

30 November 2017

Greg Skelton
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By email: gskelton@welectricity.co.nz

Dear Greg

WELL application for modifications and exemptions

1. On 13 October 2017 Wellington Electricity Lines Limited (WELL) applied for modifications to, and exemptions from, the Electricity Distribution Services Input Methodologies Determination 2012¹ (IMs) under clause 5.1.6 of the IMs. The modification and exemptions relate to a proposed customised price-quality path (CPP) application by WELL for the 2019 to 2021 disclosure years (inclusive).
2. We advise that we have approved the modifications and exemptions requested by WELL. This letter addresses each of the exemptions and modifications approved and sets out any conditions applicable to our approval. These conditions must be satisfied by WELL before it can rely on the modifications and exemptions.
3. Please also note that we considered each of the proposed modifications and exemptions on its merits and in the context of the proposed CPP. Nothing in this letter should be taken as an indication that similar modifications or exemptions would be approved with respect to a different CPP proposal. In addition, although this letter may summarise some of WELL's submissions in support of its application for modifications and exemptions, the approval of the corresponding modifications or exemptions is not an endorsement of WELL's submissions.

CPP application to which approval applies

4. The exemptions and modifications approved in this letter apply only in respect of a CPP application submitted by WELL in the 4/5 December 2017 application window, and which has the following key features:
 - A three year CPP regulatory period commencing on 1 April 2018 and terminating on 31 March 2021 (the 2019, 2020, and 2021 disclosure years).

¹ As consolidated 28 February 2017.

- Proposed additional capital and operating expenditure of approximately \$32 million over the three year CPP regulatory period. The expenditure will enhance WELL's readiness to respond in the event of a major earthquake affecting the Wellington region.
 - For the first two disclosure years of the CPP regulatory period the building block costs used to set the CPP maximum allowable revenues (MAR) are the approved MAR for the current default price-quality path (DPP), plus the building block costs of the proposed earthquake readiness expenditure (excluding any expenditure that has been accommodated under the DPP MAR).
 - For the third (and final) disclosure year of the CPP regulatory period the building block costs used to set the CPP MAR are a roll-forward of the building block values from the current DPP period using projected business as usual capital and operating expenditure for the 2021 disclosure year, plus the building block costs of the proposed earthquake readiness expenditure.
 - The form of control is a revenue cap, smoothed over the three year CPP regulatory period, with a wash-up mechanism. Quality standards are proposed to be set in a manner similar to the current DPP, with potential additional quality standard(s) related to the specific resilience expenditure.
5. Given the key features outlined above, variations to the IMs that would usually apply to WELL in respect of a CPP proposal will be required to be considered by the Commission under section 52V of the Commerce Act 1986.
6. A CPP application submitted by WELL which has features that differ materially from those outlined above will not qualify for the modifications and exemptions, and our approval cannot be relied upon by WELL in that circumstance.

Modifications and exemptions

7. We approve modifications to, and exemptions from, the following IM clauses:
- 7.1 Clauses 5.1.2 and 5.5.1, which relate to consumer consultation.
 - 7.2 Clause 5.4.3, which relates to information about the priority of the CPP proposal.
 - 7.3 Clauses 5.4.6 to 5.4.26, 5.4.28 to 5.4.30, and Schedules B to E, which relate to price path and building block information.
 - 7.4 Clauses 5.1.3, 5.1.4, 5.5.2, 5.5.3, and Schedules F and G, which relate to verification and audit.
 - 7.5 Clause 5.5.4, which relates to certification.

Consumer consultation - clauses 5.1.2 and 5.5.1

8. Clauses 5.1.2 and 5.5.1 require an applicant to inform and engage with its consumers about the implications of a CPP proposal, and summarise responses in the CPP application, including how issues raised by consumers have been accommodated.
9. WELL seeks to modify the requirements of these clauses to reduce the scale of the consultation. It proposes to inform only key stakeholders, including the local Councils, the Wellington Lifelines Group, Wellington Water and major customers, and to include a summary of any feedback it receives from these stakeholders in its CPP application. In notifying these stakeholders it does not intend to outline price versus quality trade-offs made in expenditure alternatives.
10. We are satisfied that the modifications to clauses 5.1.2 and 5.5.1 in this case will not detract, to an extent that is more than minor, from the Commission's evaluation or determination of the CPP proposal or the ability of interested persons to consider and provide their views on the CPP proposal.
11. Accordingly, the Commission approves the modification by:

11.1 replacing clause 5.1.2 with the following text:

Evidence of consumer consultation

For the purpose of clause 5.1.1(2)(a), in respect of **consumer** consultation, the specified information is a summary of any available feedback from key stakeholders in respect of the CPP applicant's intended CPP proposal.

11.2 and replacing clause 5.5.1(1) and (2) with the following text:

- (1) Prior to submission of the CPP proposal, the CPP applicant must have adequately notified key stakeholders-
 - (a) that it intends to make a CPP proposal;
 - (b) of the expected effect on price of its electricity distribution services were the Commission to determine a CPP entirely in accordance with the intended CPP proposal;
 - (c) if it intends to propose to include a quality standard variation under clause 5.4.5, why the proposed quality standard variation has been chosen over alternative quality standards;
 - (d) where and how further information in respect of the intended CPP proposal may be obtained; and
 - (e) of their opportunity to participate in the consultation process required of the Commission by s 53T of the Act after any CPP proposal is received and considered compliant by the Commission.

Priority of CPP proposal – clause 5.4.3

12. Clause 5.4.3 requires an applicant to explain why a CPP proposal deserves to be prioritised for assessment before other CPP proposals.
13. WELL seeks to be exempted from the requirement to comply with clause 5.4.3. This exemption is sought on the basis that the Commission is currently considering only one other CPP application (in respect of Powerco Limited) and no other CPP applications are likely to be made in the current regulatory year.
14. We are satisfied that exempting WELL from the requirements of clause 5.4.3 in this case will not detract, to an extent that is more than minor, from the Commission's evaluation or determination of the CPP proposal or the ability of interested persons to consider and provide their views on the CPP proposal.
15. Accordingly, the Commission approves an exemption from the requirements of clause 5.4.3.

Price path and building block information - clauses 5.4.6 to 5.4.26, 5.4.28 to 5.4.30, and Schedules B to E

16. Clauses 5.4.6 – 5.4.26, 5.4.28 – 5.4.30, and Schedules B to E require an applicant to include detailed information in a CPP application to support the construction of a price path over the proposed CPP regulatory period (for example, qualitative and quantitative expenditure, asset valuation, cost allocation and taxation information).
17. WELL seeks to modify these requirements by replacing the information usually required by the IMs with alternative information, including a CPP financial model setting out quantitative information about the proposed price path, and other information relating to readiness expenditure and business as usual expenditure.
18. WELL notes that in the circumstances of the proposed CPP the Commission's evaluation will be focused on the proposed incremental expenditure and that a significant part of the costs of the proposed revenue cap will derive from the current regulatory allowances under the DPP, or a roll forward of the values from the current DPP using projected business as usual expenditure.
19. We are satisfied that the modification to the clauses relating to price path information in this case will not detract, to an extent that is more than minor from the Commission's evaluation or determination of the CPP proposal or the ability of interested persons to consider and provide their views on the CPP proposal.
20. Accordingly, the Commission approves the modification to price path and building block information by:
 - 20.1 removing the requirements of clauses 5.4.6 to 5.4.26 (inclusive), 5.4.28 to 5.4.30 (inclusive), and Schedules B to E (inclusive);

20.2 on the condition that WELL provides the following information as part of its CPP application:

- (a) WELL's 2017 Asset Management Plan;
- (b) The detailed Business Case for the earthquake readiness expenditure, including quantitative information on the readiness spend, and analysis of different options considered to address identified earthquake risks;
- (c) Independent review of that expenditure, to be carried out by Jacobs Engineering;
- (d) A CPP financial model, which includes quantitative information on the proposed RY 2021 business as usual operating and capital expenditure; and
- (e) Commentary on any material differences in RY2021 business as usual operating expenditure and capital expenditure as between WELL's 2017 and expected 2018 Asset Management Plans, and as against historical spend.

Verification and audit - clauses 5.1.3, 5.1.4, 5.5.2, 5.5.3, and Schedules F and G

- 21. The clauses relating to verification and audit require that independent experts review the information provided in a CPP application to ensure that the Commission can have confidence in the quality of information provided. The information should be robust, reliable and compliant with the applicable IMs. Key issues the Commission should focus on during the assessment of the CPP proposal should be highlighted.
- 22. WELL seeks to be exempted from the verification requirements on the condition that WELL provides an independent engineering review report by Jacobs Engineering as part of its CPP application. WELL also seeks to modify the audit requirements to instead comprise a scope of review in relation to the CPP financial model. The scope of the audit will be agreed by WELL with the Commission.
- 23. This exemption is sought on the basis that the Jacob's engineering review and the reduced scope audit review will enable appropriate scrutiny for a streamlined CPP application, given the extent to which reliance is placed on previously scrutinised Commission models and publicly disclosed information.
- 24. We are satisfied that exempting or modifying WELL from the verification and audit requirements in this case will not detract, to an extent that is more than minor from the Commission's evaluation or determination of the CPP proposal or the ability of interested persons to consider and provide their views on the CPP Proposal.
- 25. Accordingly, the Commission approves:
 - 25.1 an exemption from clauses 5.1.3, 5.5.2, and Schedules F and G on the condition that WELL will provide, as part of its CPP application, an independent engineering review report by Jacob Engineering, which includes:
 - (a) reviewing the engineering options analysis and selection process used by WELL;

- (b) commenting on the prudence of the preferred options;
- (c) review of project costings for the preferred option; and
- (d) a detailed review of WELL's approach and the costs associated with its seismic reinforcement programme.

25.2 modification from clause 5.1.4 by replacing it with the following text:

Audit and assurance reports

- (1) For the purpose of clause 5.1.1(2)(a), in respect of audit or assurance, the specified information is a report written by an auditor and signed by that auditor (either in an individual's name or that of a firm) in respect of an audit or assurance engagement undertaken of the matters specified in clause 5.5.3, stating-
 - (a) the work done by the auditor;
 - (b) the scope and limitations of the audit or assurance engagement;
 - (c) the existence of any relationships (other than that of auditor) which the auditor has with, or any interests which the auditor has in, the CPP applicant or any of its subsidiaries;
 - (d) whether the auditor obtained all information and explanations that he or she required to undertake the audit or assurance engagement, and, if not-
 - (i) details of the information and explanations not obtained; and
 - (ii) any reasons provided by the CPP applicant for its or their non-provision;
 - (e) the auditor's opinion of the matters in respect of which the audit or assurance engagement was undertaken.
- (2) A report in respect of an audit or assurance engagement undertaken other than expressly to meet the requirements of clause 5.5.3 may be considered to comply with subclause (1) to the extent that the report in respect of that other audit or assurance engagement fully or partially meets the requirements of clause 5.5.3.
- (3) The CPP applicant must ensure that reports required by this clause relate to the CPP proposal as submitted to the Commission.

25.1 modification from clause 5.5.3 by replacing it with the following text:

Audit and assurance

- (1) A CPP application must include a report by an auditor, with the scope and limitations of the audit engagement to be agreed in writing between the CPP applicant and the Commission.

- (2) For the purposes of agreeing, as between the CPP applicant and the Commission, the scope of the audit, and as a statement of the high level principles that shall apply to any interpretation of the scope (once agreed), the purpose of the audit is to test and comment on:
- (a) the application of the methodology for the streamlined CPP price path modelling approach;
 - (b) the use of the existing, Commission-published, DPP price path model, and the Commission's Orion CPP price path model, including any combining of those models and/or any modifications made to them, as being in accordance with the proposed price path methodology;
 - (c) the application of any stated assumptions in respect of the proposed price path for the CPP period;
 - (d) whether quantitative historical data used in the models referred to in clause 5.5.3(2) (a),(b) and (c) is properly compiled on the basis of the relevant underlying source information; and
 - (e) whether quantitative forecast information used in the models referred to in clauses 5.5.3(2) (a), (b) and (c) is properly compiled on the basis of relevant disclosed assumptions.

Certification - clause 5.5.4

26. An applicant is required to certify information provided in a CPP application and clause 5.5.4 sets out the specific certification requirements for certification that must be met.
27. WELL seeks to modify the requirements for certification in clause 5.5.4 so that the certification requirements align with the modifications to verification-related requirements approved above.
28. We are satisfied that the modification to clause 5.5.4 in this case will not detract, to an extent that is more than minor, from the Commission's evaluation or determination of the CPP proposal or the ability of interested persons to consider and provide their views on the CPP Proposal.
29. Accordingly, the Commission approves the modification of clause 5.5.4 by replacing it with the following text:

Certification

- (1) In the case of all information of a quantitative nature, other than forecast information, provided in accordance with this Part, no fewer than 2 directors of the CPP applicant must certify in writing his or her belief that-
- (a) the information was derived and is provided in accordance with the relevant requirements; and

- (b) it properly represents the results of financial or non-financial operations as the case may be.
- (2) In the case of all information of a qualitative nature, other than forecast information, provided in accordance with this Part, no fewer than 2 directors of the CPP applicant must certify in writing his or her belief that-
- (a) the information is provided in accordance with the relevant requirements; and
 - (b) it properly represents the events that occurred during the current period.
- (3) In the case of all forecast information provided in accordance with this Part, no fewer than 2 directors of the CPP applicant must certify in writing his or her belief that-
- (a) the information was derived and is provided in accordance with the relevant requirements; and
 - (b) the assumptions made are reasonable.
- (4) No fewer than 2 directors of the CPP applicant must certify in writing-
- (a) that, to the best of his or her knowledge, the-
 - (i) matters the auditor was engaged to audit included the matters specified in clause 5.5.3; and
 - (ii) the auditor was instructed to report on at least the matters described in clause 5.1.4; and
 - (b) that the-
 - (i) audit report provided pursuant to clause 5.1.4; and
 - (ii) other certifications required by this clause,
 all relate to the same CPP proposal.
- (5) Where-
- (a) a director has certified a matter of opinion in accordance with this clause; and
 - (b) his or her opinion has changed before the Commission's determination of the CPP in question,
- that director must notify the Commission as soon as reasonably practicable.
- (6) Where-
- (a) a director has certified a matter of fact in accordance with this clause; and

- (b) before the Commission's determination of the CPP in question he or she-
 - (i) becomes aware that the fact is untrue; or
 - (ii) has significant cause to doubt the accuracy of that fact,that director must notify the Commission as soon as reasonably practicable.
- (7) For the avoidance of doubt, the certifications required by the different subclauses of this clause may be made by the same or different directors.

Yours sincerely

A handwritten signature in blue ink that reads "Sue Begg". The signature is written in a cursive, flowing style.

Sue Begg
Deputy Chair