

Amendment to Electricity Distribution Services Input Methodologies Determination and Electricity Distribution Services Default Price-Quality Path Determination 2020

Correction to definition of discount – draft amendment companion paper

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Associated documents

Publication date	Reference	Title
26 November 2019	ISBN 978-1-869456-71-6	Amendments to electricity distribution services input methodologies determination – Reasons paper
26 November 2019	[2019] NZCC 20	Electricity Distribution Services Input Methodologies Amendments Determination (No. 2)
27 November 2019	ISBN 978-1-869457-68-6	Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision – Reasons Paper
27 November 2019	[2019] NZCC 21	Electricity Distribution Services Default Price-Quality Path Determination 2020
27 February 2020	ISBN 978-1-869457-95-2	[DRAFT] Electricity Distribution Services Default Price-Quality Path (Definition of discount) Amendments Determination 2020
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Wellington, New Zealand

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Chapter 1 Introduction

Purpose of this paper

- 1.1 This paper discusses an error in the Electricity Distribution Services Input Methodologies 2012 (EDB IMs) related to the definition of discounts, and the amendment we are proposing to correct it. It also discusses our proposed consequential amendment to the Electricity Distribution Services Default Price-Quality Path Determination 2020 (EDB DPP3 determination), which would allow the proposed EDB IM amendment to apply for the default price-quality path for 2020-2025 regulatory period (DPP3).

Summary

- 1.2 The issue relates to how ‘discount’ is defined in clause 3.1.1(11) of the specification of price IMs.¹ This clause requires (among other things) that any discount must have ‘applied when the **forecast net allowable revenue** was determined’.² This determination occurred on 27 November 2019 when DPP3 was determined.³
- 1.3 The current drafting means electricity distribution businesses (distributors) subject to DPP3 cannot include any discounts not offered before 27 November 2019 in their calculations of “forecast revenue from prices” when demonstrating compliance with the price path. This effectively removes a price-quality regulated distributor’s ability to offer new discounts or alter their terms in a way that is acknowledged by the revenue cap.
- 1.4 We propose an EDB IM amendment and a consequential EDB DPP3 determination amendment to resolve this error.

Structure of this paper

- 1.5 This paper first explains the process we are following and how you can provide your views. The second chapter sets out the frameworks we apply:
- 1.5.1 when considering the scope of an IM amendment process; and
- 1.5.2 in deciding whether to make IM amendments within the scope of that amendment process.

¹ The latest consolidated version of the EDB IMs can be accessed at: https://comcom.govt.nz/_data/assets/pdf_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-29-January-2020.pdf.

² [Commerce Commission Electricity Distribution Services Input Methodologies Determination 2012 \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), clause 3.1.1(11)(1)(c).

³ [Commerce Commission Electricity Distribution Services Default Price-Quality Path Determination 2020 \[2019\] NZCC 21 \(27 November 2019\)](#), schedule 1.4.

- 1.6 The third chapter explains the definition of discounts issue we have identified and discusses our proposed solution, applying the framework from Chapter 2.
- 1.7 Alongside this paper, we have also published a draft of the EDB IM amendments determination and a draft amendment to the EDB DPP3 determination.

Process we intend to follow and how you can provide your views

Process we intend to follow

- 1.8 Following the publication of the Notice of Intention to amend the EDB IMs and DPP3 determination published 11 February 2020,⁴ we have published this paper and the accompanying draft amendments determinations. We are allowing two weeks for submissions (due by 12 March 2020) and one week for cross-submissions (due by 19 March 2020).
- 1.9 We will publish a final decision before 31 March 2020.

How you can provide your views

Timeframe for submissions

- 1.10 We welcome your views on the matters raised in this paper within the time frames set out below:
- 1.10.1 submissions by **5pm on Thursday, 12 March 2020**; and
- 1.10.2 cross-submissions by **5pm on Thursday, 19 March 2020**.

Address for submissions

- 1.11 Responses should be addressed to:

Matthew Lewer (Manager, Regulation development)
c/o regulation.branch@comcom.govt.nz

- 1.12 Please include “EDB IMs discounts issue” in the subject line of your email. We prefer submissions in both a format suitable for word processing (such as a Microsoft Word document) as well as a ‘locked’ format (such as a PDF) for publication on our website.

⁴ [Notice of Intention: Proposal to Consider Amending Input Methodologies and Default Price-Quality Path for Electricity Distribution Services \(11 February 2020\)](#).

Confidential submissions

- 1.13 While we discourage requests for non-disclosure of submissions so that all information can be tested in an open and transparent manner, we recognise that there may be cases where parties that make submissions wish to provide information in confidence.⁵ We offer the following guidance:
- 1.13.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential.
 - 1.13.2 Where commercial sensitivity is asserted, submitters must explain why publication of the information would be likely to unreasonably prejudice their commercial position or that of another person who is the subject of the information.
 - 1.13.3 Both confidential and public versions of the submission should be provided.
 - 1.13.4 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.
- 1.14 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'.

⁵ Parties can also request that we make orders under section 100 of the Commerce Act 1986 in respect of information that should not be made public. Any request for a section 100 order must be made when the relevant information is supplied to us, and must identify the reasons why the relevant information should not be made public. We will provide further information on section 100 orders if requested by parties. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any section 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.

Chapter 2 Framework

Purpose of this chapter

- 2.1 This chapter summarises the framework we have applied in reaching our draft decision. In doing so, it explains:
- 2.1.1 the approach we take when considering the scope of an IM amendment process;
 - 2.1.2 how we consider what IM amendments to make within that process; and
 - 2.1.3 the effect of a change to the EDB IMs on the DPP3 determination.
- 2.2 How we have applied this framework to the current issue is explained in the following chapter.

Framework for considering whether to amend IMs

- 2.3 To aid us in making decisions about the scope of IM amendments in a way that is consistent with the Commerce Act 1986 (the Act), we have developed a decision-making framework over the 2016 input methodologies (IM) review and 2019 pre-DPP3 reset process.⁶
- 2.4 We may amend an IM at any time, provided that, where the change is material, we follow the consultation process set out in section 52V of the Act.⁷ However, in deciding whether to exercise our power to consult on amendments to the IMs, we must also have regard to section 52A of the Act as the central purpose of Part 4, as well as the purpose of IMs (section 52R of the Act).
- 2.5 While it is important to ensure the IMs are error-free and appropriate for the forthcoming DPP regulatory period, we must be mindful that being overly willing to entertain amendments may have an unduly detrimental effect on:
- 2.5.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with section 52A(1) of the Act; and
 - 2.5.2 the role that the IMs play in promoting certainty for suppliers and consumers in relation to the rules, requirements, and processes in advance of being applied by us and suppliers (for example, in setting the DPP).

⁶ A fuller explanation of this framework can be found in: [Commerce Commission “Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons Paper” \(26 November 2019\) Chapter 2.](#)

⁷ [Commerce Act 1986](#), section 52X.

- 2.6 As such, the approach we have taken in the past to amendments that are outside of a section 52Y IM review process is to consider amendments that either:
- 2.6.1 support implementation of incremental improvements to the way the DPP is set; or
 - 2.6.2 enhance certainty about the rules and correct for technical errors ahead of the DPP reset.⁸
- 2.7 Conversely, it is not generally appropriate to consider fundamental changes to the IMs outside of a section 52Y IM review process. By fundamental changes, we primarily mean significant changes to the IMs listed in s 52T(1)(a) of the Act – being the cost of capital, valuation of assets, allocation of common costs, and treatment of taxation. These IMs provide the foundational building blocks used to set price-quality paths. While we might consider such amendments in exceptional circumstances, we consider that they will normally be more appropriately considered as part of the next s 52Y review of the IMs.

Framework for considering IM amendments

- 2.8 In deciding whether to make potential IM amendments within the scope of an amendments process, we apply a decision-making framework that we have developed over time to support our decision making under Part 4 of the Act.⁹ This has been consulted on and used as part of prior processes, and helps provide consistency and transparency in our decision making.
- 2.9 Specifically, we consider whether candidate IM amendments would promote the following outcomes:
- 2.9.1 promoting the Part 4 purpose in s 52A of the Act more effectively than the current IM;
 - 2.9.2 promoting the IM purpose in s 52R of the Act more effectively (without detrimentally affecting the promotion of the s 52A purpose); or
 - 2.9.3 significantly reducing compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

⁸ [Commerce Commission “Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons Paper” \(26 November 2019\)](#), para 2.11.

⁹ [See Commerce Commission “Input methodologies review decisions: Framework for the IM review” \(20 December 2016\)](#), para 59.

Relationship of IM amendment to the DPP

- 2.10 To allow the IM amendment in this case to apply for DPP3, we must also make an amendment under s 52Q to the section 52P DPP3 determination. This is because the DPP3 determination specifies the IMs that apply to the DPP which currently only capture IMs in effect as of 27 November 2019.¹⁰

¹⁰ [Commerce Commission Electricity Distribution Services Default Price-Quality Path Determination 2020 \[2019\] NZCC 21 \(27 November 2019\)](#) – see the definition of “IM determination” in clause 4.2 and clause 6.

Chapter 3 Proposed amendment to definition of discounts

Purpose of this chapter

- 3.1 This chapter explains the error we have identified in the EDB IMs, and then analyses our proposed solution in light of the framework discussed in Chapter 2.

Problem definition

- 3.2 Under the current EDB IMs, non-exempt distributors¹¹ cannot include (or in other words 'net off') the value of any discounts made after a default price-quality path (DPP) or customised price-quality path (CPP) is determined when complying with that DPP or CPP. This means non-exempt distributors must either:
- 3.2.1 avoid offering any new discounts when setting their prices; or
 - 3.2.2 risk non-compliance with the price path.
- 3.3 We consider these outcomes are undesirable as they:
- 3.3.1 do not achieve the intent of the original IM provision – to distinguish between discretionary discounts (which are treated as dividends) and non-discretionary discounts (treated as reductions in revenue);
 - 3.3.2 do not promote outcomes consistent with section 52A(1)(c), in that distributors are limited in their ability to use discounts to share the benefits of gains in efficiency; and
 - 3.3.3 limit our ability to assess whether the section 52A(1)(d) outcome is being met, as the exclusion of certain discounts offered in practice but not included in disclosures affects the calculation of a distributor's profitability.

Prices are defined to include certain kinds of discounts

- 3.4 The error is caused by clause 3.1.1(11)(c) of the EDB IMs, which states (among other requirements) that:¹²

(11) 'discount' means a discount to charges payable for the **supply of electricity distribution services...**

¹¹ By "non-exempt distributions", we mean distributors that are not exempt from default/customised price-quality regulation under section 54G of the Act.

¹² [Commerce Commission Electricity Distribution Services Input Methodologies Determination 2012 \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), clause 3.1.1(11)(1)(c).

(c) that applied when the **forecast net allowable revenue** was determined.

3.5 This definition of ‘discount’ is referenced in the definition of ‘prices’ in clause 3.1.1(9) of the IMs:¹³

(9) ‘Prices’ means-

(a) individual tariffs, fees or charges; or

(b) individual components thereof,

in nominal terms exclusive of **GST** for the **supply** of an **electricity distribution service**, and must include a **discount** taken up by **consumers**.

3.6 The revenue cap that non-exempt distributors must comply with is defined in terms of “forecast revenue from prices”, the definition of which is given in clause 3.1.1(3) of the EDB IMs:¹⁴

(3) For the purpose of this subpart, ‘forecast revenue from prices’ for a **disclosure year** means the forecast revenue used by an **EDB** to set **prices**, where forecast revenue is the total of each **price** multiplied by each forecast **quantity**.

3.7 Finally, the revenue cap that non-exempt distributors must comply with is also defined in terms of “actual revenue from prices”, which is referred to in clause 3.1.3(13)(f) of the EDB IMs.¹⁵

3.8 Applying these definitions if discounts are ignored, ‘prices’ will be higher, and as a result ‘forecast revenue from prices’ and ‘actual revenue from prices’ will also be higher.

Forecast net allowable revenue for the regulatory period has already been determined

3.9 ‘Forecast net allowable revenue’, the relevant term for determining the time by which a non-exempt distributor must offer a discount that qualifies for inclusion in prices, is defined in clauses 3.1.1(6) and 3.1.1(7) of the EDB IMs:¹⁶

(6) For the purpose of this subpart, ‘forecast net allowable revenue’ for the first **disclosure year** of a **DPP** or **CPP regulatory period** will be specified by the **Commission** at the start of the **regulatory period** in a **DPP determination** or **CPP determination**.

¹³ Ibid. clause 3.1.1(9).

¹⁴ Ibid. clause 3.1.1(3).

¹⁵ Ibid. clause 3.1.3(13)(f).

¹⁶ Ibid. clauses 3.1.1(6) and (7).

(7) For each **disclosure year** of the **DPP** or **CPP regulatory period** after the first **disclosure year**, ‘forecast net allowable revenue’ is calculated by applying-

- (a) the **forecast net allowable revenue** for the preceding **disclosure year**;
- (b) the **forecast CPI**, as specified in subclause (8); and
- (c) any X factor applicable to the **EDB**.

3.10 We made the DPP3 determination referenced in these definitions on 27 November 2019. Schedule 1.4 of the DPP3 determination specifies ‘forecast net allowable revenue’ for each distributor for each year of the regulatory period.¹⁷ Because of this, only discounts to prices that were offered on or before 27 November 2019 can be recognised when calculating ‘forecast revenue from prices’.

3.11 Because ‘forecast net allowable revenue’ is determined based on forecast CPI, we were able to determine the values for each assessment period of the regulatory period at the outset of the period, not just the values for the first assessment period. This means that the problem will persist for all assessment periods of the DPP3 period, not only the first assessment period.

Proposed solution

3.12 To remedy this situation, we propose amending clause 3.1.1(11)(c) to require that discounts apply “when forecast revenue from prices is calculated”, in place of when “forecast net allowable revenue was determined”.

3.13 We also propose amending the definition of “IM determination” in clause 1.4 of the EDB DPP3 determination to include the IM amendments determination that would give effect to the change in paragraph 3.12.

Analysis of proposed solution

3.14 This section analyses the proposed amendment in light of the framework set out in Chapter 2, considering:

- 3.14.1 whether this is an appropriate use of our IM amendment powers; and
- 3.14.2 whether this proposed change meets the criteria we apply when considering whether to make an amendment to the IMs.

¹⁷ [Commerce Commission Electricity Distribution Services Default Price-Quality Path Determination 2020 \[2019\] NZCC 21 \(27 November 2019\)](#), schedule 1.4.

Whether to consider an IM amendment

- 3.15 We consider this amendment an appropriate use of our amendment powers. The issue here relates to the correction of a technical error – drafting that is not achieving the intent of the IM provision – and does not affect fundamental aspects of the IMs. We have not identified any other aspects of the IMs that are affected by this issue or the proposed change, and so consider that we can make this change in isolation.
- 3.16 Additionally, we consider it appropriate to consider the amendment now, rather than waiting for the next review of IMs under section 52Y. To be effective during DPP3, an IM amendment would need to be in place prior to 1 April 2020.

Whether to make an IM amendment

- 3.17 In this section, we assess the proposed amendment against the three criteria we apply when considering changes to the IMs:
- 3.17.1 promoting the Part 4 purpose in s 52A of the Act more effectively than the current IM;
 - 3.17.2 promoting the IM purpose in s 52R of the Act more effectively (without detrimentally affecting the promotion of the s 52A purpose); and
 - 3.17.3 significantly reducing compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

Policy intent of the discount provisions in the IMs

- 3.18 The original requirement in the EDB IMs for discounts to be ‘posted’ to qualify as a reduction in revenue was intended to distinguish them from ‘discretionary discounts’. The key difference between the two is that ‘posted discounts’ have the characteristics of prices, in that they are ‘locked in’ once tariffs are set, and consumers are able to respond to them.¹⁸
- 3.19 Discretionary discounts, on the other hand, may be offered, varied, or removed after the fact, and are more akin of the payment of a dividend to consumer-shareholders. Preserving the distinction between these two situations is important, as it allows more accurate reporting and analysis of distributor profitability. As such, this issue is relevant to the assessment of whether the outcome in section 52A(1)(d) of the Act is being met.

¹⁸ [Commerce Commission “Input Methodologies \(Electricity Distribution and Gas Pipeline Services\) – Reasons Paper” \(22 December 2010\)](#), paras G2.40-G2.47.

- 3.20 The original EDB IMs published in 2010 required discounts to be “offered by an **EDB** in a published tariff schedule”.¹⁹
- 3.21 The definition of ‘posted discounts’ was changed as a result of the 2016 IM review to the current drafting. This was done because the inclusion of the word “posted” in the definition meant that it could not encompass non-standard contracts, which are not generally published. The current requirement was included as a substitute for this.²⁰
- 3.22 Any amendment to the IMs should preserve this approach, specifically:
- 3.22.1 distributors should have the ability to offer non-discretionary discounts to their consumers and for these to be netted off revenues; but
 - 3.22.2 qualifying discounts must be fixed at a certain point in time, so that consumers can respond to them.
- 3.23 We consider that by enabling distributors to offer discounts, and for these discounts to be properly accounted for in the distributor’s revenue path, the amendment we are proposing better promotes the original purpose of the IM.

Certainty for consumers and EDBs

- 3.24 The statutory purpose of IMs is “to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation... of goods or services”.²¹
- 3.25 We consider the amendment we propose better promotes certainty for suppliers and consumers. Under the current IMs, the intent of the provision conflicts with the way it is drafted. An amendment would remedy this, and therefore give distributors better certainty about how the rules should be applied.

Cost and complexity

- 3.26 The amendments to the EDB IMs and DPP3 determinations we are proposing are relatively straightforward (both involve a single change to a single definition). A ‘do nothing’ option may require distributors to change the approach they take to pricing, increasing cost. Furthermore, it will involve continued discussions between distributors and us, increasing the complexity of complying with the IMs and the DPP3 determination.

¹⁹ [Commerce Commission Electricity Distribution Services Input Methodologies Determination 2012 \[2012\] NZCC 26 \(Consolidated as at 29 January 2020\)](#), Appendix Part 4, clause 3.1.1(5)(b).

²⁰ [Commerce Commission “Input methodologies review decisions – Report on the IM review” \(20 December 2016\)](#), para 273.2.3 and footnote 81.

²¹ [Commerce Act 1986](#), section 52R.