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Brett Woods
Senior Analyst
Regulation Branch
Commerce Commission
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Dear Brett,

Proposed amendment to WACC range for information disclosure

Introduction

1. Vector welcomes the opportunity to respond to the Commerce Commission's (Commission) consultation paper *Proposed amendment to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services*, dated 30 October 2014. This submission is not confidential.

Retention of the 25th to 75th percentile WACC range

2. The Commission's revised draft decision is to retain the current information disclosure WACC range of the 25th to 75th percentiles. Vector supports this revised draft decision.

Requirement to also publish and disclose against 67th percentile

3. The Commission also proposes to annually determine and publish 67th percentile estimates of WACC. These estimates will then be published in regulated suppliers' information disclosures as an additional comparison with actual ROIs. Below Vector outlines why we do not support this approach and instead suggests an alternative.

4. In the Commission's recently released consultation paper on amendments to information disclosures, the Commission set out the reasons for disclosure of ROI profitability assessments:¹

Interested persons require an indicator of profitability to assess whether the Part 4 purpose is being met. ROI is a commonly used measure of profitability, which allows interested persons to compare the relative performance of firms of different sizes. **In particular, ROI allows interested persons to compare a supplier's profitability to its allowed WACC.** [emphasis added]

5. The current (and proposed) information disclosure ROI requirements do not achieve the outcome described by the Commission. This is because the disclosures do not compare actual ROI to regulated suppliers' allowed WACC, which is the WACC used in each price reset decision for a regulated supplier. Instead the disclosures compare actual ROI to the annually updated estimates of WACC. Publishing a re-estimate of the 67th percentile WACC each year does not address this issue.
6. Vector **recommends** the Commission requires the 67th percentile WACC used in the relevant price reset decision (DPP or CPP) to be published in the disclosures alongside actual ROIs. This proposal would mean the annually disclosed ROIs would be compared to both the 25th-75th percentile WACC range determined each year and to the 67th percentile estimate determined at each reset.
7. In our view this is a better approach than estimating and publishing a 67th percentile estimate of WACC for information disclosure purposes each year, when that point is already within the disclosed ID range.
8. We recognise the Commission may want to publish annually updated WACC estimates to reflect new market conditions, or because the updated estimates may better reflect what a similar business in a workably competitive market could earn in that year.² However, we believe it is important for interested parties to understand how actual rates of return compare against allowed rates of return. Also, we note that "similar businesses" to regulated suppliers are unlikely to be operating in workably competitive markets so we are not sure this objective previously identified by the Commission is real. In our view the

¹ Commerce Commission, *Proposed amendments for 2015 to information disclosure determinations for electricity distribution and gas pipeline services*, 22 October 2014, paragraph 3.6.

² Commerce Commission, *Information Disclosure for Electricity Distribution Businesses and Gas Pipeline Businesses: Final Reasons Paper*, 1 October 2012, paragraph 3.7.

primary benefit of recalculating the WACC each year is to indicate how WACC is trending.

9. We recognise our recommendation set out above is less relevant for electricity distribution businesses that are exempt from price-quality regulation. However, there may still be value in comparing actual returns to what their allowed return would have been if they were subject to price-quality regulation. Also, for those businesses the 67th percentile estimate will have little effect, irrespective of whether it is updated each year for disclosure purposes. Alternatively, they could be exempted from the requirement to disclose the 67th percentile estimate.

Contact details

10. If you would like further information please contact me on 09 978 8277 or at ian.ferguson@vector.co.nz.

Yours sincerely,

A handwritten signature in blue ink that reads "I. Ferguson". The signature is cursive and somewhat stylized.

Ian Ferguson
Regulatory Policy Manager