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31 October 2014

John McLaren
Manager
Regulation Branch
Commerce Commission
Wellington

Dear Mr McLaren,

Proposed amendments to the draft incremental rolling incentive scheme (IRIS)

Introduction

1. Vector welcomes the opportunity to respond to the Commerce Commission's consultation paper 'How we propose to implement amendments to input methodologies for electricity lines businesses subject to price-quality regulation: Incremental Rolling Incentive Scheme', dated 20 October 2014. This submission is not confidential.

2. Vector's contact person for this submission is:

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General comments

3. Vector has reviewed the Commission's proposed changes to the IMs to account for the IRIS. We do not have many comments on the drafting of the IM determination and the revised models – they generally seem to deliver the intended outcomes.

4. However, Vector notes the proposed changes involve a large number of scenarios that are currently not applicable to EDBs subject to the default price path (DPP). Given the short time for consultation, Vector cautions against this consultation being considered an adequate opportunity to inspect all the IM amendments for the various scenarios to ensure they operate as expected.

5. Vector continues to recommend the proposed IM amendments for different IRIS scenarios that are less relevant to the current DPP reset (e.g. rollover prices, regulated suppliers migrating to a CPP or back onto a DPP) are subject to further consultation with affected suppliers in future, if and when they become relevant to one or more suppliers and the supplier(s) request that amendments be considered.

Opex incentive

6. Vector notes the Commission has not revised its proposed opex incentive rate despite concerns about the degree to which the opex incentive is influenced by the Commission's first year forecast of EDB opex. Given this general feedback, Vector would expect the Commission to address this concern by providing more realistic expectations of first year opex for the 2015-2020 DPP.

7. While Vector has not fully reviewed the roll-over scenario, the roll-over adjustment term delivers a very large adjustment in year 7. Where a permanent saving of 10 is made in years 1-4 in either worksheet 1C(i) or 1C(iii) the model produces a value for the rollover adjustment term of -54. A price swing of this magnitude may be challenging to manage and, given that it is a one-off, the chances of retailers passing such an adjustment through to consumers seems small. We query whether there is another way of achieving the same outcome.

Capex incentive

8. Vector notes there are challenges with applying an incentive scheme to capex expenditures when the scheme is based on commissioned assets, because capex spending and asset commissioning do not always align (i.e. for multi-year projects). Vector is concerned that using commissioned asset values to represent actual capex when the forecast capex is based on EDB's capex forecasts creates a bias against long term capex projects. Vector **recommends** these capex forecasts are compared to actual capex in each year, not actual commissioned asset values.

9. Vector supports the change to the capex incentive to smooth the reward or penalty over multiple years over the DPP period.

10. Vector notes that in the revised version of the capex IRIS model released with this consultation package, the capex retention factor in the model was set to 36%. This was not discussed in the consultation paper so it is not clear if this is the Commission's current view of what the retention factor should be. As

set out in our previous submission,[1] Vector continues to support a low capex retention factor until such time as a more robust means of forecasting capex is developed.

Catastrophic events

11. Vector **recommends** that clause 3.3.13 applies to both catastrophic events as well as change events. Where a change event occurs, it will by definition affect expenditure and it would not be reasonable to penalise EDBs for over-spending against forecasts that have not been adjusted to reflect the change event.

Major transactions

12. We note the IRIS IMs do not allow for adjustments to forecast opex or capex following a major transaction. We believe this is a gap in the IMs that will have the following perverse effects:

    a) Non-exempt EDBs will be incentivised to not purchase assets from other parties; and

    b) Non-exempt EDBs will be incentivised to sell assets to other parties (which will be particularly relevant where the other party is an exempt EDB).

13. Vector **recommends** the IRIS IM allows for changes to be made to forecast opex and capex where a major transaction takes place.

Yours sincerely,

Ian Ferguson
Regulatory Policy Manager

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[1] Vector Limited, *Submission on Input Methodology amendments for the Incremental Rolling Incentive Scheme*, 29 August 2014, paragraphs 50-51.