

2010-2015 ELECTRICITY DISTRIBUTION DEFAULT PRICE-QUALITY PATH REFINEMENTS DISCUSSION AND DRAFT DECISIONS PAPER

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GLOSSARY OF TERMS, ABBREVIATIONS & DEFINITIONS

Abbreviation / Term	Definition
Act, the	The Commerce Act 1986
Commission, the	The Commerce Commission
Compliance assessment formula	The price path compliance assessment formula as set out under Clause 8.4 of the Initial Reset Determination
CPI	Consumer Price Index
DPP	Default Price-Quality Path
Draft IMs	Draft Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010, 2 July 2010
EDBs	Non-exempt Electricity Distribution Businesses
GST	Goods and Services Tax
Headroom	Refers to the difference between an EDB's notional revenue and allowable notional revenue in a single assessment period
Revenue differential term	As set out in Appendix A
IMs	Input Methodologies
IM Draft Reasons	Input Methodologies Electricity Distribution Services, Draft Reasons Paper, 18 June 2010.
Initial Reset Determination	Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010, 30 November 2009
IRIS	Incremental Rolling Incentive Scheme
2010-2015 DPP	The default price-quality path applying to EDBs from 1 April 2010 to 31 March 2015 as set out by the Initial Reset Determination
Reset DPP Decisions Paper	The Initial Reset of the Default Price-Quality Path for Electricity Distribution Businesses, Decisions Paper, 30 November 2009
Reset DPP Discussion Paper	The Reset of the Default Price-Quality Path for Electricity Distribution Businesses, Discussion Paper, 19 June 2009
X-factor	Under a CPI-X mechanism a regulated business may increase annual prices by no more than CPI, less an annual percentage i.e., the X-factor

CHAPTER 1: INTRODUCTION

Overview

Background

1.1 On 30 November 2009, the Commerce Commission (**the Commission**) published the *Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 (Initial Reset Determination)*. This determination gives effect to the default price-quality path (**DPP**) applying to non-exempt electricity distribution businesses (**EDBs**) for the period 1 April 2010 to 31 March 2015. This paper refers to this DPP as the 2010-2015 DPP.¹

Purpose and Scope of Paper

1.2 In the corresponding decisions paper for the *Initial Reset Determination*, the Commission set out its intention to undertake further work on some aspects of the 2010-2015 DPP, including taking account of input methodologies for electricity distribution services.

1.3 This *Discussion and Draft Decisions Paper* advances this further work and is structured into three chapters plus appendices:

- Chapter 1 provides an overview and next steps for further work on the 2010-2015 DPP;
- Chapter 2 provides the Commission's draft decisions on a revenue differential term;
- Chapter 3 provides the Commission's initial views on other matters of further work for the 2010-2015 DPP;
- Appendix A sets out the draft amendment to the *Initial Reset Determination* to include the revenue differential term as a result of the Commission's draft decisions; and
- Appendix B sets out a consolidated version of the *Initial Reset Determination* incorporating the draft amendment as set out in Appendix A.

1.4 A brief overview of the draft decisions and initial views chapters is set out below.

Chapter 2: Draft Decisions

1.5 Chapter 2 sets out the Commission's considerations and draft decisions on the modification of the current price path compliance assessment formula (**compliance assessment formula**) to ensure the 2010-2015 DPP price path is set independent of EDB pricing behaviour.

1.6 The proposed modification to the compliance assessment formula arose as part of the consultation process on the 2010-2015 DPP in which parties submitted that the compliance assessment formula should allow EDBs to set prices below their allowable notional revenue in any given year without it affecting their allowable notional revenue for the remainder of the regulatory period. The modification to the compliance assessment formula is proposed to take effect from 1 April 2011.

¹ Previously the Commission has referred to the 2010-2015 DPP as the 'Reset DPP'. However, the Commission considers 2010-2015 DPP to provide more clarity going forward in the context of future DPP resets.

Chapter 3: Discussion of Initial Views

- 1.7 Chapter 3 sets out discussion of the Commission's initial views for further work on the 2010-2015 DPP in relation to:
- *potential amendments to take account of input methodologies*: the Commission published the *Draft Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010 (Draft IMs)* on 2 July 2010. This section sets out the Commission's initial views on the implications of these *Draft IMs* for the *Initial Reset Determination*;
 - *a potential amendment to the derivation of the consumer price index (CPI) term within the compliance assessment formula*: as part of the 2010 budget the New Zealand Government announced an increase in goods and services tax (GST) taking effect from 1 October 2010. This section sets out the Commission's initial views on the implications of the GST increase for the derivation of the CPI term used in the compliance assessment formula; and
 - *the timing of proposed amendments*: this section sets out the Commission's initial views on the timing of the potential amendments to the *Initial Reset Determination* discussed in Chapter 3.

Next Steps

- 1.8 The Commission published an Updated Process Paper setting out its intentions for addressing further work on the 2010-2015 DPP on 3 May 2010.² Table 1 below sets out a revised version of this process to take account of the Commission's decisions on the modification of the compliance assessment formula to ensure the 2010-2015 DPP price path is set independent of EDB pricing behaviour.
- 1.9 The Commission's decisions on the modification of the compliance assessment formula potentially have an impact on EDBs' allowable notional revenue under the 2010-2015 DPP for the assessment period beginning 1 April 2011 onwards. The Commission considers it appropriate to finalise and give effect to these decisions by 1 December 2010 to allow EDBs to take account of these decisions in their price setting process.

Table 1: Indicative process for modification of the compliance assessment formula

Key Step	Indicative Date
Submissions due on this paper	27 September 2010
Decisions Paper and Amendment to <i>Initial Reset Determination</i> published	30 November 2010

- 1.10 Discussion on the next steps relating to other potential amendments discussed in the remainder of this paper is provided at the conclusion of Chapter 3.

² Commerce Commission, *Further Work on the Reset Default Price-Quality Path for Electricity Distribution Businesses Updated Process Paper*, 3 May 2010.

Submissions

- 1.11 Submissions are invited on this *Discussion and Draft Decisions Paper* and should be submitted to the Commission no later than 5pm Monday 27 September 2010. All submissions should be supported by documentation and evidence, where appropriate.
- 1.12 To foster an informed and transparent process, the Commission intends to publish all submissions on its website. Accordingly, the Commission requests an electronic copy of each submission and requests that hard copies of submissions not be provided (unless an electronic copy is not available). The Commission also requires that these electronic copies be provided in an accessible form (i.e., they are ‘unlocked’ and text can be easily transferred). If the submission contains confidential information or if the submitter wishes that the published version be ‘locked’, an additional document labelled “public version” should be provided. Submissions should be sent to:
- regulation.branch@comcom.govt.nz;
or
Matthew Lewer
Regulation Branch
Commerce Commission
P.O. Box 2351
Wellington

Confidentiality

- 1.13 The Commission discourages requests for non-disclosure of submissions, in whole or in part, as it is desirable to test all information in a fully public way. The Commission is unlikely to agree to any requests that submissions in their entirety remain confidential. However, the Commission recognises that there will be cases where interested parties making submissions may wish to provide confidential information to the Commission.
- 1.14 If it is necessary to include such material in a submission the information should be clearly marked and preferably included in an appendix to the submission. Interested parties should provide the Commission with both confidential and public versions of their submissions. The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
- 1.15 Parties can request that the Commission makes orders under s 100 of the Commerce Act 1986 (**the Act**) in respect of information that should not be made public. Any request for a s 100 order must be made when the relevant information is supplied to the Commission and must identify the reasons why the relevant information should not be made public. The Commission will provide further information on s 100 orders if requested by parties, including the principles that are applied when considering requests for such orders. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any s 100 order will apply for a limited time only as specified in the order. Once an order expires, the Commission will follow its usual process in response to any request for information under the Official Information Act 1982.

CHAPTER 2: DRAFT DECISIONS – MODIFICATION TO COMPLIANCE ASSESSMENT FORMULA

Overview

- 2.1 Clause 8.4 of the *Initial Reset Determination* sets out the compliance assessment formula for the 2010-2015 DPP. This chapter provides the Commission's draft decision and reasons on a modification to the compliance assessment formula to ensure the 2010-2015 DPP price path is set independent of EDB pricing behaviour. This chapter also sets out background and discussion relevant to the draft decision.

Draft Decisions

- 2.2 The Commission's draft decision in respect of the relationship between the 2010-2015 DPP and EDB pricing behaviour is that:
- the compliance assessment formula will be amended to include a revenue differential term in the form set out in Appendix A.
- 2.3 The Commission's draft decision is based on the matters set out in the remainder of this chapter. The Commission welcomes submissions on this draft decision and on any other issues relating to the implementation of the proposed revenue differential term.

Background

- 2.4 As part of the development of the 2010-2015 DPP, the Commission consulted on the compliance assessment formula. Submissions observed that if an EDB was to price below its allowable notional revenue in any given assessment period, it would be prevented from pricing back up to the maximum allowed under its price path in subsequent assessment periods. Submissions referred to this matter as 'headroom', or the difference between an EDB's allowable notional revenue and notional revenue in a single assessment period.³
- 2.5 Due to the specification of the compliance assessment formula, where an EDB's prices in one assessment period form the basis for its allowable notional revenue in the next assessment period, headroom will have an effect on an EDB's future price path. Submissions contended that this effectively penalises EDBs for charging prices less than the allowed maximum, and that it represented a departure from the approach under the thresholds regime implemented under Part 4A of the Act (now repealed).⁴
- 2.6 To address this matter, submitters proposed an amendment to the compliance assessment formula to account for headroom.⁵ The proposed amendment was

³ For example, Powerco Limited (**Powerco**), *Submission on Initial Reset of the Default Price-Quality Path for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 4; and PricewaterhouseCoopers (**PwC**), *Submission on Initial Reset of the Default Price-Quality Path for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 14.

⁴ For example, PwC, *Submission on Initial Reset of the Default Price-Quality Path for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 9.

⁵ For example, Orion New Zealand Limited, *Submission on Initial Reset of the Default Price-Quality Path for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 2; and Electricity Networks Association (**ENA**), *Submission on the Reset of the DPP for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 7.

intended to allow an EDB to return to its maximum price path under the 2010-2015 DPP if it had chosen to price below the price path in one or more previous assessment periods.⁶

- 2.7 Having considered submissions, the Commission determined in its *Initial Reset of the Default Price-Quality Path for Electricity Distribution Businesses Decisions Paper (Reset DPP Decisions Paper)* that the compliance assessment formula for the *Initial Reset Determination* would not include a revenue differential term. The Commission's decision was based on two factors:
- the proposed revenue differential term was first introduced close to the deadline for setting the 2010-2015 DPP – meaning a limited amount of time for the Commission to assess its implications; and
 - headroom would not have an impact on EDBs until the second assessment period of the 2010-2015 DPP – meaning a decision was not immediately required.
- 2.8 The Commission stated it would further assess the effects of headroom with a view to making a decision prior to 1 December 2010 when EDBs set their prices for the second assessment period. The *Reset DPP Decisions Paper* also set out a number of preliminary considerations for headroom, which have been considered by the Commission when making its draft decision.⁷

Justification for a Revenue Differential Term

- 2.9 The current specification of the compliance assessment formula derives an EDB's allowable notional revenue for each forthcoming assessment period from the notional or actual prices charged by the EDB in the previous assessment period. In effect, this creates a relationship between an EDB's pricing behaviour within the regulatory period and its price path, whereby each EDB's price path is dependent on the prices it has charged previously.
- 2.10 For example, an EDB that has exceeded its price path during a previous assessment period will have a price path higher than if it had charged the maximum allowed revenue over that period. Conversely, an EDB that has priced below its price path in a previous assessment period will have a price path lower than if it had charged the maximum allowed prices over that period.
- 2.11 The Commission considers that the 2010-2015 DPP price path should be set independent of EDB pricing behaviour, so that the prices an EDB charges within the regulatory period cannot influence the trajectory of its price path. The Commission

⁶ The Commission described the proposed amendment to account for headroom as a 'revenue adjustment term' in its *Initial Reset of the Default Price-Quality Path Decisions Paper*, 30 November 2009. The Commission now considers 'revenue differential term' as a more appropriate description of the proposed amendment to reflect the considerations the Commission has made in the 'Justification for a Revenue Differential Term' section of this paper.

⁷ The Commission notes that ENA has subsequently written to the Commission arguing, in a different context, that amendments to the DPP may not be made unless provided for as part of an input methodology re-opening the price path (ENA, *Starting price adjustment methodology, Letter from Alan Jenkins to Mark Berry*, 23 July 2010). The Commission notes that, if this logic were correct, it would not be possible to amend the Reset DPP to account for the effects of headroom from 1 December 2010. However, the Commission does not agree with ENA and considers there is no legislative impediment to undertaking an amendment to the Reset DPP (Commerce Commission, *Re: Starting price adjustments, Letter from Mark Berry to Alan Jenkins*, 30 July 2010).

does not consider it appropriate for an EDB to either be penalised for offering lower prices to consumers, or benefit from breaching its price path. The Commission therefore considers that a revenue differential term is appropriate for the 2010-2015 DPP to decouple the relationship between an EDB's pricing behaviour within the regulatory period and the trajectory of its price path.

- 2.12 The Commission considers that a revenue differential term will also assist in mitigating potential disincentives for EDBs to charge lower prices, and also retaining pricing flexibility for EDBs under the 2010-2015 DPP. The Commission considers that EDBs may have potential disincentives to charge lower prices under the current compliance assessment formula as lower prices will reduce the EDB's level of allowable notional revenue for the remainder of the regulatory period, effectively retaining short-term pricing decisions over the longer-term.
- 2.13 As a result of the potential disincentives for EDBs to offer lower prices, the Commission considers that headroom is likely to affect the flexibility afforded under the 2010-2015 DPP for EDBs to set prices within the limits of their price path as they require. A flow-on effect of this is that it will also negate the short-term benefits consumers would receive through the charging of lower prices. The Commission considers that pricing flexibility is an important component of the 2010-2015 DPP and that EDBs should be able to fully utilise this flexibility within the limits of their price path.

Practical Considerations for a Revenue Differential Term

- 2.14 The Commission has identified several factors to be considered in the implementation of a revenue differential term which are discussed in this section:
- the specification of the revenue differential term;
 - headroom in instances of price path breaches;
 - the potential for price shocks to consumers;
 - the potential compounding of forecasting errors in relation to pass-through costs; and
 - the treatment of headroom across regulatory periods.

Specification of the revenue differential term

- 2.15 The Commission has assessed the form of the revenue differential term proposed by submitters and considers that it appropriately allows EDBs to price below their allowable notional revenue in any given assessment period, without reducing the level of their allowable notional revenue for the remainder of the regulatory period. Details of the revenue differential term proposed to be included in the compliance assessment formula are set out in Appendix A.

Headroom in instances of price path breaches

- 2.16 In the instance of an EDB breaching its price path (i.e., the EDB's notional revenue exceeds its allowable notional revenue in any given period), the current compliance assessment formula will perpetuate the effects of the breach over the remainder of the regulatory period in the absence of any correction. This is due to the derivation of the next assessment period's allowable notional revenue from the prices charged in the previous assessment period.

- 2.17 The Commission does not consider it appropriate for the compliance assessment formula to effectively validate breaches of the price path, and has considered the revenue differential term as a means of removing the effect of a price path breach on an EDB's allowable notional revenue for subsequent assessment periods.⁸
- 2.18 Under a price path that includes a revenue differential term, where an EDB breaches its price path, a headroom figure that is negative, and proportionate to the amount by which the EDB exceeded its allowable notional revenue, is produced. When this figure is then applied to the compliance assessment formula to set the EDB's allowable notional revenue for the next assessment period, the allowable notional revenue will be based on the maximum prices that an EDB could have charged in the previous assessment period without breaching its price path. In effect the revenue differential term has removed the impact of the breach and returned the EDB back to its original price path.

Potential for price shocks to consumers

- 2.19 Powerco Limited's submission on the Commission's *Initial Reset of the Default Price-Quality Path for Electricity Distribution Businesses Draft Decisions Paper* commented that a revenue differential term is necessary so EDBs can choose to under recover revenues and avoid price shocks to consumers during a high inflation year.⁹ While this is an argument in favour of a revenue differential term, the Commission considers that a revenue differential term itself has the potential to result in price shocks to consumers.
- 2.20 As it is possible for EDBs to price below their allowable notional revenue, the Commission considers it possible that some EDBs may choose to do so over several assessment periods. If the reduction in prices is substantial, there is potential for a significant difference between the EDB's recent prices and the maximum prices that it could potentially charge under its price path. If the EDB then chooses to return to the maximum prices allowed under its price path in a single assessment period, the resulting increase in prices may be considered a price shock to consumers.
- 2.21 The Commission's view is that the impact of any potential price shocks to consumers would be compensated for by the benefit of reduced prices in the assessment periods preceding any price increase. The Commission therefore considers the revenue differential term to be appropriate for the 2010-2015 DPP.

Potential compounding of forecasting errors

- 2.22 The 2010-2015 DPP requires an EDB to take into account its pass-through costs for the current assessment period when setting its prices for the forthcoming assessment period. The timing of the price setting process requires the EDB to estimate a portion of these pass-through costs, thus leading to potential forecasting errors with compliance implications for the 2010-2015 DPP.
- 2.23 The implication of this for a revenue differential term is that any forecasting errors in the previous assessment period's allowable notional revenue will be carried forward into the next assessment period's allowable notional revenue as part of headroom. In

⁸ The Commission will provide further detail of its processes in the event of a breach of the price path in consultation on its enforcement guidelines.

⁹ Powerco, *Submission on Initial Reset of the Default Price-Quality Path for Electricity Distribution Business Draft Decisions Paper*, 12 October 2009, p. 4.

light of this, the Commission has considered the potential impact of these forecasting errors on the revenue differential term.

- 2.24 The Commission's view is that although pass-through costs are based on estimates by EDBs, variances between estimated and actual pass-through cost values should not be material given that the majority of these costs are known in advance.¹⁰ In addition, submissions have commented that overall pass-through costs (excluding transmission charges) represent less than 1% of an EDB's allowable revenue.¹¹ Given the potential effects of forecasting errors in pass-through costs are not likely to be material the Commission considers the revenue differential term to remain appropriate.

Treatment of headroom at the end of a regulatory period

- 2.25 The discussion of headroom in this paper is based on accounting for headroom between individual assessment periods within a single regulatory period. The Commission has also considered the treatment of headroom at the end of a regulatory period.
- 2.26 The Commission considers that, for future regulatory periods, if it decided to specify starting prices as the maximum prices allowed at the end of the previous regulatory period in accordance with s 53P(3)(a), the allowable notional revenue would effectively be a continuation of allowable notional revenue under the previous DPP (albeit with a potentially different X-factor), and headroom from the previous price-quality path may therefore be taken into account.
- 2.27 On the other hand, if the Commission decided to adjust starting prices in accordance with s 53P(3)(b), that process would effectively establish an entirely new price-quality path at the beginning of the regulatory period. As noted in its Discussion Paper on Starting Price Adjustments however, the Commission considers that, to the extent a breach of the price-path in the previous regulatory period affects the starting price adjustment process, the supplier should not benefit from this breach.¹²

¹⁰ Commerce Commission, *Initial reset of the Default Price-Quality Price Path for Electricity Distribution Businesses – Consultation Update Paper*, 16 November 2009, p. 13.

¹¹ Powerco, *Submission on Form of Control in Issues Paper: Initial Default Price-Quality Path for Gas Pipeline Businesses*, 30 April 2010, p. 2.

¹² Commerce Commission, *Starting Price Adjustments for Default Price-Quality Paths Discussion Paper*, 5 August 2010, p. 16.

CHAPTER 3: POTENTIAL AMENDMENTS TO THE INITIAL RESET DETERMINATION

Overview

- 3.1 This chapter provides discussion of potential amendments (excluding the revenue differential term) to the *Initial Reset Determination* that the Commission anticipates making as part of further work on the 2010-2015 DPP, and is split into three sections:
- potential amendments to take account of the Commission's draft decisions on input methodologies in the recently published *Draft IMs*;
 - a potential adjustment to the derivation of the CPI term used in the compliance assessment formula to account for an increase in GST from 1 October 2010; and
 - the timing of the potential amendments to the *Initial Reset Determination*.

Potential Amendments to Take Account of Input Methodologies

- 3.2 The Commission stated in Clause 6 of the *Initial Reset Determination* that it would amend the 2010-2015 DPP to take account of relevant input methodologies once they had been published. In light of the publication of the *Draft IMs* on 2 July 2010, this section sets out the Commission's initial views on potential amendments to the *Initial Reset Determination*.
- 3.3 The Commission intends to amend the *Initial Reset Determination* so that all relevant definitions are consistent with input methodologies, and has deliberately chosen to focus the views provided in this section on the wider implications of the input methodologies within the *Initial Reset Determination* to avoid duplication with the input methodologies process.
- 3.4 As such, the remainder of this section sets out the specific impacts of the *Draft IMs* on the 2010-2015 DPP including: a brief description of the relevant matter as provided by the *Draft IMs*, how each matter relates to the *Initial Reset Determination*, and the Commission's initial view on how the *Initial Reset Determination* may need to be amended to take account the relevant matter. These matters include:
- the specification of price
 - pass-through costs
 - the specification of recoverable costs , which includes:
 - avoided transmission charges
 - transmission charges
 - new investment contracts
 - the net carry-forward amount of the incremental rolling incentive scheme (**IRIS**)
 - the CPP application window
 - the treatment of transactions between EDBs
 - the circumstances under which the price path may be reconsidered.

Specification of Price

- 3.5 The *Draft IMs* set out the draft decision that price for EDBs is to be specified by a weighted average price cap, which is given by a function of price(s) and quantities, net of pass-through costs and recoverable costs.¹³
- 3.6 The major impact of this for the *Initial Reset Determination* is the addition of the recoverable costs (discussed further below in paragraphs 3.11 - 3.15) category which is not currently specified in the *Initial Reset Determination*.

Pass-through Costs

- 3.7 The *Draft IMs* propose a set of criteria that costs must meet in order to be considered as a pass-through cost. Consistent with this, a pass-through cost is deemed to be:
- outside the control of the supplier;
 - unable to be accurately forecast; and
 - approved as a pass-through cost by the Commission.¹⁴
- 3.8 Under this set of criteria, local authority rates, Commerce Commission levies and levies paid under the Electricity Act 1992 are considered as pass-through costs.
- 3.9 The major implication of the proposed set of criteria for pass-through costs is that transmission charges (and its subsets) are no longer considered under this category and have been proposed as a recoverable cost. This however will not have a substantive effect on the price path as it is a reclassification of cost and not an alteration of the function of those costs.
- 3.10 The Commission's initial view is that pass-through costs will remain specified in the compliance assessment formula under the term '*K*'.

Recoverable Costs

- 3.11 The *Draft IMs* propose that recoverable costs are costs the Commission considers that EDBs should be able to pass through to consumers but do not necessarily meet the definition of pass-through costs.¹⁵
- 3.12 The major implication of this category is that in addition to some new costs, many costs that are currently considered as pass-through costs are proposed as recoverable costs. Transmission charges, new investment contract charges, and avoided transmission charges are all currently pass-through costs in the *Initial Reset Determination*, whilst the net carry-forward amount of IRIS is a new category of cost for the 2010-2015 DPP.
- 3.13 In light of this proposed new category, the Commission's initial view is that the *Initial Reset Determination* should be amended to include a '*V*' term within the compliance assessment formula. Consistent with the *Draft IMs* for the specification of price, the Commission anticipates that *V* will be subtracted from the function of price and quantities in the same manner as the current *K* term for pass-through costs. The Commission will provide further detail of the compliance assessment formula in

¹³ Commerce Commission, *Draft Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010*, 2 July 2010, p. 37.

¹⁴ Ibid, p. 38.

¹⁵ Ibid, p. 39.

future consultation on input methodologies related amendments to the *Initial Reset Determination*.

- 3.14 Further to the above, it is the Commission's initial view that all recoverable costs be specified separately as part of the annual compliance statement to clearly identify each recoverable cost and demonstrate its effect.
- 3.15 Discussion of the implications of individual recoverable costs for the *Initial Reset Determination* is set out below.

Transmission Charges

- 3.16 The *Draft IMs* propose that transmission charges be restricted to those charges payable by an EDB under the Transmission Pricing Methodology.¹⁶
- 3.17 The effect of this is that avoided transmission charges and new investment contracts charges, both previously a subset of transmission charges are now specified as separate recoverable costs.
- 3.18 The Commission's initial view is to require EDBs to separately specify transmission charges consistent with the new definition under the 'V' term as part of their annual compliance statement.

Avoided Transmission Charges

- 3.19 The *Draft IMs* propose that avoided transmission charges be defined as charges arising from when an EDB undertakes a capital investment that both lowers transmission charges to the EDB, and lowers the total cost of supplying electricity lines services. The full avoided transmission charges may be recovered over a period of five years.¹⁷
- 3.20 The implication of this is that an EDB will be required to demonstrate that its investment both lowers the cost to the EDB but also the total cost in supplying the electricity lines service overall. Previously an EDB was not required to demonstrate a reduction in the total cost of the electricity lines service.
- 3.21 The Commission's initial view is therefore that the *Initial Reset Determination* will be amended to require that EDBs supply supporting information concerning each individual investment contributing to an avoided transmission charge as part of its annual compliance statement. In this way the Commission can verify the validity of the charge and also track the duration of its five year period.

IRIS

- 3.22 The *Draft IMs* propose that an EDB coming off a customised price-quality path and on to the DPP may recover the net incremental carry-forward amount under IRIS.¹⁸
- 3.23 The Commission considers that as this cost will have been determined under the CPP using detailed information, the Commission will not require any additional supporting information to ensure that the amounts under this category are appropriate.
- 3.24 The Commission's initial view is that EDBs will therefore specify any amounts consistent with the IRIS input methodology in its annual compliance statement as the same as those provided through information disclosure.

¹⁶ Ibid, p. 39.

¹⁷ Ibid, p. 39.

¹⁸ Ibid, p. 39.

New Investment Contracts

- 3.25 The *Draft IMs* set out a new definition of new investment contracts charges in which they are to be considered as a separate category from transmission charges under recoverable costs.¹⁹
- 3.26 The Commission's initial view is that EDBs will specify new investment contracts charges separately under the recoverable costs category in their annual compliance statements.

Applicable Input Methodologies

- 3.27 Parts 3 and 4 of the *Draft IMs* set out the relevant input methodologies for the 2010-2015 DPP.
- 3.28 The Commission's initial view is to amend the *Initial Reset Determination* to make reference to these input methodologies.

CPP application window

- 3.29 The Commission has proposed that it will accept applications for a CPP in two instances: general applications during the last week of January each year; and applications based on a catastrophic event at any time.
- 3.30 The Commission's initial view is that an amendment to the *Initial Reset Determination* is required to specify the general application window for CPP applications as the last week of January each year, and also state that applications will be considered at any time if based on a catastrophic event. The Commission considers that the assessment of what is considered to be a catastrophic event should be based on criteria set out in the Commission's draft reasons paper corresponding to the *Draft IMs*.²⁰

Transactions between EDBs

- 3.31 Subpart 3 of Part 3 of the *Draft IMs* sets out proposed requirements for the price path of EDBs involved in transactions (amalgamations, acquisitions, and becoming a related company) during a regulatory period.²¹
- 3.32 Depending on the circumstances of both the EDBs involved in a transaction, the *Draft IMs* propose that both the EDBs concerned be subject to a joint price-quality path at the end of either the current DPP regulatory period (if both regulated suppliers are on a DPP), or at the end of the DPP regulatory period following the expiry of a CPP (if one or both of the regulated suppliers are on a CPP).
- 3.33 Clause 10 of the *Initial Reset Determination* currently sets out the requirements for 'Mergers and Acquisitions'. It is the Commission's initial view to amend this clause to adopt how transactions between EDBs are dealt with under input methodologies.
- 3.34 The implication of this proposed amendment is that EDBs will have requirements relating to: transactions involving CPPs; and also that transactions not involving CPPs will result in a joint price path at the end of the regulatory period and not the end of the next assessment period as currently specified in the *Initial Reset Determination*.

¹⁹ Ibid, p. 39.

²⁰ Commerce Commission, *Input Methodologies for Electricity Distribution Businesses and Gas Pipelines Businesses Companion Paper*, 2 July 2010, p. 15.

²¹ *Supra* n 13, p. 40.

Reconsideration of the Reset DPP

- 3.35 Subpart 2 of Part 4 of the *Draft IMs* sets out the circumstances in which the 2010-2015 DPP may be reconsidered.
- 3.36 The implications of this subpart are that the Commission may reconsider the 2010-2015 DPP in light of either a material error in the *Initial Reset Determination*, or if a supplier has provided false or misleading information which the Commission relied upon in making the *Initial Reset Determination*.
- 3.37 The Commission's initial view is to amend the *Initial Reset Determination* to specify the circumstances under which the 2010-2015 DPP may be reconsidered for the purposes of clarity.

Potential Amendment to the Derivation of the CPI

- 3.38 As announced in the 2010 New Zealand Government Budget, an increase in the rate of GST from 12.5 percent to 15 percent will take effect from 1 October 2010. It is expected that this new rate of GST will result in a step change in the CPI without having a permanent impact on the CPI inflation rate.²²
- 3.39 The Commission considers that, if not accounted for, the step change in the CPI will result in an increase in allowable notional revenue for EDBs.²³ Prices and revenues within the 2010-2015 DPP are typically GST exclusive, and suppliers are able to claim back their GST costs.²⁴ The Commission has therefore considered whether or not it is appropriate for EDBs to receive additional revenues resulting from the impact of the GST increase on the CPI.
- 3.40 The Commission's initial view is that EDBs should not receive an increase in allowed revenue (which is an exclusive of GST measure) due to the impact of the GST increase on the CPI. The 2010-2015 DPP price path is intended to apply to prices before GST. It is therefore the Commission's view that price, as set out in Clause 4.1 of the *Initial Reset Determination*, should be amended to clarify that posted prices means exclusive of GST.²⁵ As EDBs are also able to claim back their GST costs, the Commission considers any additional revenues arising from the GST increase to be windfall gains and should not accrue to EDBs under the 2010-2015 DPP. The Commission therefore considers it appropriate to remove the impact of GST from the CPI used for the purpose of setting an EDBs' allowable notional revenue.
- 3.41 The Commission's initial view is to remove the impact of the GST increase on the CPI by making a one-off adjustment to the derivation of the CPI within the compliance assessment formula. The proposed adjustment will be made by multiplying the CPI values used in the compliance assessment formula prior to 1

²² The Reserve Bank of New Zealand, *Monetary Policy Statement June 2010*, p. 22. See <http://www.rbnz.govt.nz/monpol/statements/jun10.pdf>.

²³ The Reserve Bank of New Zealand has published a GST impact figure estimating the effect of the GST increase on the CPI index at 2 percent. This will affect an EDB's revenues due to the indexation of the 2010-2015 DPP against CPI as set out in Clause 8.4 of the *Initial Reset Determination*.

²⁴ The Commission understands that currently Eastland Network Limited is the only EDB subject to the 2010-2015 DPP that specifies its prices as inclusive of GST.

²⁵ The Commission notes the GST increase may have potential impacts on compliance for the assessment period ending 31 March 2011. In light of this, the potential clarification of 'posted price' within the *Initial Reset Determination* may be appropriate prior to 31 March 2011 (paragraph 3.46).

October 2010 (i.e., the quarterly figures to 30 September 2010) by 1.02. This figure is based on the GST impact estimate published by the Reserve Bank of New Zealand. Effectively, this adjustment increases the CPI prior to 1 October 2010 by two percent therefore removing the step change in the CPI series. The adjusted CPI will then produce a change in the CPI figure for the compliance assessment formula that negates the impact of the GST increase.²⁶

Timing of Potential Amendments

- 3.42 The Commission has identified the following considerations when making a decision on the timing of potential amendments to the *Initial Reset Determination* in relation to the matters discussed in this chapter:
- amendments related to input methodologies can only be made after final input methodologies have been published (no later than 31 December 2010) so as not to pre-empt the final input methodologies;
 - amendments to take effect for the second assessment period beginning 1 April 2011 must be made prior to 31 March 2011 to be in place for the start of the assessment period; and
 - amendments related to input methodologies and affecting EDB pricing decisions should be made by 1 December 2011 to take effect for the assessment period beginning 1 April 2012. The reason for this being that EDBs need to factor these input methodologies into their prices prior to the date at which they are set for the forthcoming assessment period (this date being 1 December 2011).
- 3.43 In light of the above, the Commission suggests that there are two dates by which potential amendments to the *Initial Reset Determination* can be made:
- 31 March 2011 for non-pricing related amendments taking effect for the assessment period beginning 1 April 2011; and
 - 1 December 2011 for all amendments taking effect for the assessment period beginning 1 April 2012.
- 3.44 It is the Commission's initial view to make a single amendment by 1 December 2011 for all of the matters discussed in this chapter. The Commission considers an amendment by 1 December 2011 will ensure a reasonable consultation process and allow the maximum time available for detailed consideration of related matters. Potential amendments would then come into effect at the start of the assessment period beginning 1 April 2012. Consistent with this, the Commission intends to publish a draft decisions paper and draft amendment to the *Initial Reset Determination* for the matters discussed in this chapter in either the first or second quarter of 2011. A final decisions paper and final amendment to the *Initial Reset Determination* would then be made by 1 December 2011.
- 3.45 However, the Commission is aware that an earlier amendment by 31 March 2011 may potentially be desirable for some matters. The Commission has identified that

²⁶

Due to the use of a lagged CPI series within the compliance assessment formula, the proposed amendment to the Initial Reset Determination for the adjustment to CPI does not have to be made until prior to assessment period beginning 1 April 2012. This is the first assessment period in which quarterly CPI figures within the compliance assessment formula are affected by the increase in GST.

these matters could potentially relate to transactions between EDBs, the CPP application window, and reconsideration of the price path.

- 3.46 In light of the above, the Commission is interested in the views of interested parties on a potential separate earlier amendment to the *Initial Reset Determination* by 31 March 2011 to take account of input methodologies and other matters.

APPENDIX A: DRAFT AMENDMENT – INITIAL RESET DETERMINATION**COMMERCE COMMISSION****Amendment to the 2010-2015 Default Price-Quality Path for Electricity Distribution Businesses****Decision No. [XXX]**

The Commission:

Dr M Berry
PJM Taylor
S Begg
P Duignan
D Caygill

Summary of the Determination: Pursuant to Part 4 of the Commerce Act 1986, the Commerce Commission has amended the default price-quality path that applies to electricity distribution businesses under Decision 685 to include a revenue differential term under Clause 8.4. The attached determination amends the default price-quality path provided for by section 54J(2) of the Act, under section 52Q of the Act. The determination takes effect on and from 1 April 2011 and applies for the period 1 April 2011 to 31 March 2015.

Date of Decision: [XX XXXX] 2010

**COMMERCE ACT (ELECTRICITY DISTRIBUTION
DEFAULT PRICE-QUALITY PATH) AMENDMENT DETERMINATION 2011**

Pursuant to Part 4 of the Commerce Act 1986, the Commerce Commission makes the following determination:

Title

(1) This amendment determination is the Commerce Act (Electricity Distribution Default Price-Quality Path) Amendment Determination 2011.

(2) In this amendment determination, the Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 is called the “principal determination”.

Commencement

This amendment determination comes into force on 1 April 2011.

Default price-quality path

Clause 8.4 of the principal determination is amended by omitting clause 8.4, and substituting the following:

8.4 Compliance with the price path

The notional revenue (NR_t) of a Non-exempt EDB at any time during the Assessment Period must not exceed the allowable notional revenue (R_t) for the Assessment Period, such that:

$$\frac{NR_t}{R_t} \leq 1$$

where:

NR_t is the notional revenue for the Assessment Period t , being equal to:

$$\sum_i P_{i,t} Q_{i,t-2} - K_t$$

R_t is the allowable notional revenue for the Assessment Period t , other than the First Assessment Period, being equal to:

$$\left(\sum_i P_{i,t-1} Q_{i,t-2} - K_{t-1} \right) + (R_{t-1} - NR_{t-1}) \times ((1 + \Delta CPI_t) \times (1 - X))$$

where:

t denotes the year of the Assessment Date in the Assessment Period, for which compliance is being assessed;

i denotes each Price relating to an Electricity Lines Service;

$P_{i,t}$ is the i^{th} Price during any part of the Assessment Period t ;

$P_{i,t-1}$ is the i^{th} Price during any part of the Pricing Period $t-1$;

$Q_{i,t-2}$ is the Quantity corresponding to the i^{th} Price during the Pricing Period $t-2$;

- K_t is the sum of all Pass-Through Costs during the Assessment Period t ;
- K_{t-1} is the sum of all Pass-Through Costs during the Pricing Period $t-1$;
- R_{t-1} is the Allowable Notional Revenue during the Assessment Period $t-1$;
- NR_{t-1} is the Notional Revenue during the Assessment Period $t-1$;
- X is the rate of change for the Non-exempt EDB as specified in Schedule 2; and
- ΔCPI_t is the derived change in the CPI to be applied during the Assessment Period t , being equal to:

$$\frac{CPI_{Dec,t-3} + CPI_{Mar,t-2} + CPI_{Jun,t-2} + CPI_{Sep,t-2}}{CPI_{Dec,t-4} + CPI_{Mar,t-3} + CPI_{Jun,t-3} + CPI_{Sep,t-3}} - 1$$

where:

$CPI_{q,t}$ is the CPI for the quarter q of year t

Dated at Wellington this [XX] day of [XXX] 2010.
COMMERCE COMMISSION.

APPENDIX B: CONSOLIDATED VERSION – INITIAL RESET DETERMINATION**COMMERCE COMMISSION****Decision No. 685**

Electricity distribution default price-quality path determination pursuant to Part 4 of the Commerce Act 1986 (the Act).

The Commission:

- Dr M Berry**
- PJM Taylor**
- S Begg**
- P Duignan**
- D Caygill**

Summary of the Determination: Pursuant to Part 4 of the Act, the Commerce Commission has determined a default price-quality path that applies to electricity distribution businesses that are subject to default/customised price-quality regulation under the Act (“Non-exempt EDBs”). The attached determination resets the default price-quality path provided for by section 54J(2) of the Act, as required by section 54K(1) of the Act. The determination takes effect on and from 1 April 2010 and applies for the period 1 April 2010 to 31 March 2015.

Date of Decision: 30 November 2009

**AMENDMENTS TO THE COMMERCE ACT (ELECTRICITY DISTRIBUTION
DEFAULT PRICE-QUALITY PATH) DETERMINATION 2010**

This is a consolidated version of Decision No 685, and incorporates all current amendments to that Decision.

Pursuant to Part 4 of the Commerce Act 1986, the Commerce Commission has made the following amendments to this determination:

Decision [XXX]

On 30 November 2010, clause 8.4 of the original determination was substituted with a new clause 8.4. [Insert gazette summary reference] sets out a summary of the amendment.

COMMERCE ACT (ELECTRICITY DISTRIBUTION DEFAULT PRICE-QUALITY PATH) DETERMINATION 2010

Pursuant to Part 4 of the Commerce Act 1986, the Commerce Commission makes the following determination:

1 Title

This determination is the Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010.

2 Commencement Date

This determination comes into force on 1 April 2010.

3 Application

3.1 This determination resets the default price-quality path provided for by section 54J(2) of the Act, as required by section 54K(1) of the Act.

3.2 This determination applies to every Non-exempt EDB during the Regulatory Period.

4 Interpretation

4.1 In this determination, unless the context otherwise requires,—

Act means the Commerce Act 1986

Annual Compliance Statement means a written statement made by a Non-exempt EDB under clause 11

Assessed Values means the aggregate SAIDI Values and SAIFI Values for an Assessment Period, which are derived from a Normalised Assessment Dataset

Assessment Dataset means the set of daily SAIDI Values and SAIFI Values for an Assessment Period, with SAIDI Values and SAIFI Values for an Interruption that spans multiple calendar days accrued to the day on which the Interruption began

Assessment Date means a date as at which compliance with the default price-quality path must be demonstrated, being 31 March of each of the years 2011 to 2015

Assessment Period means a period of 12 months ending on an Assessment Date

Auditor, in relation to a Non-exempt EDB, means a Person who:

- (a) is qualified for appointment as auditor of a company under the Companies Act 1993 or, where the Non-exempt EDB is a public entity (as defined in section 4 of the Public Audit Act 2001), is the Auditor-General; and
- (b) has no relationship with, or interest in, the Non-exempt EDB that is likely to involve the Person in a conflict of interest; and
- (c) has not assisted with the preparation of the Annual Compliance Statement or provided advice or opinions (other than in relation to audit reports) on the methodologies or processes used in preparing the Annual Compliance Statement; and

- (d) has the necessary expertise to properly undertake an audit required by clause 11.2; but
- (e) need not be the same Person as the Person who audits the Non-exempt EDB's accounts for any other purpose

Avoided Transmission Charge means any expense (including the cost of capital) of a Non-exempt EDB that arises during an Assessment Period from any activity which substitutes for use of the Transmission System

Class B Interruptions means planned Interruptions by a Non-exempt EDB

Class C Interruptions means Unplanned Interruptions originating within the System Fixed Assets of a Non-exempt EDB

Commerce Act Levy means an electricity industry levy paid or payable by a Non-exempt EDB under the Commerce Act 1986

Commission means the Commerce Commission

Consumer has the same meaning as in section 2(1) of the Electricity Act 1992

Consumer-Owned has the meaning set out in section 54D of the Act

CPI means the consumer price index stipulated in the "All Groups Index SE9A" (or any successor to that index), as published by Statistics New Zealand

Director means, in the case of a Non-exempt EDB that is not a company, a person occupying a position in, or in relation to, the Non-exempt EDB that is comparable with that of a director of a company

EDB means a supplier of Electricity Lines Services other than Transpower

Electricity Commission Levy means an industry levy paid or payable by a Non-exempt EDB in accordance with section 172ZC of the Electricity Act 1992

Electricity Lines Services has the meaning set out in section 54C of the Act

First Assessment Period means the period 1 April 2010 to 31 March 2011

Interruption means, in relation to the conveyance of electricity to a Consumer by means of a Prescribed Voltage Electric Line, the cessation of conveyance of electricity to that Consumer for a period of 1 minute or longer, other than by reason of disconnection of that Consumer—

- (a) for breach of the contract under which the electricity is conveyed; or
- (b) as a result of a request from the Consumer; or
- (c) as a result of a request by the Consumer's electricity retailer; or
- (d) for the purpose of isolating an unsafe installation

Non-exempt EDB means an EDB other than a Consumer-Owned EDB exempt under section 54G(2) of the Act

Normalised Assessment Dataset means an Assessment Dataset normalised in accordance with Schedule 3

Normalised Reference Dataset means a Reference Dataset normalised in accordance with Schedule 3

Pass-Through Costs means:

- (a) the Transmission Charges, Rates, Electricity Commission Levies, and Commerce Act Levies paid or payable by a Non-exempt EDB during a Pricing Period;

but does not include:

- (b) any amounts described in paragraph (a) if the Non-exempt EDB demonstrates to the satisfaction of the Commission that those amounts were passed on transparently to its Consumers and/or electricity retailers

Person includes a corporation sole, a body corporate, and an unincorporated body

Posted Discount means a discount to line charges payable for Electricity Line Services where those discounts are offered by way of published tariffs schedules, whose take-up is determined by Consumers

Prescribed Voltage Electric Line means an electric line that is capable of conveying electricity at a voltage equal to or greater than 3.3 kilovolts

Price means:

- (a) a posted price (as defined in section 52C of the Act) in nominal terms (such as a tariff, fee or charge) or a component thereof, in relation to an Electricity Lines Service, and may include a Posted Discount;

but does not include:

- (b) any amounts described in paragraph (b) of the definition of Pass-Through Costs

Pricing Period means a 12 month period ending on 31 March

Quantity means the unit of quantity (which may include, but is not limited to, kWh, kVA, kW, and day) corresponding to a Price

Rates means the rates on System Fixed Assets paid or payable by a Non-exempt EDB to a territorial local authority under the Rating Powers Act 1988 or the Local Government (Rating) Act 2002

Reference Dataset means the set of daily SAIDI Values and SAIFI Values for the Reference Period, with SAIDI Values and SAIFI Values for an Interruption that spans multiple calendar days accrued to the day on which the Interruption began

Reference Period means the period 1 April 2004 to 31 March 2009

Regulatory Period means the period 1 April 2010 to 31 March 2015

Reliability Limits means the SAIDI and SAIFI levels against which a Non-exempt EDB's annual reliability performance is assessed

SAIDI Values means system average interruption duration index values based on Class B Interruptions and Class C Interruptions

SAIFI Values means system average interruption frequency index values based on Class B Interruptions and Class C Interruptions

System Fixed Assets means all fixed assets owned, provided, maintained, or operated by a Non-exempt EDB or Transpower that are used or intended to be used for the supply of Electricity Lines Services

System Operator Services means co-ordination services for the control, dispatch, and security functions necessary to operate the Transmission System

Transmission Charge means any amount in respect of:

- (a) Electricity Lines Services provided to a Non-exempt EDB in respect of the Transmission System in accordance with the Transmission Pricing Methodology; and
- (b) the provision of System Operator Services; and
- (c) new investment contracts, as defined in Schedule F5 of Section IV of Part F of the Electricity Governance Rules 2003, between Transpower and a Non-exempt EDB; and
- (d) Avoided Transmission Charges

Transmission Pricing Methodology means the methodology Transpower uses to determine the prices it charges for its services, as set out in Schedule F5 of Section IV of Part F of the Electricity Governance Rules 2003

Transmission System means New Zealand's national electricity grid

Transpower has the meaning set out in section 54B of the Act

Unplanned Interruption means any Interruption in respect of which less than 24 hours notice, or no notice, was given, either to the public or to all Consumers affected by the Interruption.

4.2 Unless the context otherwise requires,—

- (a) terms used in this determination that are defined in the Act but not in this determination have the same meanings in this determination as in the Act;
- (b) words appearing in this determination with capitalised initial letters are defined terms and bear the meanings given to them in this clause 4; and
- (c) a word which denotes the singular also denotes the plural and vice versa.

5 **Default price-quality path**

During the Regulatory Period every Non-exempt EDB must comply with the default price-quality path, which consists of both:

- (a) the price path specified in clause 8; and
- (b) the quality standards specified in clause 9.

6 **Applicable input methodologies**

No input methodologies will apply to this determination until applicable input methodology determinations have been made.

7 **Customised price-quality path proposal date**

The annual period within which any proposal for a customised price-quality path must be received by the Commission will be determined following the publication of input methodology determinations.

8 Price path

8.1 Starting Prices

The starting Prices that apply during the Regulatory Period are as set out in Schedule 1 unless reset or amended as provided for under the Act.

8.2 Rate of change

The annual rate of change in Prices (i.e., X), relative to the CPI, allowed during the Regulatory Period is as set out in Schedule 2.

8.3 Allowable notional revenue

Allowable notional revenue (R_t) specifies the maximum Prices that may be charged during an Assessment Period.

8.4 Compliance with the price path

The notional revenue (NR_t) of a Non-exempt EDB at any time during the Assessment Period must not exceed the allowable notional revenue (R_t) for the Assessment Period, such that:

$$\frac{NR_t}{R_t} \leq 1$$

where:

NR_t is the notional revenue for the Assessment Period t , being equal to:

$$\sum_i P_{i,t} Q_{i,t-2} - K_t$$

R_t is the allowable notional revenue for the Assessment Period t , other than the First Assessment Period, being equal to:

$$\left(\sum_i P_{i,t-1} Q_{i,t-2} - K_{t-1} \right) + (R_{t-1} - NR_{t-1}) \times ((1 + \Delta CPI_t) \times (1 - X))$$

where:

t denotes the year of the Assessment Date in the Assessment Period, for which compliance is being assessed;

i denotes each Price relating to an Electricity Lines Service;

$P_{i,t}$ is the i^{th} Price during any part of the Assessment Period t ;

$P_{i,t-1}$ is the i^{th} Price during any part of the Pricing Period $t-1$;

$Q_{i,t-2}$ is the Quantity corresponding to the i^{th} Price during the Pricing Period $t-2$;

K_t is the sum of all Pass-Through Costs during the Assessment Period t ;

K_{t-1} is the sum of all Pass-Through Costs during the Pricing Period $t-1$;

R_{t-1} is the Allowable Notional Revenue during the Assessment Period $t-1$;

NR_{t-1} is the Notional Revenue during the Assessment Period $t-1$;

X is the rate of change for the Non-exempt EDB as specified in Schedule 2; and

ΔCPI_t is the derived change in the CPI to be applied during the Assessment Period t , being equal to:

$$\frac{CPI_{Dec,t-3} + CPI_{Mar,t-2} + CPI_{Jun,t-2} + CPI_{Sep,t-2}}{CPI_{Dec,t-4} + CPI_{Mar,t-3} + CPI_{Jun,t-3} + CPI_{Sep,t-3}} - 1$$

where:

$CPI_{q,t}$ is the CPI for the quarter q of year t

8.5 Allowable notional revenue (R_t) for the First Assessment Period

R_{2011} is the allowable notional revenue for the First Assessment Period, being equal to:

$$\left(\sum_i P_{i,2010} Q_{i,2009} - K_{2010} \right) \times ((1 + \Delta CPI_{2011}) \times (1 - X))$$

where:

$P_{i,2010}$ is the i^{th} starting Price as specified in Schedule 1;

$Q_{i,2009}$ is the Quantity corresponding to the i^{th} Price for the Pricing Period 1 April 2008 to 31 March 2009;

K_{2010} is the sum of all Pass-Through Costs, other than Commerce Act Levies, during the Pricing Period 1 April 2009 to 31 March 2010;

X is the rate of change for the Non-exempt EDB as specified in Schedule 2; and

ΔCPI_{2011} is the derived change in the CPI to be applied during the First Assessment Period, being equal to:

$$\frac{CPI_{Dec,2008} + CPI_{Mar,2009} + CPI_{Jun,2009} + CPI_{Sep,2009}}{CPI_{Dec,2007} + CPI_{Mar,2008} + CPI_{Jun,2008} + CPI_{Sep,2008}} - 1$$

8.6 Restructuring of Prices

If a Non-exempt EDB restructures its Prices that apply during an Assessment Period, it must demonstrate to the satisfaction of the Commission in its Annual Compliance Statement for that Assessment Period:

- (a) whether or not the restructuring of itself increased its allowable notional revenue for that Assessment Period above that which would have applied if the restructuring had not occurred; or
- (b) where it is not possible to demonstrate the effects of the restructure on allowable notional revenue under paragraph (a), whether or not the restructuring of itself increased its revenue for that Assessment Period above that which would have applied if the restructuring had not occurred;

and, if the restructuring of itself—

- (c) did not increase the Non-exempt EDB's allowable notional revenue (referred to in paragraph (a)) or revenue (referred to in paragraph (b)) for

that Assessment Period, clause 8.4 will apply as if the new Price structure applied on and from the beginning of that Assessment Period; or

- (d) did increase the Non-exempt EDB's allowable notional revenue (referred to in paragraph (a)) or revenue (referred to in paragraph (b)) for that Assessment Period, the price path will not have been complied with.

8.7 Alternative compliance following restructuring of Prices

If a Non-exempt EDB restructures its Prices that apply during an Assessment Period, and—

- (a) the Commission is satisfied that, because of a lack of information beyond the control of the Non-exempt EDB, it is not practicable for the Non-exempt EDB to demonstrate the effect of the restructuring under clause 8.6 and therefore to demonstrate compliance with the price path for that Assessment Period; and
- (b) the Non-exempt EDB demonstrates to the satisfaction of the Commission, by use of an alternative approach that has the equivalent effect of clause 8.6, that the substance of that clause has been complied with—

the Non-exempt EDB will be regarded as having complied with the price path during that Assessment Period.

8.8 2009/10 Commerce Act Levies

If a Non-Exempt EDB paid Commerce Act Levies during the Pricing Period 1 April 2009 to 31 March 2010 then that Non-Exempt EDB may apportion those levies evenly over the Regulatory Period and include the resulting apportioned amounts as Pass-Through Costs.

9 Quality standards

9.1 Compliance with quality standards

A Non-exempt EDB must, in respect of each Assessment Period other than the First Assessment Period, either:

- (a) comply with the annual reliability assessment specified in clause 9.2 for that Assessment Period; or
- (b) have complied with those annual reliability assessments for the two immediately preceding extant Assessment Periods.

9.2 Annual reliability assessment

A Non-exempt EDB's Assessed Values for an Assessment Period must not exceed its Reliability Limits for that Assessment Period, such that:

$$\frac{SAIDI_{ASSESS,t}}{SAIDI_{LIMIT}} \leq 1; \text{ and}$$

$$\frac{SAIFI_{ASSESS,t}}{SAIFI_{LIMIT}} \leq 1$$

where:

- $SAIDI_{ASSESS,t}$ is the SAIDI Assessed Value for the Non-exempt EDB for the Assessment Period t , and is calculated using the process outlined in Schedule 3;
- $SAIDI_{LIMIT}$ is the SAIDI Reliability Limit for the Non-exempt EDB, and is calculated using the process outlined in Schedule 3;
- $SAIFI_{ASSESS,t}$ is the SAIFI Assessed Value for the Non-exempt EDB for the Assessment Period t , and is calculated using the process outlined in Schedule 3; and
- $SAIFI_{LIMIT}$ is the SAIFI Reliability Limit for the Non-exempt EDB, and is calculated using the process outlined in Schedule 3.

10 Mergers and acquisitions

- 10.1 If a Non-exempt EDB completes a purchase, merger, takeover, disposal, or other similar transaction with another Non-exempt EDB during an Assessment Period, it must state, to the extent practicable, as part of its Annual Compliance Statement for that Assessment Period:
- (a) whether or not each of the Non-exempt EDBs involved in the transaction complied with the price path in clause 8 for that Assessment Period; and
 - (b) whether or not each of the Non-exempt EDBs involved in the transaction complied with the quality standards in clause 9 for that Assessment Period.
- 10.2 If a Non-exempt EDB completed a purchase, merger, takeover, disposal, or other similar transaction with an EDB in the preceding Assessment Period:
- (a) the price path for the current Assessment Period must be calculated in accordance with clause 8 as if the transaction occurred at the beginning of the current Assessment Period; and
 - (b) the Reliability Limits for the current Assessment Period must be recalculated using the process outlined in Schedule 3 as if the transaction occurred at the beginning of the Reference Period; and
 - (c) the Assessed Values for the current Assessment Period must be calculated using the process outlined in Schedule 3; and
 - (d) the annual reliability assessments as specified in clause 9.2 for the two immediately preceding extant Assessments Periods must be recalculated using the process outlined in Schedule 3 as if the transaction had occurred at the beginning of those periods.
- 10.3 If—
- (a) the Commission is satisfied that, because of a lack of information, beyond the control of the Non-exempt EDB, it is not practicable to determine whether a Non-exempt EDB involved in a purchase, merger, takeover, disposal, or other similar transaction complied with the price path and quality standards in an Assessment Period; and
 - (b) the Non-exempt EDB demonstrates to the satisfaction of the Commission, by use of an alternative approach that has the equivalent effect of clauses 8 and 9, that the substance of those clauses has been complied with—

the Non-exempt EDB will be regarded as having complied with the default price-quality path during that Assessment Period.

- 10.4 If System Fixed Assets were transferred from Transpower to a Non-exempt EDB by way of sale, gifting, lease or similar transaction, the Non-exempt EDB must, for the Assessment Period that immediately follows the Assessment Period in which the transfer was completed:
- (a) recalculate its Reliability Limits using the process outlined in Schedule 3, including the planned and unplanned interruptions by Transpower that are relevant to the System Fixed Assets transferred, as if the transfer occurred at the beginning of the Reference Period; and
 - (b) calculate its Assessed Values using the process outlined in Schedule 3, including any planned and unplanned interruptions by Transpower that are relevant to the System Fixed Assets transferred.

11 Annual Compliance Statement

- 11.1 Every Non-exempt EDB must provide to the Commission within 50 working days following each Assessment Date, an Annual Compliance Statement consisting of:
- (a) a written statement that states whether or not the Non-exempt EDB has complied with the price path in clause 8 and the quality standards in clause 9 in respect of the Assessment Period ending on that Assessment Date;
 - (b) sufficient information to support the statement required by paragraph (a), including:
 - (i) the amount of allowable notional revenue, the amount of notional revenue, Prices, Quantities, units of measurement associated with all numeric data, and other relevant data, information, and calculations;
 - (ii) the amounts of Pass-Through Costs, including both the forecast amounts when the Non-exempt EDB set Prices for the Assessment Period and the actual amounts for the Assessment Period, and any information relevant to the variance between the forecast and actual amounts;
 - (iii) if the Non-exempt EDB restructured its Prices as referred to in clause 8.6, information of the kind set out in clause 11.1(b) paragraphs (i) and (ii) that demonstrates:
 - (a) if clause 8.6(a) applies, whether or not the restructuring has of itself increased the Non-exempt EDB's allowable notional revenue above that which would have applied if the restructuring had not occurred, using both the previous and restructured Prices and Quantities; and
 - (b) if clause 8.6(b) applies, whether or not the restructuring has of itself increased the Non-exempt EDB's revenue above that which would have applied if the restructuring had not occurred, using both the previous and restructured Prices and Quantities, and reasoning why it is not practicable for the Non-exempt

- EDB to demonstrate the effects of the restructuring on allowable notional revenue; and
- (c) if clause 8.7 applies, why it is not practicable for the Non-exempt EDB to demonstrate the effects of the restructuring on allowable notional revenue or revenue;
 - (iv) Assessed Values and Reliability Limits for the Assessment Period, relevant SAIDI and SAIFI statistics and calculations (including those in Schedule 3), the annual reliability assessments for the two immediately preceding extant Assessment Periods, and other relevant data and information;
 - (v) a description of policies and procedures which the Non-exempt EDB has used for recording the SAIDI and SAIFI statistics for the Assessment Period;
 - (vi) if System Fixed Assets were transferred from Transpower to the Non-exempt EDB, SAIDI and SAIFI statistics and calculations (including those in Schedule 3) for the Assessment Period in which the transfer was completed that demonstrate whether or not the transfer increased the Non-exempt EDB's Assessed Values;
 - (vii) if a Non-exempt EDB used an alternative approach to demonstrate compliance as referred to in clause 10.3, an explanation as to why that alternative approach was needed;
 - (viii) the date on which the statement was prepared; and
- (c) a certificate in the form set out in Schedule 5, signed by at least one Director of the Non-exempt EDB.
- 11.2 An Annual Compliance Statement referred to in clause 11.1 must be accompanied by a report on the Annual Compliance Statement that is signed by an Auditor and is in the form set out in Schedule 4.
- 11.3 An Auditor's report given for the purposes of clause 11.2:
- (a) may be qualified only if the Auditor considers that the Annual Compliance Statement concerned has not been prepared, in all material respects, in accordance with this determination, and the report explains with full reasons the respects in which the statement so fails; and
 - (b) where this determination requires the Commission to be satisfied in relation to a matter, need not express a view in relation to the Commission's satisfaction.

Dated at Wellington this 30th day of November 2009.
COMMERCE COMMISSION

SCHEDULE 1

Clause 8

STARTING PRICES

The starting Prices that apply during the Regulatory Period are the Prices that applied as at 31 March 2010.

SCHEDULE 2

Clause 8

RATE OF CHANGE

The annual rate of change in Prices (i.e., X) is 0%.

SCHEDULE 3*Clause 9***RELIABILITY LIMITS AND ASSESSED VALUES**

This schedule sets out the process for calculating a Non-exempt EDB's Reliability Limits and Assessed Values for the purposes of assessing compliance with the quality standards as set out in clause 9.

Reliability Limits

In order for a Non-exempt EDB to calculate its Reliability Limits, the Non-exempt EDB must undertake the steps set out below:

Develop a non-zero dataset

Construct a non-zero dataset containing only those days from the Reference Dataset where the daily SAIDI Value is greater than zero (i.e., exclude zero SAIDI days).

Calculate boundary values

Using the non-zero dataset, calculate the SAIDI boundary value (B_{SAIDI}) as follows:

$$B_{SAIDI} = e^{(\alpha_{SAIDI} + 2.5\beta_{SAIDI})}$$

where:

α_{SAIDI} is the average of the natural logarithm (\ln) of each daily SAIDI Value in the non-zero dataset;

β_{SAIDI} is the standard deviation of the natural logarithm (\ln) of each daily SAIDI Value in the non-zero dataset.

Using the non-zero dataset, calculate the SAIFI boundary value (B_{SAIFI}) as follows:

$$B_{SAIFI} = e^{(\alpha_{SAIFI} + 2.5\beta_{SAIFI})}$$

where:

α_{SAIFI} is the average of the natural logarithm (\ln) of each daily SAIFI Value in the non-zero dataset;

β_{SAIFI} is the standard deviation of the natural logarithm (\ln) of each daily SAIFI Value in the non-zero dataset.

Normalise the Reference Dataset

For any day in the Reference Dataset where the daily SAIDI Value is greater than B_{SAIDI} :

- (i) replace the daily SAIDI Value with B_{SAIDI} ; and
- (ii) replace the daily SAIFI Value with B_{SAIFI} if the daily SAIFI Value for that day exceeds B_{SAIFI} .

Calculate Reliability Limits

The SAIDI Reliability Limit ($SAIDI_{LIMIT}$) is as follows:

$$SAIDI_{LIMIT} = \mu_{SAIDI} + \sigma_{SAIDI}$$

where:

μ_{SAIDI} is the average annual SAIDI Value in the Normalised Reference Dataset, which is given by:

$$\frac{\text{Sum of daily SAIDI Values in the Normalised Reference Dataset}}{5}$$

σ_{SAIDI} is the standard deviation of daily SAIDI Values in the Normalised Reference Dataset multiplied by $\sqrt{365}$.

The SAIFI Reliability Limit ($SAIFI_{LIMIT}$) is as follows:

$$SAIFI_{LIMIT} = \mu_{SAIFI} + \sigma_{SAIFI}$$

where:

μ_{SAIFI} is the average annual SAIFI Value in the Normalised Reference Dataset, which is given by:

$$\frac{\text{Sum of daily SAIFI Values in the Normalised Reference Dataset}}{5}$$

σ_{SAIFI} is the standard deviation of daily SAIFI Values in the Normalised Reference Dataset multiplied by $\sqrt{365}$.

Assessed Values

In order to calculate its Assessed Values, a Non-exempt EDB must undertake the steps set out below.

Normalise the Assessment Dataset

For any day in the Assessment Dataset for Assessment Period t where the daily SAIDI Value is greater than B_{SAIDI} :

- (i) replace the daily SAIDI Value with B_{SAIDI} ; and
- (ii) replace the daily SAIFI Value with B_{SAIFI} if the daily SAIFI value for that day exceeds B_{SAIFI} .

Calculate Assessed Values

- (a) The SAIDI Assessed Value ($SAIDI_{ASSESS,t}$) is the sum of daily SAIDI Values in the Normalised Assessment Dataset for the Assessment Period t ; and
- (b) The SAIFI Assessed Value ($SAIFI_{ASSESS,t}$) is the sum of daily SAIFI Values in the Normalised Assessment Dataset for the Assessment Period t .

SCHEDULE 4

Clause 11

FORM OF AUDITOR'S REPORT ON ANNUAL COMPLIANCE STATEMENT

To the readers of the Annual Compliance Statement of [*insert name of Non-exempt EDB*] for the Assessment Period ended on [*insert Assessment Date*]:

I/We have audited the attached statement, which is an Annual Compliance Statement in respect of the default price-quality path prepared by [*insert name of Non-exempt EDB*] for the period [*insert Assessment Period*] and dated [*insert date*] for the purposes of clause 11 of the *Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010* (“the Determination”).

In relation to the price path set out in clause 8 of the Determination, my/our audit included examination, on a test basis, of evidence relevant to the amounts and disclosures contained on pages [*insert page references*] of the Annual Compliance Statement.

In relation to the SAIDI and SAIFI statistics for the Reference Period and the Assessment Period ended on [*insert Assessment Date*], including the calculation of the Reliability Limits and the Assessed Values, which are relevant to the quality standards set out in clause 9 of the Determination, my/our audit included examination, on a test basis, of evidence relevant to the amounts and disclosures contained on pages [*insert page references*] of the Annual Compliance Statement.

My/Our audit also included assessment of the significant estimates and judgments, if any, made by [*insert name of Non-exempt EDB*] in the preparation of the Annual Compliance Statement and assessment of whether the basis of preparation has been adequately disclosed.

Directors' Responsibilities

The Directors of [*insert name of Non-exempt EDB*] are responsible for the preparation of the Annual Compliance Statement in accordance with the Determination and for such internal control as the Directors determine is necessary to enable the preparation of an Annual Compliance Statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities

My/Our responsibility is to express an opinion on the Annual Compliance Statement based on my/our audit. I/We conducted my/our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that I/we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Annual Compliance Statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Annual Compliance Statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Annual Compliance Statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the Annual Compliance Statement in order to design audit procedures that are appropriate in the

circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the Annual Compliance Statement.

I/We believe that the audit evidence I/we have obtained is sufficient and appropriate to provide a basis for my/our audit opinion.

I/we have no relationship with, or interests in *[insert name of Non-exempt EDB]* other than *[insert relationship and/or interests including a statement verifying that no conflict of interest exists]*.

Opinion

In my/our opinion, the Annual Compliance Statement of *[insert name of Non-exempt EDB]* for the Assessment Period ended on *[insert Assessment Date]*, has been prepared, in all material respects, in accordance with the Determination.

***[Qualification on Opinion]**

*[My/Our opinion is qualified as follows:]

**[Insert the nature of and reason(s) for the qualification together with the impact on the Annual Compliance Statement]*.

My/Our audit was completed on *[insert date]* and my/our opinion is expressed as at that date.

[Signature of Auditor]

[Name of auditing firm]

[Address of auditing firm]

[Date]

*Delete if inapplicable.

Note: Section 103(2) of the Commerce Act 1986 provides that no person shall attempt to deceive or knowingly mislead the Commission in relation to any matter before it. It is an offence to contravene section 103(2) and any person who does so is liable on summary conviction to a fine not exceeding \$10,000 in the case of an individual or \$30,000 in the case of a body corporate.

SCHEDULE 5*Clause 11***FORM OF DIRECTORS' CERTIFICATE ON ANNUAL COMPLIANCE STATEMENT**

I/We, [*insert full name/s*], being director/s of [*insert name of Non-exempt EDB*] certify that, having made all reasonable enquiry, to the best of my/our knowledge and belief, the attached Annual Compliance Statement of [*name of Non-exempt EDB*], and related information, prepared for the purposes of the *Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010* are true and accurate **[except in the following respects]*.

**[insert description of non-compliance]*

[Signatures of Directors]

[Date]

*Delete if inapplicable.

Note: Section 103(2) of the Commerce Act 1986 provides that no person shall attempt to deceive or knowingly mislead the Commission in relation to any matter before it. It is an offence to contravene section 103(2) and any person who does so is liable on summary conviction to a fine not exceeding \$10,000 in the case of an individual or \$30,000 in the case of a body corporate.

EXPLANATORY NOTE

The purpose of the *Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010* (“the Determination”) is to set a default price-quality path for non-exempt EDBs for the 5 years beginning 1 April 2010, pursuant to Part 4 of the Commerce Act 1986 (“the Act”).

Pursuant to section 53N of the Act, each non-exempt EDB is required to provide to the Commission an annual compliance statement stating whether or not it has complied with the default price-quality path set in this determination together with supporting evidence. The annual compliance statement is to be accompanied by both an auditor’s report and a directors’ certificate. Each non-exempt EDB should publish its annual compliance statement on its website as soon as practicable.

The Commission is permitted under section 54K(2) of the Act to make this determination prior to the determination of applicable input methodologies. The Commission intends to amend this determination (including the provisions relating to starting prices) following the publication of input methodology determinations.

Once applicable input methodologies have been determined, the Commission will also amend this determination to state the annual period during which any proposal for a customised price-quality path must be received (given that the requirements and criteria for such proposals will be set in input methodology determinations under section 52T(1)(d) of the Act).

The allowable notional revenue for the first assessment period (i.e., the period from 1 April 2010 to 31 March 2011) has been set out in clause 8.5. This clause has been included to remove potential misunderstanding of the use of starting prices in the price path and demonstrates that 31 March 2010 prices may be inflated by the CPI-X term.

The Commission has conducted a comprehensive process of consultation before making this determination. A decisions paper providing detailed background to, and analysis of, this determination, has been issued together with this determination, and can be found at:

<http://www.comcom.govt.nz/IndustryRegulation>

Copies of this determination are available for inspection free of charge at the Commission (during ordinary office hours), on the Commission’s website at the above link, or for purchase at a reasonable price at the Commission.