



Submission on

Input Methodologies Review

Draft Amended Determinations

18 August 2016

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1. Introduction

1. Thank you for the opportunity to comment on the Commerce Commission's (**Commission**) draft amended determinations.
2. This submission focuses primarily on the amendments proposed in relation to customised price-quality path (**CPP**) requirements. The Commission's views on the relevant amendments, as well as a summary of the drafting amendments, are contained in the Commission's *Topic 2: CPP requirements* paper.
3. The secondary focus of this submission is the proposed amendments in relation to finance leases, easements and the treatment of prudently incurred expenditure on assets prior to commissioning. These amendments apply to the draft determinations for both Gas Distribution Services and Electricity Distribution Services.
4. As for the balance of the proposed amendments on which we have not commented, we support the ENA's views on behalf of electricity distribution businesses (**EDBs**).
5. Submission format:
 - 5.1 CPP requirements
 - 5.2 General amendments
6. For clarity, we have provided our comments by reference to the numbering in the draft amendments.

2. CPP requirements

2.1. Substantive comments

Schedule D, subclause D3(3):

In addition to the information required by clause 3.13 of Attachment A of the ID determination, describe the procedures and processes used by the EDB to-

- (a) plan and develop;*
- (b) estimate the cost of;*
- (c) approve;*
- (d) implement; and*
- (e) monitor;*

the capex and opex projects and programmes described in the CPP proposal, and develop unit costs, and assess whether the costs are comparable with industry costs.

- 7. We understand that the Commission has included this requirement for detailed project descriptions in order to ensure that CPP applicants' forecast strategies are consistent with their strategies, policies, and processes.¹
- 8. While we support the overall policy intent, there are aspects of this subclause that are overly onerous. As currently drafted, Powerco is concerned that it is not practical for an EDB to comply with this requirement.
- 9. For instance, it is not clear to us how an EDB would assess whether its costs are "comparable with industry costs". For example, projects and programmes are unique to each EDB, and so comparisons of cost at this level are not meaningful. Unit costs, in addition to usually being specific to particular circumstances, tend to be commercially confidential and are not readily available for comparisons.

Schedule D, clause D5:

Where not included in information provided in respect of clause 5 of Attachment A of the ID determination, provide-

- (a) a description as to how each performance indicator and performance target described in accordance with clause 5 of Attachment A of the ID determination-*
 - (i) relates to the EDB's relevant policies; and*
 - (ii) reflects the expenditure objective;*
- (b) for each performance indicator identified and defined in accordance with subclause (a):*
 - (i) the measured performance for each year of the current period; and*

¹ Commerce Commission, "Input methodologies review draft decisions, Topic Paper 2: CPP requirements" (16 June 2016), at p 58.

- (ii) *the target performance for each year of the next period;*
 - (c) *a comparison and evaluation of each actual service level achieved for each disclosure year in the current period against each relevant performance target, including explanations for all significant variances.*
- 10. The requirements of this subclause appear reasonable for targets that were established prior to the current period.
- 11. However, the IMs need to recognise that new performance targets may be introduced that create new performance measures with new data that has not previously existed. For example, Powerco put in place its Electricity Field Services Agreement with subcontractors in 2014 and introduced new key performance indicators. These included measures to improve its fault response performance. Systems were established to collect this data from the date that the agreement took effect, and as such no previous data exists.
- 12. We ask that the Commission clarify the approach that should be taken by applicants in this situation.

Schedule D, subclauses D9(1) – (3):

- (1) *Describe details of the extent that business support and system operations and network support costs have been included in the capex forecast. Sufficient information must be provided to enable the actual and forecast allocation of business support and system operations and network support costs for capex to be separately identified for each disclosure year of both the current period and the next period.*
 - (2) *Identify all relevant documents, policies and consultants' reports that were taken into account in preparing these opex forecasts.*
 - (3) *Describe any anticipated material changes to the information provided in subclause (1) over the course of the next period, including changes to the cost allocations and discuss-*
 - (a) *the rationale for and timing of the changes; and*
 - (b) *the impact of the changes on the opex forecast.*
13. In Powerco's view, the requirement under subclause D9(1) is potentially very broad, meaning compliance with it will be onerous. We ask the Commission to clarify what it deems to be "sufficient information" and consider its cost effectiveness.

Schedule D, subclause D10(1)(i):

- (1) *Where not already required to be disclosed by Attachment A of the ID determination, for each identified programme provide-*

...

- (i) *in addition to the breakdown provided in response to subclause (f)-*
 - (i) *a description of the methodology used to prepare the estimate;*
 - (ii) *where applicable, the quantities provided for in the project or programme cost;*
 - (iii) *if not provided elsewhere in the CPP proposal, evidence that all unit or component costs used to compile the estimate are*

consistent with efficient current costs for the electricity distribution industry, taking due account of the project or programme location; and

(iv) identification of scope or cost uncertainties and an explanation of how such uncertainties have been taken into account in the estimate;

14. We are concerned that the requirement for EDBs to provide “evidence that all unit or component costs used to compile the estimate are consistent with efficient current costs for the electricity distribution industry, taking due account of the project or programme location” is impractical. We note that there are no standards within the industry for unit rates, and that there is no central reliable source for this information.
15. In our view, this requirement is likely to be impossible for CPP applicants to comply with. We suggest the Commission reconsider the practical difficulties of showing the efficiency of unit rates, and reconfigure this requirement in a practical manner.

Clause 1.1.4: interpretation of “Asset Category”

asset category means one of the following asset types:

- (a) assets owned by the **EDB** but installed at bulk **supply** points owned by others;*
- (b) sub-transmission network including power transformers;*
- (c) distribution network including distribution transformers;*
- (d) switchgear;*
- (e) low voltage distribution network; and*
- (f) supporting or secondary systems including-*
 - (i) ripple injection plant;*
 - (ii) SCADA;*
 - (iii) communications equipment;*
 - (iv) metering systems;*
 - (v) power factor correction plant;*
 - (vi) **EDB**-owned mobile substations and generators whose function is to increase **supply** reliability or reduce peak demand; and*
 - (vii) other generation plant owned by the **EDB**; and*
- (g) other;*

16. We note that the definition of asset category has been moved from Schedule D into interpretation clause (clause 1.1.4), but is largely kept the same as it was previously.
17. In our view, this definition is inconsistent with how ‘asset category’ is used in information disclosure (ID). Although in the ID context it is not a defined term, it is used throughout a number of the ID schedules, and generally refers to asset expenditure categories summarising transactions relating to asset class and type. On the other hand, the draft

IMs introduce a defined term for an ‘asset expenditure category’, which we believe is consistent with how asset categories are described in ID.

18. Having assessed the draft IMs for areas where asset category detail is required,² it is not clear to us how this additional category of information adds to the Commission’s analysis of CPP applications. Indeed, the costs associated with compiling this information seem to outweigh the benefits it may offer. This goes against the Commission’s policy objective for this review which is to reduce complexity and compliance costs.³
19. Ideally, we consider the Commission should remove the definition of ‘asset category’ from the draft IMs, and instead rely on the ‘asset expenditure category’ definition. This definition has already been included in the draft IMs, and in our view is consistent with how this term is used in ID. Alternatively, we ask that the Commission explains its rationale for introducing this term by describing what additional information it adds to the Commission’s analysis.

Clause 5.4.26: Regulatory tax asset value by asset category

5.4.26 Regulatory tax asset value information

...

(4) sum of regulatory tax asset values by asset category at the start of the disclosure year

20. In our previous submission [add ref?], we objected to the requirements in clause 5.4.26 that CPP applicants must provide regulatory tax asset value (RTAV) information disaggregated by asset category. The same goes for other clauses which require RTAV information disaggregated by asset category (i.e. clauses 5.4.22 and 5.4.25). We see that the Commission has made no change to these requirements.
21. Powerco does not understand what these requirements add to the Commission’s CPP analysis. And, due to the complexity and cost for EDBs in calculating these figures, we consider that all requirements to disaggregate tax information by asset category should be removed.

Schedule E: Capital and operating expenditure - Regulatory templates

22. Inconsistency between the table headings and the information requirements in a number of schedule E tables is causing confusion.
23. In tables 2c and 2d the headings suggest that only forecast data is required, but the table requests current period data. We assume that the requirement is for forecast data only as historic commissioned assets data disaggregated by capex category has not been required through ID and would therefore need to be recreated. It would therefore be clearer if the table excluded input cells for the current period.
24. Table 3 headers suggest only forecast information is required whereas the table provides inputs for the current period. In this case, historic ID data is available in this format so we assume that it is required. If this assumption is correct, the first two headings should be changed to ‘Actual and Forecast Opex in constant prices’ and ‘Actual and Forecast Opex in nominal prices’.

² For instance tax requirements, and Schedules B and C of the draft IMs.

³ Commerce Commission, “Input methodologies review draft decisions: Framework for the IMs review” (16 June 2016), at X14.

25. Tables 4 and 5 require a forecast value of commissioned assets to be disaggregated by capex projects and programmes and asset expenditure categories. Forecast value of commissioned assets excludes capital contributions as per clause 5.3.11(1)(h) so the tables should not provide inputs for capital contributions in the forecast value of commissioned assets sections.
26. The tables have a number of errors and inconsistencies in them. We would like to see the tables subjected to a technical review that will address these issues before the schedule is finalised. Examples include:
 - 26.1 The sections within tables 2, 4, 5 and 6 are separately labelled a through to d (e.g. table 2 has sections 2a through to 2d) which is useful for referencing. Table 3 has omitted this standard for its 3 sections.
 - 26.2 Table 1 requires estimated costs for capex and opex projects. It is unclear whether these costs should be disclosed in nominal or constant prices.
 - 26.3 Table 4.5 is incorrectly labelled 4a.4.1
 - 26.4 Various undefined terms used to refer to forecast value of commissioned assets in tables 2c, 4, 5 and 6 creates uncertainty that this is indeed the values that are required.
27. The issues identified indicate that a comprehensive review has not been undertaken. Ensuring the tables are tightly integrated and internally consistent with the IMs will prevent the unintended introduction of terms and requirements.

3. General Amendments

3.1. Summary

28. This section proposes amendments to non-CPP related IMs. In particular, Powerco suggests changes to IMs that relate to finance leases, easements and the treatment of prudently incurred costs associated with assets that are constructed prior to their commissioning date.

Clause 1.1.4: “finance lease”

operating cost means a cost incurred by the EDB in question relating to the supply of-

...
 (h) *payments associated with a finance lease, where the finance lease has an opening RAB value;*

29. We note that in the Commission’s report on the IMs review, the Commission proposes to amend the application of the term “finance leases” for the purposes of RAB to have the effect of excluding from the RAB any value associated with amounts treated under the IMs as finance lease recoverable costs.⁴
30. In the draft IMs determination, however, the change is made to the definition of “operating cost”. In our view the Commission’s stated objective in the policy paper and the draft IMs determination are inconsistent. In particular, this amendment:

⁴ Commerce Commission, “Input methodologies review draft decisions: Report on the IM review” (22 June 2016), at p 24.

- 30.1 Does not have the effect of excluding from the RAB any finance leases where the annual payments are included as a recoverable cost; and
- 30.2 Does not recognise that finance leases may incur maintenance (opex) costs.
31. We suggest the Commission should amend the RAB definition of finance leases to exclude any value associated with charges included as a recoverable cost.

Clause 1.1.4 “commissioned” with reference to Easement rights

32. Decision AV08 of the Commission’s report on the IMs review proposes there will be no change to the original 2010 decision on easement rights.⁵ This decision refers EDBs and GDBs to section E6, Appendix E of the Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010).
33. The 2010 EDB/GDB Input Methodologies Reasons Paper provides that “all regulated suppliers must include new easement rights in the RAB value at cost in the year in which the rights are acquired, provided that the RAB value of new easement rights does not exceed fair market value, as determined by an independent valuer”.⁶ However, the IMs themselves suggest that easements only enter the RAB when the underlying assets are commissioned.
34. It has been Powerco’s experience that where there is a disjuncture between the two documents, reliance is placed on the requirements specified by the Input Methodology.
35. We recommend the Commission amend the Input Methodologies definition for “commissioned” to specify that commissioned, in relation to easement rights, means the year in which the rights are acquired.

Assets prudently constructed prior to use for providing electricity lines services

36. The IMs currently provide that suppliers should include assets in the RAB at cost in the year in which the asset is commissioned, that is, when the asset is first used by the regulated supplier to provide electricity distribution services/gas pipeline services. The Commission has advised that it does not intend to change this.
37. This approach is problematic for certain types of assets that may most cost-effectively be constructed several years before they are used to provide electricity distribution services. For example, where Powerco anticipates a future need for a duct, it may be more efficient to construct that duct immediately as part of existing public works undertaken by a local authority than to delay construction until closer to the time at which the duct will be needed. Deferring construction of the duct will require duplication of construction costs that would be avoided if the work had been aligned with existing public works.
38. The current approach involves two related problems:
- 38.1 If a supplier constructs an asset several years before it is used to provide distribution services, the supplier cannot recover the costs associated with that asset for the period of time between its construction and its commissioning date. This disincentivises the supplier from constructing the asset at the most efficient point in time (i.e. at a point that will involve least cost to consumers in the long-run); and

⁵ Commerce Commission, “Input methodologies review draft decisions: Report on the IM review” (22 June 2016), at p 153.

⁶ See paragraph E6.1

- 38.2 Interest during construction, which is intended to compensate suppliers for holding costs during the construction of major projects, follows GAAP and is therefore not applied during the period after the asset is constructed but before it is commissioned.
39. The Commission should allow suppliers to recover prudently incurred costs associated with assets that are constructed prior to their commissioning date. That could be achieved by either:
- 39.1 Allowing assets constructed prior to their commissioning date to be included in the RAB from the date of their construction, as long as:
- (a) The costs were prudently incurred (i.e. that the timing of the construction was prudent in light of the projected savings relative to constructing the asset at a later date); and
 - (b) The asset is commissioned within a reasonable period; or
- 39.2 Alternatively, interest during construction should be extended to cover periods between construction and commissioning where the EDB or GDB can establish, to the satisfaction of its auditors, that the early construction of the asset was prudent.
40. This proposed change is consistent with:
- 40.1 The section 52A purpose, and particularly the requirements to ensure that suppliers:
- (a) Have incentives to improve efficiency; and
 - (b) Share with consumers the benefits of efficiency gains, including through lower prices; and
- 40.2 The Commission's analogous treatment of network spares, which allows EDBs to recover the costs associated with network spares that are held in prudent numbers taking into account the historical reliability and number of the assets it is held to replace
41. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact Lyn Taylor tel. (06) 968 6235, email Lyn.Taylor@powerco.co.nz.

Yours sincerely



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