Date:

3 November 2016

Name of submitter:

Electricity Networks Association

Industry/area of interest:

Utilities/infrastructure

Contact details

Graeme Peters, Chief Executive

Address:

Level 5, Legal House

101 Lambton Quay

WELLINGTON 6011

Telephone:

64 4 471 1335

Email:

gpeters@electricity.org.nz

Input methodologies review: Technical consultation update paper

Submission to the Commerce Commission

Final

From the Electricity Networks Association

Contents

1. Introduction

1. The Electricity Networks Association (ENA) appreciates the opportunity to make this submission to the Commerce Commission (Commission) on the consultation paper **Input methodologies review: Technical consultation update paper, 13 October 2016 (Technical consultation paper)**.

2. The ENA represents all of New Zealand's 29 electricity distribution businesses (EDBs) or lines companies, who provide critical infrastructure to NZ residential and business customers. Apart from a small number of major industrial users connected directly to the national grid and embedded networks (which are themselves connected to an EDB network), electricity consumers are connected to a distribution network operated by an ENA member, distributing power to consumers through regional networks of overhead wires and underground cables. Together, EDB networks total 150,000 km of lines. Some of the largest distribution network companies are at least partially publicly listed or privately owned, or owned by local government, but most are owned by consumer or community trusts.

2. Overview of submission

3. This submission first discusses the live industry issue of compliance with the DPP quality standards in the light of recent changes to health and safety legislation, which the Commission has requested comments on in this consultation round. The submission builds on our recent letter to the Commission and responds to the discussion of quality standard reopeners in the Technical consultation paper.

4. The submission then comments on the draft IM determination in the order of the sections within the IM. For each section of the IMs we discuss the substantive outstanding topics with those sections and provide a table which contains a clause-by-clause discussion of the issues we have identified with the draft determination.

5. Attached to this submission is a marked up copy of the draft IM determination. This is the draft IM determination published by the Commission on 13 October alongside the Technical consultation paper with the ENA's suggested changes indicated by:

    - Underline text, for recommended additions.
    - Strikethrough text, for recommended deletions.

6. The reasoning for our substantive comments on and recommended changes to the draft IM determination are described in this submission.

7. While we are grateful for the opportunity for input at this important drafting stage we note that reviewing the draft IM determinations has been somewhat challenging as the explanations for many of the changes which have been made following submissions has been limited. This has made it difficult in some instances to understand the intent behind the proposed amendments. In this respect we would be happy to discuss our drafting suggestions with the Commission before the final determinations are made.

3. Quality variation reopeners

8. The Technical consultation paper provides the Commission's view that the new quality standard reopener cannot apply before 1 April 2020 due to the requirements of section 53ZB of the Act.[1] We do not dispute this view.

9. However, as discussed in our letter to Sue Begg titled *Re: Impact of a reduction of live line work on Non-Exempt EDBs under the Default and Customised Price Quality Path*, the effect of new health and safety legislation on EDBs' quality standards is becoming pressing. We consider that the current change event reopener may be a workable option provided the materiality threshold is suitable for a quality standard context.

10. The Technical consultation paper proposes removing the materiality threshold for change events that make the IMs unworkable. We recommend either that the materiality threshold is also removed for change events that affect the quality standard, or that these events have a quality-specific materiality threshold (e.g. an event that changes SAIDI or SAIFI by, say, 3% per annum for the remainder of the regulatory period). The current issues for live line work created by changes to health and safety legislation have highlighted the prospect for change events to affect the quality standard also. The problem is that a percentage of revenue is not a useful or meaningful materiality threshold for a change to a quality standard.

11. In any event this change should be made to apply from 1 April 2020. However, if the Commission agrees to remove the materiality threshold for change events that affect the quality standard, we consider this should apply to change events in the current regulatory period also. We consider this would be consistent with section 53ZB because the DPP is not being directly reopened because of a change in the IMs. Instead the DPP is being reopened by a change event, which now has a workable materiality threshold in relation to the quality standard.

12. We note that to implement this approach successfully, the transitional provisions would need to provide that the amendments to Part 4 of the IMs apply from the commencement date of the IM amendments and not from 1 April 2020.

13. Alternatively, a more straightforward approach could be for the Commission to amend the quality standards as required in the DPP determination under section 52Q of the Act. As the method for setting the quality standard is not specified in the IMs, this seems to be an appropriate way forward. We accept the Commission would require supporting information from each EDB in order to adjust the quality standard requirements in the DPP.

[1] Technical consultation paper, paragraph 53.

4. Part 1: Transitional arrangements

14. This section considers the arrangements the Commission has proposed for transitioning to the new IMs. These are somewhat convoluted and we consider that some changes could be made more quickly than is proposed.

15. Our main comment is that the draft determination and the Technical consultation paper disagree regarding the timing of when the amendments to the non-cost allocation information disclosure (ID) IMs (Subparts 2-4 of Part 2) take effect. Paragraph 58 of the Technical consultation paper states the Commission intends to update the ID determinations to reflect the new IMs "by the end of 2017" and assumes that the new IMs "would apply for the 2017-18 disclosure year" in respect of ID.

16. However, clause 1.1.2(4)(b) of the draft IM determination states that the non-cost allocation ID IMs would only "apply from the first disclosure year of each DPP or CPP determined after the commencement date".

17. We support the Commission implementing the new ID IMs (excluding cost allocation) in the 2017-18 disclosure year. The Commission should also prioritise amending the ID determinations to resolve the outstanding issues with the drafting at the same time. We do not support delaying the application of these ID IMs to the start of the next DPP or CPP determination for the following reasons:

    - There is no reason to delay the implementation of ID IMs until the next price-quality path resets.
    - It is not clear when, or if, these updated ID IMs would apply to exempt EDBs.
    - If an EDB applies for a CPP they will face different ID IMs than other EDBs up to 2020, which would not be sensible.

18. We agree the new IMs should apply to customised price-quality paths from the date the amendment determinations take effect, noting that the updated cost allocation IM would not immediately apply as the CPP IMs draw from Part 2 in relation to cost allocation.

Clause	Discussion
1.1.2(4)(b)	As discussed above, this clause is incorrect and should provide for the IM amendments to Subparts 2-4 of Part 2 to take effect from the commencement of disclosure year 2018.
1.1.2(4)(d)	As discussed in the Quality variation reopeners section of this submission, this clause should provide that the IM amendments come into force on the commencement date of the amendment determination.
1.1.2(4)(f)	This clause makes some erroneous references. The references to clauses 4.5.5 and 4.5.6(1)(c), 4.5.6(1)(d) and 4.5.7(2)(b) are for clauses that do not appear to mention a quality standard variation CPP. The wording of the clause also does not align with the wording of other clauses in 1.1.2(4). We have suggested wording changes to adjust for this.

5. Part 1: Definitions

19. This section considers the definitions contained in clause 1.1.4 of the draft IM determination.

Clause	Discussion
1.1.4 – actual allowable revenue	This definition of actual allowable revenue should refer to clause 3.1.3(13)(e) only. The definition of actual allowable revenue does not vary depending on whether a year is the first or a subsequent year of a regulatory period.
1.1.4 – capital contribution	The draft IM determination retains the reference in the definition of capital contribution to money or other consideration received for the "acquisition" of assets. We remain of the view that this is an unnecessary addition. We cannot conceive of a circumstance where a contribution would be received in respect of an asset acquisition. We request the Commission either explain when this would occur or remove the amendment to the definition.
1.1.4 – tax depreciation rules	Clauses (a) and (b) of this definition are identical.
1.1.4 – term credit spread difference & differential	The definition of term credit spread difference refers to clauses 2.4.8 and 5.3.24. These should be 2.4.8(1) and 5.3.24(1). The definition of term credit spread differential refers to clause 5.3.23(1). This should be clause 5.3.23.

6. Subpart 1 of Part 2: Cost allocation

20. This section considers the amendments made to the cost allocation ID IMs. While the ENA disagrees with the removal of the ACAM option from the IMs, we have considered the drafting of how to implement this if the Commission does not change its updated draft decision.

21. Our most significant comments on this section are that:

- The ACAM limit should apply only to OVABAA allocations, not all cost allocations made under Subpart 1 of Part 2.
- The ABAA allocation clause does not provide for costs to be allocated to unregulated services under ABAA.

Clause	Discussion
2.1.1(4)	This clause would fit better in clause 2.1.2 as it is an allocation constraint. Also, this clause implies that ACAM should be the limit for ABAA allocations. This is unnecessary and adds cost. It is unnecessary as it is very unlikely ABAA would allocate more to a regulated business than ACAM. It is costly because every EDB will need to apply both ACAM and ABAA every time they allocate costs to reflect the requirements of this clause.
2.1.3	This clause only provides for allocations to regulated services under ABAA. The cost allocation IM would be clearer if this clause stated that ABAA could also allocate costs to unregulated services.
2.1.3(3)-(5)	These clauses are consistent with the draft decision. However, they seem out of place in the IMs and would be more appropriate in an ID determination (they will not apply until the ID determination is updated in any case). The ID determination requires other explanations – e.g. explanations for changes in cost allocation approach and the explanations required by Schedule 14. However, none of these explanations are also specified in the IMs. It is not clear why a particular set of explanations are required to be specified in the IMs.
2.1.3(4)-(5)	These clauses refer to "a selected quantifiable measure". This term is confusing and can be deleted as the focus of the explanation should be on why a particular allocator is chosen, not on why a selected quantifiable measure is chosen as an allocator.
2.1.5	This clause is unclear as it does not clarify when ACAM may be used, or why, and the instructions that a supplier "must" take certain actions may be confusing in a context where ACAM is only able to be applied as an upper bound for other allocation approaches. We have suggested wording to clarify that this clause is only to be applied for the purpose of ensuring that allocations of costs to the regulated services under OVABAA do not exceed the allocations that would be made under ACAM.

7. Subpart 2 of Part 2: Asset valuation

22. This section considers the drafting amendments made to the ID asset valuation IMs.

23. We note the drafting of the 15% accelerated depreciation is unchanged from the previous draft determination and the consultation material does not respond to submissions on this point. The current drafting only makes this option available to non-exempt EDBs at the time DPPs are set and not for exempt EDBs. For reasons described in our previous submission[2] this mechanism should also be available for exempt EDBs.

[2] ENA, Input methodologies review – Topic paper 3, impact of emerging technologies: Submission to the Commerce Commission, 4 August 2016 paragraph 42.

24. We refer the Commission to the drafting recommendations accompanying our previous submission on the draft decision determination for implementation of this recommendation.[3]

25. Additionally, it does not appear that 15% accelerated depreciation is available as part of a CPP, even though paragraph 92 of the relevant draft decisions paper[4] implies this was the intention.

Clause	Discussion
2.2.8(4)(a)	The term "aggregate opening value for existing assets" should be "aggregate opening **RAB** value for existing assets" [new wording in bold].

8. Subpart 4 of Part 2: Cost of capital

26. This section of the submission responds to the proposals in the Technical consultation paper regarding debt issuance costs and the historical average for the debt premium. It then considers the drafting amendments made to the ID cost of capital IMs.

8.1. Debt issuance costs

27. The Technical consultation paper proposes to move the recovery of debt issuance costs from the regulatory cost of capital allowance to regulatory cash flows. The ENA does not support this proposal. The Technical consultation paper is the first time this proposal has been raised, which is extremely late in the IM review process for a substantive new issue to be put on the table. The paper also provides insufficient justification for moving away from the status quo. The ENA submits that retaining debt issuance costs in the WACC appropriately recognises that issuance costs are part of the costs of financing. Importantly, the use of a notional debt issuance cost allowance ensures that it is internally consistent with the notional leverage assumption, and the underlying basis for the regulatory WACC estimate.

28. This is consistent with the 2010 IM Reasons Paper, which sets out the Commission's original rationale for including issuance costs as part of the WACC allowance. It states that "…[since the WACC IM] provides a supplier with compensation for a notional cost of debt capital rather than its actual cost of debt capital … it should also incorporate the debt issuance costs as a notional amount in the cost of debt capital rather than as an actual cost in the cash flows." (para H5.94) The Technical Consultation paper has not suggested that this rationale is no longer appropriate, and therefore we do not accept that a change in approach is warranted.

29. In addition, and as stated in our submission on the Draft Decision, the ENA is of the view that there is insufficient evidence to modify the current allowance of 35 bps. It is therefore consistent with good regulatory practice, and the framework for the IM review to retain the current approach and allowance.

[3] Drafting changes in clauses 2.2.5, 2.2.8(4) and 4.2.2 of ENA mark-ups on draft EDB IM determination as submitted on 18 August 2016.

[4] Commerce Commission, Input methodologies review – Topic paper 3, impact of emerging technologies in the energy sector, 16 June 2016.

30. We note that the proposed approach raised a number of implementation details which appear to have not been considered in the draft amendments. Importantly components of operating expenditure and cost of debt are used throughout the IMs, and the proposed amendments will have flow on effects into the application of them within the various regulatory processes and methods.

31. Accordingly, the ENA submits that the recovery of debt issuance costs should remain within the cost of capital.

8.2. Historical average for debt premium

32. The Technical consultation paper states that the Commission is considering the adoption of a trailing average method for estimating the debt premium, to be based on historical data over 5 years.

33. We note that the proposed method is an average of 5 annual 3-month samples.

34. The ENA supports a move to a historical average approach for the debt premium. However, the ENA questions why the historical average has been specified in this way, and not as an average of the full five year period. This could be achieved for example by extending the annual determination window to 12 months, or by estimating a debt premium every quarter and then averaging the quarterly values over 5 years.

35. We also note some ambiguity in the Technical consultation paper about how the new proposal would apply in practice, and in particular what specific months would be used as for the determination windows for ID and DPPs/CPPs. The paper states that the same average debt premium would be applied to ID and DPP (para 95), and the proposed drafting is consistent with that. The proposed drafting suggests that the determination window therefore would be January to March each year for EDBs.

36. However, this proposal is sub-optimal for DPPs as information for the January – March period immediately prior to a DPP reset would not be available at the time a DPP was reset. Accordingly the data would need to be derived 12-15 months prior to the reset.

37. We also note that this proposal is inconsistent with the proposed determination windows for the risk-free rate, which are to be January to March for ID and June to August for the DPP. The ENA submits that these same windows should be used for estimating the debt premium, if the proposed approach is adopted.

Clause	Discussion
2.4.2(6)	Previous clause 2.4.2(6) setting the debt issuance costs at 0.35% should be reinstated for the reasons discussed in the Cost of Capital section of this submission.
2.4.4(3)	As discussed above we recommend this clause is amended to calculate the debt premium over full five year timeframe.
2.4.8	The adjustment for issuance costs has been removed from the calculation of the TCSD, as a result of moving the debt issuance costs recovery from the WACC allowance to cash flows. We suggested above that debt issuance costs should remain part of the WACC allowance. Consistent with this, we consider that the adjustment to the TCSD for issuance costs should remain unchanged.

9. Part 3: IMs for DPPs and CPPs

38. This section considers the detailed drafting for implementing the new revenue cap and associated wash-ups, as well as the other pass-through and recoverable costs.

39. Our key points on this section are:

- We welcome the removal, since the previous draft, of the cap and collar on the draw-down amount.
- The revenue cap method and associated wash-up mechanism is still too complicated. The IMs would be much simplified if clause 3.1.3 could be split into separate clauses.
- We do not support the 'function of demand' proposal. Firstly it is not clear that a smoothing mechanism is necessary. Secondly, it is not clear how a 'function of demand' rate of increase would be set and we are concerned the limit this places on price changes may be unsustainable. The IMs should not tie the Commission into using this method at this time before it has been worked through.
- The forecast of CPI should no longer track to the mid-point of the RBNZ range as recent years have shown that this is not a credible inflation forecast.
- The IMs should provide that any outstanding pass-through balance is included in the wash-up account at the start of the next regulatory period.
- The IMs should use a consistent rate for making time value of money adjustments.
- The flow charts included in the Technical consultation paper should be reviewed for accuracy and consistency with the IMs.

Clause	Discussion
3.1.1(2) and 3.1.1(5)	Our interpretation of these clauses is that the price compliance test for determining whether prices change by more than forecast allowable revenue as a function of demand is a price smoothing mechanism. We are not convinced this price smoothing mechanism is necessary. EDBs already take steps to smooth price shocks for their consumers and adding an additional compliance test to resolve a problem that may never arise is not good practice. The consultation material also does not provide sufficient detail on how the function of demand may be specified and without this information it is difficult to comment on the proposal. Also, the proposed smoothing mechanism is based on forecast allowable revenue. Forecast allowable revenue, as defined in clause 3.1.1(4) includes pass-through and recoverable costs and the wash-up account balance. This means: • the smoothing mechanism applies to total prices rather than just regulatory prices and thus EDB's revenues net of pass-through and recoverable costs can increase

Clause	Discussion
	faster or slower than the rate of change in the function of demand by virtue of changes in the growth rate of pass-through and recoverable costs. • the smoothing mechanism is gross of the wash-up account balance. If an EDB has a large wash-up account balance they will be prevented from recovering it as a result of this smoothing mechanism. If the rate of change in the function of demand is low, then conceivably an EDB would be effectively unable to wash-up for the differences between actual and allowable revenue as the constraint would be too tight to allow material changes. We are also unsure why the price smoothing limit relates to forecast allowable revenue rather than forecast revenue from prices, which will reflect the prices that are actually set by the EDB. The challenge is finding a smoothing mechanism that is sufficiently high to accommodate standard CPI-X price changes, plus fluctuations in pass-through costs, plus allowing wash-ups to be made in a reasonable timeframe. We are not convinced that a 'function of demand' calculation will necessarily achieve this. A cleaner approach may be for the section 52P determination to specify a price limit as a direct percentage. This debate could be engaged in at the time of the next DPP price reset. Specifying in the IMs that the 'function of demand' approach must be used may tie the Commission to an approach that turns out to be problematic in practice.
3.1.1(2)	This clause provides that the annual increase in forecast allowable revenue as a function of demand may not exceed the percentage increase specified in a 52P determination. Our assumption is that this limit on the revenue path would not bind in the first year of a regulatory period where the forecast net allowable revenue is specified by the Commission. This transitional point is not stated in the IMs or in the Attachment B flow-charts.
3.1.1(4)	The new term forecast allowable revenue is defined in this clause as: "includes (a) forecast net allowable revenue; (b) forecast pass-through costs; (c) forecast recoverable costs…; and (d) the balance of the wash-up account before calculating an amount for draw down…" The term "includes" is unhelpful as it implies forecast allowable revenue includes other items than those listed but these other items are not stated in the IMs. This is likely to cause confusion. We suggest specifying that forecast allowable revenue equals the sum of the items listed in clause 3.1.1(4). The wording of subclause (d) could also be simplified and we have suggested wording in this regard.
3.1.1(8)(a)	This clause still references paragraphs (b) and (c) of the definition of CPI in clause 1.1.4 even though what was paragraph (b) of that definition has now been deleted.

Clause	Discussion
3.1.1(8)(c)	This clause does not reflect plausible CPI trends and we recommend changing it. As previously explained by CEG,[5] we are in a period of consistently low inflation that is well below the mid-point of the RBNZ target range. A method that requires an assumption that CPI will track back to the mid-point in a relatively short timeframe is not realistic. We recommend this clause adopts the solution provided in clause 3.3.15(6)(b) of the IMs where forecast CPI beyond the end of the RBNZ forecast is set equal to: a constant annual percentage change equal to the arithmetic mean of the values forecast in the most recent four quarters in respect of which a RBNZ forecast has been made.
3.1.1(9)-(10)	The Technical consultation paper proposes removing the term 'posted' from the definition of price on the grounds that the Commission does "not consider it necessary under a revenue cap". We are not sure why the term posted would be more or less relevant under different forms of control – the price still needs to be multiplied by quantities to determine actual and allowable revenues. The term posted is not defined in the current IMs and there may be no harm in removing it, but we are not persuaded that its removal is necessary and request further information from the Commission on why it thinks this is not relevant.
3.1.3 - general	With the growth in the number and complexity of recoverable costs, clause 3.1.3 of the draft IM determination has become unwieldy and difficult to follow. We suggest the IMs could be made more user-friendly by splitting this clause in one of the following ways: • have separate clauses for wash-ups and for financial incentives • have separate clauses for wash-ups associated with the revenue cap and for all other recoverable costs. We have not marked up drafting suggestions in the attached draft IM determination to implement this suggestion as this would distract from the substantive recommendations we have made in this clause.
3.1.3(1)(7)	The Commission has not proposed changes to this clause from the previous IM determination. However, reviewing it again, it does not appear quite correct. Payments made by an EDB under the extended reserves scheme would never be negative recoverable costs that result in lower prices – this would mean EDBs pay twice, once to other EDBs and once to their consumers. Instead, where an EDB makes a payment under the extended reserves scheme (if this is implemented) that EDB would need to recover those additional costs from its consumers and these costs would need to be a positive recoverable cost. This is consistent with the definition of 'extended reserves allowance' in clause 1.1.4.

[5] CEG, Key reforms to rate of return under the IMs: report for the ENA, February 2016, section 8.2.

Clause	Discussion
	Conversely, where an EDB receives a payment under the extended reserves scheme, the EDB would be likely to pass these on to consumers and could do so as a negative recoverable cost. For the avoidance of doubt, subclause (b) of this clause is reasonable where it would allow EDBs to benefit from investments to facilitate an extended reserves scheme without those revenues being required to be passed through or treated as other regulated income.
3.1.3(9)(a)	This clause provides that "necessary adjustments may be made" to BBAR in order to set forecast net allowable revenue for a disclosure year as part of the capex wash-up. It is not clear what "necessary adjustments" means or who is empowered to make those necessary adjustments and in what circumstances with what scrutiny. The lack of clarity is inconsistent with the statutory purpose of IMs. We recommend this clause is deleted or clarified.
3.1.3(9)(b)	This clause provides that the discount rate must be determined by discounting BBAR "to the end of the preceding DPP regulatory period". This is workable where the capex wash-up applies for a DPP. However, where a capex wash-up applies for a CPP the intent is not to discount to the end of the previous DPP regulatory period, but to the point in the current DPP regulatory period at which the CPP began.
3.1.3(11)(b)	This clause provides that an urgent project allowance can be applied where net costs would not (among other tests) be included in a value of commissioned asset. This is unnecessarily restrictive and may lead to perverse outcomes where asset values cannot be recovered through an urgent project allowance even where they would not be recovered. We recommend that this clause refers to costs that "will not be otherwise recovered by the EDB".
3.1.3(12)	The draft IMs do not specify what will happen to any pass-through balance that is carried over from the current DPP regulatory period when the new revenue cap begins on 1 April 2020. The ENA's understanding is that it was the Commission's intent to provide for balances to be carried forward. In the final 2015 DPP Determination the Commission had removed its earlier draft Determination proposal to restrict carrying forward recoverable cost balances. We recommend that the Commission confirm that any outstanding pass-through balance is included in the wash-up account and may be drawn down in the 2021 regulatory year.
3.1.3(1)(p) 3.1.3(1)(q) 3.1.3(12)(e) 3.3.2(2)(b)	These clauses apply the time value of money adjustments for various recoverable cost items (the revenue cap wash-up, the capex wash-up adjustment, the transmission asset wash-up adjustment and IRIS incentive amounts). The clauses are inconsistent in that some of them apply the 67th percentile estimate of WACC to calculate the time value of money adjustment and some apply the cost of debt.

Clause	Discussion
3.3.10(2)(a) and Figure 2	There is no clear reason for these differing approaches. The ENA recommends that the cost of capital is used to calculate the time value of money across the IMs, which appears to be consistent with the Commission's current view. Where the 67th percentile estimate of WACC is used to calculate time value of money adjustments it would be helpful to clarify that this is the 67th percentile estimate of vanilla WACC.
3.1.3(12)(e) and Figure 2	With regard to the revenue cap wash-up time value of money adjustment, the IMs do not specify how this will be calculated but state that it will be set out in a section 52P determination. As such, we recognise the calculation will be assessed again for the 2020 reset. However, the time value of money formula as set out in Figure 2 of Attachment B of the Technical consultation paper does not properly account for the transition to the revenue cap. The formula includes an adjustment for the 'wash-up amount t-2', but in the first two years of the next regulatory period there will be no wash-up amount t-2.
3.1.3(13)(a)	The drafting of this clause implies the voluntary undercharging amount itself, rather than the formula of how to calculate it, will be specified in the DPP determination. We question whether this is consistent with the Commission's intention.
3.1.3(13)(c)	The ENA continues to oppose the arbitrary cap on revenue wash-ups due to major negative demand shocks, for reasons discussed in our previous submission.[6] If the cap is applied it should be a percentage cap on the forecast allowable revenue, not the forecast net allowable revenue. The wash-up is, otherwise, a wash-up of the full difference between actual revenues and actual allowable revenues, inclusive of pass-through and recoverable costs. The wash-up limit should be set on this basis. Approximately 1/3 of EDB revenues relate to pass-through and recoverable costs. Setting the cap as a percentage of net allowable revenues effectively requires the EDBs to fund any lost pass-through and recoverable costs themselves, making the effective cap much lower than the proposed 20%. This is not appropriate. The limit should also be a percentage of the forecast allowable revenue for the disclosure year in which the event occurs, not the forecast allowable revenue for the first disclosure year of the regulatory period. The year in which the event occurs is the one where the revenue will be lost so the percentage cap should apply to revenues in that year. Additionally, the drafting of the clause is unclear. It states that the cap is: *"20% of the forecast net allowable revenue for the first disclosure year of the regulatory period* ***as adjusted to reflect*** *the revenue wash up draw down amount of*

[6] ENA, Input methodologies review – Topic paper 1, form of control and RAB indexation: Submission to the Commerce Commission, 4 August 2016 paragraphs 26-30.

Clause	Discussion
	the disclosure year and the impact of any limit on the forecast allowable revenue under clause 3.1.1(2)". [emphasis added] The "as adjusted to reflect wording is not clear. Figure 2 of Attachment A of the Technical paper clarifies that this means add the revenue wash up draw down amount and subtract the limit on the forecast allowable revenue. This clarity should also be included in the IMs (if the other drafting changes we recommend are not accepted).
3.1.3(13)(d) and (e)	Actual revenue and actual allowable revenue are defined as "includes" specific items. The term "includes" is potentially confusing as it implies these terms may include other, unspecified, items. We recommend defining these terms as "the sum of" the inputs specified in the clauses.

9.1. Consistency between flow charts and draft IM

40. Attachment B of the Technical consultation paper contains two flow charts that seek to explain how the new revenue cap price compliance and wash-up requirements. These are helpful but could be more helpful if they were more closely tied to the IMs. The flow charts include terms that are not used in the IMs and thus need some judgement and interpretation to assess their meaning, which is not always clear.

41. For example, Figure 1 includes the term "the balance of the wash-up account before calculating the revenue wash-up draw down amount t" and Figure 2 includes the term "closing wash-up account balance before draw down". It seems these two terms may mean the same thing but as neither is defined this is not clear.

42. A worked example of the revenue cap and wash-up arrangements over time may be more helpful.

9.2. Transition from current weighted average price path and pass-through balance

43. The wash-ups of revenue cap amounts will need to be lagged by two regulatory years as:

- In year t-2 actual revenue will differ from actual allowable revenue.
- In year t-1 the EDB will determine the difference between actual revenue and actual allowable revenue and set prices for year t.
- In year t the EDB's prices will include a wash-up for the difference between actual revenue and actual allowable revenue in year t-2.

44. This is not clearly spelled out in the IMs. However, several clauses in the IMs (3.1.3(12)(a), 3.1.3(13)(a) and 3.1.3(13)(h)(i)) reference a section 52P determination so it may be that this detail will be contained in the DPP determination.

45. We note that the way this is described in the flow chart in Figure 2 of Attachment B of the Technical consultation paper is not correct. This states that 'actual net allowable revenue t-2' equals, for the first year of a regulatory period, 'forecast net allowable revenue t-2' and this value is then adjusted annually

for CPI-X. However, this would not be workable as, for the 2021 regulatory year, there will be no 'forecast net allowable revenue t-2' value available – 2021 is the first year in which 'forecast net allowable revenue' will be specified by the Commission.

10. Part 4: IMs for DPPs

46. This section considers the proposed IM amendments regarding the DPP IMs. Our key points on this section are:

- The 1% of revenue materiality threshold should be calculated net of pass-through and recoverable costs and wash-ups.
- A revenue-based materiality threshold should not be applied to quality standard reopeners. Instead the threshold, if there is one, should be based on the materiality of the impact on the quality standard.
- Major transaction reopeners should not be limited to transactions between two regulated EDBs. Where an EDB acquires or disposes of regulated customers with a counterparty that is not a regulated EDB (eg an embedded network) this should also be able to trigger the major transaction reopener in the same way as any other major transaction.

Clause	Discussion
4.2.2(3)	The drafting of the changes to this clause is somewhat unclear and we have marked up changes to improve readability.
4.2.3(4)(a)	See comments on clause 3.1.1(8)(a) which apply equally to this clause.
4.2.3(4)(c)	See comments on clause 3.1.1(8)(c) which apply equally to this clause.
4.4.2(5)	Previous clause 4.4.2(5) setting the debt issuance costs at 0.35% should be reinstated for the reasons discussed in the Cost of Capital section of this submission.
4.4.4(3)	As discussed above we recommend this clause is amended to calculate the debt premium over full five year timeframe.
4.5.1(d)(iv) and 4.5.2(e)	These clauses state that the materiality threshold will be 1% of "forecast allowable revenue". Clause 3.1.1(4) states that forecast allowable revenue includes forecast net allowable revenue, forecast pass-through and recoverable costs and the balance of the wash-up account. We consider that including pass-through and recoverable costs and wash-ups in the threshold calculation is incorrect as these costs are not relevant to whether a price path needs to be reopened. The threshold for reopening a price path for a catastrophic or change event should be based on 'forecast net allowable revenue' instead.
4.5.1(d)(iv) and 4.5.2(e)	The Commission has added the wording "has had or will" to clause 4.5.1(d)(iv) to clarify that the materiality threshold for catastrophic event reopeners can be met by costs already incurred as well as costs that are expected to be incurred.

Clause	Discussion
	We support this change, but it does not appear to have been applied to change event reopeners in clause 4.5.2(e).
4.5.1(d)(iv)	Additionally, we suggest the wording is changed to "has had **and/**or will" [new wording in bold] as this is even clearer about what costs can contribute to the threshold.
4.5.2(e)	This clause refers to "reasonable costs" being incurred. The IMs do not otherwise refer to reasonable costs. "Efficient costs" is a more useful term as it links to the CPP expenditure objective.
4.5.2(f)	This clause provides that where a change event makes an IM unworkable the IM may be amended even where a materiality threshold is not met. We consider this approach is reasonable. As discussed above, we recommend that the materiality threshold for change events that affect the quality standard is based on a percentage of SAIDI minutes or SAIFI interruptions rather than a percentage of revenue. The current issues for live line work created by changes to health and safety legislation have highlighted the prospect of change events to affect the quality standard also and 1% of revenue is not a useful or meaningful materiality threshold for a change to a quality standard.
4.5.4	This clause defines 'major transaction' as a transaction in which consumers are transferred between consumers of the same type of regulated service where certain materiality thresholds are met. A price-quality path may be reopened where a major transaction occurs. This clause overlooks circumstances where consumers are transferred between a regulated EDB and an unregulated electricity network business (e.g. a large embedded network or networks owned by a person who is not an EDB). The need to reopen a price path may be similarly pressing in such circumstances but this is not enabled by this clause.
4.5.5(2)(a)	Subclauses (i) and (ii) of this clause should be deleted as they reference SAIDI and SAIFI terms that are no longer applied in a DPP determination for the quality standard.

11. Part 5: Customised Price-Quality Paths

47. This section considers the proposed IM amendments regarding the CPP IMs. A number of CPP IM amendments are required before the final IMs are produced. The more substantive of these amendments include:

    - Amending the CPP BBAR calculation of depreciation to reflect the asset lives set out in Table A.2 of Schedule A. Although the CPP information requirements have been linked to this table, the actual RAB logic used to derive asset building blocks for CPPs has not. The consequence is that, without the change we have proposed, the CPP IM has become more

complex than the status quo as there are two different sets of asset categories that must be used for CPP forecast information.

- When reopening a CPP price path for a WACC change, the amendments to the price path should include modifications to the regulatory tax calculations to adjust for the revised cost of debt component of the WACC. This adjustment is missing from the proposed amendments.
- While the CPP Summary proposal has changed since the earlier draft, we consider that the changes do not adequately address the cost and complexity concerns we had raised previously. We have suggested further refinements to better link the CPP Summary proposal to the incremental AMP approach which has been adopted more broadly throughout the revised CPP IMs. In particular, we submit that:
    i. a CPP Summary should provide an explanation of the extent to which the capex forecast; opex forecast; and expected SAIDI and SAIFI values to be included in its CPP proposal differ from its most recently published AMP
    ii. this information will provide the verifier and the Commission with an indication of the magnitude of the CPP proposal relative to the status quo. Importantly it also avoids the applicant having to prepare detailed calculations of BBAR/MAR and quality standards at an unnecessarily early in the CPP development stage.

Clause	Discussion
5.3.1(2)	This clause provides a very broad remit to make "necessary adjustments" to maximum allowable revenue values in order to set forecast net allowable revenue for a CPP determination. Similar to our comments on clause 3.1.3(9)(a), it is not clear what "necessary adjustments" means or who is empowered to make those necessary adjustments and in what circumstances with what scrutiny. The lack of clarity is inconsistent with the statutory purpose of IMs. We recommend this clause is deleted or clarified.
5.3.7	This clause uses the term **remaining asset life** to define the depreciation period for CPP building block depreciation. This in turn refers to the Clause 1.1.4 definitions of **asset life** and **physical asset life,** which in turn refer to Part 2, Clause 2.2.8. Clause 2.2.8 requires depreciation to be calculated using **standard physical asset life,** with some exceptions (for example for fixed life easements). **Standard physical asset life** is defined in Clause 1.1.4 with reference to Schedule A, Table A.1 Standard Physical Asset Lives of EDBs. As a consequence, in order for an applicant to calculate CPP depreciation in accordance with Clause 5.3.7, forecast commissioned asset information will need to be disaggregated to match Table A.1 asset categories (ie: those which are currently required for deriving actual depreciation for ID purposes).

Clause	Discussion
	This is contrary to the intent of introducing Table A.2 asset lives for CPP commissioned assets. The purpose of this more aggregated set of asset lives is to reduce cost and complexity for CPP proposals, by reducing the disaggregation of forecast commissioned asset information. While the commissioned asset information templates in Schedule E do align with the categories in Table A.2, the building block depreciation method does not. Clause 5.3.7 must be amended to reflect the asset lives for CPP commissioned assets, for the purpose of calculating CPP depreciation. If this is not changed, applicants will be required to prepare two sets of commissioned asset forecasts, one to match the categories specified in Table A1 in order to calculate CPP depreciation, and another to match the categories specified in A2 in order to comply with the Schedule D and E information requirements. This will have increased, not reduced cost and complexity of CPPs relative to the status quo. Our August submission on the Draft Determinations included appropriate edits in this respect.
5.3.10(5)(a)	This clause refers to clause 4.2.3(4). It seems it should only reference clause 4.2.3(4)(a).
5.3.10(5)(c)	See comments on clause 3.1.1(8)(c) which apply equally to this clause.
5.4.5(a)	This clause retains references to parameters which are no longer used in deriving DPP quality standards. Accordingly, clauses (a)(i) and (ii) should be deleted to avoid confusion.
5.4.9(4)(d)	The cost allocation information requirements are inconsistent with the cost allocation method to be applied for CPPs. As specified in Clause 5.3.5, the cost allocation method for the **next period** is to be the same as the cost allocation method applied by the applicant in the final year of the **current period**. Accordingly subclauses (d)(ii) and (iii) should be removed as they refer to changes in methodology type and allocators which cannot be applied in the context of the Schedule B cost allocation information.
5.4.12 (1)(a)	While the depreciation information can be aggregated as specified in this Clause, this does not avoid the need to calculate depreciation at the more disaggregated level, as explained in our response to Clause 5.3.7 above.
5.4.26	We question why the asset category disclosure of the regulatory tax asset base is required.
5.4.30	Suggest reorder clauses (1) – (9), so that instructions for each Table are provided in consecutive order, ie: for Table 1, Table 2 etc. This would improve its usefulness for CPP applicants, verifiers and auditors. References to 'real prices' should be changed to 'constant prices' to be consistent with the rest of the IM. Suggest add an explanation for how 'constant prices' are to be derived for the **current period** and the **assessment period**.

Clause	Discussion
5.5.3(2)(b)	References to the cost allocation method, rather than cost allocation information requirements, should be included here. Accordingly, replace reference to Clause 5.4.14 with Clause 5.3.6(3)(b).
5.6.**4**	See comments on clause 4.5.4 which apply equally to this clause.
5.6.8(5)	As submitted in our August submission on the Draft Determinations, we consider that the WACC change should also include an adjustment to the notional deductible interest of the regulatory tax building block, to reflect the updated cost of debt component of the WACC. It is not apparent why this amendment was not adopted in the latest draft. We ask the Commission to reconsider this point (refer to our previous mark ups to 5.6.8(7)(iv)). In this respect.
Schedule B, Table 4	Remove the repeated heading, and the explanation which follows it, which incorrectly refers to asset allocations, and is inconsistent with the other tables in this section, which include no such explanation.
Schedule E, Tables	As previously submitted, we consider adding definitions for 'constant prices' and 'nominal prices' would improve the usability of the Schedule E templates.
Schedule E, Table 1	Suggest remove comment 'for information of Commission and for selection for detailed review by the verifier). This is not accurate, as it is also required for the CPP proposal, and the explanations for completing Schedule E templates are appropriately included in Clause 5.4.30.
Schedule E, Tables 1a and 1b	Suggest replacing column heading 'Reference for policy/business case/supporting information/' with 'Reference to primary supporting document(s)'. It is possible that there could be numerous sources of information which support a project or programme. It is not necessary for them to be all listed in this summary schedule. They can be referenced in the primary supporting documents instead.
Schedule E, Table 3	The '3c' reference is missing from the third table, and the table title should be 'Actual and forecast opex by provider in nominal prices ($000)' It is not clear why Table 3c is optional, whereas Table 2d (which captures similar information for capex) is not. We suggest they both could be optional.
Schedule E, Table 4	Include rows for 'total network assets' (after Table 4e3) and 'total assets' (after Table 4f2), which will help with reconciliation to other capex schedules.
Schedule E, Table 5 & Table 8	Replace 'nominal prices' in the last table with 'nominal terms', to be consistent with other information about commissioned asset values.

Clause	Discussion
Schedule E, Tables 6 & 7	Include rows for 'total network opex' (after Table 6d) and 'total non-network opex' (after Table 7b), which will help with reconciliation to other opex schedules. A 'total opex' row at the end of Table 7 would also help achieve the same objective.
Schedule E, Table 9	Add 'CPP' before the term 'Regulatory Period'.
Schedule F5	Suggest replace clauses (c), (d) and (e) with a requirement for the CPP applicant to provide an explanation in its 'Summary of intended CPP proposal' of the extent to which the: • capex forecast; • opex forecast; and • expected SAIDI and SAIFI values, to be included in its CPP proposal differ from the most recently published AMP. This information will provide the verifier and the Commission with an indication of the magnitude of the CPP proposal relative to the status quo, with reference to information already available to them through regulatory AMP disclosures. It is consistent with the incremental AMP approach which has largely been adopted in the amendments to the CPP IM which are now proposed. Importantly it also avoids the applicant having to prepare unnecessarily early (and in our view premature) calculations of BBAR/MAR and quality standards, during the period when the applicant is compiling its evidence, building its models, and developing its proposal.

12. Appendix

The Electricity Networks Association makes this submission along with the explicit support of its members, listed below.

Alpine Energy

Aurora Energy

Buller Electricity

Centralines

Counties Power

Eastland Network

Electra

EA Networks

Horizon Energy Distribution

Mainpower NZ

Marlborough Lines

Nelson Electricity

Network Tasman

Network Waitaki

Northpower

Orion New Zealand

Powerco

PowerNet

Scanpower

The Lines Company

Top Energy

Unison Networks

Vector

Waipa Networks

WEL Networks

Wellington Electricity Lines

Westpower