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Vector cross-submission on proposed amendments to the input methodologies (IMs) for electricity distribution businesses (EDBs), gas pipeline businesses (GPBs) and Transpower relating to insurance entitlements, other compensatory entitlements, and other regulated income (ORI)

1. This is Vector's ('our,' 'we,' 'us') cross-submission on the Commerce Commission's (Commission) proposed IM amendments relating to EDBs and GPBs issued in September 2024. No part of this submission is confidential, and it can be published on the Commission's website. All quotations, unless referenced, are from submitters' responses to the Commission's proposed amendments, as published on the Commission's website.

2. Vector supports the Commission's objectives in amending the IMs currently in force and commencing 1 April 2025 as the current treatment of insurance proceeds exposes EDBs to IRIS penalties and consumers to price distortions.

3. Vector supports the principle of choice advocated by Unison. Allowing a supplier to choose whether they net compensatory entitlements against expenditure or alternatively treat such payments as ORI, is the most sensible approach, given the differing impacts compensatory entitlements can have on exempt EDBs, non-exempt EDBs and GPBs.

4. Vector supports the Commission's initial decision proposing for EDBs and GPBs that:

> *"…'insurance entitlements' and 'compensatory entitlements' in respect of damaged or destroyed assets are treated as if they were like capital contributions and are netted off commissioned asset costs."*[1]

5. Although Electricity Networks Aotearoa (ENA) has tried to resolve the inconsistencies of the Commission's proposed approach, Vector disagrees with the ENA's approach given the cashflow implications and we agree with Unison the cashflow implications are significant. Unison explains this issue:

> *"The downside of that [ENA] approach – and we think this is a significant problem – is that EDBs do not get the cashflow benefits of holding insurance. When planning for the risk of a catastrophic event, it is important that EDBs can use insurance cover to manage the financing challenge of the response to a natural disaster/catastrophic event. ENA's solution assumes that EDBs will always have debt headroom to finance the response."*

6. We also note that the netting off approach should not be limited just to insurance proceeds as there should be equivalence for those EDBs and GPBs that choose to insure and those that do not for valid reasons (such as the rising costs of insurance premiums for some assets). Ultimately the cost of insurance is borne by consumers so EDBs and GPBs need to be prudent when placing insurance.

7. An example of the above point can be illustrated by a pole that is insured by EDB A and a similar pole that is not insured by EDB B. The poles get damaged EDB A claims insurance and recovers costs. EDB B pursues the party that damaged the pole and recovers the costs. Irrespective off the recovery method, the treatment must be the same between the two EDBs.

8. We agree with Unison that if the Commission was to move ahead with its proposed approach it must address the IRIS implications (including consideration of how the base year IRIS adjustment will be affected) and the timing issues highlighted by Unison including that netting off should not be restricted to capex as netting for opex is also valid:

   a. *"The Commission's approach only applies to opex "arising from damaged or destroyed assets". That assumes that only opex arising from damaged or destroyed assets is insured and therefore eligible for this treatment. A wider definition that captures all insured opex is more appropriate given the policy objectives of the amendments.*

   b. *The amendments to the clauses providing for value of commissioned assets only apply to "an asset that replaces an asset" in respect of which insurance was received. Again, a broader definition is more consistent with the Commission's policy objectives. We*

[1] Commerce Commission, *Proposed amendments to input methodologies for electricity distribution businesses, gas pipeline businesses and Transpower relating to insurance entitlements, other compensatory entitlements, and other regulated income: Draft reasons paper* 3 September 2024) at 3.17.2

propose this should instead refer simply to "an asset in respect of which insurance was received".

c. *The Commission's solution to timing differences between when opex/capex is incurred and when insurance is received/recognised is to allow for: (i) restatement of opex, and (ii) recording additional positive/negative asset values. The former seems do-able but is administratively complex and may not work if the delay between incurring opex and recognising insurance is too great. We do not understand how disclosing separate 'adjustment' assets will deal with the capex IRIS. Given the IRIS is calculated annually based on annual forecasts of commissioned assets it would appear that adjusting assets in subsequent years would not deal with retention factors in relation to insured assets commissioned in earlier years."*

9. Vector does not see the timing issues raised by submitters as an issue if the choice of netting or treating as ORI is adopted. If a supplier chooses to net compensatory entitlements against related expenditure, then they are not treating those compensatory entitlements as revenue but as "negative expenditure" and therefore the revenue recognition criteria required under GAAP would not apply allowing those suppliers to accrue such "negative expenditure" in the same way as they would accrue any expenditure. Being able to accrue the compensatory entitlements when netting against expenditure should in our view address most of the timing issues. Obviously if the supplier chose to treat the compensatory entitlements as ORI, then the revenue recognition criteria would apply.

10. Finally, Vector asserts that the IMs should place more weight on the Part IV purpose than GAAP compliance. There are many examples in the current IM and DPP determinations where the treatment of various transactions does not agree with GAAP, such as the recognition of capital contributions, revaluation of assets, depreciation, related party transactions to name a few. We strongly encourage the Commission to implement an IM change that is consistent with the Part IV purpose. We understand that the intention of the ENA's suggested approach was driven by being consistent with GAAP and therefore lowering the burden on some suppliers such as exempt EDBs whose preference maybe to have the regulatory disclosures as close to their statutory financial statements prepared under GAAP. We therefore consider allowing a choice of treatment maintains the low-cost burden for some suppliers but also protects other suppliers from cashflow implications of not allowing netting.

Catastrophic event allowance

11. Unison's submission notes that:

> "[…] *we understand the catastrophic event allowance mechanism was intended to remedy the adverse regulatory consequences, including consequent IRIS penalties and an inadvertent negative wash-up adjustment, of catastrophic events. However, Unison is unable to meet the threshold as at 4 October 2024, given the threshold is measured in terms of the impact on the price path (BBAR impact), net of insurance entitlements. Our first insurance claim is not settled and we cannot determine the price path impact 'net of any insurance entitlements'. The threshold also excludes the IRIS incentives from the*

> *thresholds because those incentives will not be applied to the price path until the next DPP period*"

12. Vector has faced similar issues meeting the catastrophic event re-opener threshold based on the "impact on the price path" measure (although this is not related to insurance proceeds in our case). We are currently unable to meet the threshold for costs associated with the 2023 Auckland Anniversary Weekend flooding. Similarly, for Cyclone Gabrielle, we can only meet the threshold for costs incurred in RY23 despite also incurring costs in RY24.

13. We support the Commission's intent in amending the IM insurance treatment as it relates to catastrophic events (i.e., remedying the current IM treatment where insurance must be netted off in calculating the price path impact and in calculating the catastrophic event allowance).

14. We understand the Commission's view is these amendments do not re-open the price-path as "*the IM amendments would not reopen within the regulatory period, the allowable revenue for the remaining years of the regulatory period*."[2]

15. If this is the case, we recommend the Commission further address issues with the catastrophic event re-opener threshold by amending the current IM to replace the "impact on the price path" threshold to one based on costs incurred. This would better meet the policy intent of the catastrophic event re-opener and, in line with the Commission's proposed changes, would not re-open the allowable revenue for the remaining years of the period.

16. This consultation or the upcoming consultation on IM amendments for re-openers would be an appropriate forum to make this change.

Yours sincerely

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[2] Commerce Commission, *Proposed amendments to input methodologies for electricity distribution businesses, gas pipeline businesses and Transpower relating to insurance entitlements, other compensatory entitlements, and other regulated income: Draft reasons paper* 3 September 2024) at 3.18