

APPENDIX B: PRICE RESTRUCTURING

Formula 7 in the *Draft Decisions Paper* sets out the proposed price path assessment formula. This is accurately reflected in clause 8.3 of the *Draft Determination*.

However, clause 8.5, concerning the restructuring of prices, does not reflect the Commission's Draft Decisions.

The *Draft Determination* states:¹

8.5 Restructuring of Prices

(a) If a Non-exempt EDB restructures its Prices applying during an Assessment Period, it must demonstrate to the Commission, with supporting evidence, the impact of the restructuring on its Allowable Notional Revenue.

(b) To satisfy clause 8.3 the restructuring, of itself, should not increase the Non-exempt EDB's Allowable Notional Revenue. If this is the case clause 8.3 will apply as if the new Price structure applied on and from the beginning of the Assessment Period.

The clause as drafted refers to Allowable Notional Revenue. Allowable Revenue is revenue from the previous period, net of pass-through costs, and inflated by the rate of change. Allowable Notional Revenue thus requires prices, quantities and pass-through costs from the previous period.

To demonstrate that the price restructure does not increase Allowable Notional Revenue would require that both the existing prices and the proposed new price structure are available for the previous period. It is unclear how one can have prices from the previous period when this is the first time that the prices are being introduced.

One possible interpretation of clause 8.5 as drafted is that:

- The proposed prices are used as the prior-period prices in the calculation of Allowable Notional Revenue;
- Actual previous period quantities and pass-through costs are used in the calculation of Allowable Notional Revenue;
- Allowable Notional Revenue must not increase as a result of the new prices (i.e. Allowable Notional Revenue must be the same using the actual prices that applied under the old pricing structure and the new prices that will apply under the new pricing structure).

However, this interpretation means that the EDB is effectively unable to utilise price indexation of the notional revenue path in the year that a price restructure occurs, and it also introduces the risk of a technical breach if pass-through costs increase by less than the rate of change.

The relevant decision from the *Draft Decisions Paper* is that Notional Revenue at each Assessment Date is not to exceed the Allowable Notional Revenue at that Assessment Date. The Allowable Notional Revenue is based on previous period prices and quantities and, therefore, is completely invariant to any change in price structure. It is Notional Revenue that will potentially change as a result of a change in pricing structure. Therefore the important condition is that Notional Revenue under the new price structure does not exceed the Allowable Notional Revenue.

The Commission's Draft Decisions would best be given effect by amending Clause 8.5 to read:

If a Non-Exempt EDB restructures its Prices during an Assessment Period, clause 8.3 will apply as if the new Price structure applied on and from the beginning of the Assessment Period.

The effect of this would then be:

- Price restructuring does not affect the Allowable Notional Revenue, which remains revenue from the previous period net of pass-through costs and indexed at the rate of change;
- Notional Revenue must continue to be no greater than the Allowable Notional Revenue.

The one area of difficulty that may arise with price restructuring is where an EDB does not have accurate information on previous period quantities. An example is where a new tariff is being introduced to accommodate the roll-out of smart meters to residential households. Such a tariff is likely to include a time-of-use (TOU) element. In the first year that the tariff and meters are introduced there will be no prior period quantities. In theory, this could allow the EDB to set those tariffs on an unconstrained basis, as the term $P_t Q_{t-1}$ in the notional revenue path will always equal zero if $Q_{t-1} = 0$. The same could also apply if the EDB introduces a new industrial tariff class and changes some customers across to that class.

A reasonable approach to adopt when previous period quantities are not available under a new pricing structure is for the EDB to demonstrate that the new pricing structure does not result in an expected increase in revenue. Under the thresholds regime this approach was expressly allowed under Clause 5(2) of the Commerce Act (Electricity Distribution Thresholds) Notice 2004. Unison relied on this provision when it restructured its pricing pursuant to the Administrative Settlement with the Commerce Commission.

Therefore, we suggest that the following be added to Clause 8.5:

Where it is not reasonable practicable to calculate Notional Revenue due to the absence of information, the Non-Exempt EDB must state the reasons for the same and satisfy the Commission that it is not reasonably practicable and demonstrate that the restructuring does not, of itself, create an increase in revenue for the Non-Exempt EDB.

The wording proposed above is consistent with paragraph B18 in the *Draft Decisions Paper* (p. 136), and is consistent with the clause 5(2) of the Commerce Act (Electricity Distribution Thresholds) Notice 2004.

The complete wording of Clause 8.5 would be:

If a Non-Exempt EDB restructures its Prices during an Assessment Period:

- (e) *Clause 8.3 will apply as if the new Price structure applied on and from the beginning of the Assessment Period; and*
- (b) *Where it is not reasonable practicable to calculate Notional Revenue due to the absence of information, the Non-Exempt EDB must state the reasons for the same and satisfy the Commission that it is not reasonably practicable and demonstrate that the restructuring does not, of itself, create an increase in revenue for the Non-Exempt EDB.*