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Regulation Branch
Commerce Commission
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18 February 2010

Submission on the type of regulation to apply to Transpower

1. Vector welcomes the opportunity to provide this submission on the Commerce Commission's (Commission) consultation paper *Recommendation to the Minister regarding the type of regulation to apply to Transpower*.

2. As the Commission acknowledges¹, there are significant inherent differences between Transpower and the electricity distribution businesses (EDBs). In Vector's view, these differences mean decisions that are made in order to meet the Purpose of Part 4 with regard to Transpower cannot be regarded as precedent setting for decisions made with regard to EDBs, and vice versa. Our comments on appropriate mechanisms for regulating Transpower should not therefore be interpreted as necessarily indicative of Vector's position regarding regulation of EDBs, particularly in light of Transpower's different regulatory history and commercial pressures.

3. Vector has not commented on the Commission's discussion of the Part 4 Purpose Statement and refers the Commission to our previous submissions on this topic.²

Individual price-quality regulation

4. Vector agrees with the Commission that individual price-quality regulation is the most suitable form of regulation for Transpower of the possible regulatory

¹ For example, *Draft for Consultation: Recommendation to the Minister regarding the type of regulation to apply to Transpower*, paragraph 133.

² *Vector submission to Commerce Commission on Input Methodologies Discussion Paper*, 14 August 2009. *Vector Cross Submission to Commerce Commission on Input Methodologies Conferences*, 15 October 2009. *Vector pre-workshop Submission on Emerging Views Papers*, 3 February 2010.

arrangements that are available under Part 4. In particular, where it is all but certain that Transpower would need to apply for a customised price-quality path, there is no value in the Commission taking the time to develop a default price-quality path for Transpower.

Ex-post review and forecasting errors

5. Vector is generally opposed to *ex-post* reviews of capital and operating expenditure. It is always difficult to look back at expenditure incurred over the regulatory period and judge whether it was prudent and efficient. What may have been prudent and efficient at the time may look less so a number of years after the event when circumstances are quite different. Essentially such cases often come down to the view of one expert engineer versus another. Both views are often equally valid and determining the “right” answer can be difficult if not impossible.

6. The Commission’s justification for *ex post* reviews is a concern about potential significant forecasting errors by Transpower³. It is not clear how material this concern is, particularly given the Commission’s intention to only set a four-year regulatory period and roll over some or all of the administrative settlement for one year to provide Transpower with time to prepare forecasts. Given the additional time to be provided for forecasting and the fact the price-quality path may effectively be in operation for just three years, we do not believe that *ex post* reviews are justified. In Vector’s view Transpower should receive what it reasonably forecasts to spend and bear any over-spend risk during the regulatory period.

System operator services

7. Vector does not agree that system operator functions of Transpower should be subject to regulation. The system operator agreement between Transpower and the Electricity Commission is enforceable as a contract and existing legal mechanisms to enforce the contract should be sufficient to ensure that Transpower performs its duties to a suitable standard. While Transpower is the only realistic supplier of system operator services (soon to become the only possible supplier, subject to the Electricity Industry Bill becoming law), Transpower is limited in its ability to extract excessive profits from the contract as the Electricity Commission/Authority is the only possible provider of funds for the service. The monopoly/monopsony arrangements should ensure reasonable cost-quality outcomes are achieved. The regulation of system operator services would appear to add additional compliance costs on Transpower with no detectable benefit. It is

³ Vector notes that these concerns are not translatable to EDBs.

unclear what additional benefit the Commission would bring in regulating these services. It would seem to be a duplication of the EC/EA's role for the Commission also to scrutinise the system operator role.

8. However, Vector notes that the Commission intends to exclude the revenue and costs associated with any contract between Transpower and the Electricity Commission for providing the system operator functions from any individual price-quality path. If this is the case, it is not clear what, if anything, the Commission would in fact be regulating that relates to system operator services. Vector recommends the Commission clarifies this point so interested parties can comment effectively.

Quality standards for Transpower

9. Vector requests that more clarity be provided on how quality standards will be set for Transpower. The Commission's stance in the consultation paper appears to assume that it will have some discretion in the means by which the quality standards set by the Electricity Commission (EC) for Transpower will be implemented. Vector agrees that section 54M(6) could be interpreted as giving the Commission the ability to determine how the EC-set quality standards are to be given effect to. As the Commission notes, section 54M(6) of the Commerce Act is likely to be repealed by the Electricity Industry Bill. However, the Commission does not acknowledge that section 149 of the Electricity Industry Bill would create a new section 54V(4) of the Commerce Act and the wording of section 54V(4) appears to restrict the Commission to only including the quality standards set by the Electricity Authority for Transpower. Section 54V(4) appears more restrictive than section 54M(6) and the Commission may no longer have any discretion as to the quality standards that are set for Transpower. While Vector does not support the EA having control over setting quality standards for Transpower and the Electricity Industry Bill is not yet law, the implications of this should be discussed. In particular, it is not clear how relevant the Commission's preliminary views are regarding quality standards for Transpower.

Rationale for regulating Transpower

10. While we understand that the Commission is required to report to the Minister pursuant to section 54M on the form of regulation applying to Transpower, Vector questions whether there are overall benefits from economic regulation of Transpower.

11. While we agree with external scrutiny of Transpower's investment decisions, it is not clear whether there are net benefits from regulating Transpower's

prices/revenues given that there is not a strong commercial driver on Transpower to exceed its WACC. The Government can simply direct Transpower (as it has done in the past) to only earn a reasonable return on investment. Given the ownership structure of Transpower, it is not clear that the situation is notably different to consumer trusts.

12. The Commission should not under-estimate the significant management costs associated with regulatory processes, which at a time of significant pressure on the national grid, may generate little value.

13. Vector would therefore recommend that the Commission initiate an inquiry under section 52H to test whether there are net benefits from price/revenue regulation of Transpower.

Contact details

14. Thank-you for considering this submission. If you require further information please contact me on 04 803 9039 or at nathan.strong@vector.co.nz.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nathan Strong', is written over a light grey circular stamp.

Nathan Strong
Manager Regulatory Affairs