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Regulation Branch
Commerce Commission
Wellington

Sent by email to: regulation.branch@comcom.govt.nz

Cross-submission DPP Issues Paper

1. Vector welcomes the opportunity to provide a cross-submission on the Commerce Commission's (Commission) consultation paper *Default price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper* (Issues Paper), dated 21 March 2014.

Appropriate discount rate for claw-back

2. In its submission on the Issues Paper, Unison Networks Limited discussed the appropriate discount rate for claw-back. Unison argued that:¹

The expert report from CEG in 2012 provided that if claw-back amounts were to be recovered from consumers as part of general revenues then the WACC should apply as the discount rate, whereas if the claw-back amounts were a guaranteed payment then they should effectively be seen as a loan from EDBs to consumers and the cost of debt should apply.

The Commission's proposal is that claw-back amounts should be recovered as part of general revenues under the price path calculation, but Unison has no means of ensuring that it is able to recover the claw-back amount. Under the compliance requirements, Unison would be permitted to set prices such that prices in each year multiplied by quantities in the t-2 year can recover the overall allowable revenues, but if volumes fall relative to the t-2 quantities (which Unison has directly

¹ Unison Networks Limited, *Submission on the Default Price-quality paths from 1 April 2015: Process and issues paper*, 30 April 2014, paragraphs 80 and 81.

experienced over the past few years) or there is a catastrophic event (for example, Napier becomes uninhabitable following an earthquake/tsunami) then the claw-back amount would not be recovered and there is clearly a shareholder risk associated with not being able to recover such.

3. It is worth noting that the CEG report quoted by Unison was less definitive than has been implied. What the CEG report actually said was:²

Alternatively, **it may be argued** that cashflows which are modelled as part of the recovery of this shortfall (or disgorgement of an over-recovery), **to the extent that** these form part of Vector's general revenue, are subject to the same risks as Vector's ordinary business and should be discounted back to the present time at Vector's regulated WACC of 8.77%. [emphasis added]

4. More importantly, Vector is not persuaded that the volume risk attached to claw-back will be equivalent to the volume risk attached to general revenues over the next regulatory period, for the following two reasons:
 - a) It can be possible to adjust prices mid-year (in a downwards direction at least) to significantly increase certainty of recovering a particular revenue quantum.
 - b) The view of the risk associated with recovery of claw-back seems to be based on the treatment of recoverable costs under the current DPP. However, the Commission is currently considering options for the 2015 reset that would substantially reduce the risk associated with pass-through and recoverable costs (e.g. using an "ascertainable" method as in the Gas DPP or other options that have been suggested in submissions such as a wash-up mechanism³, and removing the K and V terms from the price path compliance formula⁴). If one or more of these approaches is implemented for the 2015 reset, the risk associated with recovery of pass-through and recoverable costs, including claw-back, will be less than the risk associated with general revenue recovery.

Wash-up mechanism for pass-through and recoverable costs

5. Several submissions on the Issues Paper (e.g. Powerco and PwC) supported a wash-up mechanism to address the issues relating to recovery of pass-through and recoverable costs. For avoidance of doubt, it may be helpful to clarify that Vector would support a wash-up mechanism for pass-through and recoverable costs as an alternative to the ascertainable approach used in the Gas DPP, and described how

² CEG, *Application of claw-back: A report for Vector*, June 2012, paragraph 20.

³ Suggested by PwC, *Submission to the Commerce Commission on Default Price-quality paths from 1 April 2015 for 17 electricity distributors: Process and issues paper*, 30 April 2014, page 16.

⁴ Suggested by Vector, *Submission to Commerce Commission on the Default Price-Quality Paths from 1 April 2015: Process and issues paper*, 30 April 2014, paragraph 51.

a wash-up mechanism could work in paragraph 51 of our submission on the Issues Paper.

Contact details

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

Kind regards,

A handwritten signature in blue ink that reads "Ferguson". The signature is written in a cursive, flowing style.

Ian Ferguson
Regulatory Policy Manager