# Submission to the Commerce Commission on the Preliminary version of the financial model for electricity default price-quality paths from 2015: Technical consultation

**14 February 2014**

## Introduction

1. Vector welcomes the opportunity to submit on the Commerce Commission's "Preliminary version of the financial model for electricity default price-quality paths from 2015: Technical consultation" (Financial Model Consultation Paper), dated 29 November 2013.

2. Please find attached the following report from CEG, *Review of the Commerce Commission financial cost model*, February 2014 (CEG Report).

3. No part of this submission is confidential and Vector is happy for it to be made publicly available.

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

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## Opening comments

5. Vector acknowledges and welcomes the Commission's responsiveness to feedback that regulated suppliers prefer early engagement on regulatory matters, and the financial model should be released early in the process with explanations of any changes from the previous versions.

6. We also acknowledge changes made to the financial model have made it more user-friendly and accessible.

## Recommended modelling changes

7. An important improvement we believe should be made to the financial model is for it to include a calculation of the expected Return on Investment (ROI) (comparable to WACC) in each year of the regulatory period. Notwithstanding that the model relies on a building block approach that includes weighted average cost of capital times regulatory investment value as inputs there is a risk, and it is our perception, that the outputs of the model do not deliver an equivalent (average over time) outcome. It would seem sensible for the model to include a proof or reconciliation of the returns.

8. The attached CEG Report identifies two issues with the model:

   a. The model does not escalate the depreciation allowance by inflation in the year in which that depreciation occurs, leading to inappropriate back-loading of revenue recovery. This issue has been raised in CEG reports for Vector on previous financial models. CEG has revisited the issue and has responded to the Commission's views. This is discussed in section 2 of the CEG Report.

   b. The cost of debt figure in cell B15 of the inputs sheet should be adjusted to make it consistent with the timing assumptions elsewhere in the model. This is discussed in section 3 of the CEG Report.

9. Vector has also identified the following linking errors in the proposed model:

| Tab name | Cell range | Label | Error |
|---|---|---|---|
| MAR | D7:H7 | Operating expenditure | Linked to the incorrect operating expenditure forecast rows in the input tab. |
| MAR | D8:H8 | Other regulated income | Linked to the incorrect other regulated income forecast rows in the input tab. |

**Commission should remain open to making future changes to the model**

10. As will be apparent from the relatively limited number of comments above, Vector considers that the mechanical operation of the model does what it we understand the Commission intends it to do (subject to the issues we have identified being addressed).

11. However, we have concerns that there are problems with the wider price setting construct. If these concerns are substantiated then the model may require further development. For example, if the Commission may decide to introduce wash-ups for certain items in the DPP, this could conceptually be done inside or outside the model. Vector may provide further suggestions for such mechanisms later; at this stage we simply raise it as a possibility that should not be precluded from being addressed in the model.

**Selection of a base year**

12. The Financial Model Consultation Paper seeks views on how to determine the 'base year' to be used when applying input methodologies. Vector notes that the 'base year' as determined by the Commission in accordance with the input methodologies may not be the same as the 'base year' used when forecasting opex for the regulatory period.

13. Vector has a number of comments on selection of Base Year as determined under the input methodologies.

14. Vector supports the adoption of 2013-14 (Year 4) as the Base Year for the final price reset decision. The use of the most recent year's data is appropriate as it will be the best available information available relating to the regulated suppliers and we are not aware of any reasons why 2013/14 is anomalous.

15. However, 2014 data will not be available (disclosed) at the time of the draft decision. This would mean the final determination would have to use data that was not available to the Commerce Commission for the draft determination. Instead the Commission would need to use 2013 data for the draft decision with a note that these inputs will be updated for the final decision.

16. Vector does not believe the Commission should issue a 53ZD request seeking forecasts of 2014 inputs for use in the final decision. The disclosure of these forecasts would not influence the final decision, would create additional work for EDBs and would create a need for EDBs to go through a process of explaining the difference between actuals and forecasts, including to market analysts.

17. Additionally, regulated suppliers will have (undisclosed) versions of the data that will be used in the final determination at the time of the draft determination. Regulated suppliers will be able to input this data into the Commission's draft financial model to obtain a more accurate estimate of the final determination. Overall, we consider that the costs in providing the additional data would outweigh the benefits.