

Amendments to Electricity Distribution Services Input Methodologies Determination in relation to accelerated depreciation

Reasons paper

Date of publication: 8 November 2018

Associated documents

Publication date	Reference	Title
8 November 2018	NZCC 19	Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018
17 July 2018	N/A	Notice of Intention: Proposed Amendments to Input Methodologies for Electricity Distribution Services
20 December 2016	NZCC 24	Electricity Distribution Services Input Methodologies Amendments Determination 2016
20 December 2016	978-1-869455-47-7	Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector
20 December 2016	978-1-869455-51-4	Input methodologies review decisions: Report on the IM review

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1. Introduction

Purpose of paper

- 1.1 This paper outlines our reasons for implementing fast-track amendments to input methodologies (**IMs**) for Electricity Distribution Services contained in the *Electricity Distribution Services Input Methodologies Determination* [2012] NZCC (**IM determination**).¹
- 1.2 These amendments relate to implementation changes to the IMs for default price-quality paths (**DPPs**) in respect of the valuation of assets, specifically the accelerated depreciation of existing assets of electricity distribution businesses (**EDBs**).²
- 1.3 We have also made consequential changes to the IMs for DPPs and EDB information disclosure (**ID**) in respect of the treatment of taxation.

Amendments outlined in this paper

Why these amendments were required

- 1.4 As a result of the IM review in 2016, we introduced a mechanism for EDBs to apply for a discretionary net present value-neutral shortening of their remaining asset lives.³ This mechanism allows EDBs to elect new asset lives based on their assets' expected economic asset lives rather than their physical asset lives.⁴ This mechanism is to take effect at the time of the next DPP reset.⁵
- 1.5 We identified implementation errors in the IM determination. These amendments aim to clarify the provisions relating to:
 - 1.5.1 the timing for us to receive accelerated depreciation applications from EDBs;
 - 1.5.2 the applicable adjustment factor; and

¹ Prior to the amendments outlined in this paper, the principal determination was most recently amended in December 2017 by the *Electricity Distribution Services Input Methodologies Amendments Determination* [2017] NZCC 30. A consolidation of the principal determination and all subsequent amendments was published by us on 3 April 2018.

² See clause 1.1.4(2) of the IM determination for the definition of 'existing assets'.

³ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 84.

⁴ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 84.

⁵ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 86.

- 1.5.3 the applicable remaining asset lives used in calculating ‘adjusted depreciation’.

Why we made these amendments on a fast-track basis

- 1.6 We made these amendments on a fast-track basis to give better effect to our 2016 IM review decision on accelerated depreciation in time for the next EDB DPP commencing 1 April 2020.⁶
- 1.7 We prioritised these amendments to allow EDBs, which may be considering proposing an adjustment factor for the next EDB DPP reset, to have sufficient time before our draft DPP decision on the 2020 reset in Q2 2019, to:⁷
- 1.7.1 consult with interested persons on their proposed adjustment factor; and
- 1.7.2 if they wish, propose the adjustment factor to us in writing.⁸
- 1.8 Chapter 2 explains our amendments in more detail, including in each case the previous IM requirements, what we have amended and our responses to submissions on our draft decision.⁹

Amendments in accordance with Commerce Act 1986

- 1.9 This paper outlines amendments to the EDB IMs, which were originally determined in accordance with Part 4 of the Commerce Act 1986 (the **Act**) on 22 December 2010.¹⁰
- 1.10 The amendments outlined in this paper are in accordance with s 52X of the Act.
- 1.11 In accordance with sections 52V(1) and 52X of the Act, we published a notice of intention for these amendments on 17 July 2018.¹¹

⁶ Input methodologies review decisions: Report on the IM review (20 December 2016), para 93-99, and Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 83-95.

⁷ ‘Adjustment factor’ is the term used in the IM determination to implement accelerated depreciation.

⁸ Default price-quality paths for electricity distribution businesses from 1 April 2020: Proposed process (14 June 2018), p. 6.

⁹ Our draft decision documents are “[DRAFT] Electricity Distribution Services Input Methodologies Amendments Determination 2018” (23 August 2018) and “Proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to accelerated depreciation: Draft reasons paper” (23 August 2018).

¹⁰ A detailed outline of our Part 4 regime, including the role of IMs in Part 4 regulation is outlined in Input methodologies review decisions: Framework for the IM review (20 December 2016), para 16-37.

1.12 As required by s 52V(2)(a) of the Act, we published a draft decision, which outlined our proposed changes to the IMs for DPPs in respect of the valuation of assets, specifically the accelerated depreciation of existing assets of EDBs.¹² Our draft decision also outlined our proposed consequential changes to the IMs for DPPs and EDB ID in respect of the treatment of taxation.¹³

1.13 As required by s 52V(2)(b) of the Act, we gave interested persons a reasonable opportunity to give their views on our draft decision.¹⁴ As required by s 52V(2)(d) of the Act, in making the amendments outlined in this paper, we have had regard to views received from interested persons within our consultation period.¹⁵

Material released alongside this paper

1.14 Alongside this paper, we have published an Electricity Distribution Services Input Methodologies Amendments Determination (**IM amendments determination**) specifying our implementation changes to the IMs for the EDB DPP in respect of the accelerated depreciation of existing assets.¹⁶ We have also made consequential changes to the IMs for DPPs and EDB ID in respect of the treatment of taxation.

¹¹ Notice of Intention: Proposed Amendments to Input Methodologies for Electricity Distribution Services (17 July 2018).

¹² Proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to accelerated depreciation: Draft reasons paper (23 August 2018), para 2.3-2.9.

¹³ Proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to accelerated depreciation: Draft reasons paper (23 August 2018), para 2.10-2.13.

¹⁴ Proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to accelerated depreciation: Draft reasons paper (23 August 2018), Chapter 3.

¹⁵ We received submissions from Orion New Zealand Limited, PricewaterhouseCoopers, and Vector Limited and no cross-submissions. See - Orion New Zealand Limited "Submission on EDB IM Accelerated Depreciation" (6 September 2018), PricewaterhouseCoopers "Submission on proposed amendments to Electricity Distribution Services IMs in related to accelerated depreciation" (6 September 2018), Vector Limited "Submission on proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to Accelerated Depreciation" (6 September 2018).

¹⁶ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018).

2. Amendments

Purpose of this chapter

- 2.1 This chapter sets out the specific matters that we have amended in our IM amendments determination in relation to EDB accelerated depreciation, and why we have made these changes.
- 2.2 We have clarified the provisions relating to:
- 2.2.1 the timing for us to receive accelerated depreciation applications from EDBs;
 - 2.2.2 the applicable adjustment factor; and
 - 2.2.3 the applicable remaining asset lives used in calculating ‘adjusted depreciation’.

Timing for us to receive accelerated depreciation applications from EDBs

Previous requirement

- 2.3 Previously, under our IM determination, EDBs could propose, by a notice in writing, an adjustment factor prior to the commencement of the ‘**base year**’,¹⁷ to be applied by us for the DPP commencing 1 April 2020.¹⁸

Amendment

- 2.4 We have amended the date for when EDBs may propose an adjustment factor from ‘prior to the commencement of the **base year**’ to ‘not later than 13 months prior to the commencement of the next **DPP regulatory period**’.¹⁹ We have made this change to allow EDBs more time to consult with interested parties on a potential adjustment factor.
- 2.5 We consider that this change:

¹⁷ In clause 1.1.4(2) of the IM determination, ‘base year’ is defined as meaning ‘the **disclosure year** selected by the **Commission**’. We intend to select our ‘base year’ for the DPP commencing 1 April 2020 in our DPP Issues paper, which we are intending to publish in November 2018.

¹⁸ Clause 4.2.2(3)(d) of the *Electricity Distribution Services Input Methodologies Amendments Determination* [2017] NZCC 30.

¹⁹ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.5.

- 2.5.1 allows EDBs, which may be considering proposing an adjustment factor for future DPP resets, and in particular the upcoming 2020 DPP reset, to have sufficient time before our draft DPP decisions to:
 - 2.5.1.1 consult with interested persons on their proposed adjustment factor; and
 - 2.5.1.2 if they wish, propose the adjustment factor to us in writing; and
- 2.5.2 allows us sufficient time to consider an EDB's proposed adjustment factor before making our DPP draft decisions and final decisions.
- 2.6 Our amendments allow EDBs to propose by not later than 1 March 2019 an adjustment factor for the DPP commencing on 1 April 2020.
- 2.7 In its submission on our draft decision, PricewaterhouseCoopers Consulting (New Zealand) (**PwC**)²⁰ and Vector Limited (**Vector**) supported our proposed amendment.²¹

Applicable adjustment factor

Previous requirement

- 2.8 Previously, our IM determination was silent about the applicable adjustment factor to use for any successful accelerated depreciation applications in a disclosure year between the base year²² and the first year of the next DPP regulatory period.

Amendment

- 2.9 We have amended the IM determination by specifying that the adjustment factor for a disclosure year after the base year, but before the start of the next DPP regulatory period, is '1'.²³ We have made this implementation change to clarify our policy intent from the 2016 IM review that any adjustment to the remaining asset lives for

²⁰ PwC "Submission on proposed amendments to Electricity Distribution Services IMs in related to accelerated depreciation" (6 September 2018), para 2.

²¹ Vector "Submission on proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to Accelerated Depreciation" (6 September 2018), para 5.

²² For the 2010-2015 EDB DPP, we used the disclosure year commencing two years before the start of the DPP regulatory period as the 'base year'. See Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020: Low cost forecasting approaches (28 November 2014), para 2.5.

²³ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.5.

existing assets will only apply as a one-off adjustment at the time a DPP is reset, not in a disclosure year prior to the reset.²⁴

- 2.10 We have also clarified that the adjustment factor made at the time a DPP is reset will apply for each disclosure year of the applicable new DPP regulatory period.²⁵ Having that adjustment factor also apply in a disclosure year between the base year and the first year of the next DPP regulatory period would lead to the accelerated depreciation in that disclosure year reducing the opening regulatory asset base (**RAB**) at the start of the regulatory period, which would be contrary to our policy intent from the 2016 IM review.²⁶
- 2.11 In its submission on our draft decision, Orion New Zealand Limited (**Orion**) suggested that the wording proposed for the treatment of new assets commissioned during the regulatory period is unclear.²⁷ Orion suggested that new assets enter the RAB at the standard asset lives and no adjustment factor is applied.²⁸ Orion suggested that we review if our intent is clear in the drafting.²⁹
- 2.12 We consider that the drafting accurately reflects our policy intent. We note as a result of the 2016 IM review that we suggested the following:
- “To implement this policy change, an EDB subject to a DPP is, at the time a DPP is reset, able to propose a factor by which to adjust the weighted average remaining asset life for its existing assets...EDBs will be required to adjust their individual asset lives used for ID to ensure that in the first year of the new regulatory period, the implied weighted average asset life for the purposes of ID is consistent with their new weighted average remaining asset life for the purposes of the DPP. Assets commissioned after this date will have asset lives which are in line with similar assets already in the RAB.”³⁰
- 2.13 We note that in accordance with clause 2.2.8(1)(i)(iii) of the IM determination, standard physical asset lives will generally apply for new assets.³¹ However, we note

²⁴ Commerce Commission, Input methodologies review decisions: Report on the IM review (20 December 2016), para 93-99.

²⁵ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.5.

²⁶ Input methodologies review decisions: Topic paper 3: The future impact of emerging technologies in the energy sector (20 December 2016), para 83-95.

²⁷ Orion “Submission on EDB IM Accelerated Depreciation” (6 September 2018), para 8.

²⁸ Orion “Submission on EDB IM Accelerated Depreciation” (6 September 2018), para 8.

²⁹ Orion “Submission on EDB IM Accelerated Depreciation” (6 September 2018), para 8.

³⁰ See Input methodologies review decisions: Report on the IM review (20 December 2016), para 94-95.

³¹ See clause 2.2.8(1)(i)(iii) of the IM determination. In clause 1.1.4(2) of the IM determination, ‘standard physical asset life’ is defined as meaning ‘life for an asset as specified in *Table A.1: Standard Physical Asset*

that in accordance with clause 2.2.8(3) of the IM determination, an engineer may determine a different physical service life potential.³²

- 2.14 In its submission on our draft decision, PwC suggested that we should explicitly define ‘adjustment factor’.³³ We do not consider a definition is necessary because an ‘adjustment factor’ will only ever be a value not lower than 0.85, nor higher than 1.³⁴
- 2.15 In its submission on our draft decision, PwC also suggested that our reference to ‘the disclosure year immediately following the base year’ in our draft amendments determination was ‘not sufficiently flexible’, as we have discretion to decide which ‘disclosure year’ is used as the base year.³⁵ We agree and have amended the IM determination to allow us to apply an adjustment factor across all existing assets of ‘1’ for ‘a disclosure year after the base year in respect of the DPP regulatory period’.³⁶ This amendment will allow us to apply an adjustment factor across all existing assets of ‘1’ for any disclosure year after the base year and not just the disclosure year between the base year and the first year of the next DPP regulatory period.
- 2.16 In its submission on our draft decision, Vector supported our proposed amendment.³⁷

Applicable remaining asset lives used in calculating ‘adjusted depreciation’

Previous requirement

- 2.17 Previously, our IM determination was silent about the interplay between ‘adjusted depreciation’³⁸ and ‘total depreciation’³⁹ when calculating the remaining asset lives for existing assets following a successful adjustment factor application.

Lives for EDBs of Schedule A’. Table A.1: Standard Physical Asset Lives for EDBs of Schedule A of the IM determination specifies standard physical asset lives.

³² See clause 2.2.8(3) of the IM determination.

³³ PwC “Submission on proposed amendments to Electricity Distribution Services IMs in related to accelerated depreciation” (6 September 2018), para 4b-para 5.

³⁴ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.5.

³⁵ PwC “Submission on proposed amendments to Electricity Distribution Services IMs in related to accelerated depreciation” (6 September 2018), para 4a.

³⁶ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.5.

³⁷ Vector “Submission on proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to Accelerated Depreciation” (6 September 2018), para 6.

Amendment

- 2.18 We have amended the IM determination by specifying for a DPP that any remaining asset lives for existing assets used when calculating ‘adjusted depreciation’ for ‘amortisation of revaluations’⁴⁰ and ‘depreciation temporary differences’⁴¹ must be consistent with the remaining asset lives for existing assets used for calculating ‘total depreciation’.⁴²
- 2.19 We have amended the IM determination by specifying for ID and customised price-quality path proposals that any remaining asset lives used when calculating ‘adjusted depreciation’ for ‘amortisation of revaluations’ and ‘depreciation temporary differences’ must be consistent with the remaining asset lives used for calculating ‘total depreciation’.⁴³
- 2.20 We have made these amendments to clarify that any differences between ‘total depreciation’ and ‘adjusted depreciation’ should arise solely from the inclusion (or exclusion) of revaluation amounts. Differences between ‘total depreciation’ and ‘adjusted depreciation’ should not arise from using different remaining asset lives.
- 2.21 In its submission on our draft decision, PwC⁴⁴ and Vector supported our proposed amendment.⁴⁵

³⁸ See clause 1.1.4(2) of the *Electricity Distribution Services Input Methodologies Amendments Determination* [2017] NZCC 30 for the definition of ‘adjusted depreciation’.

³⁹ See clause 1.1.4(2) of the *Electricity Distribution Services Input Methodologies Amendments Determination* [2017] NZCC 30 for the definition of ‘total depreciation’.

⁴⁰ See clause 1.1.4(2) of the IM determination for the definition of ‘amortisation of revaluations’.

⁴¹ See clause 1.1.4(2) of the IM determination for the definition of ‘depreciation temporary differences’.

⁴² Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.1.

⁴³ Electricity Distribution Services Input Methodologies (Accelerated Depreciation) Amendments Determination 2018 (8 November 2018), clause 4.1.

⁴⁴ PwC “Submission on proposed amendments to Electricity Distribution Services IMs in related to accelerated depreciation” (6 September 2018), para 2.

⁴⁵ Vector “Submission on proposed amendments to Electricity Distribution Services Input Methodologies Determination in relation to Accelerated Depreciation” (6 September 2018), para 7.