Vector Limited
101 Carlton Gore Road
PO Box 99882, Newmarket
Auckland 1149,
New Zealand
www.vector.co.nz

Corporate Telephone
+64-9-978 7788

Corporate Facsimile
+64-9-978 7799

21 September 2012

Regulation Branch
Commerce Commission
Wellington

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

CPP cash-flow timings

Introduction

1. Vector welcomes the opportunity to respond to the Commerce Commission's (Commission) consultation paper Consultation on Electricity and Gas Input Methodologies (IMs): Cash flow timing for customised price-quality paths (CPPs), dated 10 August 2012. No part of this submission is confidential.

2. This submission is supported by an expert report from Castalia which is attached. Vector has seen and endorses the submission by the Electricity Networks Association (ENA) on this topic.

3. Vector's contact person for this submission is:
   Ian Ferguson
   Senior Regulatory Advisor
   09 978 8277
   ian.ferguson@vector.co.nz

Commission proposals

4. The Commission is proposing to amend the electricity distribution, gas distribution and gas transmission CPP IMs to provide for what it considers to be more accurate assumptions with regard to the timing of cash-flows for regulated suppliers.

5. Specifically it proposes to change the timing assumptions of the following items to the timings set out in table 1.

Table 1: Commission's proposed new CPP timing assumptions

Building block item	Proposed timing assumption
Revenue	3 November
Operating expenditure	Mid-year
Tax	Mid-year
Other regulatory income	Mid-year
Term credit spread differential allowance	Mid-year

6. At present under the CPP IMs, these cash flows are considered to occur at year end.

Vector's preference

7. Vector's preference is for the cash-flow timing of all items to be consistent (either mid-year or end-year) and for a separate and clear allowance for working capital to be provided. We consider the Commission's proposal to be unduly complicated and to push the detail of the BBAR formula to a point where it is not easily understood by regulated suppliers or other interested parties. We strongly agree with the views of the ENA on the complexity caused by the Commission's proposal. In our view the complexity is out of all proportion to the supposed benefits of increased accuracy. In the context of the DPP model, the cash-flow timing approach changes model outcomes by approximately 0.4% across the entire industry, an outcome that could be delivered more easily by applying a year-end approach with a clear allowance for working capital.

8. However, the Commission's proposal delivers an acceptable outcome and Vector can accept it, subject to the comments below in relation to working capital and the option of proposing an alternative approach as part of a CPP application.

Revenue timing proposal provides implicit allowance for working capital

9. As discussed in more detail in the Castalia report, the Commission's proposal appears to be providing an allowance for working capital to suppliers. This is welcome and we recommend it is explicitly acknowledged as a reason for the assumption that revenue is received on 3 November. For Vector, the impact of the 3 November assumption is similar to our actual working capital requirements. We therefore consider it is a reasonable proposal that is well correlated to actual business requirements.

Suppliers should be permitted to propose alternatives

10. As discussed above, the Commission's cash-flow timing assumptions, including the 3 November assumption for revenue are generally reasonable and currently appropriate for Vector. However, the timings identified by the Commission may not be appropriate for all suppliers over time. It is conceivable that a supplier may experience substantial in-year variations in cost or revenue profiles that are not accommodated by the Commission's proposals.

11. While consistency between the mechanics of a DPP and a CPP is generally desirable, cash flow timing issues might be one reason that regulated businesses choose to apply for a CPP. Fixing cash flow timing assumptions for CPPs in input methodologies that are the same as the DPP could therefore decrease the option value of CPPs for regulated businesses.

12. In the context of a CPP, Vector submits that it would not be unduly onerous to use the Commission's proposals as a default set of assumptions but allow suppliers to recommend their own timing assumptions where the Commission's are not suitable. Vector sees no harm that such an amendment could create.

13. Vector notes the Commission's statement in footnote 9 of the consultation paper that in such cases suppliers can apply for a variation of the input methodology under section 53V(2). However, this adds an additional hurdle for suppliers to cross to achieve more accurate cash-flow timings under a CPP and we see little value in such a restriction.

14. Vector notes the Commission's statement in paragraph 18 that reflecting specific transactions at this level of detail is not appropriate because it would exceed the level of detail typically employed by suppliers in their own planning. However, in other instances the Commission has been willing to make demands of suppliers that go beyond normal business management requirements. For example, the requirement in the draft ID determinations to forecast expenditure on motor vehicles and office furniture on a ten-yearly basis, which Vector considers to be a degree of forecasting that is unlikely to be found in many workably competitive markets.

Recommendation

15. Vector **agrees** with the Commission's proposed cash-flow timings for CPPs, but **recommends** they are set as the default assumptions and suppliers are permitted to propose variations as part of their CPP application.

Yours sincerely,

Bruce Girdwood
Manager Regulatory Affairs