

**COMMERCE COMMISSION**

Regulation of Electricity Lines Businesses

Targeted Control Regime

Threshold Decisions

**6 June 2003**



COMMERCE COMMISSION

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## **EXECUTIVE SUMMARY**

This paper presents the Commission's decisions on aspects of the targeted control regime, which it is developing pursuant to Part 4A of the Commerce Act.

After consulting with interested parties on possible thresholds for declaration of control in relation to electricity lines businesses (i.e. distribution businesses and Transpower), the Commission decided on the form of thresholds it would set. The Commission has set two thresholds – a price path threshold and a quality threshold. These thresholds will provide incentives for lines businesses to maintain the quality of their services while reducing their prices in real terms.

The purpose of the price path threshold is to provide incentives for lines businesses to reduce their prices in real terms, and therefore to improve efficiency, to be limited in their ability to extract excessive profits, and to share the benefits of efficiency gains with consumers.

The purpose of the quality threshold is to provide incentives for lines businesses to not allow their reliability to fall, as a means of reducing costs in response to the price path threshold, and to incentivise them to provide services at a quality demanded by consumers.

Having considered submissions from interested parties, the Commission has decided a profit threshold, assessed at the end of five years (as was proposed in the Commission's draft decisions), may not be the best means to achieve the purpose of the targeted control regime, as it could deter investment and innovation.

A decision paper was issued by the Commission, along with a draft of the *Gazette* notice proposed to be used to set the thresholds, on 2 May 2003. Following two rounds of comments from interested parties recommending technical amendments, the *Gazette* notice was published on 6 June 2003 as the Commerce Act (Electricity Lines Thresholds) Notice 2003. This decision paper updates the decision paper of 2 May 2003 to reflect the technical amendments made to the draft *Gazette* notice, and to provide clarifications where the Commission considered necessary.

## **Thresholds**

The thresholds are a screening mechanism to identify lines businesses whose performance may warrant further investigation and, if required, control by the Commission.

All lines businesses will be assessed against the price path threshold as at 6 September 2003. Distribution businesses will be assessed again as at 31 March 2004, and annually thereafter. Transpower will be assessed again as at 30 June 2004, and annually thereafter.

Distribution businesses will be assessed against the quality threshold as at 31 March 2004, and annually thereafter. Transpower will be assessed against the quality threshold as at 30 June 2004, and annually thereafter.

The threshold assessments are summarised in the following table.

Threshold	Assessment Dates	Criteria for Compliance
Price Path	(First assessment date) 6 September 2003 (all lines businesses including Transpower)	Average price (i.e. base-weighted notional annual revenue) at the first assessment date does not exceed the lowest average price at any time between 8 August 2001 and the publication date of the <i>Gazette</i> notice  and  no increase in average price since the publication date of the <i>Gazette</i> notice
	(Second assessment date) 31 March 2004 (distribution businesses) 30 June 2004 (Transpower)	No increase in average price (i.e. base-weighted notional annual revenue) since the first assessment date
Quality	31 March 2004 (distribution businesses) 30 June 2004 (Transpower)	No material deterioration in recent levels of reliability  and  meaningful consumer engagement on the “price-quality trade-off”

The price path assessment criteria are consistent with a CPI-X price path, in which prices at the end of each assessment period are not greater, in nominal terms, than prices at the start of that period.

The quality threshold assessment has two criteria:

- no material deterioration in reliability, assessed on the basis of quantitative analysis of reliability performance data; and
- meaningful engagement with consumers to determine their demands for service quality, assessed on the basis of a qualitative review of, for example, disclosed asset management plans (or similar).

The purpose of the reliability criterion is to provide incentives for lines businesses to not allow their reliability to fall as a means of reducing costs in response to the price path threshold. Distribution reliability will be assessed in terms of actual or annualised SAIDI and SAIFI for planned and unplanned interruptions arising within the distribution system during the year ending on 31 March 2004. Transmission reliability will be measured in terms of numbers of unplanned interruptions and interruptions measured in system minutes during the year ending 30 June 2004. In both cases, these indices will be compared with the corresponding averages for the five years ending 31 March 2003 and 30 June 2003.

The purpose of the consumer engagement criterion is to provide incentives for lines businesses to develop formal processes to engage with their consumers on the price-quality trade-off and plan to provide services that reflect consumer demands for quality.

## **Demonstrating Compliance with the Thresholds**

In the case of the price path and reliability criteria, the Commission has set out guidelines on how compliance could be demonstrated. In the case of the consumer engagement criterion, some guidelines are provided, but compliance will necessarily be somewhat subjective.

## **Thresholds to Apply from 2004**

The Commission expects it will set different price path assessment criteria to apply from 1 April 2004. Those threshold criteria may vary between different lines businesses or groups of lines businesses according to business-specific factors. In its draft decision paper (31 January 2003), the Commission proposed grouping lines businesses into three categories, with each group having a different X-factor. The Commission received written submissions on this proposal, and several X-factor grouping methodologies were discussed during the Commission's conference in March 2003.

The Commission plans to develop and review various methodologies for determining X-factors and/or other criteria to apply from 2004, and will consult on these matters with interested parties during 2003. This development process was signalled in the Commission's draft decision paper and its media release (2002-03/118) on 27 February 2003, and was followed up with the release of a discussion paper – *Resetting the Price Path Threshold* – on 30 May 2003. Further details on the planned process are set out in this paper, and summarised in Annex 2.

## **Commission Processes and Methodologies**

Lines businesses' incentives to comply with the thresholds depend to some extent on what they consider might happen if they were identified to have breached a threshold. The Commission considers the regulatory objectives may not be achieved if lines businesses were inclined to be unduly cautious or averse to uncertainty about the consequences of their conduct in relation to thresholds.

The Commission is developing the methodology it would apply if it were to commence an investigation arising from a threshold breach, and the methodology it would apply following a declaration of control. The Commission's process and timetable for developing the detail of the investigation and control phases is discussed further in Annex 3. The Commission intends to make public any guidelines or papers it develops in this regard.

## INTRODUCTION

- 1 Part 4A of the Commerce Act 1986 (the Act) came into effect on 8 August 2001. Among other things, Part 4A contains provisions relating to:

- the targeted control of goods or services supplied by large electricity lines businesses (“lines businesses”);
- a review of methodologies for the valuation of lines businesses’ system fixed assets; and
- information disclosure by lines businesses.

The Commission must develop a regulatory regime for electricity lines businesses.

- 2 This decision paper sets out the Commission’s decisions on thresholds for the declaration of control of goods or services supplied by lines businesses (i.e. distribution businesses and Transpower). These decisions are a key milestone in the Commission’s development of a regulatory regime pursuant to Part 4A. In making the decisions, the Commission has fully considered information and analysis from a range of sources, including submissions from interested parties and the advice of external legal and economic experts.

This paper outlines the thresholds to be used in that regime.

- 3 A decision paper was issued by the Commission, along with a draft of the *Gazette* notice proposed to be used to set the thresholds, on 2 May 2003. Following two rounds of comments from interested parties recommending technical amendments, the *Gazette* notice was published on 6 June 2003 as the Commerce Act (Electricity Lines Thresholds) Notice 2003. This decision paper updates the decision paper of 2 May 2003 to reflect the technical amendments made to the draft *Gazette* notice, and to provide clarifications where the Commission considered necessary.

- 4 This decision paper is structured as follows.

Section	Content
Introduction	<ul style="list-style-type: none"><li>• The process by which the Commission has made decisions</li><li>• The nature of the decisions made to date</li><li>• Why the Commission has decided not to set a profit threshold</li><li>• How the Commission intends to assess lines businesses against thresholds</li></ul>
Price Path Threshold	<ul style="list-style-type: none"><li>• How the price path threshold works in concept</li><li>• Assessment dates and criteria</li><li>• How lines businesses can demonstrate compliance</li></ul>

Section	Content
Quality Threshold	<ul style="list-style-type: none"> <li>• How the quality threshold works in concept</li> <li>• Assessment dates and criteria</li> <li>• How lines businesses can demonstrate compliance</li> </ul>
Next Steps	<ul style="list-style-type: none"> <li>• Discussion of future work</li> </ul>
Annex 1	Glossary of terms and abbreviations
Annex 2	Process and timetable for resetting thresholds from 1 April 2004
Annex 3	Process and timetable for developing the detail of the investigation and control phases

## Process to Date

- 5 This section summarises the process to date, by which the Commission has come to its decisions.

### *Targeted Control Regime*

- 6 On 21 March 2002, the Commission released a discussion paper – *Regulation of Electricity Lines Businesses*. The paper discussed the Commission’s interpretation of the purpose of the targeted control regime, various options as to possible thresholds for the declaration of control, and other matters relevant to the development of the targeted control regime.
- 7 The Commission sought and received written submissions on the paper from interested parties, and held a conference in July 2002. Further written submissions on matters raised during the conference were also received and considered.
- 8 On 23 December 2002, the Commission released draft decisions on the form of thresholds it intended to set. This paper was followed, on 31 January 2003, by draft decisions on some of the implementation details flowing from the earlier paper. The Commission invited written submissions on both papers at the end of February 2003, and held a conference from 10 to 14 March 2003. Further written submissions were invited following the conference.
- The Commission has consulted with interested parties...
- ... including on its draft decisions.

### *Thresholds for Declaration of Control*

- 9 Having considered the relevant factors, including those raised by interested parties in written submissions and at conferences, the Commission decided on the form of thresholds it would set, as required by section 57G of the Act. There are two thresholds – a price path threshold and a quality threshold. These types of
- The Commission has decided on a price path threshold and a quality threshold.

thresholds were discussed among other options in the Commission's March 2002 discussion paper, and in its 23 December 2002 and 31 January 2003 draft decision papers.

- 10 These decisions do not cover all aspects of the regulatory regime, but they do provide the foundation for the development of the regime over time.

Other aspects of the regime are yet to be decided.

### ***Review of Asset Valuation Methodologies***

- 11 On 14 March 2002, the Commission released an issues paper – *The Review of Asset Valuation Methodologies* – and sought responses to questions covering the main issues associated with the review. Interested parties were also invited to raise any additional issues they considered relevant to the review.

The Commission has conducted a review of asset valuation methods.

- 12 On 1 October 2002, the Commission released a discussion paper – *Review of Asset Valuation Methodologies: Electricity Lines Businesses' System Fixed Assets*. In that paper, the Commission discussed a number of asset valuation methodologies and proposed criteria for evaluating the options.

- 13 The Commission sought and received written submissions on the discussion paper from interested parties, and held a conference in November 2002. Further written submissions on matters raised during the conference were also invited and received.

The views of interested parties have been considered.

- 14 The Commission's papers released on 23 December 2002 and 31 January 2003 set out draft decisions on regulatory asset valuation in the context of thresholds. The Commission has considered submissions from interested parties on those draft decisions.

The Commission made draft decisions ...

- 15 The threshold assessment criteria do not rely upon regulatory asset valuation, and in that sense, the decisions set out in this paper do not relate to asset valuation. However, the Commission considers that asset valuation is likely to be relevant during the investigation and control phases of the regime. Accordingly, the Commission will make decisions on regulatory asset valuation as part of its ongoing development of the regime.

... but has not made final decisions on asset valuation at this time, as asset valuation is not central to the thresholds.

### **THE THRESHOLDS**

- 16 The thresholds are a screening mechanism to identify lines businesses whose performance may warrant further investigation and, if required, control by the Commission. The Commission has set two thresholds – a price path threshold and a quality threshold – through the Commerce Act (Electricity Lines

Thresholds are a screening mechanism, set through the *Gazette* notice of 6 June 2003.



Thresholds) Notice 2003, published in the *New Zealand Gazette* on 6 June 2003 (the *Gazette* notice).

- 17 All lines businesses will be assessed against the price path threshold as at 6 September 2003. Distribution businesses will be assessed again as at 31 March 2004, and annually thereafter. Transpower will be assessed again as at 30 June 2004, and annually thereafter.
- 18 Distribution businesses will be assessed against the quality threshold as at 31 March 2004, and annually thereafter. Transpower will be assessed against the quality threshold as at 30 June 2004, and annually thereafter.
- 19 The threshold assessments are summarised in the following table. Further details are provided in subsequent sections of this paper.

**Table 1 – Thresholds and Assessment Criteria**

Threshold	Assessment Dates	Criteria for Compliance
Price Path	(First assessment date) 6 September 2003 (all lines businesses including Transpower)	Average price (i.e. base-weighted notional annual revenue) at the first assessment date does not exceed the lowest average price at any time between 8 August 2001 and the publication date of the <i>Gazette</i> notice  and  no increase in average price since the publication date of the <i>Gazette</i> notice
	(Second assessment date) 31 March 2004 (distribution businesses)  30 June 2004 (Transpower)	No increase in average price (i.e. base-weighted notional annual revenue) since the first assessment date
Quality	31 March 2004 (distribution businesses)  30 June 2004 (Transpower)	No material deterioration in recent levels of reliability  and  meaningful consumer engagement on the “price-quality trade-off”

### Reasons for Not Setting a Profit Threshold

- 20 Having considered submissions from interested parties, the Commission has decided a profit threshold, assessed at the end of five years (as was proposed in the Commission’s draft decisions), may not be the best means to achieve the purpose of the targeted control regime, as it could harm incentives to improve efficiency.

A profit threshold was proposed but will not be set at this time.

- 21 The purpose of the profit threshold, as proposed in the Commission's draft decisions, was to ensure lines businesses were limited in their ability to earn excessive profits and incentivised, alongside the price path threshold, to share with consumers, through lower prices, the benefits of any efficiency gains over the five-year period. The profit threshold was also intended to encourage lines businesses to reduce prices at a rate faster than the price path threshold, if necessary, to limit any excessive profits currently being earned.
- 22 However, the Commission is aware that this form of threshold might also incentivise lines businesses, perversely, to incur inefficiently high costs. It could also damage incentives they might otherwise have to innovate and invest in new services.
- 23 On balance, the Commission considers the potential detriments of the proposed profit threshold outweigh the potential benefits.
- 24 The Commission's preferred way to ensure lines businesses are limited in their ability to extract excessive profits, which the purpose statement for the regime requires, is to consider the efficiency of prices and costs as part of the resetting of the price path threshold. If, however, the work on resetting the price path threshold cannot be satisfactorily completed this year, the Commission may need to consider, as per its draft decisions, implementing a profit threshold to apply from 1 April 2004.

Regulatory incentives for lines businesses to share efficiency gains will still be provided.
- 25 In relation to its decision on the profit threshold, the Commission has considered various submissions on the level of profits currently being earned by lines businesses. Some parties have submitted that current price levels reflect excessive rates of profit, particularly when revaluations of system fixed assets using the optimised deprival value (ODV) methodology are treated as income. The Commission expects to make decisions on the measurement of profit as it develops its methodologies in relation to the investigation and control phases of the regime. The issue may also arise in the context of resetting the price path threshold to apply from 1 April 2004.

## **Threshold Assessment Process**

- 26 Each lines business will be required, pursuant to section 57T of the Act, to provide the Commission with written statements, confirming its compliance, or otherwise, with each of the thresholds. These threshold compliance statements should include sufficient evidence in the form of revenues, prices, costs, reliability indices and other data, supporting the declaration.

Lines businesses are to submit their own self assessments against the thresholds.
- 27 Threshold compliance statements are to be signed by two directors of the board (or one, should there be only one director)

and must be accompanied by a signed independent auditor's report to the effect that the compliance statement provided gives a true and fair view of the matters to which it relates. The *pro forma* certificates setting out the Commission's minimum requirements in this respect are included as Schedules to the *Gazette* notice.

- 28 For the purposes of a compliance statement audit, an independent auditor means a person who:
- is qualified for appointment as auditor of a company under the Companies Act 1993;
  - has no relationship with, or interest in, the lines business, being a relationship or interest that is likely to involve that person in a conflict of interest;
  - has the necessary expertise to properly undertake the audit,<sup>1</sup> but
  - need not be the same as the person who audits the accounts of the lines business for any other purpose.
- 29 The Commission requires that it receive the compliance statements containing the self assessments of each lines business no later than 40 working days after each assessment date.
- 30 In fulfilling the requirement to assess lines businesses against the thresholds, the Commission considers that the appropriate time to consider information and explanations provided by lines businesses will be after receiving compliance statements. Therefore, prior to receiving the compliance statements, the Commission does not intend to hold discussions with lines businesses or auditors regarding any issue on which the Commission may need to exercise its discretion (for example, what is included or excluded under the definition of specified services).
- 31 Lines businesses are also required, within 35 working days of the relevant assessment date, to publicly disclose the compliance statements and publish them on the Internet. Any confidential information may be removed, but the Commission reserves the right to subsequently require its disclosure, if the Commission is not satisfied with the reasons for withholding the information.
- 32 Before assessing lines businesses against the thresholds, the Commission will make an initial review of the compliance statements. During this initial review process, the Commission

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<sup>1</sup> The Commission recognises that, in providing audit services relating to a threshold compliance statement, auditors may require input from independent technical advisers. However, the independent auditor will still be responsible for certifying that the related information provided in the compliance statement is correct.

may seek clarification or confirmation of the information provided. The Commission may use the provisions of section 57U(1)(b) of the Act, if necessary, to require further information to be provided.

- 33 The initial review period is an opportunity for lines businesses, at the Commission's request, to explain aspects of their self assessments. This would not be an opportunity to justify the performance in question, but rather to clarify information where required.
- 34 The Commission will consider whether it is necessary to provide further detail on how compliance with the thresholds is assessed, particularly where application of the Commission's discretion is required. If the Commission does consider further guidance is necessary, any guidelines or papers it develops in this regard would be published.

### **Process Following Assessment**

- 35 Once it has completed its assessment of lines businesses against the thresholds, the Commission must identify any lines business that breaches the thresholds, and in respect of each such business, either make a control declaration or publish the reasons for not declaring control.
- 36 At this stage, the Commission has not decided on the details of its process following threshold assessments. However, it is likely the Commission would consider a range of responses to threshold breaches, depending on the nature of the breach and other criteria. Possible responses could include, for example, issuing a warning, or entering into an administered settlement. In both of these cases, the Commission would publish the reasons for not declaring control.
- 37 It is also possible, during the assessment of a threshold, or as a result of a short investigation soon after a breach was identified, the Commission might be satisfied that a breach was trivial or readily justifiable. In such cases, the Commission would announce, at the same time as announcing a breach, that no further investigation was warranted, and would publish its reasons for that conclusion.
- 38 The Commission may consider making orders under section 100 of the Act to ensure confidentiality of information during assessments, during an initial investigation of a breach and/or during any further investigations. The Commission also may prioritise its assessment and investigation activities in respect of different lines businesses, if necessary, as provided in section 57K of the Act.

- 39 The Commission intends to develop and release further details on its subsequent processes, as discussed in the section headed “Next Steps” and Annex 3.

## PRICE PATH THRESHOLD

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|----|--|---|
| 40 | The price path threshold is broadly comparable to the various forms of CPI-X price control that regulators commonly use in other jurisdictions. However, the thresholds are not instruments of control and the price path threshold differs in many important respects from the price control mechanisms used elsewhere.   | Price paths are used by other regulators for control of lines businesses. |
| 41 | The price path threshold is consistent with a CPI-X price path, in which prices at the end of each assessment period are not greater, in nominal terms, than prices at the start of that period.   | The price path threshold is of the form CPI-X.                            |
| 42 | Regarding the evolution of the price path criteria, at this stage the Commission considers that X-factors applying from 2004 could vary between lines businesses or groups of lines businesses according to business-specific factors. The Commission’s 30 May 2003 discussion paper – <i>Resetting the Price Path Threshold</i> – sets out the issues the Commission considers are relevant to deciding on the preferred methodology for resetting the price path threshold, and outlines the process and timetable for the reset work. The Commission’s intended process for resetting the price path threshold is also summarised in Annex 2 of this paper. | The price path threshold will be reset to apply from April 2004.          |

## Price Path Threshold Assessments

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|----|--|--|
| 43 | As discussed in the Commission’s draft decision papers, price in the context of the price path threshold means the weighted average price for relevant lines services, adjusted for certain “pass-through” costs. The threshold does not apply to individual tariff components or to average prices for individual customers. The threshold applies only to the average price of specified services, as described in more detail below. In practice, the price path is assessed in terms of “base-weighted notional annual revenues”, which are the annualised revenues that would result from applying each set of prices to the same set of base quantities (e.g. customer numbers, energy delivered in kWh, maximum demand in kW, connected capacity in kVA, etc), net of pass-through costs. | Assessment will be based on weighted average prices. |
| 44 | The purpose of the price path threshold is to provide incentives for lines businesses to reduce their prices in real terms, and therefore to improve efficiency, to be limited in their ability to   |  |

extract excessive profits, and to share the benefits of efficiency gains with consumers.

- 45 Lines businesses will be assessed initially against the price path threshold as at 6 September 2003. Two criteria will apply for this first assessment. The first criterion is that a lines business would breach the threshold if its average price (i.e. base-weighted notional annual revenue) as at the first assessment date were to exceed its lowest average price (base-weighted notional annual revenue) at any time between 8 August 2001 and the publication date of the *Gazette* notice. The second criterion is that a lines business would breach the threshold if its average price at any time since the publication date of the *Gazette* notice were to exceed its average price at that date.
- 46 Distribution businesses will be assessed again as at 31 March 2004, and Transpower will be assessed again as at 30 June 2004. At this second assessment, a lines business would breach the threshold if its average price (base-weighted notional annual revenue) at any time since the first assessment date were to exceed its average price at that date.
- 47 For the avoidance of doubt, the implicit rebate calculation, discussed in the Commission's draft decisions, will not be applied during these assessments. Consistent with those draft decisions, the Commission will give further consideration to this matter in the context of resetting the price path threshold to apply from 1 April 2004 (1 July 2004 in the case of Transpower).

### **Excluded Distribution Services**

- 48 For the purposes of the price path threshold, specified distribution services include all services directly related to electricity distribution except those provided in a market with effective competition. Distribution businesses should indicate which, if any, line services they have excluded in their threshold compliance statements, and provide evidence, to the satisfaction of the auditor and the Commission, that the exclusions are warranted. For example, distribution businesses may exclude:
- connection, disconnection and reconnection services, provided there is effective competition for those services;
  - “non-conveyance” services, such as energy use monitoring services, consulting services, or the provision of information not directly related to line services; and
  - services provided in response to contestable tenders, provided the relevant customers agree in writing that there is effective competition for those services.

Lines businesses can exclude services if, for example, there is effective competition for those services.

- 49 The Commission reserves the right to ultimately determine which services, if any, will be excluded in a price path threshold assessment. Moreover, the Commission may require distribution businesses to provide further evidence, if necessary, justifying any exclusions they have identified in threshold compliance statements, during its review of those statements.

## **Distribution Cost Pass-Through**

- 50 Having considered submissions on the matter, the Commission has decided to provide for the “pass through” of certain operating costs – transmission charges and territorial local authority rates – on the grounds that these are largely beyond distribution businesses’ control, and are not always stable or predictable.
- 51 “Transmission charge”, in this context, means the net amount a distribution business is liable to pay to Transpower or other parties in relation to transmission service (or avoided transmission service) and system operation service during the relevant period. For example, pass-through transmission charges may include:
- connection and interconnection charges paid or payable to Transpower;
  - charges paid or payable to Transpower for the provision of coordination services for the control, dispatch and security functions necessary to operate the transmission system; and
  - avoided transmission charges (i.e. any expense of a distribution business that arises from any generation or other activity which substitutes for use of the transmission system).
- 52 Rebates received from Transpower (net of any payments) for “loss and constraint rentals” and/or gains (net of losses) arising from the settlement of financial transmission rights (FTRs), if any, should be included as pass-through items except where the distribution business can demonstrate, to the satisfaction of the auditor and the Commission, that it has passed through to its customers any amounts received (or any payments made) during the period by way of a specific rebate mechanism (as distinct from its posted tariffs). In addition, any Transpower economic value (EV) adjustments should be treated in a similar manner.
- 53 Rates, in this context, are rates on system fixed assets, as defined in the Electricity (Information Disclosure) Regulations 1999 (the Regulations), paid or payable during the period concerned to territorial local authorities under the Rating Powers Act 1988 and/or the Local Government (Rating) Act 2002.
- Some costs can be “passed through” by lines businesses, specifically...
- ... transmission charges...
- ... including loss and constraint rentals, FTRs and EV adjustments, and also ...
- ... local government rates on network infrastructure.

- 54 The decision on pass-through costs means that a distribution business would not breach the price path threshold if its tariffs increased only to cover an increase in transmission charges or local authority rates. Conversely, a distribution business would breach the threshold if its transmission charges and rates were to fall and it did not reduce its average price (base-weighted notional annual revenue) in the same year by a corresponding amount.
- This means prices net of cost pass-throughs will be used for assessments, ...
- 55 The Commission is aware that transmission charges have fallen for some distribution businesses since 2001, and those businesses may need to reduce their average prices before the first threshold assessment in order to comply with the price path threshold at that time.
- ...including where pass-through costs have fallen.
- 56 Because transmission and distribution services are to some extent substitutes, and the boundary between transmission and distribution services can change over time, it is possible that some movements in transmission charges will be offset by opposite movements in distribution costs. The pass through of transmission charges could make breaches more likely in such circumstances, which would require specific consideration during any investigation by the Commission.

### **Transmission Service Exclusions and Cost Pass-Through**

- 57 Specified transmission services are those related to connection to Transpower's network and the conveyance of electricity through that network. Transpower should indicate which services it has excluded in its threshold compliance statement, and provide evidence, to the satisfaction of the auditor and the Commission, that the exclusions are warranted. For example, transmission service prices may exclude prices or amounts received in relation to:
- Transpower can also pass through to its customers a limited subset of its costs.
- the provision of coordination services for the control, dispatch and security functions necessary to operate the transmission system, provided there is effective competition for such services;
  - loss and constraint rentals and/or financial transmission rights, provided that the amounts arising from settlement of those services are passed on transparently to Transpower's customers;
  - new investment contracts, where the counterparty agrees the terms and conditions are reasonable and/or reflect contestable provision of the services; and
  - new investments approved and undertaken under a process (whether regulatory or otherwise) that provides for affected customers to make and approve price-quality trade-offs and



opportunity for competitive provision of new investment by parties other than Transpower.

- 58 The Commission reserves the right to determine which services, if any, will be excluded in a price path threshold assessment. Moreover, the Commission may require Transpower to provide further evidence, if necessary, justifying any exclusions Transpower has identified in its compliance statement, during the Commission's review of that statement.
- 59 Like distribution businesses, Transpower may pass through rates on system fixed assets payable to territorial local authorities.

### *Transpower's Economic Value Adjustments*

- 60 In respect of its price path assessment, Transpower should include all "economic value adjustments" in its calculation of average prices. In other words, for Transpower's price path assessment, its average price (base-weighted notional annual revenue) is net of economic value (EV) adjustments.
- 61 This is not to say that Transpower's price path criteria, from 1 July 2004, will lock-in the current level of EV adjustments. In setting Transpower's price path to apply from 1 July 2004, the Commission will consider the status of Transpower's EV account balance, the contribution of asset revaluations to that balance, and whether the revaluation component represents value that will be realised by Transpower in the future. The Commission's objective will be to ensure that neither Transpower nor its customers experience windfall gains or losses, in respect of the EV adjustments, as a result of the regulatory regime the Commission is required to develop.
- Initially, Transpower should include all economic value adjustments in its prices.
- The Commission will further consider this issue in resetting the price path threshold to apply from July 2004 for Transpower.

### **Demonstrating Compliance with the Price Path Threshold**

- 62 The approach taken by lines businesses to demonstrate compliance with the price path threshold assessment criteria may vary according to specific circumstances. In particular, calculating the average price (base-weighted notional annual revenue) path is likely to be more straightforward for lines businesses whose tariffs or tariff structures have not changed since 8 August 2001 than those that have restructured their tariffs, as illustrated in Table 2.
- Lines businesses need to demonstrate their compliance with the thresholds.

**Table 2 – Compliance with the Price Path Threshold**

Type of tariff change since 8 August 2001	Information Required to Demonstrate Compliance
No change	Evidence that pass-through costs did not fall during the period
Same tariff structure, but changes to individual tariff elements	Evidence of no increase in base-weighted notional annual revenue (which is calculated net of pass-through costs)
Change in tariff structure	Evidence that the restructuring did not, of itself, increase the base-weighted notional annual revenue
Increase in fixed charges (charges not expressed in terms of a measure of the service provided)	Evidence that the increase in fixed charges was consistent with an increase in the level of service provided

- 63 Where a lines business has changed individual tariffs but not the structure of tariffs, compliance with the price path criteria should be demonstrated via a transparent application of the following expression:

$$\sum_i P_i^1 Q_i^0 - K^1 \leq \sum_i P_i^0 Q_i^0 - K^0$$

where, for the first assessment:

$P_i^1$  *for the purposes of the first criterion*

is the price in tariff  $i$  as at the first assessment date (i.e. 6 September 2003)

*for the purposes of the second criterion*

is the price in tariff  $i$  as at that time between the publication date of the *Gazette* notice and the first assessment date at which base-weighted notional annual revenue is at a maximum;

$P_i^0$  *for the purposes of the first criterion*

is the price in tariff  $i$  at that time between 8 August 2001 and the publication date of the *Gazette* notice at which base-weighted notional annual revenue is at a minimum;

Prices at the time of assessment need to be no greater than when the legislation was passed.

*for the purposes of the second criterion*

is the price in tariff  $i$  as at the publication date of the *Gazette* notice;

$Q_i^0$  is the total quantity to which tariff  $i$  applies (being number of connections, energy delivered in kWh, maximum demand in kW, transformer capacity in kVA, etc), for the year ended 31 March 2003 (30 June 2003 for Transpower);

$K^1$  *for the purposes of the first criterion*

is the sum of all pass-through costs budgeted for the year ending 31 March 2004;

*for the purposes of the second criterion*

is equal to  $K^0$  and is therefore not taken into account;

$K^0$  *for the purposes of the first criterion*

is the sum of all pass-through costs actual or budgeted, as appropriate, for the year ending 31 March that includes the date between 8 August 2001 and the publication date at which base-weighted notional annual revenue is at a minimum;

*for the purposes of the second criterion*

is equal to  $K^1$  and is therefore not taken into account;

$i$  denotes each of the relevant tariff categories and components relating to all specified services;

and, for the second assessment:<sup>2</sup>

$P_i^1$  is the price in tariff  $i$  at a time between the first assessment date and 31 March 2004 at which base-weighted notional annual revenue is at a maximum;

$P_i^0$  is the price in tariff  $i$  as at the first assessment date;

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<sup>2</sup> Being as at 31 March 2004 for distribution businesses and as at 30 June 2004 for Transpower.

$Q_i^0$  is the total quantity to which tariff  $i$  applies, and should be the same value as that used for the first assessment;

$K^1$  is the sum of all actual pass-through costs incurred during the year ending 31 March 2004;

$K^0$  is the sum of all pass-through costs budgeted for the year ending 31 March 2004.

64 The terms on each side of the expression above are referred to in this paper as “base-weighted notional annual revenue”. They represent the annual revenue that would result from applying the prices ( $P_i$ ) to a base set of annual quantities ( $Q_i^0$ ), net of annual pass-through costs. In other words, compliance with the price path is assessed in terms of movements in notional annual revenue excluding any “quantity effects”.

65 The first and second assessments against the price path threshold are based on posted prices. In general, they are all prices associated with “prescribed contracts” as defined in the Regulations (which are disclosed pursuant to regulations 10 to 14, and which may be identified in the disclosure of pricing methodologies pursuant to regulations 23 and 24). However, for the avoidance of doubt, in the case of lines businesses predominantly owned by consumer trusts, the notional annual revenue terms in the first and second assessments are exclusive of any rebates or discounts in lieu of dividends.

66 The cost pass-through items ( $K$ ) in the above expression (in paragraph 63) are defined in terms of annual periods that are not strictly aligned to the threshold assessment dates. In any case, the Commission reserves the right to determine allowable pass-through costs in relation to the price path threshold. The Commission may require further evidence, if necessary, justifying any pass-through costs identified in threshold compliance statements, during its review of those statements.

Cost pass-throughs are taken into account.

67 The quantities ( $Q_i^0$ ) in the expression in paragraph 63 should represent either invoiced or budgeted quantities during the year ended 31 March 2003 (30 June 2003 for Transpower). Lines businesses are not required to provide a complete set of tariffs and volumes, but the compliance statement auditor and the Commission must be satisfied that the expression holds.

68 Where the tariff structure has changed since 8 August 2001, the lines business should provide evidence of the effective change in average price (base-weighted notional annual revenue).

- 69 For example, if the tariff for a particular consumer group in “period 0” were based on annual energy delivered, and the tariff for the same group in “period 1” were based on annual maximum demand, then those two quantity weights (energy and maximum demand) should be derived from a common customer data set containing those quantities (either measured or estimated). If this were not possible, for example, if the new tariff were based on a quantity that was not previously measured or recorded, the compliance statement should be based on the best information reasonably available, to the satisfaction of the auditor and the Commission. In most cases, records of the relevant business plans and budgets should be suitable for this purpose.
- 70 If a lines business has breached the price path threshold at the first assessment, its average price (base-weighted notional annual revenue) at the first assessment date will be above its lowest average price at any time between 8 August 2001 and the publication date of the *Gazette* notice. This being the case, a lines business could comply with the price path threshold at the second assessment, yet have an average price at the second assessment date that remains above its average price as at 8 August 2001. In such a case, the Commission would determine the appropriateness of that average price level during the course of an investigation.
- 71 The price path assessments apply to all lines businesses, including Transpower, and including those that have been involved in business mergers or acquisitions since 8 August 2001.

### *Prices Not Based on Measured Service Level*

- 72 Where line service prices are not directly related to measured service level quantities such as energy delivered (in kWh), installed transformer capacity (in kVA), or number of connections, compliance with the price path threshold may be difficult to demonstrate using the expression in paragraph 63.
- 73 In particular, where the tariff for a particular customer or group is expressed as a fixed dollar amount, any movement in those fixed charges would, if assessed on the basis of base-weighted notional annual revenue, more accurately represent a revenue path than a price path. By definition, the price path threshold requires movements in revenue to be commensurate with movements in relevant measures of the level or quality of service provided, such as connection capacity or security.
- 74 So, where prices, like Transpower’s, comprise significant fixed charge components that are not directly related to measured service levels, a lines business should provide evidence that any change in the fixed charges was consistent with a change in the level or quality of service demanded. The level of service

Linking some prices to actual quantities may be difficult for some services, ...

...for example, where prices have a significant fixed charge component.

Where this is so, lines businesses need to explain why they consider they comply.

demanded could be defined for individual customers or in aggregate for all customers.

### *Demonstrating Compliance*

- 75 The Commission does not wish to prescribe the manner in which compliance may be demonstrated in cases where the Commission is satisfied that it is not practicable to determine whether a lines business has complied with the price path threshold using the expression in paragraph 63. However, in such circumstances, the lines business will need to demonstrate to the satisfaction of the auditor and the Commission, that compliance can be demonstrated through the use of an alternative approach that has an equivalent effect.

### *Timeframe for Demonstrating Compliance*

- 76 Lines businesses should provide their audited threshold compliance statements to the Commission no later than 40 working days after each assessment date.

## **QUALITY THRESHOLD**

- 77 In its draft decisions, the Commission proposed a form of quality threshold requiring lines businesses to maintain their recent rates of improvement in reliability, as measured by SAIDI and SAIFI. Having considered submissions on that proposal, the Commission has decided on a quality threshold initially requiring no material deterioration, rather than continuous improvement, in reliability.
- 78 The reasons for this departure from the draft decisions include:
- the Commission does not presume that consumers demand increasing levels of reliability;
  - past rates of reliability improvement may not be sustainable for some lines businesses; and
  - a separate quality threshold criterion will require lines businesses to demonstrate how their quality targets are related to identified consumer demands.

The quality threshold requires no material deterioration in reliability, ...

... as well as meaningful engagement with consumers.

## **Quality Threshold Assessments**

- 79 The Commission will assess lines businesses against a quality threshold based upon two criteria initially:

- no material deterioration in reliability, assessed on the basis of quantitative analysis of reliability performance data disclosed under the Regulations; and
  - meaningful engagement with consumers to determine their demand for service quality, assessed on the basis of a qualitative review of, for example, disclosed asset management plans (or similar).
- 80 The purpose of the reliability criterion is to provide incentives for lines businesses to not allow their reliability to fall as a means of reducing costs in response to the price path threshold. The purpose of the consumer engagement criterion is to encourage lines businesses to engage with their consumers and to plan future services to reflect their consumers' demands for quality.
- The quality threshold is to avoid lines businesses dropping quality to meet the price path threshold.
- 81 Distribution businesses will be first assessed against the quality threshold as at 31 March 2004. Transpower will be assessed as at 30 June 2004.
- The quality assessment is at March 2004 (June 2004 for Transpower).

### **Reliability Criterion for Distribution Businesses**

- 82 The reliability criterion for distribution businesses is based on two standard measures disclosed under the Regulations, namely:
- SAIDI, being the sum of SAIDI in respect of interruptions planned by the lines business and unplanned interruptions arising in the distribution business' network; and
  - SAIFI, being the sum of disclosed SAIFI for planned and unplanned interruptions.
- The reliability criterion is based on measured SAIDI and SAIFI.
- 83 Planned and unplanned interruptions in this context have the same meaning as Class B and Class C interruptions, as defined in the Regulations. At this stage, the Commission intends to rely upon the definition provided in the Regulations, but it will consider developing guidelines to ensure that distribution businesses measure and record these and other performance indices in a consistent manner.
- 84 A distribution business would comply with the reliability criterion if, at the first assessment, neither SAIDI nor SAIFI for the year ended 31 March 2004, were to exceed its previous five-year average. Given that the *Gazette* notice has been published during the year ending 31 March 2004, distribution businesses may instead elect to have these conditions evaluated by comparing the previous five-year averages to annualised values derived from SAIDI and SAIFI for the period from 6 June 2003 to 31 March 2004. These alternative conditions can be expressed as follows:
- The reliability assessment is relative to a 5-year average.

$$S_{2004} \leq \left( \frac{S_{1999} + S_{2000} + S_{2001} + S_{2002} + S_{2003}}{5} \right)$$

where:

$S_t$  is the SAIDI or SAIFI disclosed for year  $t$  (ended 31 March);

*or (at the option of the distribution business), in relation to the year 2004 only –*

is the SAIDI or SAIFI for the period commencing on 6 June 2003 and ending on 31 March 2004, divided by 299 and multiplied by 366.

85 For simplicity, the Commission has decided not to specify the reliability criterion in terms of differences between short and long term trends using a normal statistical test, as proposed in its draft decisions.

86 Any distribution business breaching the reliability criterion may provide the Commission with an explanation supported by evidence of mitigating circumstances. The Commission will consider such explanatory information and will not investigate further if it is satisfied the breach was due to uncontrollable circumstances.

Lines businesses may explain why they breached.

### **Merged Networks**

87 Where a distribution business has been involved in a business merger or acquisition since 1 April 1998 that resulted in a change in its total customers or system length of 10% or more, the relevant SAIDI and SAIFI measures are to be calculated as weighted averages of the previously disclosed indices for the pre-merger businesses, weighted by disclosed customer numbers.

Reliability information prior to any mergers needs to be used.

### **Reliability Criterion for Transpower**

88 The reliability criterion for Transpower is based on two standard measures disclosed under the Regulations, namely:

- number of unplanned interruptions; and
- total interruptions expressed as system minutes.

The same reliability criterion applies to Transpower, albeit with reliability measured differently.

89 Transpower would comply with the reliability criterion, at the first assessment, if neither of these measures for the year ended 30 June 2004 were to exceed its previous five-year average, as follows:



$$S_{2004} \leq \left( \frac{S_{1999} + S_{2000} + S_{2001} + S_{2002} + S_{2003}}{5} \right)$$

where:

$S_t$  is the number of unplanned interruptions or the total system minutes disclosed for year  $t$  (ended 30 June).

## Consumer Engagement Criterion

90 The purpose statement in subpart 1 of Part 4A of the Act requires that lines businesses face strong incentives to provide services at a quality that reflects consumer demands. The Commission therefore considers lines businesses should be able to demonstrate:

The quality threshold also requires lines businesses to engage with end consumers to better understand their preferences...

- how they engage with consumers, directly or indirectly, to explain the trade-offs between quality and price, and to assess consumers' willingness to pay for different quality levels;
- what service offers or commitments they make to consumers, directly or indirectly, in response to information obtained during these engagements;
- how they make decisions about target quality levels;
- what types of contractual or other arrangements, if any, they enter into in relation to quality; and
- how they plan to deliver the target quality in terms of medium-term service delivery.

91 For the avoidance of doubt, the Commission does not require lines businesses to embark upon exhaustive or comprehensive research into consumers' willingness to pay for different levels or quality of line services. However, the Commission does require lines businesses to demonstrate that they have well-developed business processes directed at understanding and responding to consumers' preferences.

92 The Commission does not intend to prescribe the nature of consumer engagement. In particular, distribution businesses may choose to engage directly with consumers and/or consumer groups, and/or via the retailers with which they have use of system agreements. However, in the latter cases, distribution businesses should be confident, and should seek to demonstrate to the satisfaction of the Commission, that the retailers or consumer groups accurately reflect the interests of the consumers which they supply or represent.

... either directly or via retailers and/or consumer groups.

- 93 Similarly, Transpower may choose to engage with distribution businesses and/or retailers as proxies for consumers that are not directly connected to its network, if it is confident, and can demonstrate to the Commission's satisfaction, they accurately represent those consumers' interests.

## **Demonstrating Compliance with the Quality Threshold**

- 94 If the Commission is satisfied that, because of lack of information, it is not practicable to determine whether a lines business has complied with the reliability criterion, the lines business will need to demonstrate to the satisfaction of the auditor and the Commission, that compliance can be demonstrated through the use of an alternative approach that has an equivalent effect.
- 95 In the case of the consumer engagement criterion, the Commission does not intend to prescribe the manner in which lines businesses demonstrate compliance. The Commission is aware that lines businesses are required to disclose asset management plans annually, and considers that consumer engagement should be central to the asset management planning process. Therefore, the documented asset management plans are likely to be an important component, in the first instance, for demonstrating compliance with the consumer engagement criterion, provided the Commission is satisfied with the scope and detail of such plans.

Asset management plans are likely to be an important component of demonstrating compliance.

## ***Timeframe for Demonstrating Compliance***

- 96 The Regulations require reliability data to be published in the *Gazette* within five months of the end of the financial year. The Commission considers this same information should be provided to it in the audited threshold compliance statement, and submitted to the Commission no later than 40 working days after each assessment date, so that the assessment can be completed sooner.
- 97 The Regulations require lines businesses to disclose their asset management plans within three months of the beginning of the financial year. For the purposes of assessing compliance with the consumer engagement criterion, the Commission also requires relevant information to be included in the audited compliance statement (i.e. no later than 40 working days after each assessment date).

## **NEXT STEPS**

- 98 This section outlines the Commission's plans for implementation and further development of the regulatory regime, particularly in

regard to setting thresholds in the future, the process and detail of the investigation and control phases, and establishing information disclosure requirements under section 57T of the Act.

### **Price Path Threshold First Assessments**

- 99 The Commission will commence the first assessments against the price path threshold as soon as practicable after receiving the threshold compliance statements. The prices to be assessed will be those as at 6 September 2003, allowing three months from the publication of the *Gazette* notice for lines businesses to modify their prices, if necessary, to comply with the threshold, and a further two months for them to prepare and submit audited threshold compliance statements to the Commission.

### **Threshold Criteria to Apply from 2004**

- 100 As foreshadowed in its media statements of 27 February 2003 and 31 March 2003, the Commission will consult further on the methodology for setting parameters to apply in price path assessments from 1 April 2004.
- 101 The Commission welcomed the submissions it received on possible methodologies for setting X-factors in the CPI-X price path and grouping lines businesses, in response to the 31 January 2003 draft decision paper. The Commission considered the various proposals and as a result released the discussion paper – *Resetting the Price Path Threshold* – on 30 May 2003. The Commission has invited submissions on that paper.
- 102 The Commission intends to make decisions on X-factors to apply from 1 April 2004 in reasonable time for lines businesses to factor those decisions into their business planning processes. To this end, the Commission plans to complete the process around mid-December 2003. Further details on the planned process and timetable for resetting the price path threshold are set out in Annex 2 of this paper.

There will be further work to reset the price path threshold from April 2004.

The Commission is considering options and is seeking further input from interested parties.

Further information on the process for this work is contained in Annex 2.

### **Investigation and Control Processes and Methodologies**

- 103 Lines businesses' incentives to comply with the thresholds depend to some extent on what they consider might happen if they were identified to have breached thresholds. The Commission considers the regulatory objectives may not be achieved if lines businesses were inclined to be unduly cautious or averse to uncertainty about the consequences of their conduct in relation to thresholds.

There will be ongoing work on the investigation and control parts of the regime. Further information on this work is set out in Annex 3.

- 104 Accordingly, the Commission will endeavour to provide greater certainty about its processes in relation to investigations (following breach), declarations of control, and implementation of control, including:
- the role, if any, of warnings and administered settlements; and
  - the manner in which the Commission would seek and consider the views of interested parties.
- 105 The Commission is also developing the methodology it would apply if it were to commence an investigation arising from an identified threshold breach, and the methodology it would apply following declaration of control. The Commission intends to be transparent about any guidelines or papers it develops in this regard. The Commission's process and timetable for developing the detail of the investigation and control phases is discussed further in Annex 3.

## Information Disclosure

- 106 The Commission will use the information disclosure provisions in section 57T of the Act to acquire information required to conduct its assessment of lines businesses against the thresholds. These disclosure requirements are set out in the *Gazette* notice. The onus will be on lines businesses to provide the Commission with sufficient information for the threshold assessments to be undertaken.
- 107 Information disclosure requirements will evolve with the development of future threshold criteria. For example, the Commission may identify and develop additional information disclosure requirements over the next few months as it considers methodologies for setting X-factors. The Commission also expects to require any information that would be relevant to any investigations following any breach of thresholds. In particular, the Commission intends to develop information requirements in relation to regulatory accounts. The Commission will also consider developing any other information disclosure requirements required to meet the purpose of subpart 3 (Information Disclosure) of Part 4A of the Act.
- 108 In the meantime, lines businesses are required to make disclosures pursuant to the Regulations, including with respect to asset valuation using the current ODV Handbook. The Commission intends to make use of this public information where possible before requiring new or additional disclosures, and in doing so, the Commission may also take other information into account.

Information will need to be disclosed to facilitate threshold assessments.

The existing information disclosure Regulations still apply.

## ANNEX 1 GLOSSARY

List of terms, abbreviations and acronyms	
The Act	Commerce Act 1986
The Commission	Commerce Commission
Control	Means, having made a declaration of control in respect of goods or services supplied by an electricity lines business in markets directly related to distribution and transmission services, the Commission making a provisional authorisation, final authorisation, or accepting an undertaking from the lines business in respect of prices, revenues or quality, as set out in Part V of the Act
CPI	Consumer Price Index
Distribution Business	A lines business providing distribution services rather than transmission services (i.e. a lines business other than Transpower)
EV	Economic Value
FTR	Financial Transmission Right
kW	kilowatt (a measure of real power)
kWh	kilowatt hour (a measure of electrical energy)
kVA	kilovolt-amperes (a measure of electrical capacity and apparent power)
Lines Business	A business defined to be a “large electricity lines business” in s57D of Part 4A, including Transpower
ODV	Optimised Deprival Value
Part 4A	Part 4A (Provisions Applicable to Electricity Industry) of the Commerce Act 1986, which commenced on 8 August 2001
Regulations	The Electricity (Information Disclosure) Regulations 1999
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
System Minutes	The amount calculated by dividing estimated energy not supplied by system maximum demand during a period (expressed in minutes)
WACC	Weighted average cost of capital
X-factor	An efficiency sharing factor, used in the context of a CPI-X price path

## **ANNEX 2 THRESHOLD RESET PROCESS**

### **Purpose**

- 1 This annex briefly summarises the process and timetable the Commission intends to follow in resetting the price path threshold to apply from April 2004.

### **Background**

- 2 The Commission expects it will reset the CPI-X price path threshold to apply from 1 April 2004 (1 July 2004 in the case of Transpower), for a number of years. Lines businesses will be assessed as at 31 March 2005 (30 June 2005 in the case of Transpower) and annually thereafter.
- 3 The methodology for resetting the price path threshold will be developed through the process set out below. This will include further work on the levels of the X-factor to apply when the price path threshold is reset.
- 4 In its draft decisions of 31 January 2003, the Commission provided its preliminary view that lines businesses would be grouped and assigned a relevant X-factor, taking into account factors such as expected growth in industry productivity and the efficiency of prices and costs. Given that Transpower is the only transmission business, it would not be grouped with other lines businesses.
- 5 This view was expanded upon in the Commission's discussion paper of 30 May 2003 – *Resetting the Price Path Threshold*. That discussion paper sets out the issues the Commission considers are relevant to deciding on the preferred methodology for resetting the price path threshold, and outlines the process and timetable for the reset work.

### **Process and Timetable**

- 6 The process for resetting the price path threshold is summarised in Table 3 below. The Commission has invited submissions from interested parties on its May 2003 discussion paper, and intends to further engage with interested parties as per this process.

**Table 3 – Price Path Reset Process**

Approximate Date	Process Step
Beginning May 2003	Process outlined in decision paper of 2 May 2003 and list of issues included in Annex 2
End May 2003	Release of discussion paper - <i>Resetting the Price Path Threshold</i> - and submissions invited
Early June 2003	Publication of <i>Gazette</i> notice (thresholds set), and release of updated decision paper
June to August 2003	Meetings and discussions with interested parties
End June 2003	Deadline for formal submissions on discussion paper
End August 2003	Release of draft decision paper on methodology and proposed price path threshold to apply from 2004
End September 2003	Submissions on draft decision paper
Mid-October 2003	Conference on draft decision paper
End October 2003	Cross-submissions following conference
Mid-December 2003	Final decision
January 2004	<i>Gazette</i> notice resetting the price path threshold

## **ANNEX 3    WORK ON THE INVESTIGATION AND CONTROL PHASES**

### **Purpose**

- 1     This annex briefly summarises the process the Commission intends to follow in developing the detail of the investigation and control phases of the regulatory regime under subpart 1 of Part 4A of the Act.

### **Background**

- 2     In outlining its methodologies for investigation and control, the Commission must be cognisant of applicable provisions in the Act. Sections 57H and 57I set out the broad processes by which the Commission must make decisions concerning lines businesses that have breached the thresholds. Section 57K provides for the prioritisation of the Commission's duties under subpart 1 of Part 4A.
- 3     However, the Act does not specify the detailed processes and methodologies for undertaking an investigation into whether to declare control, or following a declaration of control. Furthermore, lines businesses' incentives to comply with the thresholds depend to some extent on what they consider might happen if they were identified to have breached thresholds. Accordingly, the Commission will endeavour to provide greater certainty about its processes and methodologies in relation to investigations (following breach), declarations of control, and implementation of control.

### **Process and Timetable**

- 4     In its 21 March 2002 discussion paper, the Commission outlined its initial proposals for fulfilling its duties under subpart 1 of Part 4A of the Act, to investigate whether to declare control, to declare control and to implement control. The Commission intends to extend and finalise this work according to the process and timetable set out in Table 4.
- 5     The Commission's work on the detail of the investigation and control phases will have two broad areas, viz:
  - the processes the Commission will follow in implementing those phases; and
  - the implementation detail associated with those phases, for example, the Commission's views on asset valuation and weighted average cost of capital (WACC).
- 6     In respect of process, the Commission will extend the work presented in its March 2002 discussion paper, by preparing a draft paper that outlines the Commission's proposed processes for the investigation and control phases. Following discussion with interested parties, this paper will be finalised.



- 7 In respect of implementation detail, the Commission's draft decisions of 23 December 2002 and 31 January 2003 on regulatory asset valuation, as well as related material, will be expanded to provide the Commission's proposals for the detailed methodologies to apply to investigation and control. The Commission intends to make final decisions on these matters, and to combine these with the paper on investigation and control processes, around mid-December 2003. In due course, the Commission will advise what level and type of discussions with interested parties it considers most appropriate to each step of this process.

**Table 4 – Process for Developing Investigation and Control Methodology**

Approximate Date	Process Step
Beginning May 2003	Process outlined in decision paper as an annex
End July 2003	Release draft paper on processes for investigation and control phases
August to September 2003	Discussions with interested parties
End September 2003	Release final paper on processes for investigation and control phases
End October 2003	Release draft paper on implementation detail for investigation and control phases
November 2003	Discussions with interested parties
Mid-December 2003	Release combined final paper on processes and implementation detail for investigation and control phases

- 8 The Commission considers that asset valuation is likely to be relevant during any investigations and implementation of control, following a declaration of control. These issues may also arise in the context of resetting the price path threshold to apply from 1 April 2004 (Annex 2). The Commission intends to include its final views on regulatory asset valuation, WACC and the measurement of profit as part of its combined paper on the investigation and control phases of the targeted control regime.