

Reconsideration of Powerco Limited's quality standards and quality incentive measures

Consultation Paper

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Associated documents

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28 November 2014	ISSN 1178–2560	Electricity Distribution Services Default Price-Quality Path Determination 2015 [2015] NZCC 33
28 November 2014	ISBN 978-1-869454-12-8	Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020: Main policy paper
28 November 2014	ISBN 978-1-869454-13-5	Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020: Quality standards, targets, and incentives
18 July 2014	ISBN 978-1-869453-86-2	Proposed Quality Targets and Incentives for Default Price-Quality Paths From 1 April 2015
28 September 2012	ISBN 978-1-869452-16-2	Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26
22 December 2010	ISBN 978-1-869451-32-5	Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper

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1. Introduction

Purpose of paper

- 1.1 This consultation paper outlines and explains a proposed amendment to Powerco Limited's (Powerco) quality standards and quality incentive measures applicable to its 2015–2020 Default Price-Quality Path.
- 1.2 We seek the views of interested parties on this proposed amendment.

Background

- 1.3 On 28 November 2014, the Commission reset the default price-quality paths for 16 electricity distribution businesses following the process set out in s 53P of the Commerce Act 1986 (the Act) and applying all relevant input methodologies.¹ The reset default price-quality path applies for the regulatory period commencing 1 April 2015 and expiring 31 March 2020.
- 1.4 As part of that reset, we used interruption data provided by electricity distributors to:
 - 1.4.1 set the quality standards that will apply for the regulatory period; and
 - 1.4.2 determine the quality incentive measures used to calculate the incentives for suppliers to maintain and improve their quality of supply during the regulatory period.
- 1.5 The primary data used to calculate the SAIFI parameters was the number of customers interrupted. However, subsequent to our final determination, Powerco identified that its SAIFI parameters had been calculated from an incorrect data series.²

¹ The default price-quality path is set out in the *Electricity Distribution Services Default Price-Quality Path Determination 2015* [2014] NZCC 33.

² SAIFI refers to the System Average Interruption Frequency Index, defined as the number of customers interrupted divided by the customer base.

- 1.6 In the data supplied by Powerco the number of customers interrupted was adjusted for staged interruptions. As a consequence of these adjustments, the data provided did not reflect the actual historical number of customers interrupted.
- 1.7 We used this data to calculate the SAIFI quality standards and quality incentive measures for the 2015–2020 regulatory period. The resulting quality standards and quality incentive measures are lower than they would have been had the information reflected the actual historical SAIFI of Powerco.
- 1.8 We sought additional information from Powerco on the expected cost impact of complying with the quality standards as set out in the default price-quality path determination. Powerco advised that its indicative modelling suggested that its increased costs would range from \$5 to \$10 million of additional operating expenditure and \$10 to \$20 million of additional capital expenditure per disclosure year of the regulatory period.

2. Reconsideration framework

Purpose of this chapter

- 2.1 This chapter sets out the statutory context and legal framework under which the reconsideration and any amendment to a default price-quality path may occur.

Reconsideration of a price-quality path

- 2.2 Default price-quality paths are set on an *ex ante* basis, and apply for a regulatory period of 4 or 5 years. Once set, a default price-quality path may not be amended except in limited circumstances, which include in accordance with the identified circumstances in which they may be reconsidered under the input methodologies made under s 52T(1)(c)(ii) (the reconsideration input methodologies).
- 2.3 We determined input methodologies identifying the circumstances in which price-quality paths may be reconsidered within a regulatory period in accordance with s 52T(1)(c)(ii) of the Commerce Act 1986 (the Act).³ The reconsideration input methodologies applicable to default price-quality paths for electricity distribution businesses are set out in Subpart 5 of Part 4 of the Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26 (the EDB IMs).
- 2.4 Under clause 4.5.4(1) of the electricity distribution businesses input methodologies, we may reconsider a supplier's default price-quality path if we consider, or the supplier in question satisfies us that there has been an error:

4.5.4 When price-quality paths may be reconsidered

- (1) An **EDB's DPP** may be reconsidered by the **Commission** if-
- (a) the **Commission** considers; or
 - (b) the **EDB** in question satisfies it, upon application,
- that-
- (c) there has been an **error**...

³ The "reconsideration" input methodologies were subsequently amended by the High Court following an appeal against the input methodologies under s 52Z of the Act.

2.5 Clause 4.5.3 of the electricity distribution businesses input methodologies defines an “error” for which reconsideration is allowed as follows:

4.5.3 Error

Error means incorrect data-

- (a) discovered in a **DPP determination** and clearly unintended by the **Commission** to be included in it; or
- (b) relied upon by the **Commission** in making or amending a **DPP determination** and clearly unintended by the **Commission** to be relied upon in making or amending it,

determined by the **Commission** to have an impact on the price path by an amount at least equivalent to 1% of the aggregated **allowable notional revenue** for the **disclosure years** of the **DPP** affected by the incorrect data.

2.6 Before we commence a reconsideration of the quality standards applicable to Powerco, we must be satisfied that the cost impact of the error will, in aggregate, exceed 1% of the allowable notional revenue provided for under the price path.

2.7 As we explained in our original input methodologies reasons paper, the purpose of the materiality threshold is to provide a balance between:⁴

the need to ensure that a supplier can seek a reconsideration of the price-quality path if an event is so material in terms of financial effects on the business, that the existing path is no longer appropriate; and

the need to appropriately restrict the circumstances or events under which a path may be reconsidered. Reconsidering a price-quality path could be a costly and time consuming task, and leaving the criteria too broad could give rise to moral hazard. As a result, price-quality paths should only be reconsidered in circumstances where the benefit of reconsidering the path is expected to outweigh the likely cost (including both immediate and longer term costs), with other risks the responsibility of the supplier.

⁴ Commerce Commission “Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper” (22 December 2010), paragraph 8.4.8.

2.8 We have based the materiality threshold in terms of its estimated impact on allowable notional revenue as all costs can, in practice, be translated into a revenue impact.⁵

The threshold is based on the impact on revenue for suppliers as all types of costs can be reflected in these terms. For instance, the costs of rectifying an event may involve both opex and capex. Each can be translated into an effect on revenue. The threshold also allows events to be treated equally regardless of the year in which they occurred.

Amendments to a default price-quality path following reconsideration

2.9 Reconsideration of the price-quality path involves considering amendments to an existing s 52P determination in accordance with s 52Q of the Act. In considering what, if any, material amendments are appropriate, we must consult with interested parties.⁶

2.10 In reconsidering the default price-quality path because of an error, we may not amend the price-quality path more than is reasonably necessary to mitigate the effect of the error.⁷

4.5.5 Amending price-quality path after reconsideration

(1) Where, after reconsidering a **DPP**, the **Commission** determines that the **DPP** should be amended, the **Commission** may amend either or both of the price path or the quality standards specified in the **DPP determination**, subject to the rest of this clause.

(2) The **Commission** will not amend the-

(a) price path more than is reasonably necessary to mitigate the effect of-

...

(iii) **error**; ...

on **price**; or

(b) quality standards more than are reasonably necessary to mitigate the effect of-

...

⁵ Commerce Commission "Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper" (22 December 2010), paragraph 8.4.6.

⁶ Commerce Act 1986, s 52Q(1).

⁷ *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, clause 4.5.5.

(iii) **error; ...**

on quality.

2.11 As we noted in the 2010 IM Reasons Paper:⁸

Reconsidering the price-quality path involves making amendments to an existing determination. Amendments will be limited to the extent required to take into account the change in costs arising from the 'event', therefore will not allow for amendments beyond those required to rectify or compensate for the event. Undertaking a broader review of the price-quality path, for example, allowing the whole path to be reconsidered when a qualifying event occurs, is undesirable as it creates uncertainty for suppliers and consumers as to the allocation of risk.

2.12 Therefore, any amendments to the default price-quality path for Powerco will be limited to the extent necessary to remedy the error.

When an amendment to a default price-quality path applies following a reconsideration

2.13 S 53M(7) of the Commerce Act 1986 provides that:

No default price-quality path applies to a supplier until the date specified in the relevant section 52P determination, which must be a date at least 4 months after a summary of the determination is published in the *Gazette* under section 52P(7)(b).

2.14 Our preliminary view is that s 53M(7) applies to any reset or material amendment to the default price-quality path applicable to a supplier, and therefore we must give four months' notice to Powerco before the new quality standards come into effect, unless Powerco chooses to waive the notice period.⁹

2.15 In this instance, the effect of the amendment is to make the quality standards that apply to Powerco higher. Because the proposed amended quality standards are higher, Powerco will only fail to meet the amended quality standards if it has already failed to meet the pre-amendment quality standards before the amended standards come into effect. Furthermore, Powerco (and other suppliers) will only be assessed for compliance with the quality standards at the end of each 12 month period within the five year regulatory period.

2.16 We understand that Powerco are comfortable waiving the four month waiting period in s 53M(7). We therefore propose to adopt the amended quality standards with effect from 1 April 2015.

⁸ Commerce Commission "Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper" (22 December 2010), paragraph 8.4.31.

⁹ See *Attorney-General v Howard* [2011] 1 NZLR 58 at [119] – [120].

2.17 We welcome any feedback from interested parties regarding this view.

Assessment of impact of error on Powerco's allowable notional revenue

2.18 As noted in paragraph 2.5, the criteria for correcting any error includes:

2.18.1 identifying evidence of incorrect data, that is, information has been found in a determination, or relied upon in making the determination, that was clearly unintended by the Commission to be included or relied upon; and

2.18.2 the error must have an impact exceeding the materiality threshold.

2.19 The assessment of the first criterion is, in most circumstances, likely to be relatively straight-forward. The second criterion may be clear in some cases, but in others may be more difficult to quantify, particularly in relation to quality errors. One means of assessing the impact is to re-run the estimated costs through the financial model used to determine the supplier's price path.

2.20 We set out below our reasons for determining that there has been an error as defined in clause 4.5.3 of the EDB IMs.

2.21 We set out our methodology for how we determined the SAIFI quality standards and quality incentive measures in our draft and final reasons papers.¹⁰

2.22 As noted previously at paragraph 1.6, the incorrect data relied upon by the Commission for determining the SAIFI quality standards and quality incentive measures did not reflect the actual historic SAIFI values, and was clearly unintended by the Commission to be relied upon for that purpose. Our reliance on the incorrect data consequentially led to an error in the SAIFI data contained in the default price-quality path determination (ie, the SAIFI quality standards and quality incentive measures).

2.23 We have further determined that the error will have an impact on the price path of over 1% of the aggregated allowable notional revenue for Powerco for the regulatory period.

¹⁰ Commerce Commission "Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020: Quality standards, targets, and incentives" (28 November 2014).

2.24 We reach this view based on the following:¹¹

- 2.24.1 Powerco advised that achieving a reduction by 10% in SAIFI would require \$5–10 million of additional operating expenditure and \$10–20 million of additional capital expenditure per disclosure year of the regulatory period.¹²
- 2.24.2 Based on the estimated range of additional operating and capital expenditure required, as provided by Powerco, we estimate an impact of between 2.7% and 5.4% in the allowable notional revenue for the regulatory period to cover increased cost.

¹¹ We also assessed the potential revenue impact of the error as a result of the quality incentive scheme and conclude that it does not meet the materiality test in this situation. The maximum revenue impact is 0.64%.

¹² Letter from Richard Fletcher (Chief Executive, Powerco Limited) to John McLaren (Manager, Regulation Branch, Commerce Commission) responding to request for further information on the understatement of Powerco's SAIFI target in the 2015-2020 default price-quality path determination (18 March 2015).

3. Proposed amendments to the default price-quality path determination

Purpose of this chapter

- 3.1 This chapter outlines the amendments that are proposed for Powerco’s quality standards and incentive scheme measures.

Proposed amendments to quality standards and incentive measures

- 3.2 Having determined that there has been an error and reconsidering the default price-quality path applicable to Powerco, we propose to amend the default price-quality path determination to mitigate the effects of the error.
- 3.3 We consider that, in light of the nature of the error, the appropriate approach is to amend Powerco’s quality standards and quality incentive measures. The proposed amendments apply to:
- 3.3.1 the SAIFI limit and SAIFI boundary value, as set out in Schedule 4A; and
 - 3.3.2 the SAIFI cap, SAIFI collar, and SAIFI target, as set out in Schedule 5B of the default price-quality path determination.¹³
- 3.4 The proposed amendments to the relevant measures contained in the default price-quality path determination are set out in Table 1.¹⁴

Table 1: Powerco’s SAIFI parameters for the 2015-2020 regulatory period

SAIFI parameter	Determination	Proposed amendment
Unplanned boundary value	0.059	0.064
Target	2.1068	2.3247
Collar	1.9404	2.1473
Cap	2.2731	2.5021
Limit	2.273	2.502

¹³ *Electricity Distribution Services Default Price-Quality Path Determination 2015* [2014] NZCC 33.

¹⁴ These proposed amendments are based on SAIFI values provided by Powerco rather than the number of customers interrupted and are indicative only, pending resubmitted data.

- 3.5 We propose that the amended quality standards and quality incentive measures apply from the commencement of the regulatory period, ie, from 1 April 2015. We consider this is appropriate and consistent with the purposes of the Act and the reconsideration input methodologies. However, we acknowledge that if the amendments were to result in a reduction of the quality standards, or included a change to the price path, the effective date of the amended quality standards might need to be deferred until 1 April 2016.¹⁵
- 3.6 As this is the first time we have considered this issue in application, we welcome any submissions on the timing and effective date of proposed amendments to a price-quality path following reconsideration.

¹⁵ This is consistent with our indicative approach to the application of the reconsideration IMs to catastrophic events, as set out in Commerce Commission “Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper” (22 December 2010), paragraph 8.4.32.

4. How you can provide your views

Purpose of this chapter

- 4.1 This chapter sets out how you can provide your views on matters relating to the amendments of Powerco's quality standards and quality incentive measures applicable to their default price-quality paths from 1 April 2015.

Timeframe for submissions

- 4.2 We welcome your views on the proposed amendments and process discussed in this paper. Submissions are due by 5pm, Friday 1 May 2015.
- 4.3 We do not intend to take into account any material that is submitted outside of this timeframe. Any party that is concerned about the time to engage with the material should contact us with a request for an extension outlining their specific concerns.

Address for submissions

- 4.4 Submissions should be addressed to:

John McLaren (Manager, Regulation Branch)
c/o regulation.branch@comcom.govt.nz

Format for submissions

- 4.5 We prefer submissions in both MS Word and PDF file formats.
- 4.6 Please include "Submission on the reconsideration of Powerco's quality standards and quality incentive measures" in the subject line of your email.

Requests for confidentiality

- 4.7 We encourage full disclosure of submissions so that all information can be tested in an open and transparent manner, but we offer the following guidance.
- 4.7.1 If it is necessary to include confidential material in a submission, both confidential and public versions of the submission should be provided.
- 4.7.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
- 4.8 We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions and cross-submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.