

30 April 2014

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**SUBMISSION ON THE DEFAULT PRICE QUALITY PATH FROM 1 APRIL 2015 FOR
17 DISTRIBUTORS – PROCESS AND ISSUES PAPER**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper (the **issues paper**) released by the Commerce Commission (the **Commission**) on 21 March 2014.
 - 1.1 Orion's submission should be read in conjunction with (and is intended to be complementary to) the submission filed by the ENA on the issues paper.
 - 1.2 Orion's comments are limited to just a few issues that are specific to Orion's transition from our customised price quality path (CPP) to a default price quality path (DPP).

Orion specific Issues

- 2 Orion supports the Commission's view that there is little reason to depart from the approaches that the Commission has previously relied upon when resetting default price-quality paths unless new issues become apparent or new information is available.
- 3 In Orion's case there are no approaches that the Commission has previously relied upon when setting a DPP at the end of a CPP. However

we consider that approaches that have been applied to previous DPP resets may provide useful guidance in this case.

Starting prices

- 4 When Orion's CPP ends, section 53X of the Commerce Act states that it will become subject to a DPP determination generally applicable to other distributors unless it has been granted a new CPP.
- 5 In regard to starting prices the Commission's preliminary view is that they are not required to determine separate starting prices for Orion at this time. This view is based on what the Commission considers are two possible interpretations of Section 53X(2) of the Commerce Act¹.
- 6 We agree, albeit for different reasons, with the Commission's preliminary view that they are not required to determine separate starting prices for Orion now.

Consultation on what starting prices the Commission should set?

- 7 The Commission has broad discretion as to what starting prices it sets in the future. Given this, our major concern is lack of clarity around the process the Commission will follow at that time to determine starting prices.
- 8 As we set out in our submission on the CPP draft decision and determination we encourage the Commission, at least 24 months prior to the expiry of the CPP period, to set out for consultation with us, the options and process by which the DPP settings will be determined at the end of the CPP period.
- 9 For ease of reference, we set out below the process we suggest the Commission considers, and which we included in our submission on the draft determination for our CPP. It does contemplate quality standards too:

¹ Section 53X(2) states: *53X(2) The starting prices that apply at the beginning of the default price-quality path are those that applied at the end of the customised price-quality path unless, at least 4 months before the end of the customised price-quality path, the Commission advises the supplier that different starting prices must apply.*

The Commission will consult with Orion at least 24 months prior to the end of the CPP period regarding Orion's intentions around applying for another CPP Determination, and the implementation of section 53X and Orion's DPP starting prices.

The Commission will determine, at least 12 months prior to the end of the CPP regulatory period, and after consultation with Orion, whether, in the event that Orion does not apply for another CPP Determination, the Commission intends to set starting prices at the end of the CPP regulatory period under s53X(2) by either:

(a) applying the prices that applied at the end of the CPP regulatory period; or

(b) applying different prices.

If option (b) above is to apply, the Commission will consult with Orion as to how those prices will be determined, including the method, application of the DPP Input Methodologies, the information to be used, and the calculations to be applied in determining the starting prices.

The Commission will determine, at least 12 months prior to the end of the CPP regulatory period, and after consultation with Orion, how the DPP quality standards will be set for Orion, including the method, the information to be used, and the calculations to be applied in determining the quality standards.

- 10 In regard to the choice of starting prices to apply:
- 10.1 use the prices that applied at the end of the customised price quality price, or
 - 10.2 determine new prices to apply at the end of customised price quality price

The issues paper notes ²:

We consider that the interpretation most consistent with the intended operation of the default/customised price-quality framework is that the

² Paragraphs 9 and 10 of the issues paper

starting prices that apply when Orion again becomes subject to the default price-quality path are the prices that applied in the last year of the customised price-quality path.

If we consider the prices under the customised price-quality path will no longer be appropriate at the expiration of the customised price-quality path, the Act allows us to set different starting prices, to apply when Orion again becomes subject to the default price-quality path, at least 4 months prior to the expiration of the customised price-quality path. These starting prices would likely be based on Orion's current and projected profitability as determined in the final year of the customised price-quality path.

- 11 It is unclear from the issues paper which of the options the Commission prefers or the basis on which it may make this choice.
- 12 In relation to the DPP reset the Commission has indicated that to inform its choice on whether to roll over the prices that previously applied, or adjust starting prices based on the current and projected profitability of each distributor it will calculate starting prices that would apply if starting prices are adjusted based on the current and projected profitability.³

"When setting starting prices, we can either roll over the prices that previously applied, or adjust starting prices based on the current and projected profitability of each distributor, ie, using either s 53P(3)(a) or (b) of the Act. We are interested in your views on the approach we should use to set starting prices for the next regulatory period.

In our view, it is generally not possible to make a decision on the approach to use until we have calculated the starting prices that would apply if starting prices are adjusted based on the current and projected profitability of each distributor. By carrying out this calculation, and determining the materiality of differences between the alternative starting prices, we will be able to make an informed decision."

- 13 From the issues paper it is not clear whether the Commission considers that it would also apply this approach in relation to the decision of whether to roll over the CPP prices or adjust starting prices based on the current and future profitability. We consider that it would be extremely useful if the

³ Paragraphs 2.4 and 2.5 of the issues paper

Commission could clarify whether it will adopt a process similar to the process it has indicated that it will apply in relation to the DPP reset.

- 14 If the Commission does adopt the approach of calculating starting prices that would apply if starting prices are adjusted based on the current and projected profitability to inform its decision on the choice of starting prices, then whether it is applied at the end of the DPP or CPP determination, this process means that the Commission will naturally always calculate starting prices based on the current and projected profitability of each distributor.
- 15 Having gone through this process of calculating starting prices based on the current and projected profitability we consider that the Commission will be in a position that it will always have to choose to apply these prices rather than roll over the existing prices regardless of materiality. We consider that this would be a reasonable position for the Commission to take as it would be a more accurate assessment.

Information on process

- 16 To a limited extent the issues paper has indicated the process that the Commission may take if it chooses to determine new prices to apply at the end of the CPP. The paper indicates that⁴

“We will notify parties of our particular process for assessing and, if we deem it necessary and appropriate, determining new starting prices closer to the expiration of the customised price-quality path. However, we expect that the process will be substantially similar to the process we currently use for resetting the default price-quality path under section 53P of the Act, including:

requesting information from Orion to assess its current and projected profitability;

using similar approaches to assessing and modelling forecast expenditure;

consulting on a draft decision; and

advising Orion of the starting prices that apply.”

⁴ Paragraph D15 of the issues paper

- 17 Subject to appropriate timing on the consultation as outlined in our CPP and repeated above, we consider that a process substantially similar to the process currently used for resetting the DPP under section 53P of the Act as outlined above would be appropriate.

Use of prices that applied at the end of the CPP

- 18 In the event that the Commission chooses to use the prices that applied at the end of the CPP, then we consider that the Commission will need to clarify in greater detail the mechanics of how it will actually implement and apply this choice.

What Rate of change should the Commission Set?

- 19 A further question to consider is what rate of change to set. The Commission has indicated that⁵:

When Orion comes off the customised price-quality path and onto the default price-quality path, they will be subject to the rate of change generally applicable to distributors.

- 20 While this can be considered as part of the consultation suggested above, should Orion's prices be set on the basis of current and future profitability and the rate of change generally applicable to distributors is greater or less than zero, then we do not consider that it is appropriate to apply this value to Orion's one year DPP, as Orion would either over or under recover its revenue in that one year.

- 21 We believe that this view is borne out by the issues paper where it states⁶:

If starting prices are based on the current and projected profitability of each supplier, the rate of change will not affect the amount of revenue the distributor can expect to recover over the regulatory period. This is because we use the rate of change when setting expected revenues equal to expected costs over the regulatory period. The rate of change will, however, affect the level of prices in particular years including at the end of the regulatory period. It may therefore have a significant impact on the size of price changes at resets.

⁵ Paragraph D6 of the issues paper

⁶ Paragraph 3.11.2 of the issues paper

- 22 This confirms that if the Commission sets Orion's prices based on current and projected profitability it makes no sense to set X at any value other than zero over the one year DPP period.

Quality standards

- 23 It is unclear from the issues paper how quality standards are to be reset. The Commission states in the issues paper⁷

While we are not setting starting prices for Orion at this time, Orion will be subject to the quality standards set under this reset of default price-quality path at the expiration of the customised price-quality path.

- 24 the Commission goes on to say⁸:

...after Orion's customised price-quality path, the quality standard for the remainder of next regulatory period should reflect the quality standard in place under the customised price-quality path, ie, retain a pass/fail quality standard based around the average duration and frequency of interruptions.

- 25 If the Commission's view is that quality standards should not be set now, but later, as is the case for starting prices, we agree.
- 26 We also agree with the papers view that the benefits of moving from a pass/fail quality regime under the customised price-quality path to a revenue-linked reliability incentive scheme for a relatively short period of time may be limited. We do not consider that gearing up to operate under an incentive scheme for one year would be a good use of our or the Commission's resources or fair for a set of quality standards set under different circumstances.
- 27 Similar to our views on starting prices, further clarity as to what the Commission's proposed approach is would be useful. For example:

- 27.1 does the Commission's approach mean that the reliability limits and boundary values for the period 1 April 2019 to 31 March 2020 will be the same as those set out for assessment period 2019 in schedule 3

⁷ Paragraph D5 of the issues paper

⁸ Paragraph D21 of the issues paper

of the Orion New Zealand Customised price path determination
2013 NZCC 21? or

- 27.2 that the Commission's approach is to set the reliability limits based on the last 5 years past data immediately preceding the end of the CPP or some other period? or
- 27.3 something else?
- 28 We would also like clarity regarding what would constitute a breach of quality. That is how would the two out of three rule apply?

Concluding remarks

- 29 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email dennis.jones@oriongroup.co.nz.

Yours sincerely



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