation" in the subject line of your email.
- 3.7 Where submitters propose an alternative to the draft decision, we encourage submitters to outline their reasoning and proposed change. We prefer proposed changes to be identified as track changes to our draft IM amendments determination.

Requests for confidentiality

- 3.8 We encourage full disclosure of submissions so that all information can be tested in an open and transparent manner. We intend to publish all submissions and cross-submissions on our website.
- 3.9 If it is necessary to include confidential material in a submission that you do not wish to have published, both confidential and public versions of the submission should be provided.

- 3.10 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.

Next steps in our process

- 3.11 We intend to make final decisions on the proposed amendments to the IMs in relation to accelerated depreciation by the end of November 2018.
- 3.12 At this stage, we do not intend to hold a technical consultation prior to our final decisions. We will review this position after considering submissions and cross-submissions and notify parties if there is any change to this.