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18 April 2005

Network Performance Group
Commerce Commission
By e-mail

**CROSS-SUBMISSION ON THE REVIEW OF INFORMATION DISCLOSURE
REGIME AND IMPLEMENTING ASSET VALUATION CHOICE**

Purpose

1. Vector appreciated the recent opportunity to present its views to the Commission at its conference. This letter constitutes Vector's cross-submission on the review of the information disclosure regime and implementing asset valuation choice for lines businesses. Vector welcomes the opportunity to make this submission. Vector's comments are structured around the specific questions asked and information requested by the Commission at the conference. Some additional comments are also provided.

Information requested by Commission

2. During Vector's presentation, Vector undertook to come back to the Commission with answers to specific questions and additional information on Vector's views. These are provided below.

Trade-offs between thresholds and information disclosure for the purpose of achieving the regulatory objectives for lines businesses

3. Vector has been asked to consider the trade-off, in terms of cost effectiveness, of achieving regulatory objectives through either thresholds or information disclosure. More specifically, the Chair noted:

"I mean, right now the threshold regime is the main driver in the regulatory environment. But I wonder if it's not a dangerous thing to let ourselves think that that's the way it always has to be or should be. I, myself, don't see any reason why in the future as companies adjust to the threshold regime, that the threshold regime may play a lesser role in the regulatory environment, say, compared to information disclosure. So, if I think of information disclosure and its role, I don't see it as a once and for all, you know, it would be the same today as it might be tomorrow, or it was yesterday. I think there's a real danger if you look at it in the way you have, where you think of it as an increment to the threshold regime, incremental, you overlook a similar cost benefit analysis that says, if you're trying to impact behaviour in this industry, what's the least cost way to do it? Is it through the threshold regime or is it through the information disclosure regime? And I might argue to you that in many cases it's far more cost effective to influence behaviour through the information disclosure regime in the future than it might be through investigations, the threshold regime, control investigation or absolute control." - page 278 of the transcript

4. While Vector appreciates the sentiment behind the above comment – achieving outcomes most cost effectively – we do have some concerns. In particular:

- the legislation requires the Commission to set thresholds and, therefore, sole reliance on disclosure seems unlikely (albeit there is relatively wide discretion available to the Commission as to the thresholds set, but setting none does not seem to be an option);
- the Chair's comments have the effect of undermining regulatory certainty – not only has the Commission not said anything about resetting the thresholds, but now the Chair's comments suggest the thresholds concept, in totality, may be up in the air. Vector supports achievement of outcomes at least cost, as well as cost-effectiveness assessments of alternative methods; however, this should ideally be within a holistic and strategic framework for the evolution of the regime;
- in essence, the trade-off that Vector is asked to consider has already been made – the Commission has set thresholds that will continue to be the flagship of the regime until the reset in 2009. In Vector's understanding, the Commission is now considering what the appropriate information disclosure regime should be, within the context of the current thresholds being in place until 2009. If the Commission considers that some of the issues being addressed by the current thresholds can be better achieved through enhanced information disclosure within the current regulatory period, it should put these views forward as soon as possible (but with the knowledge that this, as noted above, will undermine regulatory certainty).

In Vector's view, the analysis of such a trade-off is best carried out closer to and aligned with the thresholds reset in 2009;

- if the Commission considers that the additional disclosures proposed are required to address incremental issues that are not currently addressed by the thresholds (or the current disclosure requirements), the Commission should outline what those issues are and why they warrant regulatory intervention. Once these issues have been identified the Commission should then consider which tool (disclosure or thresholds) is best suited to addressing the issues in order to choose the more efficient one.

5. To date, Vector has not seen analysis from the Commission that considers the above issues. Vector considers that the thresholds currently in place and the information disclosed through compliance statements, along with other information disclosed under the current requirements (some of which may no longer be necessary) provide sufficient incentives for lines businesses to achieve the desired outcomes. Therefore, Vector does not see the need for the more detailed disclosure proposed by the Commission.

6. Related to this point, Vector would also like to note that it is easy for the line between thresholds and disclosure to become blurred as disclosure and summary analysis become more detailed. As emphasised to the Commission at the conference, the risk is that this undermines the thresholds and will invariably bring about their demise. The comments below, made by Mr Brian Furness of Genesis in relation to the proposed disaggregation of disclosure information, during his presentation, illustrate this point [emphasis added]:

"There would ideally be some kind of comparisons between different electricity lines businesses and **this is starting to get into the realm of threshold setting and threshold monitoring**. Again, that could be done at a feeder class level and could be included in the sort of industry summaries like PricewaterhouseCoopers do, and presumably with the Commerce Commission itself it carries out these kinds of analysis to establish threshold breach. We see that as - we need some kind of regulatory compliance. **It's just not enough to disclose information**. What do you do about this information? As we see it, it's a substitute for consumer power that would normally say, "I'm out of here. I'm going to my other supplier because I'm not happy with this deal." Of course, you can't do that with electricity lines businesses so some substitutes are required. So, **we would expect in some way**, and we have no pre-conceived idea of how, **that this level of disclosure would become part of the threshold regime**." - page 98 of the transcript

7. What Mr Furness is describing cuts to the root of Vector's concern that additional disclosure will soon become *de facto* thresholds. Where information is disclosed, it is only a matter of time before it is used in a thresholds type analysis and hence the disclosing parties will act accordingly, trying to ensure that any such analysis does not cast them in a bad light. This is why Vector maintains that information disclosure, at this point in time, should be for the sole purpose of setting and resetting the thresholds. If a given set of information is not, in the Commission's view, required for that purpose, it should not be disclosed.

8. A subtlety on this argument is what information will be required for the threshold reset in 2009 (which may be a possible argument to require disclosure of more (as opposed to less) information to keep resetting options open). However, in Vector's view, the cart must not be put before the horse. As noted at the conference, the best use of the Commission's time (in consultation with interested parties) at present is to develop and decide on the threshold resetting methodology. Not only would this promote regulatory certainty (on a matter the Commission has currently said nothing about), but it would further focus the Commission's work on information disclosure to information that has a useful and designated purpose.

Certification of disclosed information by directors as opposed to the CEO

9. Upon further consideration, Vector agrees that the Commission may wish to retain certification of some of the disclosure information by directors (rather than CEOs, as suggested by Vector in its earlier submission), given the further discipline placed on them through their statutory responsibilities under the Companies Act. As directors will then be involved in the process, there is little benefit in separating the certification of disclosure (e.g. by having some sections certified by the CEO and some by the Directors).

Need for full financial statements to be disclosed

10. The Commission has asked Vector to comment on the suggestion made by PricewaterhouseCoopers that there may be no need for full financial statements to be disclosed. The comment made by PwC is consistent with Vector's general comment made in its earlier submission on the need for the Commission to step back from the detail of the disclosure requirements and undertake a needs assessment for each disclosure being contemplated (whether a historical disclosure to be retained or a new one to be introduced). Vector suggested some key assessment questions in its main submission.

11. If a rigorous assessment is applied, it may well show that disclosure of full financial statements is not necessary. Vector suggests that the Commission should undertake such an assessment for all disclosures (including the need for full financial statements) and publish the results for consultation.

Information disclosure as less intrusive instrument to address issues

12. The Commission has asked Vector to comment on the potential use of information disclosure as a less intrusive instrument (when compared to thresholds) for addressing issues of concern to the regulator. In particular, Dr. Calum Gunn referred to the issue related to pricing in embedded subdivisions (an issue that Vector itself had raised proactively with the Commission).

13. As noted in Vector's submission, it is important for the Commission to consider the trade-off between requiring public disclosure of information, as opposed to obtaining it through some other means. This concept is relevant when considering the embedded subdivisions issue and others like it.

14. Vector considers that, where the Commission has concerns around such issues, it should in the first instance request information for its analysis using the information gathering powers it has under the Commerce Act. Thus the issue can be properly considered without imposing costly and ongoing requirements on all companies. Should the analysis of the information gathered identify a widespread problem that is likely to be durable in nature, the Commission could then consider the best way to address it (change to thresholds, information disclosure requirements, or some other means).

15. In the case of embedded subdivisions, Vector had originally proposed changes to the thresholds and others have suggested enhanced disclosure. However, having evolved its thinking on information disclosure throughout the Commission's consultation process, Vector no longer considers either of these suggestions necessary. The problem, given the effect of the regime over time, is unlikely to be durable in nature. Further, extensive information on pricing is already disclosed. Therefore, if a customer wanted to compare line charges of the embedded subdivision operator to those of the incumbent, they could do so. It is difficult to see how further disclosure would help address the issue.

16. Thus, if the Commission considered any further action was necessary on this matter, Vector suggests, consistent with the facilitative approach suggested in our earlier submission, that the Commission should clearly state its concerns and allow the relevant parties a reasonable timeframe to address these proactively. Failing that, the Commission could make amendments to disclosure or the thresholds.

Disaggregated disclosure

17. Vector has provided extensive comments on the proposed disaggregation of information disclosure. These views remain unchanged. Dr Gunn invited further comment from Vector at the conference, viz:

"That particular sub-networks issue really comes to the heart of Vector's submission that the focus should be on price and quality, sub-networks is a sort of example like that. I think that it really shows to what extent can disclosure be meaningful for consumers on a completely aggregate level right across to non-contiguous networks. There's been a lot of references in the submission to Parliament's intent and I think if you go back to where Part 4A came from and look at the Ministerial Inquiry, a lot of the recommendations came from KPMG's report looking at performance indicators. KPMG looked at the issue of disaggregation and the recommendation really was that in terms of customer outcomes price and quality, disaggregation, not down necessarily to the enth degree, but in terms of different geographical areas, CBD versus rural and remote rural, is something that can be useful. That does seem at odds with Vector's suggestion that we should focus

entirely on the aggregate. We certainly would be interested in seeing Vector's comments further."

18. Vector notes that the KPMG report was only one input to the Electricity Inquiry process. The MED's final report to the Minister of Energy refers to the KPMG report and makes a number of recommendations. None of these recommendations refer to the need or desirability for disaggregated information disclosure. As noted by Vector and ENA in submissions on the Commission's discussion paper of 24 December, the MED's final report focuses on performance indicators that relate to those aspects most important to consumers, being:

- availability of supply;
- fitness for purpose of supply; and
- price.

19. This is consistent with the approach the Commission itself has (appropriately) taken with respect to thresholds. As noted in Vector's submission, further disaggregation of disclosure information will provide no net benefit to achieving the purpose of the regime. More importantly, the Commission has not provided a case by case analysis of the need for disaggregated information. Vector considers that such an analysis should be undertaken and the results made subject to public scrutiny before any further disaggregation is contemplated.

Optimisation of Transpower's investments approved by the EC

20. In our main submission, Vector suggested that Transpower investments approved by the Electricity Commission under the Grid Investment Test (GIT) should continue to be subject to optimisation. With the benefit of further time to consider this issue and talk with other parties, Vector has somewhat softened its view, although we have not resolved our thinking to have a definitive view. While reflecting the risk of optimisation in Transpower's WACC is a valid option (advocated by Vector at the conference), another option to fairly compensate Transpower for relevant investments is to remove the provision for these to be optimised. There are pros and cons to each approach. Before a decision is made, the Commission must carefully work through all options and consult on such. To the extent no further consultation on this issue is contemplated, Vector would appreciate an opportunity to further appraise the Commission of its thinking.

21. As noted at the conference, a key driver in Vector's earlier position – no change for Transpower (i.e. optimisation applies to all assets) - was to ensure consistency in the treatment of Transpower with other lines businesses. Specifically, the GIT is conceptually equivalent to any reliability and economic test

applied by lines businesses day in day out in making investments. While Vector remains of that view, the regulatory overlay of the EC does change the investment environment for Transpower, relative to distributors. However, we are not yet convinced that the ex ante scrutiny of the EC (particularly given they do not *require* investment but judge whether the proposed investment is economic or necessary) is grounds for permanently nullifying the optimisation provisions. In its thinking to date Vector is conscious that distributors (not just Transpower) face large investment requirements in the near future, largely as a result of the age profile of New Zealand's electricity networks. As such, any grounds to treat Transpower differently than distributors with respect to optimisation must be clearly rationalised on the basis of sound analysis.

Other issues relevant to Commission's consideration

22. Vector would also like to reinforce the following issues that are relevant for the Commission's consideration of the information disclosure regime:

- the need to consider the impact of the EC's work, which may help achieve the purpose of Part 4A (e.g. work on model use of system agreements); there appears to have been no consideration of this to date; and
- the purpose statement of subpart 3 of Part 4A does not necessitate an intrusive and detailed approach to information disclosure (such as the one proposed in the Commission's discussion paper) and accords the Commission substantial flexibility; the purpose could be satisfied through fairly *de minimis* disclosure and, therefore, the Commission should carefully consider the long-term costs resulting from overly intrusive disclosure becoming *de facto* thresholds.

Closing comment

23. Thank you for considering this submission. Should you require further assistance, please contact Anton Murashev, Vector's Regulatory Analyst, in the first instance, (anton.murashev@vectornetworks.co.nz; 021 273 0709).

Kind regards

A handwritten signature in black ink, appearing to read 'Mackenzie', written in a cursive style.

Simon Mackenzie

Group General Manager Networks