



Project no. 15103

Public version

Input methodologies review

CPP requirements - workshop

Summary of views expressed

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Purpose

1. This paper provides a summary of views expressed by participants at the CPP requirements workshop for the input methodologies review (IM review).

Workshop objective

2. The objective of the workshop was to test our evolving thinking on improvements to two aspects of the input methodologies for customised price-quality paths (CPP requirements) ahead of the June 2016 draft decision for the IM review:
 - 2.1. refinements to Schedules D and E of the CPP information requirements; and
 - 2.2. the potential to introduce flexibility to the number of identified projects that the verifier will select for review, and the criteria the verifier would use for selecting this number.
3. The workshop focussed on potential improvements to the IMs for electricity distributors, with the expectation that the discussions on the number of projects the verifier will review would be useful to gas pipeline businesses ahead of future work on the IMs for this sector.¹

Workshop format and process

4. The workshop used a round table format to allow an open discussion and exchange of information between workshop participants.
5. Commission staff presented materials on several topics to encourage discussion. A range of views were provided by workshop participants in response.
6. Any views expressed by our staff at the workshop were for the purpose of stimulating discussion, and were not intended to reflect the views of the Commission. The Commission's position is provided in the draft decision.

Role of workshop in the consultation process

7. The workshop was a step in our process for considering amendments to the IM Determinations to improve the CPP requirements.
8. The workshop focused solely on making improvements to reduce the cost and complexity associated with Schedules D and E of the CPP information requirements, and the number of identified projects the verifier is required to assess.

¹ In February we stated that we intended to consider the CPP information requirements for gas as part of a separate process for the IM review. See Commerce Commission "Input methodologies review process update paper" (29 February 2016).

9. These improvements are part of a wider range of proposed changes to the CPP requirements set out in our draft decision published for comment 16 June 2016. Views expressed at the workshop informed our proposed solutions to amendments to the IM Determinations.
10. We intend to complete the IM review by December 2016, and provide a process update to confirm this timing in September 2016.

Workshop date and venue

11. The workshop was held 19 April 2016 at the Terrace Conference Centre, 114 The Terrace, Wellington.

Outcome of the workshop

12. The workshop was attended by key stakeholders in the electricity distribution and gas pipeline services sectors. The list of attendees is attached to this document as Attachment A.
13. The workshop generally followed the agenda and materials provided in advance of the workshop.² The agenda is attached to this document as Attachment B.
14. Due to the interrelated nature of the topics, issues were sometimes discussed and addressed in an alternative order to what was outlined in the agenda and workshop materials.
15. Commission staff appreciated the open discussion, and we would like to thank participants for their contribution to the outcome of the workshop.
16. A summary of views expressed at the workshop is included as Attachment C.

² The workshop papers can be found on our website at <http://comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/interactions-between-dpps-and-cpps-and-the-requirements-for-cpps/>.

Attachment A: Workshop attendees

No.	Representing	Name	Role
1	Commerce Commission	Dane Gunnell	Senior Analyst
2	Commerce Commission	Hazet Adam	Chief Adviser
3	Commerce Commission	Kade Sheely	Analyst
4	Commerce Commission	Matthew Lewer	Manager, Price-Quality Regulation
5	Commerce Commission	Rachael Coyle	Senior Legal Counsel
6	Commerce Commission	Simon Todd	Chief Adviser
7	Commerce Commission	Stephanie Dwan	Assistant Analyst
8	ENA	David de Boer	Senior Adviser
9	Geoff Brown & Associates	Geoff Brown	Managing Director
10	MDL	Jelle Sjoerdsma	Technical Advisor
11	Orion	David Freeman-Greene	GM Commercial
12	Orion	Dennis Jones	Industry Developments Manager
13	Powerco	Oliver Vincent	Regulatory Analyst
14	Powerco	Richard Fletcher	GM Regulation and Government Relations
15	Powerco	Ryno Verster	Asset Manager
16	ENA	Lynne Taylor	Director, PWC
17	Strata	Bill Heaps	Managing Director
18	Vector	Catherine O'Brien	Regulatory Business Support Manager
19	Vector	Richard Sharp	Head of Regulatory

Attachment B: Workshop agenda

Time	Topic
10:00	Welcome and objective of the workshop
10:10	Overview of the review of the CPP IMs
10:30	Schedule D – Qualitative information requirements
13:00	Lunch
13:30	Schedule D – Qualitative information requirements (continued)
14:30	Verifier
15:15	Afternoon tea
15:30	Schedule E - Quantitative information requirements
16:00	Wrap up and general discussion
16:30	Finish

Attachment C: Summary of views

Introduction

1. This attachment is a summary of the views expressed at the CPP requirements workshop. The summary of views has been grouped as per the agenda. However, due to the interrelationship closely related nature of the topics, some aspects of the views as outlined below may have been covered off at differing points during the workshop.

Overview of the review of the CPP IMs

2. Commission staff provided an overview of the workshop and the review of the CPP IM requirements, explaining:
 - 2.1. the objective and scope of the workshop within the IM review process;
 - 2.2. the objectives of the DPP/ CPP regime as set out in the legislation;
 - 2.3. the Commission's objectives for CPPs as part of the IM review; and
 - 2.4. the IM review framework used to consider changes to IMs.

Orion CPP experience

3. There was discussion throughout the workshop of Orion's CPP and how improvements to the CPP process could be drawn from this experience. It was acknowledged amongst the attendees that many of the issues experienced in setting Orion's CPP were unlikely to occur, or be as significant, in future CPP processes. This was due to the unique circumstances in which Orion's proposal was submitted—a catastrophic event proposal in the context of a significant natural disaster, and the first time the CPP IMs had been used in practice.
4. There was also broad discussion throughout the workshop of policy matters such as the role of expenditure objective; and the tension between reducing cost and complexity, and ensuring the Commission is able to effectively assess the CPP proposal.

Verification process

5. To provide context for the discussion on the number of projects the verifier must assess, Commission staff briefly outlined the scope of work on the verifier topic as a whole. This included the issues identified and potential solutions.
6. The issues outlined with the verification process that were raised following Orion's CPP, included:
 - 6.1. A lack of clarity as to the verifier's purpose and the perception that the Commission duplicated the verifier's role in the Orion CPP.

- 6.2. The Commission asked for the same information as the verifier and there was a lack of knowledge sharing between the Commission and the verifier after the proposal had been submitted.
 - 6.3. The verifier review of cost allocation and non-standard depreciation is not appropriate, and would be better considered by the Commission.
 - 6.4. There was insufficient time to complete a thorough verification.
 - 6.5. The rules on communication between parties during the verification process need to be clarified.
 - 6.6. The requirement for the verifier to document a 'paper trail' was too onerous requirement.
7. The potential solutions to issues under consideration included:
- 7.1. allowing the verifier to have discretion about number of projects verified;
 - 7.2. clarifying the verifier's role and purpose;
 - 7.3. removing non-standard depreciation from the verifier's TOR;
 - 7.4. removing the reference to a "duty of care" but clarifying the verifier's duty;
 - 7.5. introducing a clear communication protocol; and
 - 7.6. requiring the applicant, not an independent engineer, to provide the quality standard variation report, with the verifier to review that report.

Number of identified projects

- 8. The current CPP IMs require the supplier to provide the verifier detailed information on 22 projects, which the verifier will use as a sample to test whether the high level policies described in the application have being applied in practice.
- 9. Commission staff proposed that it might be appropriate to introduce a degree of flexibility in the number of identified projects in some circumstances.
- 10. There was general agreement amongst the attendees that an absolute number of identified projects was not ideal, and that allowing the verifier flexibility to choose which projects required in-depth information and verification was preferable. A specified number of projects was viewed as being unhelpful, given that the way different businesses cut their projects may vary. It may also result in unnecessary compliance costs as businesses cut programmes to suit the CPP requirements.

11. The workshop discussed what an appropriate number of identified projects would be, and how these projects would be selected, including any criteria that the verifier might apply if it was to select them.

How the verifier would choose number and type of identified projects

12. The workshop discussed the possibility of the verifier having the flexibility to choose the number of identified projects. The Commission asked for views on how the verifier would judge an appropriate number of projects.
13. Suggestions by attendees of appropriate ways that a verifier could select the number of projects included:
 - 13.1. Percentage of expenditure reviewed, and across a range of projects and programmes.
 - 13.2. Focus on growth, abnormal expenditure that would be the subject to board scrutiny. Not so much on run of the mill business/BAU.
 - 13.3. No further criteria, other than a sufficient number to provide a view to the Commission on view on whether the policies and procedures set out in the proposal have been followed, and the other matters that the verifier is required to provide a view on.
 - 13.4. Current requirement of 22 could be retained as a cap.
14. Geoff Brown, the verifier from the Orion CPP, commented that he would be comfortable as a verifier with discretion to pick the number of identified projects.
15. Powerco agreed that allowing some flexibility would be good, but emphasised the importance of settling the identified projects early, in order to know where the effort would be required. It would not be desirable for the verifier to subsequently change the number of identified projects. Powerco also commented that it would be useful for the verifier to come in early, understand the drivers and asset management plan, then propose bespoke terms of reference for the CPP application.
16. MDL suggested that a lot of flexibility was required and the number of projects should be scalable to the size of the business.

Verifier doesn't need to see price path info

17. PwC suggested that the verifier does not need to see the full price path proposal as it is not tasked with forming a view on the price path. Suggested that the verifier only needs to view the proposals capex, opex and demand components.

Suppliers have to prepare detailed information for all projects, not just identified projects

18. Orion raised the issue that where the verifier has flexibility to pick identified projects, the CPP applicant may not know what projects will be picked in advance so would have to prepare detailed information for all of them, requiring time, effort and duplication. Orion had to artificially create projects to fit the number of opex categories.
19. Strata energy made the point that a well-run business should have this information readily available anyway.
20. Orion was of the view that a well-run business would not have this information readily available in the manner prescribed by the IM's unless it was under a regulatory regime such as the Australian approach where at each regulatory reset a full building block analysis is required.
21. Orion was also of the view that it was important that suppliers who were considering a CPP were not required to do the work behind the scenes just in case they decided to apply for one. Australia is geared up to do that, but it is more difficult for New Zealand businesses. To suddenly try produce all the information required to apply is costly when and the businesses are not set up for it.

Early engagement of the verifier

22. Powerco expressed the view that it would be useful for the verifier to come in early, understand the drivers and asset management plan, then propose bespoke terms of reference for the CPP application,
23. Commission staff agreed, however noted potential concerns about the risk to the verifier's independence.
24. The workshop discussed this point, and while wary of the risk in theory, most attendees were of the view that this would not be an issue in reality, given the verifier's professional reputation and standards.

Timing

25. PwC raised an issue with sequencing and that fact that the verifier receives all information at once, some of which may not be relevant (such as price path information).

Schedule D – Qualitative information requirements

26. Commission staff and consultants explained that the proposed changes were being made to better align the CPP information requirements with the information disclosure requirements.
27. Attendees noted the significant amount of information required in the CPP information requirements.
28. PWC suggested that there should be sufficient flexibility for supplier's to exercise judgement as to what is in a CPP proposal – which goes to the heart of what has to be in Schedule D. Suggested that while it is important that Schedule D requires a complete document, requiring all the reasoning of how the applicant got there may not be necessary.
29. PWC suggested that the costs could be reduced by allowing the Commission to acquire some information through workshopping with intending CPP applicants, rather than prescriptively requiring it in the information requirements.
30. However, Orion noted that it was important that it was as certain as possible what was and was not required by the IM.
31. Geoff Brown explained that Schedule D should make it clear to the applicant the depth and breadth of information that the Commission might require in order to evaluate the CPP proposal. This risk is, if it is pared down that small businesses won't have the right information as part of their application.
32. MDL acknowledged the difficulty of designing an IM that covers everyone and suggested that the Commission needed to be flexible, not require all information, but retain the ability to ask for it later.
33. MEUG expressed that it expected well run business to be able to provide the information the Commission was seeking.
34. There was general agreement that information should be able to be incorporated into a CPP proposal by reference and the Commission explained that incorporation of information by reference to AMPs was appropriate.

Structure of Schedule D and alignment with ID

35. Suppliers made suggestions for potential changes to the structure and presentation of Schedule D so as to better reflect information disclosure requirements and asset management plans (AMPs).
36. Suppliers generally agreed that AMPs were a good starting place for the information requirements. It was suggested that the information requirements could specify what is

required only by exception of what is not in the AMP and could also potentially reference ID clauses in the information requirements.

37. PWC suggested that this was preferable to taking businesses AMPs and manipulating them to fit Schedule D, as Orion did. It was noted that the schedules are very prescriptive.
38. There were also suggestions to better align the schedule with BAU processes to further reduce cost and complexity.
39. Commission staff agreed that alignment with ID was important and that they would look to do this where possible.

Substance of schedule D

40. There was general agreement that the *substance* of the information set out in the proposed Schedule D of the workshop materials was the correct information for the Commission to be asking for, despite the issues relating to the form and presentation outlined above.
41. Geoff Brown explained that the old schedule D implied a preconceived idea of how to prepare forecasts and that in the proposed Schedule D the Commission has attempted to move away from that level of prescription.
42. Geoff Brown also explained that provisions D7 and D9 had been combined in the proposed schedule to avoid duplication.

Schedule E – Quantitative information requirements

43. The workshop discussed the proposed Schedule E tables that were presented.
44. There was general discussion of the proposed changes to schedule E. Attendees made a number of comments:
 - 44.1. It was suggested that the historical real and nominal prices be provided in their respective tables, rather than only in nominal.
 - 44.2. PWC suggested that information on related parties could be presented in other ways but agreed with the proposed change from the current requirements.
 - 44.3. PWC commented that the tables for unit escalation should allow flexibility.
 - 44.4. PWC suggested the disaggregation of capex by capex expenditure categories be removed. Strata mentioned that this disaggregation is useful for evaluation and should be retained.

- 44.5. The workshop agreed that for the purpose of the depreciation and tax IMs, capex projects and programmes could be disaggregated into fewer categories than the current requirements (which require disaggregation at a individual asset level), or under the DPP (by assumed asset life). PWC clarified the implications of these changes.