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CPP and in-period adjustment mechanisms topic paper

Part 4 Input Methodologies Review 2023-Draft decision

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All above documents can be found on our website.

Commerce Commission
Wellington, New Zealand

Glossary

Abbreviation	Definition
ACOD	Avoided Cost of Distribution
AMWEE	Alternative Methodologies with Equivalent Effect
the Act	Commerce Act 1986
AER	Australian Energy Regulator
AMP	Asset Management Plan
ANR	Allowable Notional Revenue
Capex	Capital Expenditure
CCRA	Climate Change Response Act 2002
CPP	Customised Price-quality Path
DER	Distributed Energy Resources
DPP	Default Price-quality Path
DSO	Distribution System Operator
EDB	Electricity Distribution Business
EV	Electric Vehicle
Fibre IMs	Fibre IMs set under Part 6 of the Telecommunications Act 2001
FMCP	Foreseeable major capex project
FNAR	Forecast Net Allowable Revenue
GAAP	Generally Accepted Accounting Practice
Gas IMs	Input Methodologies for gas pipeline businesses
GDB	Gas Distribution Business
GPB	Gas Pipeline Businesses, comprising GDBs and the GTB
GTB	Gas Transmission Business
ID	Information Disclosure
IMs	Input Methodologies (refers to Part 4 IMs which are the subject of the IM Review, unless identified otherwise)
IM Review	Input Methodologies Review 2023
IPP	Individual Price-quality Path
IRIS	Incremental Rolling Incentive Scheme
kWh	Kilowatt hour
LCC	Large Connection Contract
LV	Low Voltage
MAR	Maximum Allowable Revenue
MW	Megawatt
Non-exempt EDBs	EDBs that are not consumer-owned and are subject to price-quality regulation
Ofgem	The Office of Gas and Electricity Markets
Opex	Operating expenditure

Part 4	Part 4 of the Commerce Act 1986
PQ	Price-quality
Price-quality path	Refers to the maximum revenues (or weighted average prices) regulated suppliers can recover from their consumers and the minimum quality standards they must meet when delivering electricity and/or gas transmission and distribution services.
RAB	Regulated Asset Base
Totex	Totex regimes (total expenditure rather than treating capex and opex separately)
UMCP	Unforeseeable major capex project

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Contents

Executive summary

Purpose of this paper

X1 This paper sets out how:

X1.1 the CPP IMs and the in-period adjustment mechanism IMs for CPPs and DPPs apply as a package to address changed or unexpected circumstances requiring changes to price-quality path regulatory periods;

X1.2 we have applied the IM Review decision-making framework to identify issues and problems with that package;[1] and

X1.3 we have assessed proposed changes to the IMs that will meet one or more of the IM Review's overarching objectives.[2]

X2 In our consideration of the overarching objectives of the framework, we have also had regard to the following factors where we consider they are relevant and promote the s 52A purpose more effectively:[3]

X2.1 whether there are alternative ways to address the identified issues with the relevant IM that do not involve changing the IMs as part of our review;

X2.2 the permissive considerations under s 5ZN of the Climate Change Response Act 2002 (**CCRA**);

X2.3 decisions made under the Electricity Industry Act 2010, in accordance with s 54V of the Commerce Act 1986 (**the Act**); and

X2.4 promoting incentives and avoiding disincentives for regulated suppliers to invest in energy efficiency, demand-side management, and reduce energy losses, in accordance with s 54Q of the Act.

X3 The changes we are proposing to the CPP IMs and price-quality path in-period adjustment IMs will apply to non-exempt EDBs and where applicable, to GDBs, the GTB, and Transpower. These IM changes do not apply to specified airport services, as airports are not subject to price-quality regulation.

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[1] Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para X21-X22.

[2] Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para X21-X22.

[3] Commerce Commission, "Part 4 Input Methodologies Review 2023 – Framework paper", (13 October 2022), para X21.2.

X4 Most of our proposed changes are for the EDB DPP IMs, as we consider EDBs are likely to have a greater need for new price-quality path adjustments. This is due to the likelihood of changing circumstances during a regulatory period driven by decarbonisation and greater electrification. Because CPPs and the IPP have a more tailored nature, they already allow greater inherent ability to respond in an appropriate and timely way.

X5 We have proposed some changes for the Gas sector where these are appropriate in that sector context. The Gas sector is faced with the prospect of declining demand due to the transition away from gas and therefore is unlikely to require price-quality path adjustments at the scale required by EDBs. The majority of the IM changes for GDBs and the GTB relate more to maintaining incentives to invest, which is discussed in the *Financing and incentivising efficient expenditure during the energy transition* topic paper.[4]

X6 Only a subset of the proposed changes would apply to Transpower, as it is on an IPP and has existing specific in-period adjustment mechanisms. The proposed changes applicable to Transpower are for the more general changes to the price-quality path reopener process and the general suite of in-period adjustment mechanisms that will apply to EDBs, GDBs, the GTB and Transpower.

We invite your views

X7 We invite your submissions in response to our draft decisions on the IM Review, which are presented in our draft Report on the Review, draft topic papers, and draft IM amendment determinations. We intend to publish submissions we receive and invite cross-submissions on those submissions at that point.

X8 Submissions are due by 5pm on 19 July 2023. Cross-submissions are due by 5pm on 9 August 2023.[5]

X9 We list the components of our draft decision package for the IM Review at paragraph **Error! Reference source not found.** below and outline how submissions and cross-submissions can be made from paragraph 1.23.

[4] Commerce Commission "Input Methodologies Review 2023 – Draft decision – Topic paper: Financing and incentivising efficient expenditure during the energy transition" (14 June 2023).

[5] The Transpower IM amendment determination and the Transpower Capex IM amendment determination will be published on 21 June, one week later than the rest of the draft decisions package. As with the other amendment determinations, a seven-week consultation period will apply for these two amendment determinations.

Context of this topic

Why in-period adjustment mechanisms are necessary

X10 The DPP/CPP/IPP regime is a form of regulation in Part 4 of the Act that promotes the long-term benefit of consumers by promoting outcomes consistent with those in workably competitive markets.[6] The outcomes sought are that suppliers have incentives to innovate and invest, improve efficiency, provide services at a quality that reflects consumer demands, share efficiency gains with consumers, including through lower prices, and are limited in their ability to extract excessive profits.

X11 We can set price-quality paths for a four-to-five-year period for DPPs and IPPs, and a three-to-five-year period for CPPs. These price-quality paths provide certainty to suppliers about limits on revenue, quality standards and incentive mechanisms for efficiency and quality over the regulatory period.[7]

X12 We are not restricted in the way we set price-quality paths, subject only to the IMs and other relevant statutory provisions. In particular, neither Part 4 of the Act nor the IMs specify how we may determine forecasts of expenditure. For instance, a DPP could be reset using an entirely forward-looking approach to forecasting expenditure, or by including an increased percentage cap applied to historical levels of expenditure, without requiring any change to the current IMs.

X13 A supplier can face changed or unexpected circumstances during a regulatory period, requiring it to:

X13.1 incur additional expenditure that it may not be able to accommodate within the settings of its current price-quality path through reprioritisation of expenditure;[8] and/or

X13.2 make a variation to the quality standards and incentives of its current price-quality path.

X14 In order to address these changed circumstances, mechanisms to change the price-quality path during the regulatory period may be warranted. Mechanisms to change the price-quality path may also be needed if the price-quality path we have set excluded spend that was uncertain in need, timing or cost.

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[6] Commerce Act (1986), s52A(1).

[7] Commerce Act (1986) s 53M(4) and (5); s 53W; s53ZC.

[8] The price-quality paths we set do not restrict a regulated supplier in their extent of spending. If a supplier chooses to spend and, in doing so, exceeds the revenue limits set by our price-quality path, the IRIS scheme means approximately 78% of the overspend is shared with consumers. If the spend was within the revenue limits set by our price-quality path, it is fully recoverable from consumers.

X15 Once a price-quality path has been set, the IMs provide forward-looking certainty about when the path can automatically 'adjust', or may be adjusted or changed, during the regulatory period. In particular they set out:

X15.1 costs that may be directly passed through to consumers under the price-quality path (ie, pass-through costs and recoverable' costs);

X15.2 the circumstances in which the price-quality path may be reconsidered (ie, 'reopeners'); and

X15.3 requirements that a regulated supplier subject to a DPP must meet if it applies to shift from a DPP to a CPP (ie, the CPP requirements).

X16 The simplified regulatory continuum for the DPP/CPP regime in Figure X1 shows the package of existing regulatory tools and mechanisms for EDBs, GDBs and the GTB.

Figure X1 Existing Regulatory Continuum

Context for our draft decisions

X17 The suppliers we regulate under Part 4 are managing the pressures of an ageing asset base and rising input costs. In forthcoming regulatory periods, they are likely to face greater uncertainty of their future expenditure requirements. This is expected due to decarbonisation activities and the energy transition.[9] These activities are expected to increase expenditure in the electricity network, and over time to decrease demand in the gas sector. In the electricity sector the shift towards flexibility services, including distributed generation, is an additional uncertainty.[10]

[9] Transition risks as discussed in Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para A18.1

[10] In the IM amendments we are proposing to introduce the following definition of 'flexibility' to describe flexibility services: "means the ability to modify energy generation injection or consumption patterns (or both)".

X18 Suppliers are also having to consider whether they need to increase spend on their networks to be better prepared for natural disasters, adverse weather events as the result of climate change, and to manage a landscape of increasing risks (such as from other natural hazards, cybersecurity threats and supply chain constraints).[11]

X19 Where possible and appropriate, we consider it may be best to deal with forecasting uncertainties at the next DPP and IPP resets when we expect to have additional information from suppliers. We also want to ensure we have the mechanisms to respond to forecasting uncertainties during a regulatory period appropriately and in a timely way at those resets.

X20 We consider we generally have sufficient flexibility to respond appropriately at the right time and in the right way through the tools currently available to us. Where we consider the risk is sufficiently known now and some refinement to our tools is desirable in accordance with the Framework, we are proposing some targeted changes to the IMs.

X21 Introducing new mechanisms or expanding the scope of existing ones involves making trade-offs in our regime between certainty and responsiveness to change. We must be cognisant of the purposes of DPP/CPP regulation and balance the need to appropriately limit the circumstances or events under which a price-quality path should be reconsidered.

X22 Any changes we outline in this IM Review topic paper, such as the reopener processes and the various updated reopeners will, in most cases, apply to EDBs in the DPP regulatory period commencing in 2025, the Transpower IPP regulatory period commencing in 2025, and the GDB and GTB DPP regulatory periods in 2026.[12] We note that the Transpower IPP reset preparation is underway for the 2025-2030 regulatory period, which may mean that it may not be practical for some Transpower IM changes, that would otherwise apply to the setting of the 2025-2030 price path, to instead be effective for the 2030-2035 IPP reset.

Our draft decisions

Our draft decisions as a package

X23 We have looked at the current roles of the DPP, the CPP and the various price-quality path in-period adjustment mechanisms, how they work together, and how they address the current and anticipated future operating contexts of suppliers.

[11] Physical risks as discussed in Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para A18.2

[12] The amended IMs may apply earlier if a CPP is set part way through the current DPP regulatory period for electricity distribution, gas distribution or gas transmission.

X24 As a package, we consider that the existing IMs and our proposed changes to them provide a suitable regime under which suppliers should be able to manage much of the future change and uncertainty they might be expected to face.

X25 In designing our proposed IM changes, we have aimed to enable price-quality paths to be set without providing additional funding upfront to mitigate all uncertainty risks. The changes will also ensure we retain required scrutiny of any additional funding later sought by suppliers during a regulatory period. This approach will help ensure consumers are only subject to price increases where these are justified and represent value for them.

X26 Figure X2 shows a visual of our proposed changes at a glance.

Figure X2 Proposed changes at a glance

New IM provisions **Amended IM provisions** **Unchanged IM provisions**

IM draft decision	Applicability
Chapter 4: Whether changes to CPP IMs are necessary	
Not amend CPP IMs for the purposes of streamlining CPPs	EDB, GDB, GTB
Not allow for a single-issue CPP	EDB, GDB, GTB
Chapter 5: Improving the price-quality path reopener processes	
Introduce the definition of a 'reopener event'	EDB, GDB, GTB, Transpower
Require suppliers who nominate a reopener event to provide sufficient information	EDB, GDB, GTB, Transpower
Require the Commission to publish notices after a significant step in the reopener process	EDB, GDB, GTB, Transpower
Prescribe factors the Commission must have regard to when deciding whether to amend a price-quality path	EDB, GDB, GTB, Transpower
Introduce a new clause to provide the Commission the option to identify reopener applications that are better suited to CPPs	EDB, GDB, GTB
Introduce a new clause on how the Commission will handle confidential information in a reopener application	EDB, GDB, GTB, Transpower
Introduce a new clause to require the Commission to take into account the expenditure objective when determining extent of price-quality path amendment	EDB, GDB, GTB
Not introduce timeframes for the Commission to evaluate reopener applications	-
Not provide more prescription about the types of information required in reopener applications	-
Not include application windows for reopeners	-
Not prescribe when consultation is required and when it is not	-

IM draft decision		Applicability
	Not include a modification or exemption provision for DPP or IPP reopeners	-
	Not include a pre-application stage for the process of reapplying for a reopener	-
	Not include a reopener for the purposes of assessing programme financeability	-
	Not allow price-quality path reopeners to apply across more than one regulatory period without suppliers having to reapply	-
	Not allow a single CPP application to cover multiple parties	-
	Not allow a single reopener application to cover multiple parties	-
Chapter 6: Whether the reopeners will cover future circumstances		
	Allow opex solutions for system growth	EDB, GDB, GTB
	Allow system growth to include general growth for Foreseeable major capex project (**FMCP**) reopeners where project is identified in the AMP and is well-evidenced	EDB
	Not allow system growth to include general growth for Unforeseeable major capex project (**UMCP**) reopener	EDB
	Allow consequential opex and consequential capex for FMCP, UMCP, Capacity reopeners	EDB, GDB, GTB
	Include resilience related expenditure in EDB FMCP and UMCP reopeners and a separate resilience and asset relocation reopener for GPBs	EDB, GDB, GTB
	Extend the GDB/GTB risk event reopener to EDBs	EDB
	Change how the impact of GAAP changes are assessed in the Change event reopener to remove the potential for windfall gains and losses	EDB, GDB, GTB, Transpower
	Not include a reopener to cover Government policy changes, Local Government rule changes and legislation affecting others in the supply chain	-
	Not include a general reopener or a general escalating costs reopener	-
	Not include a 'contingent projects reopener' for DPPs in the EDB, GDB and GTB IMs	-
	Not include a reopener to address digitalisation and data	-
	Not include a reopener to address monitoring of Low Voltage (**LV**) networks	-
	Not include a reopener to address changes to a system operator's approach to security	-
	Not include a reopener to address software as a service (SaaS)	-
	Not include a reopener to address avoided cost of distribution payments (**ACOD**)	-
	Not include a reopener to address increased insurance premiums	-
	Not include a reopener to address Distribution System Operation (**DSO**) type services	-
Chapter 7: Reviewing our approach to reopener thresholds		
	Change the test and materiality threshold which applies to Catastrophic event and Change event reopeners (non GAAP changes) for all suppliers	EDB, GDB, GTB, Transpower
	Change the Error event lower materiality threshold for all suppliers to $100,000 for errors related to the price path	EDB, GDB, GTB, Transpower

IM draft decision		Applicability
	Raise the existing dollar thresholds which apply to EDB FMCP and UMCP reopeners	EDB
	Retain the percentage of revenue threshold for all EDB reopeners apart from Error event	EDB
	Retain existing thresholds which apply to Gas reopeners, apart from Error event	GDB, GTB
	Not implement a lower threshold for high consumer benefit projects	-
	Not implement a change in requirements to specifically allow for cumulative application of lower thresholds	-
	Remove the $30 million upper threshold for EDB FMCP and UMCP reopeners	EDB
	Apply reopener thresholds for new and extended reopeners on a consistent basis with other reopeners	EDB, GDB, GTB
Chapter 8: Large Connection Contract Mechanism		
	Introduce a 'large connection contract' mechanisms for EDBs	EDB
Chapter 9: Whether other in-period adjustment mechanisms are necessary		
	Not allow new volume wash-up mechanisms	EDB
	Not allow new pass-through costs or recoverable costs to manage increased forecasting uncertainty	-
	Not incorporate new contingent expenditure allowances as recoverable costs	-
	Not incorporate new use-it-or-lose-it allowances	-

X27 Table X1 provides a high-level summary of the main benefits of our package of draft decisions.

Table X1 Benefits of our draft decisions

Benefits to consumers	How our draft decision(s) will deliver the benefits
Resilient, safe and reliable supply of electricity and gas	Extending the reopeners to provide for targeted resilience-related expenditure will support EDBs, GDBs and the GTB to reducethe vulnerability of electricity lines and gas pipelines to adverse weather events from the impacts of climate change, other natural disasters, and cybersecurity threats. Extending the risk event reopener to EDBs will allow significant safety and quality issues to be addressed. This will minimise the exposure of consumers to potentially longer and more frequent power outages, and will reduce the exposure of consumers, EDB staff, and contractors to a safety incident due todegraded assets. Simplifying the reopener processes, clarifying the information that suppliers will need to provide to support a reopener application, and specifying how we will evaluate and make decisions on reopener applications will result in more clarity for suppliers. We expect this to improve overall reopener timeframes, allowing required network investment to be delivered quicker, and to help ensure the continued supply of safe and reliable electricity and gas services.

Benefits to consumers	How our draft decision(s) will deliver the benefits
Promoting decarbonisation investments	Extending the suite of reopeners to provide a greater ability to address forecasting uncertainty arising from decarbonisation requirements will provide the ability for suppliers to access additional funding in a regulatory period when required and appropriate. This would also mean consumers are more likely to only pay for projects that are both warranted and efficient. Extending reopeners to provide for opex based solutions to address system growth (rather than just capex alternatives) will provide suppliers with a wider choice of solutions to alleviate network constraints, allowing efficient solutions to be procured. Allowing for increased recovery of opex costs consequential to capex solutions will provide incentives for suppliers to invest and innovate. Retaining our view that the starting point for all CPP applications should be full scope will mean that all inputs needed to set the CPP will require sufficient information to support our required scrutiny. This will ensure that proportionate scrutiny is retained over additional decarbonisation-related investment expenditure sought by suppliers, and that consumers will only be subject to price increases where these are justified and represent value for them. Simplifying the reopener process, clarifying the information suppliers will need to provide to support a reopener application, and specifying how we will evaluate and make decisions on reopener applications will also help suppliers decide on whether they should submit a reopener application or not. Amending reopener materiality thresholds will provide for a greater inclusion of costs related to projects while maintaining the incentives for suppliers to operate efficiently by prioritising work programmes within their revenue allowances.
Supports changes in consumer preferences over time	Introducing the large connection contract mechanism for EDBs will allow large customers to electrify more swiftly and easily, and this will provide options to electrify should they choose. Allowing opex solutions within the suite of reopeners will better enable suppliers to choose the most efficient solutions for required investment on their networks to be able to support changes in consumer preferences over time. Removing the upper materiality threshold on some reopeners will mean suppliers are not disincentivised to deliver projects that could help support changes in consumer preferences over time. Maintaining an appropriately defined boundary between a DPP and a CPP will encourage suppliers to consult with their customers when they forecast a significant change in network expenditure is required.

X28 Our changes to the existing price-quality path reopeners address targeted situations where we consider the forecasting uncertainty risk is highest and would, where appropriate:

X28.1 extend the scope of certain reopeners;

X28.2 extend the application of certain reopeners to regulated sectors where they currently do not exist; and

X28.3 clarify the coverage of certain reopeners.

X29 We propose some new in-period adjustment mechanisms in this IM Review which will help support the price-quality path reopeners:

X29.1 A large connection contract mechanism for EDBs which will address connection forecast uncertainty in situations where EDBs can demonstrate that large customers have entered into commercially negotiated contracts with the EDB and where these reflect terms and conditions which would likely be agreed under conditions of workable or effective competition for the provision of electricity distribution services. This would avoid the need for a price-quality path reopener, taking pressure off the reopener processes for the Part 4 regime as a whole and provide greater ability of suppliers to respond; and

X29.2 A connections volume wash-up mechanism for EDBs on a CPP to reduce the exposure of the EDB and consumers to uncertainty in future network growth.

X30 We have concluded that at the more complex and relatively higher cost end of price-quality path adjustments the CPP regime is generally fit for purpose. Our view is that the starting point for suppliers on a DPP seeking price-quality path amendment to fit their change in circumstances would be the DPP reopeners, especially with our proposed extensions and refinements. We consider that there will only be limited instances where the extended DPP reopeners will not provide a possible solution. The CPP regime remains appropriate where the scope and scale of individual supplier need is greater.

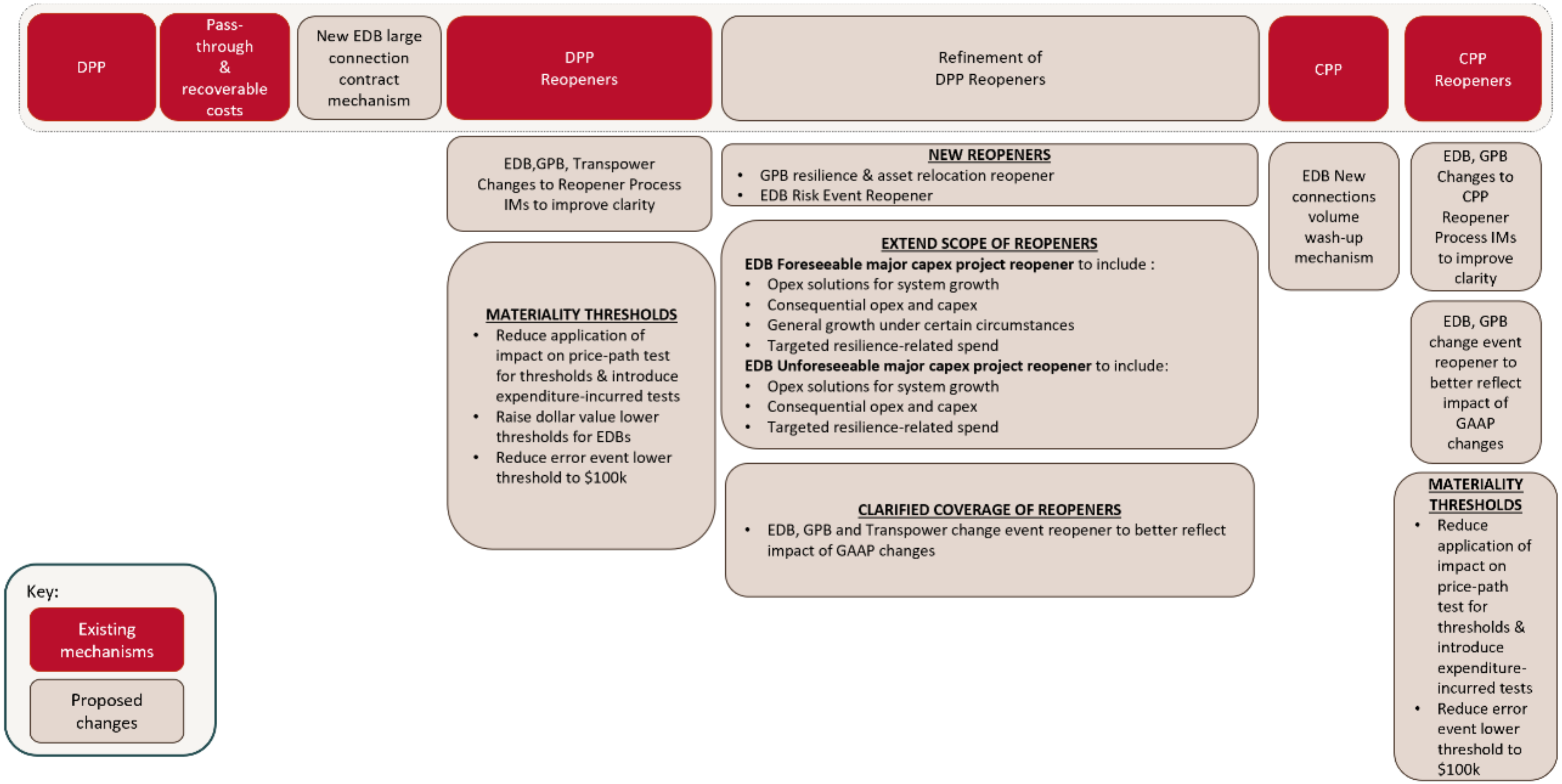
X31 We proposed making appropriate changes to the CPP reopeners that are consistent with those proposed for the DPP reopeners.

X32 In order to set a better platform for existing and proposed amended and new reopeners, we are proposing to update the DPP, CPP and IPP reopener processes in line with the Fibre IMs. These process improvements will make it easier for suppliers to prepare for a reopener and provide clarity to suppliers on the evaluation and assessment process we follow when we receive a price-quality path reopener application.

X33 Figure X3 shows the updated regulatory continuum including the key changes we propose.[13]

[13] The EDB new connections volume wash-up mechanism is discussed in our Commerce Commission "Part 4 Input methodologies Review 2023 - Draft decision - Financing and incentivising efficient expenditure during the energy transition topic paper" (14 June 2023), published alongside this paper.

Figure X3 Updated regulatory continuum showing proposed changes



X34 We set out a summary of the key proposed changes and rationale for these changes below.

We are proposing some changes to the CPP IMs

X35 We improved the CPP IMs in the 2016 IM Review; the majority of changes were to reduce cost and complexity, and to improve certainty. We are now proposing some further changes to the CPP IMs to improve clarity of the reopener application and consideration processes.

X36 Apart from those changes, we are proposing no additional changes to further streamline the CPP IMs. Our view is that the CPP IMs allow us to accept, evaluate and determine a CPP in a streamlined manner where appropriate. For example, under the existing IMs suppliers can apply in a CPP proposal, for Commission's approval:

X36.1 for modifications and exemptions from certain IM requirements;

X36.2 to apply alternative methodologies with equivalent effect (**AMWEEs**) and use information that is more closely aligned to their business information and accounting practices; and

X36.3 for IMs to be varied.

X37 We do apply proportionate scrutiny in our assessment approach and we accept a CPP application if it is compliant “in all material respects”.

X38 We encourage suppliers contemplating a CPP to engage early with us so we can provide guidance on the application process and to support streamlining where relevant and appropriate. The proposed changes to the reopener process within the CPP IMs should also assist suppliers.

X39 We are not proposing to amend the IMs to explicitly provide for a single-issue CPP. We maintain our view that the starting point for all CPPs is that they would be "full scope".[14]

X40 We propose a connections volume wash-up mechanism for EDBs on a CPP to reduce the exposure of EDBs to uncertainty in future network growth. For example, demand for new connections could exceed forecasts through greater than expected uptake of electric vehicles (**EVs**) or general connection growth. We apply a similar scheme to Chorus under the Fibre IMs.

[14] By "full scope" we mean that the scope of the CPP application will encompass all inputs needed to set the price-quality path and that these inputs are potentially subject to scrutiny.

X41 The proposed connections volume wash-up mechanism would provide for the difference between the forecast and actual number of connections and be symmetrical, ie, if actual connection growth is lower or higher than forecast, protecting consumers from unnecessarily higher prices.

X42 We do not consider the mechanism would be appropriate for EDBs on a DPP currently, due to the lack of verifiable connection cost information available. We discuss this mechanism in our *Financing and incentivising efficient expenditure during the energy transition* topic paper, published alongside this paper.

We are proposing improvements to the reopener process IMs

X43 The price-quality path reopener process refers to a series of provisions that outline the 'how' of reopening a price-quality path. Specifically: when a price-quality path may be reopened, the procedural requirements for reopening a price-quality path, our considerations when deciding whether to amend a price-quality path and any constraints on us when amending a price-quality path.

X44 During the drafting of the Fibre reopener IMs which were modelled on the Part 4 reopener IMs, we identified opportunities to improve clarity, consistency, coherence and ease-of-use. The current Fibre reopener IMs reflect these improvements. Submissions on this topic particularly focused on timeframes for the price-quality path reopener decision-making, and the lack of clarity and guidance on information required to fulfil reopener application requirements.

X45 We propose improvements to the reopeners in the DPP, CPP and Transpower IMs to align tothe Fibre reopener IMs for better clarity and consistency of the reopener processes. We consider the improved clarity will result in better processes and more certainty for suppliers. These changes specifically cover the extent of information required to support our assessment of reopener events and the factors we must consider when evaluating reopener applications. These improvements should help address timeliness concerns.

We are proposing changes to the reopener materiality thresholds

X46 We assessed the appropriateness of reopener materiality thresholds and the tests applied in determining these. We considered whether changing these thresholds would enable DPP reopeners and CPPs to work better together as a package, while still balancing the need to appropriately limit the circumstances or events under which a price path should be reconsidered. Submitters suggested that reopener materiality thresholds would benefit from recalibration to enable greater use of reopeners.

X47 We propose to reduce the use of materiality threshold tests which assess the impact on the revenue allowance and introduce tests which consider costs incurred in response to the event. This proposed change would make it easier for suppliers to assess whether they have met the threshold. We note that in general, the application of 'cost' tests rather than 'revenue' tests will result in thresholds being met at a lower level of expenditure.

X48 Our draft decision is to raise, or introduce the dollar value lower materiality thresholds for all EDB reopeners except for the Error event reopener, from $2 million to $5 million for Vector Limited and Powerco Limited, and from $2 million to $2.5 million for other EDBs. This better reflects our expectation of EDBs' ability to reprioritise within expenditure allowances and changes to reopeners which would allow a greater set of costs to be included in a reopener application.

X49 We propose amending the lower materiality thresholds for Transpower's catastrophic event and change event reopeners from a % revenue threshold to a dollar value threshold of $5 million. We propose to not change the limits which apply to GPBs as these were more recently set, aside from reducing the threshold for error event reopener applications to $100,000 which applies also to EDBs, GDBs, the GTB and Transpower.

X50 We propose to not allow for cumulative application of the lower thresholds noting that related projects are already allowed to be requested as a programme of work.

X51 We propose removing the $30 million upper materiality thresholds for the Unforeseeable and Foreseeable major capex project reopeners (EDBs) to better reflect that the delineation between DPPs and CPPs is not purely based on a dollar threshold and to avoid the potential deferral of desirable projects.

X52 We also propose adding a new clause to the reopener IMs to enable us to decline DPP reopener applications that we consider should be considered as CPPs. In those cases, the supplier will be encouraged to submit a CPP application. Suppliers are only able to apply for one CPP per regulatory period. If we exercise this clause, it will not give the supplier the ability to make an extra CPP application in the regulatory period.

X53 We encourage suppliers considering DPP reopener applications to engage with us early before formally applying for a DPP reopener, especially in circumstances where the boundary between a DPP reopener and a CPP is not clear.

X54 We propose applying reopener thresholds for new and amended reopeners on a consistent basis with other reopeners. This will maintain certainty for suppliers because there will be consistency with the way thresholds are applied and will not add unnecessary complexity.

We propose introducing a 'large connection contract' mechanism for EDBs to help address increased connection forecast uncertainty

X55 Suppliers identified that large new customer-initiated connections are a key source of expenditure uncertainty for EDBs. They also raised concerns about our ability to deal with a potentially higher volume of reopener applications related to this.

X56 To relieve pressure on the EDB DPP reopener application and approval process by removing these complex and potentially time-consuming reopener applications, we propose introducing a 'large connection contract' mechanism, similar to the new investment contract (**NIC**) provisions that apply to Transpower and some of its customers.

We propose changes to reopeners where appropriate to improve coverage of future circumstances

X57 We mapped the circumstances or situations relating to forecasting uncertainty that we noted in submissions against the coverage provided by the existing reopeners. Based on that analysis, we propose changes to the DPP reopeners to address material gaps in the DPP/CPP regime where these better meet the overarching objectives of the IM Review. In particular, these refinements will better provide for the increasing role of opex-based solutions and should help mitigate concerns about the potential need for increased resilience expenditure.

X58 We propose changes to the existing price-quality path reopeners to address targeted situations where we consider the forecasting uncertainty risk is highest. The changes we propose would, where appropriate:

X58.1 extend the scope of certain reopeners by allowing for:

X58.1.1 opex solutions in response to system growth;[15]

X58.1.2 consequential opex and consequential capex in reopeners for system growth, connections, a combination of system growth and connections, and asset relocations; and

X58.1.3 general growth in some certain circumstances;

X58.2 extend the application of selected reopeners to regulated sectors where they currently do not exist:

X58.2.1 allowing for targeted resilience-related expenditure; and

X58.2.2 introducing for EDBs a reopener similar to the GDB and GTB Risk event reopener.

[15] We consider this proposed change will better promote incentives for EDBs, GDBs and the GTB to invest in demand side management consistent with s54Q of the Act.

X58.3 clarify the coverage of certain reopeners by:

X58.3.1 modifying the Change event reopener in all sectors to include the impact of GAAP changes.

We propose no other in-period adjustment mechanisms

X59 Reopeners are not the only possible tool to address forecasting uncertainty. We considered the potential viability of a range of other potential in-period adjustment mechanisms for addressing forecasting uncertainty. These mechanisms would allow for recovery of costs but are not reopeners.

X60 Submitters told us that the existing suite of mechanisms does not adequately address future forecasting uncertainty and they suggested we assess whether other mechanisms should be considered so the regulatory continuum would operate as a cohesive package.

X61 We considered increasing the scope of pass-through costs or recoverable costs, contingent expenditure allowances, use-it-or-lose-it allowances and quantity wash-ups.

X62 With the exception of the large connection contract mechanism outlined in Chapter 8, which supports the reopener regime but which is not an in-period adjustment mechanism, we have not identified any proposed changes which would meet the IM Review decision-making framework. [16]

[16] Commerce Commission "IM Review 2023 - Decision-making Framework paper " (13 October 2022), para X21-X22.

Chapter 1 Introduction

Purpose of this paper

1.1 This topic paper sets out the reasons for the amendments to the input methodologies (**IMs**) for:

1.1.1 customised price-quality paths (**CPPs**)

1.1.2 the price-quality path mechanisms applying to default price-quality paths (**DPPs**); and

1.1.3 the Transpower individual price-quality path (**IPP**).

1.2 The amendments have been made under the IM Review process we commenced for considering the CPP, DPP and IPP IMs under s 52Y(1) of the Commerce Act 1986 (the Act). The review of the IMs is scheduled for completion in December 2023.

1.3 This paper considers:

1.3.1 the issues we have identified;

1.3.2 the draft decisions we have made to address those issues, including any IM changes;

1.3.3 the reasons for our draft decisions; and

1.3.4 how we have taken stakeholders' submissions into account in considering the issues.

Structure of this paper

1.4 Table 1.1 details the structure of the chapters and attachments in this paper.

Table 1.1 Structure of this paper

Section	Title	Description of content
Chapter 1	Introduction	Sets out the purpose of this paper, what it covers and how it is structured. Explains the process we have followed in arriving at our decisions.
Chapter 2	Decision-making framework	Describes the high-level framework we have applied in making our decisions for the 2023 IM Review.
Chapter 3	Context for our draft decisions	Summarises the context for the draft decisions we have made. Sets out the issues we have identified for this IM Review, high-level problem definitions for these issues and locates where these issues are discussed in this paper.

Section	Title	Description of content
Chapter 4	Whether changes to CPP IMs are necessary	Summarises our decisions on whether improvements can be made to the CPP IMs and considers whether there is a need for a single issue CPP or whether specific reopener mechanisms could be made more effective.
Chapter 5	Improving the price-quality path reopener processes	Summarises our decisions on whether changes to the process regarding application for, and our consideration of, price-quality path reopeners are required.
Chapter 6	Whether the reopeners will cover future circumstances	Summarises our decisions on current price-quality path reopeners and considers whether they provide for a sufficient range of future solutions.
Chapter 7	Reviewing our approach to reopener thresholds	Discusses our decisions on existing price-quality path reopener thresholds and if they remain appropriate.
Chapter 8	Introduction of a large connection contract mechanism for EDBs	Describes the amendment we are proposing to make to introduce a large connection contract mechanism for EDBs similar to the Transpower new investment contract (NIC).
Chapter 9	Whether other potential in-period adjustment mechanisms are necessary	Summarises our consideration of a range of potential mechanisms for addressing forecasting uncertainty to allow for recovery of costs, but which are not reopeners.

Our draft decision package for the IM Review

1.5 This paper forms part of a package of draft decisions papers on the IM Review. Alongside this paper, we have published and invite stakeholders' views on:

1.5.1 our draft EDB, GDB, GTB, and Airports IM amendment determinations.[17] We will take account of submissions on these amendment determinations. These documents, with changes in response to submissions as appropriate, will be finalised and will then give legal effect to our final IM decisions;

1.5.2 our draft Summary and Context paper;

1.5.3 our other Topic papers, which explain our draft IM policy decisions relevant to the following key topics:

[17] The Transpower IM amendment determination and the Transpower Capex IM amendment determination will be published on 21 June, one week later than the rest of the draft decisions package. As with the other amendment determinations, a seven-week consultation period will apply for these two amendment determinations.

1.5.3.1 Financing and incentivising efficient expenditure during the energy transition;

1.5.3.2 Cost of capital;

1.5.3.3 Transpower investment; and

1.5.4 our draft Report on the IM Review, which summarises for every IM policy decision:

1.5.4.1 any changes we propose making;

1.5.4.2 where we have considered changes but not made them; and

1.5.4.3 where we have not found reason to consider changes.

Previously published papers and other materials relevant to this topic

1.6 On 23 February 2022 we published our Notice of Intention.[18]

1.7 On 20 May 2022 we published the IM Review Process and issues paper.[19]

1.8 On 13 October 2022 we published the Decision-making Framework paper.[20]

1.9 On 7 November we held our Forecasting and incentivising efficient expenditure for EDBs workshop.[21]

1.10 On 29 November we held our Price-quality path in-period adjustment mechanisms workshop where:

1.10.1 we provided stakeholders with discussion slides;[22] and

1.10.2 we asked follow-up questions from the workshop on 5 December.[23]

[18] Commerce Commission "Input Methodologies Review 2023: Notice of intention to commence IM Review" (23 February 2022).

[19] Commerce Commission "IM Review 2023 - Process and issues paper" (20 May 2022).

[20] Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022).

[21] Commerce Commission "IM Review 2023: Role of price-quality path in-period adjustment mechanisms - 'Workshop slides'" (7 November 2022).

[22] Commerce Commission "IM review 2023 – In period adjustment mechanisms – Workshop 'Discussion slides'" (29 November 2022).

[23] Commerce Commission "IM review 2023 – In period adjustment mechanisms – Workshop follow up questions" (5 December 2022).

1.11 On 21 December 2022 we provided a Clarification note with respect to our Framework paper and s 5ZN of the Climate Change Response Act 2002.[24]

1.12 On 1 March 2023 we updated our notice of intention.[25]

Introduction to the topic of this paper

1.13 The following brief topic introduction summarises key points that we discuss in more detail in our context chapter (Chapter 3).

1.14 Part 4 of the Act specifies at a high level how DPP/CPP regulation and IPP regulation function. It gives us a discretion as to how we design and set the DPP, CPP and IPP price-quality path mechanisms.

1.15 The DPP/CPP regime is one of the key regulatory mechanisms in Part 4 to promote the long-term benefit of consumers by promoting outcomes consistent with those in workably competitive markets. Price-quality paths are set for a three-to-five-year period and provide certainty over that period about limits on revenue, quality standards, and incentive mechanisms for efficiency and quality.

1.16 There are uncertainties about what will happen during a regulatory period due to changed circumstances faced by suppliers and there are mechanisms in the regime to manage the impacts of uncertainty where appropriate. Once we have set a price-quality path, the IMs provide certainty about when the price path can automatically 'adjust', or may be adjusted or changed, during the regulatory period, in particular by setting out:

1.16.1 which costs may be directly passed through to consumers under the price path (ie, **pass-through costs** and **recoverable costs**);

1.16.2 the circumstances in which the price-quality path may be reconsidered (ie, **reopeners**); and

1.16.3 requirements that a regulated supplier must meet if it applies to shift from a DPP to a CPP during a regulatory period (**CPP requirements**).

1.17 In this topic paper we consider whether changes are required to our in-period adjustment mechanisms and CPP IMs in view of accelerated changes to the external environment in which the EDB, GDB, GTB and Transpower sectors operate.

[24] Commerce Commission "IM Review 2023 - Decision-making Framework Clarification note- s5ZN of the CCRA" (21 December 2022).

[25] Commerce Commission "IM Review 2023 – Amended Notice of intention for IM Review 2023" (1 March 2023).

1.18 DPPs are not intended to meet all circumstances that regulated suppliers may face, especially if these circumstances require significant scrutiny of costs and/or quality targets of a particular supplier.

1.19 DPPs allow for expenditure where it is well-justified and evidenced. Within the revenue limits, suppliers can choose to spend their allowable revenue however they wish, irrespective of whether we have included specific investments/expenditure in forecasts when setting those revenues. Suppliers may also spend more than the revenue limit explicitly provides for and can prioritise and reprioritise expenditure as they see fit.

1.20 In setting a price-quality path we might decide not to include spend that was uncertain in need, timing or cost, or spend that is not well justified or evidenced.

1.21 For changed circumstances during a regulatory period, suppliers can make use of price-quality path reopeners. Reopeners exist so that a price-quality path can be reconsidered by us during the regulatory period.

1.22 A supplier on a DPP could also apply for a CPP, subject to the exceptions in s 53Q(3) of the Act.[26] A CPP offers suppliers the opportunity to propose an alternative price-quality path that better meets its individual circumstances. CPPs are designed to better meet the particular circumstances of a supplier, there is a greater emphasis on supplier-specific costs in setting a CPP than in setting a DPP and a CPP proposal involves a higher degree of scrutiny than a DPP.

How you can provide your views

Process and timeline for making submissions

1.23 Submissions on our draft decisions and their implementation in our draft IM amendment determinations are due by 5pm on 19 July 2023.[27] We will then invite cross-submissions by 5pm on 9 August 2023.[28] Cross-submissions should only focus on matters raised in submissions. We strongly discourage stakeholders from raising new matters via cross-submissions.

1.24 Submissions and cross-submissions can be made to the Input Methodologies Review 2023 mailbox (IM.Review@comcom.govt.nz). Please clearly indicate in your email subject line and submission which of our draft decisions your submission relates to.

[26] Commerce Act, s 53Q(1).

[27] Ibid.

[28] Ibid.

1.25 We request that submitters clearly confirm in their submission and covering email that the submission can be published on our website and does not include confidential information. If your submission does include confidential information we set out our process below.

Confidentiality

1.26 The protection of confidential information is something the Commission takes seriously. If you need to include commercially sensitive or confidential information in your submission or cross-submission, you must provide us with both a confidential and non-confidential/public version of your submission that are clearly identified. We intend to publish the non-confidential/public version of all submissions we receive on our website. This also applies to cross-submissions.

1.27 You are responsible for ensuring that commercially sensitive or confidential information is not included in a public version of a submission or cross-submission that you provide to us.

1.28 All submissions and cross-submissions we receive, including any parts of them that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we do not publish unless good reason existed under the Official Information Act 1982 to withhold it. We would normally consult with the party that provided the information before we disclose it to a requester.

Chapter 2 Decision-making framework

Purpose of this chapter

2.1 The purpose of this chapter is to explain how we have applied the draft IM Review 2023 decision-making framework (**Framework**) in reaching our draft decisions on the topic of CPPs and in-period adjustment mechanisms.

Decision-making framework

2.2 Our decision-making in the IM Review is driven by achieving the three overarching objectives of our Framework:

2.2.1 promoting the Part 4 purpose in s 52A of the Act more effectively;

2.2.2 promoting the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); and

2.2.3 significantly reducing compliance costs, other regulatory costs, or complexity (without detrimentally affecting the promotion of the s 52A purpose).

2.3 Section 52A(1) states that the purpose of Part 4 is to promote the long-term benefit of consumers in markets referred to in s 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—

2.3.1 have incentives to innovate and to invest, including in replacement, upgraded, and new assets;

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

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

2.3.4 are limited in their ability to extract excessive profits.

2.4 Section 52R provides that the purpose of IMs is to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of goods or services under Part 4.

2.5 For further detailed discussed on the Framework, see the IM Decision Making Framework Paper. [29]

[29] Commerce Commission "IM Review 2023 - Draft Framework paper" (20 May 2022), para X21-X22.

2.6 In applying the Framework's overarching objectives, we have had regard to whether our draft decisions promote the s 52R purpose of the IMs more or less effectively than the status quo in providing certainty for regulated suppliers and consumers in relation to the rules, requirements, and processes applying to regulation under Part 4.[30]

2.7 In reflecting the differences in approach in setting a DPP versus a CPP, we have made draft decisions having regard to s 53K. That section sets out the purpose of providing a relatively low-cost way of setting and amending price-quality paths for suppliers of regulated goods or services under a DPP, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances under a CPP.

2.8 Some of our draft decisions have involved tension between making IM changes to improve the regime and better promote the s 52A Part 4 purpose on the one hand, and certainty in terms of the s 52R IM purpose on the other. In such cases, we have taken careful account of the certainty effects, while ensuring that promoting s 52A remains at the forefront of our decision-making – both in considering which IMs to change and in reaching decisions on changing IMs.[31]

2.9 Where we consider it relevant and where the s 52A purpose of Part 4 is promoted more effectively, we may have regard to:

2.9.1 whether there are alternative ways to address the identified issues with the relevant IM that do not involve changing the IMs as part of the review;

2.9.2 the permissive considerations under s 5ZN of the Climate Change Response Act 2002;

2.9.3 promoting incentives and avoiding imposing disincentives for suppliers of electricity lines services to invest in energy efficiency and demand-side management, and to reduce energy losses, when applying Part 4 in relation to electricity lines services (per s 54Q of the Commerce Act); and

2.9.4 decisions made under the Electricity Industry Act 2010 (per s 54V of the Commerce Act).

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[30] Commerce Commission “IM Review 2023 - Draft Framework paper” (20 May 2022), para X21.

[31] Commerce Commission “IM Review 2023 - Draft Framework paper” (20 May 2022), para X22.

Chapter 3 Context for our draft decisions

Purpose and structure of this chapter

3.1 This chapter sets out:

3.1.1 the key background information and context for our draft decisions on changes to the CPP and in-period adjustment mechanism IMs (**IMs**);

3.1.2 how we have identified the issues to be resolved in this IM Review from our internal review of the IMs and from stakeholder submissions;

3.1.3 high-level problem definitions for the identified issues and the rationale behind why we considered IM changes for these issues; and

3.1.4 a roadmap of where the issues, problems and proposed IM changes that meet the IM Review's overarching objectives are discussed.

Context for the draft decisions in this paper

Why in-period adjustment mechanisms are necessary

3.2 The DPP/CPP/IPP regime is a form of regulation in Part 4 of the Act that promotes the long-term benefit of consumers by promoting outcomes consistent with those in workably competitive markets.[32] The outcomes sought are that suppliers have incentives to innovate and invest, improve efficiency, and provide services at a quality that reflects consumer demands, share efficiency gains with consumers including through lower prices and are limited in their ability to extract excessive profits.

3.3 We set price-quality paths for a four-to-five-year period for DPPs and IPPs and a three-to-five-year period for CPPs. These price-quality paths provide certainty to suppliers about limits on revenue, quality standards and incentive mechanisms for efficiency and quality over the regulatory period.

3.4 A supplier can face changed or unexpected circumstances during a regulatory period, requiring:

[32] Commerce Act (1986), s52A.

3.4.1 it to incur additional expenditure that it may not be able to accommodate within the settings of its current price-quality path through reprioritisation of expenditure;[33] and/or

3.4.2 a variation to the quality standards and incentives of its current price-quality path.

3.5 In order to address these changed circumstances, mechanisms to change the price-quality path during the regulatory period may be warranted. Mechanisms to change the price-quality path may also be needed if the price-quality paths we have set excluded spend that was uncertain in need, timing or cost.

3.6 Once a price-quality path has been set, the IMs provide ex ante certainty about when the path can automatically 'adjust', or may be adjusted or changed, during a regulatory period. In particular, they set out:

3.6.1 which costs may be directly passed through to consumers under the price path (ie, 'pass-through' costs and 'recoverable' costs);

3.6.2 the circumstances in which the price-quality path may be reconsidered (ie, 'reopeners'); and

3.6.3 requirements that a regulated supplier subject to a DPP must meet if it applies to shift from a DPP to a CPP ('CPP requirements').

We considered whether our existing mechanisms are still appropriate for the current and future operating environment

3.7 The suppliers that we regulate under Part 4 are managing the pressures of an ageing asset base and rising input costs. In forthcoming regulatory periods, they are likely to face greater uncertainty of their future expenditure requirements. This is expected due to decarbonisation activities and the energy transition.[34] These activities are expected to increase expenditure in the electricity networks, and over time to decrease demand in the gas sector. In the electricity sector the shift towards greater use of flexibility services, including distributed generation, is an additional uncertainty.

[33] The price-quality paths we set do not restrict a regulated supplier from spending. If a supplier chooses to spend and in doing so, exceeds the revenue limits set by our price-quality paths, approximately 78% of the overspend is shared with consumers. If the spend was within the revenue limits set by our price-quality paths, it is fully recoverable from consumers.

[34] Transition risks as discussed in Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para A18.1

3.8 Suppliers are also having to consider whether they need to increase spend on their networks to be better prepared for natural disasters, adverse weather events as the result of climate change, and to manage a landscape of increasing risks (such as from other natural hazards, cybersecurity threats and supply chain constraints).[35]

3.9 Where possible and appropriate, we consider it may be best to deal with forecasting uncertainties at the next DPP and IPP resets when we expect to have additional information from suppliers. We also want to ensure that at the time of those resets, we have the mechanisms in place to respond to forecasting uncertainties during the regulatory period appropriately and in a timely way.

3.10 We consider that we generally do have this sufficient ability through the tools currently available to us. Where we consider the risk is sufficiently known now and some refinement to our tools is desirable in accordance with the Framework, we are proposing some targeted changes to the IMs.

3.11 We have considered whether changes are required to our in-period adjustment mechanism and CPP IMs in view of changes to the external environment in which the sectors operate. Introducing new mechanisms or expanding the scope of existing ones involves making trade-offs in our regime between certainty and responsiveness to change, while keeping in mind the purposes of DPP/CPP regulation.

3.12 Any IM changes we outline in this IM Review, such as the reopener processes and the various updated reopeners, will in most cases apply to EDBs in the DPP regulatory period commencing in 2025, the Transpower IPP regulatory period commencing in 2025, and the GDB and GTB DPP regulatory periods commencing in 2026.[36] We note that the Transpower IPP reset preparation is already underway for the 2025-2030 regulatory period, which may mean it is not practical for some Transpower IM changes that would otherwise apply to the setting of the 2025-2030 price path to instead be effective for the 2030-2035 IPP reset.

Overview of in-period adjustment mechanisms

Regulatory continuum

3.13 The simplified regulatory continuum in Figure 3.1 shows the package of existing regulatory tools and mechanisms for EDBs, GDBs and the GTB. We describe each tool and mechanism in the continuum below.

[35] Physical risks as discussed in Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), para A18.2

[36] Amended IMs can apply if a CPP is set part way through a DPP regulatory period for electricity distribution and gas distribution or transmission.

Figure 3.1 Existing Regulatory Continuum

DPPs

3.14 We set DPPs for all regulated suppliers in a relatively low-cost way. DPPs are not intended to meet all circumstances that regulated suppliers may face, especially if these circumstances require significant scrutiny of costs and/or quality targets of a particular supplier.

3.15 The price-quality path set in a DPP limits revenues that a supplier can recover from its consumers and provides efficiency incentives to outperform the path. DPPs also set minimum quality standards and incentives to ensure that services to consumers do not suffer (ie, outages of higher frequency and duration) due to excessive cutting of costs.

3.16 DPPs allow for expenditure where it is well-justified and evidenced. Within the revenue limits, suppliers can choose to spend this revenue however they want, irrespective of whether we have included specific investments/expenditure in forecasts when setting revenues. Suppliers may also choose to spend more than the revenue limit explicitly provides for if they are not able to prioritise and reprioritise expenditure as they see fit.

3.17 Traditionally we have set DPPs using:

3.17.1 a "revealed costs" approach for opex, with historic expenditure levels as a base, increased by step changes and forward-looking trend factors; and

3.17.2 for capex, allowed expenditure consistent with AMP forecasts based on the quality of supporting information with an absolute 20% cap applied in aggregate relative to historic levels.

3.18 Subject to the IMs and other relevant statutory provisions, we are not restricted in the way we set DPPs. In particular, neither Part 4 nor the IMs specify how we may determine forecasts of expenditure. For instance, a DPP could be reset using an entirely forward-looking approach to forecasting expenditure, or by including a different or increased percentage cap applied to historical levels of expenditure, without requiring any change to current IMs.

Pass-through costs and recoverable costs

3.19 There are costs we allow suppliers to "pass-through" to their consumers which are generally outside a supplier's control, eg, Transpower's transmission charges and local body rates. There are also specific costs that can be recovered from consumers such as efficiency incentive payments under IRIS, quality incentive amounts, or various other 'wash-up' amounts set by us. These amounts are collectively called pass-through costs and recoverable costs.

3.20 Suppliers can recover these full costs without sharing the cost or benefits of over/under spend with consumers, regardless of whether the costs are greater or smaller than expected. Categories of pass-through costs and recoverable costs that a supplier is permitted to recover are specified in the IMs, with the more detailed calculation of the actual amounts usually set out in a DPP determination.

DPP Reopeners

3.21 For changed circumstances during the regulatory period, suppliers can avail themselves of price-quality path reopeners. Reopeners allow a price-quality path to be reconsidered by us during the regulatory period when a material change in circumstances occurs. They are intended to be used on a justified basis, rather than routinely.

3.22 This approach of limiting the circumstances in which DPPs can be reconsidered is consistent with s 53K of the Act which sets out that the purpose of a default price-quality regulation (ie, a DPP) is to provide a relatively low-cost way of setting and amending price-quality paths for suppliers of regulated goods or services.

3.23 Reopener applications by suppliers generally involve less scrutiny than a CPP proposal and may be more appropriate in circumstances that:

3.23.1 are separately identifiable or discrete;

3.23.2 are targeted to address a specific, rather than a general problem;

3.23.3 have less interdependence with the rest of the supplier's network;

3.23.4 are likely to affect a smaller number of consumers (especially if supported by them); and

3.23.5 are not likely to require wide consultation with consumers and other stakeholders.

3.24 In Table 3.1 we summarise the existing price-quality path reopeners for EDBs, GDBs, the GTBs and Transpower. Table 3.1 shows that there are a number of common reopeners which apply across each of these sectors. There are also reopeners which are specific to the circumstances of individual sectors, and this is even more the case under the Transpower IPP IMs.[37]

Table 3.1 Summary of existing DPP, CPP and IPP Reopeners

Type of Reopener	Driver of Reopener	Applicability of sector and type of price-quality path (DPP/CPP/IPP)				
		Electricity distribution		Electricity transmission	Gas distribution & transmission	
		DPP	CPP	Transpower IPP	DPP	CPP
Quality standard variations	Proposal to vary quality standards to better reflect the realistically achievable reliability performance of a supplier	X	X			
False or misleading information	Where we relied on false or misleading information provided in setting the DPP or CPP	X	X	X	X	X
Catastrophic event	For unforeseeable events beyond the control of suppliers with adverse consequences that need to be rectified	X	X	X	X	X
Change event	Change in, or new legislative or regulatory requirement applying to a supplier	X	X	X	X	X

[37] Under s 53ZC of the Act we have wide discretion on setting an individual price-quality path like Transpower's IPP, but we must use the IMs that apply to the supply of services to which the individual price-quality path applies. In addition to including some of the common reopeners, the Transpower IPP IMs include Transpower- specific reopeners that cover large buildups in the EV account balance, the use of Enhancement and Development projects, and the reconsideration of the Transpower IPP for the price path impacts of approved Major Capex and approved Listed Project Base Capex.

Type of Reopener	Driver of Reopener	Applicability of sector and type of price-quality path (DPP/CPP/IPP)				
		Electricity distribution		Electricity transmission	Gas distribution & transmission	
		DPP	CPP	Transpower IPP	DPP	CPP
Error event	Either incorrect data was used, or data was incorrectly applied to set the price-quality path	X	X	X	X	X
Major transaction	For situations where consumers are acquired or no longer supplied, and this results in assets used to serve consumers being acquired or sold	X	X		X	X
Unforeseeable major capex project	Unforeseeable capex project or programme for connection, system growth, combination of connection and system growth, or asset relocation	X				
Foreseeable major capex project	Foreseeable but under-forecasted or underfunded capex project or programme for connection, system growth, combination of connection and system growth, or asset relocation	X				

Type of Reopener	Driver of Reopener	Applicability of sector and type of price-quality path (DPP/CPP/IPP)				
		Electricity distribution		Electricity transmission	Gas distribution & transmission	
		DPP	CPP	Transpower IPP	DPP	CPP
Capacity event	Need for additional capacity (established or reasonably anticipated demand for connection, system growth, combination of connection and system growth, or asset relocation) that was uncertain in timing or could not have reasonably been foreseen		X (Aurora only)		X	
Risk event	Asset deterioration impacting quality standards or safety that is either unforeseen or foreseeable but not sufficiently certain		X (Aurora only)		X	
Unforeseen projects	Unforeseeable project or programme		X			X
Existing CPP Contingent project	Project that is reasonably required but is contingent on a trigger being activated		X			X
Large build up in EV account balance	The EV account balance builds up to a level that means there is likely to be a price shock impact from this regulatory period to the next regulatory period			X		

Type of Reopener	Driver of Reopener	Applicability of sector and type of price-quality path (DPP/CPP/IPP)				
		Electricity distribution		Electricity transmission	Gas distribution & transmission	
		DPP	CPP	Transpower IPP	DPP	CPP
Enhancement & development projects	Transpower may apply once in a regulatory period for an additional base capex allowance with respect to two or more Unforeseeable Enhancement and Development Projects and/or Foreseeable Enhancement and Development Projects where that base capex was not included in the base capex allowances for the regulatory period			X		
Reconsider the IPP for the revenue impact of major capex and listed project base capex approved by the Commission	When the Commission approves Transpower's major capex or any base capex that is shown as a listed project in the IPP, the price-quality path is amended to reflect the forecast price path revenue effect of this capex for remaining complete pricing years of the regulatory period			X		

3.25 The outcome of a price-quality path reopener application is not guaranteed. A reopener application is subject to a three-stage decision-making process by us:

3.25.1 Consider whether the reopener trigger criteria specified in the IMs are met;

3.25.2 Decide whether the price-quality path should be amended; and

3.25.3 Decide how the price-quality path should be amended.

CPPs

3.26 A supplier could also apply for a CPP. A CPP offers suppliers the opportunity to propose an alternative price-quality path that better meets its individual circumstances. Since CPPs are designed to better meet the particular circumstances of a supplier, there is a greater emphasis on supplier-specific costs in setting a CPP than in setting a DPP. All inputs needed to set a CPP are potentially subject to scrutiny.

3.27 The information to be provided as part of a CPP proposal must therefore be sufficient to support this analysis, test whether the CPP application meets the evaluation criteria, and enable us to determine a CPP. A CPP application must comply with process and content requirements for the CPP proposal and must apply or adopt all relevant IMs unless the supplier obtains our approval for IMs to be modified, exempted from or varied.

3.28 Not all supplier circumstances would require a CPP. A CPP may be more appropriate for circumstances:

3.28.1 where the price or quality impact on consumers is significant;

3.28.2 that affect a large number or proportion of consumers rather than a smaller subset;

3.28.3 that require wide engagement with consumers and stakeholders; and

3.28.4 which have upstream or downstream effects on the supplier's wider network.

CPP Reopeners

3.29 For changed circumstances after a CPP is set, a range of CPP reopeners are available to suppliers. These were summarised in Table 3.1 above.

Rationale for considering changes to IMs

3.30 We considered the following factors when deciding which IMs we should consider changing and why:

3.30.1 changes in the current and future operating environments of the electricity distribution and gas sectors;

3.30.2 opportunities we identified to improve IMs;

3.30.3 what we heard from stakeholders in submissions; and

3.30.4 feedback we have received from suppliers on CPP applications and DPP reopener applications.

Changes in the current and future operating environments of the electricity distribution and gas sectors

3.31 We discussed the changes in the current and future operating environments of the sectors earlier in this chapter at paras 3.2 to 3.12.

Recent opportunities before the 2023 IM Review to consider IM improvements

3.32 We took several opportunities to identify potential improvements to IMs between the 2016 IM Review and this review during the process of creating the Fibre IMs in 2020, in various DPP and CPP resets, and in the Unison Tauhara DPP reopener application.

What stakeholders told us

3.33 Key themes we heard from stakeholders were:

3.33.1 suppliers needing to respond in a more timely manner to electrification and to other areas of uncertainty;[38]

3.33.2 if the forecasting approach of the DPP was more forward-looking rather than the previous historical approach, there would be less need for in-period adjustment mechanisms;[39]

[38] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Powerco "Submission on Price-quality path workshop" (20 December 2022); Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022).

[39] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022) ; Methanex – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022) ; Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022) ; Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022).

3.33.3 CPPs are complex, need streamlining and their viability is questioned, especially for smaller suppliers. A single-issue CPP may be helpful if price-quality path reopeners stay as they are; [40]

3.33.4 in-period adjustment mechanisms should allow for greater coverage of current and future scenarios and should include opex solutions; [41]

3.33.5 reopener materiality thresholds need to be recalibrated to allow suppliers to better respond to changed circumstances;[42]

3.33.6 the process for applying and assessing reopeners is not timely enough and more guidance is required for suppliers;[43] and

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[40] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p 15; Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 16; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 37; Vector "Submission on the Process and issues paper" (11 July 2022), p. 26; Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022) p. 27; Vector "Submission on Price-quality path workshop" (20 December 2022), p. 10; Powerco "Submission on Price-quality path workshop" (20 December 2022), p. 7; Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022).

[41] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 15; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 5; Vector "Submission on the Process and issues paper" (11 July 2022); Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022) ; Vector "Submission on Price-quality path workshop" (20 December 2022), p. 7; Transpower NZ Ltd "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022); Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Orion "Submission on Price-quality path workshop" (20 December 2022); Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022).

[42] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 16; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 38; Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Vector "Submission on the Process and issues paper" (11 July 2022), p. 26; Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Powerco "Submission on Price-quality path workshop" (20 December 2022); Orion "Submission on Price-quality path workshop" (20 December 2022); Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022)

[43] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Chorus "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Vector "Submission on Price-quality path workshop" (20

3.33.7 other in-period adjustment mechanisms which are not currently available could be beneficial.[44]

We distilled key themes into issues

3.34 We defined eight issues to be considered for this topic:

3.34.1 whether adjustments to the IMs are required for the initial setting of the DPP to respond to potential increased forecasting uncertainty;

3.34.2 whether improvements can be made to the CPP IMs;

3.34.3 whether there is a need for a single-issue CPP or whether specific reopener mechanisms would be more effective;

3.34.4 whether changes to the processes regarding the application for, and consideration of, reopeners are required;

3.34.5 whether existing reopener thresholds remain appropriate;

3.34.6 whether reopeners provide adequate coverage for current and future supplier circumstances;

3.34.7 whether the current reopeners provide for a sufficient range of solutions; and

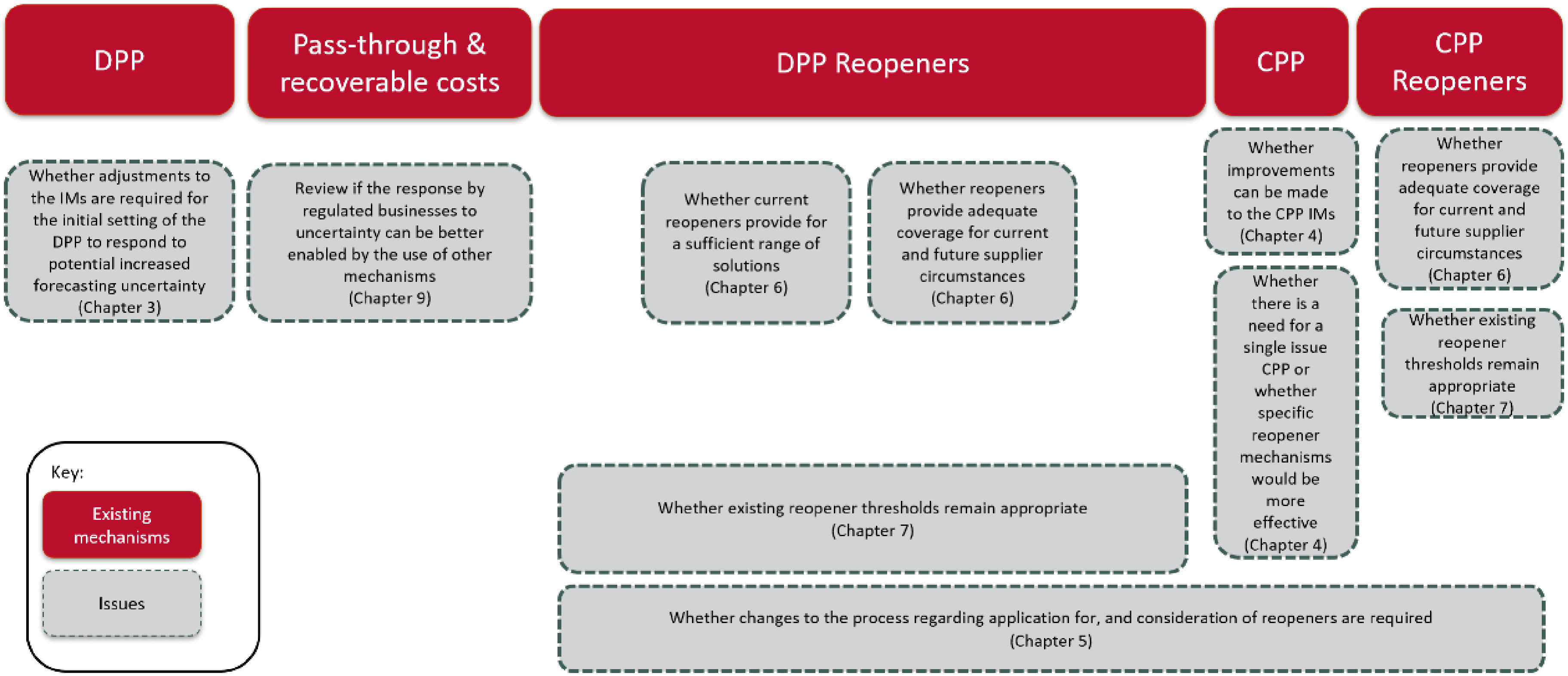
3.34.8 review if the response by regulated businesses to uncertainty could be better enabled by the use of other mechanisms.

3.35 Figure 3.2 shows the issues mapped against the regulatory continuum and identifies where further discussion is contained in this paper.

December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Powerco "Submission on Price-quality path workshop" (20 December 2022); Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022); Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022); Transpower NZ Ltd "Submission on Price-quality path workshop" (20 December 2022).

[44] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 6; Vector "Submission on the Process and issues paper" (11 July 2022), p. 26; Chorus "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022); Transpower NZ Ltd "Submission on Price-quality path workshop" (20 December 2022); Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022); Orion "Submission on Price-quality path workshop" (20 December 2022).

Figure 3.2 Issues mapped against the regulatory continuum and discussion reference



3.36 We describe each issue at a high-level below, including some of the factors we took into account when applying the Framework.

Whether adjustments to the IMs are required for the initial setting of the DPP to respond to potential increased forecasting uncertainty.

3.37 Neither Part 4 of the Act nor the IMs specify how we may determine forecasts of expenditure, hence the approach to DPP forecasting is not within the scope of this IM Review. We consider it will be best to decide on a forecasting approach at the time of setting future DPPs when we have additional information from suppliers.

3.38 We consider that DPPs can appropriately consider and address increases in the level of forecasting uncertainty as there are relatively few limitations outlined within either the IMs or the Act regarding the DPP forecasting approach. Accordingly, no change to the IMs is required to respond to increasing forecasting uncertainty with regards to DPP forecasting approaches.

Whether improvements can be made to the CPP IMs

3.39 There appears to be a general perception by industry that the CPP mechanism is complex and time- and resource-intensive and that streamlining the CPP requirements might make the CPP mechanism more workable. The issue to be resolved is whether, applying the IM Review decision-making framework, the current CPP provisions could and should be further streamlined without undermining the intent of the CPP mechanism.

Whether there is a need for a single issue CPP or whether specific reopener mechanisms would be more effective

3.40 In the 2016 IM Review we concluded that CPPs should always be full scope and that we did not consider single-issue CPPs to be appropriate.[45] A “single-issue CPP” would be a reduced-scope CPP (compared to a regular CPP) where customisation is sought only in respect of one part of the supplier’s DPP, which could be a single project or several projects that make up a programme of work. The single-issue CPP would attract wider scrutiny than a DPP reopener but narrower scrutiny than a full scope CPP.

3.41 The issue we have considered in this IM Review is whether there is a gap in the regulatory continuum that is not covered by DPP reopeners or a regular CPP.

[45] Commerce Commission “Input methodologies review decisions. Topic paper 2: CPP requirements.” (20 December 2016), para 67.

Whether changes to the process regarding application for, and consideration of reopeners are required

3.42 The IMs for reopener process, including the provisions that cover the application and evaluation of a reopener have been developed and amended progressively over the years. The process as it is currently prescribed in the IMs is not as clear as it could be because the amendments have been done in a piecemeal manner.

3.43 The current Fibre reopener process IMs are an improvement on the Part 4 reopener process IMs. We considered whether and how we might align the Part 4 reopener process IMs with the improved Fibre reopener process IMs, and further ideas for improving the reopener process based on submitter feedback.

Whether existing reopener thresholds remain appropriate

3.44 Recalibration of reopener thresholds could enable suppliers to better respond to changed circumstance during the regulatory period. We considered whether the current reopener materiality thresholds continued to be appropriate, whether finetuning these thresholds would provide better responsiveness to change and appropriately limit the circumstances or events under which a price path will be reconsidered.

Whether reopeners provide adequate coverage for current and future supplier circumstances

3.45 Submitters raised a range of different costs which they considered reopeners should be extended to cover such as resilience, demand, material changes in cost structure and legislative and regulatory change. We considered whether additional reopeners may be warranted to address circumstances not covered by the existing suite of reopeners due to the potential increased levels of forecasting uncertainty. We did this while being mindful of the impact of new or extended reopeners on supplier incentives to be efficient, innovate, reprioritise expenditure, and the purpose in s 53K of the Act that a DPP is to provide a relatively low-cost way of setting the price-quality path.

Whether current reopeners provide for a sufficient range of solutions

3.46 The existing capex-based reopeners, (ie, the EDB Unforeseeable and Foreseeable major capex project reopeners and the Gas capacity reopener), may not always provide incentives for suppliers to adopt the most efficient solutions. Increasingly, there are opex solutions available as an effective substitute for capex.

3.47 Consequential opex related to capex can be significant and is currently also not provided for. We assessed whether the reopeners should be extended to allow for opex solutions, opex which is consequential to capex-based solutions, and capex which is consequential to opex-based solutions.

Review if the response to uncertainty by regulated businesses can be better enabled by the use of other mechanisms

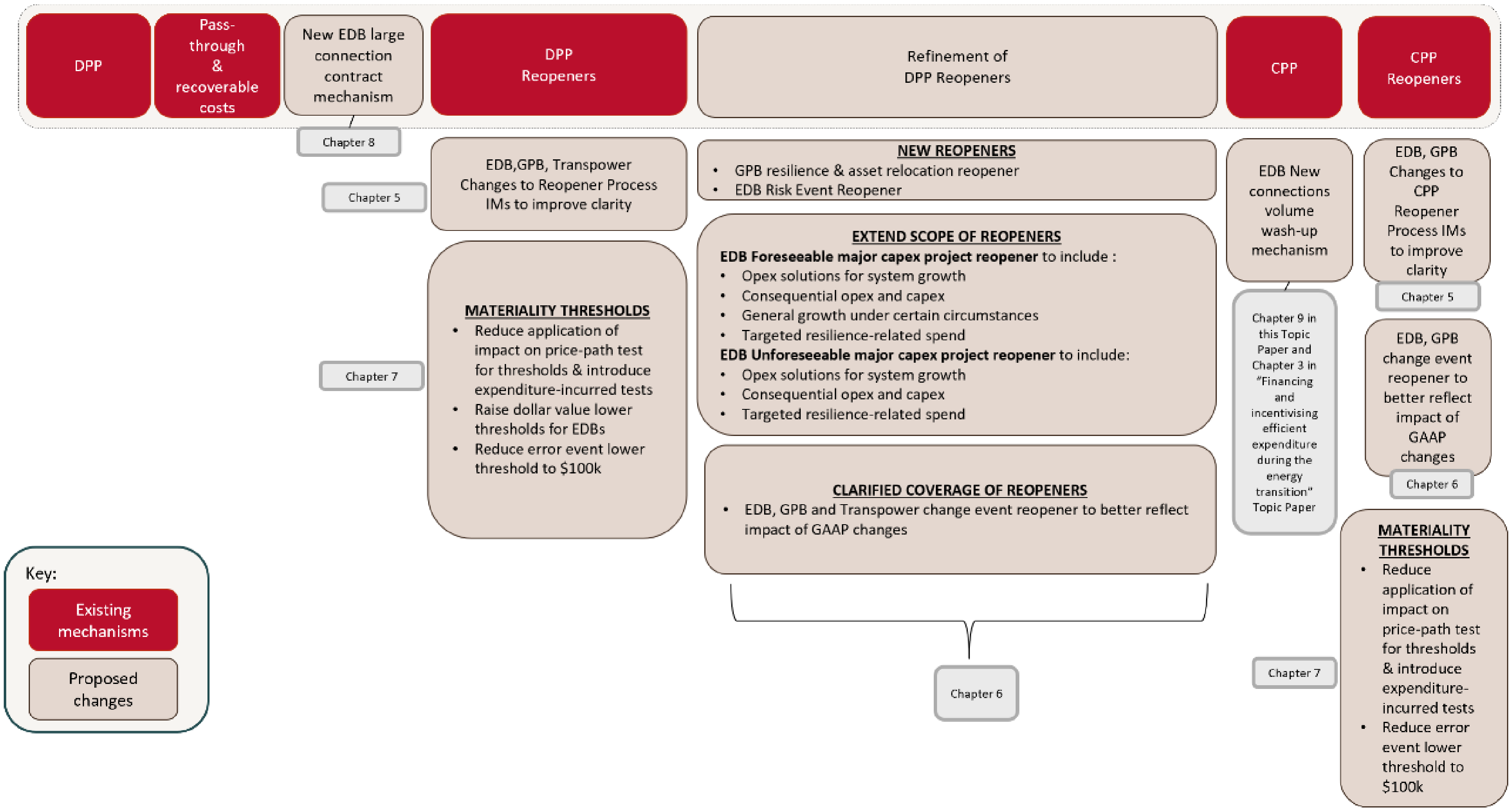
3.48 Reopeners are not the only tool to address forecasting uncertainty. We assessed the potential viability of other in-period adjustment mechanisms that do not exist currently in the regulatory continuum such as increasing the scope of pass-through costs or recoverable costs, contingent expenditure allowances, use-it-or-lose-it allowances and quantity wash-ups.

Updated regulatory continuum showing proposed changes

3.49 Figure 3.3 shows the regulatory continuum which has been updated with the changes we are proposing in our draft decisions and identifies where to find further discussion in this paper.

3.50 This updated regulatory continuum includes the proposed ‘large connection contract’ mechanism for EDBs which, although not in the reopener IMs, is a key feature that we consider will help address increased connection forecast uncertainty. We set out the details of the ‘large connection contract’ mechanism in Chapter 8.

Figure 3.3 Updated regulatory continuum showing proposed changes and discussion reference



Chapter 4 Whether to make changes to the CPP IMs

Purpose and structure of this chapter

4.1 This chapter considers whether we need to make changes to the CPP IMs for EDBs, GDBs and GTBs.

4.2 Our draft decisions address whether:

4.2.1 improvements can be made to the CPP IMs; and

4.2.2 there is a need for a single-issue CPP or whether specific reopener mechanisms would be more effective.

CPP Background

4.3 A customised price-quality path is tailored to a supplier's specific plans when the supplier does not consider that the default price-quality path meets its needs and the Commission approves the application. A customised price-quality path allows a regulated business to apply for a unique price-quality path that better meets its specific needs, particularly in terms of its future investment requirements.

4.4 The key difference between a DPP and CPP is that the DPP is established using a relatively low-cost industry-wide regulatory approach whereas CPP regulation is addressed to a supplier's particular circumstances. It is available where a supplier does not expect to earn a normal return on the DPP and its particular circumstances are not able to be dealt with through a DPP reopener.[46]

4.5 An EDB, GDB or GTB supplier on a DPP may propose a CPP. At any time after a DPP is set by the Commission, a supplier that is (or is likely to be) subject to the DPP may make a proposal to the Commission for a CPP to apply to that supplier.[47] A supplier may make only one CPP proposal during a regulatory period and may not make a proposal within the 12 months before a default price-quality path is due to be reset[48].

4.6 Table 4.1 provides an overview of the CPP applications we have processed to date. Since the 2016 IM Review, there have been two "full scope" CPPs, Powerco and Aurora and a streamlined one, Wellington Electricity.[49]

[46] Commerce Commission "Input methodologies review decisions. Framework for the IM Review" (20 December 2016).

[47] Commerce Act (1986) s 53Q(1).

[48] Commerce Act (1986) s 53Q(3).

[49] By "full scope" we mean that the scope of the CPP application will encompass all inputs needed to set the price-quality path and that these inputs are potentially subject to scrutiny.

Table 4.1 CPP decisions to date

Supplier	Primary driver(s) of CPP
Orion 2014-2019	Address the impact of the Canterbury earthquakes
Wellington Electricity 2018-2021	Delivery of a more resilient network that is less susceptible to earthquake damage
Powerco 2018-2023	Asset renewal to ensure safety and resilience. Enable and support economic growth in regions. Enable customers to take up benefits from smart grid technologies
Aurora 2021-2025	Repair and upgrade network to address safety and reliability

4.7 Wellington Electricity's CPP proposal was for very specific circumstances, ie, it was focused on urgent resilience-related expenditure. In this respect the Government issued a policy statement, which we had regard to under s 26 of the Act. As a result we used a streamlined approach in setting its CPP, enabled by approved modifications and exemptions under clause 5.1.6 of the IMs, and IM variations under s 53V of the Act.

CPP Streamlining

4.8 There is a view that the CPP mechanism is complex, time- and resource-intensive and that we should allow for the application process and information requirements to be streamlined based on the applicable CPP driver.

Draft decision

4.9 Our draft decision is not to amend our current CPP IMs for the purposes of streamlining CPPs.

Problem definition

4.10 Suppliers hold the view that CPPs are costly, require significant time and resources to prepare, submit and assess and are not flexible enough nor workable for a smaller supplier.

4.11 Suppliers, especially EDBs, consider they are likely to experience greater uncertainty on their future expenditure requirements than in previous periods. They have expressed the view that, unless the IM reopeners are modified and our DPP expenditure-setting approach changes we could receive a higher number of CPP applications in future.

Analysis and proposed solution

4.12 Section 53K of the Commerce Act 1986 describes the purpose of default/customised price-quality regulation. It 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."

4.13 Unlike a DPP, CPPs are designed to better meet the particular circumstances of the supplier so there is a greater emphasis on supplier-specific costs. The information to be provided as part of a CPP proposal must therefore be sufficient to support this analysis.[50]

4.14 A CPP offers suppliers the opportunity to propose a price-quality path that better meets their individual circumstances. Setting a customised path naturally is a more intensive and complex process when compared to the default path.[51]

4.15 A CPP is usually appropriate in circumstances where the price or quality impact on consumers is significant, requiring wider engagement with the consumers and stakeholders and where there is either upstream or downstream effects on the wider network or supplier's business.

4.16 The current CPP regime allows us to accept, evaluate and determine a CPP in a streamlined manner. Suppliers can:

4.16.1 apply for modifications and exemptions (**M and Es**)[52] from certain IM requirements relating to the process for preparing, and content of, CPP proposals (content of a CPP application, information required in a CPP proposal, requirements relating to consumer consultation, verification, audit and certification).

4.16.2 apply to use alternative methodologies with equivalent effect (**AMWEEs**) in CPP proposals; and

4.16.3 apply under s53V(2)(c) of the Act for IMs to be varied.

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[50] Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) Reasons paper" (22 December 2010).

[51] Commerce Commission "Input methodologies review decisions. Topic paper 2: CPP requirements." (20 December 2016), para 26.

[52] The M&E provisions, proposed by the applicant, allow us to agree with an applicant to modify or remove specific information requirements prior to a CPP application being submitted, provided it does not detract from our ability to assess a CPP proposal in a way that is more than minor (IM Determination, cl 5.1.6(2)).

Modifications and Exemptions (M and Es)

4.17 Suppliers have successfully applied for M and Es as part of their CPP applications in the past. For the Powerco and Aurora CPPs, for example, M and Es were used mainly to tailor requirements relating to the content of CPP applications and the information required in the proposals.

Alternative methodologies with equivalent effect (AMWEEs)

4.18 Suppliers may propose alternative methodologies to those specified in certain IMs that contribute to the core 'building blocks' for determining allowable revenue, ie, cost allocation, asset valuation, treatment of taxation or the estimation of term credit spread differentials.[53] AMWEEs can also be used for a more flexible and cost-effective approach to determining a CPP as they allow the use of information that is more closely aligned to a CPP applicant's business information and accounting practices.[54] No CPP applicants have applied for AMWEEs to date.

IM Variations

4.19 Orion, Wellington Electricity, Powerco and Aurora applied for IM variations in their respective CPPs. Given IMs are intended to promote certainty for regulated suppliers and consumers, we adopt a high threshold for agreeing to IM variations.

Our assessment and acceptance approach

4.20 We apply proportionate scrutiny in our assessment approach ie, the scrutiny that an element of a CPP proposal receives should be commensurate with the potential impact of that element on price and quality.

4.21 We accept a CPP application if it is compliant "in all material respects", ie, the proposal is substantially complete in that all information material to our evaluation and determination of a CPP has been provided. [55]

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[53] *Electricity Distribution Services Input Methodologies Determination 2012 (consolidated 20 May 2020),* clause 5.3.26(1) and *Gas Distribution Services Input Methodologies Determination 2012 (consolidated 9 September 2022),* clause 5.3.23(1), *Gas Transmission Services Input Methodologies Determination 2012 (consolidated 9 September 2022),* clause 5.3.19(1).

[54] Commerce Commission "Input methodologies review: Amendments to input methodologies for customised price-quality paths - Final reasons paper for Limb 1 of the CPP fast track." (12 November 2015), para 66.

[55] *Electricity Distribution Services Input Methodologies Determination 2012 (consolidated 20 May 2020),* clause 5.4.1 and *Gas Distribution Services Input Methodologies Determination 2012 (consolidated 9 September 2022),* clause 5.5.1(1), *Gas Transmission Services Input Methodologies Determination 2012 (consolidated 9 September 2022),* clause 5.1.1(2).

Streamlining

4.22 We have considered whether to amend our current CPP provisions by streamlining CPP requirements and have decided that instead our existing reopeners could be amended to cover a wider set of circumstances, which may particularly be helpful for smaller suppliers. These reopeners are discussed in Chapter 6.

4.23 Some stakeholders saw benefit in a "streamlined" CPP like Wellington Electricity's 2017 CPP for earthquake resilience (ie, use of modifications and exemptions, variations of IMs and/or AMWEEs) but were concerned that the application and assessment burden would still be similar to a full CPP.

Summary

4.24 CPPs are not seen as a routine adjustment mechanism and should only be used for a supplier's particular circumstances. The CPP information requirements are therefore tailored depending on a supplier's circumstances and on the key reason or driver for the CPP.

4.25 We consider there is already sufficient flexibility to respond appropriately within the CPP regime. This has been used for past CPPs and suppliers can continue to rely on tools such as modifications and exemptions, which can be used in the process of preparing for, and the content of, CPP proposals.

4.26 The current prescriptive approach for a CPP assessment helps to ensure relevant statutory considerations are taken into account and the conditions that have led a supplier to apply for a CPP are in accordance with Part 4 of the Act. The alternatives proposed would not better promote certainty for and the long-term benefit of consumers in line with Part 4 purpose s 52A of the Act and IM purpose in s 52R, more effectively.

Single issue CPP

4.27 We considered whether there was a gap in the regulatory continuum, which could be filled by a potential single issue CPP.

Draft decision

4.28 Our draft decision is to not amend our current CPP IMs to allow for a single-issue CPP.

Problem definition

4.29 A single issue CPP would be a reduced scope CPP (compared to a regular CPP) where customisation is sought only in respect of one part of the supplier's DPP, which could be a single project or several projects that make up a programme of work. This "single issue" would attract wider scrutiny than a DPP but there would not be a review of all other aspects of a supplier's business as would occur with a "full scope" CPP.

4.30 In our process and issues paper, we asked for feedback on whether there is a gap in the regulatory continuum that is not covered by DPP reopeners or a regular CPP. There was relatively limited engagement on this topic compared to the depth of submissions on other topics.

Stakeholder views

4.31 Some submitters saw benefit in a "streamlined" CPP like Wellington Electricity's 2017 CPP for earthquake resilience (ie, use of M&Es, variations of IMs and/or AMWEEs) but were concerned that the application and assessment burden would be similar to a full CPP.

4.32 Some submitters[56] did not view DPP reopeners in their current form as a useful substitute for potential single-issue CPPs unless they were modified to include opex, include more primary drivers (or triggers) and thresholds were reset. Wellington Electricity added that unlike a single-issue CPP, the window of delivery for reopeners is limited to the current regulatory period and this requirement limits the use of reopeners to smaller projects that can be planned and delivered before the end of the regulatory period, suggesting a single-issue CPP may be a viable alternative.

4.33 Following our price-quality path workshop (on 29 November 2022), we asked submitters for examples of scenarios that are not covered by DPP reopeners, which might require a single-issue CPP. Overall, submitters were unable to provide clear examples of scenarios.

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[56] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022); Powerco "Submission on Price-quality path workshop" (20 December 2022).

4.34 Powerco[57] and Vector[58] were of the view that setting the upper thresholds/caps for the EDB Unforeseeable major capex project and Foreseeable major capex project reopeners higher than the current $30 million cap value for the forecast value of commissioned assets attributable to major capex project[59] would enable DPP reopeners to fulfil a similar purpose as a single-issue CPP. Reopener thresholds are discussed in Chapter 7.

Analysis and proposed solution

4.35 The EDB, GDB and GTB IMs identify the events or circumstances, which allow a DPP to be reopened. There are currently ten reopener provisions in the EDB, GDB and GTB IMs[60]. If a supplier does not consider the DPP that is set, or the DPP reopener provisions meet their particular circumstances, they can apply for a CPP.

4.36 In the 2016 IM Review we considered whether there was value in providing for a single issue CPP but concluded they are problematic due to DPP/CPP regulatory period alignment, asymmetry between suppliers and consumers, interdependencies of inputs with other aspects of the path, and suppliers using their one CPP opportunity for the regulatory period to tailor a single parameter.

Stakeholder views

4.37 Suppliers voiced that they do not believe reopeners in their current form are a useful substitute for single-issue CPPs unless they were modified to include opex, include more primary drivers (or triggers), and price-quality path reopener thresholds are reset.[61] These substitutes are discussed in Chapter 6.

4.38 Our view is that the starting point for suppliers seeking a price-quality path adjustment amendment to fit their circumstances would be the DPP reopeners, especially with our proposed extensions and refinements (discussed in Chapter 6). We expect there would only be limited cases where the expanded range of DPP reopeners might not provide a possible solution to a specific circumstance involving a single issue.

[57] Powerco "Submission on Price-quality path workshop" (20 December 2022).

[58] Vector "Submission on Price-quality path workshop" (20 December 2022).

[59] *Electricity Distribution Services Input Methodologies Determination* (20 May 2020), clause 4.5.6(4).

[60] We have separately assessed whether these reopeners are likely to cover the future circumstances that may be faced by regulated suppliers in Chapter 6.

[61] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022); Vector "Submission on Price-quality path workshop" (20 December 2022).

4.39 We consider the CPP IMs are flexible enough to cater for select circumstances where suppliers have a single material issue requiring focused scrutiny on that issue. We are therefore not explicitly amending the IMs to provide for a single-issue CPP. This approach promotes the Part 4 purpose in s 52A of the Act and IM purpose in s 52R more effectively.

Chapter 5 Improving the price-quality path reopener processes

Purpose and structure of this chapter

5.1 This chapter explains our draft decisions to make changes to improve the Part 4 price-quality path reopener processes. These cover the EDB, GDB, GTB and Transpower reopener processes.

5.2 The chapter covers the process of how a price-quality path may be reopened. However, it does not cover the 'what' of reopeners, this is covered in Chapter 6 (Whether the reopeners will cover future circumstances) and Chapter 7 (Reviewing our approach to reopener thresholds).

5.3 Our draft decisions:

5.3.1 address the key issue of whether changes to process regarding application for, and consideration of reopeners are required; and

5.3.2 include other refinements to the price-quality path reopener process IMs.

5.4 Our draft decision is to:

5.4.1 change the Part 4 price-quality reopener processes:

5.4.1.1 to align the EDB, GDB, GTB and Transpower price-quality path reopener processes with the reopener process outlined in the Fibre IMs; and

5.4.1.2 to adopt other ideas we considered to improve the reopener processes of the EDB, GDB and GTB IMs; and

5.4.2 make drafting consistency changes to the various reconsideration event allowance recoverable cost provisions of the EDB, GDB and GTB IMs.

Aligning the price-quality path reopener processes and other improvements

Draft decisions

Aligning the Part 4 price-quality path reopener processes with the reopener process in the Fibre IMs

5.5 Our draft decision is to amend the price-quality path reopener process IMs to follow the structure of the Fibre IMs reopener process. This introduces new provisions that are in the Fibre IMs but not in the EDB, GDB, GTB and Transpower IMs. Specifically:

5.5.1 amending the EDB, GDB, GTB and Transpower IMs to:

5.5.1.1 define a ‘reopener event’ as an event, or series of related events that occurs within the twelve-month period before or during the regulatory period of the price-quality path determination;

5.5.1.2 require a supplier who nominates a reopener event to provide sufficient information to enable the Commission to assess whether a reopener event has occurred and whether a price-quality path should be amended;

5.5.1.3 require the Commission to publish notice on our website after a significant step in the reopener process has been carried out (eg, a reopener event has been nominated by a supplier, the Commission decides to reconsider a price-quality path, or the Commission decides to amend a price-quality path);

5.5.1.4 prescribe a list of factors the Commission must have regard to when deciding whether to amend the price-quality path if we are satisfied that a reopener event has occurred; and

5.5.1.5 require the Commission to take into account the expenditure objective when determining the extent of any amendments to the price path.

Other ideas considered to improve the reopener process

5.6 Our draft decision is to amend the EDB, GDB and GTB IMs to include a new clause to provide the Commission with the option to decline DPP reopener applications that are better suited to a CPP application. This clause applies to the Catastrophic event, the Change event, a Proposal of a quality standard variation, an Unforeseeable major capex project, a Foreseeable major capex project and a Risk event reopener application.

5.7 Our draft decision is to amend the EDB, GDB, GTB and Transpower IMs to include a clause on confidential information.

5.8 Our draft decision is to not amend the EDB, GDB, GTB and Transpower reopener IMs to do any of the following:

5.8.1 include timeframes for the Commission to evaluate reopener applications;

5.8.2 provide more prescription about types of information required in reopener applications;

5.8.3 include application windows for reopeners;

5.8.4 prescribe when consultation is required and when it is not;

5.8.5 include a modification and exemption provision for DPP or IPP reopener information requirements;

5.8.6 include a pre-application stage for the process of applying for a reopener;

5.8.7 include a reopener for the purposes of assessing programme financeability; and

5.8.8 allow reopeners to be moved across regulatory periods or to be extended between two regulatory periods without having the supplier reapply for approval.

5.9 Our draft decision is to also not amend the EDB, GDB and GTB IMs to allow either of:

5.9.1 a single CPP application to cover multiple parties; or

5.9.2 a single reopener application to cover multiple parties.

Problem definition

5.10 Section 52T(1)(c)(ii) requires the IMs to include regulatory processes and rules, such as identifying circumstances in which price-quality paths may be reconsidered within a regulatory period.[62] Reconsideration of a price-quality path is commonly referred to as reopening a price-quality path. The price-quality path reopener process refers to a series of provisions that outline the 'how' of reopening a price-quality path. The current drafting of the reopener process for the EDB, GDB, GTB and Transpower IMs outlines when a price-quality path may be reopened and constraints on the Commission when amending a price-quality path.

5.11 The price-quality paths we set under Part 4 provide certainty to suppliers about limits on revenue, quality standards and incentive mechanisms for efficiency and quality over the regulatory period. The regime also provides mechanisms to respond to change that occurs during the regulatory period. There is a relatively high level of uncertainty at present. This highlights the importance that the process of applying for and assessing reopeners and other changes during the regulatory period is clear.

5.12 The IMs for reopener process, the provisions that cover the application and evaluation of a reopener, have been developed and amended progressively over the years. Because the amendments have been done in a piecemeal manner, the process as currently described in the IMs is not as clear as it could be.

[62] Commerce Act, s 52T(1)(c)(ii).

5.13 The Fibre reopener process IMs were developed more recently with a focus on clarity and coherence. We considered whether and how we might align the Part 4 reopener process IMs with the Fibre reopener process IMs, and further ideas for improving the reopener process based on submitter feedback.

5.14 We set out below our proposed solution for the reopener process and discuss a number of standard key features of the process. In that discussion we include for each key feature a description of the problem that feature is aiming to address.

Stakeholder views

5.15 Submissions on our Process and issues paper for this topic mainly focused on the timeframes for reopener decision-making and the lack of clarity on the quality of the information required to fulfil reopener application requirements. Submitters were particularly concerned about the time it took to process the Unison reopener in 2021. Specifically:

5.15.1 Aurora suggested the inclusion of a specified timeframe in which we would make a decision and the inclusion of a more prescriptive list of information required for a reopener application were needed;[63] and

5.15.2 Wellington Electricity submitted that not all reopeners would require the same level of assessment and questioned the need for consultation on applications where the connecting customer is funding the majority of the connection costs.[64]

5.16 At the reopener workshop on 29 November 2022,[65] we outlined Commission staff's views on the broad approach we proposed taking for all in-period adjustments (not just reopeners). We explained that the process would include three clear stages – trigger, consideration and amendment stages.

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[63] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022).

[64] Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022).

[65] Commerce Commission "Workshop: Price-quality path in-period adjustment mechanisms" (29 November 2022).

5.17 We asked for submitter views on specific questions after the reopener workshop. While submitters were generally supportive about proposed updates to the reopener process,[66] one submitter thought it was not a material improvement[67] and another submitted that we should not make the process more onerous than it is.[68]

Proposed solution

5.18 We believe improved clarity will result in a better process and more certainty for suppliers and will go some way towards improving timeliness of reopener decisions being made. This will streamline the process and reduce implementation and transaction costs, which is an important consideration when reopeners are likely to be sought more frequently. The adoption of the Fibre IM process will also require suppliers to provide sufficient information to support our assessment of reopener applications. These requirements will likely speed up the process and improve timeliness of reopener decisions being made.

5.19 The proposed changes promote the Part 4 purpose in s 52A and the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose) through improved clarity and certainty as well as reducing complexity. This benefits suppliers and the Commission by improving the coherence and ease-of-use of the reopener provisions which should speed up process times for suppliers and the Commission.

5.20 Our proposed changes relating to the reopener process can be split into two categories:

5.20.1 structure and provisions imported from the Fibre IMs; and

5.20.2 other ideas considered to improve the reopener process.

Aligning the Part 4 reopener processes with the reopener process in the Fibre IMs

5.21 The proposed changes add the following steps to the reopener process:

5.21.1 the specification of a time window within the definition of reopener event (paragraphs 5.23 to 5.26);

5.21.2 the requirement of suppliers to provide sufficient information for the Commission's assessment (paragraphs 5.27 to 5.30);

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[66] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 18; Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), p. 2; Powerco "Submission on Price-quality path workshop" (20 December 2022), p. 2.

[67] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 21.

[68] Vector "Submission on Price-quality path workshop" (20 December 2022), p. 2.

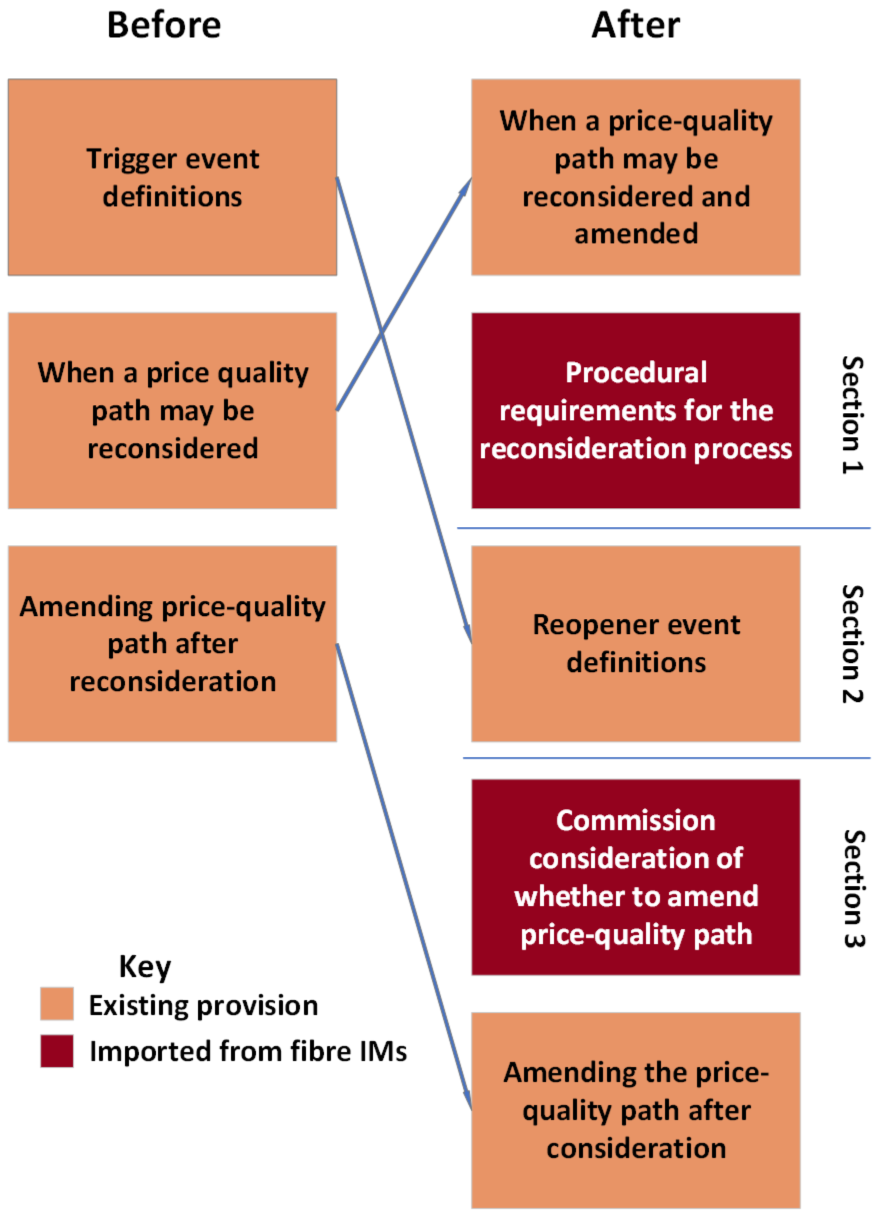
5.21.3 the specification of the Commission’s notification requirements for reopener event applications (paragraphs 5.31 to 5.33);

5.21.4 the specification of a list of considerations the Commission must have regard to when deciding whether to amend the price path (paragraphs 5.34 to 5.36); and

5.21.5 require the Commission to take into account the expenditure objective when determining the extent of any amendment to the price path (paragraphs 5.37 to 5.40).

5.22 The adoption of similar price-quality path reopener process to the reopener process from the Fibre IMs involves rearranging the structure of the reopener provisions as well as importing and adapting provisions from the Fibre IMs. Figure 5.1 below illustrates the new structure of the reopener process, showing the new order of provisions and the provisions that have been imported from the Fibre IMs.

Figure 5.1 Updated structure of reopener process



Time window within reopener event definition

5.23 We propose to amend the EDB, GDB, GTB and Transpower IMs to define a 'reopener event' as an event, or a series of related events, that occurs within the twelve-month period before or during the regulatory period of the price-quality path determination.

5.24 The current drafting of the EDB, GDB, GTB and Transpower IMs does not consistently set out the timeframe for which the reopener applies, with "Change event" stating this "must take place during the current regulatory period" and no representative statement for the timing of "Catastrophic event".

5.25 We consider providing a timeframe which starts in advance of the DPP regulatory period is appropriate and allows application of the reopener provisions to events which may not be able to be appropriately reflected in a DPP Determination. This better reflects a timeframe by which changes could be accommodated within a DPP reset and more effectively promotes the s 52R purpose by giving suppliers certainty over the timeframe when a reopener event may occur.

5.26 The Fibre IMs define a reopener event that occurs within six months before or during the regulatory period.[69] We think extending this to twelve months is beneficial, and more effectively promotes the s 52R IM purpose without detrimentally affecting the promotion of the s 52A purpose, as it reduces the risk of a significant event not being recognised in expenditure allowances if this were to occur during a DPP reset process.

Requirement of suppliers to provide sufficient information

5.27 We propose to amend the EDB, GDB, GTB and Transpower IMs to require a supplier who nominates a reopener event to provide sufficient information to enable the Commission to assess whether a reopener event has occurred and whether a price-quality path should be amended. This clause cross references the list of factors the Commission must have regard to when deciding whether to amend the price-quality path (see paragraphs 5.33 to 5.35). This has been adapted from the Fibre IMs.[70]

5.28 The requirement to provide information to support the reopener application is not clearly stated in the current EDB, GDB, GTB and Transpower IMs, with the existing statement being the supplier "applies to the Commission and satisfies the Commission that an event has occurred."

5.29 Wellington Electricity submitted in favour of a clear process and providing examples of the type of information needed.[71] Requiring a supplier to provide the information (and cross referencing our mandatory considerations) signals to suppliers what information is required.

5.30 This approach requires the supplier to provide enough information to support the consideration stage, and therefore more clearly outlines the type of information a supplier will need to provide. This should minimise any back-and-forth requests for information between the supplier and the Commission which will speed the process up, thereby more effectively promoting the s 52R purpose of the Act without detrimentally affecting the promotion of the s 52A purpose.

[69] *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.9.1(2).

[70] *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.9.2(2).

[71] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), p. 2.

Requirement to publish notice for reopener event applications

5.31 We propose to require the Commission to publish notices on our website after:

5.31.1 a reopener event has been nominated; and

5.31.2 the Commission decides whether:

5.31.2.1 it is satisfied a reopener event has occurred;

5.31.2.2 to reconsider the price-quality path; and

5.31.2.3 to amend a price-quality path.

5.32 The EDB, GDB, GTB and Transpower IMs currently do not specify those requirements. The change mirrors reopener provisions from the Fibre IMs.[72] For the Unison Tauhara reopener, our notifications largely followed the Fibre prescribed approach, with the only difference being we did not separately notify that the Unison reopener application had been received. Instead, we published the Unison application at the same time as publishing our draft reopener decision.

5.33 Our draft decision provides certainty and transparency to other stakeholders about the reopeners that are being considered, which promotes the s 52R purpose more effectively (without detrimentally affecting the promotion of the s 52A purpose) and is consistent with natural justice principles. We note that the Fibre IMs do not address how confidential information is dealt with in respect of reopener applications, but it is addressed in the subparts relating to capital expenditure.[73] As part of our draft decision, we have included a clause outlining our process for confidential information. This is discussed below in paragraphs 5.47 to 5.49.

Considerations the Commission must have regard to

5.34 We propose to amend the EDB, GDB, GTB and Transpower IMs to prescribe a list of factors the Commission must have regard to when deciding whether to amend the DPP, CPP or IPP if we are satisfied that a reopener event has occurred.

5.35 This has been imported from the Fibre IMs, adjusted for context.[74] Although there are no such mandatory considerations in the current EDB, GDB, GTB and Transpower IMs, these would feature in any case through our assessment and decision-making process.

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[72] *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.9.2(3) and (4).

[73] *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clauses 3.7.6 and 3.8.4.

[74] *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.9.8.

5.36 This draft decision will promote the s 52A purpose and s 52R purpose more effectively than the status quo by giving greater clarity and certainty to suppliers about how we make decisions, and what constrains our decision making in regard to amending the price-quality path.

Specification that any expenditure will be assessed against the expenditure objective

5.37 Our draft decision is to amend the EDB, GDB and GTB IMs to require the Commission to take into account the expenditure objective when determining the extent of any amendment to the price path (ie, whether the opex and capex reflects the efficient costs that a prudent supplier of electricity lines services or gas pipeline services would require to meet or manage expected demand for its services, at appropriate service standards).

5.38 A similar clause exists in the Fibre IMs that requires the Commission to evaluate whether the proposed capital expenditure meets the capital expenditure objective.[75]

5.39 The current EDB IMs states the Commission will not amend the price path in respect of a Foreseeable major capex project or an Unforeseeable major capex project more than an amount that reflects the efficient costs that a prudent non-exempt EDB would incur.[76]

5.40 We consider that requiring the Commission to take into account the expenditure objective better promotes the s 52R purpose by setting out our considerations up front. It will also better promote the s 52A(1)(b) purpose by allowing for scrutiny of any proposed expenditure, which will encourage suppliers to be efficient.

Other ideas considered to improve the Part 4 reopener processes

5.41 In addition to provisions imported from the Fibre IMs, we also considered other ideas to improve the Part 4 reopener processes. Specifically:

5.41.1 including a new clause to provide the Commission with the option to decline a DPP reopener application because we consider it is better suited to a CPP application;

5.41.2 specifying how the Commission will deal with confidential information;

5.41.3 specifying timeframes within the price-quality path reopener process IMs;

5.41.4 more prescription to guide price-quality path reopener applications;

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[75] *Fibre Input Methodologies Determination 2020, as amended on 29 November 2021*, clause 3.9.9(3)(a).

[76] *Electricity Distribution Services Input Methodologies Determination 2012,* clause 4.5.7(3).

5.41.5 including reopener application windows;

5.41.6 the need for consumer consultation;

5.41.7 the need for a modification or exemption provision;

5.41.8 the inclusion of a pre-application stage for a reopener application into the IMs;

5.41.9 the inclusion of a reopener to support project or programme financeability;

5.41.10 allowing reopeners to be moved across regulatory periods, or to be extended between two regulatory periods without having the supplier reapply for approval;

5.41.11 allowing a single issue CPP application to cover multiple parties; and

5.41.12 allowing a single reopener application to cover multiple parties.

Consideration of whether an application is better suited to a CPP

5.42 We propose to amend the EDB, GDB, and GTB IMs to include a new clause to provide the Commission with the option to decline DPP reopeners that are better suited to CPPs. This clause applies to the Catastrophic event, Change event, Foreseeable major capex project, Unforeseeable major capex project, Quality standard variation and Risk event reopener applications.

5.43 Any DPP reopener application we identify as one being better suited to a CPP may be declined and the supplier would be encouraged to submit a CPP application. Suppliers are only able to apply for one CPP per regulatory period. If the Commission declines the DPP reopener application, it does not give the suppliers an additional CPP application. This provision has not been imported from the Fibre IMs, which do not provide for CPPs.

5.44 We are amending the requirements for a reopener applicant to provide information in relation to a reopener to include information to enable us to decide whether to amend the DPP and this includes information to help our decision on whether the Commission considers a CPP proposal more appropriate.

5.45 We have excluded the error event, major transaction and false or misleading information reopener events, as we consider based on the nature of these reopener events, they are unlikely to represent a programme of work which is better considered as a CPP.

5.46 Allowing for the option to decline reopener applications that are better suited to CPPs, promotes the IM purpose of certainty and clarity for suppliers more effectively than the status quo by signalling this to suppliers up front. This also gives effect to the s 53K purpose more effectively than the status quo by ensuring the more suitable price-quality regulation is utilised (DPP or CPP). Those outcomes do not detrimentally affect the promotion of the s 52A purpose.

Confidential information

5.47 We propose to amend the EDB, GDB and GTB IMs to include a new clause on confidential information into the reopener process IMs. The clause has been repurposed from the Fibre IMs and the Transpower Capex IMs. This new clause will be included in the "Procedural requirements for the reconsideration process" section which has been imported from the Fibre IMs and Transpower Capex IMs.

5.48 The EDB, GDB and GTB IMs are silent as to how we deal with confidential information, while for Transpower only the Transpower Capex IM contains a clause on confidentiality.

5.49 Including a confidentiality clause more effectively promotes the s 52R purpose by giving certainty and clarity to suppliers on how we deal with confidential information (without detrimentally affecting the promotion of the s 52A purpose).

Timeframes within the reopener process IMs

5.50 We propose to not amend the EDB, GDB, GTB and Transpower IMs to include timeframes for the Commission to evaluate reopener applications. The current drafting of the EDB, GDB, GTB and Transpower IMs, as well as the Fibre IMs, do not prescribe a timeframe for processing reopener applications.

5.51 Several submitters suggested we prescribe a time limit for processing an application within the IMs.[77] We disagree and do not think this is easily workable as there are factors outside of our control that would impact our turnaround time. The number of applications we have to consider at a particular time will impact processing times. The extent and quality of information provided by reopener applicants, and consequently our requests for further information from applicants, could impact our ability to process reopener applications within specified timeframes. We think an improved process can influence turnaround time if a regulated supplier has clarity about what information is required and what to expect from the process.

[77] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 25.3; Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), p. 2; Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), p. 1.

5.52 We do not think introducing a timeframe for the Commission to consider reopener applications within the reopener IMs would more effectively promote certainty for suppliers (s 52R purpose) as there are several factors outside of the Commission's control that could result in these timelines not being met (as set out in the preceding paragraph). Prescribing timelines that we may not be able to meet for reasons outside of our control would not promote certainty and clarity for suppliers.

More prescription to guide reopener applications

5.53 We have decided to not amend the EDB, GDB, GTB and Transpower IMs to provide more prescription about the types of information required in reopener applications, beyond the guidance provided by the reopener event criteria and the mandatory requirements in the consideration stage.

5.54 Several submitters suggested we provide more detail and guidelines for the information required for a reopener.[78]

5.55 We consider the reopener event criteria already provide a guide as to the information required from applicants to satisfy the criteria. Our draft decision to change the structure of the reopener process IMs and include mandatory considerations that we must take into account when considering whether to amend the price path (discussed above at paragraphs 5.34 to 5.36), should provide sufficient clarity for regulated suppliers to know what information is required. We think these changes are more effective than providing guidelines or more prescription.

5.56 These changes better promote the s 52R purpose more than the current IMs and the proposed alternative (and do so without detrimentally affecting the promotion of the s 52A purpose) by providing clarity and certainty to suppliers for what information is required to successfully reopener a price-quality path while avoiding adding further detail into the IMs.

5.57 We have recently seen high levels of pre-engagement from suppliers ahead of applications being submitted for reopeners. This has included suppliers seeking clarification of the information that is required. We expect this to continue. We will encourage the use of pre-existing and currently available information which suppliers have used for their internal approval processes. This should reduce delays in processing future reopener applications.

[78] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 25.1; Vector "Submission on Price-quality path workshop" (20 December 2022), p. 2; Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022), p. 2; Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), p. 3.

Need for reopener application windows

5.58 We propose to not amend the EDB, GDB, GTB and Transpower IMs to include application windows for reopeners.

5.59 We outlined at the reopener workshop that we were considering the use of reopener windows during the regulatory period.[79] We compared against overseas jurisdictions, specifically Ofgem in the UK which limits reopener applications to a one-week application window.

5.60 Reopener windows have benefits. They can increase certainty for regulated suppliers and the Commission, to allow for appropriate resourcing for completing/processing applications. However, the concentration of applications into a reopener window could overwhelm our resources if we receive a larger number than predicted. This would slow the process down. The inclusion of application windows could cause significant delays to investment or other projects where work is not well aligned with application windows.

5.61 Reopener windows do not suit all types of reopeners (eg, catastrophic event) and they can act as a barrier to reopeners. This may affect the ability of a regulated supplier to invest in the network (s 52A(1)(a)) and its ability to provide services at a quality that reflects consumer demands (s 52A(1)(b)), and those effects do not promote the Part 4 purpose more effectively than the alternative of not having reopener application windows.

Need for consultation

5.62 We propose to not amend the EDB, GDB, GTB and Transpower IMs to prescribe when consultation is required and when it is not. The only information about the consultation requirements in the reopener IMs is in relation to the quality standard variation reopener in the EDB IMs. When applying in respect of this type of reopener, the EDB's proposal must demonstrate any consumer consultation that has been undertaken and the results of that consultation for our consideration.

5.63 Section 52Q(1) of the Act requires the Commission to consult with interested parties before amending a s 52P determination in a material way. The Act does not give the Commission a discretion to not apply the s 52Q requirement. As a reopener request would usually involve a material change to the DPP determination, we would usually consult on the application.

[79] Commerce Commission "IM Review 2023: In-period adjustment mechanisms – Workshop 'Discussion slides'" (29 November 2022), slide 22.

5.64 Aurora questioned the need for consultation in instances where one connecting customer is funding the majority of the connection costs.[80] We have introduced the large connection contract mechanism to deal with such situations, and if the supplier opts to use that mechanism, consultation and negotiation of the contract will largely take place with the connecting customer (see Chapter 8 for more discussion of the large connection contract).

Modification or exemption provisions

5.65 We propose to not amend the EDB, GDB, GTB and Transpower IMs to include a modification or exemption provision for DPP or IPP reopeners.

5.66 At the reopener workshop,[81] we sought feedback on the usefulness of including a modification or exemption provision that would apply to DPP IM provisions, as currently provided for in the CPP IMs for CPP applications. Feedback at the workshop was positive.

5.67 Our view is that the information we ask for in a reopener application is needed byus to be able to evaluate the proposal and therefore the status quo provides certainty for suppliers and promotes the s 52R purpose, more than introducing a modification or exemption provision for DPPs or IPPs (without detrimentally affecting the promotion of the s 52A purpose). We consider that the list of information required is not unduly long or onerous. Pre-application discussions with suppliers provide an opportunity for guidance to be provided on information required to satisfy the requirements.

Inclusion of a pre-application stage

5.68 We propose to not amend the EDB, GDB, GTB and Transpower IMs to include a pre-application stage for the process of applying for a reopener.

5.69 At the reopener workshop,[82] we raised the idea of including a pre-application stage to the reopener process where suppliers would engage with us prior to submitting a reopener application. Powerco submitted in support of this idea.[83] Our draft decision is to not include a step like this as this is something that can be done informally, if appropriate, and does not need to be codified into the IMs. If it was added to the IMs, it may lengthen the process.

[80] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 20.

[81] Commerce Commission "IM Review 2023: In-period adjustment mechanisms – Workshop 'Discussion slides'" (29 November 2022), slide 42.

[82] Commerce Commission "IM Review 2023: In-period adjustment mechanisms – Workshop 'Discussion slides'" (29 November 2022), slide 22.

[83] Powerco "Submission on Price-quality path workshop" (20 December 2022), p. 2.

5.70 Rather than codify a pre-application stage, we have reviewed whether changes are required to the defining of reopener events to make them clearer for suppliers. This includes reopener thresholds, which are discussed in Chapter 7. We think clarifying the drafting regarding reopener events and the consideration and amendment stages, more effectively promotes certainty over the requirements and processes (and therefore the s 52R purpose and significantly reducing compliance costs and complexity without detrimentally affecting the promotion of the s 52A purpose), than formalising a pre-application stage.

Reopeners to support project or programme financeability

5.71 We propose to not amend the EDB, GDB, GTB and Transpower IMs to include a reopener for the purposes of assessing programme financeability.

5.72 Vector submitted that the Commission should[84]

> "introduce a re-opener to support financeability for specific projects (for example, by allowing suppliers to propose a different cashflow profile or rate of return) where current regulatory arrangements do not allow the project to be funded and this would result in sub-optimal outcomes for consumers"

5.73 We note s 53ZB(1) prohibits default or customised price-quality paths being reopened within a regulatory period on the grounds of a change in an input methodology, aside from those changes as a result of an appeal.

5.74 An alternative approach considered was that the IMs could specifically allow an application for accelerated depreciation for financeability reasons.

5.75 This has been considered within the section titled "We considered and rejected an option of depreciation loadings in DPPs to address financeability concerns" within the *Financing and incentivising efficient expenditure during the energy transition* topic paper. There we outline that we consider that in the absence of evidence of a widespread, industry-wide financeability problem, CPPs remain the preferred means of enabling a price-quality path that better meets an individual supplier's particular circumstances, in line with s 53K.

[84] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 20.

5.76 Vector noted that the mechanism could apply where a full CPP application would not be justifiable for individual smaller scale projects.[85] We consider that assessing financeability for an individual project or programme would materially increase the complexity and compliance costs of the DPP reopeners, as it may require wider assessment of other aspects of an EDB's operations beyond the specific project to appropriately consider financeability. Depending on the extent and complexity of the analysis, this could go against the purpose of DPP/CPP regulation under s 53K and be at odds with the IM Review overarching objective of significantly reducing compliance costs without detrimentally affecting the promotion of the s 52A purpose.

Allowing reopeners to be moved across regulatory periods

5.77 We propose to not amend the EDB, GDB, GTB and Transpower IMs to allow price-quality path reopeners to be moved across regulatory periods, or to be extended between two regulatory periods. This will require the supplier to reapply for approval for the subsequent regulatory periods.

5.78 When price-quality path reopeners are approved by us, the price path is amended for the current regulatory period. The 'approval' only applies for the current regulatory period. It is foreseeable that any additional expenditure relating to a reopener could be delayed for various reasons, both within and outside of a supplier's control. This might mean delivery of the investment carries over into the following regulatory period.

5.79 Wellington Electricity has submitted that reopeners should cover projects that bridge more than one regulatory period and that a reopener, which has been provided for in one regulatory period, should be able to apply in the next regulatory period as well without the need for the regulated supplier to make another application.

5.80 Wellington Electricity stated that "reopeners in their current form are of limited value because they have to be approved, the investment designed and built, and the final assets commissioned within the same regulatory period. Practically, this limits the use of reopens [sic] to smaller projects that can be started early in the regulatory periods so that they can be completed before the regulatory period ends."

5.81 In setting a DPP we set a spend envelope but are not explicit about what it covers. The expenditure in the allowed revenue under a DPP is fungible, ie, the supplier has the freedom to prioritise the projects, programmes and expenditure it undertakes throughout the regulatory period.

[85] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 24.

5.82 The approval of a DPP reopener and the amended price path resets the spend envelope. It is then up to the supplier whether it chooses to deliver the project or programme of work that the reopener relates to, based on its business priorities. If the project or programme of work that the reopener relates to was deprioritised, this would not be reflected in its actual spend. If all else was equal, an underspend would result, with the 'savings' shared with consumers in future periods according to the IRIS retention rate.

5.83 In our current DPP/CPP regime, under a DPP we do not currently:

5.83.1 check whether the supplier has delivered the project or programme of work that the DPP reopener relates to;

5.83.2 have a specific mechanism to claw back funding for the approved DPP reopener if the funding is not used for the purpose we initially approved it for; or

5.83.3 have delivery reporting in place to identify projects and programmes related to an approved reopener that the supplier has spent funding on, compared to what it had planned.

5.84 The expenditure forecasts in a supplier's annual AMP, or AMP update, detail the funding that the supplier considers it requires. This should include projects, programmes or categories of expenditure related to past reopeners that might have been deprioritised or deferred into future regulatory periods. We would set the DPP for the next regulatory period based on AMPs disclosed. Costs for non-delivered or partly delivered past reopeners would be subjected to the DPP expenditure setting approach that applies to all expenditure.

5.85 If the DPP we set does not include the roll-over of past reopeners, and the supplier considers that the expenditure is insufficient, it could apply for a subsequent reopener provided it has not exceeded the time limit prescribed in the definition of 'reopener event'. A mechanism that allows rollover of reopeners between regulatory periods could create situations where multiple reopeners are sought where it may be more appropriate to utilise a CPP. A mechanism that allows rollover of reopeners between regulatory periods does not incentivise investment or efficiency improvements more than the status quo and therefore does not promote the s 52A purpose of the Act.

Allowing single CPP applications to cover multiple parties

5.86 We propose to not amend the EDB, GDB and GTB IMs to allow a single CPP application to cover multiple parties.

5.87 In their submissions on our Process and issues paper, ENA and Orion proposed that the IMs should be amended to allow a co-joined single CPP application to address issues impacting multiple suppliers, resulting in a CPP for each impacted supplier.[86]

5.88 To date, our view has been that since a CPP is a customised price path to suit the particular circumstances of a supplier, it requires an individual CPP application by that supplier.

5.89 Although one CPP application cannot cover multiple parties under the Act, we consider that if there is a common issue that requires individual CPPs from multiple suppliers, there is nothing preventing those suppliers from collaborating on the work required to put together their respective CPP applications to minimise effort and for efficiency. We would be open to accepting common materials or analysis shared across multiple suppliers in consideration of CPP applications, for example, verification.

5.90 We note that a supplier is able to apply for an IM modification to or exemption from CPP application requirements which can help speed up the application process.

Allowing single reopener applications to cover multiple parties

5.91 We propose to not amend the EDB, GDB and GTB IMs to allow a single reopener application to cover multiple parties.

5.92 ENA and Orion have submitted that a single reopener application covering multiple parties should be able to be made to reopen the price quality path in response to situations that impact multiple suppliers concurrently.[87]

5.93 Although the Act does not expressly prevent a reopener application covering multiple parties to be made, our EDB, GDB and GTB IMs currently envisage that a supplier will apply for a reopener on its own behalf.[88]

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[86] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 16; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 118.

[87] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p. 16; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 118.

[88] For example, clause 4.5.6(1) of the *Electricity Distribution Services Input Methodologies Determination 2012,* refers to ""the EDB applies", rather than "an EDB or EDBs apply" and clause 4.5.5(1) of the *Gas Distribution Services Input Methodologies Determination 2012 (consolidated 9 September 2022), r*efers to "the GDB applies", rather than "a GDB or GDBs apply".

5.94 The IMs do not prevent multiple suppliers working collaboratively on reopener applications to share information and minimise costs. However, the price-quality paths that are reset in response to reopeners are unique to each supplier and even if a reopener event occurs that affects most, or even all, suppliers, the impact on each supplier's business is likely to be different given their exposure to the event, location, and specifics of their networks. We are therefore of the view that allowing for a single reopener application for multiple parties would not better promote the IMs purpose as it does not reduce compliance costs or complexity enough to justify changing the IMs.

5.95 Although we are not proposing to amend the IMs so that they explicitly state that one reopener application can cover multiple parties, suppliers can work together and use some of the same information in their applications, where relevant. Where multiple suppliers supply the same information in their respective applications, the Commission will consider the information together but will assess whether each applicant's price path needs to be adjusted separately.

'Reopener event allowance' recoverable cost

Draft decision

5.96 Our draft decision is to amend the IMs to introduce a 'reopener event allowance' recoverable cost in the EDB, GDB and the GTB IMs, which enables EDBs and GPBs to recover costs incurred as a result of any 'reopener event' up until the date the reconsidered price-quality path takes effect.

5.97 Our draft decision will promote the overarching objectives for the IM Review by:

5.97.1 reducing complexity and compliance costs through having one recoverable cost which covers all reopener events (as opposed to being split across different recoverable costs); and

5.97.2 more effectively promoting the s 52A(1)(a) purpose by maintaining incentives to invest through allowing regulated suppliers to be compensated for prudent and efficient costs in responding to reopener events (not just catastrophic events, as is the case under the GDB and GTB IMs).

5.98 In addition, our draft decision has the benefit of ensuring cross-sector consistency between the EDB, GDB and GTB IMs.

Problem definition

5.99 The current recoverable costs for costs and impacts resulting from reopener events are inconsistent across electricity and gas. The EDB, GDB and GTB IMs allow for the recovery of a 'catastrophic event allowance',[89] while the EDB IMs also allow for the recovery of a 'reconsideration event allowance'.[90]

5.100 The 'reconsideration event allowance' covers change events, error events and the provision of false or misleading information, while the 'catastrophic event allowance' relates to catastrophic events. This could be simplified by having one allowance, and therefore recoverable cost, for the costs associated with responding to any reopener event.

Background

5.101 As part of the last EDB reset, the Commission introduced a recoverable cost allowing regulated suppliers to recover for expenditure resulting from the provision of false or misleading information, an error event or change event that was incurred from the date of the event until the reconsidered price-quality path took effect. This is done by way of the 'reconsideration event allowance'.

5.102 Currently the GDB and GTB IMs do not include a recoverable cost for any 'reconsideration event allowance'.

5.103 In contrast, both the EDB, GDB and GTB IMs include a recoverable cost allowing regulated suppliers to recover for costs or impacts resulting from a catastrophic event that were incurred before the reconsidered price-quality path took effect. This is done by way of the 'catastrophic event allowance'.

Proposed solution

5.104 We see benefit in incorporating the 'catastrophic event allowance' into the 'reconsideration event allowance' to simplify the EDB IMs and create a clearer link between catastrophic events and reconsideration events – by making a catastrophic event a type or subset of a reconsideration event. We propose to rename this the 'reopener event allowance' to reflect that it covers all reopener events.

5.105 We also propose to bring across the 'reopener event allowance' to the GDB and GTB IMs to:

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[89] *Electricity Distribution Services Input Methodologies Determination 2012*, clause 3.1.3(1)(m); *Gas Distribution Services Input Methodologies Determination 2012*, clause 3.1.3(i); *Gas Transmission Services Input Methodologies Determination 2012*, clause 3.1.3(1)(j).

[90] *Electricity Distribution Services Input Methodologies Determination 2012*, clause 3.1.3(1)(s).

5.105.1 enable GPBs to recover costs resulting from all reopener events, not just catastrophic events; and

5.105.2 create cross-sector consistency between the GDB, GTB and EDB IMs.

Alternatives considered

5.106 We considered maintaining the status quo, but this does not deal with the difference between the EDB, GDB and GTB IMs and risks continuing uncertainty in the regulatory rules and requirements under the Act. In addition, extending the reopener event allowance to the GDB and GTB IMs promotes the Part 4 purpose more effectively than the status quo (as discussed above).

5.107 We also considered removing the allowances entirely, but we see them as a useful tool to have as part of the reopener processes. The reopener event allowance allows for the recovery of expenditure between the time of the event and the point at which a reconsideration of the price-quality path takes effect.

Chapter 6 Whether the DPP reopeners will cover future circumstances

Purpose and structure of this chapter

6.1 This chapter identifies the amendments we are proposing to make to some of the DPP price-quality path reopeners to provide greater ability to address forecasting uncertainty as a result of decarbonisation and resilience requirements and promote investment in energy efficiency and design side management.

6.2 Our draft decisions address the following key issues:

6.2.1 whether DPP reopeners provide adequate coverage for current and future supplier circumstances; and

6.2.2 whether current DPP reopeners provide for a sufficient range of solutions.

6.3 Our draft decisions cover:

6.3.1 Amendments to existing reopener provisions

6.3.1.1 inclusion of opex; and

6.3.1.2 electricity distribution system growth.

6.3.2 Additions to reopener provisions

6.3.2.1 Resilience; and

6.3.2.2 Risk event.

6.3.3 Clarification of coverage

6.3.3.1 GAAP changes.

6.4 We also considered whether amendments needed to be made to the reopeners to cover Government policy changes or legislation affecting others in the supply chain, escalation of costs, contingent projects and categories of expenditure.

Background

6.5 The IMs contain reconsideration provisions, which allow us to 'reopen' the DPP price-quality path. We refer to these as DPP reopeners. The reopeners allow us to respond in a timely way to material changes in the circumstances facing individual suppliers. DPP reopeners involve a lower level of scrutiny than a CPP and may be more appropriate in circumstances that are targeted to address a specific, rather than a general problem. There are currently ten DPP reopener provisions in the EDB, GDB and GTB IMs.

6.6 There are a number of common reopeners which apply across each of these sectors. Many also apply to Transpower. There are also reopeners which are specific to the circumstances of individual sectors, and this is even more the case under the Transpower IPP IMs.[91]

6.7 During the next regulatory period,[92] regulated suppliers are likely to experience greater levels of uncertainty in relation to their future expenditure requirements due to different views on the speed, nature and location of decarbonisation activities, their use and availability of new energy sector technologies (the "energy transition") and increased resilience requirements.

6.8 For example, the Electricity Network Association (**ENA**) submitted that

> The electricity sector is undergoing a once-in-a-century transformation. The pace, scale, and path of the transformation is and will remain uncertain. Government energy policy to support the transformation is in the early stages of development. The most impactful policies are likely to be the phase-out of fossil fuel use including, gas and coal. These scenarios should be covered by uncertainty mechanisms such as re-openers, contingent allowances, or wash-ups.[93.]

6.9 Chorus submitted that

> We support reviewing types/extent of re-openers to address the anticipated greater-than-normal uncertainty and provide greater flexibility – eg, from a transition to a low carbon emissions economy and associated changes in the demand.[94]

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91 Under s 53ZC of the Act we have wide discretion in setting an individual price-quality path like Transpower's IPP, but we must use the IMs that apply to the supply of services to which the individual price-quality path applies. Apart from including most of the common reopeners, the Transpower IPP IMs include specific reopeners that cover large build-ups in the EV account balance, the use of Enhancement and Development projects, and the reopening of the Transpower IPP for the price path impacts of approvals of Major Capex applications and approvals of Listed Project Base Capex applications.

92 The next regulatory period for EDBs and Transpower is due to take effect from 1 April 2025. The next regulatory period for GDBs and GTB is due to take effect on 1 October 2026.

93 Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), response to question C3, p 4.

94 Chorus "Options to address the gap in CPI inflation correction" (11 July 2022), para 30c.

6.10 Regulated suppliers will face different challenges based on their network characteristics (eg, capacity availability) and underlying consumer drivers. They will also be dealing with high levels of supply chain disruption and a global drive for decarbonisation which raises concerns on the deliverability of significantly elevated expenditure.

6.11 Table 6.1 summarises how we are proposing to extend the suite of reopeners to address some of the concerns raised by suppliers. The proposed amendments will better provide for the increasing role of opex-based solutions and mitigate concerns about the potential need for increased resilience expenditure.

Table 6.1 Assessment of reopener coverage

Circumstance	Coverage provided by existing reopener	Draft Decision	Location of further discussion
Inability to select the most appropriate/efficient solution	Partial coverage by Unforeseeable and Foreseeable major capex project and Capacity event reopeners - capex costs only	Extend existing DPP reopeners by inclusion of opex (EDB, and GDB and GTB IMs	Paras 6.12-6.28
General growth	Coverage by Unforeseeable and Foreseeable major capex project reopeners - demand growth	Clarify coverage of existing DPP system growth reopeners in relation to general growth (EDB IMs only)	Paras 6.29-6.60
Security of supply	No coverage provided	Extend existing EDB DPP reopener by including resilience expenditure. Provide a new, separate GDB and GTB resilience expenditure DPP reopener	Paras 6.61-6.73
	Partial coverage Risk event reopener (GDB and GTB DPP only)	Provide new EDB Risk event DPP reopener	Paras 6.74-6.78
Clarification of coverage	Coverage by Change event reopener	Amend Change event reopener by clarifying GAAP and tax assessment process (EDB, GDB, GTB and Transpower IMs for DPP, CPP and IPP)	Paras 6.79-6.88

Amendments to existing reopener provisions

Inclusion of opex

6.12 The current DPP Unforeseeable and Foreseeable major capex project reopeners (EDBs) and the DPP Capacity event reopener (GDBs and GTB) provide for the ability to reconsider a price path if identified capex costs meet the trigger conditions and the threshold. However, unlike other reopeners in the EDB, GDB, GTB and Transpower reopener IMs, opex solutions and costs are not covered by these reopeners, which may lead to a capex bias.

Draft decision

6.13 Our draft decision is to amend the EDB Unforeseeable major capex project and the Foreseeable major capex project reopeners in the EDB IMs, and the Capacity event reopeners in the GDB and GTB IMs by providing for predominantly opex solutions in relation to system growth, and by including opex consequential to the implementation of capex-based solutions, and capex consequential to the implementation of opex-based solutions.[95]

6.14 The Unforeseeable major capex project reopener and the Foreseeable major capex project reopener in the EDB IMs and the Capacity event reopeners in the GDB and GTB IMs will be amended by:

6.14.1 changing the defined term "system growth capex" to "system growth expenditure" to provide for recovery of the costs of a capex capacity investment or an opex solution (eg, through the procurement of flexibility services for EDBs);[96]

6.14.2 extending expenditure to include opex (other than consequential operational and maintenance costs) that is directly associated with the implementation of a capex solution, providing the expenditure would not have been incurred but for that particular project or programme (ie, consequential opex); and

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[95] When an application for consequential opex is made, we expect the regulated supplier to sufficiently demonstrate why the opex increase is required by providing evidence supporting that increase and an explanation covering those consequential opex costs that are one-off costs and those that are ongoing costs.

[96] We are also proposing to amend and expand the innovation allowance (IPA) into the 'innovation and non-traditional solutions allowance' to enable more scope to set a wider range of schemes to provide better incentives for innovation and non-traditional solutions, at DPP resets or when setting a CPP. These allowances are intended to provide funding for trials or relatively small-scale solutions. The scale, application and reporting requirements for these allowances would be detailed in the DPP (not in the IMs). More information on these allowances can be found in Commerce Commission "Part 4 Input methodologies Review 2023 - Draft decision - Financing and incentivising efficient expenditure during the energy transition topic paper" (14 June 2023), s 6b.

6.14.3 extending expenditure to include capex that is directly associated with the implementation of an opex solution, providing it would not have been incurred but for that particular project or programme (ie, consequential capex).

6.15 To better reflect their future scope, the names of the EDB Unforeseeable major capex project and Foreseeable major capex project reopeners in the EDB IMs will be amended by referring to them as the Unforeseeable large project reopener or Foreseeable large project reopener respectively.

Problem definition

6.16 The current DPP Unforeseeable and Foreseeable major capex project reopeners (EDB IMs) and the DPP Capacity event reopener (GDB and GTB IMs) are currently restricted to the recovery of capital expenditure (capex).

Stakeholder views

6.17 Some submitters have stated that such a restriction may mean that regulated suppliers do not make use of the most efficient solutions. Vector, for example, said

> Currently some re-opener provisions are limited to capex only. We consider all reopener provisions should be neutral as to whether opex or capex (or a mixture of the two) is provided to ensure regulated businesses are able to adopt the most efficient solutions.[97]

6.18 Wellington Electricity stated that while reopeners are an effective tool for capturing unforeseen events like unexpected new customer connections, the mechanism needs to be refined:

> The current re-opener excludes opex expenditure. This restriction limits any network solution to traditional wire network designs and excludes using flexibility services that could provide a more efficient option. It also excludes the ability for an EDB to recover any related opex costs like insurance increases.[98.]

6.19 The exclusion of opex from some of the reopeners was also identified as a problem by the Electricity Network Association (ENA):

> The current re-opener provisions exclude the recovery of opex. This is a significant oversight, as highlighted by the recent Unison re-opener decision. Opex must be included in all re-opener mechanisms to remove any potential capex bias and allow greater consideration of opex-based non-network solutions.[99.]

6.20 The ENA also submitted that:

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[97] Vector "Submission on the Process and issues paper" (11 July 2022), p 26.

[98] Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p 28.

[99] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p15.

> Non-network solutions can provide mechanisms to defer capex. Under the current IMs these solutions won't be able to be taken into account as regulated capex or opex. Consideration should be given to whether costs incurred to efficiently defer capex investment should be considered as part of reopener applications, if thresholds are met.[100]

Analysis and proposed solution

6.21 The EDB IMs currently provide for Unforeseeable and Foreseeable major capex projects (in the DPP) where the primary driver of the project or programme is to meet demand for connection capex, system growth capex, asset relocation capex or a combination of connection capex and system growth capex. The GDB and GTB IMs use similar terminology within the Capacity event reopener (in the DPP).

6.22 We consider the IMs should, to the extent possible, minimise capex bias in order to be technology agnostic, and that extending the scope of solutions under the existing reopeners to include alternative opex approaches will encourage regulated suppliers to use the most efficient solutions and promote energy efficiency and demand side management.

6.23 We consider that the system growth definition should be extended to include opex as an allowable alternative to capex. We are not proposing to extend connection capex or asset relocation capex in the same way as it is our understanding that it would not be possible to provide an alternative to establishing a new connection with an opex solution, nor would it be possible to provide an opex solution in response to a request to physically relocate assets.

6.24 EDB submitters have stated a desire to increase the use of flexibility services as an alternative to capex but have reflected that it is not clear how quickly this market will develop or whether the reliability and consistency of the service will meet their expectations and accordingly allow for the deferral of capex.[101] Wellington Electricity, for example identified that the

> Flexibility services are currently immature – they have not been developed to the point that the industry understands how effective they will be at delaying network investment.[102]

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[100] Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), response to question C5, p5.

[101] In the IM amendments we are proposing to introduce the following definition of 'flexibility' to describe flexibility services: "means the ability to modify energy generation injection or consumption patterns (or both)".

[102] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to question D1.

6.25 Submitters have argued that opex associated with a capex solution is often significant. We agree and consider that opex that is incurred in connection with a capex project or programme and would not otherwise be incurred but for that project or programme, ie, "consequential opex", could be considered as part of an Unforeseeable large project, Foreseeable large project or Capacity event reopener application. For example, traffic control costs directly associated with the relocation of assets may be considered to be consequential opex. The on-going maintenance and operating costs of an asset would not be considered.

6.26 We also note that there may be capex costs associated with implementation of an opex solution, such as flexibility services where they have been externally procured. An example is the installation and implementation of IT assets that can automatically communicate with (and respond to) an external flexibility services provider. We therefore consider that capex costs that are consequential to the implementation of an opex solution should also be able to be considered as part of reopener application.

6.27 Providing for predominantly opex solutions in relation to system growth will promote the Part 4 purpose more effectively by providing an incentive for EDBs, GDBs and GTBs to innovate and invest, to improve efficiency and to provide services at a quality that reflects consumer demands.[103] It will also provide incentives for EDBs, GDBs and the GTB to invest in energy efficiency and demand side management consistent with s 54Q of the Act.

6.28 Allowing for the recovery of consequential opex (and the equivalent for capex in respect of an opex solution) will promote the Part 4 purpose more effectively. It will provide a greater incentive for EDBs, GDBs and GTB to invest, including in replacement, upgraded and new assets, which promotes s 52A(1)(a).

Electricity distribution system growth

6.29 EDBs have stated that consumer demand will be uncertain over the next decade and that they will need to respond promptly where investment is required.

6.30 We have seen various forecasts that indicate likely increases in electricity usage, which have consequential impacts on system growth requirements over future periods. However, the ability of demand management services to mitigate the need to significantly expand the size of networks to cater for the potential increase in loads is currently unclear.

[103] Chapter 7 of this topic paper covers our approach to reopener thresholds. The threshold for opex solutions will be calculated based on lifetime solution costs, which are discounted into a net present value equivalent.

Draft decision

6.31 Our draft decision for system growth in relation to general growth is to amend the EDB DPP IMs by:

6.31.1 amending what may be considered as DPP reopener events for system growth expenditure within the proposed Foreseeable large project reopener to provide for reopeners for general growth only where the relevant project or programme was identified within an Asset Management Plan (**AMP**) used in setting the DPP. This was previously allowed within the IM Determination definition, but Reasons Paper positioning indicated no general growth-based reopeners would be appropriate, whether included in the AMP used to set the DPP or not; and

6.31.2 amending the IMs relating to system growth expenditure within the proposed Unforeseeable large project DPP reopener to not allow for applications driven by general growth. This was previously allowed within the IM Determination definition, but Reasons Paper positioning indicated no general growth-based reopeners would be appropriate.

6.32 Our draft decision for system growth reopeners not relating to general growth is that IM amendments are not required as the following are already provided for by the existing IM drafting:

6.32.1 system growth expenditure for specific growth, ie, those projects or programmes which can be clearly attributed to changes in large individual connections for either Foreseeable or Unforeseeable major capex project[104] reopeners; and

6.32.2 expenditure relating to a change in network service requirements as a result of the introduction of new or emerging technologies for either Foreseeable or Unforeseeable major capex project reopeners.[105]

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[104] As identified above we are proposing to amend the names of the Unforeseeable major capex project reopener to Unforeseeable large project reopener and the Foreseeable major capex project reopener to Foreseeable large project reopener.

[105] As identified above we are proposing to amend the names of the Unforeseeable major capex project reopener to Unforeseeable large project reopener and the Foreseeable major capex project reopener to Foreseeable large project reopener.

Problem definition

6.33 System growth capex is one of the subcategories of the current EDB Foreseeable and Unforeseeable major capex project DPP reopeners. System growth capex is relatively broadly defined within the IMs. However, in the 2019 DPP Reasons paper we identified that we did not intend for the reopener mechanism to cover general growth in demand due to decarbonisation, such as the high uptake of electric vehicles.[106]

6.34 EDBs consider that more electrification scenarios need to be provided for in the reopeners. For example, Wellington Electricity stated we should extend the use of re-openers: to unforeseen network investment caused by incremental demand growth, rather than just large new connections.[107]

6.35 Aurora represented that further electrification scenarios need to be provided for in reopeners stating that additional capex will be required to accommodate increased system growth expenditure likely to be driven by:

6.35.1 congestion on low voltage networks, affecting DER [distributed energy resources];

6.35.2 hosting capacity for large distributed generation; and

6.35.3 increased demand on high voltage circuits from industrial process heat conversions.[108]

Application to Gas pipeline businesses

6.36 We consider the issues identified and discussed in further detail for EDBs relating to the application of system growth DPP reopeners are not relevant for the GDB and the GTB IMs and, accordingly, do not require amendment.

6.37 The system growth sub-category reopener is available for GDBs and the GTB under the Capacity event DPP reopener. The definition of system growth capex is not narrowly defined in either the GDB or GTB IMs and the rationale of application of reopeners in the gas context as represented in the May 2022 Gas DPP3 Reasons paper at paragraph 3.81 is still appropriate:[109]

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[106] Commerce Commission “Default price-quality paths for electricity distribution businesses from 1 April 2020 Final decision Reasons paper” (27 November 2019), para 4.37 - 4.39.

[107] Wellington Electricity – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p.27.

[108] Aurora Energy “Submission on Price-quality path workshop” (20 December 2022), para 31.1.

[109] Commerce Commission “Amendments-to-input-methodologies-for-gas-pipeline-businesses-related-to-the-2022-default-price-quality-paths-Reasons-paper(30-May-2022).

In our draft decision we also noted that in investing in their networks for growth purposes, suppliers needed to understand that these investments risked being stranded in future due to the expected fall in demand for piped natural gas. We stated that this risk may mitigate supplier over-investment in growth and incentivise suppliers to seek greater contributions from new connecting parties including for wider network reinforcement. We also expected that, for large new connection and asset relocations capex not covered by capital contributions, suppliers would need to provide us with an undertaking from the third party driving the expenditure, that it was committed to the project in the reopener application.

Analysis and proposed solution

6.38 The current EDB Foreseeable major capex project and Unforeseeable major capex project reopeners provide for projects or programmes that have a primary driver of meeting demand for system growth capex, which is defined as:

> **capex** other than **connection capex**, where the **primary driver** for the **capex** is either a requirement for additional capacity at a particular location or a change in the requirement for **electricity distribution service**s as a result of the introduction of new or emerging technologies. It includes **capex** associated with network protection, control, automation, and telecommunications assets and also includes capex incurred in the acquisition of **networks** from other providers of **electricity lines services**.[110]

6.39 We note the definition provides for (a) capacity growth; and (b) capex associated with investment required on the network to provide for new technologies, eg, investment to allow two-way flows for DER.

6.40 We have revised the IM determination to identify the instances of general growth within system growth which we consider will not be appropriate for consideration as a DPP reopener. Our positioning is broadly consistent with that provided in the Reasons paper for amending the IMs alongside DPP3.[111] However, we have amended the draft amendments determination to reflect this positioning, rather than include these in this topic paper.

6.41 We consider desirable objectives in consideration of the application of the system growth reopener subcategory are to:

6.41.1 encourage good planning;[112]

6.41.2 provide reopeners for situations where the planning was appropriate but the timing (ie, need in the current period) is uncertain; and

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[110] *Electricity distribution services input methodologies determination 2012* (consolidated 20 May 2020), clause 1.1.4.1(2).

[111] Commerce Commission "Amendments to Electricity Distribution Services Input Methodologies Determination Reasons paper" (26 November 2019), para 3.111 - 3.124.

[112] We note there is a difference between good planning and accurate forecasting, where despite good planning accurate forecasting may be difficult due to potential variability of underlying drivers outside of an organisation's control.

6.41.3 clearly identify where characteristics better align with a CPP, or do not meet reopener requirements.

System growth related to capacity requirements

6.42 We consider that specific growth, ie, those projects or programmes that can be clearly attributed to changes in large individual connections are more likely to be viewed as appropriate for both Foreseeable and Unforeseeable system growth DPP reopeners. We have separately assessed the introduction of a large connection contract mechanism for EDBs in Chapter 8.

6.43 We recognise that large industrial connection requirements can arise quickly on a network and are accordingly more difficult to forecast. In these instances, there is a clear independent external driver, and it is likely that the customer could be allocated the charges related to the additional expenditure.

6.44 We consider that forecasted growth which relates to general growth in demand across a number of customers may be appropriate as a Foreseeable system growth reopener, if the projects or programmes were forecast by the EDB (ie, included in its AMP) prior to the DPP being set but were not provided for within the DPP.

6.45 We also note that some EDB system growth projects are closely related to the actions of Transpower, which can create external uncertainty for an EDB. For example, if it was established that a new grid exit point that was planned to be completed by Transpower and that this resulted in the EDB incurring system growth capex in its own network, then we would likely consider allowing for this expenditure under a reopener for the EDB if it is in the long-term interests of consumers (and all reopener criteria are met).

6.46 Changes to the definition and application of system growth expenditure will allow for system growth DPP reopeners to provide for the purchase of flexibility services. We consider this market is likely to develop over the next regulatory period but recognise there is currently limited certainty as to its potential role as the services continue to evolve.

6.47 We have removed the ability for an EDB to apply for a reopener for a system growth project relating to growth that had not been forecast by the EDB before the DPP was set but arises due to general growth in demand. The reopener provisions are asymmetric in nature, actual demand can be greater or less than expected but an EDB would not request a reopener due to lower than expected demand making a planned system growth project no longer necessary.

6.48 We note the forecast considered covers the full 10-year AMP period and is not restricted to only projects or programmes forecast to be delivered within the upcoming DPP regulatory period.

6.49 The EDB DPP reopener IMs currently include the distinction between projects sufficiently included within an AMP within the definition of the “Foreseeable major capex project” and those that are not, which may be covered by the Unforeseeable capex project reopener. For the Foreseeable major capex project reopener the projects or programmes need to be included within the EDB’s forecast used for setting the DPP. This includes forecasts relating to the current DPP regulatory period or a future DPP regulatory period.

6.50 Consideration of a future DPP regulatory period allows for an appropriate response where projects which were previously forecast for beyond the current regulatory period are required to be brought forward due to changes in demand.

Change in network requirements as a result of new or emerging technologies

6.51 There is no restriction within the IM Determination regarding applications for reopeners relating to a change in requirements for electricity distribution services as a result of the introduction of new or emerging technologies, under either the Foreseeable major capex project or Unforeseeable major capex project reopener.

6.52 However, we note that consideration of reopeners relating to new and emerging technologies is likely to be more challenging for the EDB to evidence and the Commission to assess.

6.53 A CPP may be more appropriate than a DPP reopener where the impact of new technologies on the network and the associated expenditure requirement is significant, particularly where it is unique to that network. In that instance it may be difficult to assess this on a-project or programme basis and maintain consistency with the expectation of a low-cost DPP.

6.54 In consideration of applications for reopeners based on emerging technology-projects that were not forecast, consideration will need to be given as to the certainty of expenditure requirements, particularly where these reflect services of a more anticipatory nature. We note the innovation and non-traditional solutions allowance may be more appropriate in some instances.

Implementation within the DPP IMs

6.55 We have introduced a requirement within the trigger stage for the proposed Foreseeable large projects that reflects the requirement that general growth driven projects are appropriately evidenced in the AMPs.

6.56 This requires where the project or programme has a primary driver of meeting demand for system growth capex due to general growth that:[113]

[113] Where general growth reflects incremental changes in demand across a number of ICPs.

6.56.1 sufficient information clearly identifying and outlining the project or programme was contained within the AMP; and

6.56.2 sufficient information clearly justifying the requirement for the project or programme was contained within the AMP.

6.57 For clarity, we propose to specifically exclude general growth from system growth expenditure in the proposed EDB Unforeseeable large project DPP reopener.

Summary

6.58 The system growth reopener is intended to allow EDBs to connect and manage significant new demand; including where it arises from demand for low carbon technologies as New Zealand increases its focus on decarbonisation, while maintaining network reliability and meeting the long-term interests of consumers.

6.59 We consider that improving the clarity about what is covered by a system growth reopener should promote s 52R of the Act more effectively by promoting certainty for suppliers in relation to the rules, requirements, and processes applying to the regulation (ie, the proposed EDB Unforeseeable and the Foreseeable large projects DPP reopeners in the EDB IMs), without detrimentally affecting the promotion of the s 52A purpose.

6.60 Increasing the capacity of connections and providing new or emerging technologies could improve the quality of service to consumers and that should be encouraged. This promotes the Part 4 purpose in s 52A(1)(a) and (b) of the Act more effectively by incentivising suppliers to innovate and to invest in replacement, upgraded and new assets, and to improve efficiency and provide services at a quality that reflects consumer demands.

Additions to the reopener provisions

Resilience expenditure

6.61 The current Part 4 price-quality path DPP reopeners cover the occurrence of specific events (for example, a Catastrophic event or Change event), false or misleading information, quality standard variations, or are growth focussed. They do not cover resilience-related expenditure which may be needed to maintain reliability and security of supply.

Draft decision

6.62 Our draft decision is to:

6.62.1 amend the EDB IMs to extend the drivers in the proposed EDB Foreseeable and Unforeseeable large project DPP reopeners to include targeted resilience-related expenditure; and

6.62.2 amend the GDB and GTB DPP IMs by including a new (separate) reopener for expenditure relating to targeted resilience and asset relocation, and include within the expenditure for targeted resilience and asset relocation, opex that is directly associated with the implementation of a capex solution provided it would not have been incurred but for that particular project or programme preceding it.

Problem definition

6.63 Pre-emptive expenditure in relation to natural disaster readiness, climate change adaptation or cyber security preparedness is not covered by the current DPP reopeners. Such expenditure may reduce the effect of such events by maintaining reliability and security of supply.

Stakeholder views

6.64 Submitters advised that while increased costs associated with resilience expenditure are not unexpected, their magnitude and when such expenditure will be required may be unknown. Submitters also stated that there is no ability for suppliers to apply for a DPP reopener for a step change in resilience expenditure related to, for example, cyber security preparedness.

6.65 The ENA, for example, submitted that:

> The need for expenditure by EDBs on cybersecurity, digitalisation and data is foreseeable, but the scale and timing of this expenditure is unknown. These costs are not entirely controllable by EDBs due to the discovery nature of some of these projects. [114.]

6.66 The ENA also submitted that

> Resilience expenditure is an area that is not adequately covered by the IM re-openers. Provision for re-opening projects with a resilience driver should be made. [115]

6.67 Aurora submitted that increased expenditure on disaster readiness is likely to be foreseeable, but the expenditure growth may be greater than other opex growth, and therefore the Commission’s ‘step and trend’ forecasting processes need to be responsive to this. In relation to cybersecurity costs, Aurora submitted that while under most circumstances these costs should be foreseeable, it is a fast-moving arena where new threats can emerge at short notice, and can be expensive to counter. The relatively short timeline over which new threats may emerge makes cybersecurity a reasonable candidate for a new reopener category.[116]

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[114] Electricity Networks Association (ENA) “Submission on Price-quality path workshop” (20 December 2022), response to question c4, p 4.

[115] Electricity Networks Association (ENA) “Submission on Price-quality path workshop” (20 December 2022), response to question D4, p 6.

[116] Aurora Energy “Submission on Price-quality path workshop” (20 December 2022), para 30.

6.68 ENA submitted that for individual EDBs and clusters of EDBs, the gas phase-out and process heat conversions will be critical. Consideration of encompassing projects with a resilience driver should be made.[117]

6.69 In relation to electrification scenarios that need to be accounted for by reopeners, Vector identified climate change in terms of net zero expenditure and adaptation of resilience.[118]

6.70 Vector[119] and Wellington Electricity[120] however submitted that resilience related investment programmes are not always foreseeable. Wellington Electricity identified that unforeseen investments could be driven from

> local government sea level adaption programmes (sea level rise rezoning decisions) that also require electrical assets to be shifted [and] Wider earthquake resilience programmes that also capture electrical assets. An example of this type of unexpected investment was Wellington Lifeline Group earthquake readiness programme which drove WELL's single issue CPP.

Analysis and proposed solution

6.71 In general, most resilience type expenditure should occur as part of a regulated supplier's ordinary asset replacement and renewal programme of work. Accordingly, the proposed driver is designed to cover a step change in proactive capex beyond the intended programme (at an EDB, GDB and GTB DPP reset) of asset replacement. It does not include asset replacement and renewal capex that is consistent with appropriate lifecycle and asset management planning, or expenditure for cybersecurity.

6.72 Resilience expenditure will be limited to a capex project or programme and any opex that is directly associated with the implementation of a capex solution, providing the expenditure would not have been incurred but for that particular project or programme.

6.73 Extending the DPP reopeners for EDBs, and the inclusion of a new separate DPP reopener for GDBs and the GTB, to provide for resilience expenditure and asset relocation will better promote the Part 4 purpose in s 52A of the Act, as it will provide incentives for innovation and investment and provide services at a quality that reflects consumer demand, promoting the long-term benefit of consumers.

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[117] Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), response to questions C2 and D4.

[118] Vector "Submission on Price-quality path workshop" (20 December 2022), response to question C2, p 5.

[119] Vector "Submission on Price-quality path workshop" (20 December 2022),response to question C1, p 4.

[120] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to question C1, p 4.

Risk events

6.74 The GDB and GTB IMs include a risk event DPP reopener covering the deterioration of one or more assets or immediate surrounds, which would have a materially adverse effect on the GDB's or GTB's ability to meet its quality standards, and/or compromise safety for any person, equipment or the network. Although EDBs may be exposed to similar risks, there is not the equivalent DPP reopener in the EDB IMs.

Draft decision

6.75 Our draft decision is to amend the EDB IMs to include a Risk event DPP reopener for expenditure relating to the deterioration of one or more of an EDB's network assets or their immediate surrounds, if this would have a materially adverse effect on the EDB's ability to meet its quality standards, and/or compromise safety for any person, equipment or the network.

Problem definition

6.76 The EDB IMs do not have a DPP reopener which covers risk management expenditure. The absence of a DPP reopener covering asset replacement and renewal expenditure to address significant safety or quality issues could result in EDBs delaying such expenditure, which may be detrimental to consumers.

Analysis and proposed solution

6.77 The addition of a Risk event DPP reopener in the EDB IMs will more effectively promote the Part 4 purpose by providing better incentives for suppliers to invest and provide services at a quality that reflects consumer demands.

6.78 The Risk event DPP reopener will enable necessary asset replacement and renewal to occur: (i) minimising the exposure of consumers to potentially longer and more frequent power outages that could result from deferred or delayed investment and (ii) minimising the exposure of consumers, EDB staff and contractors to a safety incident as a result of degraded assets.

Clarification of reopener coverage

GAAP changes

6.79 Generally accepted accounting practices (GAAP) changes are outside of the control of a regulated supplier. The Fibre IMs include a GAAP change reopener. However, the EDB, GDB and GTB, and Transpower IMs do not currently include such a price-quality path reopener in their DPP, CPP or IPP.

Draft decision

6.80 Our draft decision is to change how the impact of GAAP changes are assessed in the Change event reopener in the EDB, GDB and GTB, and DPP, CPP, and Transpower IPP reopener IMs to remove the potential for windfall gains and losses.

Problem definition

6.81 Having a separate GAAP reopener in the Fibre IMs but not specifically identifying GAAP changes in the EDB, and GDB and GTB, and Transpower IMs may give the impression that GAAP changes are not covered by the DPP, CPP or IPP reopener provisions in the EDB, GDB and GTB, and Transpower IMs. Both Vector and the ENA, for example, identified that the costs associated with a GAAP change are beyond the control of a regulated supplier and as such should be included the IMs.

Stakeholder views

6.82 ENA and Vector submitted that the costs that are outside the control of an EDB as a result of GAAP changes could be subject to a washup mechanism. Vector noted in its submission that:

> the Fibre IM contains a re-opener for GAAP changes although this is subject to a 1% threshold. In the context of EDBs and IRIS, we do not consider a threshold appropriate. Lower value cost changes could still result in perverse outcomes under IRIS.[121]

Analysis and proposed solution

6.83 GAAP is a defined term in the Financial Reporting Act 2013. A GAAP change that applies to regulated supplier in the way specified by clause 4.5.2 may be covered by the existing Change event reopener. As a GAAP change may be covered by the Change event reopener, we do not think that there is a need for a separate GAAP change DPP, CPP or IPP reopener in the EDB, GDB and GTB, and Transpower IMs.

6.84 However, we do consider that it would be beneficial if the Change event DPP, CPP or IPP reopener was amended to better reflect the potential impacts of a GAAP change as a Change event. We consider that a GAAP change may not necessitate a regulated supplier incurring a significant increase in costs, but changes may allow material changes in recognition criteria which could potentially result in windfall gains or losses.

6.85 GAAP and taxation changes can materially change the revenue-path which a supplier would be entitled to, or the impacts of IRIS, without significantly changing the costs incurred by the regulated supplier.

[121] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 30.

6.86 As GAAP changes can be applied by a regulated supplier before they are a mandatory requirement, we propose that the impact of GAAP changes on a supplier's revenue will be calculated from the time the GAAP changes are given effect to by the business. Without this caveat, early adopters could potentially benefit from windfall gains.

6.87 We propose that the Change event DPP, CPP or IPP reopeners in the EDB, GDB, GTB, and Transpower IMs be amended to include a subclause similar to clause 3.9.5 in the Fibre IMs and that a GAAP change is defined as a change event that amounts to a change in the recognition or measurement (including timing) of: operating expenditure, capital expenditure, assets, liabilities, forecast net allowable revenue. actual net allowable revenue; and taxation, including deferred tax.

6.88 Clarifying and changing the approach to assessing the impact of GAAP changes will better promote the Part 4 purpose under s 52A of the Commerce Act. One impact is that it will limit ability of regulated suppliers to extract excessive profits. The proposed approach will also promote the s 52R IM purpose more effectively (without detrimentally affecting the promotion of the s 52A purpose) by providing greater certainty for regulated suppliers and consumers in relation to the impact of GAAP changes.

Government policy changes, Local Government rule changes or legislation affecting others in the supply chain

Draft Decision

6.89 Our draft decision is not to amend the EDB, GDB and GTB IMs to include DPP reopeners to cover Government policy changes, Local Government rule changes or legislation affecting others in the supply chain, unless otherwise covered by the Change event reopener.

6.90 Submitters[122] have represented that Government policy changes, Local Government rule changes and legislation affecting parties in the supply chain other than a regulated supplier can affect the cost of supplying a regulated service.

[122] Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), response to question C3; Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022), response to question C4, p 5; Unison "Submission on Price-quality path workshop" (20 December 2022) response to question c2, p 4; Vector "Submission on Price-quality path workshop" (20 December 2022) response to question C1, p 4; Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to questions C1, C3 and C4; Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 30.6; First Gas Limited "Submission on IM Review Process and issues paper and draft Framework paper" (13 July 2022, p 4, para 3.1.1, p 11, para 3.1.4, p 11-12; Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 19.2, p 5.

Government policy changes

6.91 The Change event DPP reopener covers a change in, or a new, legislative, or regulatory requirement that necessitates a regulated supplier incurring additional reasonable costs. Some submitters proposed that the scope of this DPP reopener should be broadened to include government policy relating to climate change, as such announcements can impact on regulated suppliers' behaviour, before or even without regulatory change occurring.

6.92 With respect to Climate change policy covered by the Climate Change Response Act 2002 (**CCRA**), the Commission is expressly allowed to take into account "the 2050 target", "an emissions budget" and "an emissions reduction plan" under s 5ZN of the CCRA. The extent to which these provisions can be taken into account has already been considered by the Commission. As outlined in the Part 4 IM Review 2023 Framework paper, the Commission can only take s 5ZN of the CCRA into account to the extent that doing so promotes the purpose of Part 4 of the Commerce Act (s 52A refers) more effectively.

6.93 Future gas policy such as the Gas Transition Plan, the Emissions Reduction Plan and the Aotearoa NZ Energy Strategy, may affect the future of reticulated gas. However, until the policies are announced we are not able to assess their impact, and we do not consider that the prospect of those policies justifies an expansion to the suite of the reopeners. The regulatory period for GDB and GTB was set at four years as part of DPP3 to enable us to review price-quality path settings at the earliest opportunity, ie, at the GDB and GTB DPP4 reset, after further Government gas policies are scheduled to be announced.

6.94 We do not consider that the scope of the Change event DPP reopener should be amended to include Government policy more generally. We consider costs arising in response to Government policy are more appropriately managed within reprioritisation of existing expenditure allowances, as suppliers are able to make decisions on whether to respond or not. Providing for a DPP reopener covering Government policy changes would not promote the Part 4 purpose in s 52A more effectively as it would reduce the incentives for regulated suppliers to improve efficiency for the long-term benefit of consumers.

Local Government rule changes

6.95 Some submitters thought that the scope of the Change event DPP reopener should be amended to cover Local Government rules such as land use zone changes and amended traffic management requirements.

6.96 Local Government rules that are legislative or regulatory requirements and relate to the supply of a regulated service are already covered by the Change event DPP reopener (provided that reopener's other requirements are met). Depending on the particular circumstance, changed (or new) local government regulatory requirements relating to the supply of other (unregulated) services may also be covered by this DPP reopener provided that, among other things, it also necessitates a change in the supply of electricity lines services (or gas distribution or gas transmission services).

Legislation affecting others in the supply chain

6.97 Legislation affecting others in the supply chain but which does not have a direct impact on the regulated service provided by the regulated supplier is not covered by the Change event DPP reopener.

6.98 Considering the impact of legislation affecting others in the supply chain would be complex, as regulated suppliers may use different models for delivering services, ranging from entirely in-house to nearly entirely outsourced. It would be hard to determine for a regulated supplier whether the increase in costs from its provider is due to the change in legislative or regulatory requirements, or a cost increase has been simply attributed to it.

6.99 Providing for a DPP reopener that covers legislation affecting others in the supply chain would not promote the Part 4 purpose in s 52A of the Act more effectively as it may reduce the incentives for regulated suppliers to improve efficiency for the long-term benefit of consumers. Such a reopener would also not promote the s 52R purpose of the IMs more effectively, as it may reduce certainty for suppliers and consumers in relation to the rules, requirements and processes.

General reopener/General escalating costs

Draft Decision

6.100 Our draft decision is not to amend the EDB, GDB and GTB IMs to include a general DPP reopener or a general escalating costs price-quality path DPP reopener, including those costs driven by supply chain delays.

6.101 Submitters have identified that they consider they will be faced with a wide range of escalating costs during the next regulatory period which will be difficult to forecast. [123]

[123] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Vector "Submission on the Process and issues paper" (11 July 2022); Wellington Electricity –

6.102 We recognise suppliers may face challenges with escalating costs, as has recently occurred. We note the difference between inflation, which we consider is compensated for within the DPP regime, and costs which are increasing beyond the rate of inflation.[124]

6.103 We consider that suppliers' expenses, particularly those of EDBs, may rise quicker than inflation. The global growth of decarbonisation strategies, for example, is likely to increase the cost of key network infrastructure components and drive higher competition for skilled labour.

6.104 A general DPP reopener provision has the potential to address the concern that there may be significant increases in expenditure during the regulatory period, which is unanticipated and not able to be covered by one of our existing DPP reopeners. A general DPP reopener provision could give the Commission discretion to reopen the price path for unanticipated circumstances not covered by existing DPP reopeners.

6.105 However, neither a general DPP reopener nor a broad general escalating costs provision would provide suppliers with any certainty about the types of categories of expenditure which we may consider appropriate for a DPP reopener. Such a provision may also disincentivise suppliers from reprioritising and managing their costs.

6.106 We consider the lack of specificity about what may be covered by a general DPP reopener or a general escalating costs DPP reopener would not promote the IM purpose in s 52R of the Act more effectively as it would not provide certainty for suppliers and consumers in relation to the rules, requirements, and processes (without detrimentally affecting the promotion of the s 52A purpose) and may be inconsistent with s 52T because of the lack of detail.

Contingent project reopener

6.107 Further reopeners could be provided where project or programme allowances are provided contingent on certain events occurring. This may allow the regime to respond to increasing levels of uncertainty appropriately and in a timely way.

"Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022); Horizon Energy Group “Submission on Price-quality path workshop” (20 December 2022); Orion “Submission on Price-quality path workshop” (20 December 2022); Powerco “Submission on Price-quality path workshop” (20 December 2022); Vector “Submission on Price-quality path workshop” (20 December 2022).

[124] Commerce Commission “Part 4 Input methodologies Review 2023 - Draft decision - Financing and incentivising efficient expenditure during the energy transition topic paper" (14 June 2023), Chapter 5 covers our review of the IMs that relate to the method for forecasting inflation, and to exposure to inflation risk and associated compensation.

Draft decision

6.108 Our draft decision is not to amend the EDB, GDB and GTB IMs to include a new DPP contingent project reopener.

Problem definition

6.109 At a DPP reset suppliers may be able to identify, in their AMPs, projects that need to be undertaken during the regulatory period but because the timing and costs are uncertain the projects are not provided for within the DPP.

6.110 It also may not be clear to suppliers which projects or programmes are either explicitly or implicitly included within the DPP. This may mean suppliers do not know which projects or programmes may be appropriate to apply for as a reopener. This may be a particular issue for those projects that are foreseeable and were forecasted within an AMP.

Analysis and proposed solution

6.111 Some submitters have raised concerns, about the uncertainties associated with reopener coverage. For example, First Gas submitted:[125]

> The Commission notes issues related to reopener mechanisms including: ambiguity in the evidential requirements for certain trigger events; and uncertainty about reconsiderations and the framework it applies when assessing whether to amend a price-quality determination. The current uncertainty means:
>
> We may expend management effort on considering whether or not to seek a reopener – the need to incur such costs is likely to be inefficient and could be avoided with greater clarity.

6.112 We considered whether particular projects which may be readily identifiable as being required, but which were dependent on an external trigger occurring during the regulatory period, could be identified as being a contingent project in a DPP Determination.

6.113 A contingent project reopener already exists in the EDB, GDB and GTB CPP IMs and we have used that for reference as to how a contingent project mechanism might work in a DPP context.

6.114 Specific identification of a contingent project within a DPP Determination could provide a clearer and more streamlined process allowing a supplier to access additional funding where an external trigger has been met indicating additional expenditure is required.

[125] First Gas Limited "Submission on IM Review Process and issues paper and draft Framework paper" (13 July 2022), s 4.4.2, p 21.

6.115 A contingent projects reopener would be subject to the same process steps as the other reopeners, but the application and assessment processes may be more straight forward as it should be clearer that:

6.115.1 a reopener event has occurred, given the trigger which drives the contingent project would be verifiable and stated within the DPP Determination; and

6.115.2 the relevant price-quality determination did not provide, either explicitly or implicitly, for the contingent project.

6.116 If the quantum of a project was able to be established with sufficient confidence and limited additional effort at the time of DPP reset, a quantum could also be included within the DPP Determination, removing the requirement for this to be assessed at the time of consideration of the reopener. In addition, other considerations within the reopener criteria that we think existing documentation may have already addressed, may be identified within the DPP Determination on the same basis, expectations of reprioritisation etc.

6.117 We note, a contingent project mechanism would not be able to be used for significant step changes in expenditure requirements or for projects which require significant scrutiny and necessitate more information, consumer consultation and verification requirements as required under a CPP. Further information regarding the types of projects or programmes which are better suited to a CPP application is outlined in Chapter 5.

6.118 While there are those potential benefits to a contingent project reopener mechanism, we consider this would be difficult to operationalise in a DPP context, given the lower level of scrutiny which is provided compared to proposed expenditure under a CPP.

6.119 The potential application of this mechanism may also be limited. Particularly, if the base expenditure for all suppliers and for all types of expenditure is not able to be thoroughly scrutinised at a DPP reset. Therefore, we may not know the extent to which the incremental expenditure is already accommodated in the DPP.

6.120 The potential application of the mechanism would also be limited to readily identifiable projects given creating an exhaustive listing of all possible contingent projects would not be consistent with a relatively low-cost DPP.

6.121 In addition to potential complexity and costs the reopener would not provide additional coverage as the types of projects which could be covered by a contingent project mechanism are already covered by the current Foreseeable major capex project reopener for EDB IMs and Capacity event reopeners for GDB and GTB IMs.

6.122 Given these factors, we are not proposing to implement a contingent project reopener within the DPP IMs for EDBs, GDBs and GTBs, as it would not promote the Part 4 purpose in s 52A more effectively than the suite of reopeners that is being proposed. The contingent project reopener would also not be consistent with the relatively low-cost purpose of DPP regulation, as specified in s 53K of the Act, given the complexity and cost that would be involved.

6.123 We note there is a distinction between a contingent project reopener and contingent allowances, which have been requested by some stakeholders. We have separately assessed the potential introduction of contingent expenditure allowances, which are a recoverable cost rather than as a reopener, in Chapter 8.

Categories of expenditure

6.124 The price-quality path reopener IMs currently cover specific events or are focussed on expenditure on the network, rather than non-network expenditure. As outlined in Table 6.2 below, submitters raised that the DPP reopeners should be amended to cover other wider particular material changes in cost structures.

Draft decision

6.125 Our draft decision is not to amend the price-quality path DPP reopener IMs to specifically address changes in the following specific categories of costs:

6.125.1 digitalisation and data;

6.125.2 monitoring of Low Voltage (**LV**) networks;

6.125.3 changes to a system operator’s approach to security;

6.125.4 software as a service (**SaaS**);

6.125.5 avoided cost of distribution payments (**ACOD**);

6.125.6 increased insurance premiums; and

6.125.7 Distribution System Operation (**DSO**) type services.

Analysis and proposed solution

6.126 The particular categories of costs proposed by suppliers reflect those which they consider are likely to have greater levels of volatility during upcoming regulatory periods.

6.127 Whilst we recognise there may be a level of uncertainty, regulated suppliers will forecast each of these cost elements and include these forecasts in their AMPs for the purposes of the DPP resets. Forecasted variations in forecast expenditure requirements will then be considered as part of the DPP reset process.

6.128 Unlike other DPP reopeners, these requests appear to be based on uncertainty regarding the ability to accurately forecast costs in the short-term rather than an on-going requirement.

6.129 If there is variability in these costs during the regulatory period, then the variation in costs (and not the total costs themselves) may be able to be addressed by reprioritisation of expenditure.

6.130 Providing for DPP reopeners for specific categories of costs would not promote the Part 4 purpose in s 52A of the Act more effectively, as it may reduce incentives to improve efficiency for the long-term benefit of consumers.

Table 6.2 Response to submissions on specific material changes in cost structure

Cost structure issue	Draft Decision	Reasoning
Digitalisation and data[126]	Not to amend the EDB, GDB or GTB IMs to include digitalisation and data reopeners.	Some of these costs will be outside of the control of suppliers, but a significant proportion will be driven by supplier choices, including network strategy and the use of outsourcing compared to internal delivery of services. Further specificity on the expected scope and identification of digitalisation and other costs which are outside of the control of the supplier and subject to increased volatility would be useful for any further consideration of whether they will be appropriately addressed within the scope of the DPP reopeners.

[126] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to question C4; Vector "Submission on Price-quality path workshop" (20 December 2022), response to question C4, p 6; Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022), response to question C4; Powerco "Submission on Price-quality path workshop" (20 December 2022), response to question C4, p 5 (ENA and Powerco refer to digitisation and data).

Cost structure issue	Draft Decision	Reasoning
Monitoring of LV network[127]	Not to amend the EDB IMs to include reopeners to cover LV monitoring	A step change in costs may be incurred, but it is not clear that on-going volatility is likely to be an issue or whether funding at a DPP reset could be sufficient.
System operator's approach to security[128]	Not to amend the EDB IMs to include reopeners to cover a system operator's approach to security.	Depending on the mechanism used to provide system security at the request of the system operator, this may be a regulatory change under the "Change event" DPP reopener.
Software as a service (SaaS)[129]	Not to amend the EDB, GDB or GTB IMs to include reopeners to cover SaaS.	Increased move to SaaS will increase opex costs, but this should be offset in part by reduction in capex in the longer term. We consider this is able to be forecast and can be considered as part of a DPP reset process.
Avoided Cost of Distribution (ACOD)[130]	Not to amend the EDB IMs to include reopeners to cover ACOD payments	These payments should be reflected and well documented in the AMPs, and accordingly considered as part of the DPP reset process
Increases in insurance premiums[131]	Not to amend the EDB, GDB or GTB IMs to include reopeners to cover increases in insurance premiums	These costs should be reflected in the Report on forecast operational expenditure[132] and considered as part of the DPP reset process.

[127] Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022), response to question C4, p 6; Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to question C4.

[128] Vector "Submission on Price-quality path workshop" (20 December 2022), response to question C3, p 6.

[129] Vector "Submission on Price-quality path workshop" (20 December 2022), response to question C5, p 7.

[130] Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022), response to question C5, p 6.

[131] Wellington Electricity "Submission on Price-quality path workshop" (21 December 2022), response to question C4.

[132] *Electricity Distribution Information Disclosure Determination 2012,* schedule 11b.

Cost structure issue	Draft Decision	Reasoning
DSO type services[133]	Not to amend the EDB IMs to include reopeners to include the costs of preparing for DSO type services	Unable to determine the scale of the costs and whether the costs are forecastable or controllable and whether these relate to the regulated service under s 54C(1) of the Act.

Other solutions considered

6.131 There may be certain categories of expenditure where suppliers are less likely to be able to provide robust justification to support a step change to expenditure as part of a DPP reset, but where material cost increases may occur during a DPP regulatory period.

6.132 Extending the scope of DPP reopeners to cover more costs could recognise the difficulty in forecasting certain specified classes of costs.

6.133 Specific material changes in costs are likely to be clearest at the time of setting a DPP. We therefore considered whether it was possible to provide for categories of expenditure within the current Foreseeable major capex project reopener (EDBs) and Capacity event reopener (GDBs and GTB), with the specific categories defined within a DPP Determination.

6.134 A general categories of expenditure reopener, however, would not be consistent with the requirement in s 52T(1)(c)(ii) of the Act that the IMs identify the circumstances in which price-quality paths may be reconsidered. It would not promote the IM purpose in s 52R more effectively, as it may reduce certainty for suppliers and consumers in relation to the rules, requirements and processes under Part 4.

[133] Vector "Submission on the Process and issues paper" (11 July 2022), para 142, p 36.

Chapter 7 Reviewing our approach to reopener thresholds

Purpose and structure of this chapter

7.1 This chapter sets out the reasons for draft decisions we have made regarding our approach to thresholds for EDB, GDB, GTB and Transpower reopeners.

7.2 The draft decisions we have made address these issues:

7.2.1 whether the current lower reopener thresholds are appropriate;

7.2.2 whether the lower reopener thresholds should be applied cumulatively;

7.2.3 whether the current upper reopener thresholds that apply are appropriate; and

7.2.4 how thresholds should apply for any new reopeners or reopeners with increased scope.

Reopener thresholds

7.3 We have a set of materiality thresholds in the reopener provisions that establish where it would, or would not, be appropriate to consider an amendment to the price-quality path.

7.4 Reopeners have a minimum/lower threshold because suppliers should be able to manage relatively small changes in expenditure requirements within the price path set for them. We have set the levels of the lower thresholds to ensure that the benefits of the reopeners outweigh the administrative and compliance costs associated with suppliers making reopener applications and us assessing those applications.

7.5 Upper thresholds exist for certain reopeners for EDBs, GDBs and GTBs because it was our view that larger projects and programmes, that are out of step with historic expenditure or forecasts, require a level of scrutiny that is not consistent with DPPs, so a CPP would be more appropriate than a DPP reopener.

Lower Materiality Thresholds

7.6 In our 2023 IM Review Process and issues paper we said we would review our existing policy on the use of reopener lower materiality thresholds and consider how that policy would apply to any new reopeners.

7.7 For lower materiality thresholds, we have assessed:

7.7.1 whether the test which applies for the calculation of the materiality threshold is appropriate;

7.7.2 the appropriateness of the lower thresholds for the different reopeners; and

7.7.3 whether the lower thresholds should be applied cumulatively.

Draft decision

7.8 Our draft decisions on the lower materiality thresholds for EDBs, GDBs, GTBs and Transpower are to:

7.8.1 change the basis for establishing the threshold for the Catastrophic event reopener from an 'impact on revenue' test, to an 'incurred cost' test:

7.8.1.1 For EDBs this will be that the total cost incurred in responding to the reopener event exceeds the lower of 1% of Forecast Net Allowable Revenue (**FNAR**) for the regulatory period, or $5 million for Vector Limited and Powerco Limited, or $2.5 million for all other EDBs;

7.8.1.2 For GDBs and the GTB this will be that the total cost incurred in responding to the reopener event exceeds $100,000 for GasNet Limited or $2 million for all other GDBs and the GTB; and

7.8.1.3 For Transpower this will be that the total cost incurred in responding to the event exceeds $5 million.

7.8.2 change the basis for establishing the threshold for the Change event reopener, not relating to Generally Accepted Accounting Practice (**GAAP**) changes, from an 'impact on revenue' test, to an 'incurred cost' test:

7.8.2.1 For EDBs this will be that the total cost incurred in responding to the event exceeds the lower of 1% of FNAR for the regulatory period, or $5 million for Vector Limited and Powerco Limited, or $2.5 million for all other EDBs;

7.8.2.2 For GDBs and the GTB this will be that the total cost incurred in responding to the event exceeds $100,000 for GasNet Limited or $2 million for all other GDBs and the GTB; and.

7.8.2.3 For Transpower this will be that the total cost incurred in responding to the event exceeds $5 million.

7.8.3 maintain the 'impact on revenue' test for the Error event materiality threshold, but change the threshold to be $100,000 for errors related to the price path for all entities;

7.8.4 retain the '1% of FNAR revenue' threshold, applied on a 'cost incurred' test, for the EDB Foreseeable and Unforeseeable large project reopeners, but raise the existing dollar thresholds that could apply to $5 million for Vector Limited and Powerco Limited, or $2.5 million for all other EDBs; and

7.8.5 retain the existing materiality thresholds which apply to the Capacity event and Risk event reopeners for GPBs.

7.9 Our draft decisions are not to implement:

7.9.1 a reduced threshold for 'high consumer benefit' projects; and

7.9.2 a change in requirements to specifically allow for the cumulative application of any of the lower thresholds.

Summary of changes to lower materiality thresholds

7.10 Table 7.1 provides a summary of the changes to the lower thresholds for the previous suite of reopeners for EDBs, GDBs, GTB and Transpower. We note this is a simplified illustration of the changes. The relevant IM Determination reflects the specifics of how values should be calculated, which includes more considerations than are expressed in this table.

Table 7.1 Existing Reopeners (reflecting changes in lower thresholds)

Reopener	Existing threshold	Draft decision threshold
Quality standard variation (EDBs)	No dollar value. Test whether better reflects the realistically achievable performance of the EDB	No change
False/misleading information reopener (EDBs, GPBs, Transpower)	None	No change
Catastrophic event & Change event- not GAAP (EDBs)	Necessitates costs with impact on price path of 1% of FNAR for disclosure years in which cost will be incurred	The sum of total expenditure incurred in response to the event (net of any insurance or compensatory entitlements) exceeds: 1% of EDB's FNAR for the DPP regulatory period; / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)

Reopener	Existing threshold	Draft decision threshold
Catastrophic event & Change event - not GAAP (GPBs)	Necessitates costs with impact on price path of 1% of FNAR for disclosure years in which cost will be incurred.	The sum of total expenditure incurred in response to the event (net of any insurance or compensatory entitlements) exceeds. $100 thousand for GasNet Limited or $2 million for all other GPBs
Catastrophic event & Change event – not GAAP (Transpower)	Necessitates costs with impact on price path of 1% of forecast MAR for disclosure years in which cost will be incurred.	Sum of total expenditure incurred in response to the event (net of any insurance or compensatory entitlements) exceeds $5 million.
Error event - quality (EDBs, GPBs, Transpower)	No threshold	No change
Error event - price path (EDBs, GPBs, Transpower)	Impact on price path of 1% of FNAR (EDB and GTB); allowable notional revenue (GDB) or forecast MAR (Transpower) for affected disclosure years.	Revenue test - whether the impact of the error on FNAR for EDBs and GTBs, Allowable Notional Revenue for GDBs or forecast MAR for Transpower exceeds $100,000
Unforeseeable major capex project (now Unforeseeable large project) (EDB)	Incurred capex exceeds 1% of EDB's FNAR for the DPP regulatory period /$2 million (whichever is lower)	For an opex solution for system growth, discounted lifetime solution costs plus consequential capex For all other cases capex (net capital contributions) plus consequential opex Exceeds 1% of that EDB's FNAR for the DPP regulatory period / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)
Foreseeable major capex project (now Foreseeable large project) (EDB)	Incurred capex exceeds 1% of EDB's FNAR for the DPP regulatory period /$2 million (whichever is lower)	For an opex solution for system growth, discounted lifetime solution costs plus consequential capex For all other cases capex (net capital contributions) plus consequential opex Exceeds 1% of that EDB's FNAR for the DPP regulatory period / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)

Reopener	Existing threshold	Draft decision threshold
Capacity event (GDB and GTB)	Sum of incurred capex exceeds at least $100,000 (GasNet)/$2 million (other GPBs)	Sum of incurred capex plus consequential opex exceeds at least $100,000 (GasNet)/$2 million (other GPBs)
Risk event (GDB and GTB)	Sum of incurred costs exceeds at least $100,000 (GasNet)/$2 million (other GDBs)	Sum of incurred capex plus consequential opex exceeds at least $100,000 (GasNet)/$2 million (other GPBs)
Major transaction	10% opening RAB value	No change
CPP Contingent project – CPP only (EDBs and GPBs)	Incur costs >10% of Annual Revenue	No change

Problem definition

7.11 We assessed whether the lower reopener materiality thresholds appropriately reflect when it may be appropriate to reconsider a price-quality path.

7.12 This included assessing whether the logic of the various threshold tests is appropriate, whether having different threshold values applying to different suppliers is appropriate and the appropriateness of the value of those thresholds.

Stakeholder views

7.13 One stakeholder argued that the reopener lower thresholds favour smaller suppliers and result in larger suppliers absorbing significant costs, suggesting that the scaled element of the threshold to % of revenues could be removed, and the absolute value threshold should be lowered from $2 million to $0.5 million.[134]

7.14 One submitter stated that the 1% of net allowable revenue threshold may not capture expenditure that is below the threshold but has a high impact and value for consumers.[135]

7.15 Several submitters asked for the lower threshold of $2 million to be applied cumulatively for multiple projects.[136]

[134] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 69.

[135] Vector "Submission on Price-quality path workshop" (20 December 2022), response to question B1; Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), paras 5 -7.

[136] Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), Para 110; Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 46.

Analysis and solution

Impacts of different assessment approach applying across different types of reopeners.

7.16 The previous drafting of the Catastrophic event, Change event and Error event for EDBs, GDBs, GTBs and Transpower applied a materiality test which assessed whether the event has an impact on the price path of an amount equivalent to at least 1% of the FNAR for EDBs and GTBs, Allowable Notional Revenue (**ANR**) for GDBs or aggregated forecast Maximum Allowable Revenue (**MAR**) for Transpower for the affected disclosure years of the DPP, CPP or IPP.

7.17 This test requires the “impact on the price path” to be assessed ie. how much does the price path change if new inputs to the model were to be included. We refer to this here as a “revenue test”.

7.18 The implication of this test is that it requires adjusted opex and capex values (or for an Error event, any value) be populated into the DPP, CPP or IPP price path model(s) to determine if the movement in FNAR, ANR or forecast MAR exceeds the threshold.

7.19 The revenue test is not used for all reopeners, some consider whether the forecast total value of commissioned assets for that project or programme, but excluding capital contributions, exceeded either a percentage of FNAR or a stated dollar value. We refer to these as a “cost test”.

7.20 We note the Major transaction reopener which applies for EDBs, GDBs and GTBs applies a different threshold of 10% of RAB value.[137] We have assessed that there is no requirement to change this boundary value. We note we have had no submissions on the appropriateness, or not, of this boundary value. Further information regarding the Major transaction reopener is contained within the draft Report on the Review - Pre-review reconsideration of price-quality path IM decision RP01.5/RP02.5.

7.21 Requiring some reopeners to be considered against a revenue test raises some complexities, in particular:

7.21.1 It is more difficult for a supplier to assess the impact of a reopener event on the price path (ie, the revenue test) than it is for the supplier to assess a cost incurred in response to an event against a known threshold (the cost test).

[137] Given the very different nature of this reopener, the comparison with the other reopeners is not directly relevant.

7.21.2 The price path model has relatively limited sensitivity to capex, but opex is immediately passed through. This may create a perverse incentive to undertake less efficient opex to meet the threshold. Further, in the case of EDBs and Transpower, this does not reflect financial neutrality between capex and opex due to IRIS.

7.21.3 Having both revenue tests and cost tests could provide inconsistent outcomes with an equivalent project meeting the threshold for a cost test for large project reopeners for EDBs or Capacity event reopeners for GPBs, but not meeting the revenue test under Catastrophic event or Change Event reopener provisions.

Decision on approach to assessing boundary for Catastrophic Event and Change Event reopeners

7.22 Our draft decision is to amend the EDB, GDB, GTB and Transpower IMs for Catastrophic event reopeners, and some parts of the Change event reopeners. The change is to apply a test which assesses whether total expenditure in response to the event exceeds a stated threshold, rather than to apply an assessment against an impact on the revenue allowance. The materiality threshold which applies to these reopeners is outlined in the following sections.

7.23 To apply a cost test, total expenditure incurred would be summed, which will be incentive neutral between opex and capex. In addition, having a consistent approach to reopener tests, to the extent possible, would remove potential distortions between the categories of reopeners.

7.24 In general, the application of 'cost' tests rather than 'revenue' tests will result in thresholds being met at a lower level of expenditure.

7.25 Under a 'cost' test, the full value of capex is considered, rather than only the return on and off capital (which would be the result arising from inputting revised expenditure values into the price path model to establish a level of change in FNAR, AAR or forecast MAR under a 'revenue' test). This means capex-based expenditure is more likely to meet a specified threshold level under a cost test than a revenue test. As opex is immediately passed through the price path, there is limited impact from the change from a revenue test to a cost test, compared to capex. Noting that there are limitations for some reopeners regarding what opex is allowed to be recognised.

7.26 We consider this will more effectively promote the Part 4 purpose as it will provide incentives to invest, where capex investments in response to catastrophic events would be treated equally to opex and promote efficiency as a potential bias, in this case opex, is removed.

7.27 We also consider that the amendment will reduce complexity and compliance costs for both suppliers and the Commission in establishing whether a Catastrophic event or Change event (non-GAAP change) has met the required materiality threshold.

7.28 Unlike for the Catastrophic event and Change event reopeners, there is not an equivalent cost test which could be applied for Error events. Error events require changes to inputs used within the Building Block models applied to establish the price path, they are not events which necessitate a supplier incurring responsive costs. Accordingly, a cost test would not be appropriate.

7.29 Our draft decision is to continue to use a revenue test for assessing Error event reopeners. We have reduced the threshold which applies for Error event reopeners for all entities to $100,000.

Appropriateness of lower thresholds

7.30 For EDBs the lower bound materiality threshold for Foreseeable capex project and Unforeseeable capex project reopeners is currently set both as a percentage of FNAR and an absolute value of $2 million (whichever is lesser).

7.31 For GDB and GTB Capacity event and Risk event reopeners, the lower bound materiality threshold is based on proportionate size of the suppliers, with the boundary which applied for GasNet Limited lower than other GPBs.

7.32 For Transpower, boundary values for the Enhancement & Development (**E&D**) reopener provisions and base capex thresholds are discussed in Chapter 7 of the *Transpower Investment* topic paper.

Scaling of revenue thresholds based on supplier size

7.33 Aurora suggested we should remove the scaled revenue threshold which applies to EDBs and lower an absolute value threshold (say to $0.5 million).[138] It states that for an equivalent level of investment, an investor in a large EDB must wait for up to 5 years to be compensated for its investment, while an investor in a small EDB can be compensated much earlier through the reopener mechanism. Aurora considered that the reopener thresholds could be improved by removing the scaled element and setting a lower uniform threshold of $0.5 million.

7.34 Our draft decision to retain the scaled revenue threshold prevents larger suppliers applying to reopen the path for projects that are proportionately less material. A project of a given dollar scale is proportionately less material for a large supplier.

[138] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 69.

7.35 We expect suppliers to reprioritise their expenditure allowances during a regulatory period. Larger suppliers can reprioritise within their larger funding allowances for proportionately smaller projects more easily. This is reflected in the consideration stage of the reopener process (discussed in Chapter 5) which requires the Commission to have regard to whether the planned capex and opex for the remainder of the period has been appropriately reviewed and reprioritised. This would also avoid a higher volume of low value reopener applications that would otherwise increase compliance costs.

7.36 Vector stated there were significant limitations with the reopener threshold of 1% of forecast net allowable revenue, and it may not appropriately capture expenditure with high consumer benefit.[139]

7.37 We note that the reopeners for EDBs have both a 1% of FNAR for the regulatory period, or dollar caps, whichever is the lesser. For Vector, this would be the dollar cap. Regardless, we consider suppliers should be reprioritising within their revenue limits to accommodate high consumer benefit projects, particularly those which do not require significant levels of expenditure.

7.38 We were not provided with sufficient evidence on high consumer benefit projects that are not currently delivered and that an alternative revised threshold could enable. The examples provided were broad and included costs related to decarbonisation, cybersecurity, data and resilience. If this was to be considered further, a definition of "high consumer benefit projects" would need to be established along with a process to identify how these differed from programmes of work which an EDB, GDB or GTB was delivering as part of its business as usual.

Decision on threshold values

7.39 Our draft decision is to amend the EDBs, GDBs and GTB IMs for the Catastrophic event and Change event reopeners to set threshold values consistent with the thresholds used for Foreseeable and Unforeseeable major capex projects for EDBs, and the Capacity event reopener for GDBs and the GTB.

7.40 We consider applying a consistent approach to assessing materiality thresholds where possible, and applying consistent threshold values, will reduce complexity for suppliers and will reduce the risk of potential perverse outcomes where a similar programme of work may be acceptable under one type of reopener but not another.

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[139] Vector "Submission on Price-quality path workshop" (20 December 2022), Response to Question B1; Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), paras 5-7.

7.41 For EDBs, we have decided to introduce an additional threshold of $5 million which will apply to Vector Limited and Powerco Limited to reflect the more significant FNAR and associated expenditure allowances for these entities, and accordingly their greater ability to reprioritise within expenditure allowances compared to other EDBs.

7.42 We have also raised the dollar threshold, which applies to EDBs other than Vector Limited and Powerco Limited from $2 million to $2.5 million.

7.43 Increases in threshold values reflect other changes to reopeners which have allowed a greater scope of costs to be included in the reopener application. In particular the inclusion of consequential opex for capex projects and opex solutions which would allow more projects to meet the lower threshold without adjustment. This is further discussed in Chapter 6.

7.44 For opex solutions for system growth, the threshold is calculated based on lifetime solution costs which are discounted into a present value equivalent. This is undertaken because capex is incurred upfront but opex is spread across all periods in which the solution is in place. In the absence of consideration of future period costs, there is likely to be a bias towards capex solutions in order to meet the thresholds.

7.45 We recognise, consistent with submissions, that depending on the extent of forecast growth the purchase of flexibility services may not be a permanent solution, but a temporary deferral of the requirement for capex.[140] To address this issue, the definition of lifetime solution costs provides for the inclusion of forecasted capex where it is anticipated that opex will not, by itself, be able to delay capex that is part of the project or programme beyond the end of the next regulatory period. We consider this approach will allow for temporary opex solutions for system growth which provide value to consumers to also be appropriately considered against the threshold.

7.46 When the reopener thresholds were initially set for the Foreseeable and Unforeseeable major capex projects in 2019, these values were not indexed, and accordingly periodic adjustments to the values are required otherwise the thresholds in real terms will decline over time.

7.47 We consider the revised limit for reopener applications will maintain the incentive for suppliers to prioritise within their revenue allowances.

[140] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 13.

7.48 Our draft decision is not to change the lower threshold for the Capacity event in the GDB and GTB IMs, as this specifically applies when a "network needs additional capacity". We are not aware of significant opex solutions in the gas context to necessitate moving the threshold and the boundary values for GDBs and the GTB were set more recently than EDBs for the Capacity event and Risk event reopeners in 2022.

7.49 For Transpower, our draft decision is to implement a new lower threshold for Catastrophic event and Change event reopeners which requires the total opex and capex incurred in response to the event to exceed $5 million.

7.50 We consider the application of a lower threshold for the Catastrophic event and Change event reopeners compared to other thresholds which apply to Transpower is appropriate. The threshold for major capex under the Transpower capex IM determination is different in nature to the threshold for a reopener, as it relates to a threshold for greater scrutiny of expenditure, rather than allowing additional expenditure in the base allowances. The threshold for Catastrophic event and Change Event reopeners for Transpower is also aligned with the larger EDBs.

7.51 We consider these threshold values promote the s 52A purpose more effectively, as they provide an appropriate balance of incentives to invest, as reopeners are available for more material events whilst maintaining an incentive on suppliers to efficiently prioritise work programmes for smaller events or programmes of work.

7.52 If the thresholds were set at lower values, there is a risk that there would be significant increases in the volume of reopener applications, which would increase compliance costs and complexity in the reopener regime. This would be inconsistent with the intent of a DPP which is to set price-quality paths in a relatively low-cost way, as specified in s 53K of the Commerce Act.

Threshold for Error events

7.53 As noted earlier, the current materiality threshold for Error events related to the price path is applied against a revenue test which assesses the impact of the error on the price path that would have otherwise applied. In this instance we consider a revenue test is appropriate to maintain, as a cost test would not be relevant for all instances of potential errors.

7.54 We have considered the appropriateness of having a materiality boundary for EDBs, GPBs and Transpower for price path related error events, and what an appropriate materiality boundary may be.[141]

[141] We note that Error events which relate to quality standards or quality incentive measures do not have a materiality threshold, aside from the requirement the error represents an error in the value of the metric.

7.55 We consider there is value in maintaining a threshold to ensure that suppliers do not apply for reopeners for errors that are immaterial, nor does the Commission need to consider them. However, we consider there is value in reducing the existing materiality threshold so that suppliers are not negatively impacted by clearly unintended errors.

7.56 We consider that the costs associated with considering, processing and amending a price path as a result of an Error event reopener application are not directly related to the size of the supplier and so a consistent threshold should be applied across EDBs, GPBs and Transpower. Our draft decision is to set this value as an impact on FNAR for EDBs and GTBs, AAR for GDBs or forecast MAR for Transpower exceeding $100,000 when revised values are included in the appropriate price path model.

7.57 We note the distinction to other reopener thresholds which have reference to supplier size. We consider that for Error events, it would not be appropriate to expect suppliers to reprioritise expenditure.

7.58 We consider this decision will promote the s 52A purpose more effectively, as errors which may otherwise distort the incentives are able to be considered and addressed at a lower boundary level. The maintenance of a lower boundary level ensures errors which are not material, and therefore do not detrimentally affect the promotion of the s 52A purpose, do not need to be considered. A reopener to consider these immaterial errors could otherwise increase regulatory costs for limited benefit.

Cumulative application of the lower threshold

7.59 Submitters asked for the lower threshold of $2 million which applies to the EDB Foreseeable and Unforeseeable capex project reopeners to be applied cumulatively for multiple projects.[142]

7.60 There was some support from submitters, for the cumulative application of the default lower materiality threshold.[143] Their support was mainly to address system growth, electrification and digitalisation projects.

[142] Orion "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), Para 110; Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 46.

[143] Electricity Networks Association (ENA) "Submission on Price-quality path workshop" (20 December 2022); Vector "Submission on Price-quality path workshop" (20 December 2022); Unison "Submission on Price-quality path workshop" (20 December 2022); Aurora Energy "Submission on Price-quality path workshop" (20 December 2022).

7.61 Cumulative application of projects that are individually below the lower threshold for the EDB Foreseeable and Unforeseeable capex project reopeners already exists, at least in part, as these reopeners allow for ‘programmes’ of work (ie, a group of related projects with a common purpose) in addition to ‘projects'. This is the same for the GDB and GTB Capacity event reopener which provides for 'programmes' of work and the Risk event reopener for EDBs, GDBs and the GTB which is based on costs in response to an event which could include a number of related projects.

7.62 We consider that cumulative application of the lower thresholds across different unrelated programmes of work, or relating to a similar scenario which may be broadly defined, would have an effect of significantly lowering the limit. This could result in a substantial increase in the number of reopener applications, and therefore is likely to remove the incentive for efficient reprioritisation of expenditure. In addition, establishment of whether a large volume of individually immaterial programmes of work were provided for either explicitly or implicitly within a price path would be difficult. We consider it is unlikely that suppliers would identify projects which may have been provided for but were not progressed resulting in available funds from deprioritised projects.

7.63 Our draft decision is to not allow for cumulative application of the lower threshold, beyond what is already provided for within the IMs. This promotes the IM purpose in s 52R more effectively, without detrimentally affecting the promotion of the s 52A purpose, by providing certainty for suppliers and consumers. This will avoid a high volume of reopener applications for low value projects which would otherwise significantly increase regulatory costs. Significant increases in the volume of reopener applications for lower value projects would also be inconsistent with the intent of a DPP as a relatively low-cost way of setting price-quality paths.

Upper Materiality Thresholds

7.64 We considered whether the existing reopener upper materiality thresholds remain appropriate for the:

7.64.1 EDB Unforeseeable and Foreseeable major capex project reopeners; and

7.64.2 Capacity event and Risk event reopeners for GPBs.

Draft decision

7.65 Our draft decision is to remove the $30 million upper threshold for the EDB Unforeseeable and Foreseeable major capex project reopeners, but retain the upper thresholds ($350,000 for GasNet and $10 million for all other GDBs and the GTB) in the Capacity event and Risk event reopeners.

Problem definition

7.66 Upper thresholds currently apply to the following reopeners:

7.66.1 EDB Unforeseeable major capex project reopener;

7.66.2 EDB Foreseeable major capex project reopener;

7.66.3 GDB and GTB Capacity event reopeners; and

7.66.4 GDB and GTB Risk event reopeners.

Stakeholder views

7.67 We received stakeholder feedback on the upper thresholds for the EDB Unforeseeable and Foreseeable major capex project reopeners.

7.68 Submitters raised whether the upper threshold for the EDB Foreseeable and Unforeseeable major capex project reopeners should be raised to accommodate scenarios that are not complex enough to warrant a CPP and are better suited to reopeners.

7.69 Powerco encouraged us to consider whether increasing the upper threshold for the EDB Foreseeable and Unforeseeable major capex project reopeners is a potential alternative solution to a single-issue CPP, to accommodate scenarios that include large levels of expenditure, but not complex enough to warrant a full CPP and accordingly are better suited to reopeners. [144]

Analysis and solution

7.70 We originally introduced a cap (ie, an upper threshold) to the EDB Unforeseeable and Foreseeable major capex project reopeners because we considered that, particularly with inclusion of system growth and asset relocation capex, the reopeners could otherwise apply to situations when a CPP is more appropriate.

7.71 The level of scrutiny applied under these reopeners, in line with the relatively low-cost nature of DPPs, may not be appropriate for larger projects and programmes that are out of step with original forecasts or historic expenditure. Our previous view was that $30 million is the appropriate level to achieve this.

7.72 However, the cap of $30 million may be too low for some larger projects, such as replacement of a substation. This may result in desirable projects being deferred by suppliers to the detriment of consumers. In these circumstances, a CPP may not be an appropriate option and removing the cap would provide an alternative to the “single-issue” CPP that some suppliers have suggested.

[144] Powerco “Submission on Price-quality path workshop” (20 December 2022).

7.73 Removing the upper threshold for EDBs will result in EDBs having better incentives to innovate and invest and provide services at a quality that reflects consumer demands, promoting the s 52A purpose more effectively. By removing the $30 million bound we will likely have:

7.73.1 better visibility of the scale of investment that is required, especially of future CPP candidates; and

7.73.2 greater assurance that investment is not being deferred to the detriment of consumers.

7.74 We note we will be able to decline reopener applications if we think the expenditure is better suited to a CPP application. This is discussed further in Chapter 5.

7.75 We did not receive any submissions regarding removing the upper threshold which applies for Capacity event and Risk event reopeners for GPBs. We consider there is a different context between EDBs and GPBs and that the provisions operate differently. Accordingly, there is not a sufficiently compelling case for change when applying the IM Review decision-making framework.

7.76 The $30 million cap for EDBs applies on a cumulative basis of all unforeseeable and foreseeable large projects across a disclosure year. The threshold caps for GPBs do not apply on a cumulative basis but are related to the specific event the reopener seeks to address.

7.77 In the Gas DPP3 IM Reasons paper which accompanied the introduction of these reopener mechanisms for GPBs, we noted that in investing in their networks for growth purposes, suppliers needed to understand that the investments risked being stranded in future due to the expected fall in demand for piped natural gas.[145]

7.78 We stated that this risk may mitigate supplier over-investment in growth and incentivise suppliers to seek greater contributions from new connecting parties including for wider network reinforcement. We also expected that, for large new connection and asset relocations capex not covered by capital contributions, suppliers would need to provide us with an undertaking from the third party driving the expenditure that it was committed to the project in the reopener application.

[145] Commerce Commission "Amendments-to-input-methodologies-for-gas-pipeline-businesses-related-to-the-2022-default-price-quality-paths-Reasons-paper(30-May-2022), para 3.81.

7.79 We consider maintaining the upper threshold for GPBs, given its different application, does not negatively impact the GPBs incentives to innovate and invest consistent with s 52A of the Act.

7.80 We note that while there will not be a cumulative limit for EDBs, the changes to reopener provisions (discussed in Chapter 5) state under the 'consideration of whether and how to amend the DPP' section the Commission should have regard to whether a CPP proposal is more appropriate than a DPP, which may limit the likelihood of a number of cumulatively material reopener requests.

Application of thresholds to new and extended reopeners

7.81 We considered how reopener thresholds should apply to proposed new reopeners and reopeners whose scope of application has been extended in our draft decisions.

Draft decision

7.82 Our draft decision is to:

7.82.1 apply reopener thresholds for the new and extended reopeners proposed in our draft decisions on a consistent basis with other reopener provisions; and

7.82.2 revise the impact on revenue test for Change event reopeners relating to GAAP changes to be based on if the changes had been in place at the time of the price path reset, there would have been a different price path, rather than a cost incurred test, with thresholds being;

7.82.2.1 for EDBs the lower of 1% of FNAR for the regulatory period, or $5 million for Vector Limited and Powerco Limited, or $2.5 million for all other EDBs,

7.82.2.2 for GDBs and the GTB, the impact of the event exceeds $100,000 for GasNet Limited or $2 million for all other GPBs; and

7.82.2.3 for Transpower the impact of the event exceeds $5 million.

Problem definition

7.83 The following new and extended reopeners are outlined in Chapter 6:

7.83.1 adding a Risk event reopener for EDB DPPs similar to the existing GDB and GTB Risk event reopener (ie, new EDB reopener)

7.83.2 adding a resilience or asset relocation event reopener for GDBs and GTBs (ie, new GDB and GTB reopeners);

7.83.3 inclusion of revised drivers in the EDB Unforeseeable and Foreseeable capex projects reopeners to include resilience-based capex (ie, extension of existing EDB reopeners);

7.83.4 inclusion of opex solutions within system growth for the EDB Unforeseeable and Foreseeable capex project reopeners, and consequential capex (ie, extension of existing EDB reopeners);

7.83.5 inclusion of consequential opex for the EDB Unforeseeable and Foreseeable capex project reopeners (ie, extension of existing EDB reopeners); and

7.83.6 inclusion of consequential opex for the GDB and GTB Capacity event and Risk event reopeners (ie, extension of existing GDB and GTB reopeners).

7.84 The problem definition for this section comprises two parts:

7.84.1 whether the new reopeners should adopt the comparable thresholds for existing reopeners; and

7.84.2 whether the reopener thresholds should be consequentially amended for the extended reopeners.

Analysis and solution

7.85 For new reopeners, being the Risk event reopener for EDBs and Resilience based reopener for GPBs, we consider it is appropriate to apply a threshold consistent with existing reopeners.

7.86 Applying a different threshold may create a perverse incentive to identify particular projects or programmes as being more applicable to a particular reopener than the underlying driver would indicate. We do not consider that either of these reopeners are sufficiently distinct from the other reopeners to justify a different boundary, given the boundary relates to expectations of a supplier's ability to reprioritise its expenditure.

7.87 For the EDB reopeners that we have extended, we propose applying the increased lower materiality threshold values as discussed earlier in this Chapter in paragraphs 7.41 to 7.44. For the extended Gas Capacity and Risk event reopeners, we consider it appropriate to apply existing thresholds to these reopeners as discussed earlier in this Chapter in paragraph 7.48.

7.88 Similar to the Error event reopener, there is not an equivalent cost test which could be applied for Change events relating to changes in generally accepted accounting practice in New Zealand (GAAP). GAAP driven Change events require changes to inputs used within the Building Block models applied to establish the price path, they are not events which necessitate a supplier incurring responsive costs. Accordingly, a cost test would not be appropriate.

7.89 Our draft decision is to continue to use a revenue test for assessing Change events relating to a change in GAAP. However, we have amended how the value is established for a change in GAAP requirements from a cost incurred in response to the change, to an approach which considers the impact on FNAR using revised inputs into the price path. The Change event relating to GAAP uses the same dollar threshold as applies to other reopeners.

7.90 Change events relating to a change in GAAP are discussed in more detail in Chapter 6. Error events are discussed later in this chapter.

7.91 Table 7.2 below shows our new and extended reopeners and how thresholds apply to these. Explanation of the operation and coverage of the expanded reopeners, and the rationale for these is discussed in Chapter 6.

Table 7.2 New and extended reopeners

Reopener	Extensions	Lower threshold
New Reopeners		
Risk event (EDB)	New risk event reopener for EDBs. No change to the Risk event reopeners which apply to GPBs.	1% of that EDB's FNAR for the DPP regulatory period / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)
Resilience or asset relocation event reopener (GDBs and GTB)	New resilience reopener for GPBs, including asset relocations not related to capacity growth.	At least $100,000 (GasNet)/$2 million (other GDBs and GTBs)
Amended reopeners		
Foreseeable Large Project (EDB)	Includes opex solutions for system growth; with value calculated based on discounted lifetime cost; Includes consequential opex for implementing a capex solution (and vice versa); Includes targeted resilience-related expenditure.	1% of that EDB's FNAR for the DPP regulatory period / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)

Reopener	Extensions	Lower threshold
Unforeseeable Large Project (EDB)	Includes opex solutions for system growth with value calculated based on discounted lifetime cost; Includes consequential opex for implementing a capex solution (and vice versa); Includes targeted resilience-related expenditure.	1% of that EDB's FNAR for the DPP regulatory period / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)
Capacity event & Risk event (GDB and GTB)	Includes consequential opex for implementing a capex solution	No change to existing thresholds. At least $100,000 (GasNet)/$2 million (other GDBs and GTBs)
Change event – GAAP (EDBs)	GAAP now separately identified within Change event. Test basis is whether would have caused the price path to have differed	If FNAR would have differed by 1% of EDB's forecast net allowable revenue for the DPP regulatory period; / $5 million for Vector Limited and Powerco Limited or $2.5 million for all other EDBs (whichever is lower)
Change event – GAAP (GDBs and GTB)	GAAP now separately identified within Change event. Test basis is whether would have caused the price path to have differed	If FNAR would have differed by $100,000 thousand for GasNet Limited or $2 million for all other GPBs
Change event – GAAP (Transpower)	GAAP now separately identified within Change event. Test basis is whether would have caused the price path to have differed	If forecast MAR would have differed by $5 million

7.92 We consider that setting the thresholds across different reopeners in a consistent manner, considering the type of reopener, will promote the Part 4 purpose in s 52A more effectively than the alternative. It will provide consistency with the way thresholds are applied, reducing complexity. This approach will also promote the IM purpose in s 52R more effectively by promoting certainty in relation to the rules, requirements, and processes when compared with the alternative of taking a less coherent approach. Those things are achieved without detrimentally affecting the promotion of the s 52A purpose.

Chapter 8 Introduction of a large connection contract mechanism for EDBs

Purpose and structure of this chapter

8.1 This chapter describes our draft decision to introduce a mechanism for EDBs similar to the Transpower new investment contract (**NIC**) mechanism, with the purpose of taking pressure off the number of DPP price-quality path reopener applications.

Introduction of a large connection contract mechanism for EDBs

Draft decision

8.2 Our draft decision is to introduce a 'large connection contract' (LCC) mechanism into the EDB IMs that will allow connection assets created under LCCs to be excluded from the RAB where certain conditions around workable competition and the size of the connection are met.[146]

8.3 As part of this mechanism, we propose to exclude any revenue and connection costs associated with the connection assets funded under an LCC from the EDB's forecast allowable revenue for DPPs and CPPs.[147]

8.4 The LCC mechanism is not intended to cover the replacement or upgrade of existing connection assets, which we expect to be reasonably predictable. An asset replacement can be forecast with an acceptable degree of precision to be included as part of the DPP or CPP capex process.

Background

8.5 This proposed mechanism is based on the NIC mechanism in the Transpower IMs.[148] Under the Transpower IMs a NIC is described as a contract for the provision of new electricity transmission services between Transpower and another person in respect of which-[149]

> (a) the other person has agreed in writing (whether in the same contract or not) that the terms and conditions of the contact-
>
> (i) are reasonable; or
>
> (ii) reflect workable or effective competition for the provision of the electricity transmission services; or

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[146] We do not consider the mechanism is needed for gas pipeline connections, given it is designed to respond to large increases in connection capex as a result of increased demand arising from decarbonisation.

[147] Any costs associated with the LCC will be excluded from operating costs.

[148] See the following provisions in the Transpower IMs: (a) the definition of 'new investment contract' in cl 1.1.4; and (b) the nil-valuation of these assets in cl 2.2.7(d).

[149] Transpower Input Methodologies Determination 2010, cl. 1.1.4, 'new investment contract'.

(b) Transpower demonstrates beyond a reasonable doubt that the terms and conditions of the contract were determined following a process that provided opportunities for-

(i) Transpower's affected customers to make or approve reasonable price-quality trade-offs; and

(ii) the competitive provision of new electricity transmission services by parties other than Transpower.

8.6 Assets used in providing services under a NIC are nil-valued, and therefore excluded from Transpower's RAB.[150] Any capex included in NICs is also excluded from capex forecasts used to determine Transpower's price path.

Problem definition

8.7 Stakeholders have raised concerns regarding expenditure uncertainty, especially due to decarbonisation. We understand that large new customer-initiated connections are a key source of such uncertainty for EDBs, as these loads are not foreseeable.[151]

8.8 This uncertainty could result in a higher volume of reopener applications, which can be time and resource intensive for both the applicant and the Commission.[152] Suppliers have raised concerns that the reopener process, in particular the timeframes, may impact the viability of these new connection projects.

Stakeholder views

8.9 Vector has submitted that the IMs should provide more scope for commercial arrangements to manage costs in line with the approach to Transpower's NICs, which are excluded from its price path.[153]

8.10 Vector suggested that this approach would support the long-term benefit of consumers by:[154]

8.10.1 mitigating forecast uncertainty;

[150] *Transpower Input Methodologies Determination 2010 (consolidated 29 January 2020)* at clause 2.2.7(d).

[151] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 15.

[152] As an example of the work involved, in early 2021, Contact Energy Limited (Contact) entered into an agreement with Unison Networks Limited (Unison) for the supply of electricity from Unison's network for the construction and operation of Contact's Tauhara generation station near Taupō (project). This project was not included in Unison's DPP capex forecast, as details of the project were uncertain at that time. On 29 June 2021, Unison applied to us to reopen the DPP3 Determination to increase its allowable revenue to cover the cost of the project of $7.3 million. We published our final decision on 4 March 2022: Commerce Commission "Reconsideration of default price-quality path for Unison Networks Limited - unforeseeable major capex project to supply Tauhara geothermal power station - Final decision" (4 March 2022).

[153] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 15-19; Vector "Submission on Price-quality path workshop" (20 December 2022), response to question D4.

[154] Vector – Cover letter – "Submission on Price-quality path workshop" (20 December 2022), para 14; Vector "Submission on Price-quality path workshop" (20 December 2022), response to question D4.

8.10.2 allowing negotiation of contracts on commercial terms providing more consumer options for new large connects; and

8.10.3 avoiding costs attributable to an individual connecting party being recovered from consumers through lines charges.

8.11 Consistent with the requirements on the Commission under s 54V(4) to take account of certain specified matters, we asked the Electricity Authority to comment on our draft decision. It noted:

8.11.1 the importance of information disclosure with respect to the proposed LCC contracts;

8.11.2 that it considered our proposed lower threshold of 10MW for a contract, reasonable to qualify as an LCC; and

8.11.3 that some of the proposed connections might involve significant upgrades.

Proposed solution

8.12 The proposed introduction of a LCC mechanism promotes the s 52R purpose more effectively, by providing greater certainty for regulated suppliers and consumers in relation to the rules, requirements, and processes applying to regulation under Part 4:

8.12.1 a mechanism which allows EDBs to enter into commercially negotiated contracts for large connections without the intervention of the Commission will provide greater certainty to suppliers regarding the recovery of connection costs which would otherwise require a reopener;

8.12.2 the LCC mechanism will avoid the need for reopeners where certain conditions around workable competition and the size of the connection are met and provide a way of dealing with uncertainty in relation to new connections;

8.12.3 suppliers will be able to include appropriate terms within the contract, when agreed as commercially acceptable by the customer, that may not be available under a reopener;[155] and

[155] Commerce Commission "Reconsideration of default price-quality path for Unison Networks Limited - unforeseeable major capex project to supply Tauhara geothermal power station - Final decision" (4 March 2022) para 4.13.

8.12.4 suppliers and customers will have greater control over the timing of a decision. This will be important, for example, in relation to meeting decarbonisation targets. Once they have struck a commercial agreement, this will not need to be ratified by the Commission, in contrast to using a reopener mechanism.

8.13 The proposed change should also significantly reduce compliance costs, other regulatory costs, and complexity. This is because it reduces the need to involve the Commission in the decision-making process via a reopener, which avoids further cost (including costs that relate to demonstrating compliance) and complexity to the initial commercial agreement.

8.14 There is a risk that EDBs utilise their bargaining power to extract excessive profits from these contracts, which could affect the promotion of the s 52A purpose. However, we consider this risk is mitigated by limiting the mechanism to contracts for 'large' connections, as these will generally be negotiated with large customers with significant bargaining power.[156]

8.15 Following the Electricity Authority's feedback, we will consider in our ongoing information disclosure regulation processes whether to introduce requirements to enable stakeholders to have appropriate visibility of these contracts.[157]

Implementation

Operating costs

8.16 The implementation of the LCC in the EDB IMs for both DPPs and CPPs is proposed to be similar to the Transpower NIC mechanism.

8.17 The key difference is that we are excluding costs associated with assets funded under an LCC from operating costs. This ensures that recovery of operating costs relating to the LCC assets will be excluded on an ongoing basis from the EDB's forecast and actual regulated revenue. Operating costs associated with the LCC assets are instead recovered under the contract.

[156] For the purposes of the threshold of 'large', we have included in the definition of 'large connection contract' the requirement that there is a supply of new electricity distribution services for which the maximum capacity required is at least 10MW.

[157] An example of how ID may be used to monitor the contracts being undertaken are capturing the costs and associated connection capacity provided, which can be compared to other similar connections and costs to help us detect potential excessive profits. Transpower is currently required to disclose information on NICs under information disclosure requirements.

Large connections

8.18 As noted above, this mechanism is to be limited to 'large' connections. We propose for this purpose that the mechanism would be available for contracts for which the maximum capacity of the connection under the contract is at least 10MW.

Chapter 9 Whether other in-period adjustment mechanisms are necessary

Purpose and structure of this chapter

9.1 We consider that EDBs, GDBs, GTB and Transpower are likely to experience greater levels of forecasting uncertainty for upcoming regulatory periods than has historically been the case.

9.2 Price-quality paths will need to consider how this increased level of uncertainty should be accommodated whilst staying consistent with the purpose of default/customised price-quality regulation as outlined in s 53K of the Act.

9.3 In this context, the ENA has represented:[158]

> A wide gulf exists between the current low-cost (generic) DPP process and the bespoke, high-cost CPP process. ENA believes there is scope for the IMs to enable regulatory tools that bridge this gulf by allowing the Commission's determinations to adapt during a regulatory period to respond to changing circumstances and new information.
>
> The existing regime provides for both limited re-openers and resource-intensive customised price-quality path applications. ENA recommends the Commission consider development of contingent allowances, pass-throughs, or other flexibility mechanisms that automatically trigger on the occurrence of specific events. These flexibility mechanisms should allow for collective application.

9.4 This suggests that future uncertainty is not adequately provided for in DPPs by the existing suite of reopeners or other mechanisms, and that the DPP forecasting approach and price path adjustment mechanisms need to be considered as a cohesive package.

9.5 Consumers can also benefit from in-period adjustment mechanisms that allow the price path to be amended as circumstances change, as these mechanisms potentially allow a lower price path to be initially set. This means that consumers are more likely to only pay for projects that are undertaken.

9.6 In Chapter 3, the Context chapter of this topic paper, we outlined the regulatory continuum and indicated where we considered different mechanisms may be used to address forecasting uncertainty.

9.7 In this Chapter 9 we introduce and consider a range of potential mechanisms for addressing forecasting uncertainty which allow for recovery of costs, but which are not reopeners.

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158 Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p.6.

9.8 We then consider Issue 8 as framed in the Context chapter ie, whether the response by regulated businesses to uncertainty can be better enabled by the use of other mechanisms and whether the implementation of mechanisms within the IMs may assist in addressing forecasting uncertainty in a DPP, CPP or IPP.

9.9 We note that a CPP provides significant ability to respond in an appropriate and timely way, as outlined in Chapter 4, and an IPP has even greater responsiveness built in to include the possible use of in-period adjustment mechanisms in a way which is different to a DPP.

9.10 This chapter introduces some in-period adjustment mechanisms and identifies potential issues which the mechanisms could address. We assess the potential application of the mechanisms for addressing the issues outlined and include analysis of:

9.10.1 increasing the scope of pass-through costs or recoverable costs to cover a wider spectrum of categories of costs;

9.10.2 contingent expenditure allowances;

9.10.3 use-it-or-lose-it allowances; and

9.10.4 quantity wash-ups.

9.11 Whilst this chapter considers the potential application of in-period adjustment mechanisms, including those proposed by suppliers, it is not exhaustive of all potential applications. The design and application of in-period adjustment mechanisms depends on the nature of the forecasting uncertainty to be addressed. The cost, complexity, and accuracy of the mechanisms will vary according to the specific variables or inputs available and accordingly the suitability of any proposed adjustment mechanism needs to be individually assessed against our IM Review framework.

Other considerations

9.12 We acknowledge the ENA submission on the IM Review Process and issues paper which stated:[159]

> While expenditure allowances are the domain of DPP and CPP Determinations, the IM Review should consider how the Commission will undertake future expenditure forecasting requirements, as this has implications for reopeners, pass-through and contingent allowances.

[159] Electricity Networks Association "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p.16.

9.13 In assessing the potential application of other in-period adjustment mechanisms we have not pre-determined what DPP expenditure forecasting approach may be used in future price-quality path resets or the potential drivers of CPP and IPP proposals. We consider this approach still provides for appropriate consideration of the potential application of a variety of in-period adjustment mechanisms and does not require establishment of what future expenditure forecasting approaches will be.

9.14 We acknowledge the viability of different mechanisms will be dependent on expenditure forecasting practices, and the quality of information available to establish mechanisms and to then assess against, during the regulatory period.

9.15 We consider that for specific categories of costs or expenditure requirements increased automation such as the inclusion of a financial sum and triggers in the price-quality path determination could be beneficial, where possible and consistent with the Act and IM Review framework. This is because an adjustment or allowance could result in less time spent in subsequent consideration and accordingly be more consistent with the relatively low-cost nature of a DPP. We note potential concerns where significant effort is required in establishing mechanisms which are not required as the trigger condition is not met.

Increasing the scope of pass-through costs or recoverable costs to cover a wider spectrum of categories of costs

9.16 Pass-through costs and recoverable costs are able to be passed through to prices, ie, they are netted-off the notional revenue allowance in assessing compliance annually under either a DPP, CPP or IPP.[160] These are costs which by their nature are outside of the control of a supplier and are uncertain in terms of amount and accordingly are not subject to the same incentives as costs provided for within the notional revenue allowance.

9.17 This topic paper does not cover the role and application of the existing pass-through costs and recoverable costs. Other changes and refinements to existing costs are discussed in Chapter 7 of the draft Report on the IM Review with the reclassification of transmission costs as a pass-through cost, discussed in Part 1 in the draft Report on the Review. We have extended the 'reconsideration event allowance' recoverable costs to cover all reopener events in the EDB IMs and introduced the revised 'reconsideration event allowance' recoverable cost into the GDB and GTB IMs. This is discussed in Chapter 5 of this paper.

[160] Pass-through costs and recoverable costs are added, along with other factors to forecast net allowable revenue to establish forecast allowable revenue.

Draft decision

9.18 We have not identified any new pass-through costs or recoverable costs which we consider should be introduced to manage increased forecasting uncertainty for EDBs, GPBs or Transpower.

9.19 Whilst greater use of pass-through costs or recoverable costs may reduce regulatory costs, we consider this would not more effectively promote s 52A as it may remove the incentive for active cost management by suppliers, who in most cases are best placed to manage the risk. It could expose consumers to volatility in the underlying costs and overlap with the boundary and rationale for reopener mechanisms, which would not promote the s 52R IM purpose of providing certainty more effectively.

Problem definition

9.20 The existing suite of pass-through costs which apply to EDBs, GDBs, GTBs and Transpower covers local authority rates and industry levies,[161] with recoverable costs covering a wider range of incentives, costs and wash-ups.[162]

9.21 One option would be to expand the scope of application of recoverable costs within the IMs to cover further specified categories of opex and/or capex expenditure. This would remove these categories of expenditure from the allowable revenue component of the price path, reducing risks associated with forecasting uncertainty as changes in costs are able to be passed through.

9.22 Inclusion of a cost as a recoverable cost would reflect that whilst the nature of the cost may be reasonably foreseeable, there is a relatively high level of exposure to changes in quantum, which are outside of the control of the supplier.

Stakeholder views

9.23 Vector requested a significant broadening of the suite of in-period adjustment mechanisms, stating in its submission on the Process and issues Paper:[163]

> Amend the IMs to make better use of pass-through and recoverable costs. This should include allowing more ex-post costs to be passed-through (in line with the approach the IM currently takes for gains and losses on disposed assets).

[161] *Electricity Distribution Services Input Methodologies Determination 2012*, clause 3.1.2; *Gas Distribution Services Input Methodologies Determination 2012*, clause 3.1.2; *Gas Transmission Services Input Methodologies Determination 2012*, clause 3.1.2.

[162] *Electricity Distribution Services Input Methodologies Determination 2012*, clause 3.1.2; *Gas Distribution Services Input Methodologies Determination 2012*, clause 3.1.2; *Gas Transmission Services Input Methodologies Determination 2012*, clause 3.1.2.

[163] Vector "Submission on the Process and issues paper" (11 July 2022), p.26.

9.24 The ENA has requested a new pass-through cost or recoverable cost for an EDB's carbon abatement cost under the Climate Change Response Act 2002.[164]

Analysis – Consistency of extending the scope of pass-through costs or recoverable costs with our economic principles

9.25 Our decision-making framework identifies key economic principles which provide guidance on how we might better promote the purpose of Part 4 under s 52A through our decisions.[165]

9.26 Our risk allocation principle is that, ideally, particular risks should be allocated to suppliers or consumers depending on which are best placed to manage them. Options for managing risks include:

9.26.1 taking actions to influence the probability of occurrence where possible;

9.26.2 taking actions to mitigate the costs of occurrence; and

9.26.3 the ability to absorb the impact where it cannot be mitigated.

9.27 Regulated suppliers have various risk management tools at their disposal, including investment in network strengthening/resilience, contracting arrangements, and delaying certain decisions. Some of these tools may have associated costs to suppliers.

9.28 Increasing the spectrum of categories of costs which are recognised as pass-through costs or recoverable costs would reduce uncertainty for suppliers but would mean consumers would be exposed to volatility in the underlying costs.

9.29 We note there could be some partially controllable costs that it may be appropriate to allow to be fully recoverable from consumers. This may be the case where the costs associated with applying a mechanism to provide incentives for the supplier to manage the risk are unlikely to outweigh the benefits to consumers of doing so, based on currently available information.

9.30 Accordingly, any potential increase in the scope of pass-through costs or recoverable costs will need to consider who is best placed to manage risks, with consideration given to the supplier's ability to control costs.

[164] Electricity Networks Association "Feedback on the impact of decarbonisation on electricity lines services" (21 December 2021), p 2.

[165] Commerce Commission "IM Review 2023 - Decision-making Framework paper" (13 October 2022), Chapter 4.

Cross-over with other reopeners

9.31 When evaluating whether to extend pass-through costs and recoverable costs, we have considered what the appropriate boundary is between the role of reopeners, and these other mechanisms.

9.32 We consider the reopener mechanism is more appropriate to use instead of pass-through costs or recoverable costs where the costs were at least partially controllable by the supplier. Accordingly, it would be appropriate to assess the efficiency and prudency of the costs before they could be recovered.

9.33 For example, in the case of catastrophic events or legislative change, although the event may be outside of the control of a supplier, the costs associated with responding to the event are not.

Analysis – extension of pass-through costs

9.34 The IMs currently provide for additional pass-through costs to be specified by way of a DPP, CPP or IPP determination where the cost in question must-[166]

(a) be-

(i) associated with the **supply** of **electricity distribution services**;

(ii) outside the control of the **EDB**;

(iii) not a **recoverable cost**;

(iv) appropriate to be passed through to **consumers**; and

(v) one in respect of which provision for its recovery is not otherwise made explicitly or implicitly in the **DPP** or, where applicable, **CPP**; and

(b) come into effect during a **DPP regulatory period** or, where applicable, **CPP regulatory period.**

9.35 Accordingly, the IMs already provide for additional pass-through costs to be recognised where they meet these criteria and so further amendments are not required to potentially extend the application of pass-through costs.

[166] This representation is in the context of *Electricity Distribution Services Input Methodologies Determination 2012 (consolidated 20 May 2020),* clause 3.1.2 (3), but a similar clause exists for *Gas Distribution Services Input Methodologies Determination 2012 (consolidated 9 September 2022)* at clause 3.1.2 (3), and *Gas Transmission Services Input Methodologies Determination 2012 (consolidated 9 September 2022)* at clause 3.1.2 (3) and *Transpower Input Methodologies Determination 2010 (consolidated 29 January 2020)* at clause 3.1.2 (3).

Analysis – extension of recoverable costs, general

9.36 The decision to make certain expenditure a recoverable cost implies that there may be limited control over the extent of expenditure which a supplier has whilst still meeting good industry practice. In practice, the level of control will vary depending on the expenditure category, but network design or operational decisions will drive, at least in part most expenditure requirements not already provided for as recoverable costs.

9.37 Where the extent of expenditure incurred is at least in part driven by supplier choices, inclusion of the cost as a recoverable cost may change supplier behaviour. In particular suppliers could:

9.37.1 become increasingly risk averse having less focus on active cost control for particular categories of costs, as all costs, efficient or not, are able to be recovered in full;

9.37.2 choose to invest more in this type of category than would otherwise be required to provide network services; or

9.37.3 less actively manage the risk of adverse outcomes, given they are not exposed to the consequences.

9.38 Extension of categories of recoverable costs may also increase revenue volatility with limited ability for the Commission to reassess if significant volumes of costs were allocated. To the extent any extension was made, we consider any the role of recoverable costs would need to be tightly defined. We have considered the specific submissions in this contract and outline this in the next section.

Analysis – extension of recoverable costs, specific requests

9.39 Vector identified a number of specific costs which it considered should be established as pass-through costs or recoverable costs:[167]

> Both cyber security costs and data costs are two prime examples of areas that are rapidly changing and/or where efficient costs are being established. We also consider all legislative, regulatory and government policy driven costs would be appropriate to be included as passthrough costs.

9.40 We acknowledge that technological transformation may result in increases in the amount of cyber security costs and data costs for some suppliers. However, both of these areas have substantial elements of supplier control over the quantum of costs based on network design decisions and operating models, and so are not well suited to being recoverable costs.

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[167] Vector "Submission on the Process and issues paper" (11 July 2022), p.26-27.

9.41 In addition, the current information lacks specificity to identify what is anticipated to be covered by the request and the extent these are outside the control of suppliers. In particular, “data costs” is a wide-ranging term and we would anticipate could capture a substantial amount of a supplier's operations.

9.42 We have similar concerns on the lack of specificity regarding what is anticipated to be covered by the request for inclusion of “all legislative, regulatory and government policy driven costs”.

9.43 We note the existing suite of pass-through costs and recoverable costs already includes a number of these costs which are outside the control of suppliers:

9.43.1 rates on system fixed assets paid or payable by to a local authority under the Local Government (Rating) Act 2002;

9.43.2 levies payable-

9.43.2.1 under regulations made under s 53ZE of the Act;

9.43.2.2 under regulations made under the Electricity Industry Act 2010;

9.43.2.3 under regulations made under the Gas Act 1992;

9.43.2.4 the Commerce (Levy for Control of Natural Gas Services) Regulations 2005;

9.43.2.5 by all members of the Electricity and Gas Complaints Commissioner Scheme by virtue of their membership;

9.43.2.6 by all members of the approved scheme under Schedule 4 of the Electricity Industry Act 2010; and

9.43.3 any levy payable to Fire and Emergency New Zealand under the Fire and Emergency New Zealand Act 2017.[168]

[168] The Fire and Emergency levy is only a recoverable cost in the *Electricity Distribution Services Input Methodologies Determination 2012 (consolidated 20 May 2020)*, (clause 3.1.3(1)(w)).

9.44 Legislative and regulatory requirements will apply across a wide range of functions, similar to other entities which operate in New Zealand. Further specificity is required on what specific legislative or regulatory requirements would be appropriate to include as a pass-through cost or recoverable cost and the underlying logic for this. We note that a "Change event" reopener already exists for changes in, or new, legislative and regulatory requirements which are material and not explicitly or implicitly provided for within a price path. Further discussion on the coverage provided by the change event reopener is in Chapter 6 of this topic paper.

9.45 Government policies can be framed in quite broad terms, and accordingly it is difficult to envisage how these may relate to direct expenditure requirements on a supplier which are outside of a supplier's control.

9.46 In addition, introduction of a Government policy may not require a supplier to incur costs, or they may have more discretion in response, unlike a change in legislative or regulatory requirements. We have also separately assessed whether changes in Government policies may be appropriate to include as a reopener, given this is particularly relevant for GPBs in the current context. This has been considered within Chapter 6 of this topic paper.

9.47 ENA's submission on the decarbonisation workshop stated:[169]

> The existing regime provides for both limited re-openers and resource-intensive customised price-quality path applications. ENA recommends the Commission consider development of contingent allowances, pass-throughs, or other flexibility mechanisms that automatically trigger on the occurrence of specific events. These flexibility mechanisms should allow for collective application. Specifically, the regime must include a pass-through of EDB's carbon abatement costs under the Climate Change Response Act 2002.

9.48 Carbon abatement costs could be managed by a number of practices which are within the control of an EBD, including but not limited to, changes in the use of electric vehicles, use of circuit breakers which use SF6 gases, and purchase of carbon credits etc. Accordingly, we have not extended the scope of recoverable costs to provide for carbon abatement costs.

Contingent expenditure allowances

9.49 The current DPP, CPP and IPP regimes have limited mechanisms, outside of the reopener process, to account for events that were foreseeable at the time of setting a price-quality path but had uncertainty regarding the timing of requirement for investment.

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[169] Electricity Networks Association "Feedback on the impact of decarbonisation on electricity lines services" (21 December 2021), p 2.

9.50 Inclusion of an expenditure allowance which is contingent on a specified trigger or driver occurring may provide a faster process for suppliers to receive increased expenditure allowances during the regulatory period.

Draft decision

9.51 Our draft decision is to not extend the EDB, GTB, GDB or Transpower IMs to incorporate new contingent expenditure allowances as recoverable costs.

9.52 The introduction of contingent expenditure allowance as a recoverable cost may reduce regulatory costs, when compared to consideration of costs through the reopener process to the extent the contingent allowances are able to be considered and established with limited cost at the time of undertaking a price path reset. We are not satisfied that there would be material savings in analysis costs, and there is a risk that required analysis to establish the mechanism is undertaken, but the mechanism itself may never be triggered.

9.53 We consider the incorporation of new contingent expenditure allowances as recoverable costs would not more effectively promote the s 52A purpose. It would be likely to reduce the incentives on suppliers to actively manage their costs. As discussed further below, the expansion would not be consistent with the purpose of relatively low-cost DPP regulation, as specified in s 53K of the Commerce Act.

Problem definition

9.54 Contingent expenditure allowances, as a recoverable cost could be utilised where the need and cost for a particular expenditure is well established but there is uncertainty regarding timing. A contingent expenditure allowance would provide for increased expenditure contingent on a specified trigger or driver occurring.

9.55 Recoverable costs allow suppliers to recover specified costs. A “contingent expenditure allowance” recoverable cost mechanism is distinct from the “Contingent project” reopener discussed in Chapter 6, as it does not have the same process requirements of a reopener, and its impact on the price path is different. Reopeners adjust the FNAR and IRIS forecasts (if applicable) but for recoverable costs these costs are passed on to consumers and are outside the FNAR (or forecast MAR).

9.56 The ENA requested the Commission include contingent allowances or similar mechanisms stating:[170]

[170] Electricity Networks Association “Submission on IM Review Process and issues paper and draft Framework paper” (11 July 2022), p15-16.

> Contingent allowances should be incorporated into the IMs for events that were foreseeable at the time of forecasting but uncertain or were outside the control of EDBs. Typical trigger events for contingent allowances should include large-scale DG and load connections, as the timing and investment decisions are determined by customers and therefore outside EDBs' control.

9.57 Vector represented that contingent allowances could be an alternative to reopeners and make the regime less costly and complex:

> The introduction of contingent allowances as an alternate to re-openers or CPPs would also remove cost and complexity from the regime and administrative burden on the Commission (as recently observed in the delayed Unison reopener decision).[171]
>
> Vector: Consider amending the IM to provide contingent allowances for expenditure reasonably expected (but not certain) during the period. For example, the Commission could provide a certain amount of expenditure to deal with eg, EV connections with access to the allowance triggered only once sufficient EV connections were seeking access to the network.[172]

Analysis

9.58 Contingent expenditure allowances are a mechanism which could apply where the Commission considered the cost of specified projects was material but not provided for in a DPP, CPP or IPP as they represented significant costs, and the commencement dates could not be forecast with an appropriate degree of certainty. A contingent expenditure allowance could provide for increased revenue during the period when a specified trigger occurred.

9.59 There is likely to be a high degree of overlap between the mechanism and the existing EDB Foreseeable major capex project reopener and Transpower expenditure proposal mechanisms.

9.60 The potential value of this mechanism, implemented as a recoverable cost, is a reduction in the requirement for reopeners if the projects identified as conditional on a clearly identifiable trigger or driver can be appropriately specified in a price-quality path determination and the analysis of the need can be undertaken at lower cost at the time of the reset. They would most likely occur where there is high confidence on the need and cost, but the timing is uncertain.

9.61 Contingent expenditure allowances would require a trigger or driver to be specified in the price-quality path determination. The triggers or drivers would need to tie directly to expenditure requirements, with a clear causal relationship to the underlying expenditure requirement.

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[171] Vector "Submission on the Process and issues paper" (11 July 2022), para 143.

[172] Vector "Submission on the Process and issues paper" (11 July 2022), p 36.

9.62 We think it would be preferable that a contingent expenditure allowance, if used, provided a stated dollar value in the determination for each contingent project or programme that is allowed to be recovered.

9.63 We consider if a contingent expenditure allowance warranted a more than limited degree of verification on costs, then it is better established and assessed as a reopener and should be considered under that process.

9.64 However, there are a number of challenges related to contingent expenditure allowances which may make this an undesirable mechanism.

9.65 A contingent expenditure allowance established as a recoverable cost would not be subject to the same incentives as other expenditure provided for within the price-quality path. This is different to the reopener mechanism, which adjusts the price path and IRIS value to maintain incentives on suppliers.

9.66 An increased use of contingent expenditure allowances could create a perverse incentive to represent a wider range of expenditure as being contingent on events than is practically the case and avoid IRIS incentives.

9.67 We consider the requirement for a project specific expenditure assessment to establish contingent expenditure allowances in setting a price-quality path may present a challenge, and be inconsistent with a relatively low-cost DPP particularly where more than a limited degree of verification of the costs is required and where specified amounts are provided for within a DPP Determination.

9.68 Depending on its implementation, a contingent expenditure allowance may require detailed assessment of specific projects given the need to set specified trigger or driver values and expenditure values in the Determination, this is unlikely to be consistent with the relatively low-cost nature of the DPP.

9.69 We note that if contingent expenditure allowances were to be implemented, consideration would need to be given to the accounting for capex-based programmes of work. Without this, capex costs could be recovered immediately in their entirety. This could provide a large change in prices year-on-year and would need rules established to ensure where already recovered as a recoverable cost that expenditure is also not capitalised within the Regulatory Asset Base (**RAB**).

9.70 Vector identified an example for consideration as a contingent allowance, with access to an allowance triggered once sufficient EV connections were seeking access to the network.[173] Whilst we understand an increase in EV connections may drive increased network expenditure requirement, the type and extent of investment required will be driven by the capacity available on specific parts of the network and could be extensive. Whilst EVs will be a driver of potentially increased expenditure requirements, a specified trigger point with direct causal costs would need to be established at a more granular level.

9.71 We have not identified any proposed changes that meet the requirements of the IM decision-making framework.

Use-it-or-lose-it allowances

9.72 Use-it-or-lose-it allowances are a targeted allowance or fund that provides funding for a specified type of activity against a pre-established allocated funding pool.

9.73 The mechanism could be used to:

9.73.1 encourage activities in areas which may otherwise be under-delivered; or

9.73.2 provide a simpler process for suppliers to access additional funds where the costs of a reopener were determined to be a disincentive to desired investments.

Draft decision

9.74 Our draft decision is to not amend the IMs to incorporate new use-it-or-lose-it allowances.

9.75 The introduction of use-it-or-lose-it allowances as a recoverable costs could reduce regulatory costs, when compared to consideration of costs through the reopener process. However, a reopener is likely to provide the benefit of improved quality of information in undertaking an assessment of reasonableness of costs. We consider that the innovative and non-traditional solutions allowance would be a more effective way of encouraging targeted investment.

[173] Vector "Submission on the Process and issues paper" (11 July 2022), p36.

9.76 We consider that additional use-it-or-lose-it allowances are not justified under the IM Review decision-making framework, as required, as there are other mechanisms which provide appropriate incentives to innovate and invest consistent with s 52A and the proposed additions would not promote the s 52A purpose more effectively.[174].

Problem definition

9.77 There may be particular activities which are beneficial to consumers which are not appropriately incentivised by the current regime, either by explicit or implicit incentives associated with the price path or by the perceived costs in applying for certain regulatory tools ie, reopeners.

9.78 The NERA Economic Consulting submission referred to this as uncompensated outputs (or outcomes), stating these:[175]

> are problematic because the EDB will innovate too little to improve these outputs/outcomes. Recall that by uncompensated outputs we mean outputs or outcomes that are desired by customers but EDBs are either not funded to deliver (through their allowances) or provided rewards for good performance (through revenue linked outcome/quality incentives). In other words, there is a conflict between minimising costs compared to improving quality or delivering these outputs/outcomes. Therefore, one type of solution is to reward the EDB for delivering these outputs that are currently not measured.

9.79 There is also a risk that smaller suppliers may be proportionately less likely to apply for reopeners, due to the perceived cost or complexity in engaging in the process. Providing a use-it-or-lose-it allowance may provide a lower cost mechanism for smaller suppliers to access additional funding.

Analysis

9.80 Use-it-or-lose-it allowances are a targeted allowance or fund that provides funding for a particular activity against a pre-established cap, which could either be established as:

9.80.1 funding for expenditure provided in advance, which is subsequently removed at the next reset if expenditure did not occur; or

9.80.2 a pool of funding which is available on application, and if the supplier does not draw all or part of that allowance down (within a regulatory period or specified timeframe) it does not get the remainder.

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[174] The potential role of use-it-or-lose-it allowances is also discussed within Attachment C, Commerce Commission "Part 4 Input methodologies Review 2023 - Draft decision - Financing and incentivising efficient expenditure during the energy transition topic paper" (14 June 2023).

[175] NERA Economic Consulting "Innovation under the DPP - potential barriers and solutions" (report prepared for 'Big six' EDBs, 20 December 2022), para 46.

9.81 Ofgem identifies use-it-or-lose-it allowances as one of its uncertainty mechanisms that it is using in the RIIO-2 price control, with the use-it-or-lose-it allowance used:

> to adjust allowances where the need for work has been identified, but the specific nature of work or costs are uncertain.[176]

9.82 We consider that a use-it-or-lose-it allowance needs to be a targeted allowance with specified criteria against which specific projects or expenditure can be assessed. In the absence of criteria for assessment, it would simply operate as a true-up of actual expenditure versus expenditure forecasted, which would remove the efficiency incentive and would be inconsistent with our regime design of setting allowances in advance.

9.83 Our proposed approach relating to incentivising certain activities is consistent with that outlined by Ofgem in terms of how it represents the role of use-it-or-lose-it allowances within its RIIO-2 framework:[177]

> Purpose: We set UIOLI allowances for certain non-transferable qualifying activities where the need for expenditure has been identified, but there is uncertainty about volumes and costs for those qualifying activities.
>
> Benefits: UIOLI provides licensees with allowances and flexibility in delivering qualifying activities, whilst protecting consumers by ensuring that unspent allowances are returned to consumers.

9.84 Ofgem's application of use-it-or-lose-it allowances allows licensees to recover actual expenditure subject to the expenditure incurred being efficient. The recovery of the actual expenditure is subject to a cap set out in the supplier's licence condition. Any underspend is clawed back, and licensees bear the costs of overspends.

9.85 The submission from NERA Economic consulting also provides a useful summary of the potential role and international application of targeted allowances and funds:[178]

> Targeted allowance or fund: which is an allowance that can only be spent on a specific category that is difficult to measure in the allowance setting process. The purpose is to incentivise innovation in the direction of generating the uncompensated outputs/outcomes.
>
> For precedent, Ofgem has several use-it-or-lose-it allowances for specific purposes. Regarding examples, there is a visual amenities allowance (to address environmental impacts eg, pollution) and the worst served customer allowance (to mitigate the number of interruptions experienced by customers who experience unusually poor service)."

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[176] Ofgem "RIIO-2 Final Determinations - Core Document (Revised)" (3 February 2021), para 7.2.

[177] Ofgem "RIIO-2 Final Determinations - Core Document (Revised)" (3 February 2021), para 7.35.

[178] NERA Economic Consulting "Innovation under the DPP - potential barriers and solutions" (report prepared for 'Big six' EDBs, 20 December 2022), p 21.

Application of use-it-or-lose-it allowances to encourage investment in targeted areas

9.86 We consider that use-it-or-lose-it allowance mechanism could be particularly useful where uncertainty exists around the extent of expenditure which may be required but increased investment in that targeted area may be beneficial. This could be particularly relevant in areas with lower levels of expenditure historically, which could be encouraged in a capped environment.

9.87 Use-it-or-lose-it allowances require clear definitions, where allowances apply, the type and extent of any ex-post verification required and a balance of prescriptiveness to meet the criteria for the allowance whilst providing suppliers with the ability to deliver qualifying activities in the most efficient way.

9.88 We do not propose to introduce use-it-or-lose-it allowances to encourage investment in targeted areas. We consider that the innovative and non-traditional solutions allowance is a more effective way of encouraging targeted investment, promoting the Part 4 purpose in s 52A more effectively. [179]

Application of Use-it-or-lose-it-allowances to reduce regulatory costs

9.89 Following the reopener workshop, we asked for feedback on whether a use-it-or-lose-it mechanism in a DPP context may help cater to different supplier size, reducing the number of potential reopener applications. This included the following question:[180]

> Do you consider that there may be value in us considering a range of in-period adjustment mechanisms, eg, reopeners used for larger suppliers and as part of the DPP, use-it-or-lose-it allowances for smaller suppliers, and if so, why?

9.90 Feedback reflected that suppliers saw potential benefit in the application of a use-it-or-lose-it mechanism, but its application should not be restricted to only smaller suppliers with:

9.90.1 Aurora stating that large EDBs have more capacity to absorb the costs of preparing a reopener application, but a reopener project has a greater consumer price impact for small EDBs owing to scale effects;[181]

9.90.2 Vector stating it did not see any benefit in preventing larger EDBs from using alternative adjustment mechanisms to manage uncertainty where the need arises;[182] and

[179] Commerce Commission "Part 4 Input methodologies Review 2023 - Draft decision - Financing and incentivising efficient expenditure during the energy transition topic paper" (14 June 2023), section 6b.

[180] Commerce Commission "IM review 2023 – In period adjustment mechanisms – Workshop follow up questions" (5 December 2022), question D3.

[181] Aurora Energy "Submission on Price-quality path workshop" (20 December 2022), para 42.

[182] Vector "Submission on Price-quality path workshop" (20 December 2022), p 9.

9.90.3 Horizon stating the concept of a use-it-or-lose-it allowances would enable it to respond to changing consumer needs that may not have been forecast at the start of the DPP period.[183]

9.91 We note that targeted refinements to our reopener process and further communication on its expectation are expected to reduce the burden for all reopener applications, large or small. The introduction of the Large Connection Contract (**LCC**) mechanism for EDBs is also expected to reduce the volume of potential reopeners required for customer connection expenditure, this is discussed further in Chapter 8.

Application of a use-it-or-lose-it allowance for Transpower

9.92 Transpower submitted that the Capex IM should include what it called uncertainty mechanisms for expenditure that could be passed through in a 'use-it-or-lose-it' fashion. Transpower suggested that these could apply for certain categories of expenditure such as pro-active resilience capex, major IST renewals projects, and to address the First Mover Disadvantage type 2 investments following introduction of the new Transmission Pricing Methodology.[184]

9.93 We have addressed these proposed use-it-or-lose it mechanisms in the *"Transpower Investment"* topic Paper and determination changes. For example, we have amended the Capex IM to ensure Transpower has a means to economically test and cost-recover First Mover Disadvantage type 2 investments.

9.94 Similarly, cost uncertainties surrounding major IST projects have been addressed by allowing these to be removed from base capex proposals and categorised as Listed Projects, while resilience capex can be either a major capex proposal (**MCP**) or as enhancement and development (E&D) capex in a base capex proposal. There is also an E&D reopener available to Transpower in each regulatory period.

Conclusion regarding application of use-it-or-lose-it allowances

9.95 We do not propose introducing a use-it-or-lose-it allowance for smaller suppliers to reduce the potential requirement for reopeners. We note design of use-it-or-lose-it allowances requires specificity of where allowances might apply, confirmation these are not implicitly or explicitly provided for in the price path, or by other mechanisms ie, innovation and non-traditional solutions allowance and targeted consideration of the type and extent of any ex-post verification which may need to apply.

[183] Horizon Energy Group "Submission on Price-quality path workshop" (20 December 2022), p 7.

[184] Transpower NZ Ltd "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), p30.

9.96 We consider that the regime provides appropriate incentives to innovate and invest and that the added complexity of use-it-or-lose-it allowances are not warranted at this time. They would not promote the Part 4 purpose in s 52A more effectively, nor would they significantly reduce compliance costs, other regulatory costs, or complexity.

Quantity wash-up mechanisms

9.97 The current DPP, CPP and IPP regimes forecast potential drivers of costs relating to forecasted increases in quantities. It does not have an automated mechanism for revenue adjustments to be undertaken ex-post where these forecasts do not represent actual outturn values.

Draft decision

9.98 Our draft decision is to extend the IMs to introduce a connections volume wash-up mechanism in the IMs for EDB CPPs, but not DPPs. This is discussed within Topic 3c in Chapter 3 of the *"Financing and incentivising efficient expenditure during the energy transition"* topic Paper.

9.99 The introduction of quantity wash-up mechanisms may reduce the risks associated with providing appropriate expenditure allowances which are related to quantities which are difficult to forecast. However, we have not identified other quantity wash-up mechanisms at this stage which would be sufficiently beneficial to implement, when compared to the potential design and implementation issues. There is a risk that the design or implementation of further quantity wash-up mechanisms may increase complexity of the regime without directly promoting s 52A more effectively.

Problem definition

9.100 Supplier expenditure forecasts are based upon several underlying quantity forecasts which are subject to intra-period volatility, including but not limited to customer connections, energy delivered (MWh) and maximum coincident system demand (MW) for EDBs and Transpower and customer connections, maximum daily load (GJ per day) and total gas conveyed (GJ per annum) for GPBs.

9.101 These expenditure forecasts are subject to uncertainty due to uncertainty of input costs, but also the uncertainty regarding underlying quantity forecasts. As represented by submissions which have stated for EDBs:

There is likely to be significant uncertainty about the pace and scale of customer capex driven by decarbonisation. Under current DPP capex forecasting approaches, EDBs must estimate their customers' requirements for network connections and upgrades for the purpose of determining DPP capex allowances.[185]

There is increasing understanding of the types of investment that EDBs will need to make to enable electrification; however, the timing and scale of investment remains subject to uncertainty.[186]

9.102 Similarly, both FirstGas and Vector noted for GPBs that there was the potential for material change arising from Government policy or other relevant matters related to the future of reticulated gas.[187]

9.103 The GDB and GTB exposure to demand risk is considered in the form of control section in Topic 3e in the *"Financing and incentivising efficient expenditure during the energy transition"* topic paper.

9.104 The assessment of the potential use of quantity wash-up mechanisms within this section is focussed on targeted drivers of expenditure which may be more difficult to forecast, rather than broader quantity variation risks.

Analysis

9.105 A quantity wash-up mechanism is an uncertainty mechanism which allows revenue to vary as a function of a volume measure. This results in adjusted expenditure allowances in line with actual values where the volume of work required over the regulatory period is uncertain.

9.106 The mechanism could be used to partially address quantity forecasting risks inherent in setting a price-quality path. The objective would be to place the supplier in approximately the same position as it would have been if the actual quantity was known at the commencement of the regulatory period when prices were set.

9.107 The wash-up mechanism returns to, or recovers from, a supplier's consumers any under- or over-recoveries of revenue resulting from differences between actual and forecast values.

[185] Unison – "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 46(c).

[186] Aurora Energy "Submission on IM Review Process and issues paper and draft Framework paper" (11 July 2022), para 61.

[187] First Gas Limited "Submission on IM Review Process and issues paper and draft Framework paper" (13 July 2022), p2 ; Vector "Submission on the Process and issues paper" (11 July 2022), para 63.

9.108 Design of quantity wash-up mechanisms needs to consider how directly related the volume metric is to the expenditure requirement. Some measures ie, kWh consumption or EV uptake, may have an indirect correlation to expenditure requirements as it will depend on available network capacity which will vary across locations. This may be practically challenging given the requirement for establishment of a proxy cost to equate to the volume requires the cost of each unit to be relatively stable.

9.109 We have noted a number of issues which would need to be considered and addressed in the design of quantity wash-up mechanisms were further expansion of this type of mechanism to be applied:

9.109.1 The quantity measure would need to directly align with the expenditure requirement, with a direct causal relationship to the change in network investment requirements. The nature of infrastructure means investment to provide a step-change in capacity often occurs at the start and is then progressively utilised over time. Accordingly, metric design would need to consider the timing of the metric compared to network investment timing requirement.

9.109.2 There are significant variations in network characteristics both within and across networks. Metrics may be difficult to design without resulting in the risk of windfall gains or losses.

9.109.3 The use of proxy costs may provide an incentive for a supplier to only deliver those services which can be provided at less than the standardised unit of cost. This could result in a focus on the delivery of projects which are easy to deliver, rather than those of highest benefit to the network.

9.109.4 Metric design would need to consider incentives on suppliers, particularly where additional revenue is provided for increases in quantity metrics. A wash-up would need to be designed to ensure it encourages appropriate network management ie, ensure it does not disincentivise managing load growth, discourage flexibility services-based solutions etc.

9.109.5 Proxy costs may be difficult to establish and may be reflective of historic network requirements, rather than anticipated network requirements. Establishing what the value for an additional unit of quantity will be challenging, particularly with restriction on benchmarking although use of external verification processes may help.[188]

[188] Section 53P(10) of the Commerce Act states: The Commission may not, for the purposes of this section, use comparative benchmarking on efficiency in order to set starting prices, rates of change, quality standards, or incentives to improve quality of supply.

9.109.6 Any quantity wash-up would need to be separable from what we have funded suppliers for either explicitly or implicitly within the price path.

9.109.7 There is the potential for quantity wash-up mechanisms to drive volatility in pricing if significant amounts of expenditure were subject to a wash-up.

9.110 Whilst we have identified a number of challenges to consider in the implementation of any quantity wash-up there is precedent for a quantity wash-up within a revenue cap within our regime. The Fibre IMs provide for an adjustment to be made to the connection capex baseline allowance that reflects changes in Chorus' actual connection volumes during the regulatory period.[189]

9.111 Aside from the proposed connections volume wash-up mechanism in the IMs for EDB CPPs, which is discussed in more detail at Topic 3c in Chapter 3 of the *"Financing and incentivising efficient expenditure during the energy transition"* Topic Paper , our draft decision is not to introduce additional quantity wash-up mechanisms as the potential benefits do not outweigh the complexity and risks around design and implementation, and the proposed change would not promote the Part 4 purpose in s 52A more effectively.

[189] *Fibre Input Methodologies Determination 2020, as amended on 29 November 2021*, clause 3.7.21.