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How we propose to implement default price-quality paths for electricity distributors from 1 April 2015

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Associated documents

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18 July 2014	ISBN 978-1-869453-84-8	Proposed compliance requirements for the 2015-2020 default price-quality paths for electricity distributors
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Regulation Branch, Commerce Commission
Wellington, NEW ZEALAND

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1. Introduction

Purpose of this paper

- 1.1 This paper invites submissions on how we propose to implement the terms of the s 52P determination for the default price-quality paths that will apply to all non-exempt electricity distributors (distributors) from 1 April 2015.¹ We are also seeking submissions on several areas where our proposed approach has changed from the draft decision published in July 2014, new items have arisen since the draft, or we are looking for further comment.
- 1.2 The deadline for making submissions is 5pm, Friday 31 October 2014.

Draft determination and draft decision papers published for consultation in July 2014

- 1.3 On 18 July 2014, we published a draft determination for the default price-quality paths to apply to distributors from 1 April 2015 to 31 March 2020.² This followed a draft decision paper that sought views on the proposed default price-quality paths, which we released on 4 July 2014.³
- 1.4 As part of our draft decision, we published companion papers explaining:
- 1.4.1 our low-cost forecasting approaches;⁴
 - 1.4.2 the proposed quality targets and incentives;⁵ and
 - 1.4.3 the proposed compliance requirements.⁶
- 1.5 We also published for consultation:
- 1.5.1 an independent report on productivity by Economic Insights Limited;⁷ and
 - 1.5.2 an independent report on econometrics by Professor Jeff Borland.⁸

¹ The default price-quality path determination is issued under s 52P of the Commerce Act 1986.

² Commerce Commission “Electricity distribution services default price-quality path draft determination 2015” (18 July 2014).

³ Commerce Commission “Proposed default price-quality paths for electricity distributors from 1 April 2015” (4 July 2014).

⁴ Commerce Commission “Low cost forecasting approaches for default price-quality paths” (4 July 2014).

⁵ Commerce Commission “Proposed quality targets and incentives for default price-quality paths from 1 April 2015” (18 July 2014)

⁶ Commerce Commission “Proposed compliance requirements for the 2015-2020 default price-quality paths for electricity distributors” (18 July 2014).

⁷ Economic Insights “Electricity Distribution Industry Productivity Analysis: 1996–2013” (24 June 2014)

- 1.6 We also published draft input methodology amendments that would affect:
- 1.6.1 the structure of the financial model (a finalised version of which is proposed to be used to set starting prices based on the current and projected profitability of each distributor);⁹
 - 1.6.2 the Incremental Rolling Incentive Scheme (IRIS);¹⁰ and
 - 1.6.3 other aspects of default price-quality paths.¹¹
- 1.7 The draft determination that we published on 18 July 2014 included provisions for how these draft input methodology amendments were proposed to be reflected.

Additional consultation on drafting of determination

- 1.8 In our draft decision paper released on 4 July 2014, we stated our intention to provide an updated determination for technical consultation on drafting.¹² We are now also seeking submissions on several areas where our proposed approach has changed from the draft decision, new items have arisen since the draft, or we are looking for further comment.
- 1.9 This step follows our consideration of:
- 1.9.1 submissions and cross-submissions on the proposed default price-quality paths; and
 - 1.9.2 additional information gathered from distributors.
- 1.10 We have now considered all the material received in response to our draft decision. We are grateful for the submissions made in response to our draft decision.

⁸ Jeff Borland “Comments on NZCC approach for forecasting opex” (26 June 2014).

⁹ Commerce Commission “Proposed amendments to input methodologies for electricity distribution services – consultation paper” (24 June 2014).

¹⁰ Commerce Commission “Proposed amendments to input methodologies: Incremental Rolling Incentive Scheme” (18 July 2014); Commerce Commission “Draft Incremental Rolling Incentive Scheme Input Methodology Amendments 2014” (18 July 2014).

¹¹ Commerce Commission “Proposed amendments to input methodologies for electricity distribution services – consultation paper” (18 July 2014); Commerce Commission “Proposed Electricity Distribution Input Methodology Amendments 2014” (18 July 2014).

¹² Commerce Commission “Proposed default price-quality paths for electricity distributors from 1 April 2015” (4 July 2014), paragraphs 9.11-9.12.

- 1.11 We expect to publish a final decision by 28 November 2014, following consideration of submissions received in this additional round of consultation.

We invite drafting suggestions and submissions before the final decision

- 1.12 Before we publish our final decision, we invite drafting suggestions on the updated proposed drafting of the default price-quality path determination to apply to distributors from 1 April 2015.
- 1.12.1 Chapter 2 provides an overview of the updated draft determination.
- 1.12.2 Chapter 3 sets out specific matters that should be reflected in the updated draft determination for which we are seeking feedback on the sufficiency and clarity of the drafting.
- 1.13 We also invite submissions on the additional matters for further consultation set out in Chapter 4.
- 1.14 We welcome your views on these matters, and the proposed options for implementation. Chapter 5 provides details for how you can provide your views.

Material released alongside this paper

- 1.15 Alongside this paper, we have published updated proposed drafting of the default price-quality path determination to apply to distributors from 1 April 2015 (updated draft determination).¹³
- 1.16 We have also published updated draft input methodology amendment determinations and companion papers that would affect:
- 1.16.1 the structure of the financial model, and other aspects of default price-quality paths (first and second type amendments);¹⁴ and
- 1.16.2 IRIS.¹⁵

¹³ Commerce Commission “Electricity Distribution Services Default Price-Quality Path Draft Determination 2015” (20 October 2014).

¹⁴ Commerce Commission “Draft Electricity Distribution Input Methodology Amendments Determination 2014” (20 October 2014); Commerce Commission “How we propose to implement amendments to input methodologies for electricity distribution services: First and second type” (20 October 2014).

¹⁵ Commerce Commission “Draft Incremental Rolling Incentive Scheme Input Methodology Amendments 2014” (20 October 2014); Commerce Commission “How we propose to implement amendments to input methodologies for electricity lines businesses subject to price-quality regulation (IRIS)” (20 October 2014).

- 1.17 We encourage you to consider the updated draft determination, as well as the updated draft input methodology amendment determinations and companion papers, alongside this paper.

2. Overview of the updated draft determination

Purpose of this chapter

- 2.1 The purpose of this chapter is to inform interested persons about the intended purpose of each clause and schedule in the updated draft determination to apply to distributors from 1 April 2015.
- 2.2 We invite feedback on whether each clause and schedule meets its intended purpose.

Intended purpose of each clause in the updated draft determination

- 2.3 Table 2.1 sets out the intended purpose of each clause of the updated draft determination.

Table 2.1: Intended purpose of each clause of the updated draft determination

Clause	Name	Purpose
1	Short title	Sets out the formal name of the determination.
2	Commencement	Sets out the commencement date of the default price-quality path determination.
3	Application	Specifies the suppliers to which the determination applies and the suppliers to which the determination does not apply. The determination will not apply to Orion New Zealand until its current customised price-quality path ends.
4	Interpretation	Provides a list of all defined terms used in the determination, and sets out the rules of interpretation.
5	Default / customised price-quality path	States that suppliers must comply with the price path and quality standards specified in the relevant clauses for the specified regulatory period. The default price-quality path has been drafted so as to make it easier to amend for a customised price-quality path, or a reset of the default price-quality path. Regulatory period specific terms are included in the schedules to the determination.
6	Applicable input methodologies	Specifies the input methodologies that apply to this determination.
7	Dates for proposing a customised price-quality path	Specifies the date or dates for proposing a customised price-quality path.
8 <i>Schedules 1, 2, 3A, 3B and 5</i>	Price path	Specifies the price path that applies to each supplier, and how the values used to calculate the price path are established. This includes starting prices, rate of change, process for determining pass-through and recoverable costs including, energy efficiency and demand side management/D-Factor, Quality/S-Factor quality incentive adjustment, wash-ups, catastrophic risk, extended reserves and avoided cost of transmission.
9 <i>Schedule 4</i>	Quality standards	Sets out quality standards and the terms of the new revenue-linked quality scheme.
10 <i>Schedule 3C</i>	Major transactions, amalgamations and mergers	Explains how to calculate allowable notional revenue, pass-through and recoverable costs and quality standards compliance following certain large transactions.

Clause	Name	Purpose
11 <i>Schedules 6 and 7</i>	Annual compliance statements	Sets out the information that suppliers must provide in order to demonstrate compliance with the default price-quality path.
12	Reconsideration of a default price-quality path	States the conditions in which a default price-quality path may be reconsidered.

3. Matters reflected in the updated draft determination

Purpose of this chapter

- 3.1 This chapter sets out specific matters that are intended to be reflected in the updated draft determination published alongside this paper. Where applicable, we also note provisions that are included in Chapter 4 for additional consultation.
- 3.2 We invite you to highlight any instances in which the updated draft determination is either insufficient and/or unclear for reflecting the intention of the drafting set out in this chapter.

General guidance

- 3.3 The final determination will set the default price-quality path applying to electricity distribution services from 1 April 2015 to 31 March 2020.
- 3.4 Table 3.1 sets out the specific matters that should be reflected in the updated draft determination published alongside this paper.
- 3.5 Table 3.1 does not cover all of the detail within the updated draft determination. The table is intended to indicate what the specified clause or schedule is trying to achieve.
- 3.6 Interested parties should note that the relevant input methodologies have been applied in the updated draft determination, including the proposed amendments referred to in paragraphs 1.6 and 1.7. Also, the tables in the updated draft determination do not contain any numbers.

Table 3.1: Specific matters reflected in the updated draft determination

Clause	Name	Description
5	Default / customised price-quality path	<p><u>General approach</u></p> <p>These rules apply to both default and customised price-quality path determinations to allow potential future customised price-quality path determinations to be included within the existing determination with minor adjustments. Orion New Zealand is subject to a separate determination at this time.</p> <p><u>Specific points</u></p> <ul style="list-style-type: none"> Regulatory period specific terms, such as starting prices, rates of change, and quality standards that apply are specified in the schedules to the determination. Future default and customised price-quality path determinations will be specified by an amendment to the schedules to the determination. Any amendment following another default or customised price-quality path would set out the specific starting prices and rates of change in the accompanying schedules, and the regulatory period to which they apply.
8.1-8.5	Starting prices, rates of change, notional revenue and allowable notional revenue	<p><u>General approach</u></p> <p>The determination specifies:</p> <ul style="list-style-type: none"> the starting prices that apply (Clause 8.1 and Schedule 1); annual rates of change, relative to CPI (Clause 8.2 and Schedule 2); and how compliance with the price path is assessed (Clauses 8.3-8.5 and Schedules 3A and 3B).
<i>Schedule 1</i>	<i>Starting Prices</i>	
<i>Schedule 2</i>	<i>Annual rate of change</i>	
<i>Schedule 3A</i>	<i>Calculation of allowable notional revenue for the first Assessment Period</i>	
<i>Schedule 3B</i>	<i>Calculation of allowable notional revenue for the remaining Assessment periods</i>	<p>Rather than assessing compliance based on the distributor's actual revenue, we assess compliance on the basis of 'notional' revenue. The revenue is 'notional' because it is based on quantities that are lagged by two years, rather than the quantities for the year in question. This approach ensures that all the values can be calculated at the time the distributor sets its prices.</p>

Clause	Name	Description
		<ul style="list-style-type: none"> • ‘Allowable notional revenue’, is the amount that the distributor’s distribution prices are allowed to generate. • ‘Notional revenue’, is the amount that the distributor’s distribution prices did generate. <p data-bbox="869 435 2045 549">The distributor will be compliant with the price path if ‘notional revenue’ is less than or equal to ‘allowable notional revenue’. The difference between the two terms reflects the distributor’s pricing decisions, because equivalent quantity terms are used in each.</p> <p data-bbox="869 611 1025 635"><u>Specific points</u></p> <ul style="list-style-type: none"> • Distribution prices (the component of price that does not relate to the recovery of any pass-through or recoverable costs from consumers) are used in calculating ‘notional revenue’ and ‘allowable notional revenue’ both of which use a quantity lagged by two assessment periods. • For each assessment period, the ‘notional revenue’ using that assessment period’s distribution prices must be less than the prior periods distribution prices inflated by CPI and an annual rate of change on a weighted average basis. • The annual rate of change is either explicitly stated for a distributor or a generally applicable rate of change applies (Schedule 2). • The maximum allowable revenue and how this is adjusted to reflect the ‘allowable notional revenue’ is specified for the first assessment period (Schedule 3A). • For assessment periods other than the first assessment period, the ‘allowable notional revenue’ is increased by the difference between the prior periods’ ‘allowable notional revenue’ and ‘notional revenue’ to allow the distributor’s weighted average prices to not be affected by any pricing below the level of ‘allowable notional revenue’ in prior periods (Schedule 3B). • The CPI adjustment is determined on a lagged CPI-X basis to ensure the information is available when a distributor sets prices.

Clause	Name	Description
8.6	Demonstration of recovery of pass-through and recoverable cost charges	<p data-bbox="869 260 1061 284"><u>General approach</u></p> <p data-bbox="869 304 2033 376">Some costs that distributors face may be passed through directly to their consumers. These costs have been defined as pass-through costs and recoverable costs in the input methodologies.</p> <p data-bbox="869 392 2033 507">Distributors have the opportunity to recover pass-through and recoverable costs in full by the introduction of a pass-through balance approach. Our proposed approach has changed from the draft decision, and our reasons for the proposed changes are discussed in Chapter 4.</p> <p data-bbox="869 523 2033 770">Distributors are required to report each year on their actual pass-through and recoverable costs and the amount of revenue received in respect of those costs. Any under or over-recovery would be added to, or subtracted from, the allowance for the next year. The schedules to the determination set out additional information to inform how the value of some recoverable costs are to be calculated where the input methodologies do not fully provide the information required for the calculation. Additional detail is also provided on the timing recognition for when some recoverable costs can be included in prices.</p> <p data-bbox="869 834 1025 858"><u>Specific points</u></p> <ul data-bbox="869 879 2033 1342" style="list-style-type: none"> <li data-bbox="869 879 2033 994">• Pass-through prices (the component of price that relates to the recovery of any pass-through or recoverable costs from consumers) are subject to a wash-up mechanism and do not have a specific compliance test attached. <li data-bbox="869 1010 2033 1125">• The pass-through balance calculation uses actual quantities multiplied by the pass-through price to reflect the actual amount of pass-through and recoverable costs recovered through pricing. The actual pass-through costs and recoverable costs recognised for that period are then removed. <li data-bbox="869 1141 2033 1212">• This total will be negative where a distributor has under-recovered pass-through and recoverable costs for the period. <li data-bbox="869 1228 2033 1342">• An extra term is added to the equation in every period (other than the first) to reflect the prior year balance, which should be updated each year to reflect any new information on the actual pass-through and recoverable costs for prior assessment periods.

Clause	Name	Description
8.7 - 8.11	Restructure of prices	<ul style="list-style-type: none"> • This value is then adjusted by the time value of money (cost of debt) to ensure any value which was under-recovered or over-recovered from consumers is recognised in the following period. • There is no stated restriction to allowing a negative pass-through and recoverable cost balance to be carried over from one regulatory period to the next, or requiring the balance to be positive at a specific point in time.
		<p data-bbox="869 480 1066 504"><u>General approach</u></p> <p data-bbox="869 523 2040 727">A distributor may restructure its prices during an assessment period. This impacts how it calculates ‘notional revenue’, ‘allowable notional revenue’ and some pass-through and recoverable costs for that period. The rules set out how to establish what quantities should be used, and how to derive a reasonable estimate where actual quantities are not available. Our proposed approach has changed from the draft decision, and our reasons for the proposed changes are discussed in Chapter 4.</p> <p data-bbox="869 791 1025 815"><u>Specific points</u></p> <ul style="list-style-type: none"> • A restructure of price is not allowed of itself to increase ‘allowable notional revenue’ for the period in which the restructure of price is undertaken. • For the purpose of calculating compliance against the price path under Clause 8.3, where a distributor undertakes a restructure of prices, if there is quantity information which corresponds to those prices on a t-2 lagged basis then these quantities must follow the restructured prices. • Where a new pricing category (or ‘consumer group’) is created, which does not have a clear allocation of consumers from previously existing pricing categories, and the transition to the new price category is at the request of consumer or retailers, the t-2 lagged quantity is to be zero. • Where a distributor undertakes a restructure of prices and there is no quantity information available which corresponds to those prices on a t-2 lagged basis, the quantities must be estimated for the restructured prices in order to assess compliance against the price path in Clause 8.3. • A distributor must estimate a reasonable quantity using a ‘demonstrably reasonable’ methodology. This requires the consideration of information which is reasonably available to the distributor.

Clause	Name	Description
9.1-9.2 <i>Schedule 4A</i>	Quality standards <i>Quality standards</i>	<ul style="list-style-type: none"> • A distributor must apply a consistent methodology for estimating the quantity which relates to the restructured price for both the current assessment period and the following assessment period. • The establishment of a ‘demonstrably reasonable’ threshold gives distributors additional flexibility in calculating the appropriate quantities attributable to the restructured prices, while ensuring the Commission can assess whether the estimation of a quantity for use in the calculation of the price path test at Clause 8.3 was appropriate. • Information relating to the restructure and how the quantity was derived must be provided to the Commission 30 working days prior to the restructure taking place. <p data-bbox="869 651 1066 675"><u>General approach</u></p> <p data-bbox="869 699 2018 810">Distributors are subject to a quality standard that they must comply with. This quality standard is composed of two measures of reliability: the system average interruption duration index (SAIDI) and the system average interruption frequency index (SAIFI).</p> <p data-bbox="869 874 1025 898"><u>Specific points</u></p> <ul style="list-style-type: none"> • Reliability is assessed annually. To comply with the annual reliability assessment, a distributor must have both an assessed SAIDI and an assessed SAIFI value that is less than or equal to the limits stated in Schedule 4A. • To comply with the quality standard, a distributor must have either complied with the annual reliability assessment for the assessment period or have complied with the reliability assessment for the preceding two assessment periods. • The quality standard is independent of the revenue-linked quality incentive adjustment recoverable cost.
10 <i>Schedule 3C</i>	Large transactions <i>Re-calculation of allowable notional revenue following a major transaction</i>	<p data-bbox="869 1233 1066 1257"><u>General approach</u></p> <p data-bbox="869 1281 2040 1345">Major transactions require an alternative method of calculating ‘allowable notional revenue’ and compliance with the quality standards that apply to a distributor.</p>

Clause	Name	Description
		<p>The purpose of this approach is to maintain the price-quality paths that apply during a regulatory period and will ensure consumers are not, in aggregate, worse off as a result of the transaction. Our proposed approach has changed from the draft decision, and our reasons for the proposed changes are discussed in Chapter 4.</p> <p><u>Specific points</u></p> <ul style="list-style-type: none"> • Distributors are required to advise the Commission within 30 working days where they enter into a major transaction, amalgamation or merger which meets certain thresholds (either an anticipated change in the regulatory investment value of a distributor by 10% as a result of the transaction, or notional revenues are anticipated to change by 10% as a result of the transaction). • The input methodologies determination contains the rules for treatment of a transaction resulting in an amalgamation or merger between non-exempt distributors. • A major transaction is any transaction involving a transfer of assets that results in a consumer being supplied by a different distributor. • Where a distributor is required to advise the Commission of a major transaction due to meeting the thresholds above, information is required to be provided to understand the size of the transaction and likely impacts on the distributor's price path compliance calculations. • The obligation to report the information exists regardless of whether the distributor is buying or selling assets. • Regardless of whether a distributor is required to advise the Commission of a major transaction, the distributor must determine a number of values (in accordance with Schedule 3C) that relate to the transaction in order to calculate the allowable notional revenue, notional revenue and pass-through balance. • This requirement applies to all transactions other than amalgamations and mergers.

Clause	Name	Description
11	Annual compliance statements	<ul style="list-style-type: none"> • Following a major transaction or purchase of transmission assets (including a purchase forecast in the period immediately prior to a regulatory period), the distributor must also update the applicable quality limits and boundary values used to assess compliance with the quality standards, in accordance with the approach specified in Schedule 4B. • The determination specifies how the allowable notional revenue, pass-through and recoverable costs (including components of these costs) are to be established following a major transaction. However, a distributor may propose an alternative approach using an alternative methodology if it is approved by the Commission. <p><u>General approach</u></p> <p>The annual compliance statement provides the Commission and interested parties with a statement that demonstrates whether a distributor has complied with the default price-quality path in the previous assessment period in a consistent format that is understandable and allows compliance reviews to be undertaken. These provisions have been updated to reflect the information requirements associated with the proposed changes in approach to pass-through and recoverable costs (and the pass-through balance), and the price restructure and major transactions provisions. The updated proposed approach and our reasons for the proposed changes are discussed in Chapter 4.</p> <p><u>Specific points</u></p> <ul style="list-style-type: none"> • All distributors must within 50 working days of the end of an assessment period submit an annual compliance statement to the Commission and make this statement publicly available within five working days. • Distributors must also provide copies of the detailed price-quantity schedules used in calculating the price paths in an electronic format.

Clause	Name	Description
11.7 – 11.8	Annual compliance statements – price restructures	<ul style="list-style-type: none"> • The annual compliance statement requires explicit statements be made on compliance with the price path and quality standards. The annual compliance statement must include supporting information, calculations, and policies for capturing quality standard information and, where relevant, explain the reasons for any non-compliance and actions taken to mitigate future non-compliance. • Distributors are required to state whether they have undertaken a restructure of prices, received assets from Transpower or undertaken an amalgamation, merger or major transaction. In the event of one of these events occurring during the assessment period, further supporting information and calculations are required. • Distributors are required to provide supporting information on the pass-through balance, including the estimates of forecast pass-through and recoverable costs used in setting prices compared to the actual value of costs recognised in the annual compliance statement and an explanation on why the pass-through balance is not zero where required. • Each compliance statement must be accompanied by an independent audit report and director’s certificate both of which cover the entirety of the annual compliance statement. <p data-bbox="869 938 1025 962"><u>Specific points</u></p> <ul style="list-style-type: none"> • Further information relating to the restructured prices is required to be provided as part of the annual compliance statement representing the nature of the price restructure and an indication of impacted load groups. • Information relating to the restructure, including how the quantity was derived is also required to be provided within the compliance statement in order for the information to be publicly available. • The information contained within the annual compliance statement will also include a comparison of a forecast Q for the restructured price and an actual Q. • The restructure of prices does not impact the calculation of pass-through cost balance as this calculation uses the quantity for that assessment period, ie, on a non-lagged basis.

Clause	Name	Description
<i>Schedule 4A</i>	<i>Quality standards</i>	<p data-bbox="869 261 1061 282"><u>General approach</u></p> <p data-bbox="869 304 1899 373">To assess a distributor’s compliance with the reliability assessment, four values are needed: the SAIDI and SAIFI limits, and the SAIDI and SAIFI assessed values.</p> <p data-bbox="869 437 1025 458"><u>Specific points</u></p> <ul data-bbox="869 480 1989 820" style="list-style-type: none"> <li data-bbox="869 480 1944 549">• Table 4A.1 sets out the annual limits, as well as the daily boundary values used in calculating the assessed values. <li data-bbox="869 576 1966 687">• The SAIDI and SAIFI Assessed Values for each Assessment Period are calculated by adding together half the daily SAIDI or SAIFI values for planned interruptions and the daily SAIDI or SAIFI values for unplanned interruptions. <li data-bbox="869 708 1989 820">• Where a daily SAIDI or SAIFI value for unplanned interruptions exceeds the stated boundary value, a major event day is triggered, and the daily unplanned SAIDI or SAIFI value is equal to the relevant boundary. These triggers operate independently of one-another.
<i>Schedule 4B</i>	<i>Adjustments to quality standards following a major transaction or a purchase of system fixed assets</i>	<p data-bbox="869 852 1061 873"><u>General approach</u></p> <p data-bbox="869 895 2047 1139">The sale and purchase of network assets, either between distributors (as part of a major transaction) or between a distributor and Transpower, results in a distributor’s actual network assets following the transaction being different from the assets on which their quality standards and quality incentive adjustment are based. A distributor’s SAIDI and SAIFI limits used to measure compliance against the quality standards, and the comparable values used to implement the quality incentive scheme, are therefore re-calculated following the transaction.</p> <p data-bbox="869 1219 1025 1240"><u>Specific points</u></p> <ul data-bbox="869 1262 1989 1374" style="list-style-type: none"> <li data-bbox="869 1262 1989 1374">• To adjust for this, this schedule gives a series of equations that distributors use to re-calculate their SAIDI and SAIFI limits, boundaries, targets, caps, and collars that reflect historic performance of the connection points (ICPs) transferred.

Clause	Name	Description
<i>Schedule 5</i>	<i>Process for determining the amount of pass-through and recoverable costs for an assessment period</i>	<ul style="list-style-type: none"> • The approach is one of weighted average adjustment; with the number of ICPs being used to weight the SAIDI and SAIFI performance of the transferred assets. <p><u>General approach</u></p> <p>For some pass-through and recoverable costs defined within the input methodologies additional information is required in order for a distributor to calculate the value which is allowed to be recorded under the default price-quality path.</p> <p><u>Specific points</u></p> <ul style="list-style-type: none"> • Pass-through costs and recoverable costs are only allowed to be included within the annual compliance statement calculations to the extent that they have not already been recovered by the distributor, either in prior periods or are intended to be recovered through mechanisms other than prices. • There is no prohibition on a distributor recovering pass-through and recoverable costs in a later period if they are not recovered in the period incurred. • The schedule also states where the process for determining the value of certain pass-through and recoverable costs is covered in the determination. • Any costs which are not explicitly covered here have their value determined in accordance with the rules contained within the input methodologies determination.
<i>Schedule 5A</i>	<i>Approval of energy efficiency and demand incentive allowances</i>	<p><u>General approach</u></p> <p>Under the input methodologies an energy efficiency or demand incentive allowance must be approved by the Commission.</p> <p><u>Specific points</u></p> <ul style="list-style-type: none"> • The information within this clause is not required to be submitted within the annual compliance statement and accordingly is not subject to the director certification or audit assurance required of the other information, though this may be requested by the Commission. • Applications for an energy efficiency or demand incentive allowance must meet set criteria and be

Clause	Name	Description
		<p>submitted within 50 working days of the end of the assessment period.</p> <ul style="list-style-type: none"> The Commission will only approve amounts equal to foregone revenue attributable to the initiative, as determined by the Commission. The amount determined by the Commission is a recoverable cost in the assessment period following that in which the amount is determined, eg, two years after the assessment period to which the foregone revenue relates. It is therefore subject to an adjustment for the time value of money (using the cost of debt).
<i>Schedule 5B</i>	<i>How to calculate the quality Incentive adjustment</i>	<p><u>General approach</u></p> <ul style="list-style-type: none"> Specifies how distributors calculate the quality incentive adjustment which is recognised as a recoverable cost in the second year after the quality performance was observed. <p><u>Specific points</u></p> <ul style="list-style-type: none"> Tables within the schedule set out the SAIDI Target, SAIDI Collar, SAIDI Cap, SAIFI Target, SAIFI Collar and SAIFI Cap. The Quality incentive adjustment is calculated using both SAIDI and SAIFI performance, calculated individually compared to the respective target. The Quality incentive adjustment is symmetric for both SAIDI and SAIFI for every year of the regulatory period and is capped at +/- 1% of the Maximum Allowable Revenue (MAR) contained within Schedule 1. The values provided for SAIDI Target, SAIDI Collar, SAIDI Cap, SAIFI Target, SAIFI Collar and SAIFI Cap may require adjustment following a major transaction, the rules for adjusting values are contained within Schedule 4B.
<i>Schedule 5C</i>	<i>Claw-back</i>	<p><u>Specific points</u></p> <ul style="list-style-type: none"> Specifies which distributors are allowed to claim claw-back as a recoverable cost, the values allowed and the periods in which they are to be recognised.
<i>Schedule 5D</i>	<i>NPV wash-up allowance</i>	<p><u>Specific points</u></p> <ul style="list-style-type: none"> Specifies which distributors are allowed to claim the 2013-2015 NPV wash-up allowance as a recoverable cost, the values allowed and the periods in which they are to be recognised.

Clause	Name	Description
<i>Schedule 5E</i>	<i>Avoided transmission charges</i>	<p><u>Specific points</u></p> <ul style="list-style-type: none"> • Specifies how distributors calculate the avoided costs of transmission. We retain the approach contained in the 2012 DPP Determination for prior transmission asset purchases. • Purchases made after 1 April 2015 will have an avoided cost of transmission established in the first year, and then that amount is carried forward in constant nominal terms.
<i>Schedule 5F</i>	<i>Transmission asset wash-up adjustment</i>	<p><u>Specific points</u></p> <ul style="list-style-type: none"> • Where the listed distributors do not purchase all of the assets listed which relate to their transmission asset wash-up adjustment before 31 March 2015, the distributor will be required to include a negative recoverable cost at the value and for the assessment period stated in their respective table. • The assessment period to which the recoverable costs may impact starts at 2016/17 so the respective distributors will know when setting prices that the adjustment has been undertaken and can set their pass-through price accordingly.
<i>Schedule 5G</i>	<i>How to calculate recoverable costs for the incremental rolling incentive scheme</i>	<p><u>Specific points</u></p> <ul style="list-style-type: none"> • Specifies the information required for distributors to calculate the operating expenditure incentive adjustment and capital expenditure incentive adjustment. These are used to calculate the Incremental Rolling Incentive Scheme (IRIS) recoverable costs in the next regulatory period.

Clause	Name	Description
<i>Schedule 5H</i>	<i>Approval of extended reserves allowances</i>	<p data-bbox="869 260 1061 284"><u>General approach</u></p> <p data-bbox="869 304 1984 328">Under the input methodologies an extended reserves allowance must be approved by the Commission.</p> <p data-bbox="869 392 1025 416"><u>Specific points</u></p> <ul data-bbox="869 432 2033 914" style="list-style-type: none"> <li data-bbox="869 432 2033 528">• The information within this clause is not required to be submitted within the annual compliance statement and accordingly is not subject to the director certification or audit assurance required of the other information, though this may be requested by the Commission. <li data-bbox="869 549 1935 612">• Information for an extended reserves allowance recoverable cost must meet set criteria and be submitted within 50 working days of the end of the assessment period. <li data-bbox="869 633 1805 657">• The Commission may approve by notice in writing a positive or negative allowance. <li data-bbox="869 678 2033 788">• The amount determined by the Commission is a recoverable cost in the assessment period for which the amount was determined, and therefore may be included in distributors' forecast of pass-through prices for that year. <li data-bbox="869 809 2007 914">• Any updates to the amount following Commission approval must be reflected in the update to pass-through balance for that assessment period when recalculating the pass-through balance for the next assessment period.
<i>Schedule 6</i>	<i>Form of director's certification</i>	<p data-bbox="869 946 1025 970"><u>Specific points</u></p> <ul data-bbox="869 991 1995 1050" style="list-style-type: none"> <li data-bbox="869 991 1995 1050">• At least one director of the distributor is required to certify that all information contained within the annual compliance statement is true and accurate.
<i>Schedule 7</i>	<i>Independent auditor's report on annual compliance statement</i>	<p data-bbox="869 1082 1025 1106"><u>Specific points</u></p> <ul data-bbox="869 1126 1989 1233" style="list-style-type: none"> <li data-bbox="869 1126 1989 1150">• Specifies the requirement of the audit report which accompanies the annual compliance statement. <li data-bbox="869 1171 1989 1233">• We request submissions on whether a change is required to our proposed assurance requirements discussed in Chapter 4.

4. Additional matters for consultation

Purpose of this chapter

- 4.1 This chapter sets out some additional matters for consultation where our proposed approach has changed from the draft decision, new items have arisen since the draft, or we are looking for further comment. These matters cover:
- 4.1.1 a revised approach to the recovery of pass-through and recoverable costs;
 - 4.1.2 the treatment of price restructures;
 - 4.1.3 the treatment of major transactions;
 - 4.1.4 a revised methodology for components of, and compliance with, the quality standards and incentive scheme;
 - 4.1.5 the pass-through of Electricity Authority levies;
 - 4.1.6 assurance requirements; and
 - 4.1.7 the energy efficiency and demand incentive allowance.
- 4.2 We welcome submissions on our updated proposed approaches, our reasons for the proposed changes, and any suggested drafting refinements.

Revised approach to the recovery of pass-through and recoverable costs

- 4.3 Following consultation on our draft decision and further consideration, we are proposing a revised approach to the recovery of pass-through and recoverable costs under the price path.
- 4.4 Under our revised approach, we propose that all pass-through and recoverable costs will be subject to a separate price path, from the calculation and assessment of allowable notional revenue.

Ability to recover pass-through and recoverable costs

- 4.5 In principle, distributors should be able to recover pass-through and the allowed recoverable costs in full. This is because the amounts are generally outside the control of distributors, so few if any incentives are created by exposing distributors to the risk of under-recovery.

- 4.6 However, in our draft decision, we noted that two issues make full recovery problematic.
- 4.6.1 First, distributors have difficulty forecasting the amounts required to cover pass-through and recoverable costs.
- 4.6.2 Second, the recovery of pass-through and recoverable costs amounts are associated with some degree of volume risk.¹⁶
- 4.7 Submitters' general view appears to be that forecasting uncertainty is the greater of the two concerns.¹⁷

Draft decision approach to the recovery of pass-through and recoverable costs

- 4.8 In reaching our draft decision, we considered three broad approaches to the recovery of pass-through and recoverable costs.
- 4.8.1 First, the Electricity Networks Association's (ENA) proposal, which uses a 'wash-up' of all differences between the allowable notional revenue and the actual revenue.¹⁸
- 4.8.2 Second, the Vector approach, which is for each distributor to disaggregate each of its line charge prices into a component that recovers all the pass-through and recoverable costs and a component that recovers the balance of its allowed revenue.¹⁹

¹⁶ Commerce Commission "Proposed default price-quality paths for electricity distributors from 1 April 2015" (4 July 2014), paragraphs 5.3-5.4.

¹⁷ Refer: Powerco "Submission on Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and Issues paper" 30 April 2014, paragraph 89; Vector "Cross-submission DPP Issues Paper" 15 May 2014, paragraph 4.

¹⁸ Commerce Commission "Proposed compliance requirements for the 2015-2020 default price-quality paths for electricity distributors" (18 July 2014), paragraphs 3.35-3.37.

¹⁹ Commerce Commission "Proposed compliance requirements for the 2015-2020 default price-quality paths for electricity distributors" (18 July 2014), paragraphs 3.38-3.40.

4.9 Our draft decision adopted a third, ‘hybrid’ approach of that proposed by Vector and the current regime. This is where the price disaggregation would be between a price component that recovers Transpower charges and a component that recovers the balance of the allowed revenue.²⁰ We explained the reasons for this in our Main Policy Paper.²¹

Revised proposed approach to the recovery of pass-through and recoverable costs

4.10 Our revised proposed approach is to move away from the ‘hybrid’ approach, and adopt an approach substantially similar to that proposed by Vector. This means expanding the provision in the determination for the transmission recoverable cost to include all pass-through and recoverable costs.

4.11 Our revised proposed approach also requires amendments to the specification of price input methodology setting out how notional revenue and allowable notional revenue are calculated. This approach should therefore be read alongside our proposed amendments to these input methodologies.²²

4.12 Our aim is to allow distributors to fully recover their pass-through and recoverable costs, while maintaining the integrity of the weighted average price cap. Therefore, only the component of price that does not relate to the recovery of pass-through or recoverable costs will be used to calculate notional revenue and allowable notional revenue. Distributors will track a ‘pass-through balance’ of pass-through and recoverable costs separately.

²⁰ Commerce Commission “Proposed compliance requirements for the 2015-2020 default price-quality paths for electricity distributors” (18 July 2014), paragraphs 3.43-3.44.

²¹ Commerce Commission “Proposed default price-quality paths for electricity distributors from 1 April 2015” (4 July 2014), Chapter 5.

²² Refer: Commerce Commission “How we propose to implement amendments to input methodologies for electricity distribution services: First and second type” 20 October 2014.

- 4.13 We have not adopted the ENA’s proposed approach because we consider that the Vector approach or the ‘hybrid’ approach would resolve two issues that are not addressed by the ENA approach. Those issues are:
- 4.13.1 the pass-through cost anomaly, by which distributors are routinely under-compensated for pass-through and recoverable costs when quantities are generally reducing and over-compensated when quantities are increasing; and
 - 4.13.2 a submission from Vector suggested that changes in the timing of Transpower’s notification of its prices could lead to “serious cash-flow issues for all non-exempt [distributors]”.²³
- 4.14 For the draft decision, we were concerned that some distributors may have difficulty with the Vector approach as it would require each distributor to disaggregate each of its prices into a distribution price and a pass-through and recoverable price.
- 4.15 The draft decision reflected a split of prices indicating the portion of the price which related to the recovery of transmission recoverable costs consistent with existing information disclosure requirements. We did not receive any submissions on our draft decision that indicated that some distributors may have difficulty with the disaggregation of prices.

Compliance with the revised proposed approach

- 4.16 In our revised proposed approach we have extended the provision in the determination for the transmission recoverable cost to include all pass-through and recoverable costs. We consider that distributors will be able to determine the allocation of price between distribution price and pass-through price.
- 4.17 Distributors have determined the total price for each price category and have estimated the pass-through and recoverable costs for the forthcoming pricing year for many years. Distributors should be able to continue to do this and to calculate the allowable notional revenue for each forthcoming pricing year.
- 4.18 If a detailed split of a distributor’s prices was unavailable, we expect that a distributor could scale each of its total prices by a common factor to derive distribution prices such that its notional revenue is less than or equal to its allowable notional revenue.

²³ Vector “Submission to Commerce Commission on the Default Price-Quality Paths from 1 April 2015: Process and Issues Paper” 30 April 2014, paragraphs 45-52.

- 4.19 A similar approach may be taken to scaling the total prices to derive the set of pass-through and recoverable costs. The pass-through prices relate to actual quantities rather than lagged quantities. Distributors may therefore wish to take account of expected differences between the lagged quantities (which will be known) and actual quantities (which can only be estimated).
- 4.20 For the avoidance of doubt, there is no requirement in the updated draft determination for the disaggregation of total prices to be cost reflective. While the total price may be required to follow pricing principles, including being cost reflective, this is not the purpose of the requirement. Rather, our objective is to allow for a distributor to fully recover its pass-through and recoverable costs.

We are seeking feedback on our revised proposed approach

- 4.21 We welcome further views on this issue because it is possible that some distributors may not have considered the detail of how a disaggregation of prices required to implement our proposed approach might be achieved.

Treatment of price restructures

- 4.22 Following consultation and further consideration, we are proposing some changes to our draft decision for the proposed treatment of price restructures. The proposed changes reflect issues identified by parties with the scope of the provisions and some improvements to address areas of concern.

Rules for price restructures

- 4.23 A distributor may restructure or change its prices during an assessment period. These changes will affect how notional revenue and allowable notional revenue are calculated for that assessment period.
- 4.24 Notional revenue and allowable notional revenue are calculated using prices and corresponding quantities from an earlier period. In many cases, it will be possible to trace the historical quantity information to a restructured price.
- 4.25 However, historical quantity information corresponding to a restructured price may not always exist. In this instance, distributors will have to estimate a quantity. A concern we have is that if that quantity estimate is too low, the distributor will set a price that is higher than it would be for those services if the estimate was accurate.
- 4.26 Any quantity estimate that a distributor is required to make should be demonstrably reasonable. We plan to monitor price restructures where estimates are used, and must be satisfied that the approach to estimating is reasonable. Distributors will therefore be required to produce certain information concerning a restructured price.

Draft decision for the treatment of price restructures

- 4.27 Some price restructures lead to an inability to readily identify lagged quantities, which are essential elements of the price path formulas. The draft decision approach required distributors that restructure their prices to develop and use a reasonable methodology to estimate lagged quantities that were unavailable.
- 4.28 The draft decision defined the term price restructuring. It also set rules about how to determine the lagged quantities used to calculate allowable notional revenue following a price restructure, where a lagged quantity corresponding to a restructured price was unavailable.
- 4.29 Orion New Zealand submitted that the draft decision did not address issues that can arise when setting prices for the year after a restructure. Orion New Zealand pointed out that the need to estimate lagged quantities rather than those being readily available to distributors is not limited to the year in which restructured prices take effect.²⁴

Revised proposed approach for the treatment of price restructures

- 4.30 Our approach to determining the quantities that apply following a pricing restructure remains largely unchanged. Rules are provided for specific types of price restructuring. Distributors that restructure their prices are required to demonstrate an alternative approach for estimating lagged quantities that are unavailable.
- 4.31 We have updated our proposed approach for the treatment of price restructures to:
- 4.31.1 add a requirement for distributors to include certain information about a price restructuring in their annual compliance statements; and
 - 4.31.2 require distributors to apply the proposed approach when calculating the Allowable Notional Revenue and Notional Revenue in the assessment period immediately following the restructure of prices.
- 4.32 Annual compliance statements must contain:
- 4.32.1 a forecast of the quantity for the assessment period in which the restructure occurs (as prepared at the beginning of the year), and the actual quantity for the assessment period that corresponds to the price restructure; and
 - 4.32.2 an explanation of the reasons for any differences between the forecast and actual quantities.

²⁴ Orion New Zealand Limited "Submission on the draft DPP determination and related documents" 29 August 2014, paragraphs 24-25.

- 4.33 Including this requirement within the annual compliance statement will make the methodology used to establish the quantities following a price restructure publicly available.
- 4.34 Quantity information for the period in which the price restructure occurs is not used to calculate notional revenue. This information is important though for ensuring that suppliers take care in making an estimate and to allow us to assess whether a supplier's estimate and forecast assumptions were reasonable.
- 4.35 To address the issue raised by Orion New Zealand, the requirement within Clause 8 of the draft determination has been extended to apply to the assessment period immediately following the assessment period in which the price restructure first applied. This addresses the likely absence of lagged quantity information for that assessment period.

Compliance with the revised proposed approach

- 4.36 Ex-ante reporting of price restructures gives us an opportunity to raise price path compliance concerns with a distributor during an assessment year, rather than allowing potential over-charging to persist.
- 4.37 The requirement to provide information 30 working days prior to an assessment period where quantities were determined has been maintained. We consider that this early notification is valuable and provides distributors with an opportunity to ensure that price restructures meet the price path compliance requirements.
- 4.38 The requirement for the ex-post reporting on actual quantities for price restructures exists because the reasonableness of the assumptions involved may not be easily identified within the current ex-ante reporting requirement.

We are seeking feedback on our revised proposed approach

- 4.39 We welcome your views on our revised proposed approach to the treatment of price restructures and any suggested drafting refinements.

Treatment of major transactions

- 4.40 Like price restructures, major transactions create difficulties for a distributor trying to calculate its allowable notional revenue, notional revenue, pass-through balance and quality standards. The major transactions provisions of the determination set out how distributors are to calculate these amounts following the transaction.
- 4.41 Further detail on the treatment of quality standards following a mid-period sale or purchase of network assets is included in the section below titled 'Methodology for components of the quality standard and incentive scheme'.

Our objectives for the treatment of major transactions

- 4.42 One of our main objectives in drafting the provisions for the treatment of major transactions has been to provide network owners and prospective purchasers with some certainty as to the regulatory approach to a major transaction.
- 4.43 If major transactions were to be only provided for under a general requirement for Commission approval of a proposal, then the lack of certainty could impact on the pursuit of possible transactions.
- 4.44 Our focus is on ensuring the price path for distributors is maintained while keeping charges in aggregate constant, and providing no disincentive for parties to maintain prices for consumers at a similar level to the level that would have occurred absent the transaction.

Draft decision for the treatment of the impact of major transactions on the price path

- 4.45 Submissions on our draft decision indicated that the proposed drafting did not appropriately address transactions between a non-exempt distributor and an entity which was not a non-exempt distributor. This was because not all of the required parameters existed for entities not subject to the default price-quality path (eg, allowable notional revenue).
- 4.46 Accordingly, our revised proposed approach provides additional rules to address these potential transactions.

Revised proposed approach for the treatment of major transactions under the price path

- 4.47 We have retained the general approach to major transactions between non-exempt distributors as set out in our draft decision. However, some modifications have been made to reflect our revised proposed approach to the recovery of pass-through and recoverable costs.
- 4.48 When both parties to the transaction are non-exempt distributors, the parties themselves must determine the price path amounts attributable to the transaction. Parties must use a demonstrably reasonable methodology for this purpose.
- 4.49 However, if only one of the parties is a non-exempt distributor, there will be no price path amounts for the exempt distributor. In these circumstances, we propose that the non-exempt distributor calculate the changes required to allowable notional revenue and pass-through and recoverable costs (used to calculate the pass-through balance) using a formula-based approach.

- 4.50 For transactions between a non-exempt distributor and an exempt distributor a ratio referred to as the 'transaction factor' is calculated by dividing:
- 4.50.1 the sum of the seller's prices and quantities for the assets being sold; by
 - 4.50.2 the sum of the seller's prices and quantities for all of the seller's network.
- 4.51 This 'transaction factor' is then used as an allocator to determine the amount attributable to the transaction for some of the components of the price path calculations.
- 4.52 The 'transaction factor' is used to represent a measure of the size of the transaction rather than requiring the exact allocation of all cost and quantity components to be determined.
- 4.53 The values used in this calculation are 'prices' as for an exempt distributor, only a total 'price' will be available (ie, it will not necessarily have separate distribution and pass-through prices).
- 4.54 The proposed methodology does not explicitly account for part-year issues for transactions between two non-exempt distributors that occurs part-way through an assessment year. The parties should have sufficient flexibility in agreeing the allocation of the parameters that determine the price path to provide for such issues.
- 4.55 For transactions between a non-exempt distributor and an exempt distributor, we specify a 'Part-year Factor', which is the proportion of an assessment year for which the new ownership arrangements apply. This factor is then used to allocate amounts that would have applied had the transaction taken effect from the first day of the assessment period.
- 4.56 The proposed drafting also allows a distributor to propose an alternative approach for calculating allowable notional revenue, pass-through and recoverable costs following a major transaction using any reasonable alternative methodology. We expect this may be used where cost and quantity components are able to be more accurately assigned than on a proportion basis.

We are seeking feedback on our revised proposed approach

- 4.57 We welcome your views on our revised proposed approach to the treatment of major transactions and any suggested drafting refinements.

Methodology for components of the quality standards and incentive scheme

4.58 We have considered submissions regarding the quality targets and incentives that we proposed in our draft decision. Consequently, the draft determination now reflects a revised methodology for components of, and compliance with, the quality standards and incentive scheme.

Revenue linked to average reliability of network

4.59 Under the proposed incentive scheme, a distributor's revenue would be dependent on the average reliability of the network. If reliability was better than the target, then future revenues would be increased. Likewise, if reliability was worse than the target, then future revenue would be reduced.²⁵

4.60 This high-level approach of linking revenue to reliability to help improve incentives is being maintained.

4.61 The revised methodology we are now proposing:

4.61.1 provides for separation of the quality standards from the quality incentive scheme;

4.61.2 affects the calculation of the standard deviation, which is now based on daily values;

4.61.3 affects the re-calculation of SAIDI and SAIFI following major transactions or purchases of network assets; and

4.61.4 affects the setting of the SAIDI and SAIFI boundaries.

4.62 The revised methodology also provides for the adjustment of the data set for past compliance breaches.

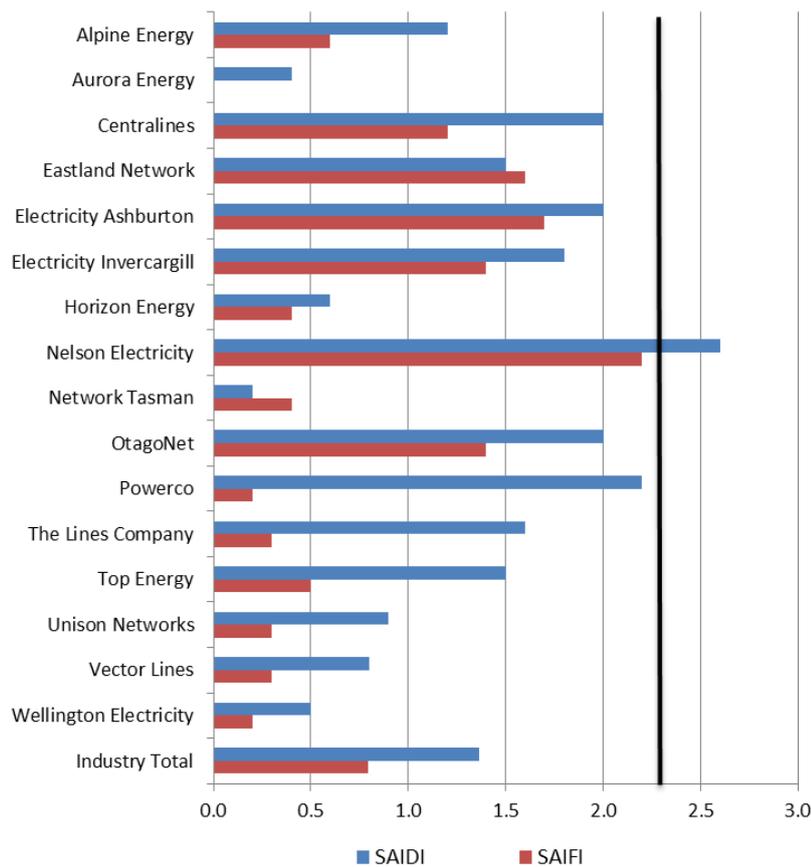
Draft decision approach for components of the quality standards and incentive scheme

4.63 Our draft decision proposed quality compliance standards that were the same as the reliability targets for the quality incentive scheme. We proposed to use our enforcement discretion to take no compliance action for breaching this quality standard where a distributor's SAIDI or SAIFI performance was above the target, but still below the cap.

²⁵ Refer: Commerce Commission "Proposed default price-quality paths for electricity distributors from 1 April 2015" (4 July 2014), Chapter 6.

- 4.64 At the draft decision stage, the standard deviation was calculated using the annual SAIDI and SAIFI performance for each distributor over the reference period. The caps and collars for SAIDI and SAIFI are set one standard deviation above and below the relevant target.
- 4.65 In our draft decision, we provided a set of equations for the re-calculation of SAIDI and SAIFI following major transactions or purchases of network assets. Our view was that this aspect of the draft decision was fit-for-purpose.
- 4.66 For setting the SAIDI and SAIFI boundaries, our draft decision was based on a modified version of the Institute of Electrical and Electronics Engineers' (IEEE) normalisation methodology. This modified version was better suited to New Zealand's situation, where many distributors experience a large number of zero-event days.

Figure 4.1: Annual frequency that SAIDI and SAIFI boundaries are exceeded under the draft decision methodology



- 4.67 However, in many cases the boundary values that result from applying this method do not reflect the expectation that distributors will experience 2.3 major event days per year, which is taken from the IEEE standard (see Figure 4.1 above). Our view is that the most likely reason for this is that the historical reliability data does not suitably fit the log-normal distribution that the IEEE approach is based on.
- 4.68 In setting the SAIDI and SAIFI targets for the draft decision, where a distributor exceeded either the SAIDI or SAIFI limit for two out of three years, the applicable years were adjusted in the reference dataset by the same proportion that the limit was exceeded by.

Revised proposed approach for components of the quality standards and incentive scheme

- 4.69 Our revised proposed approach is to set the SAIDI and SAIFI limits for assessing compliance with the price-quality path equal to the SAIDI and SAIFI caps for the quality incentive adjustment (instead of the SAIDI and SAIFI targets). Additionally, we are proposing to re-introduce the ‘two-out-of-three’ rule for complying with the quality standards.
- 4.70 We now propose to set a quality target for the operation of the automatic rewards and penalties in the quality incentive adjustment recoverable cost that is different from the quality limits used for assessing compliance with the price-quality path. We are proposing this ‘de-linking’ because submissions from distributors raised concerns that they would breach the quality standards and be non-compliant half the time (on average).
- 4.71 We consider that this revised proposed approach will provide greater certainty for distributors about when the Commission will take enforcement action, and provide appropriate incentives for the provision of service quality. The Commission will retain the ability to intervene in cases of repeated poor performance.
- 4.72 Our revised proposed approach includes that the standard deviation be calculated based on the daily SAIDI and SAIFI performance over the reference period. We are proposing this change to estimate standard deviations consistently with the approach used for the current quality standards and to improve the statistical properties of the estimate.
- 4.73 The draft determination now also provides a more detailed set of equations that must be used to re-calculate the relevant SAIDI and SAIFI figures following a mid-period sale or purchase of network assets. The approach aims to give updated values that accurately reflect the historic performance of a distributor’s post-transaction network.

- 4.74 The updated equations result in a process that gives a more refined result, which reduces the likelihood of inappropriate quality incentives. These equations are based on the principle of taking a weighted average of the performance of a distributor's current assets and the assets sold or purchased. The number of connections (or ICPs) transferred is used as a weighting factor.
- 4.75 Our revised proposed approach also determines the SAIDI and SAIFI unplanned boundaries using the 23rd highest daily unplanned SAIDI and SAIFI values from the ten year reference data set. This approach will also be used to normalise the historic SAIDI and SAIFI data sets following a large transaction.
- 4.76 We are proposing this new approach to ensure that on average, a distributor goes over the SAIDI and SAIFI unplanned boundaries 2.3 times a year (2.3 major event days are triggered per year) which the IEEE standard suggests is the appropriate number of major event days per year. We consider that identifying the 23rd largest SAIDI and SAIFI day over the ten year reference period to be a more simple and consistent way of achieving this.
- 4.77 Finally, our revised proposed approach removes the pro-rata compliance breach adjustment that applies to the calculation of the reliability limits and targets.

We are seeking feedback on our revised proposed approach

- 4.78 We welcome your views on our revised proposed approach for components of, and compliance with, the quality standards and incentive scheme, and any suggested drafting refinements.

Pass-through of Electricity Authority levies

- 4.79 We have been advised that expected Electricity Authority (EA) levies for distributors for the period 1 July 2014 to 30 June 2015 will likely be higher than the amount forecast when distributors set their prices for the current pricing year (which commenced 1 April 2014). This follows a change to the way in which EA levies are allocated.
- 4.80 Under the current default price-quality path determination, where the distributor has not recovered levies within the current pricing year, they cannot be recovered in assessment years in a subsequent regulatory period.
- 4.81 We invite submissions on this issue. We will take any submissions received into consideration in reaching our final decisions.

Assurance requirements

4.82 The draft determination that we published on 18 July 2014 replaced the pro-forma audit report in the current default price-quality path determination with a schedule that outlines the requirements of the audit report. Submitters were generally supportive of this proposed approach.

Submitters' concerns

4.83 However, some concern was expressed about the requirement to determine whether "proper records to enable the complete and accurate compilation" of the Annual Compliance Statement have been met. This is because of the likely issuance of qualified opinions as a result.²⁶

4.84 This requirement also exists within the current Electricity Distribution Information Disclosure Determination 2012. This has resulted in some qualifications in respect of reliability data. However, the relevant clause appears to have been interpreted and applied differently between audit firms.

4.85 We acknowledge that distributors have different recording practices for interruptions, where partly automated records may need to supplement manual records. The requirement within the annual compliance statement for a distributor to provide a description of policies and procedures for capturing and recording interruptions reflects the likely difference in practice between distributors.

4.86 The requirement exists to identify any serious concerns about the reliability of the information presented. We expect that an auditor will consider whether the information presented is sufficiently reliable applying relevant materiality considerations.

We are seeking feedback on this requirement

4.87 We invite submissions on whether the retention of the requirement to determine whether "proper records to enable the complete and accurate compilation" of the annual compliance statement have been met does provide useful information on the reliability of the information used to report on performance.

²⁶ Refer: Alpine Energy Limited "Submission to the Commerce Commission on Proposed Compliance Requirements for the 2015–2020 Default Price-Quality Paths for Electricity Distributors" 29 August 2014, paragraphs 10-18; PwC "Submission to the Commerce Commission on Proposed Compliance Requirements for the 2015–2020 Default Price-Quality Paths for Electricity Distributors and Associated Input Methodology Amendments - Made on behalf of 19 Electricity Distribution Businesses" 29 August 2014, paragraphs 14-18; Electricity Networks Association "Submission on the detailed drafting of the Draft default price-quality path Determination and Input Methodologies amendments" 15 September 2014, paragraphs 215-216.

Energy efficiency and demand incentive allowance

- 4.88 Schedule 5A of the updated draft determination includes additional information that describes the situation under which an initiative, project, or activity may qualify for an energy efficiency and demand incentive allowance.
- 4.89 The allowance excludes tariff-based measures and has some similarities to relevant definitions applied in Australia. We welcome feedback from interested persons on the proposed criteria we have set for determining an energy efficiency or demand incentive allowance.

5. How you can provide your views

Purpose of this chapter

- 5.1 This chapter sets out how you can provide your views on how we propose to implement default price-quality paths for electricity distributors from 1 April 2015.

Timeframe for submissions

- 5.2 We welcome your views on the amendments proposed in this paper. Submissions are due by 5pm, Friday 31 October 2014.
- 5.3 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

- 5.4 Submissions should be addressed to:

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

Format for submissions

- 5.5 We prefer submissions in both MS Word and PDF file formats.
- 5.6 Please include “Submission on implementing default price-quality paths for electricity distributors from 1 April 2015, 20 October 2014” in the subject line of your email.

Requests for confidentiality

- 5.7 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.
- 5.7.1 If it is necessary to include confidential material in a submission, both confidential and public versions of the submission should be provided.
- 5.7.2 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.
- 5.8 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’.