

1 June 2012

Karen Murray  
Manager  
Regulation Branch  
Commerce Commission  
P.O. Box 2351  
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Dear Karen,

## **Consultation on Electricity and Gas Input Methodology Determination Amendments 2012**

### **Introduction**

1. Vector welcomes the opportunity to submit on the Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012" (the IM Amendments Consultation Paper), 11 May 2012. No part of our submission is confidential and Vector is happy for it to be publicly released.
2. Vector's contact person for this submission is:  
  
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3. Please note that Vector endorses and agrees with the submission of the Electricity Networks Association (ENA) on this matter.

### **Related Party Transactions**

4. Vector **notes** we:
  - a. support the proposed amendment of clause 2.2.11(1)(g)(i) and (ii) of the Commerce Act (Input Methodologies) Determinations (IM); and
  - b. do not support the inclusion of clause 2.2.11(1)(g)(iii) providing for assets to be valued at nil.
5. While the Commission is concerned that assets could be transferred to the Regulated Asset Base (RAB) at inflated values, the possibility that assets could be required to be included in the RAB at nil value would result in the opposite (negative outcomes) occurring; with assets entering the RAB at subsidised levels (nil value).
6. The ENA submission details why circumstances may arise where depreciated historic cost or market value cannot reasonably be established.
7. It should be self-evident that including an asset in the RAB at subsidised levels (including nil value) would be in direct contravention of the purpose of Part 4 of the Commerce Act 1986; for example:

- a. regulated suppliers will not have incentives to invest if they are not able to fully recover the cost of the investment (contrary to section 52A(1)(a)); and
  - b. regulated suppliers may avoid efficient arrangements (eg with related parties) if those arrangements preclude full cost recovery (contrary to section 52A(1)(b)).
8. Vector **notes** we support:
- a. the ENA's proposal that the new clause 2.2.11(1)(g)(iii) be amended by replacing "nil" with "directly attributable cost"; or
  - b. amending the new clause 2.2.11(1)(g)(iii) by replacing "nil" with "the cost incurred by the **related party** providing the asset".
9. The alternative option "the cost incurred by the **related party** providing the asset" would align clause 2.2.11(1)(g)(iii) with the Commission's proposed clause 9.1.2 of the Commerce Act (Information Disclosure) Determinations 2012.<sup>1</sup>
10. Vector **notes** we support the proposed inclusion of conditions under which assets added to the RAB acquired through related party transactions can be valued by applying GAAP. This is an improvement on the existing Asset Valuation Input Methodologies. However, Vector considers the conditions contained in the proposed clause 2.2.11(5) to be too narrow.
11. The provisions in the proposed clause 2.2.11(5) directly parallel the Commission's proposals for the treatment of provision of services by related parties.<sup>2</sup>
12. The submissions<sup>3</sup> (and cross-submissions<sup>4</sup>) in response to the Commission's Information Disclosure Consultation raised a number of concerns about these proposals. Vector considers that these submissions are relevant for the Commission's current consultation on the IM Amendments Consultation Paper. The IM Amendments Consultation Paper makes reference to those submissions, including a high level summary of submissions by PwC and the ENA (but not others). However, the Commission does not express any views on those submissions or give any indication whether it has changed its proposals or thinking on the matter. Vector does not consider simply summarising some submissions at a very high level to be particularly useful or a demonstration that the Commission has had regard to the submissions. These submissions (and cross-submissions) provide useful background as to why clause 2.2.11(5) may be too narrow.
13. In addition, Vector considers that:
- a. a materiality test of one percent is very low;
  - b. If "the price charged to the **EDB** for the asset by the **related party** is demonstrably the same in all material respects as the price charged by the **related party** to ... other parties" (or lower) this is clear evidence that the transaction is at arm's length and the 75% threshold is unnecessary. Subclause 5(b)(i) should be split into two.

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<sup>1</sup> As proposed in January 2012.

<sup>2</sup> The Commission consulted on this in the Commission's Draft Commerce Act (Information Disclosure) Determinations 2012 and draft Reasons Paper for Gas Electricity Distribution Businesses and Gas Pipeline Businesses", dated 16 January 2012.

<sup>3</sup> Dated 9 March 2012.

<sup>4</sup> Dated 23 March 2012.

- c. Subclause 5(b)(ii) should recognise the impact of inflation.
  - d. Subclause 5(b)(iii) should recognise that it is not always appropriate or best to accept the "lowest conforming tender".<sup>5</sup>
14. Vector **recommends** that clause 2.2.11(5) be amended to widen the circumstances under which it would apply.

#### **Change of regulatory disclosure year for gas pipeline businesses**

15. Vector acknowledges the Commission's undertaking to take account of all previous work and submissions on the issues raised in the IM Amendments Consultation Paper<sup>6</sup>. On this basis Vector re-affirms its previous submissions<sup>7</sup> in relation to changing the regulatory disclosure year for GPBs (subject to any additional emphasis or modifications outlined below) and invites the Commission to reconsider its preferred option. Vector has submitted against changing the regulatory disclosure year, as we prefer that it is aligned with our financial year.
16. Vector does not support the proposed amendments to the IM for GDBs and GTBs to the extent that the amendments result in a retrospective change to the regulatory disclosure year.
17. We agree with the Commission that its proposals would result in "increased compliance costs for suppliers complying with information disclosure". We also agree with the Commission that "Another disadvantage is that gas suppliers who also operate as electricity suppliers (currently Vector and Powerco) will have three separate disclosure years – one for electricity, one for gas, and one for their financial year".<sup>8</sup>
18. The Consultation Paper states that a proportion of the increased compliance costs caused by a change to a single common disclosure year for GPBs would likely be one-off costs incurred in transitioning to a new reporting cycle. While this is undoubtedly true, it fails to acknowledge that a single common regulatory disclosure year results in substantial additional compliance costs for every regulated supplier on an ongoing basis for each disclosure year. As one of the few GPBs that also operates a regulated electricity business<sup>9</sup> we have first-hand knowledge of the practical difficulties faced where the regulatory disclosure year differs from the financial reporting year. Note also that Schedule 20 (Transitional Financial Information) of the draft ID template for GDBs<sup>10</sup> requires the regulatory asset base value, regulatory tax information (including fixed asset balances, depreciation and deferred tax) and weighted average calculations to be reported for three periods (2009 to 2011 inclusive). Plus we are now approaching the end of the 2012 financial year which would mean a fourth year needs to be prepared.
19. The Commission expresses a preference<sup>11</sup> for using the 2009 financial reporting year end (which is when the initial regulatory asset base was established) as the starting point for the transition to the new disclosure year in order to maintain continuity of asset value and deferred tax roll-forward balances. Based on the

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<sup>5</sup> A point well illustrated in the earlier submissions.

<sup>6</sup> Paragraph 95 and 96, Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012", 11 May 2012.

<sup>7</sup> In our submission dated 9 March 2012 - refer to paragraphs 47 to 54 inclusive under transitional financial information for GPBs.

<sup>8</sup> Paragraph 69, Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012", 11 May 2012.

<sup>9</sup> Under a single common disclosure year of 31 March.

<sup>10</sup> Published on 16 January 2012

<sup>11</sup> Paragraph 78, Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012", 11 May 2012.

proposals in the IM Amendments Consultation Paper and the proposed amendments to the IMs<sup>12</sup> GPBs would be required to restate the initial RAB, tax depreciation and other temporary differences for the following disclosure periods:

- a. 1 July 2009 and 30 September 2009 (a restatement); and
  - b. 1 October 2009 to 30 September 2010 (a restatement).
20. GPBs would also be required to prepare the same information for the disclosure period from 1 October 2010 to 30 September 2011. Vector considers there is insufficient benefit in requiring GPBs to restate previously disclosed information from June 2009 to align to a 30 September regulatory year. These proposals seem particularly unreasonable given the position at June 2009 was used to establish the initial RAB and was then rolled-forward to 30 June 2010 for our 2010 statutory disclosures<sup>13</sup> for GDB and GTB. Notwithstanding our opposition to a transitional disclosure year that takes effect several years prior to now, at the very least, we would have expected the Commission to seek to begin the transition disclosure period from June 2010 which would ameliorate some of the rework required of GPBs.
21. The Commission recently released its Process Update Paper<sup>14</sup> (which focuses mainly on revenue and expenditure) in which it indicated the transition from a 30 June financial year to the new 30 September disclosure year would be dealt with by way of a three month gap in disclosures. While Vector considers this to be a pragmatic approach to the disclosure requirements which we would support, the Commission needs to be aware that it would still be necessary for us to prepare asset roll-forward and deferred tax calculations across all periods in order to determine the Schedule 20 transitional financial information requirements<sup>15</sup> for GPBs.
22. While GPBs have not yet been subject to Information Disclosure Requirements set by the Commission, they have been subject to section 53ZD notices, issued under the Commerce Act 1986. The Commission's proposals in the Consultation Paper would require adjustments to information we have had to produce under the section 53ZD notices.
23. We reiterate our previous comments about requirements for us to recalculate 2009 information, for example:<sup>16</sup>
- ... the effort involved to re-do this work is significant and costly; and
  - ... the disclosure requirement will impose greater costs than benefits as it is unclear what additional benefit information from 2009 would provide to interested persons.
24. Vector notes that in responding to the section 53ZD notices in relation to its gas pipeline businesses, external assurance costs of approximately \$0.5m were incurred together with significant internal resources to provide audited information as at 30 June 2010.

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<sup>12</sup> See paragraph 81 and Attachments B and C, Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012", 11 May 2012.

<sup>13</sup> Pursuant to section 53ZD of the Commerce Act 1986.

<sup>14</sup> Information Disclosure Requirements for Electricity Distribution Businesses and Gas Pipeline Businesses" (23 May 2012).

<sup>15</sup> If our recommendations are accepted then the periods reported in Schedule 20 would be adjusted.

<sup>16</sup> Paragraph 48, Commerce Commission's consultation paper "Consultation on Electricity and Gas Input Methodology Determination Amendments 2012", 11 May 2012.

25. In summary, Vector does not support changing the regulatory disclosure year for GPBs to 30 September because it will result in ongoing onerous compliance costs and unnecessary complexity.
26. In the event that a single common regulatory disclosure year of 30 September is mandated then Vector **recommends** transitioning the regulatory disclosure year prospectively for the 2012 disclosure year being the period 1 July 2011 to 30 September 2012 in order to roll forward fixed assets and deferred tax. This would involve:<sup>17</sup>
  - a. a three month part period being 1 July 2011 to 30 September 2011 for fixed assets and deferred tax; and
  - b. a 12 month 'standard' regulatory year being 1 October 2011 to 30 September 2012, to avoid the substantial reporting costs that would arise if earlier disclosures needed to be re-stated.
27. For the avoidance of doubt, under this proposal the 2011 disclosure would be for the period ending 30 June 2011. Transitional information could be provided for the three month period 1 July 2011 to 30 September 2011 for disclosure purposes on Schedule 20 for GPBs.
28. If Vector's **recommendation** is rejected, and the adjustment to the regulatory disclosure year is to be applied retrospectively, then Vector **recommends** in the alternative that:
  - a. the Commission avoid requiring adjustment to 2009 and 2010 RAB valuations/information and deferred tax provided to the Commission under section 53ZD of the Commerce Act; and
  - b. the proposed timing for the first actual disclosure for GPBs under the IMs be extended to allow time for the additional information to be prepared in respect of the earlier periods and that the transition period should be for the period 1 July 2010 to 30 September 2010; and.

Yours sincerely,



Bruce Girdwood  
**Manager Regulatory Affairs**

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<sup>17</sup> Depending on the timing of introduction of the Gas Disclosure Requirements.