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COMMERCE ACT (DECISION NOT TO DECLARE CONTROL: VECTOR LIMITED) NOTICE 2008

PURSUANT TO PART 4A
OF THE COMMERCE ACT 1986

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Part 4A of the Commerce Act 1986 (the Act) came into effect on 8 August 2001 and, among other things, requires the Commerce Commission (“Commission”) to implement a targeted control regime for the regulation of large electricity lines businesses (lines businesses)—namely electricity distribution businesses (distribution businesses) and Transpower New Zealand Limited.

The targeted control regime

Section 57E of the Act provides that the purpose of subpart 1 of Part 4A is to promote the efficient operation of markets directly related to electricity distribution and transmission services through targeted control for the long-term benefit of consumers by ensuring that suppliers—

- (a) are limited in their ability to extract excessive profits; and
- (b) face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
- (c) share the benefits of efficiency gains with consumers, including through lower prices.

Under section 57G(1)(b) of the Act, the Commission must set thresholds for the declaration of control in relation to lines businesses.

The process for making decisions on declarations of control is set out in section 57H, which provides that the Commission must:

- (a) assess large electricity lines businesses against the thresholds set under this subpart; and
- (b) identify any large electricity lines business that breaches the thresholds; and
- (c) determine whether or not to declare all or any of the goods or services supplied by all or any of the identified large electricity lines businesses to be controlled, taking into account the purpose of this subpart; and
- (d) in respect of each identified large electricity lines business,—
 - (i) make a control declaration; or
 - (ii) publish the reasons for not making a control declaration in the *Gazette*, on the Internet, and in any other manner (if any) that the Commission considers appropriate.

On 6 June 2003, after consulting with interested parties as to possible thresholds, the Commission set two thresholds—a CPI-X price path threshold and a quality threshold—applicable until 31 March 2004 for distribution businesses. These initial thresholds were set by the *Commerce Act (Electricity Lines Thresholds) Notice 2003* published as a Supplement to the *New Zealand Gazette*, 6 June 2003, No. 62, page 1685.

The Commission reset the thresholds for all distribution businesses for a five-year regulatory period from 1 April 2004. These reset thresholds were set by the *Commerce Act (Electricity Distribution Thresholds) Notice 2004* published as a Supplement to the *New Zealand Gazette*, 31 March 2004, No. 37, page 927.

Before making a declaration of control, the Commission is required under section 57I(1) to:

- (a) publish its intention to make a declaration and invite interested persons to give their views on the matter; and
- (b) give a reasonable opportunity to interested persons to give those views; and
- (c) have regard to those views.

Assessment and identification of Vector's threshold breaches

Vector owns and operates the electricity distribution networks in the Auckland, Northern and Wellington regions. Auckland networks cover Auckland City, Manukau City and parts of Papakura District. Northern networks cover North Shore City, Waitakere City and Rodney District. Wellington networks cover Wellington City, Porirua, Lower Hutt and Upper Hutt. The Northern and Wellington networks were acquired from UnitedNetworks Limited (UNL) during October 2002, when Vector acquired 100% of the shares of UNL, including three geographic networks – Eastern, Northern and Wellington, although it subsequently sold the Eastern network in November 2002 to Powerco and Unison. On 28 April 2008, Vector announced the sale of its Wellington network, subject to a number of conditions including the approval of Vector's shareholders.

Vector is listed on the New Zealand Stock Exchange. Its majority shareholder, with a shareholding of 75.1%, is the Auckland Energy Consumers Trust (AECT). The balance of 24.9% is held by a number of individual shareholders through publicly listed shares.

The Commission has assessed Vector against the initial price path and quality thresholds set on 6 June 2003 and has identified Vector as having breached both thresholds at the second assessment date (31 March 2004).

Intention to declare control of Vector

On 9 August 2006, the Commission published as a Supplement to the *New Zealand Gazette* (9 August 2006, No. 94, page 2759) its intention to make a declaration of control under Part 4A in respect of electricity distribution services supplied by Vector. On the same day, the Commission published a paper titled *Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Intention to Declare Control, Vector Limited* which contains the Commission's reasons for its intention to declare control of Vector. The Commission invited interested persons to give their views on the matter by 4 September 2006 but suspended the consultation process on 13 October 2006 when it received an administrative settlement proposal ("Proposal") from Vector which was considered in principle to be consistent with the Purpose Statement. On 23 January 2007, Vector provided the Commission with an amended proposal reflecting a number of minor changes to the cost of supply (COS) model it uses to derive the tariff levels for each customer group.

Draft decision not to declare control of Vector

On 14 December 2007, the Commission published a paper titled *Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Draft Decision: Reasons for Not Declaring Control, Vector Limited* which contains the Commission's preliminary view to accept the Proposal made by Vector on 13 October 2006 and updated on 23 January 2007 and not to make a declaration of control under Part 4A in respect of electricity distribution services supplied by Vector. The Commission also published a copy of Vector's Proposal. The Commission

invited interested persons to give their view on the matter by 11 February 2008 and submissions were received on this date. Cross-submissions were requested and received on 25 February 2008.

Decision not to declare control

The Commission has had regard to all views expressed by interested parties at the conference and in written submissions in relation to this matter.

The Commission has determined not to make a declaration of control under Part 4A in respect of electricity distribution services supplied by Vector, for the following reasons:

- The Commission has the ability to enter into an administrative settlement with a business that has breached the thresholds in order to further the objectives of the targeted regime in Part 4A of the Act.
- Vector's Proposal involves the company voluntarily rebalancing its line charges to different regions and customer groups—subject to its existing price path threshold—so that the prices paid by consumers better reflect the underlying costs, demand and service quality.
- Vector's compliance with its existing thresholds and its commitment to address the pricing inefficiencies identified by the Commission will promote behaviour consistent with the purpose in section 57E of the Act at a lower administrative and compliance cost than control.
- Having evaluated Vector's Proposal and taken into account the views of interested parties, the Commission considers that the likely outcomes associated with the implementation of Vector's Proposal are consistent with the purpose in section 57E of the Act. Therefore a declaration of control in respect of Vector's electricity distribution services is not necessary to ensure the objectives of the targeted control regime are achieved.
- In accordance with the Proposal, Vector has already implemented the first two stages of the rebalancing programme set out in the Proposal, through price changes on 1 April 2007 and 1 April 2008 which rebalance tariffs between regions and customer groups.
- Vector has formally recorded its Proposal in a deed, which has been signed and executed by Vector and the Commission.

A more comprehensive explanation of the reasons for the Commission's decision not to declare control of Vector is contained in the paper titled *Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Reasons for Not Declaring Control, Vector Limited* dated 30 May 2008. A copy of this paper can be located on the Commission's website: www.comcom.govt.nz.

Any comments and questions on this notice may be sent by email to: electricity@comcom.govt.nz; or by mail to Network Performance Branch, Commerce Commission, P.O. Box 2351, Wellington; or by facsimile (04) 924 3700.