

Input methodologies review

Proposed amendments to input methodologies for customised price-quality paths

Draft decision for Limb 1 of the CPP fast track

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Associated documents

Publication date	Reference	Title
7 August 2015	CPP fast track process paper	Input methodologies review process paper – update on CPP fast track amendments
7 August 2015	Second amended notice of intention	Amended Notice of intention - Review of input methodologies
22 July 2015	Covering note – decision making frameworks	Covering note – Developing decision-making frameworks for the current input methodologies review and for considering changes to the input methodologies more generally – Discussion draft
3 July 2015	Process update on fast track amendments	Input methodologies review – process paper update on fast track amendments
3 July 2015	Amended notice of intention	Amended notice of intention – Input methodologies review
16 June 2015	Problem definition paper	Input methodologies review – Invitation to contribute to problem definition
10 June 2015	Cover letter	Cover letter for the Notice of Intention to commence a review of input methodologies
10 June 2015	Notice of intention	Notice of intention: Input methodologies review
27 February 2015	Open letter	Open letter on our proposed scope, timing and focus for the review of input methodologies

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1. Introduction

Purpose of this paper

- 1.1 This paper invites your views on our proposed amendments to the input methodologies (IMs) for customised price-quality paths (CPPs) that apply to electricity distribution services and gas pipeline services.
- 1.2 The amendments are proposed under the first limb of a two-limbed fast track process for considering the CPP IMs under section 52Y(1) of the Commerce Act 1986 (the Act). We intend to make any IM amendments by 9 November 2015 so that they:
 - 1.2.1 can be applied by suppliers who make a CPP application in May 2016 and beyond; and
 - 1.2.2 can be completed and re-integrated back into the overall IM review process ahead of our draft decisions on the overall IM review due in mid Q2 2016.
- 1.3 By providing your views, you will help inform our final decision on the limb one amendments.
 - 1.3.1 Submissions are due by **5pm, Friday 25 September 2015**.
 - 1.3.2 Cross-submissions are due by **5pm, Friday 2 October 2015**.

Proposed amendments are part of the IM review

- 1.4 On 21 July 2015 we decided to fast track consideration under s 52Y(1) of the Act of certain issues relating to the IMs for CPPs.¹ Our Updated Notice of Intention issued on 7 August 2015 set out the scope and timing of the two-limbed fast track process:²
 - 1.4.1 The first limb relates to certain potential amendments to the requirements for preparing, assessing and determining CPPs. The first limb has a scheduled completion date of 9 November 2015.
 - 1.4.2 The second limb relates to considering whether the weighted average cost of capital (WACC) for CPPs should be aligned with the WACC for default price-quality paths (DPPs). The second limb has a scheduled completion date of 29 February 2016.

¹ Commerce Commission "Notification email regarding decision to fast track certain amendments to Input Methodologies" (21 July 2015).

² Commerce Commission "Updated notice of intention" (7 August 2015).

- 1.5 The remainder of this paper addresses the proposed amendments to CPP IMs under the first limb. Further details of our reasons for undertaking the CPP fast track process, and how the fast track process amendments fit within the overall IM review, are contained in our Process Update Paper of 7 August 2015.³

Amendments affect electricity distribution services and gas pipeline services

- 1.6 The proposed amendments set out in this paper apply to both electricity distribution services and gas pipeline services, and affect the following IM determinations:

1.6.1 *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* (EDB IMs);

1.6.2 *Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27* (GDB IMs); and

1.6.3 *Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28* (GTB IMs).

- 1.7 In our Process Update Paper of 7 August 2015 we explained why we decided to consider potential amendments to the CPP IMs for both electricity distribution services and gas pipeline services concurrently. There are two main reasons:

1.7.1 Possible improvements considered for the CPP IMs are likely to apply equally to regulated suppliers of gas pipeline services as well as electricity distribution services. Considering amendments across all sectors subject to default/customised price-quality regulation provides the best opportunity for the Commission to understand the potential impacts on all regulated suppliers, and implement any IM amendments once in a cohesive manner.

1.7.2 The IMs are broadly aligned between these sectors at present and we anticipate there to be similar issues involved in each. Thus there are efficiencies in undertaking work on these sectors together.

Content of this paper

- 1.8 As described in our Updated Notice of Intention, the first limb is limited to considering whether certain amendments to requirements for CPPs for EDB IMs, GDB IMs, and GTB IMs should be made to introduce flexibility while still maintaining certainty for suppliers.

³ Commerce Commission “Input methodologies review process paper - update on CPP fast track amendments” (7 August 2015).

- 1.9 The following proposed amendments are addressed in this paper.
- 1.9.1 Allowing modifications or exemptions to the process for preparing, and content of, CPP proposals to introduce more flexibility for suppliers (Chapter 2).
 - 1.9.2 Providing for alternative methodologies with equivalent effect for the proposal and determination of a CPP to introduce more flexibility for suppliers (Chapter 3).
 - 1.9.3 Accepting CPP applications for consideration if they comply with the process and content IMs “in all material respects” (Chapter 4).
- 1.10 We discuss the situation where IM amendments are made after a CPP proposal is accepted as complete, but before a CPP is determined, in Chapter 5 of this paper.
- 1.11 We explain how you can provide your views on the proposed amendments in Chapter 6 of this paper.

Objectives for the IM Review

- 1.12 In our Problem Definition Paper, we stated that any decision-making framework we develop for the IM review is likely to be guided by a focus on changing only those aspects of the current IMs that would:⁴
- 1.12.1 promote the Part 4 purpose in s 52A of the Act more effectively;
 - 1.12.2 promote the IM purpose in s 52R of the Act more effectively, without detrimentally affecting the promotion of the s 52A purpose; or
 - 1.12.3 significantly reduce compliance costs, other regulatory costs or complexity, without detrimentally affecting the promotion of the s 52A purpose.
- 1.13 We have applied this approach in the analysis contained in this paper.

Draft methodologies

- 1.14 Section 52V(2) of the Act requires us to publish the draft input methodologies that we propose to implement and give interested persons a reasonable opportunity to give their views on those draft methodologies.
- 1.15 The draft input methodologies are contained in Attachments A to C of this paper.

⁴ Commerce Commission “Input methodologies review: Invitation to contribute to problem definition” (16 June 2015).

- 1.16 We invite interested parties to consider whether the draft input methodologies appropriately reflect the amendments described in Chapters 2 to 4.
- 1.17 In proposing amendments we have set out the methodologies in sufficient detail so that an affected supplier is reasonably able to estimate the material effects of the methodology on the supplier, in accordance with s 52T(2)(a) of the Act.

2. Modification or exemption from CPP process or content requirements

Purpose of this chapter

- 2.1 This chapter outlines the proposed amendment to the CPP IMs to introduce flexibility for regulated suppliers through allowing modifications or exemptions to the requirements for preparing, and the content of, CPP proposals.

Summary of proposed amendment

- 2.2 We propose amending the CPP IMs to allow for:
- 2.2.1 Modification or exemption of existing requirements relating to the process for preparing, and content of, CPP proposals. This includes requirements for consumer consultation, verification, audit and directors' certification.
 - 2.2.2 Approval of the modifications or exemptions by the Commission on a case-by-case basis in response to a request made by a supplier in advance of a CPP proposal being submitted to the Commission under s 53Q of the Act.
 - 2.2.3 Specification of the criteria that must be met in order for modifications or exemptions to be considered, and the information required to be provided by an applicant to demonstrate that it meets the specified criteria.

Allowing modification or exemption of requirements for preparing, and content of, CPPs

- 2.3 A CPP is a complement to DPP regulation, and is designed to offer a more tailored approach to a supplier's situation. A CPP is necessarily more information intensive than a DPP, and involves additional costs. The CPP information requirements contained in the IMs are intended to ensure that the Commission has sufficient information to begin evaluating a CPP proposal and determine a CPP for a particular supplier. The Commission's information gathering powers allow it to obtain further information relevant to the CPP proposal once it is submitted by the applicant.
- 2.4 The feedback we received following the setting of the CPP for Orion New Zealand Limited in 2013 suggested that the CPP application process could be simplified to reduce the time and costs involved for suppliers. More recently, Energy Networks Association (ENA), Powerco Limited (Powerco) and Wellington Electricity Lines Limited (WELL) submitted that information and process requirements could be

streamlined to modify or remove requirements that unnecessarily increase application costs.⁵

- 2.5 ENA suggested that either a targeted review of some priority IM areas, or a mechanism that allows a CPP applicant and the Commission to agree certain information requirements in advance of an application could be implemented as part of a fast track review.⁶ Powerco suggested that the current requirements could be reviewed to clarify, amend or delete certain requirements, or be made subject to an exemption mechanism that allows for tailoring to better suit the features of a particular applicant and the available information.⁷
- 2.6 We consider that introducing a process that allows a supplier to apply to the Commission to modify or obtain an exemption from particular process and content requirements for CPP applications would provide the greatest achievable benefits in a fast-tracked time frame.
- 2.7 We agree with submitters that introducing a more flexible approach to information requirements that is more closely aligned to a CPP applicant's business information practices and accounting practices could reduce time and costs and make for a more cost-effective CPP process overall. It would also be likely to reduce the actual or perceived barriers to a supplier making a CPP, and encourage suppliers to make a CPP application where it provides greater long term benefit to consumers than a DPP.
- 2.8 On this basis we consider that providing for the modification or exemption of requirements relating to the process for preparing, and the content of, CPP proposals could significantly reduce costs and complexity of regulatory processes without detrimentally affecting the promotion of the s 52A purpose.

Requirements that can be modified

- 2.9 Section 52T(1)(d) of the Act requires the Commission to set input methodologies for:

matters relating to proposals by a regulated supplier for a customised price-quality path, including—

- (i) requirements that must be met by the regulated supplier, including the scope and specificity of information required, the extent of independent verification and audit, and the extent of consultation and agreement with consumers ...

⁵ Powerco "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015); ENA "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015); WELL "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015).

⁶ ENA "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015).

⁷ Powerco "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015).

- 2.10 The IMs specify what information must be provided to the Commission to allow it to accept a CPP application, and then evaluate the CPP proposal and determine a CPP. The requirements also prescribe how aspects of the process for compiling the information that is submitted as part of a CPP application should be undertaken.
- 2.11 For example, a verifier must have prepared a verification report as part of a CPP application made by an EDB, and the verifier must also have been engaged in accordance with the process set out in Schedule F of the EDB IMs and must undertake the verification in accordance with clause 5.5.2 and Schedule G.
- 2.12 We consider that exemptions and modifications should be potentially available to all requirements relating to the process for preparing, and content of a CPP. This is because:
- 2.12.1 interested persons have provided examples of where the process for preparing a CPP could be modified, as well as the content of a CPP, in order to appropriately reduce costs;⁸
 - 2.12.2 it is not possible to foresee every instance in which a modification or exemption might apply and it is therefore difficult to prescribe comprehensive rules which apply 'up front'; and
 - 2.12.3 since the Commission will be required to approve each request for a modification or exemption (see below), a safeguard will exist against inappropriate modifications or exemptions by a CPP applicant.
- 2.13 We propose that the CPP IM requirements relating to the process for preparing, and content of, CPP proposals which are potentially subject to modification or exemption are those contained in:
- 2.13.1 Subparts 1, 4 and 5 of Part 5, and related schedules, of the EDB IMs;
 - 2.13.2 Subparts 1, 5 and 6 of Part 5, and related schedules, of the GDB IMs; and
 - 2.13.3 Subparts 1, 5, and 6 of Part 5, and related schedules, of the GTB IMs.
- 2.14 Modifications or exemptions will not be available for:
- 2.14.1 Evaluation criteria used by the Commission to assess a CPP proposal;
 - 2.14.2 IMs that apply to the determination of the CPP, such as the IMs for maximum allowable revenues, building blocks allowable revenues, WACC, cost allocation, valuation of assets, or treatment of taxation;

⁸ See, for example, Powerco "Submission on scope of CPP fast track amendments for the IM review" (23 June 2015).

2.14.3 Rules for the reconsideration of a CPP; and

2.14.4 Pricing methodologies (applying to gas pipeline services only).

Process for approving modifications and exemptions

2.15 There are a number of ways that a process for allowing modifications and exemptions could be implemented. For example:

2.15.1 It could be left to intending CPP applicants (or a third party such as the verifier) to decide what modifications or exemptions to apply;

2.15.2 A set of prescriptive rules/criteria could be included in the IMs which intending applicants apply in preparing their CPP proposal;

2.15.3 We could provide non-binding guidance to intending applicants during the period in which a CPP proposal is prepared; or

2.15.4 A CPP applicant could request a set of modifications and exemptions and the Commission could consider whether to formally approve these.

2.16 There are advantages and disadvantages to each of these options. On balance, we consider that the best option is a process by which the Commission approves modifications or exemptions on a case-by-case basis in response to a request made by a supplier. This would provide greater flexibility for suppliers, whilst retaining oversight of the appropriateness of the modification and exemptions by the Commission.

2.17 The request would be made in advance of a CPP proposal being submitted to the Commission under s 53Q of the Act. An approval would be binding on the Commission in the sense that a CPP application for which an applicant has elected to apply approved modifications or exemptions would be accepted as being compliant in that respect under s 53S(1) of the Act.

2.18 This approach means that an intending applicant will be able to obtain certainty as to the applicable CPP requirements prior to undertaking consumer consultation, verification or audit, and it would lead to a 'no surprises' situation for the Commission on receipt of the CPP application. It would also remove the need for us to consider a request for modification or exemptions within the limited (40 working day) period we have upon the receipt of a CPP proposal to determine whether it complies with requirements.⁹

⁹ Commerce Act 1986, s 53S(1).

- 2.19 Considering a request by a supplier will involve the use of Commission resources, however we already expect that, in the normal course of events, we would liaise with intending applicants and provide guidance where needed. Furthermore, we propose that criteria for approving the request for modifications or exemptions, and the information required to be supplied by the applicant, be included in the IMs. This should reduce the effort required on the Commission's part to consider approving or declining a request, as well as enhancing certainty for suppliers.
- 2.20 In most cases we do not think it will be necessary for the Commission to seek the views of interested persons as part of considering a request for modifications or exemptions. This is because:
- 2.20.1 Much of the information contained in the CPP application is technical in nature and requests for modifications or exemptions are expected to relate largely to technical matters. Moreover, the CPP application is designed primarily to meet the Commission's needs in evaluating the proposal.
- 2.20.2 There are a number of opportunities for interested persons to give their views on the proposal (including any modifications or exemptions) before the Commission determines a CPP. The applicant, for example, is required to consult with consumers about the CPP proposal prior to submitting a CPP application, and a CPP proposal is required to be made publicly available by the applicant once it is submitted.¹⁰ Interested parties will have a further opportunity to make submissions on the proposal once the Commission gives notice that the proposal is under consideration.¹¹ The Commission will also address the key features of the proposal when it publishes its draft decision on the CPP proposal.
- 2.21 We therefore consider that in most cases it will be appropriate that the Commission make a decision on what modifications or exemptions are permitted without consultation. However, there may be some instances where we consider that the nature or extent of the proposed modifications or exemptions are such that our decision would benefit from the views of interested persons or from expert advisors. The proposed amendment allows for such views to be sought by the Commission prior to its decision on the modifications or exemptions being approved if it is considered desirable.
- 2.22 When receiving a CPP application we will assess whether it complies with the requirements for the process for, and content of, CPP proposals as required by

¹⁰ Commerce Act 1986, s 53Q(4).

¹¹ The Commission must give notice to interested persons that the CPP proposal is under consideration and how copies of the proposal may be obtained once it decides that the proposal complies with process and content requirements: see s 53T(1)(a).

s 53S(1), including whether the approved modification or exemptions (including all pre-conditions specified by the Commission in the approval) have been complied with. However, an approval for modification or exemptions will not prevent the Commission from exercising its information gathering powers to:

- 2.22.1 Remedy deficiencies in the CPP proposal (including deficiencies from not meeting the modified requirements) pursuant to s 53S(2) of the Act; or
- 2.22.2 Obtain any other relevant information as part of the assessment of the CPP proposal carried out under s 53T of the Act where it considers that further information is necessary or desirable.¹²

Criteria for approving and information required to be provided by a supplier

Criteria for approving

- 2.23 Certainty of treatment for suppliers is provided by our approval of the modifications or exemptions in advance of the CPP proposal being submitted. To provide guidance for those suppliers requesting modifications or exemptions, and to assist the Commission in considering such a request, we consider that criteria for giving approval should be specified.
- 2.24 Approval may be granted if, in the Commission's opinion, the applicant has demonstrated that the modifications or exemptions will not detract from:
 - 2.24.1 the Commission's evaluation of the CPP proposal and determination of a CPP; and
 - 2.24.2 the ability of interested persons to consider and provide their views on the CPP proposal.
- 2.25 When applying this test in practice, we consider that the Commission would take into account the likely impact of the modifications or exemptions requested on: (a) the time; (b) the costs; and (c) the quality, of the Commission's evaluation of the CPP proposal and consultations with interested persons.
- 2.26 For example, a proposed exemption from providing information that is not likely to be relied on by the Commission or interested persons in evaluating the CPP would be approved because the exemption would not be expected to materially increase the time or costs of the Commission's evaluation of the CPP proposal, nor is it likely to materially detract from the quality of the evaluation or consultation.

¹² For example, if the Commission considers that the modification or exemption of any of the information requirements poses an impediment to the evaluation of the CPP proposal it may use its information gathering powers to obtain further information.

- 2.27 In contrast, a proposed modification or exemption that reduces a supplier's costs of preparing a CPP proposal, but would materially increase the time or costs required to evaluate the CPP proposal (for example, where the Commission would need to exercise its information gathering powers), or detract from the quality of the CPP evaluation or consultation (for example, because assumptions rather than data need to be relied on), is unlikely to be approved.
- 2.28 Lastly, it is not intended that modifications or exemptions are so extensive that a CPP application is effectively reduced to a set of stand-alone issues or a "single issue" CPP, nor that core requirements such as engaging a verifier or auditor, or undertaking consumer consultation or obtaining directors' certification, are substantially altered or removed.

Information required to be provided by a supplier

- 2.29 In order to demonstrate that the criteria have been met we consider that the following information should be supplied in writing by the applicant at the time of application.
- 2.29.1 Applicant's name and contact details.
 - 2.29.2 Brief description of the key features of its intended CPP proposal.
 - 2.29.3 When the applicant intends to submit the CPP proposal.
 - 2.29.4 A list of the specific modifications or exemptions sought.
 - 2.29.5 An explanation of why each modification or exemption will not detract from the CPP proposal in the ways described in paragraph 2.24.
 - 2.29.6 Evidence to support the application.
 - 2.29.7 Identification of any information that is commercially sensitive.

Approval of request

- 2.30 The request for modifications or exemptions will be considered by the Commission as soon as reasonably practicable, and the outcome will be notified in writing to the applicant. If the Commission imposes any conditions or requirements in relation to the approval these will be included in the written approval.
- 2.31 Any approval that a CPP applicant intends to rely on in making a CPP application must be identified in that CPP application when it is submitted. A CPP applicant may choose not to rely on a modification or exemption that has been approved by the Commission if the applicant instead chooses to comply with the existing requirements.

- 2.32 If approval is not given then the existing process and content requirements for CPP proposals in the IMs will apply.

Implementation matters

- 2.33 We have set out the draft input methodology in Attachment A.
- 2.34 It is proposed that the draft input methodology applies in respect of electricity distribution services and all gas pipeline services.
- 2.35 The proposed amendments are given effect in each of the EDB IMs, GDB IMs, and GTB IMs through new clauses 5.1.6 to 5.1.8.

3. Alternative methodologies with equivalent effect

Purpose of this chapter

- 3.1 This chapter describes the proposed amendment to the CPP IMs to introduce flexibility for regulated suppliers through allowing the use of alternative methodologies with an equivalent effect for CPP proposals.

Summary of proposed amendment

- 3.2 We propose amending the CPP IMs to explicitly provide for:
- 3.2.1 Alternative methodologies to be made available to CPP applicants in addition to the existing methodologies for determining a CPP, provided the alternative methodologies produce an equivalent effect. Alternative methodologies can relate to:
 - 3.2.1.1 cost allocation and asset valuation;
 - 3.2.1.2 treatment of taxation; or
 - 3.2.1.3 estimate of the term credit spread differential allowance.
 - 3.2.2 Consideration of the alternative methodologies applied by a CPP applicant by the Commission during the period that the CPP proposal is assessed and a determination is made under sections 53T and 53V of the Act.
 - 3.2.3 Specification of the criteria that must be met in order for alternative methodologies to be applied, and the information required to be provided by an applicant to demonstrate that it meets the specified criteria.

Considering alternative methodologies with equivalent effect

- 3.3 IMs are prescribed under s 52T(1) of the Act which specifies how a CPP proposal that complies with the requirements relating to the process for, and content of, a CPP proposal should be evaluated and determined by the Commission. Amongst other things, these IMs specify the 'building blocks' that must be determined in order to calculate allowable revenues for a CPP applicant over the period of the CPP.
- 3.4 We consider that introducing a process to provide for alternative methodologies with an equivalent effect to the existing methodologies to be used in determining a CPP would:

- 3.4.1 Provide a more flexible approach to determining a CPP by using information that is more closely aligned to a CPP applicant's business information practices and accounting practices;¹³ and
 - 3.4.2 Provide the greatest achievable benefits in a fast-tracked time frame, compared to a more detailed line-by-line review of the existing IMs for determining a CPP (which may occur as part of the overall IM Review).
- 3.5 Similar to the proposed amendments set out in chapter 2, we expect that allowing for alternative methodologies with an equivalent effect would:
- 3.5.1 Reduce time and costs involved in proposing and determining a CPP and make for a more cost-effective CPP process overall; and
 - 3.5.2 Reduce the actual or perceived barriers to a supplier making a CPP application, and encourage suppliers to make a CPP application where it provides greater long term benefit to consumers than a DPP.
- 3.6 On this basis we consider that allowing for consideration of alternative methodologies with equivalent effect could significantly reduce costs and complexity of regulatory processes while continuing to promote the s 52A purpose.

Requirements that can be modified

- 3.7 We consider that alternative methodologies with equivalent effect should be available for the following matters contained in the EDB IMs, GDB IMs, and GTB IMs:
- 3.7.1 cost allocation and asset valuation (Section 2 of Subpart 3 of Part 5);¹⁴
 - 3.7.2 treatment of taxation (Section 3 of Subpart 3 of Part 5); or
 - 3.7.3 estimate of the term credit spread differential allowance (Section 4 of Subpart 3 of Part 5).
- 3.8 These methodologies contribute to the core 'building blocks' which are combined to form allowable revenues for the relevant CPP regulatory period for a CPP applicant.

¹³ In many cases it is likely that the alternative methodologies proposed would align with the modification or exemptions approved to the process for, and content of, an applicant's CPP proposal. See Chapter 2.

¹⁴ An example of an alternative methodology with equivalent effect for asset valuation is that of treating forecast commissioned assets in groups, rather than as individual assets. The treatment of forecast capital contributions could then be simplified by netting them off against forecast total values for the asset groups, rather than against forecast values of individual assets as currently required by clause 5.3.11 of the EDB IMs, GDB IMs and GTB IMs. Provided that the grouping of assets was appropriately selected, the effect of applying the alternative methodology would be expected to be equivalent to the existing IMs in terms of the CPP produced.

- 3.9 We have excluded the IM for determining WACC (other than for estimating the term credit spread differential allowance) as that methodology essentially consists of the publication of a WACC by the Commission prior to a CPP being proposed. An applicant therefore does not need to propose an alternative methodology in respect of WACC in its proposal.
- 3.10 Alternative methodologies will not be available under this process for the following matters.
- 3.10.1 Calculating maximum allowable revenues.
 - 3.10.2 Calculating building blocks allowable revenues.
 - 3.10.3 Cost of capital (other than estimating the term credit spread differential allowance).
 - 3.10.4 Specification of price or amalgamations.
 - 3.10.5 Requirements of the process for, and content of CPP proposals.¹⁵
 - 3.10.6 Evaluation criteria used by the Commission to assess a CPP proposal.
 - 3.10.7 Rules for the reconsideration of a CPP.
 - 3.10.8 Pricing methodologies (applying to gas pipeline services only).

Process for considering alternative methodologies

- 3.11 We propose that requests for alternative methodologies with equivalent effect will be considered by the Commission where the applicant sets out the alternative methodologies in its CPP application.
- 3.12 We will consider applying these alternative methodologies as part of the evaluation of the CPP proposal after we have determined that the CPP proposal complies with the requirements for the process of, and content of, a CPP application.
- 3.13 This will allow us to assess the alternative methodologies in the context of the proposal as a whole and to make a determination no later than the date upon which the CPP as a whole is determined.
- 3.14 Because the alternative methodologies are considered during the same period as the overall CPP, we will be able to obtain the views of interested persons on the alternative methodologies during that consultation period.

¹⁵ See Chapter 2.

- 3.15 The process for considering alternative methodologies with equivalent effect is consistent with the intent of s 53V(2)(c) of the Act which relates to the Commission's ability to vary an input methodology that would otherwise apply, with the agreement of the CPP applicant. However, the differences are that:
- 3.15.1 The alternative methodology can be proposed by a supplier as part of a CPP application without it being necessary to submit both a proposal with, and a proposal without, the alternative methodology.¹⁶
 - 3.15.2 The alternative methodology is limited to that which has an equivalent effect on specified parts of the IMs. There is no such restriction on a s 53V(2)(c) variation.

Criteria for approving and information required to be provided by a supplier

Criteria for approving

- 3.16 Alternative methodologies will be considered by the Commission, and may be applied to the determination of a CPP, where, in the Commission's opinion, the alternative methodology:
- 3.16.1 produces an equivalent effect within the relevant CPP regulatory period to that which would otherwise have applied; and
 - 3.16.2 will not detract from the promotion of the s 52A purpose.

Information required to be provided by a supplier

- 3.17 In order to demonstrate that the criteria have been met we consider that the following information should be supplied in writing as part of the CPP application by the applicant.
- 3.17.1 A list and description of the alternative methodologies applied.
 - 3.17.2 An indication, at the relevant places within the CPP application, where the alternative methodologies have been applied.
 - 3.17.3 The reasons why each alternative methodology has been applied.
 - 3.17.4 Evidence that demonstrates that each alternative methodology.

¹⁶ Applications under s 53V(2)(c) of the Act to vary an IM that would otherwise apply to the CPP proposal may be submitted alongside the CPP proposal, although suppliers who wish to propose a variation must submit not only an IM-compliant proposal, but also a version of the proposal as it would appear as if an amended IM applied to it: see Commerce Commission "Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper" (22 December 2010), para K1.23.

3.17.4.1 has an equivalent effect within the relevant CPP regulatory period to the methodology that would otherwise apply; and

3.17.4.2 does not detract from the s 52A purpose.

3.18 This information will form part of the CPP application (unlike a request for modifications or exemptions to the process and content IMs, which is made as part of a pre-application process – see Chapter 2). A CPP application that complies with the requirements would be accepted as compliant in that respect under s 53S(1) of the Act.

Applying alternative methodologies

3.19 An alternative methodology that, in the Commission’s opinion, satisfies the criteria in paragraph 3.16, constitutes a “relevant” input methodology in accordance with s 53Q(2)(d) of the Act. The Commission may therefore choose to apply the alternative methodology in determining “any customised price-quality path that the Commission considers appropriate” in accordance with s 53V(1) of the Act.¹⁷

Implementation matters

3.20 We have set out the draft input methodology in Attachment B.

3.21 It is proposed that the draft input methodology applies in respect of electricity distribution services and all gas pipeline services.

3.22 The proposed amendments are given effect through:

3.22.1 new clauses 5.3.33 and 5.4.34 in the EDB IMs;

3.22.2 new clauses 5.3.33 and 5.5.33 for the GDB IMs; and

3.22.3 new clauses 5.3.29 and 5.5.30 for the GTB IMs.

¹⁷ We note that the original methodology remains available to be applied if the Commission considers it appropriate, and the Commission’s information gathering powers allow it to obtain relevant information in order to apply that original methodology.

4. Assessing a CPP proposal that is complete in all material respects

Purpose of this chapter

- 4.1 This chapter describes the proposed amendment of the CPP IMs to clarify that a CPP application that is complete in all material respects can be accepted by the Commission as meeting the requirements relating to the process for, and content of, a CPP proposal.

Summary of proposed amendment

- 4.2 We propose amending the CPP IMs to clarify that the Commission can accept a CPP proposal as complying with the IMs relating to the process for preparing, and content of, CPP proposals, if the CPP proposal complies with those requirements “in all material respects”.

Accepting a CPP proposal if it is compliant in all material respects

- 4.3 Section 53S(1) of the Act provides that within 40 working days after receiving a CPP application, the Commission must determine whether the application complies with the requirements set out in the IMs for the process for, and content of, CPP proposals.
- 4.4 Clause 5.1.1 of Subpart 1 of Part 5 of the EDB IMs, GDB IMs, and GTB IMs, requires that a supplier seeking a CPP in accordance with s 53Q of the Act must provide the Commission with a CPP application, where:
- (2) CPP application means the information specified in-
 - (a) this subpart; and
 - (b) Subpart 4.
- 4.5 Subpart 1 sets out requirements for providing evidence of consumer consultation, verification-related material, an audit report and directors’ certification. Subpart 4 of the EDB IMs and Subpart 5 of the GDB IMs and GTB IMs states that a CPP proposal must contain at least the information specified in that subpart, such as the reasons for the proposal, information regarding quality, and detailed price path and ‘building blocks’ information.
- 4.6 We propose amending the CPP IMs to clarify that a CPP proposal will be compliant with the IMs relating to the process for preparing, and content of, CPP proposals, if the CPP proposal complies with those requirements in “all material respects”.

- 4.7 We can envisage a situation where a CPP applicant may not comply with every requirement in preparing and submitting a CPP proposal, but in some circumstances this may not compromise:
- 4.7.1 the Commission’s evaluation of the CPP proposal and determination of a CPP; or
 - 4.7.2 the ability of interested persons to consider and provide their views on the CPP proposal.
- 4.8 We consider that modifying the IM requirements to state that a CPP proposal should contain the information prescribed in the IMs “in all material respects” would:
- 4.8.1 clarify the requirements in accordance with the purpose of the IMs as set out in s 52R of the Act, which is to promote certainty for suppliers and consumers in relation to the rules, requirements and processes applying to the regulation of goods and services under the Act;
 - 4.8.2 reduce the time and costs involved with the assessment of whether a CPP proposal complies with the information requirements; and
 - 4.8.3 reduce the actual or perceived barriers for a supplier to make a CPP, and encourage suppliers to make a CPP where it provides greater long term benefit to consumers than a DPP.
- 4.9 The Commission will still be able to exercise its information gathering powers to obtain information it considers relevant as part of the assessment of the CPP proposal carried out under s 53T of the Act.
- 4.10 On this basis we consider that the proposed amendment would promote certainty and significantly reduce costs and complexity of regulatory processes while continuing to promote certainty and the s 52A purpose.

Implementation matters

- 4.11 We have set out the draft input methodology in Attachment C.
- 4.12 It is proposed that the draft input methodology applies in respect of electricity distribution services and all gas pipeline services.
- 4.13 The proposed amendment is given effect in the EDB IMs through amendments to clauses 5.1.1 and 5.4.1, and in the GDB IMs and GTB IMs through amendments to clauses 5.1.1 and 5.5.1.

5. Clarifying which input methodologies apply, and when

Purpose of this chapter

- 5.1 This chapter sets out our view about which IMs apply to a CPP determination if IM amendments are made after a CPP proposal is submitted but before a CPP is determined.

Summary of proposed amendment (if any)

- 5.2 We propose that:
- 5.2.1 when making a CPP determination the Commission will apply the IMs that were in force at the time a CPP proposal is submitted;
 - 5.2.2 any amendments to IMs that are made after we receive a CPP application but before we make the CPP determination would not apply to the determination;
 - 5.2.3 it may be beneficial to consider varying the IMs pursuant to s 53V(2)(c) of the Act to reflect IM amendments made after receiving an application; but both the applicant and the Commission would have to agree to any variation.
- 5.3 We do not propose amending the applicable IMs to set out our view above. Ultimately this view is derived from interpreting Part 4 of the Commerce Act, and recording it in an IM provides no greater certainty.

Discussion

- 5.4 On receipt of a CPP proposal from a supplier, the Commission must apply the relevant IMs to determine any CPP that it considers appropriate for that supplier.¹⁸
- 5.5 It is not immediately clear whether the relevant IMs are:
- 5.5.1 the IMs published under s 52W at the time a CPP proposal is submitted; or
 - 5.5.2 the IMs published under s 52W at the date on which the Commission makes the CPP determination.
- 5.6 This uncertainty and the effect it may have on suppliers who are considering applying for a CPP was identified by submitters.¹⁹ We proposed clarifying our view

¹⁸ Commerce Act 1986, s 53V(1), s 52S(b).

¹⁹ For example: Aurora Energy Limited “Submission in response to the Commerce Commission’s open letter on our proposed scope, timing and focus for the review of input methodologies” (31 March 2015) at 2;

on which IMs apply and whether an amendment to the IMs would assist in that clarification.²⁰ Our preliminary view was that we should apply the IMs in force at the time the application is made,²¹ subject to any variation of the IMs made under s 53V(2)(c) of the Act.

5.7 Section 52S(b) of the Act provides:

52S How published input methodologies apply

Every relevant input methodology relating to the supply of particular goods or services that is published under section 52W must be applied,—

...

- (b) in all cases, by every person entitled or required under this Act to recommend, decide, or determine—
 - (i) whether or how regulation under this Part should apply to the goods or services; or
 - (ii) the prices or quality standards applying to the goods or services.

5.8 Where IMs are amended after a CPP proposal is made it is unclear whether the IMs that apply are those in effect at the time the Commission makes its CPP determination or those in effect when a CPP proposal is made. We consider that when viewed in light of the purposes of Part 4 regulation and in the context of the CPP scheme, the better interpretation of s 52S(b) is that the “relevant” IMs are those applying at the time the CPP application is made.

5.9 To explain, CPP regulation is intended to provide a viable alternative for suppliers whose particular circumstances are not suited to a DPP: the CPP should better promote the long term benefit of consumers.²² A supplier, however, needs certainty around the rules, requirements and processes that apply to its application in order to

PwC “Response to the Commerce Commission on the IM Letter on the proposed scope, timing and focus for the review of input methodologies” (31 March 2015), para 26.

²⁰ Commerce Commission *Input methodologies review process paper: update on CPP fast track amendments* (7 August 2015) at [26.2]; *Amended notice of intention* (7 August 2015) at [4.2.4]; *Cover letter for the notice of intention to commence a review of input methodologies* (10 June 2015), attachment one. See also *Notification Email Regarding Decision to Fast Track Certain Amendments to Input Methodologies* (21 July 2015); *Notification Email: Process Update Paper and Amended notice of intention for CPP Fast Track Processes now available* (7 August 2015).

²¹ Commerce Commission *Input methodologies review: Invitation to contribute to problem definition* (16 June 2015) at [433]–[444].

²² Commerce Act 1986, ss 53K, 52A.

assess whether a CPP will better meet its particular circumstances.²³ This certainty will only exist if the applicable IMs are those that apply at the time a supplier submits a proposal.

- 5.10 This interpretation is consistent with the Part 4 scheme relating to CPPs which emphasises the importance of the time at which a supplier submits a CPP proposal.²⁴ A supplier is required to apply or adopt all relevant IMs that exist at the time of the proposal.²⁵ Once a proposal is submitted it becomes irrevocable and cannot be withdrawn by the supplier.²⁶ The supplier is then bound by any CPP that the Commission sets.²⁷
- 5.11 From the date the proposal is submitted the relationship between the parties changes and the Commission moves from dealing with a whole sector to dealing with one party only. As the CPP process becomes irrevocable, we consider the foundations underpinning the process, the IMs, should also remain unchanged.²⁸
- 5.12 This interpretation is consistent with s 53V(2)(c) which provides the ability for the Commission and the supplier, by agreement only, to vary an IM that would otherwise apply to the CPP determination. It is also consistent with s 53ZA which provides that if the Commission does not make a CPP determination within the statutory timeframe, the supplier's CPP proposal takes effect,²⁹ and the Commission must amend the relevant s 52P determination to that effect.³⁰ That is, the Commission is required to give effect to a CPP that embeds IMs as they existed when a CPP proposal was made.

²³ Section 52R. Commerce Amendment Bill 2008 (201-1) (explanatory note) at 23 notes, in the context of describing the anticipated scheme of having an *ex ante* time-bound opportunity for an individual firm to seek a customised path, that “[t]o minimise costs and potential for delay the proposal includes strict time frames, input methodologies set upfront, preset criteria for proposals, and statutory timeframes”.

²⁴ See Commerce Act 1986, ss 53R(a) and (b), s 53V(2)(a), s 53S, s 53T.

²⁵ Commerce Act 1986, s 53Q(2)(d). Note that this use of the word ‘relevant’ could be seen to colour its meaning in s 52S.

²⁶ Commerce Act 1986, ss 53R(a).

²⁷ Commerce Act 1986, ss 53R(b) and 53V(2)(a).

²⁸ This is broadly consistent with the principle in s 17 of the Interpretation Act 1999 that the expiry, revocation or replacement of legislation does not affect an existing right. Once a proposal becomes irrevocable, the repeal or replacement of IMs by the Commission should not stop the applicant from having their CPP determined under the IMs that existed at the time of application.

²⁹ Section 53ZA(3).

³⁰ Section 53ZA(4).

Should we amend the IMs to confirm our view?

- 5.13 We have considered the option of amending the relevant IMs to include our view that it is the IMs in force when a CPP application is made that apply to the CPP determination.
- 5.14 We are inviting submissions on this issue, and setting out the reasons for our current view, with the intention that this will enable any suppliers who hold an alternative view to make submissions.
- 5.15 We consider that this process will provide suppliers with as much certainty as possible about which IMs apply. No additional certainty would be provided by including our view in an IM, as the question is ultimately one of legal interpretation of Part 4.

6. How you can provide your views

Purpose of this chapter

- 6.1 This chapter sets out how you can provide your views on our proposed amendments to the CPP IMs for regulated suppliers of electricity distribution services and gas pipeline services.

Timeframe for submissions

- 6.2 We welcome your views on the amendments proposed in this paper. Submissions are due by 5pm, Friday 25 September 2015.
- 6.3 We do not intend to take into account any material that is submitted outside this timeframe. Any party that is concerned about the time to engage with the material should contact us with a request for an extension outlining their specific concerns.

Address for submissions

- 6.4 Submissions should be addressed to:

Dane Gunnell (Project Manager, CPP Fast Track, Regulation Branch)
c/o regulation.branch@comcom.govt.nz

Format for submissions

- 6.5 We prefer submissions in both MS Word and PDF file formats.
- 6.6 Please include “Submission on first limb of CPP IM amendments” in the subject line of your email.

Requests for confidentiality

- 6.7 We encourage full disclosure of submissions so that all information can be tested in an open and transparent manner, but we offer the following guidance.
- 6.7.1 If it is necessary to include confidential material in a submission, both confidential and public versions of the submission should be provided.
- 6.7.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
- 6.8 We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be ‘locked’. This is because we intend to publish all submissions and cross-submissions on our website. Where relevant, please provide both an ‘unlocked’ electronic copy of your submission, and a clearly labelled ‘public version’.

Attachment A – Proposed amendments for modification or exemption from CPP process or content requirements

Proposed amendments for EDBs:

The proposed amendments to the *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* are as follows:

- After clause 5.1.5 in Subpart 1 of Part 5 insert the following clauses:

“5.1.6 Modification or exemption of CPP application requirements

- (1) The **Commission** may modify, or exempt a **CPP applicant** from, a requirement set out in—
 - (a) this subpart;
 - (b) Subpart 4;
 - (c) Subpart 5; or
 - (d) schedules relating to subparts identified in paragraphs (a) to (c) above.
- (2) A modification or exemption may be made where, in the **Commission’s** opinion, the modification or exemption will not detract from—
 - (a) the **Commission’s** evaluation of the **CPP proposal** and determination of a **CPP**; and
 - (b) the ability of interested persons to consider and provide their views on the **CPP proposal**.
- (3) A modification or exemption will only apply for the purposes of assessing compliance of a **CPP application** under s 53S(1) of the **Act**—
 - (a) if the **Commission** has previously approved a request by a **CPP applicant** for the modification or exemption in accordance with clause 5.1.7;
 - (b) in respect of the **CPP applicant** and the **CPP application** identified in the **Commission’s** approval; and
 - (c) if the **CPP applicant** elects to apply the modification or exemption by:
 - (i) meeting all conditions and requirements specified in the approval that relates to the modification or exemption; and
 - (ii) providing the relevant information specified in clause 5.1.8 as part of its **CPP application**.

5.1.7 Process for determining a modification or exemption

- (1) At any time prior to providing the **Commission** with a **CPP application**, a **CPP applicant** may request that the **Commission** approve modifications or exemptions to the requirements listed in clause 5.1.6(1) as alternatives to those requirements.

- (2) A request by a **CPP applicant** must—
- (a) be in writing; and
 - (b) include the following information:
 - (i) the **CPP applicant's** name and contact details;
 - (ii) a brief description of the key features of its intended **CPP proposal**;
 - (iii) the date that the **CPP applicant** intends to submit the **CPP application** for which a modification or exemption is sought;
 - (iv) a list of the specific modifications or exemptions sought;
 - (v) an explanation of why the **CPP applicant** considers the requirement in subclause (3) is met, supported by appropriate evidence; and
 - (vi) identification of any information that is commercially sensitive.
- (3) The **Commission** may approve modifications or exemptions sought by a **CPP applicant** where, in the **Commission's** opinion, the **CPP applicant** has demonstrated that the criteria specified in clause 5.6.1(2) have been met.
- (4) In considering whether to approve a request for modification or exemptions, the **Commission** may seek, and have regard to—
- (a) views of interested persons within any time frames and processes set by the **Commission**; and
 - (b) views of any person the **Commission** considers has expertise on a relevant matter.
- (5) As soon as reasonably practicable after receipt of a request for modifications or exemptions the **Commission** will, by notice in writing, advise the **CPP applicant** as to whether:
- (a) one, some, or all of the modifications or exemptions are approved; and
 - (b) the approval of any modification or exemption is subject to conditions or requirements that must be met by the **CPP applicant.**"

5.1.8 Information on modification or exemption of information requirements

Where a **CPP applicant** elects to apply a modification or exemption approved by the **Commission** in accordance with clause 5.1.7, it must include as part of its **CPP application**—

- (a) a copy of the **Commission's** approval;
- (b) a list of the approved modifications or exemptions which the **CPP applicant** has elected to apply in its **CPP application**;
- (c) evidence that any conditions or requirements of the approval have been met; and
- (d) an indication, at the relevant locations within the **CPP application**, as to where the modifications or exemptions have been applied."

Proposed amendment for GDBs and GTBs:

Equivalent amendments to those proposed for EDBs are proposed for:

- GDBs in respect of the *Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27*; and
- GTBs in respect of the *Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28*.

Attachment B – Proposed amendments for alternative methodologies with equivalent effect

Proposed amendments for EDBs:

The proposed amendments to the *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* are as follows:

- After Section 4 of Subpart 3 of Part 5, insert the following new section:

“Section 5 Alternative methodologies with equivalent effect

5.3.33 Alternative methodologies with equivalent effect

- (1) An **EDB**, in making a **CPP application**, may elect to apply an alternative methodology to that specified for—
 - (a) cost allocation and asset valuation in Section 2;
 - (b) treatment of taxation in Section 3; or
 - (c) the estimation of **term credit spread differentials** in Section 4.
- (2) The **Commission**, in evaluating a **CPP proposal** and in determining a **CPP** for an **EDB**, may apply the alternative methodology elected by an **EDB** to that specified for—
 - (a) cost allocation and asset valuation in Section 2;
 - (b) treatment of taxation in Section 3; or
 - (c) the estimation of **term credit spread differentials** in Section 4.
- (3) An alternative methodology applied by either an **EDB** or the **Commission** in accordance with this clause must:
 - (a) produce an equivalent effect within the **CPP regulatory period** to the methodology that would otherwise apply; and
 - (b) not detract from the promotion of the purpose of Part 4 of the **Act**.”

- After Section 9 of Subpart 4 of Part 5, insert the following new section:

“Section 10 Information relevant to alternative methodologies

5.4.34 Demonstration that alternative methodologies have equivalent effect

- (1) Where a **CPP applicant** elects to apply alternative methodologies in accordance with clause 5.3.33, it must provide:
 - (a) a list and description of each alternative methodology applied;
 - (b) an indication, at the relevant locations within the **CPP application**, as to where the alternative methodologies have been applied;
 - (c) reasons why each of the alternative methodologies have been applied; and
 - (d) evidence demonstrating that each alternative methodology:

- (i) produces an equivalent effect within the **CPP regulatory period** to the methodology that would otherwise apply; and
- (ii) does not detract from the promotion of the purpose of Part 4 of the **Act.**”

Proposed amendment for GDBs and GTBs:

Equivalent amendments to those proposed for EDBs are proposed for GDBs and GTBs, except that:

- In the *Gas Distribution Services Input Methodologies Determination 2012* [2012] NZCC 27:
 - replace “**EDB**” with “**GDB**” in the proposed new Section 5 of Subpart 3 of Part 5;
 - insert proposed new Section 10 of Subpart 4 of Part 5 as new Section 10 of Subpart 5 of Part 5; and
 - renumber new clause 5.4.34 as new clause 5.5.33 in the proposed new Section 10 of Subpart 5 of Part 5.
- In the *Gas Transmission Services Input Methodologies Determination 2012* [2012] NZCC 28:
 - replace “**EDB**” with “**GTB**” in the proposed new Section 5 of Subpart 3 of Part 5;
 - renumber new clause 5.3.33 as new clause 5.3.29 in the proposed new Section 5 of Subpart 3 of Part 5; and
 - insert proposed new Section 10 of Subpart 4 of Part 5 as new Section 10 of Subpart 5 of Part 5; and
 - renumber new clause 5.4.34 as new clause 5.5.30 in the proposed new Section 10 of Subpart 5 of Part 5.

Attachment C – Proposed amendments for assessing a CPP proposal that is complete in all material respects

Proposed amendments for EDBs:

The proposed amendments to the *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* are as follows:

- Replace clause 5.1.1(2) with:
 “(2) CPP application means an application containing, in all material respects, the information specified in-
 - (a) this subpart; and
 - (b) Subpart 4.”
- Replace clause 5.4.1(1) with:
 “(1) Subject to subclause (2), a **CPP proposal** must contain, in all material respects, the information specified in this subpart.”

Proposed amendment for GDBs and GTBs:

Equivalent amendments to those proposed for EDBs are proposed for GDBs and GTBs, except that:

- In the *Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27* the proposed amendment to clause 5.4.1(1) is made to clause 5.5.1(1) instead; and
- In the *Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28* the proposed amendment to clause 5.4.1(1) is made to clause 5.5.1(1) instead.