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5 July 2012

John Hamill
General Manager Regulation
Commerce Commission
PO Box 2351
WELLINGTON

By email to: john.hamill@comcom.govt.nz

Dear John

Re: Starting price adjustments for electricity distribution and gas pipeline services

Vector is writing in response to the Commerce Commission's "Process update – Default price-quality paths for electricity distribution and gas pipeline services", 19 June 2012. No part of this letter or the attached expert reports is confidential.

Vector has commissioned expert reports relating to price resets and the setting of default price-quality paths (DPPs) under Part 4 of the Commerce Act 1986. We commissioned these reports in response to the Commission's Process and Issues Paper of December 2011,¹ which detailed some substantive matters relevant to the method to be applied by the Commission when determining starting prices for DPPs (referred to as the starting price adjustment (SPA) methodology).²

It had been our intention to submit these reports in response to the Commission's consultation on its SPA methodology, which was originally scheduled to occur by now. Following the recent Court of Appeal decision, the Commission has decided it will not undertake a stand-alone consultation on this matter. Instead the Commission will next consult on its proposed the SPA methodology in its draft decision on the reset DPP (for electricity distribution services) and the first DPP (for gas pipeline services).

¹ Commerce Commission, Additional Input Methodologies for Default Price-Quality Paths, Process and Issues Paper, 9 December 2011.

² This included matters such as how to assess current and projected profitability and how to address incentive effects.

Although the consultation process has changed, we believe it may be more helpful to the Commission to submit these expert reports now, rather than after the draft decisions have been released for consultation.

Accordingly, we attach three reports for the Commission's consideration:

- a. Castalia, *Evidence on the Impacts of Regulatory Incentives to Improve Efficiency*, Report to Vector, April 2012.
- b. CEG, *Empirical studies on the impacts of economic regulation*, Report to Vector, July 2012.

These provide evidence of the importance of efficiency incentives in regulated industries and lessons from the approaches taken in other jurisdictions.

- c. CEG, *Application of claw-back*, Report to Vector, June 2012.

This details possible approaches to implementing claw-back, which may be useful if the Commission determines that it will adopt claw-back.

We will also make these reports publicly available.

Most of the issues raised in the Commission's Process and Issues Paper of December 2011 remain equally valid regardless of whether the Commission publishes (or is legally required to publish) its SPA methodology as an Input Methodology (IM).³ This includes, for example, the question of how to ensure regulated suppliers have incentives to improve efficiency.

In relation to incentives to improve efficiency, the December Issues and Process Paper stated "that one approach could involve 'staggering' the sharing of efficiency gains over time".⁴ However, while the Commission expressed an interest in views on adoption of a stagger as a way to encourage and share efficiency gains, it is yet to detail its own assessment of this (or other) options.

The efficiency-related expert reports enclosed address this issue, providing, in Vector's view, valuable and well-traversed support for:

- the importance of incentives to improve efficiency; and
- adoption of mechanisms that can best be employed to enable such improvement over time.

³ Note that, while not required to determine its SPA methodology as an IM, Vector's position remains that including the SPA methodology in the IMs would be materially better at meeting the Part 4 purpose than not including it.

⁴ Paragraph 168, Additional Input Methodologies for Default Price-Quality Paths, Process and Issues Paper, 9 December 2011.

We trust these expert reports assist the Commission. Please do not hesitate to contact me if you have any questions in relation to the attached reports by email to Allan.Carvell@vector.co.nz or by phone on 09 978 8340.

Yours sincerely



Allan Carvell
Group General Manager Regulation & Pricing

Attached:

- A. Castalia, *Evidence on the Impacts of Regulatory Incentives to Improve Efficiency*, Report to Vector, April 2012
- B. CEG, *Empirical studies on the impacts of economic regulation*, Report to Vector, July 2012
- C. CEG, *Application of claw-back*, Report to Vector, June 2012
- D. Vector clawback model excel workbook