Proposed change to Cancellation Charging Policy

Proposed changes

In response to further RSP feedback, Chorus is changing the way we calculate the monthly cancellation rate to a calculation that is more mathematically correct. We are also changing the cancellation threshold, which will start at10% from 1 March 2020 with a glidepath to 7% by 1 March 2021.

Changes explained

In response to some RSPs concerns about the mathematical correctness of the way we calculate the monthly cancellation rate, we have proposed a change to that calculation as follows:

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{all orders cancelled in month}}{\textbf{orders received in month} + \textbf{orders in WIP}}\%\right)$$

Note: All calculated percentages are rounded to two decimal places.

This change causes a significant reduction when we calculate the average cancellation rate (as a percentage) across the whole industry over the last 4 months – the rate drops from 20.55% (calculated using our previous methodology) to 9.92% (with the shift to the new calculation methodology).

The current starting point for the cancellation threshold is 21%, which represents the current average industry cancellation rate based on our previous calculation methodology. Our policy meant that only those RSPs with a higher than average cancellation rate would potentially face a cancellation charge (i.e. there would also need to be Qualifying Cancellations for the same period for a charge to result).

We've used the same approach to calculate the new starting point for the cancellation threshold - the industry average cancellation rate based on our updated calculation methodology, which is approximately 10%.

The cancellation threshold glidepath under the previous calculation methodology saw 21% reduce to 15% over a 12-month period. This represented a 30% improvement in cancellation rate across the industry. The size of this improvement meant RSPs would need to proactively make changes in this space to achieve the target (i.e. this is an aspirational target which we believe is attainable through RSP change by way of the joint improvement plans and a greater focus on cancellation issues)

If we seek the same rate of improvement under the updated calculation methodology (i.e. 30%), this results in a reduction of the cancellation threshold from 10% to 7% over the same 12-month period.

The net impact of this change is negligible for the industry. For the vast majority of RSPs (73%) the change in calculation methodology does not impact whether they are below or above the Cancellation Threshold over the last 4 months. For those who are impacted by the calculation methodology change:

- the impact is potentially positive (i.e. they have moved from potentially over the Cancellation Threshold to under the Cancellation Threshold). This is the case for 9% of RSPs but only in relation to 1 of the last 4 months; and
- the cancellation rate of the remaining RSPs impacted (18% of total) is now over the Cancellation Threshold where previously it was under. Having said that, this is the case for 1 month of the last 4 months only.

Attached are some worked examples comparing the cancellation charge impact under the previous and proposed calculation methodologies.

Example A

RSP was below threshold and remains below threshold

- 6117 orders in the month accepted by Chorus
- 1003 orders cancelled in the month:
  - 720 from orders received in month; and
  - 283 from orders received in previous months (WIP)
- 4430 orders in progress at beginning of the month (WIP)

Original method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{orders received and cancelled in month}}{\textbf{orders received in month}}\% + \frac{\textbf{orders in WIP cancelled in month}}{\textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{720}}{\mathbf{6117}}\% + \frac{\mathbf{283}}{\mathbf{4430}}\%\right) = (\mathbf{11.77\%} + \mathbf{6.39\%}) = \mathbf{18.18\%}$$

Monthly Cancellation Rate is ***below*** the current Cancellation Threshold of 21% so there won't be a cancellation charge for this month.

Proposed method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{all orders cancelled in month}}{\textbf{orders received in month} + \textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{1003}}{\mathbf{6117 + 4430}}\%\right) = \left(\frac{\mathbf{1003}}{\mathbf{10547}}\%\right) = \mathbf{9.51\%}$$

Monthly Cancellation Rate is ***below*** the proposed Cancellation Threshold of 10% so there won't be a cancellation charge for this month.

Example B

RSP was below threshold but exceeds new threshold

- 0 orders in the month accepted by Chorus
- 1 order cancelled in the month:
  - 0 from orders received in month; and
  - 1 from orders received in previous months (WIP)
- 7 orders in progress at beginning of the month (WIP)

Original method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{orders received and cancelled in month}}{\textbf{orders received in month}}\% + \frac{\textbf{orders in WIP cancelled in month}}{\textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{0}}{\mathbf{0}}\% + \frac{\mathbf{1}}{\mathbf{7}}\%\right) = (\mathbf{0}\% + \mathbf{14.29}\%) = \mathbf{14.29}\%$$

Monthly Cancellation Rate is ***below*** the current Cancellation Threshold of 21% so there won't be a cancellation charge for this month.

Proposed method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{all orders cancelled in month}}{\textbf{orders received in month} + \textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{1}}{\mathbf{0}+\mathbf{7}}\%\right) = \left(\frac{\mathbf{1}}{\mathbf{7}}\%\right) = \mathbf{14.29}\%$$

Monthly Cancellation Rate is ***now above*** the proposed Cancellation Threshold of 10% so there may be a cancellation charge for this month if there are Qualifying Cancellations.

Example C

RSP was above threshold but is now below new threshold

- 78 orders in the month accepted by Chorus
- 11 orders cancelled in the month:
  - 4 from orders received in month; and
  - 7 from orders received in previous months (WIP)
- 33 orders in progress at beginning of the month (WIP)

Original method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{orders received and cancelled in month}}{\textbf{orders received in month}}\% + \frac{\textbf{orders in WIP cancelled in month}}{\textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{4}}{\mathbf{78}}\% + \frac{\mathbf{7}}{\mathbf{33}}\%\right) = (\mathbf{5.13\%} + \mathbf{21.21\%}) = \mathbf{26.34\%}$$

Monthly Cancellation Rate is ***above*** the current Cancellation Threshold of 21% so there won't be a cancellation charge for this month.

Proposed method

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\textbf{all orders cancelled in month}}{\textbf{orders received in month} + \textbf{orders in WIP}}\%\right)$$

$$\textbf{Monthly Cancellation Rate} = \left(\frac{\mathbf{11}}{\mathbf{78+33}}\%\right) = \left(\frac{\mathbf{11}}{\mathbf{111}}\%\right) = \mathbf{9.91\%}$$

Monthly Cancellation Rate is ***now below*** the proposed Cancellation Threshold of 10% so there won't be a cancellation charge for this month.