

Commission signals start to implementing new regulatory processes

By David Blacktop, senior associate

The Commerce Commission has just released four discussion documents which represent the start of the process of implementing the new regulatory processes in the amended Part IV of the Commerce Act.

As recognised by new Commerce Commission Chair Dr Mark Berry, “a major driver of the legislative change was the desirability of increasing regulatory certainty for suppliers because it fosters efficient investment”. The publication of these documents “marks our first major milestone towards reducing uncertainty”.

The discussion documents cover “input methodologies” - the underlying building blocks for implementing regulation under Part IV, the Commission’s revised guidelines on estimating cost of capital, resetting the price path thresholds for electricity distribution businesses (EDBs) and how price-quality thresholds should apply to Transpower.

Input methodologies and estimating the cost of capital

The input methodology process was the core reform designed to improve certainty and predictability for regulated businesses. The process requires the Commission to develop and publish certain binding “building block” methodologies covering:

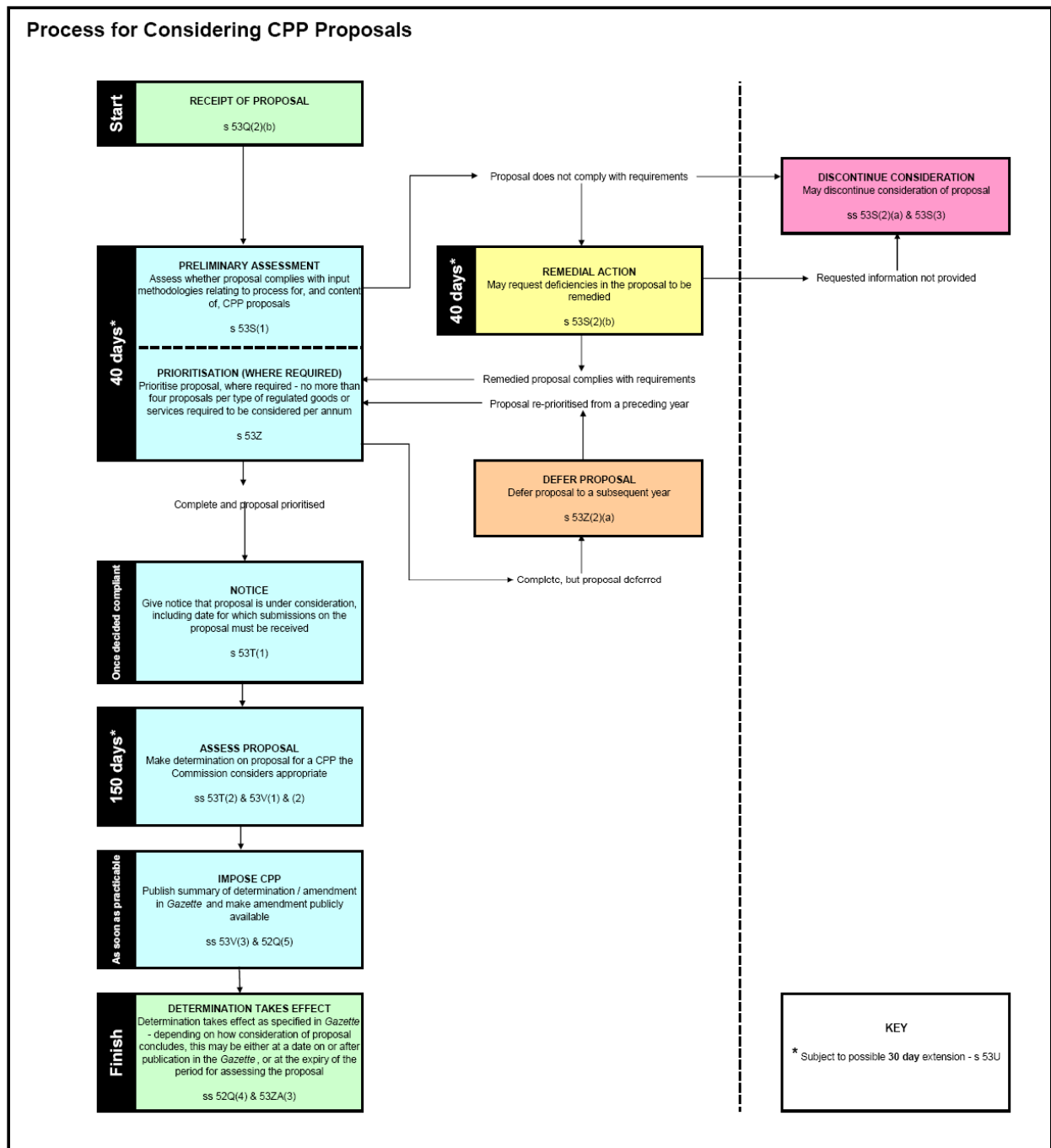
- methodologies for evaluating or determining:
 - cost of capital;
 - valuation of assets, including depreciation, and treatment of revaluations;
 - allocation of common costs, including between activities, businesses, consumer classes, and geographic areas;
 - treatment of taxation;
- pricing methodologies;
- regulatory processes and rules; and
- matters relating to customised price-quality path proposals.

The discussion paper (which is in excess of 500 pages) sets out general principles and then applies them to each industry subject to regulation (i.e., EDBs, Transpower (when regulation takes effect), gas pipelines businesses, and airports).

The Commission started reviewing its approach to estimating the cost of capital in 2006 before the Commerce Act was amended. The project has involved a detailed review by a panel of experts retained by the Commission (Professor Julian Franks of London Business School, Dr Martin Lally of Victoria University of Wellington and Professor Stewart Myers from MIT’s Sloan School of Management.) The outcome of this process is set out in a companion paper and is being consulted on as part of the input methodology process.

As well as the more technical building blocks, the input methodology discussion document sets out the Commission’s preliminary views on the process EDBs and gas pipelines businesses would have to follow if they sought to have customised price-quality thresholds applied. The Commission’s proposed process is reproduced below.

Commission’s preliminary view on process for considering customised price-quality thresholds proposals



As this shows, the process will not be quick. The key initial decision point would revolve around whether the application complies with the input methodologies the Commission will put in place for a customised path. The Commission's preliminary view is that a full bottom-up review of the supplier's business may be appropriate for customised price-quality paths. As part of the type of information that will be required, the Commission has published an accompanying expert report from Farrier Swift setting out preferred approaches to reviews of capital and operating expenditures.

The Commission seeks submissions by 31 July 2009, with cross submissions due on 17 August 2009. It is also proposing to hold a conference in the week of 14 September 2009.

While these documents contain a lot of information, the input methodologies are critical to the way in which the Commission will implement regulation. Input methodologies might not be reset for another seven years, i.e, until 2017.

Reset of default price-quality path for Electricity Distribution Businesses

The default price path-quality paths for EDBs reflect an evolution of the current price path thresholds regime.

The Commission has indicated its preliminary view is that the CPI-X regime will continue. However, importantly it has indicated its intention to closely examine the starting prices for EDBs. The Commission intends to use the prices as at 31 June 2010 as the initial starting prices and then review EDB profitability with a view to applying a subsequent price adjustment via a claw-back. This has the potential to undermine some of the certainty the reforms were designed to achieve.

The quality thresholds will likely be based on a no material deterioration in the three-year moving average System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI) from average levels that were recorded over the 2005-2009 regulatory period.

Submissions are due by 17 July 2009 and the Commission has indicated a draft decisions paper will be published in September.

Transpower process and recommendation discussion paper

Transpower's pricing behaviour is subject currently to the administrative settlement it entered into with the Commerce Commission on 13 May 2008, following breaches of Transpower's previous thresholds. This settlement remains in place until 30 June 2011.

Before that date, the Commission must make a recommendation to the Minister specifying whether Transpower should be subject to default price thresholds or customised price path thresholds.

Sensibly, given the NZ\$3b in investment Transpower is planning to undertake over the next five years, the discussion document indicates that the Commission's preliminary view is that Transpower should be subject to a customised price path threshold.

In terms of the relationship between the Commission and the Electricity Commission (responsible for approving Transpower investments under the EGRs), the Commission's proposal is to include approved projects into Transpower's revenue requirement and that requirement would be updated as projects are approved. To provide safeguards against overcharging (or undercharging), at the end of a regulatory period future revenues could be adjusted having regard to previous under or over recovery.

Submissions are due on 31 July 2009.

For further information:

David Blacktop

64 4 915 6531 david.blacktop@bellgully.com

Andrew Brown

tel 64 4 915 6848 andrew.brown@bellgully.com

David Cooper

tel 64 9 916 8978 david.cooper@bellgully.com

Torrin Crowther

tel 64 9 916 8621 torrin.crowther@bellgully.com

Garry Downs

tel 64 9 916 8932 garry.downs@bellgully.com

David Flacks

tel 64 9 916 8957 david.flacks@bellgully.com

Chris Gordon

tel 64 4 915 6836 chris.gordon@bellgully.com

Amon Nunns

tel 64 4 915 6741 amon.nunns@bellgully.com

Ralph Simpson

tel 64 9 916 8930 ralph.simpson@bellgully.com

Clive Taylor

tel 64 9 916 8943 clive.taylor@bellgully.com

26 June 2009