Price-quality path in-period adjustment mechanisms workshop

Questions regarding reopener process, reopener thresholds, type and extent of reopeners, other in-period adjustment mechanisms and CPP mechanism

For use by external stakeholders

This document provides questions to guide feedback on our 29 November 2022 workshop *"Price-quality path in-period adjustment mechanisms"*. These questions were published in advance on 23 November 2022 to guide preparation for the workshop and formed the basis for discussion at the workshop on 29 November. We have refined the questions following what we heard at the workshop, but not removed any that were on the previously published list. These questions are intended to inform our review of the Part 4 input methodologies (IM Review).

The slides we published before the workshop are available here. The recording of the workshop will be published here. It would be useful if you could take these into account when answering the questions that follow.

The framework paper published in October 2022 outlines the core framework for our decision-making for the IM Review. We recommend using the framework (especially the overarching objectives of the IM Review it sets out), in developing your feedback.

Completed forms should be sent to im.review@comcom.govt.nz, with 'Price-quality path in-period adjustment mechanisms workshop – [your submitter name]' in the subject line of the email. Please provide us with your feedback by 5pm Tuesday 20 December 2022.

If you have supporting documents that you consider would improve our understanding of the issues, please attach them with your response and reference them in your feedback below.

All completed forms and supporting documents provided to us in this context will form part of the record for the IM Review. We intend to publish completed forms and supporting documents provided to us to enable other stakeholders to engage with them throughout the IM Review. Any request that we not publish content in a completed form or supporting document provided to us must be clear and explicit with reasons supporting why that content is confidential or commercially sensitive. We will consider any such requests on their merits.

Note: “Reopener” as referred to in the following questions is a colloquial term for “in-period adjustment mechanisms” and “reconsideration of the price-quality path”.

A. Questions relating to reopener process

These questions relate to content on workshop slides 20-25.

A1.	**Would our proposed updated reopener process address any concerns you may have on the current perceived lack of clarity in the reopeners?**
	Answer: We agree a standardised process would help with ambiguity. However, we consider additional guidelines setting out the Commission’s expectations around evidence and level of detail would also be useful for suppliers to engage in the re-opener process.
A2.	**What do you think of our current thinking on updating the process steps for a reopener, broadly in line with the equivalent process under the Fibre IMs with relevant Part 4 reopener process additions?**
	Answer: We caution against adding steps that are more onerous than the existing process or the process in the Fibre IMs given re-opener mechanisms are intended to be relatively low cost. If the Commission proceeds with requirements around consumer consultation we recommend it takes a broad approach and considers for example, data analytics based evidence. The appropriate approach to consumer consultation will differ between re-opener and expenditure types. We consider a key issue in terms of process is that the Commission works with suppliers who submit applications. That is, rather than automatically rejecting an application on the basis evidence is insufficient the Commission should advise on what is needed to complete the application. We recommend the Commission also consider introducing a more streamlined process for lower value applications. We also recommend introducing the option of obtaining independent verification to bypass the full Commission approval process.
A3.	**As our current thinking is based largely on our review of the EDB reopeners, with reference to the Fibre reopener provisions, are there any significant variations to this process that we should consider for Gas or Transpower IMs?**
	Answer: We strongly recommend the Commission introduce a revenue cap for GDBs. However, if the GDB remains on a WAPC the GDB IMs should include a volume re-opener to mitigate the significant forecast risk in this sector. We consider a more streamlined process would be appropriate for this type of expenditure.
A4.	**From a workability point of view, how significant is the overhead to produce information for a reopener application? Could suppliers repurpose or use existing**

business case justification information that they already produce internally for reopener applications?

Answer: We would need more guidance on evidence and level of detail that the Commission would expect to see in an application to determine this.

A5. Note that this topic was not discussed at the workshop:
We are making refinements to DPP reopener IMs to reduce ambiguity, improve clarity and consistency. Please provide examples of areas that could be improved in this respect.

Answer: We recommend the Commission publish guidelines on evidence and level of detail it expects in applications.

B. Questions relating to reopener thresholds

These questions relate to content on workshop slides 26-29.

B1. Are the current reopener materiality thresholds still appropriate? If not, please explain why.

Answer: We consider the 1% of net allowable revenue threshold for the DPP period is not appropriate in all circumstances. In particular –

- It does not capture expenditure that is below the threshold but has a high impact and value for consumers (for example, net zero projects, cybersecurity and resilience).
- It may not capture expenditure that would cumulatively reach the threshold.
- The percentage threshold could lead to perverse outcomes. For example, a small EDB may be able to proceed with a re-opener for an investment that is in the long-term interest of consumers that a larger EDB could not due to the 1% threshold. However, the costs and benefits for consumers of the investment would be the same regardless of EDB size.
- It may not capture enabling work that could allow larger projects to proceed (i.e. where this expenditure has a timing difference to the rest of the project or is not associated with a specific project/programme). For example, a digital project that could enable an EDB to undertake other innovative projects.

There have been few re-opener applications to date, so we do not consider there is any concern around the threshold being too low. However, we consider it is too high to capture all circumstances where a re-opener would be in the long-term benefit of consumers.

B2. Some submissions on our Process and Issues paper raised that the cost of more than one project should be able to be considered to meet the lower DPP reopener threshold level. Our current thinking is that projects should only be considered for

a cumulative application if each project is substantive, and the projects are part of the same programme or relate to the same scenario. What are your views on this?

Can you please provide examples of:

- **where you would have applied for a reopener, if projects could have been considered together?**
- **potential future situations where you think you might have a number of projects, the combined cost of which will meet the current threshold?**

Answer: We strongly support the Commission considering cumulative re-openers.

Vector has recently experienced an early failure of asset type in its XLPE sub-transmission cables. These had been planned for replacement but due to a number of failures this replacement must be brought forward. This involves multiple projects around $2m.

We consider expenditure on digital projects could require a re-opener in future (given the difficulty in forecasting this expenditure due to the pace of change) and cumulatively could be over the threshold. Vector's digital projects, for example investment into our Advanced Distribution Management System, have involved expenditure that would be over threshold if projects were considered together.

C. Questions relating to the type and extent of reopeners

These questions relate to content on [workshop slides 30-35].

C1. Could you please provide feedback on our initial assessment of coverage provided by our existing DPP reopeners of the scenarios from submissions on the Process and Issues paper?

Answer: We found the Commission's assessment of coverage helpful. Having reviewed the Commission's assessment, we consider the following gaps remain -

- Government policy: The Commission notes that once policy is passed into legislation, it is covered by the change event re-opener. However, government policy could impact behaviour ahead of being passed into legislation. Similarly, some government policy (e.g. around climate change) is determined by government departments empowered by legislation to make decisions or provide guidance. That is, government policy may drive expectations around supplier behaviour without amounting to a legislative or regulatory change.
- Unforeseen and foreseen capex re-opener: This should be neutral between opex and capex.
- Climate change, digitalisation/data and cyber resilience: This is not always foreseeable given the pace of technological change, changing consumer expectations and government policy.

We also consider that –

- There is a gap to support investment that is below the threshold but is high impact and value for consumers; and
- The GDB IMs should include a volume re-opener if the Commission does not change the form of control to a revenue cap.
- The IMs should provide an option to apply for a re-opener to support project financeability (for example, through changing the cashflow profile or alternative rates of return). We have provided more detail on this in our submission and our response to D4.

C2. What are the electrification scenarios that you consider need to be accounted for in DPP reopeners, and why?

Answer: We consider the following electrification scenarios should be accounted for in DPP re-openers –

- Climate change: in terms of both net zero expenditure and adaptation for resilience;

- EV charging uptake: for public charging, residential charging and public transport (e.g. ferries and buses).

- Gas transition: This could involve electrification or a transition clean gas.

- New connections: large scale renewable generation (e.g. solar and windfarms) may seek to connect to the network.

These scenarios involve significant uncertainty but may require a rapid response by suppliers.

C3. Process and issues paper submissions suggested that new or expanded reopeners may be needed to address the higher levels of general uncertainty anticipated. Please provide specific examples of scenarios to enable us to assess coverage provided by our current reopeners.

Answer: Along with the scenarios described in our response to C2, the following areas involve significant uncertainty –

- Data centers connecting to the network: Various potential data centers have expressed interest in connecting to the network. Currently this involves around 200MW that is reasonably certain and another 200MW that is less certain.

- Inflation: Current and rising levels of inflation create significant uncertainty around cost.

- Population growth: there is increased uncertainty around in terms of forecasting demand growth post Covid-19.

- Resource constraints: increased volume of activity and supply chain issues has created a time lag and increased costs. This may require EDBs to sustain projects as a work-in-progress (WIP) for longer time frames ahead of commissioning.

- Transpower approach to security: Transpower could change the level of security at a GXP requiring investment by EDBs to maintain their own level of security. For example, Transpower recently removed N-2 at Wairau GXP which will require Vector to invest - in this case - in a transmission solution maintain security. We will consider both transmission and non-transmission solutions if this occurs again in future.

- System Operator requirements: Transpower as System Operator could potentially require distributors to maintain ripple control. This would result in increased costs, including maintenance opex costs.

- Relocations driven by third parties: This presents opportunities to bring forward investment (e.g. circuit breaker replacement) that would otherwise take place in future.

- Procurement costs for non-wire alternatives: Non-wire alternatives involve procurement costs that may be less certain and less controllable relative to a traditional network solution.

- Compliance costs: For example, Auckland Council has imposed more onerous traffic management requirements resulting in increased traffic management expenditure (both opex and capex)

- Auckland Unitary Plan: Changes to the Unitary Plan allow taller houses closer to lines. This will create lines clearance issues with new developments.

We note a number of these areas involve spend that will have a significant impact over time but, as an individual project, would not reach the revenue threshold. In the absence of mechanisms to manage these costs (whether an alternative adjustment mechanism or lower threshold), suppliers may be required to defer or re-prioritise efficient expenditure. This is not in the long term benefit of consumers.

C4. Is expenditure relating to disaster readiness, cyber security, greater use of digitalisation and data able to be foreseen and is it within the control of suppliers? If not, please explain.

Answer: Cybersecurity, digitalization and data expenditure is difficult to forecast due to the rate of technological change. Furthermore, cybersecurity practices (and stakeholder expectations around managing cybersecurity risks) may evolve rapidly following cybersecurity attacks.

In terms of disaster readiness, we note Wellington Electricity required a CPP to address disaster readiness following a Government Policy Statement issued in light of the 2016 Kaikoura Earthquakes which increased the risk of a major earthquake in Wellington. This is illustrative of new learnings and changing stakeholder expectations around disaster readiness that suppliers may not be able to anticipate.

C5. Note that this topic was not discussed at the workshop:
We are reviewing whether DPP reopeners should provide more scope for opex, for example:

- **there may be scenarios where an opex solution might be more cost-effective than a capex solution**
- **opex that is consequential to capex**

Can you tell us about any other scenarios which might be appropriate for opex to be included in DPP reopeners?

Answer: Digital expenditure, including cybersecurity, is a key area to support efficient solutions, for example non wire alternatives. The move to Software as a Service (SaaS) is likely to increasingly replace capex but it is difficult to anticipate what and when these services will be available.

The purchase of demand response services from third parties (for example, contracts for hot water load control to manage peaks) is another area involving opex as an efficient solution. As above, demand response service contracts are likely to increasingly replace capex but it is difficult to forecast what and when these services will be available.

Powerco's recently announced agreement with solarZero for 'virtual power plant' network support services is another example of an opex solution selected as a more cost effective solution.

D. Questions relating to other in-period adjustment mechanisms

These questions relate to content on workshop slides 36-38.

D1. Can you identify circumstances in which suppliers might want to make use of a potential DPP contingent project reopener?[1] Please explain why the current reopeners are not suitable in those circumstances.

Answer: We support the introduction of a contingent project re-opener.

Expenditure with less certainty around cost and timeframes would be appropriate for a contingent projects re-opener. For example, the Auckland network may see a number of data centres connect over the next DPP. This would avoid the need for

[1] A contingent project is a project that has been listed as a 'contingent project' with an associated trigger event in a DPP/CPP determination. Projects are identified and listed in advance, well supported by information in Asset Management Plans.

costs to be included in supplier allowances and would ensure consumers only fund these costs if the need actually arises in-period. A re-opener would not be appropriate in these circumstances as separate data centres could connect at different times in the period which could necessitate multiple re-opener applications.

We note Transpower proposed a 'use it or lose it' funding mechanism in its RCP4 proposal which it described as ring-fencing funding for its resilience programme where there was less certainty around scope and cost.

We consider a contingent project re-opener should also apply to projects that are high impact and value for consumers but may not reach a 1% of revenue threshold.

D2.	**Which scenarios could we consider including under a DPP wash-up mechanism, and why?**

Answer: We support introducing a DPP wash-up mechanism. We also recommend the Commission make greater use of pass-through and recoverable costs as a method of washing-up unforeseen costs.

We consider appropriate candidates for a DPP wash-up mechanism are –

- Costs that were unable to be forecast ahead of the DPP but are easy to validate ex post (e.g. cybersecurity costs where the provider also offers services in competitive markets); and
- Costs that are entirely outside the control of the supplier. For example, GAAP changes such as the recent decision on SaaS costs should be washed up to avoid IRIS impacts that do not reflect supplier efficiency.

Introducing a wash-up mechanism and making greater use of pass-through and recoverable costs would support the long term benefit of consumers by providing a lower cost and less complex method of addressing unforeseen costs. Suppliers and the Commission already have experience using wash-up mechanisms under the DPP. These mechanisms could reduce the workload burden on the Commission and suppliers relative to traditional re-openers.

In an increasingly uncertain environment the need for easily accessible mechanisms to address uncertainty has grown.

D3.	**Do you consider that there may be value in us considering a range of in-period adjustment mechanisms, eg, reopeners used for larger suppliers and as part of the DPP, use-it-or-lose-it allowances[2] for smaller suppliers, and if so, why?**

Answer: Yes we support the use of a range of in-period adjustment mechanisms.

[2] Use-it-or-lose-it allowances are provided where the need for funding has been identified at the time of setting the DPP, but the timing or exact amount of expenditure is uncertain. Unspent allowances are returned.

However, we consider alternative adjustment mechanisms such as use-it-or-lose-it allowances should be available to all suppliers regardless of size. The alternative adjustment mechanisms would provide the same benefits to all EDBs and their consumers. We do not see any benefit in preventing larger EDBs from using alternative adjustment mechanisms to manage uncertainty where the need arises.

D4. Can you identify any other potential in-period adjustment mechanisms which you think we should consider? What situations would this cover, which are not covered by current reopeners or other mechanisms we are considering as outlined in questions D1-D3?

Answer: As described in more detail in our submission, we recommend the IMs be amended to allow EDBs be able to manage new large connections in an equivalent manner to Transpower's new investment contracts (i.e. outside the price-path) through commercial arrangements. This would support the long term benefit of consumers by mitigating forecast uncertainty (and associated negative impacts on incentives and expenditure where allowances are incorrect) by removing these costs from expenditure forecast and allowances. It would also provide EDBs with the ability to offer greater options to large consumers.

We also recommend the IMs allow suppliers to apply for a re-opener to support project financing (for example, through proposing a different cashflow profile or rate of return) if the existing regulatory settings did not enable the project to be funded resulting in suboptimal outcomes for consumers.

This would support the long-term benefit of consumers by providing a mechanism to support project financing where engaging in a CPP application would be inappropriate (for example, for specific projects where the scale of expenditure would not justify a CPP application).

E. Questions relating to the CPP mechanisms

These questions relate to content on workshop slides 39-42.

E1. What are the barriers or challenges of applying for a CPP?

Answer: CPP applications involve significant cost and workload for a supplier (and for the Commission in assessing the application).

We also are concerned there is a significant risk of time delay while the Commission assesses applications. This might be unmanageable if the Commission receives multiple applications in a year.

There also may be uncertainty and complexity involved in transitioning back to the DPP once the CPP ends.

E2. How do you view the effectiveness of the modification and exemption provisions in the current CPP IMs?

Answer: We do not have experience with the modification and exemption provisions in the current CPP IMs so do not have a current view on this. However, it is not clear to us from the IM drafting what evidence the Commission would require (as required in 5.1.7(2)(vi) of the EDB IM) to consider modification or exemption of the CPP requirements.

We understand from the workshop that the Commission is considering using these provisions for re-opener applications. We agree there should be means to vary application requirements, however, we recommend a streamlined process for smaller applications.

E3. Keeping in mind the need for: (1) scrutiny of expenditure for large step-changes in investment associated with CPPs, (2) transparency of information, and (3) ability to consult for interested parties eg, consumers:

- **How might the current CPP IMs be refined to better promote the overarching objectives of the IM Review?**
- **Are there information or application requirements that you consider are not needed for the regime? If so, which ones are they, and why?**

Answer: We consider a simplified process for smaller expenditure or 'single issue' CPPs would be appropriate to reduce cost and complexity in the regime.

E4. If you hold a view that our current suite of DPP reopeners does not fulfil a similar purpose as a single-issue CPP, please explain why, and provide examples of scenarios that would not be covered by existing DPP reopeners.

Answer: The unforeseen major capex reopener has a maximum expenditure threshold ($30m) beyond which the supplier is expected to apply for a CPP. We understand Wellington Electricity's resiliency focused CPP involved $31.2m so would have been above this threshold.

Based on the current IM thresholds, single issue CPPs will be needed for expenditure above these thresholds. Undertaking a full CPP where, for example, expenditure is slightly above $30m and focused on one area (e.g. resiliency) would involve unnecessary complexity and cost.