COMMERCE COMMISSION

Regulation of Electricity Lines Businesses

Targeted Control Regime

Reasons for Not Declaring Control of

The Power Company Limited

31 March 2009

COMMERCE COMMISSION

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PURPOSE AND SCOPE

1 This paper sets out the detailed reasons of the Commerce Commission (the Commission) for its decision not to declare control in respect of The Power Company Limited's (The Power Company) distribution services. The Power Company supplies electricity distribution services to most of Southland.

2 The Commission has closed its post breach inquiry into The Power Company's 2007/ 008 breaches of the price path and quality thresholds and can therefore publish its reasons for not making a control declaration in accordance with s57H(d)(ii) of the Commerce Act 1986 (Act).

STATUTORY FRAMEWORK AND PROCESS

Targeted control regime

3 Part 4A of the Act came into effect on 8 August 2001 and, amongst other things, requires the Commission to implement a targeted control regime for the regulation of large electricity lines businesses – at that time, the 28 electricity distribution businesses (EDB), and the state-owned transmission company Transpower New Zealand Limited.[1]

4 The targeted control regime for lines businesses is outlined in subpart 1 of Part 4A of the Act.

5 The targeted control regime comprises a number of distinct elements as follows:

- *setting thresholds*, in which the Commission must set and publish thresholds for lines business performance, following consultation as to possible thresholds with participants in the electricity distribution and transmission markets and with consumers;
- *assessment and identification*, in which the Commission must assess lines businesses against the thresholds it has set, and must identify any lines businesses that breach these thresholds;
- *post-breach inquiry*, in which the Commission must determine whether to declare all or any of the goods or services supplied by all or any of the identified lines businesses to be controlled; and
- *control*, in which the Commission applies the regime under Part 5 of the Act for authorising the prices, revenues and/or quality of the controlled goods or services supplied by a lines business for which a declaration of control has been made by the Commission.

6 Control is targeted, in the sense that it is not universal, by virtue of the processes set out in subpart 1 of Part 4A. None of the lines businesses is to be automatically subject to

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1 On 24 July 2008, Vector sold its Wellington network to Hong Kong Electric Holdings and Cheung Kong Infrastructure Holding Limited. Wellington Electricity Lines Limited is the 29th EDB in the New Zealand electricity sector.

control of prices, revenues or service quality. A business may be controlled by the Commission only if it has breached a threshold and after the Commission has followed the process outlined in s 57I of the Act.

7 Under subpart 1 of Part 4A (subsections 57D to 57N of the Act), the Commission must set thresholds for the declaration of control of services provided by lines businesses. Under section 57H the Commission must assess lines businesses against the thresholds it has set, identify any lines business that breaches the thresholds, and determine whether to declare control in relation to the services supplied by an identified lines business, taking into account the purpose statement.

8 After consulting with interested parties on possible thresholds, as is required under s 57G of the Act, the Commission set two thresholds on 6 June 2003. The Commission set a price path threshold and a quality threshold applicable until 31 March 2004 for all EDBs. These initial thresholds were set by the Commerce Act (Electricity Lines Thresholds) Notice 2003 (2003 Notice).

9 The Commission reset the thresholds for all EDBs for a five-year regulatory period from 1 April 2004. The thresholds were set by the Commerce Act (Electricity Distribution Thresholds) Notice 2004 (2004 Notice).[2]

10 The Act has been amended by the Commerce Amendment Act 2008, which received Royal assent on 16 September 2008. The provisions repealing Part 4A come into force on 1 April 2009[3], however, Part 4A may continue to be applied in connection with the breach of thresholds set under Part 4A before its repeal, including when those thresholds apply as default price-quality paths[4].

11 Section 54J(2)(a) of the Act (as amended) provides that on and after 1 April 2009, the thresholds for large electricity lines business that expire on 31 March 2009 are deemed to be section 52P determinations that apply those thresholds to each supplier as if the thresholds were default price-quality paths. A breach of a default price-quality path before the close of 31 March 2010, must be dealt with in accordance with section 54N[5]. For such a breach, and for breaches occurring on or after 1 April 2007 until 31 March 2009, the Commission may publish a notice of intention to declare control under the existing Part 4A at any time before the expiry of 12 months after the end of the financial year in which the breach occurs.

12 The Commission had until 1 October 2008 to have published a notice of intention to declare control under Part 4A in respect to any breach of a threshold that occurred before the close of 31 March 2007. This includes The Power Company's 2003, 2003/04, 2005/06 or 2006/07 threshold breaches.

13 For any breach of a threshold that occurred on or after 1 April 2007, and before the close of 31 March 2009, the Commission has 12 months after the end of the financial year in which the breach occurred to publish an intention to declare control under Part 4A (such as The Power Company's breach of the 2007/08 price threshold).

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2 Thresholds for Transpower are set by the Commission by separate Gazette Notices.

3 Section 2(1)(a) of the Commerce Amendment Act.

4 Section 5(2) of the Act.

5 Section 54J of the Commerce Amendment Act.

14 At any time before the expiry of 12 months after the date on which the Commission publishes such a notice of intention to declare control, the Commission may make a control declaration under Part 4A or enter into an administrative settlement in respect of the breach under Part 4A[6]. During this transition, the purpose in section 52A must be taken to be the purpose of Part 4A[7]. In making its decision in relation to The Power Company's 2007/08 threshold breaches, the Commission has considered the purpose statement in section 52A of the Act. This section provides that the purpose of Part 4 is:

> to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services:
>
> (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets;
>
> (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands;
>
> (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
>
> (d) are limited in their ability to extract excessive profits.

15 In other words, the primary regulatory purpose is to promote the long-term benefit of consumers. This must be achieved, in a general sense, by promoting the outcomes that are produced in competitive markets. These outcomes are, in turn, to be achieved by:

(a) incentivising innovation and investment;

(b) incentivising improved efficiency and service quality;

(c) encouraging regulated businesses to share the benefits of efficiency gains with consumers, including through lower prices; and

(d) limiting the ability of regulated businesses to make excessive profits.

16 This paper, therefore, sets out the Commission's reasons for its decision not to declare control of The Power Company in respect of its 2007/08 threshold breaches.

Setting thresholds

Price path threshold

17 The price path threshold is of the form CPI-X, where CPI is the consumer price index and the X factor represents the expected annual reduction in lines business average prices (i.e. line charges) in real terms, net of certain allowable pass-through costs, most notably transmission charges (in the case of distribution businesses).

18 Setting a CPI-X price path recognises that distribution businesses face inflationary and other increasing cost pressures, but also places incentives on businesses to improve their efficiencies in real terms by X percentage each year. The price path threshold is not an instrument of control, but a screening mechanism. Nevertheless, the intention of the price

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6 See section 54N(2) of the Commerce Amendment Act.

7 See section 54N(4) of the Commerce Amendment Act .

path threshold is to provide incentives consistent with the underlying statutory objectives. In the case of the thresholds, these objectives are set out in the purpose statement.

19 The price path threshold provides incentives for distribution businesses to improve efficiency while limiting their ability to extract excessive profits. Although the price path threshold is not intended to share all the benefits of efficiency gains with consumers in the short term, consumers will benefit in the long term from prices lower than they otherwise would be, and from an appropriate level of service quality.

Quality threshold

20 The quality threshold has two sets of criteria:

- reliability criteria - no material deterioration in reliability, measured in terms of SAIDI and SAIFI[8], by comparing the current year's reliability performance against average SAIDI and SAIFI from 1999 to 2003; and
- consumer engagement (or customer communication) criteria, requiring meaningful engagement with consumers to determine their demand for service quality, assessed through qualitative review.

21 The Commission has indicated that lines businesses that have breached the reliability criteria of the quality threshold may offer some explanation or background information, explaining, for example, that the breach was attributable to:

- a rare but high impact event (an 'extreme event'), such as a severe storm;
- normal variation in the reliability performance measure; or
- increased frequency and/or duration of planned outages associated with major development or refurbishment of the network.

Initial thresholds

22 The thresholds were initially set by a notice in the Gazette to apply to distribution businesses from 6 June 2003 until 31 March 2004, and were explained in an accompanying decisions paper[9]. All distribution businesses were assessed against the initial price path threshold as at 6 September 2003 (first assessment date), and against both the price path and quality thresholds as at 31 March 2004 (second assessment date).

23 The assessment criteria set in relation to the initial price path threshold were set to be generally consistent with a CPI-X price path, in which distribution prices at the end of each assessment period were not to be greater, in nominal terms, than the distribution prices at the start of that period. Hence, the initial X factor was equivalent to the CPI.

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8 SAIDI is the system average interruption duration index, which measures the annual average length of time for a power outage, measured in minutes of lost electricity supply per consumer. SAIFI is the system average interruption frequency index, which measures the average number of power outages experienced by a consumer each year.

9 Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, *Thresholds Decision*, June 2003.

Reset thresholds

24 After further consultation with interested parties, the Commission reset the thresholds for distribution businesses from 1 April 2004 for a five-year regulatory period. The reset thresholds (Revised Thresholds) are of the same form as the thresholds set by the Commission on 6 June 2003[10]. For the price path threshold, however, new X factors applied, with businesses assigned to four groups (X = -1%, 0%, 1%, or 2%), based on their relative efficiency and relative profitability.

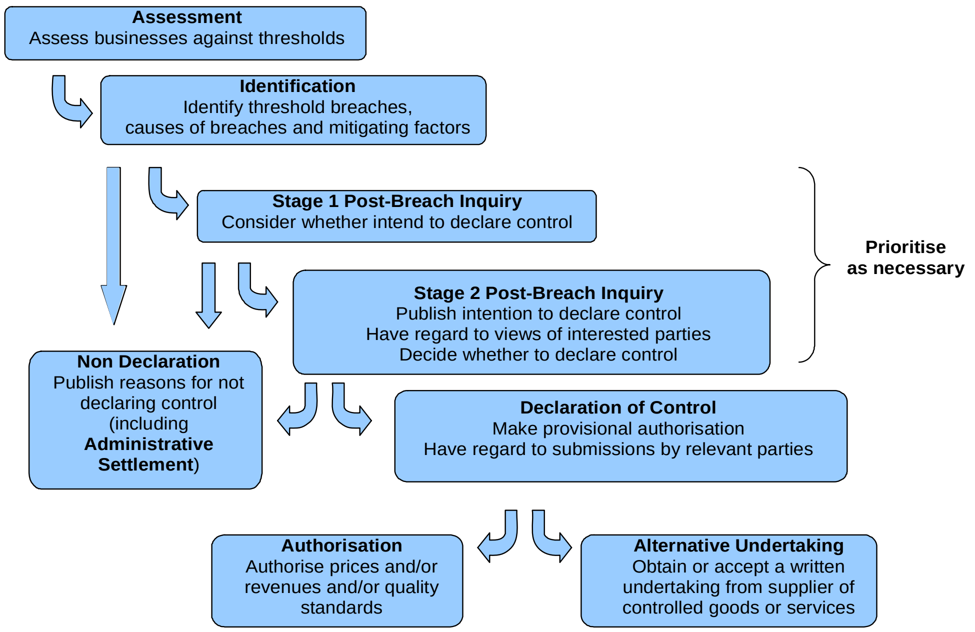
25 The Power Company was assigned an X factor of 0, which has allowed it to increase its prices by the rate of increase in CPI each year over the five-year regulatory period without breaching its price threshold.

26 All distribution businesses are required to submit threshold compliance statements reporting their self-assessments against both the reset price path threshold and the quality threshold annually.

Assessment and inquiry guidelines

27 In October 2004, the Commission published its assessment and inquiry guidelines[11], which outline the broad process and analytical framework that the Commission intends to use in deciding whether to impose control on a lines business that has breached the thresholds. These guidelines describe the statutory framework and outline both the statutory and discretionary process steps the Commission proposes following in the assessment, identification and post-breach inquiry elements of the targeted control regime. Figure 1 illustrates the process in which the various statutory and discretionary process steps are grouped and labelled.

Figure 1: Targeted Control Process Steps



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[10] Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, *Thresholds Decision*, June 2003.

[11] Commerce Commission, Regulation of Electricity Lines Businesses, *Targeted Control Regime, Assessment and Inquiry Guidelines*, October 2004.

Assessment and identification

28 Before determining whether to declare control in relation to any lines business, ss 57H(a) and 57H(b) of the Act require that the Commission must:

- assess large electricity lines businesses against the thresholds set under subpart 1 of Part 4A; and
- identify any large electricity lines business that breaches the thresholds.

29 Consequently, each lines business is annually required to provide the Commission with a threshold compliance statement in accordance with the notice in the *Gazette,* which specifies the threshold assessment criteria. Each compliance statement must provide a self-assessment, with sufficient supporting evidence, of whether or not the lines business complies with the thresholds that the Commission has set.

30 Where the Commission has identified a breach, it may request further information from the lines business concerned to identify the cause of the breach, as well as any mitigating factors pertaining to the breach. This additional information may be sufficient for the Commission to determine that taking further action would not be necessary for the long-term interests of consumers. Alternatively, in its assessment the Commission might find information that the business' current performance is not consistent with the purpose statement in 52A of the Act, in particular, the outcomes sought under (a) to (d) are not being achieved in a material aspect.

Post-breach inquiries

31 Under section 57H(c) of the Act, the Commission must determine whether or not to declare all or any of the goods or services supplied by all or any of the identified lines businesses to be controlled, taking into account the purpose of subpart 1 of Part 4A. The Commission terms this decision-making process a post-breach inquiry.

32 In addition, section 57I(1) states that, before making any declaration of control under section 57F, the Commission must:

- publish its intention to make a declaration and invite interested persons to give their views on the matter;
- give a reasonable opportunity to interested persons to give these views; and
- have regard to these views.

33 The Commission has therefore considered it convenient to divide post-breach inquiries into two stages:

- Stage 1 comprises investigations and analysis prior to the Commission forming an intention to declare control; and
- Stage 2 comprises further investigations and analysis subsequent to the Commission publishing its intention to declare control (during which the Commission must invite and consider the views of interested persons).

Administrative settlements

34 It is possible for a breach to be resolved by an 'administrative settlement' between the Commission and the business concerned. Because a settlement involves the business voluntarily reaching an agreement with the Commission on an appropriate course of action, a better outcome may be achievable than would be the case through control.

35 To date, the Commission has conducted, completed, and closed post-breach inquiries into breaches by Transpower, Unison Networks, Vector Networks and Buller. Three of these companies have agreed administrative settlements with the Commission. As part of their settlements, Vector and Unison volunteered to remain within the existing price-path and quality thresholds. Transpower's administrative settlement established revised thresholds, and the inquiry into the Buller's performance was closed with no further action taken.

36 Administrative settlements can be agreed during either a Stage 1 or Stage 2 post-breach inquiry process, but, in the case of the latter, the Commission has indicated in its guidelines that it may be inclined to do so only after formally considering the views of interested parties. It should be noted that the Commission would continue with its inquiry to determine whether or not to declare control alongside any negotiations in respect of a proposed administrative settlement.

37 If the Commission and a lines business agree an administrative settlement, the Commission will cease its inquiry and publish its reasons for not making a control declaration. These reasons would refer to the terms and conditions of the administrative settlement.

THE POWER COMPANY

Overview

38 The core business of The Power Company is the ownership and management of assets (through PowerNet Limited) for the provision of electricity distribution services to most of Southland. The parent company, The Power Company, is wholly owned by the Southland Electric Power Supply Consumer Trust. This trust was established on 1 January 1998, following divestment of The Power Company from the government after over 60 years of Crown ownership.

39 This trust holds shares in the company on behalf of its beneficiaries – current and future electricity users in the Southland region. It is therefore able to influence the company's pricing, expenditure and investment decisions, in the interests of its beneficiaries. All profits generated through the business' operations ultimately accrue to consumers through either reinvestment in the network or distribution of discounts or dividends.

40 The Power Company group consists of The Power Company and its subsidiaries, associates and joint ventures. Through its subsidiary Last Tango Limited, The Power Company holds the following:

- 50% share in PowerNet Limited (a network asset management company, which manages both The Power Company's and OtagoNet Joint Venture's network assets);
- 50% share in Electricity Southland Limited;
- 24.5% share in OtagoNet Joint Venture; and
- 24.5% share in Otago Power Services Limited (a contracting company, which supplies lines maintenance and contracting services to OtagoNet Joint Venture and others) and 50% share in Power Services Limited.

41 Of the 29 lines businesses, The Power Company is the fifth largest in terms of system length, but has the second lowest customer density per kilometre of lines.

42 In 2008, The Power Company delivered approximately 700 GWh of electricity to 32,500 customers via 8,500 kilometres of lines. At 31 March 2007, The Power Company's system assets were valued (ODV) at $210 million.

Threshold Compliance

43 The Power Company has reported having breached its price path thresholds at three of the four assessment dates, against the Revised Thresholds, as detailed in Table 1.

Table 1: Threshold price breaches for the period 2003 to 2008

Assessment date	Price path threshold breach (notional revenue)	Percentage Breach %
31 March 2005	No breach	-
31 March 2006	$2,652,338	13.8%
31 March 2007	$4,034,878	20.4%
31 March 2008	$5,593,318	27.6%

44 In accordance with clause 5(1)(b) of the 2004 Notice, 'the notional revenue of a distribution business at any time during an assessment period is not to exceed the greater of the notional revenue of the distribution business at the assessment date on which that assessment period ends and the notional revenue of the distribution business at the previous assessment date under this clause'[12].

45 The Power Company atributed the breaches at the 2006, 2007 and 2008 assessment dates to a five year commitment to increase prices in excess of the price path threshold to address the follow two operational issues:

- the need to maintain investment in the network in the long-term interest of stakeholders; and
- unsustainably low rates of return on investment and prices, which could result in insuffcent revenue streams to sustain the value of the network.

46 On 30 May 2006, in response to the 2005/06 threshold breach, the Commission opened a post-breach inquiry into The Power Company's distribution services. At that time no mitigating factors to explain the breach had been provided and the company had indicated previously its intention to breach the threshold in an effort to raise its rate of return to what it considers to be a more acceptable level.

Price path

47 Prior to 1998, The Power Company was under Crown ownership. The Power Company claims that to keep line charges to a minimum the Crown entity charged only what was necessary to cover operating and capital costs. As such The Power Company claims that between 1995 and 2005, The Power Company only increased the distribution component of line charges by 2.5%, as the sale under the Electricity Industry Reform Act 1998 of Monowai Power Station and shares in United Electricity enabled the company to partially finance operations. Table 2 shows the details of the price increases between 1998 and 2009.

48 It should be noted that ROI figures in Table 2 below are taken from historical information provided under the Electricity Information Disclosure Requirements 2004, and that the Commission has since updated its information disclosure requirements in October 2008. Therefore, if these values are calculated consistently with the current requirements, a different ROI may result. However, the Commission's view is that, without having done a detailed building block analysis, these ROI figures are sufficiently far below the likely

[12] Clause 5(1)(b) of the Commerce Act (Electricity Distribution Thresholds) Notice 2004.

WACC range that it would not change the Commission's conclusions that excess returns are not being earnt.

Table 2: Price increases 2003 to 2009

Financial year	Average change in line charges	ROI
2002/03	No increase	1.83%
2003/04	2.4%	3.32%
2004/05	12.5%	0.33%
2005/06	7.5%	1.47%
2006/07	7.5%	2.45%
2007/08	7.5%	
2008/09 (forecast)	7.5%	

49 A summary of the reasons offered by The Power Company's for price increases between 1998 and 2009 is as follows:

- the price increase of 2.4% on 1 April 2004, The Power Company increased its prices the expected increase in the CPI, consistent with its price path threshold; and
- from 1 April 2005, price increases are representative of the decision to increase prices over a five year period to raise the company's rate of return closer to its likely WACC.

50 As discussed above, it should be noted that the Commission's decision in this paper only relates to The Power Company's breaches of the thresholds at the 2008/09 assessment.

Network Reliability - Quality Threshold

51 The Power Company has had one breach of the quality thresholds, at the fourth assessment date (31 March 2008) against the Revised Thresholds of 56 minutes (23.5%). The Power Company attributes the breach primarily to a storm on 23 October 2007, which resulted in over 114 outages, lasting up to 27 hours for some customers.

52 The Commission engaged Strata Energy Consultants Limited (Strata) to undertake an engineering review of The Power Company's network reliability and provide advice to the Commission on matters such as:

- The Power Company's overall network reliability performance;
- The Power Company's response to any identified extreme events;
- whether or not The Power Company is employing sound engineering and asset management practices, and balancing these with economic rationales;
- whether or not capital expenditure forecasting is reasonable;
- the overall state of the network and underlying performance trends; and
- the consumer engagement practices employed (discussed in the following section).

53 A key objective of the review was to identify whether or not the Commission should have any concerns regarding The Power Company's network condition, network management

and operational practices, or the way in which it engages (or not) and takes into account the views of its consumers.

54 Strata's review concluded that the Commission need not have immediate concerns. This advice was based on a number of findings, such as:

- current performance within the reliability thresholds[13] and is considered likely to continue to perform within these thresholds;
- no visible signs of continuous deterioration;
- examination of planned and unplanned outages, and The Power Company's reasons for and responses to those outages;
- having appropriate management, engineering and asset management capability;
- the management team being aware of the particular issues within the network and a have appropriate strategies (and capability) to address these; and
- The Power Company's level of renewal expenditure appears reasonable.

55 The Commission concludes that, in this case, and based on the evidence and advice provided, that any possible concerns under section 52A of the Act, with respect to network reliability, have been sufficiently resolved.

56 In addition to Strata's assessment, using the Commission's Beta method, Major Event Days (MED) are identified for the 22-23 June 2007 and 23 October 2007. Replacing these days with the boundary value reduces The Power Company's SAIDI from 297 to 173, which is lower than the threshold of 240 minutes[14].

57 Figures 2 and 3, illustrate The Power Company's normalised SAIDI and SAIFI performance over the period 2002/03 to 2007/08. It can be clearly seen that The Power Company's performance for both the SAIDI and SAIFI is better than that required by the thresholds.

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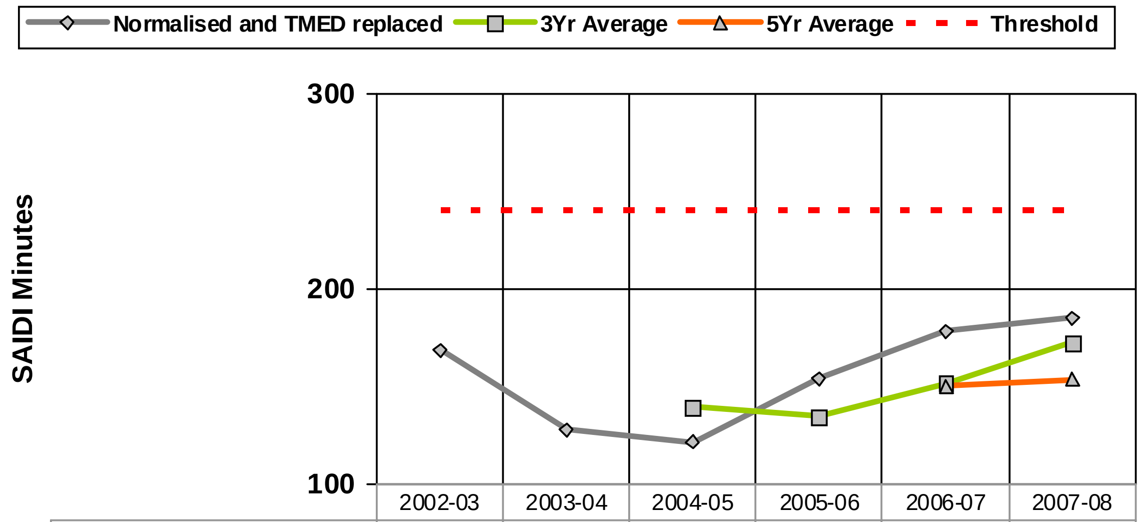
13 Once Major Event Days are taken into consideration.

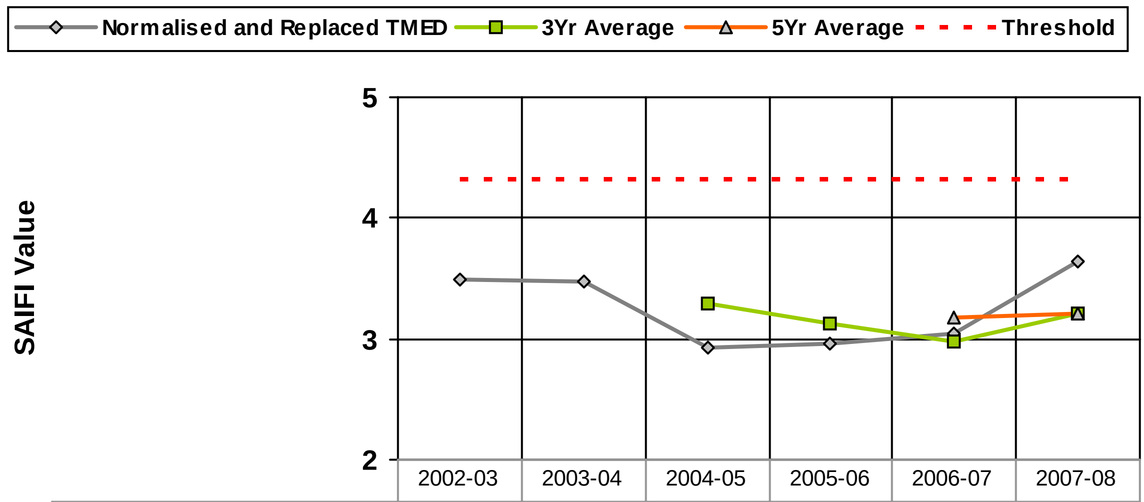
14 The Commission's process, including use of the Beta Method, is set out in the Commission's *Supplementary Guidelines for Investigating Breaches of the Reliability Criterion of the Quality Threshold*, 2 November 2007.

Figure 2: Planned and Unplanned SAIDI Outages (Class B and C)



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Normalised and TMED replaced	168.68	127.86	121.64	153.88	178.47	185.34
3Yr Average			139.39	134.46	151.33	172.57
5Yr Average					150.1	153.44
Threshold	240.28	240.28	240.28	240.28	240.28	240.28

Figure 3: Planned and Unplanned SAIFI Outages (Class B and C)



	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Normalised and Replaced TMED	3.4923	3.4751	2.935	2.9654	3.0463	3.6348
3Yr Average			3.3008	3.1252	2.9823	3.2155
5Yr Average					3.1829	3.2113
Threshold	4.32	4.32	4.32	4.32	4.32	4.32

Consumer Communication Criterion - Quality Threshold

58 Strata reviewed and provided advice to the Commission as to whether The Power Company has satisfied the Customer Communication Criterion of the quality threshold. Based on the desktop and on-site review, the Commission considers that The Power Company is complying with the Customer Communication Criterion requirement that distribution businesses demonstrate that they have well-developed business processes directed at understanding and responding to the preferences of consumers so that services are provided at a quality that reflects consumer demands.

59 Strata's review identified the following methods employed by The Power Company that indicate that it has met its Customer Communication Criterion:

- The Power Company engaged an external consultant to complete a telephone survey which uses a sample of 200 customers who had recently been subject to various types of services;
- The Power Company undertook a customer satisfaction survey which focuses primarily on quality and levels of service with respect to response to faults, new connections and alterations;
- The Power Company meets with individual (larger) customers and groups of customers on a annual basis;
- In 2007 The Power Company invited a random sample of consumers to three forums to discuss price/quality trade-offs. Due to a lack of customer interest in the fourms, in 2008, customers were invited to attend The Power Company's annual meeting;
- Customer complaints about The Power Company are handled through a formal ISO 9001 accredited system, which includes fully documented recording, tracking and reporting procedures;
- The Power Company holds regular informal meetings with broader stakeholder groups which, include the local councils and groups such as Venture Southland; and
- The Power Company holds regular meetings with the Southland Electric Power Supply Consumer Trust.

60 Based on Strata's advice, the Commission is of the view that The Power Company has demonstrated that its development, review, and introduction of business processes, such as consumer questionnaires, customer telephone surveys and face-to-face meetings with customers satisfy the Customer Communication Criterion.

Commerce Act 1986 (as amended)

61 The Commission also notes that The Power Company is likely to fall within the criteria in section 54D of the Act and be declared consumer-owned for the regulatory period commencing 1 April 2009. As such, from 1 April 2009, The Power Company may not be subject to price or quality standards under the new regulatory regime, however, breaches of the threshold as at 31 March 2009 can still be investigated under Part 4A.

62 If this is the case, after 2009 The Power Company will only be subject to information disclosure regulation requirements that will result in public disclosure of financial,

pricing and reliability metrics, which customers can use to assess whether the purpose of Part 4 is being met.

63 The Act allows consumers to make a petition to the Commission seeking the application of price-quality regulation to all or any of the electricity lines services supplied by an exempt supplier under section 54H of the Act, provided certain conditions are met.

The Commission's View

64 The Commission's inquiry has found that The Power Company's breach of the price path threshold at fourth assessment date of the Revised Threshold is the result of The Power Company's decision to increase prices over a five year period from 1 April 2005. This was to raise its rate of return from one of the lowest in the industry to closer to its likely WACC.

65 The Commission recognises that the magnitude of The Power Company's 2007/08 price path breach is significant. It is important to note, however, that the breach itself is a trigger than allows the Commission to investigate concerns in light of the purpose statement. The breach itself, and the magnitude of the breach, may be one of those matters examined. The breach on its own, however, does not fully represent the overall performance of the company under investigation, and is therefore only one of the many considerations. The Commission's focus will instead be on the overall performance of the business, and any determination will balance matters such as, but are not limited to, the level of returns on investment, capital expenditure programmes, levels of maintenance, and the overall quality performance of the network.

66 For the reasons stated above, in cases where a relatively minor breach occurs (which triggers an investigation), the Commission may take corrective action. In other cases, even where a significant breach occurs, such as with The Power Company, the Commission may consider that no further action action is required.

67 As The Power Company is not currently earning excess regulatory returns under its current prices, the Commission does not consider it appropriate to implement regulatory controls at this time. One reason for this decision is that the possible consequences of inadequate returns may be a reduced incentive to invest and maintain the network. This may not be consistent with section 52A(1)(a). This may affect reliabiltity, especially in the longer term. The Commission's analysis has found that the level of forecast capital expenditure, as well as five years of price increases, in this instance, appear reasonable as these have not yet caused it to earn excess returns, consistent with section 52A(1)(d). Based on the information readily available, the Power Company's regulatory return on investment remains below its likely WACC.

68 The Power Company has breached its quality threshold only once, at the fourth assessment date of the Revised Threshold. The beta method adopted by the Commission, identifies three 'Major Event Days' (22-23 June 2007 and 23 October 2007). The combined value of these events, when replaced by the boundary value, equates to less than the SAIDI and SAIFI criteria of the quality threshold.

69 Overall, The Power Company's network reliability performance has been consistently better than the threshold. Having only breached the quality threshold once during the regulatory period, and in light of performance consistently better than the threshold, the Commission has no concerns with regard to network reliability in light of the purpose statement.

Decision Not to Declare Control

70 The Commission has determined that it is consistent with section 52A of the Act not to make a declaration of control under Part 4A in respect of electricity distribution services supplied by The Power Company for its breach of the 2007/08 price path and quality thresholds for the following reasons:

- The Power Company does not appear to be earning excess returns, despite its five years of price increases implemented to raise its rate of return;
- The Power Company's network reliability performance trend, and the 2007/08 breach, excluding extreme events, is well below the SAIDI and SAIFI criteria of the quality threshold;
- the Commission's experts have advised that The Power Company's network reliability, level of planned capital expenditure, and maintenance and engineering practices appear sound; and
- the Commission has no other s 52A concerns.

71 This decision will take effect from the date that it is formalised by publication in the *New Zealand Gazette*.