



MAJOR ELECTRICITY USERS' GROUP

11 February 2008

Mr Michael Clark
Director Networks Branch
Vector Post-breach Inquiry
Network Performance Branch
Commerce Commission
By email to electricity@comcom.govt.nz

Dear Michael

Submission on draft decision for not declaring control of Vector's electricity line business

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission paper, "*Draft Decision: Reasons for Not Declaring Control – Vector Limited*," published 14th December 2007 (the "Draft decision").
2. The Draft decision has a qualitative assessment¹ comparing the options of control, no-control or acceptance of Vector's proposed administrative settlement. MEUG note:
 - a) For such an important decision a quantitative analysis should have been undertaken to assist understanding of the trade-offs to be considered.

For example, forecast line charges to March 2009 for the settlement option would differ little from the no-control option. The Commission previously estimated² line charges under the control option would be between 2% to 11% below that of the no-control option (and MEUG therefore suggest also below that of the settlement option). Such a decrease in line charges would be equal to between \$13m to \$73m per annum for the year ended 31 March 2009³. While this is the total wealth transfer, part of those monies is likely to be efficiency gains by end users'. An analysis of what those efficiency gains might be against the cost of control (likely to be say \$1m per annum⁴) would have assisted parties gain a better view of the trade-offs required.

- b) The qualitative assessment did not consider the benefit that the control option would have in terms of improving behaviour of other line companies. There would be very strong incentives on other line companies not to breach their thresholds if Vector were controlled. Other line companies will have less incentive not to breach their thresholds if the Commission accepts the settlement which is almost identical to a no-control option.

¹ Draft decision, table 4, page 54

² Ibid, paragraph 94, page 32

³ Percentage reductions applied to the forecast Vector Costs of Service for the year ended 31 March 2009, refer Vector, *Price Rebalancing: Explanatory Material to Support Vector's Offer of Administrative Settlement of 23 January 2007*, 7 December 2007, tables 16 to 18, pages 33 to 35.

⁴ Rough estimate by MEUG assuming slightly higher costs than the Commission's estimated \$0.6m pa cost of control for Unison

3. The Commission considers that Vector's proposed 1.5% differential in the ROI⁵ component between domestic and non-domestic consumers "is reasonable".⁶ This differential is equal to a cross-subsidisation of between \$1m to \$2m per annum from non-domestic consumers to domestic consumers. MEUG believe this differential is unwarranted because:
- a) Vector have provided no quantitative analysis of actual unplanned outages or requests from the System Operator to shed load over the last few years where restoration has significantly and consistently differentiated between consumer classes in favour of non-domestic consumers.
 - b) Vector has provided no quantitative analysis to demonstrate there actually have been assets stranded, particularly for the commercial and light industrial sectors.
 - c) In support of their proposition that commercial and industrial customers have a higher risk profile than domestic consumers⁷ and therefore should pay a higher ROI component. Vector use as an example "*bank lending rates for businesses are often higher than for residential mortgages, because of the higher probability of default.*" MEUG note some businesses have far better credit risk than households (eg Vector's customer Auckland International Airport) and therefore should have lower ROI.
4. In summary MEUG recommend the Commission:
- a) Undertake a quantitative cost-benefit analysis before making a final decision on a preferred option; and
 - b) Withdraw the Commission's conclusion that Vector's 1.5% ROI differential between domestic and other consumer classes is reasonable and instead note that there are arguments against having a differential and in time those will need to be fully considered.

Yours sincerely



Ralph Matthes
Executive Director

⁵ The ROI component in this context is a variable factor used to gross up return on assets to just under the price threshold.

⁶ Draft decision, paragraph xxvi, page 9

⁷ Vector, *Offer of Administrative Settlement*, 23 January 2007, page 17, second bullet point