## Overview of the NZ regulatory environment

### Introduction

The New Zealand Commerce Commission (NZCC) is the regulatory body of the electricity industry of New Zealand. They are granted their powers under Part 4 of the Commerce Act 1986 (the Act). The NZCC currently regulate 17 distribution businesses throughout New Zealand. The NZCC makes an Input Methodology Determination, which is the regulatory framework they use. This Input Methodology is then used to set a default price-quality path (DPP) for their distributors, and distributors have submission windows within which they can propose a customised price-quality path (CPP). The DPP and CPP are set in accordance with the NZCC regulatory framework outlined in the Input Methodologies determination.

##### Price-Quality Path determinations

The DPP is outlined in a determination that occurs at the start of the regulatory period, once every five years. It defines the maximum prices/revenues that are allowed at the start of the regulatory period, or the starting prices. Then it defines the annual rate at which all distributors’ maximum allowable prices/revenues can be increased – it is the rate of inflation minus a certain number of percentage points. The final component is the minimum service quality standards that must be met. The DPP’s are generic and apply to all distributors, unless they propose a CPP that is accepted by the NZCC.

The CPP is proposed by the distributor to the NZCC, and they reflect the specific needs of the distributor and its consumers. For example, a distributor may have an aging network that requires higher levels of investment than is available under the DPP determination. The distributor would then propose a CPP to the NZCC and request a greater level of replacement expenditure. CPP’s do however require more in-depth auditing, verification and evaluation of information provided by the regulated business than the DPP.

These DPP and CPP determinations are set for the regulatory period, however they can be reopened through several means elaborated on in the Input Methodologies determination. These options allow for the determination to be reconsidered and amended as reasonably necessary to mitigate the effects of particular events. The various categories of events that can allow a DPP and CPP determination to be reconsidered are explored below[[1]](#footnote-1).

###### Catastrophic events

Catastrophic events are defined under clause 4.5.1 of the NZCC’s Input Methodologies 21 December, 2017 amendments determination. A catastrophic event can be summarised roughly as an event beyond the reasonable control of the distributor, which could not have been foreseen or included in the DPP or CPP, and for which capital expenditure can not be delayed until future regulatory periods. Catastrophic events encompass natural disasters that have a significant impact on the network as well as other events that require significant additional operating or capital expenditure.

###### Change event

Change events are defined under clause 4.5.2 of the NZCC’s Input Methodologies 21 December, 2017 amendments determination. A change event can be summarised as a change in the legislative or regulatory requirements applying to the distributor. The change must have an impact within the existing regulatory period of greater that 1 per cent of the forecast net allowable revenue.

###### Error event

Error events are defined under clause 4.5.3 of the NZCC’s Input Methodologies 21 December, 2017 amendments determination. An error event can be summarised as an event where a DPP or CPP determination was based on incorrect data and it has an impact of at least 1 per cent of the aggregate forecast net allowable revenue for the affected years. Error events are essentially instances where the regulator or distributor has used incorrect information in their determination

###### Major transaction

Major transactions are defined under clause 4.5.4 of the NZCC’s Input Methodologies 21 December, 2017 amendments determination. Major transactions occur when a transaction results in consumers being acquired or no longer supplied by the distributor. They only include transactions that result in the acquisition or disposal of an asset (or acquiring rights or liabilities) which is equivalent to 10 per cent of the distributors opening regulatory asset base (RAB) value in the disclosure year.

##### Input Methodology determinations

As mentioned earlier, the Input Methodology determination outlines the framework for Price-Quality Path (DPP & CPP) determinations. The Input Methodology determination is subject to review occasionally and distributors are able to appeal to the New Zealand High Court (High Court) to oppose decisions, under section 52Z of the Act. The input methodology outlines the formulas that are used in DPP & CPP determinations as well as fixing certain parameters, for example the equity beta and tax-adjusted market risk premium.

###### Process for reflecting market volatility in existing DPP & CPP determinations

Distributors would need to make an appeal for a change to the Input Methodologies to the New Zealand High Court. They would then need to prove that a revised input methodology would be materially better at achieving the purpose of part 4 of the Act. If the High Court supports the appeal, then the Input Methodology determination will be altered and there will in effect be a change to the regulatory framework.

The distributor can then apply for a reconsidering of their DPP or CPP determination, under the rules for a change event. Assuming that it meets the other requirements of a change event, this application should be successful and the DPP & CPP should be altered to reasonably mitigate the effects of the event.

##### How the GFC impacted the NZCC’s input methodologies

There are two good examples of how the global financial crisis (GFC) affected the NZCC’s regulatory framework. The first is within their December 2010 Input Methodologies Reasons Paper. The second is in the appeal made by several of the NZCC’s regulated businesses to the New Zealand High Court, in 2013. Both of these changes, where they were unpredictable and met the other requirements of a change event could have resulted in the reconsideration of existing DPP and CPP determinations.

The NZCC received a large number of submissions and an expert panel report on their December 2010 Input Methodologies Reasons Paper. The expert panel found that the market risk premium (MRP) and the tax-adjusted market risk premium (TAMRP) used in the capital asset pricing model (CAPM) are likely to have increased, at least temporarily. They were divided on what they recommended the NZCC should do to alter the estimate of the MRP. The NZCC held a long standing TAMRP, relative to a five-year risk-free rate, of 7 per cent. The GFC resulted in the NZCC increasing the TAMRP to 7.5 per cent for the calendar years 2010 and 2011.[[2]](#footnote-2) This outcome ultimately resulted in a change to the Input Methodologies Determination and the regulatory environment.

Several of the NZ distributors and a transmission business also brought forward a case to the New Zealand High Court in 2013, with several arguments presented on how to best account for the long-term effects of the GFC[[3]](#footnote-3). These cases were brought forward under section 52Z of the Commerce Act 1986 and refer to the rights of any parties with a significant interest in electricity distribution to appeal any Input Methodology Determination through the High Court. The distributors challenged many of the underlying Input Methodologies of the DPP determinations, in a multifaceted appeal. The successful aspects of the appeals would have resulted in a change to the Input Methodologies Determination and the regulatory environment.

### Conclusion

The NZCC has a number of routes to react to significant unpredictable events in their electricity distribution determination framework. The process is based around ensuring that their DPP & CPP determinations accurately reflect the needs of the distributor. They allow that unpredictable events may occur and there is an allowance within the framework for dealing with them.

1. Pages 122-126 of Electricity Distribution Services Input Methodologies Determination 2012, Amended 28 February 2017, produced by the New Zealand Commerce Commission. [↑](#footnote-ref-1)
2. Pages 477 – 505 of Input Methodologies Reasons Paper, published December 2010, produced by the New Zealand Commerce Commission. [↑](#footnote-ref-2)
3. Page 503 of Wellington International Airport Ltd and others v Commerce Commission [2013] NZHC 3289 (11 December 2013). [↑](#footnote-ref-3)