

2010-2015 ELECTRICITY DISTRIBUTION DEFAULT PRICE-QUALITY PATH REVENUE DIFFERENTIAL TERM AMENDMENT

REASONS PAPER

November 2010



COMMERCE COMMISSION

Regulation Branch
Commerce Commission
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Introduction

- 1.1 This paper provides reasons for the decision of the Commerce Commission (**Commission**) to amend *Decision 685 – Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 (Initial Reset Determination)* published on 30 November 2009. The *Initial Reset Determination* is made pursuant to Part 4 of the Commerce Act 1986 (**the Act**) and comprises both the default price-quality path (**DPP**) for non-exempt electricity distribution businesses (**non-exempt EDBs**) and compliance assessment provisions for the DPP.¹
- 1.2 The amendment modifies the compliance assessment formulae in clause 8.4 of the *Initial Reset Determination* by including a new term (**revenue differential term**) to ensure that the compliance assessment of the price path is set independent of regulated suppliers' pricing behaviour within the regulatory period. The amendment is made under s 52Q of the Act and given effect by way of *Decision 704 – Commerce Act (Electricity Distribution Default Price-Quality Path) Amendment Determination 2010*.² A copy of the amendment determination is provided as Appendix A to this paper and will be published in the *New Zealand Gazette*.
- 1.3 This paper follows consultation on the *2010 – 2015 DPP Refinements Discussion and Draft Decisions Paper (Refinements Paper)* published 13 August 2010. In making this amendment, the Commission has considered submissions it has received from interested parties. A consolidated version of the *Initial Reset Determination*, the *Refinements Paper*, submissions, and other relevant material are available on the Commission's website.³

Reasons

- 1.4 As set out in the *Refinements Paper*, the Commission's primary reason for the revenue differential term is to ensure that the annual compliance assessment of each non-exempt EDB's price path is not dependent on the prices charged by that non-exempt EDB previously within the regulatory period. The original specification of the compliance assessment formulae meant that a non-exempt EDB's allowable notional revenue for each forthcoming assessment period was derived from the actual prices charged by the non-exempt EDB in the previous assessment period.
- 1.5 The inclusion of the revenue differential term removes the link between a non-exempt EDB's previous pricing behaviour within the regulatory period and its allowable notional revenue used for assessing compliance against the price path. The revenue

¹ Relevant provisions under Part 4 of the Act include s 52P, which pertains to making determinations; and s 53N, which pertains to the Commission's powers for monitoring compliance with price-quality paths.

² The Commission notes that some submitters do not support the use of s 52Q of the Act for making this amendment. For example, the Electricity Networks Association, *Submission on Default Price-Quality Path Refinements*, 27 September 2010, p. 6; and Aurora, *Submission on the Commerce Commission's Discussion and Draft Decisions for DPP Refinements*, 27 September 2010, p. 8. The Commission considers s 52Q to be appropriate for making an amendment for the revenue differential term. Section 52Q provides that the Commission may make an amendment to a s 52P determination. The *Initial Reset Determination* was made under s 52P of the Act.

³ www.comcom.govt.nz/2010-2015-default-price-quality-path/.

differential term itself is the difference between a non-exempt EDB's allowable notional revenue and notional revenue from the previous assessment period. Where a difference exists, this is factored into the non-exempt EDB's allowable notional revenue for the forthcoming assessment period.

1.6 The Commission considers that the inclusion of the revenue differential term will have the following benefits:

- providing non-exempt EDBs with the opportunity to offer lower prices to consumers without this resulting in a reduction in allowable notional revenue for those non-exempt EDBs in future assessment periods;
- allowing non-exempt EDBs to set prices as they see fit within the limits of their price path without effectively requiring those non-exempt EDBs to maintain short-term pricing decisions over the longer-term; and
- removing the need for ad hoc adjustments by the Commission to the allowable notional revenues of non-exempt EDBs that have exceeded the limits of their price path. The Commission would otherwise have to make adjustments to ensure that non-exempt EDBs do not benefit from increased allowable notional revenues over the remainder of the regulatory period.⁴

1.7 The *Refinements Paper* also set out a number of practical considerations for the revenue differential term including its application across regulatory periods. The Commission will consider how the revenue differential term will apply across the next regulatory period when undertaking the next reset.

1.8 In light of the above reasoning and support from submissions, the Commission's decision is to make an amendment to the *Initial Reset Determination* to modify the compliance assessment formulae to include the revenue differential term.⁵

Decision

1.9 The Commission's decision is that the compliance assessment formulae specified in clause 8.4 of the *Initial Reset Determination* be modified to include the revenue differential term.

1.10 The revenue differential term is represented by $(R_{t-1} - NR_{t-1})$ where:

R_{t-1} is the allowable notional revenue during the Assessment Period $t-1$; and

NR_{t-1} is the notional revenue during the Assessment Period $t-1$.

1.11 Attached at Appendix A is *Decision 704 – Commerce Act (Electricity Distribution Default Price-Quality Path) Amendment Determination 2010* which sets out the new clause 8.4 that is to be substituted into the *Initial Reset Determination*.

⁴ The Commission will provide further detail of its processes in the event of a breach of the price path in forthcoming consultation on its enforcement guidelines.

⁵ For example, the Electricity Networks Association, *Submission on Default Price-Quality Path Refinements*, 27 September 2010, p. 8; and Vector Limited, *Submission on DPP Refinements Consultation*, 27 September 2010, p. 2.

APPENDIX A: DECISION 704 – COMMERCE ACT (ELECTRICITY DISTRIBUTION DEFAULT PRICE-QUALITY PATH) AMENDMENT DETERMINATION 2010



COMMERCE COMMISSION

Decision No. 704

Amendment to Decision 685 – Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 pursuant to Part 4 of the Commerce Act 1986 (the Act).

The Commission:

- Dr M Berry**
- S Begg**
- PJM Taylor**
- P Duignan**
- S Gale**

Summary of the Amendment Determination: The attached amendment determination amends clause 8.4 of Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 under section 52Q of the Act to include a revenue differential term. The amendment determination takes effect on and from 1 April 2011 and applies for the period 1 April 2011 to 31 March 2015.

Date of Decision: 30 November 2010

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

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

1 Title

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

2 Commencement date

This amendment determination comes into force on 1 April 2011.

3 Amendment to price path compliance assessment formulae

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:

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

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 30th day of November 2010.
COMMERCE COMMISSION.

EXPLANATORY NOTE

On 30 November 2009, the Commission reset the default price-quality path for electricity distribution businesses as required by section 54K(1) of the Commerce Act 1986 (the “Act”) by publishing Decision 685 – Commerce Act (Electricity Distribution Default Price-Quality Path) Determination 2010 (the “Initial Reset Determination”).

The Initial Reset Determination sets out the default price-quality path that applies from 1 April 2010 to 31 March 2015 to all electricity distribution businesses except those that are “consumer-owned” as defined in section 54D of the Act. Electricity distribution businesses meeting the requirements of section 54D are exempt from default/customised price-quality regulation under section 54G(2) of the Act.

The Commerce Act (Electricity Distribution Default Price-Quality Path) Amendment Determination 2010 amends clause 8.4 of the Initial Reset Determination to specify a revenue differential term within the compliance assessment formulae. Further information, including a consolidated version of the Initial Reset Determination; the Commission’s reasons for the revenue differential term; and submissions received during consultation can be found on the Commission’s website at: www.comcom.govt.nz/2010-2015-default-price-quality-path/.