

20 September 2013

Ralph Matthes
Executive Director
MEUG
PO Box 8085
Wellington

MATTER NO:1055.3
OUR CONTACT: Stephen Franks
Nikki Pender

By email: ralph@meug.co.nz

Dear Ralph

**COMMERCE COMMISSION DRAFT CPP DETERMINATION FOR ORION NZ LTD:
JURISDICTION, PURPOSE AND TECHNICAL COMPLIANCE ISSUES**

1. You have asked whether the governing law enables the Commission to proceed with a CPP in line with the draft determination. In particular you ask whether it could be ultra vires, or otherwise reviewable for conflict with the purposes, disciplines and internal consistency requirements of the regulatory scheme
2. Your questions arise in the wider context of concerns that the draft determination's grant of claw-back rights would establish a bad precedent. Though the money amounts are small, in relation to Orion's turnover and balance sheet, they are significant for that very reason. The determination is clearly identified to be considered as a precedent. In relation to the right to claw-back expenditure, you consider it to be a damaging and bad precedent. In particular those rights appear to you to:
 - (a) be prompted more by sympathy for Orion than by a proper concern to propound and adhere to predictable principle;
 - (b) involve a "split the difference" concession that does not rest on logical distinctions;
 - (c) be unsupported by the reasoning intended to justify them;
 - (d) be contrary to the sound expert advice obtained by the Commission;
 - (e) result in serious uncertainty for consumers, as to what risks they carry;
 - (f) allow suppliers to expect not to bear the cost of decisions to forgo precautions for which their permitted revenue is supposed to provide; and
 - (g) consequently, create incentives for less than efficient levels of precautionary expenditure.

2 MEUG intends to respond to the substance of the Commission's draft decision to apply claw-back in its own submission. You have asked us for a brief overview of the legislation to consider whether:

- (a) A single CPP which traverses more than one DPP is consistent with the Act: and
- (b) Any claw-back period should be counted as part of the term of the CPP, meaning that Orion cannot claw-back past losses under a CPP without also including the claw-back period within the term of the CPP.

3 You intend to include a copy of this letter as part of MEUG's submission.

DPPS And CPPS Are Intended To Operate In Parallel

- 3. The proposed period of Orion's CPP is set to run from 1 April 2014 until 31 March 2019. The CPP would only overlap the existing DPP by one year and over 80% of its lifespan, it would replace a DPP which has yet to be determined.
- 4. It is doubtful that the Commission has the authority to set a CPP which would straddle more than one DPP period. The legislation expressly creates an interdependency between individual DPPs and CPPs, which could be lost if the two paths are separated. In particular:

(a) **The Act's prescriptive timing requirements ensure CPPs fall within a specified DPP regulatory period:**

Suppliers cannot propose a CPP until after a DPP has been set by the Commission (s 53Q(1)); a supplier can only make one CPP proposal during a regulatory period and cannot do so within 12 months of a DPP's expiry date (s 53Q(3)); a CPP is imposed by way of an amendment to the s 52P determination which set the applicable DPP (s 53V(3)).

Orion's CPP period would be not be synchronised with either of the DPPs that it would displace.

(b) **The IMs relating to DPPs and CPPs are to be applied consistently:**

IMs must as far as reasonably practicable be consistent with other IMs that relate to the same goods and services (s 52T(2)(c)); a CPP proposal must adopt or apply all relevant IMs that apply to the DPP (s 53Q(2)(d)); under the IMs which apply to the EDBs, both DPPs and CPPs are subject to the same IMs for cost of capital, asset valuation, treatment of tax and cost allocation; both DPPs and CPPs are immune from any IM changes for the regulatory period to which they apply other than those resulting from appeals under s 52Z (s 53ZB).

Were the Commission to amend an IM after 1 April 2014 (the proposed start-date of Orion's CPP) and before 1 April 2015 (when the next DPP period is due to begin), Orion's CPP would no longer share the same IMs as the DPP which it purports to displace.

- (c) **The Commission is to use an existing DPP as the yardstick by which to measure a proposed CPP:**

The Commission can determine whether and to what extent the supplier's individual price-quality path departs from the default path: (s 53V(2)(a)). The Commission can decide either to lower or raise a supplier's prices below those it would have otherwise been entitled to under the DPP (s 53V(2)(b)).

If the 2015-2020 DPP differs materially from the existing one, the Commission would not be able to reset Orion's CPP to align with it even if there is no logical reason for differential treatment.

Any Clawback Period Should Be Included as Part Of The CPP's Lifespan

5. The Commission can only apply claw-back when setting a CPP if prices would be higher or lower than under the DPP that would otherwise apply (s 53V(2)(b)). In other words, the Commission cannot apply claw-back to an earlier DPP that is unrelated to the proposed CPP.
6. The Commission considers the applicable DPP to be the existing DPP which was set in November 2009 and runs from 1 April 2010 until 31 March 2015 (Draft Determination para [1.4]). The costs to be clawed-back were or will be incurred between 4 September 2010 and 1 April 2014. For claw-back to be applied, the CPP must replace that DPP over the relevant period, giving the CPP an effective start date of either 4 September 2010 or the earliest date of the expenditure sought to be recouped .
7. The Commission cannot set a CPP for longer than five years (s 53W). If the Commission wishes to apply claw-back, then the current expiry date of the proposed CPP must be reset to take account of the claw-back period.

SUMMARY

8. It is our opinion that the Commission lacks the requisite jurisdiction either to determine a single CPP which traverses more than one default price-quality path (DPP); or to claw-back past losses under a CPP without also including the claw-back period within the term of the CPP.

Yours sincerely

FRANKS & OGILVIE



Nikki Pender

Consultant

nikki.pender@franksogilvie.co.nz

Direct Dial: 04 815 8037

Mobile: 021 515 395