

Part 4 Commerce Act

# Customised price-quality regulation



This fact sheet provides an overview of customised price-quality regulation under the Commerce Act. With a focus on electricity distribution and gas distribution and transmission businesses, it explains why a business might apply for a customised price-quality path and the process that is involved.

Under Part 4 of the Commerce Act, the Commerce Commission has a role in regulating markets where competition is limited. When competition is limited, consumers may end up paying a price that does not reflect the cost of services they receive.

In the electricity and gas industries, distribution and transmission services are regulated under Part 4. These businesses are subject to information disclosure regulation which requires them to publish information about their performance. For electricity distribution and gas distribution and transmission businesses, 19 of these are also subject to price-quality regulation. New Zealand's sole electricity transmission business, Transpower New Zealand has its own specialised form of price-quality regulation and is therefore not covered in this fact sheet.

## What is price-quality regulation?

Price-quality regulation is designed to mimic the effects seen in competitive markets so that consumers benefit in the long term. This includes making sure businesses have incentives to innovate and invest in their infrastructure, and to deliver services efficiently and reliably at a quality that consumers expect, while limiting businesses' ability to earn excessive profits.

The Commission administers price-quality regulation for gas distribution and transmission businesses, and electricity distribution businesses that are not consumer owned. We set what are known as 'price-quality paths' for these businesses. The paths either restrict the amount of revenue

a regulated business can earn or set the maximum average prices it can charge. They also specify the service quality standard each business must meet so that quality is not compromised as a result of the price restrictions. You can read more about the Commissions activities in regulating the electricity sector in our fact sheet *Electricity and the Commerce Commission's role* at [www.comcom.govt.nz/electricity-role](http://www.comcom.govt.nz/electricity-role)

### Electricity distribution and gas distribution and transmission businesses subject to price-quality regulation

Alpine Energy Limited, Aurora Energy Limited, Centralines Limited, EA Networks (Electricity Ashburton) Limited, Eastland Network Limited, Electricity Invercargill Limited, First Gas Limited, GasNet, Horizon Energy Distribution Limited, Nelson Electricity Limited, Network Tasman Limited, Orion New Zealand Limited, OtagoNet Joint Venture, Powerco Limited, The Lines Company Limited, Top Energy Limited, Unison Networks Limited, Vector Limited and Wellington Electricity Lines Limited.



## What makes up a price-quality path?

There are a number of different components that make up a price-quality path, including three key ones.

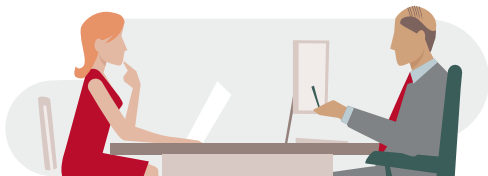
- **The starting price** – the maximum price/revenue that a business is allowed to charge/earn at the start of the regulatory period.
- **The annual rate of change** – the annual rate at which all businesses' starting prices can increase. This is expressed in the form of 'CPI-X'. This means prices are restricted from increasing each year by the rate of inflation, less an adjustment to account for productivity improvements.
- **Quality standards** – the minimum service quality standards that a business must meet. In the case of electricity distribution, these are currently based on historic averages of reliability in energy delivery.

All businesses subject to price-quality regulation start on a default price-quality path that applies for a regulatory period of up to five years. Although the paths are specific to each business, default price-quality paths are set using an industry-wide approach, providing a relatively low-cost form of regulation.

If the default path does not suit the particular circumstances of a regulated business, it can apply to the Commission for a customised price-quality path.

## What is a customised price-quality path?

A customised price-quality path is a path the Commission can set to better suit the specific needs of a regulated business and those of its consumers. For example, a business may need to invest more in its network than provided for under the default price-quality path or may have been affected by an event outside its control. Customised price-quality paths are based on the Commission's analysis of information specific to the business, and require in-depth audit, verification, and evaluation of the information provided by the regulated business.



## What happens when a business applies for a customised price-quality path?

The rules and processes for a customised price-quality path proposal, including the requirements for a proposal and the criteria we must consider when evaluating a proposal, are set out in input methodologies developed by the Commission. Input methodologies are rules, processes, requirements and evaluation criteria for services that are regulated under Part 4.

### When can an application be submitted?

Electricity distribution businesses have specified timeframes in which they can submit a customised price-quality proposal to us. Potential applicants should contact the Commission.

However, in the case of a 'catastrophic event', a business can submit a proposal at any time in the 24 months following the event, except in the 12 months before the default price-quality path is due to be reset.

As there are fewer gas distribution and transmission businesses, they can submit a customised price-quality proposal to us at any stage but should contact the Commission prior to doing so.

A customised price-quality path is a path the Commission can set to better suit the specific needs of a regulated business and those of its consumers

### What does an application need to include?

The information an applicant must provide when proposing a customised price-quality path is set out in the input methodologies. This includes:

- the reasons for the proposal
- the duration of the customised price-quality path the applicant is seeking (if less than five years)
- in the case of electricity distribution businesses, information on any proposed variation to service quality standards
- financial and other relevant information (such as forecast capital and operating expenditure) to allow the Commission to assess an appropriate price path

- an audit report and certification from the directors confirming the information provided within a proposal is accurate
- an independent expert's opinion verifying the contents of the proposal and the reasonableness of the assumptions and methodologies used.

A regulated business seeking a customised price-quality path must consult with consumers about the changes it is proposing before submitting a proposal. In its application it must provide evidence of consultation with consumers, a description of all issues raised and an explanation of whether its proposal accommodates these issues and if not, why not.

## How long does the Commission take to determine a customised price-quality path?

Within 40 working days from receiving a customised price-quality proposal we will decide whether the proposal is complete and complies with the input methodologies. This timeframe can be extended by 30 working days if both the Commission and the applicant agree.

If a proposal is not complete or does not comply with the input methodologies, we may ask the applicant for more information.

If a proposal is accepted, we will announce that we are considering the proposal, make it available upon request, and invite submissions from interested parties.

We must set a customised price-quality path within 150 working days after we have announced that the proposal is complete. This timeframe may be extended by 30 working days if both the Commission and the applicant agree.

A regulated business seeking a customised price-quality path must consult with consumers about the changes it is proposing before submitting a proposal

## What does the Commission consider when setting a customised price-quality path?

When evaluating a proposal for a customised price-quality path, we take into account a number of factors, including, but not limited to:

- whether the proposal is consistent with the input methodologies
- whether data, analysis, and assumptions underpinning the proposal are accurate, reliable and reasonable
- whether the proposed expenditure is appropriate for the expected energy demand on the network
- the extent to which any proposed changes to the applicant's quality standards reflect what the applicant can realistically achieve
- the extent to which the proposal is supported by consumers, where relevant.

## What happens next?

Once we have evaluated and considered a proposal, we will issue a decision to amend the regulated business's price-quality path. We can set any customised price-quality path that we consider appropriate for the business, as long as it is consistent with the input methodologies. Consequently, we may set a price-quality path that differs from the proposal. It is possible that this may result in lower prices than under the business's existing default price-quality path. Both the suppliers and customers of the regulated business can appeal the decision.

A customised price-quality path applies for between three and five years. This period begins at the start of a business's next pricing year.

At the end of the three to five year period, the regulated business will move back to the default price-quality path unless it applies for, and is issued with, another customised price-quality path.



# Questions and answers about customised price-quality paths

## What is the purpose of a customised price-quality path?

A price-quality path specifies minimum required quality standards and either restricts the amount of revenue a business can earn or sets the maximum prices it can charge (on average). A customised price-quality path allows a regulated business to apply for a unique price-quality path that better meets its specific needs. By contrast, default price-quality paths are established using a generic industry-wide regulatory approach.

## Will a customised price-quality path result in price rises?

Not necessarily. The Commission will assess a customised price-quality path proposal and set a price-quality path that balances both the business investment needs and the needs of consumers. The Commission can set a price-quality path that differs from a proposal made by a business, and this could involve lower prices. Businesses can also propose lower quality standards using a customised price-quality path. Such a proposal may include prices that were lower than they would otherwise be.

## Do consumers get a say in the process?

Yes, there are opportunities to have a say in the process. The best time for business and household consumers to provide their views is during the consultation round, before a regulated business has submitted its proposal to the Commission. Consumers can also make a submission to the Commission about a proposal once we have confirmed we are considering the proposal.

## Would any price rises resulting from a customised price-quality path determination hit consumers immediately?

Once the Commission has made a determination, the customised price-quality path proposal will most likely take effect at the start of the next pricing year for that business. Businesses subject to any price-quality regulation must inform consumers ahead of making any price changes.

## If a regulated business doesn't get the determination it wants from the Commission, will my electricity/gas supply be compromised?

Even if the Commission rejects or alters a proposal, the regulated business must still meet the quality standards set out in the default price-quality path or customised price-quality path. This means the quality of service it is providing will not be compromised.

## Can all regulated businesses subject to a default price-quality path apply for a customised path?

Yes, any regulated business can apply for a customised price-quality path if it believes its unique circumstances are not covered by a default path. However, a business can only make one proposal during the set regulatory period.

The Commission though is only required to consider four applications per sector for a customised price-quality path in any year.

## Can a business revert to the default price-quality path if it doesn't like the customised one the Commission determines?

No, once the Commission has set a customised price-quality path, a regulated business cannot revert to a default path until the agreed term of the customised path is complete. In addition, once submitted, a regulated business cannot withdraw its customised price-quality path application.

## I'm unhappy about an increase in the price of my electricity/gas supply as a result of a customised price-quality path. What can I do?

The Commission does not set retail electricity or gas prices. Instead we restrict the amount of revenue the regulated business can earn or determine the maximum average prices it can charge. We will only set a customised price-quality path after carefully considering a proposal and balancing both the investment needs of the business and the needs of its consumers.

Consumers should get involved early in the process such as during the consultation round and when we are considering the proposal. If we believe a regulated business needs to raise prices in order to maintain the quality of service it is providing and invest in its infrastructure, this will be reflected in the price-quality path we set. We will aim to minimise price shocks by smoothing the price increases over the timeframe of the path we set.

This fact sheet provides guidance only. It is not intended to be definitive and should not be used in place of legal advice. You are responsible for staying up to date with legislative changes.

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