

21 October 2024

Ben Woodham
Electricity Distribution Manager
Commerce Commission
Wellington 6140

By email to: infrastructure.regulation@comcom.govt.nz

Dear Ben,

Cross-submission to the Commerce Commission (Commission) on the 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

Electricity Networks Aotearoa (ENA) appreciates the opportunity to make a cross-submission to the Commission on its consultation paper on the *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*.

ENA is the industry membership body that represents the 29 electricity distribution businesses (EDBs) that take power from the national grid and deliver it to homes and businesses (refer Appendix A for list of members). EDBs employ 10,000 people, deliver energy to more than two million homes and businesses and have spent or invested \$8 billion in the last five years. ENA harnesses members' collective expertise to promote safe, reliable and affordable power for our members' customers.

1.1 ENA supports the intent of the proposed amendments

ENA continues to welcome the Commission's proposal to make changes to the input methodologies (IMs) to correct for unintended consequences of the current treatment with regards to insurance and other compensatory entitlements.

1.2 Commission’s proposed solution is challenging to implement

As identified through the various submissions, there are, however, challenges with implementing the Commission’s proposed solution. The below table summarises ENA’s assessment of the different proposals.

	COMMISSION’S PROPOSAL	ENA’S SUBMISSION	UNISON’S SUBMISSION	TRANSPOWER’S SUBMISSION
Summary of approach	For both price-quality (PQ) and information disclosures (ID), offset the proceeds against the corresponding opex or capex.	No change to ID. For PQ compliance, treat proceeds as other regulated income (ORI), but reduce the value of the compensatory entitlements by the retention factor percentage.	Choice of offsetting or treating as ORI net of retention factors.	Retain existing arrangements, where entitlements are treated as ORI net of retention factors.
EDB’s affected by the proposed amendments	All EDBs, both exempt and non-exempt, by way of the proposed changes to ID.	By proposing an alternative treatment that applies to price-quality (PQ) only, only non-exempt EDBs are affected by the change, which matches to the problem, which is only faced by non-exempt EDBs.	As per ENA.	n/a
Cashflow outcomes	With offsetting, cashflows are returned to customers over the life of the replacement asset or at the same time as the operating expenditure is recovered.	Cashflows are returned to customers within 2 years through the washup.	Opex-related entitlements are returned to customers within 2 years through the washup, but treat insurance proceeds for reinstatement of assets as capital contributions (as is currently the case).	The cashflows related to the insurance entitlement are added to Transpower’s EV account and recovered over five years in the following period.

	COMMISSION'S PROPOSAL	ENA'S SUBMISSION	UNISON'S SUBMISSION	TRANSPOWER'S SUBMISSION
Consistency with GAAP	<p>Divergence from GAAP, where offsetting is not generally permitted.</p> <p>However, also noting that current capital contributions treatment already diverges from GAAP.</p>	<p>Alignment maintained. Insurance entitlements are reported as other income under GAAP. For regulatory purposes, insurance entitlements are reported as other regulated income. Note there is a difference between the two equal to the retention rate.</p>	<p>Opex – as per ENA.</p> <p>Capex has a choice - as per Commission or as per ENA.</p>	<p>As per ENA.</p>
Administrative burden	<p>High. Greater GAAP divergence increases administrative burdens.</p> <p>Exempt EDBs get caught in the solution to a problem they do not have.</p> <p>Clauses to allow retrospective changes for matching purposes requires prior year restatements.</p> <p>Refer also to Example, below.</p>	<p>Low. Existing accounting treatments can be maintained for ID. For PQ compliance, ORI need only be adjusted by the retention rate.</p>	<p>Opex – as per ENA.</p> <p>Capex has a choice - as per Commission or as per ENA.</p>	<p>Other regulated income need only be adjusted by the retention rate.</p>
Timing differences	<p>Offsetting works best when the income and expenditure are incurred in the same financial or regulatory year.</p>	<p>Opex and capex is treated as usual, with no changes.</p>	<p>Opex – as per ENA.</p> <p>Capex has a choice - as per Commission or as per ENA.</p>	<p>As per ENA.</p>

	COMMISSION'S PROPOSAL	ENA'S SUBMISSION	UNISON'S SUBMISSION	TRANSPOWER'S SUBMISSION
	<p>If income is received in later periods, this could lead to net negative expenditure or negative assets.</p> <p>Refer also to Example, below.</p>	<p>Entitlements are recorded in line with GAAP, net of the retention factor.</p> <p>These can occur at different times, but as the treatments are not interrelated, this doesn't cause a problem.</p>		
Transparency within ID	<p>With offsetting and the different timing matters, it could be difficult for users of ID information to understand the true impacts to the EDBs.</p>	<p>Greater transparency by showing income and expenditure on a gross basis, in line with GAAP.</p> <p>Proposal is to leave ID unchanged.</p>	As per ENA.	Not considered.
Comparability of ID	<p>All EDBs follow the same treatment.</p> <p>However, different compensatory entitlements and every event will be different so comparisons would be challenging after an event anyway.</p>	As per Commission.	As per Commission.	Not considered.
Comparability of PQ	<p>All EDBs follow the same treatment.</p> <p>However, different compensatory</p>	As per Commission.	A choice of treatments could lead to difficulties in comparing different EDBs on a like-for-like basis.	Not considered.

	COMMISSION'S PROPOSAL	ENA'S SUBMISSION	UNISON'S SUBMISSION	TRANSPOWER'S SUBMISSION
	entitlements and every event will be different so comparisons would be challenging after an event anyway.		However, as noted under the Commission approach, comparability will likely always be difficult with such unique events.	
Present value of treatment	Neutral under all approaches – refer Appendix C.			Not considered.

Example

An EDB builds a new asset in year one to replace a damaged one. This asset is capitalised into the RAB and depreciated over a life of, for example, 15 years. If the compensatory entitlements are not received until year three, a negative asset is created in year 3. In order to match the entitlement to its associated asset, a new asset life of 13 years would need to be established to ensure they both depreciate to the same end date. This may require the creation of new asset categories in the regulatory fixed asset register. Additionally, if the proceeds are significant, it could mean that total additions for the year show as negative.

Further note on timing:

In some cases, including smaller third-party liability claims, the expense and the entitlements can be closely aligned timing-wise and therefore offsetting may be a more efficient treatment.

However, with larger and more complex events, the expenditure may be incurred several years before insurance proceeds are received, leading to complexities in applying the Commission's proposed off-setting approach.

1.3 Optionality is the way to implement the policy intent

ENA continues to believe that the alternative treatment proposed in our previous submission¹ offers an effective and streamlined approach to treatment, reducing regulatory burden, and avoiding a loss of transparency through offsetting.

However, we do understand the concerns raised by Unison in their submission,² and both Unison and Vector in their cross-submissions, that the proposed treatment may have unfavourable cashflow consequences for some EDBs. This may undermine incentives to invest that would otherwise result from the receipt of insurance proceeds and are not ultimately in the long-term interests of consumers. This particularly applies to capex, where it can mean passing the proceeds to customers many years earlier than under the Commission's offsetting approach, as shown in Appendix C. When recovering from an event that has required insurance or third-party entitlements, this cashflow disadvantage could limit an EDB's ability to fund necessary post-event expenditure or investments.

ENA agrees with issues identified by Vector, Transpower³ and Unison and suggests that, upon further reflection and discussion with our members, that leaving optionality in the solution is the best way to ensure the best outcomes for all parties.

In Appendix C, we demonstrate how all the options considered result in a neutral present value (PV) outcome for consumers. This means that whichever option is applied, customers will have the same overall impact on their prices over time. The neutral PV outcome should give the Commission comfort that allowing EDBs a choice in treatment will not result in 'gaming' the system.

However, the different options do have quite different cashflow impacts for EDBs. Given that the situations envisioned by these IM changes are as a result of events causing damage and unplanned costs, having flexibility in the solution to allow the best cashflow option for EDBs can be realised, is in line with the policy intent.

1.4 Precedent for offering choice

Optionality is already available in existing regulatory treatment for disclosures and compliance. Below are some examples:

- Cost allocation methodology – ABAA or OVABAA
- Allocator types – where a causal relationship can't be established a proxy cost allocator can be used
- Customer or capital contribution approach
- Physical asset life in certain circumstances a determination can be made by an engineer of the physical service life potential (IM 2.2.8(3))

¹ [ENA-Submission-on-draft-IM-amendments-Insurance-entitlements-3-October-2024.pdf \(comcom.govt.nz\)](#)

² [Unison-Submission-on-draft-IM-amendments-insurance-entitlements-4-October-2024.pdf \(comcom.govt.nz\)](#)

³ [Transpower-Submission-on-draft-IM-Amendments-insurance-entitlements-1-October-2024.pdf \(comcom.govt.nz\)](#)

1.5 Drafting requirements for offering a choice

To give effect to this revised solution of offering a treatment choice to EDBs, the required IM amendments would therefore be a combination of those proposed by the Commission and the following:

- include definitions for **insurance entitlements, compensatory entitlements and third-party liability entitlements**, as proposed in the Draft Reasons Paper
- include a definition for **retained entitlements** that applies the retention factor to insurance entitlements, compensatory entitlements and third-party liability entitlements, excluding any amounts of those entitlements which are treated as operating costs or a value of commissioned assets
- modify the definition of **other regulated income** to exclude retained entitlements for the purpose of PQ regulation (i.e. Parts 3, 4 and 5 of the IMs)
- modify the definitions of **operating cost** and **value of commissioned assets** to allow for the choice where EDBs elect to offset compensatory entitlements and/or third-party liability entitlements
- modify the definition of **retention factor** so that it may be applied in the determination of retained entitlements as well as the capex incentive amount for IRIS, for the purpose of PQ regulation.

A revised set of suggested mark-ups to the IMs are attached in Appendix B. These are mark-ups to the IM Review Amendment Determination 2023, noting that similar mark-ups will be required for existing IMs.

1.6 Other considerations

We still consider that limiting the solution to PQ would limit unnecessary regulatory burden for exempt EDBs. Although allowing a treatment choice also allows exempt EDBs to maintain their current treatment, while allowing EDBs who choose an alternative treatment to present their ID and PQ on a consistent basis. We also support Orion's submission.

We feel the amendments to the catastrophic event reopener, which we proposed in our previous submission,⁴ are still required, irrespective of the final decision regarding treatment of entitlements to achieve the Commission's original policy intent.

If you have any questions about ENA's submission please contact Gemma Pascall, Regulatory Manager

Yours sincerely

Gemma Pascall, Regulatory Manager

⁴ [ENA-Submission-on-draft-IM-amendments-Insurance-entitlements-3-October-2024.pdf \(comcom.govt.nz\)](#)

Appendix A: ENA Members

Electricity Networks Aotearoa makes this submission along with the support of its members, listed below:

- Alpine Energy
- Aurora Energy
- Buller Electricity
- Centralines
- Counties Energy
- Electra
- EA Networks
- Firstlight Network
- Horizon Networks
- Mainpower
- Marlborough Lines
- Nelson Electricity
- Network Tasman
- Network Waitaki
- Northpower
- Orion New Zealand
- Powerco
- PowerNet (which manages The Power Company, Electricity Invercargill, OtagoNet and Lakeland Network)
- Scanpower
- Top Energy
- The Lines Company
- Unison Networks
- Vector
- Waipa Networks
- WEL Networks
- Wellington Electricity
- Westpower

Appendix B: Proposed IM drafting amendments

Clause 1.1.4(2)

compensatory entitlement means, for the purposes of–

(a) Part 2, money or the monetary value of other consideration relating to an event, other than an insurance entitlement or capital contribution, that is received or receivable from consumers or other parties, for any of the following purposes:

(i) restoring damaged assets to the same operating condition and location as prior to the event;

(ii) relocating assets if required; and

(iii) compensating for damaged or destroyed assets;

(b) Parts 4 and 5, money or the monetary value of other consideration relating to an event, other than an insurance entitlement or capital contribution, that is received or receivable from, or forecast to be received or receivable from, consumers or other parties, for any of the following purposes:

(i) restoring damaged assets to the same operating condition and location as prior to the event;

(ii) relocating assets if required; and

(iii) compensating for damaged or destroyed assets;

insurance entitlement means, for the purposes of–

(a) Part 2, money or the monetary value of other consideration relating to an event, that is received or receivable from a ‘licensed insurer’ as that term is defined in the Insurance (Prudential Supervision) Act 2010, in respect of a contract of insurance that insures against damaged or destroyed assets or operating costs arising from damaged or destroyed assets, excluding business interruption insurance or third-party liability entitlements; and

(b) Parts 4 and 5, money or the monetary value of other consideration relating to an event that is received or receivable from, or forecast to be received or receivable from, a ‘licensed insurer’ as that term is defined in the Insurance (Prudential Supervision) Act 2010, in respect of a contract of insurance that insures against damaged or destroyed assets or operating costs arising from damaged or destroyed assets, excluding business interruption insurance or third-party liability entitlements;

third-party liability entitlement means, for the purposes of–

(a) Part 2, money or the monetary value of other consideration relating to an event, that is received or receivable from a ‘licensed insurer’ as that term is defined in the Insurance (Prudential Supervision) Act 2010, in respect of a contract of insurance that insures against third-party liability; and

(b) Parts 4 and 5, money or the monetary value of other consideration relating to an event, that is received or receivable from, or forecast to be received or receivable from, a ‘licensed insurer’ as that term is defined in the Insurance (Prudential Supervision) Act 2010, in respect of a contract of insurance that insures against third-party liability;

operating cost means a cost incurred by the EDB in question relating to the supply of-

- (a) regulated services alone; or
- (b) regulated services and one or more unregulated service,
net of any amount of insurance entitlements, compensatory entitlements, and/or third-party liability entitlements which the EDB elects to treat as an offset to operating cost values,
and excludes-
[...]

other regulated income for the purpose of-

- (a) Part 3, means income associated with the supply of electricity distribution services, including gains and losses on disposed assets, but excluding -
 - (i) income through prices;
 - (ii) investment-related income;
 - (iii) capital contributions;
 - (iv) vested assets;
 - (v) income associated with the assets that are funded under large connection contracts;
 - (vi) retained entitlements
- (b) Parts 4 and 5, means income associated with the supply of electricity distribution services, including gains and losses on disposed assets, but excluding -
 - (i) income through prices;
 - (ii) investment-related income;
 - (iii) capital contributions;
 - (iv) vested assets;
 - (v) income associated with the assets that are funded under large connection contracts;
 - (vi) retained entitlements
as determined by the Commission;

retained entitlements for the purpose of-

- (a) Part 3, means retention factor x (the sum of insurance entitlements, compensatory entitlements, third-party liability entitlements, excluding any amounts of those entitlements which have been netted off in calculating an operating cost or has been applied to reduce the value of a commissioned asset under clauses 2.2.11(1)(m)
- (b) Parts 4 and 5, means retention factor x (the sum of insurance entitlements, compensatory entitlements, third-party liability entitlements, excluding any amounts of those

entitlements which have been netted off in calculating an operating cost or has been applied to reduce the value of a commissioned asset under clauses 2.2.11(1)(m) as determined by the Commission;

retention factor means the percentage amount determined by the Commission in a CPP determination or DPP determination for the purpose of calculating:

- (c) the capex incentive amount; and
- (d) retained entitlements

Clause 2.2.11 Value of commissioned assets

- (1) Value of commissioned asset, in relation to an asset (including an asset in respect of which capital contributions were received or a vested asset), means the cost of the asset to an EDB determined by applying GAAP to the asset as on its commissioning date, except that, subject to subclause (2), the cost of-

[...]

(m) an asset that replaces an asset in respect of which-

- (i) an insurance entitlement or compensatory entitlement was received or is receivable;
and
- (ii) such an insurance entitlement or compensatory entitlement does not reduce the cost of the asset when applying GAAP,

is the cost of the asset by applying GAAP, reduced by the amount of insurance entitlements, compensatory entitlements, and/or third-party liability entitlements that was received and which the EDB has elected to treat as a reduction in asset values.

- (4) For the avoidance of doubt-

[...]

- (c) where an insurance entitlement forms part of the cost of an asset under subclause (1)(m), any adjustment to that amount after that asset was first commissioned, to reflect the full and final settlement of the associated insurance contract, is treated as expenditure or negative expenditure relating to a separate asset.

Clause 2.3.9 Regulatory tax asset value

[...]

- (3) 'Notional tax asset value' means, for the purpose of-

[...]

subclause (2)(a)(iii), value in respect of the disclosure year in which the asset was acquired or transferred that is-

- (i) consistent with the tax rules; and

(ii) limited to its value of commissioned asset plus any insurance entitlements, compensatory entitlements, and/or and third-party liability entitlements which the EDB has elected to treat as a reduction in asset values, or, if relevant capital contributions are treated for tax purposes in accordance with section CG 8 of the Income Tax Act 2007 (or subsequent equivalent provisions), limited to the value of commissioned asset plus any taxed capital contributions applicable to the asset plus any insurance entitlements, compensatory entitlements, and/or and third-party liability entitlements.

Clause 4.2.5 Forecast aggregate value of commissioned assets

- (1) Forecast aggregate value of commissioned assets means the forecast cost of additional assets, less any capital contributions for those assets, less any insurance entitlements, compensatory entitlements, and/or and third-party liability entitlements forecast to be received or receivable in respect of those assets and which the EDB will elect to treat as a reduction in asset values, if GAAP were to be applied to determine the cost of the assets to the EDB in the disclosure year in question, and is equal to forecast capital expenditure for the relevant disclosure year as determined by the Commission.

Clause 4.5.4 Catastrophic event

(1) A 'catastrophic event' is an event-

- (a) [...]
- (b) [...]
- (c) [...]
- (d) for which-
 - (i) action required to rectify its adverse consequences cannot be delayed until a future regulatory period without quality standards under the DPP being breached;
 - (ii) remediation requires capex, opex, or both;
 - (iii) the full remediation costs are not provided for in the DPP; and
 - (iv) the costs of remediation ~~net of any insurance or compensatory entitlements~~ exceeds one of the thresholds specified in subclause (2).

Clause 4.5.15 Amending DPP after reconsideration

[...]

(3) The Commission will not amend-

- (a) the price path more than is reasonably necessary to mitigate the effect of the reopener event on the DPP; and
- (b) the price path more than is reasonably necessary to take account of the change resulting from the reopener event net of any ~~insurance or compensatory~~ retained entitlements; and

Clause 5.6.4 Catastrophic event

(1) A 'catastrophic event' is an event-

(a) [...]

(b) [...]

(c) [...]

(d) for which-

(i) action required to rectify its adverse consequences cannot be delayed until a future regulatory period without quality standards under the CPP being breached;

(ii) remediation requires capex, opex, or both;

(iii) the full remediation costs are not provided for in the CPP; and

(iv) the costs of remediation ~~net of any insurance or compensatory entitlements~~ exceeds one of the thresholds specified in subclause (2).

Clause 5.6.13 Amending CPP after reconsideration

[...]

(2) The Commission will not amend-

(a) the CPP more than is reasonably necessary to mitigate the effect of the reopener event on the CPP; and

(b) the price path more than is reasonably necessary to take account of the change in costs net of any ~~insurance or compensatory~~ retained entitlements

Appendix C: Illustrative example of PV equivalence and cash flows

The table below shows the cash flows for an illustrative example of insurance proceeds, categorised as each of other regulated income, an offset to opex, and an offset to capex. It demonstrates that the present value of those cash flows is the same, regardless of the categorisation.

Other regulated income	PV	Y1	Y2	Y3	Y4	Y5	Y1	Y2	Y3	Y4	Y5	
Proceeds received – other regulated income		0	0	100	0	0	0	0	0	0	0	
Retained entitlement		0	0	33	0	0	0	0	0	0	0	
Reduction in line charges		0	0	0	0	-76	0	0	0	0	0	
Cash flow received		0	0	100	0	-76	0	0	0	0	0	
Present value of cashflows	28											
Opex offset	PV	Y1	Y2	Y3	Y4	Y5	Y1	Y2	Y3	Y4	Y5	
Proceeds received - reduction in opex		0	0	100	0	0	0	0	0	0	0	
IRIS incremental gain		0	0	100	-100	0	0	0	0	0	0	
IRIS recoverable cost							0	0	0	-100	0	
Cash flow received		0	0	100	0	0	0	0	0	-100	0	
Present value of cashflows	28											
Capex offset	PV	Y1	Y2	Y3	Y4	Y5	Y1	Y2	Y3	Y4	Y5	Later years
Proceeds received - reduction in capex		0	0	100	0	0	0	0	0	0	0	0
BBAR reduction		0	0	0	0	0	-6	-6	-5	-5	-5	-104 (PV)
IRIS recoverable cost - capex wash-up							0	-6	-6	-7	-7	0
IRIS recoverable cost - retention adjustment							0	11	11	12	12	0
Cash flow received		0	0	100	0	0	-6	-2	0	0	0	-104 (PV)
Present value of cashflows	28											

Note: Assumptions adopted for the above: 6% WACC, 33% retention factor, 2.0% annual inflation, proceeds earned in year 3 of a DPP period.