

29 May 2020

Ms Vanessa Howell
Head of Fibre Regulation
Regulation Branch
Commerce Commission
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Dear Vanessa,

Submission on Regulatory Processes and Rules Draft Decision

1. Vector has reviewed the Commerce Commission's (Commission) Draft Decision on the Processes and Rules Draft Decision applying to the Input Methodologies for Chorus and Local Fibre Companies (LFCs) under Part 6 of the Telecommunications Act (hereinafter referred to as the Act). In this submission we comment on two matters: the wash-up mechanism for the specification or price and proposed pass-through costs for Chorus and LFCs.

Revenue cap wash-up under section 196 of the Act

2. The proposed revenue cap wash-up for Chorus and LFCs will allow these providers to recover at the end of the regulatory period the difference between *ex-ante* revenues forecast at the beginning of the control period and actual revenues received. This mechanism is significantly different to electricity distribution businesses (EDBs) and gas pipeline businesses (GPBs) regulated under Part 4 of the Commerce Act.
3. A significant source of variation in *ex-ante* revenue forecasts is the Commission's presumption in the revenue path on price inflation across the regulatory control period. In the Part 4 context significant variances to the Commission's forecast has resulted in suppliers having to adjust prices annually at rates much less than assumed in the Commission's *ex-ante* forecast. For EDB and GPB suppliers this has resulted in revenues being significantly lower than assumed in the *ex-ante* forecast for annual price changes. The wash-up mechanism proposed for Chorus and LFCs appears to have the benefit of limiting the extent to which inflation forecast error for price inflation affects supplier revenue recovery.

4. Vector notes the issue of inflation forecasting risk has been a significant issue for EDBs and GPBs regulated under Part 4. This includes inflation forecasts for annual price adjustments and for deducting notional revaluation income from forecast revenues. The Commission has over a nine-year period consistently over-estimated inflation for both parameters in supplier revenues. For example, during the five-year 2015-20 Default Price Path (DPP) for EDBs the exaggerated price inflation forecasts resulted supplier revenues being approximately \$124 million less than the Commission's forecast of this parameter. Furthermore, notional revaluation income deductions from supplier revenues were \$259 million higher than necessary due to the over-estimation of inflation projections.
5. Accordingly, we strongly recommend the Commission consider the impact a persistent trend to over-estimating inflation has on delivering certainty to suppliers and consumers. We note the Australian Energy Regulator has recognised the evidence for inflation forecasting for Regulatory Asset Base indexation has contributed to suppliers being left out of pocket and is now consulting on whether the status quo continues to be appropriate or whether it should change its approach for target compensation. We consider the proposal for Chorus appears to address the impact of price inflation errors have on forecast revenues. To this end, we recommend the Commission consider more fully whether its approach to inflation forecasting remains appropriate or requires a more holistic review.

Pass-through costs – local council rates

6. Vector considers the Commission has erred in the application of its criteria for determining pass-through costs. The Commission decision to exclude rates has largely been influenced by its suggestion suppliers can impact their rating obligation by choosing to lease as opposed to owning parts of their network infrastructure subject to council rates. This analysis omits to recognise the unilateral right local authorities have with their levying including raising rates. Therefore, Vector considers such costs are more appropriately recognised as pass-through costs for Chorus and LFCs.

Pass-through costs – Utilities Disputes Tribunals

7. The Commission's proposal to exclude costs associated with the utilities disputes tribunal again appears to have neglected the nature of this service and its impact on suppliers. Suppliers under Part 4 are not able to opt out of the UDL and cannot control illegitimate claims being taken to the Tribunal. This may also be the case for Chorus and LFCs for managing telecommunications disputes. Therefore, we encourage the Commission to

consider the obligations the suppliers have to the UDL before assessing whether or not such costs should be treated as operating expenditure or pass-through costs.

Yours sincerely



Richard Sharp
GM Economic Regulation