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Dear Keston,

Vector cross submission on the Review Related Party Transactions Review Draft Decision

1. This is Vector's cross submission to the Commerce Commission's (Commission) Input Methodologies (IM) Review Draft Decision on Related Parties Transactions (RPT Draft Decision). No part of this submission is confidential and we are happy for it to be publicly released.

Means and motive

2. We are concerned with the following statement from ERANZ:

The risk is not just a theoretical one based on potential (or theoretical) behaviours, i.e. the means, by which regulated suppliers might cause harm to consumers, but is based on the regulated supplier having the motive as well.¹

3. This statement suggests suppliers are systemically manipulating the current RPT. The emphasis to the statement "motive" implies all RPT executed by suppliers have been to inflate costs for customers of the regulated service. This is a significant allegation and entirely unsubstantiated. There is no evidence that suppliers are acting in the manner as alleged by ERANZ. Several suppliers are reporting nil or very small volumes of RPT compared to total expenditures which further undermines the weight of the claim.

Coordination benefits

4. ERANZ has suggested the only benefit from using a related party is a "coordination benefit". Again, such an assertion reflects a naivety about the complexity involved with managing the regulated service. There are a range of considerations for management when considering insourcing versus outsourcing including, *inter alia*, the size of the market, ensuring technical capability, safety expertise and minimising the risk of capture.

¹ ERANZ, *Submission to the Commerce Commission on the Input Methodology Review draft decision on related party transactions*, p.16

5. The fact many suppliers operating in regional supply areas have a higher percentage of RPT, then suggesting such suppliers are only motivated to use related parties to inflate costs is not recognising more likely motives such as a relatively thin or captive external market for service inputs such as field technicians.
6. In that respect, the RPT rules are ensuring suppliers are using the optimal combination of insourced and outsourced inputs to deliver the regulated service. For example, Westpower noted in their region there is little opportunity to attract contracting services on reasonable terms is a key reason for their relatively high proportion of RPT. This is a legitimate consideration for retaining a related party provider given the alternative could result in unreasonable terms for equivalent contracting resources.

Disclosure of related party transactions not sourced through competitive tenders

7. We encourage the Commission to consider the unintended consequences of mandating commercial transactions to be publicly disclosed as suggested by MEUG. By creating this requirement, the Commission will significantly compromise the contracting ability of parties including issues around intellectual property. Moreover, public disclosure may compromise confidentiality clauses embedded within commercial agreements. This is especially the case given the RPT rules apply to both fully owned and partially owned related parties.
8. Given suppliers are required to demonstrate transactions are occurring on arm's length terms. This additional requirement is unnecessary and risks compromising commercial decision making.

Ring-fencing

9. ERANZ raised the issue of ring-fencing but failed to demonstrate how it is connected to the problems carefully considered by the Commission in its problem definition consultation on the RPT rules. Moreover, the failure to raise evidence for how ring-fencing could address the rising volume of RPT demonstrates the tenuous connection ERANZ is trying to make.
10. The ERANZ discussion about ring-fencing appears to be misusing the RPT consultation process to express a recurring self-serving agenda.

First principle review of the regulatory framework

11. ERANZ suggested there needs to be a first principles review of the regulatory framework. Vector notes Part 4 and the IM regulatory framework have only recently undergone their first IM review and first completed five year DPP for EDBs and gas pipelines. The seven year periodic IM reviews also provide a settled process for amending the rules and processes for setting price paths.

12. In contrast, Vector notes there is no periodic review on the effective operation of the other parts of the electricity supply chain such as the retail electricity market. Accordingly, Vector sees a need to review the retail electricity market to determine whether this sector is delivering value for consumers. A review would also consider whether high concentration of vertically integrated generator / retailing firms is an appropriate supply model.

13. In a recent address to the National Press Club in Australia, Rod Sims, ACCC Chairman noted:

The retail electricity market is also highly concentrated, with three players (Origin, AGL and Energy Australia) with over 70% of customers. The next largest two players, taking share in most states to around 90%, are also vertically integrated.

High levels of vertical integration can make it difficult for others to compete. This concentration was, of course, made worse by the sale by the NSW Government of the Bayswater and Liddell generators (known together as Macquarie Generation) to AGL a few years back, which the ACCC strenuously but unsuccessfully opposed.²

14. Given the risks surrounding vertical integration in generator / retailing sectors noted by the ACCC Chairman, we consider the high concentration of these markets in New Zealand needs to be further investigated. This type of market structure and behaviour could be obstructing competition and limiting the value customers can obtain from the market.

15. More generally, we believe a review of the retail electricity market is needed to consider whether the market is delivering for consumers. A recent report by the Grattan Institute into Victoria's retail electricity market also found:

Competition in electricity retailing hasn't delivered what was promised: low prices for consumers. The failure is worst in Victoria, the state with the most retailers and the longest experience of deregulation. Profit margins appear to be higher than in other sectors – and more than double the margin that regulators considered fair when they set retail electricity prices.³

16. The issues of high market concentration among integrated generator / retailing businesses has the potential to damage innovation, limit new service models and cause consumer harm. We recommend any review of the energy market must consider the

² Mr Rod Sims ACCC Chairman, National Press Club Address 'Shining a light: Australia's gas and electricity affordability problem', 20 September 2017: <https://www.accc.gov.au/speech/shining-a-light-australia%E2%80%99s-gas-and-electricity-affordability-problem>

³ Grattan Institute (Tony Woods and David Blowers), *Price Shock is the retail electricity market failing consumers*, March 2017 p. 3

impact this service model has on entrenching incumbent generation/retail businesses, customer outcomes and service innovation.

Conclusion

17. Given the issues raised in submissions we encourage the Commission to progress any changes cautiously and adhere to its framework for making change – namely to consider whether the change will promote the purpose of Part 4 and the purpose of the IMs. To discuss any questions in relation to this submission please contact Richard Sharp on Richard.Sharp@vector.co.nz or on 09 978 7547.

Yours sincerely

For and on behalf of Vector Ltd

A handwritten signature in blue ink, appearing to read "Richard Sharp".

Richard Sharp

Head of Regulation and Pricing