

CONSUMER COALITION ON ENERGY (CC93)

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Unison Post-Breach Inquiry
Network Performance Group
Networks Branch
Commerce Commission
PO Box 2351
WELLINGTON

Delivered by email to electricity@comcom.govt.nz

Dear Commission

CC93 recommend an amended settlement counter-offer to Unison

The Consumer Coalition on Energy (CC93) is taking a close interest how the threshold breaches by Unison will be remedied including a solution going forward that is reasonable to both consumers and Unison shareholders¹. This letter is in response to the Commission's draft decision of 9 November 2006 proposing not to control Unison and instead to accept a settlement offer by the company dated 1 September 2006.

CC93 believes the proposed settlement falls short of being reasonable for both the company and consumers for the following reasons:

¹ We last wrote to the Commerce Commission on 21 October 2005 regarding the Commission's intention at that date to declare control of Unison

- The PB Associates report for the Commission lists a number of areas where information made available by the Company has been less than adequate. CC93 believe any settlement can only be acceptable when based on a very high standard of disclosure by the company. In our view that standard doesn't appear to have been met.

CC93 is concerned that Unison has forecast a significant increase in capital and operating costs but in the recent past they have failed to meet the levels forecast in prior Asset Management Plans. It may be that planned work is delayed leaving the company in terms of the proposed settlement with additional cash and therefore continuing the recent history of the company earning substantial excess profits. A higher standard of disclosure as part of the settlement is required by Unison to allow the Commission to be better informed of this risk.

- In section 4.1 of the settlement offer Unison state,

“Unison Directors are concerned that any settlement must preserve the Company's ability to undertake necessary investment in the network. Decisions on investments must be made by Directors within the requirements of Directors duties under the Company's Act to act in the best interests of shareholders. In essence this requires that directors ensure the business and any investments to perpetuate or expand the business do not destroy shareholder value and that the business generates sufficient cash to be able to pay its debts as they fall due.”

The settlement offer provides no evidence to support the view that if the company were controlled with revenues set at the levels in the Commission's Intention to Control paper of September 2005, that investments for future demand growth and maintenance of quality of supply would not be bankable, i.e. supported from cash flow or additional equity or debt. CC93 is sceptical of claims lines companies cannot underwrite by way of loans or new equity investment where there is a genuine need for new or replacement monopoly services. The proposed settlement with its estimated ROI of 9.1% is well above the Commission's estimated mid point WACC of 7.35% - which is the rate an efficient line company could support new investment.

- Unison has not proposed penalties or incentives, other than the same incentive as any other distribution company, to ensure prices do not exceed the threshold level and timely investment consistent with their Asset Management Plan.

CC93 has not been impressed by the behaviour of Unison to date in arguably frustrating and delaying a resolution to the threshold breaches, by way of court action and lengthy periods before settlements have been tabled, while in the meantime earning unexplained excess revenues above threshold levels and excess profits. Given this history it's difficult to see why the Commission would agree to put the company back into a similar position prior to the Commission last year declaring an Intention to Control the company.

- Finally, the settlement documents make no mention of the status of the \$25 million plus in gross revenues collected from consumers since commencement of the thresholds in April 2003 above the level had the company kept prices within the thresholds². The company and the Commission should explain the status of the \$25 million overcharged. If the company cannot provide a satisfactory explanation, then the company should make an offer to repatriate the overcharged amounts back to consumers.

To allow a company to breach thresholds and in the lag between a settlement or control taking effect, to pocket the overcharged amounts without the threat of having to compensate consumers, sets a very poor precedent.

CC93 recommends the Commission should continue to pursue its intention to control Unison at that same time leaving open the option of a more reasonable settlement being reached. Relative to the settlement of 1 September 2006 proposed by Unison, CC93 suggest a reasonable compromise settlement would include:

- Unison providing the detailed forecast cost information identified in the PB Associates report so a more thorough assessment of the cash flow requirements until 31 March 2009 can be assessed.
- Unison publishes evidence to support its claim that with prices at the levels suggested under control (per the Intention to Control paper of September 2005) the company could not fund through cash, equity or debt an efficient capital expenditure programme.
- Unison proposing and accepting a financial penalty if it fails to achieve the expenditure planned.
- Unison providing an explanation of what benefit consumers will gain from the overcharging to date, relative to threshold prices, of over \$25 million. If there is no satisfactory answer then the company should offer to pay back that over-charging as part of the settlement.

Failing a revised settlement being negotiated CC93 believe control over the remaining 2¼ years of the existing threshold time period is compelling. It appears that the proposed settlement will allow Unison to continue earning substantial excess revenues. Those excess revenues are likely to be much higher than the annual cost of control (both the regulator's costs and the compliance costs by the company) estimated by the Commission in September 2005 of approximately \$614,000 pa. On that basis the control option remains potentially a creditable alternative.

² Commerce Commission, Draft Decision: Reasons for not declaring control – Unison Networks Limited, 9 November 2006, paragraph 65 to 67, p 25

Yours sincerely



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