



**Submission on the Review of  
Parts 4, 4a and 5 of the  
Commerce Act**

**7 December 2007**

## INTRODUCTION

1. Vector Limited welcomes the opportunity to comment on the design details for the new regime to replace Parts 4, 4A and 5 of the Commerce Act ("**the Act**").
2. Vector is grateful to the Government and the Ministry of Economic Development ("**MED**") for the commitment they have demonstrated to consultation throughout the review process.
3. As Vector stated in its press statement of 22 November 2007, Vector considers that the draft decisions in the Cabinet Paper ("**the Paper**") are moves in the right direction and will provide a more stable regulatory environment in the longer term which will promote investor confidence.
4. Vector is active in developing a demand side response to climate change and thus is encouraged at the recognition in the Paper of the need to integrate energy efficiency into the regulatory framework to avoid the risks of inconsistent outcomes or unintended consequences.
5. Vector has, however, identified areas which, if not addressed, could blunt the Government's policy objectives and prevent the changes from achieving their full potential in a timely manner.
6. Under the proposal as currently designed, access to new input methodologies for Vector's controlled gas pipelines and, possibly, for its electricity business may not be effective until 2012. Vector considers it would be counter-productive to allow the existing regimes to continue for such an extended period, given the acknowledged issues regarding investment and investor confidence.
7. Vector submits that benefits from the new regime will not be realised until there has been a proper focus on establishing regulatory methodologies that support infrastructure investment and that this should be done as soon as possible. Vector considers it highly unlikely that three years is required to establish a robust set of input methods.
8. This submission elucidates the problems as Vector sees them and proposes practical solutions.

## EXECUTIVE SUMMARY

9. Vector strongly supports the great majority of the decisions to emerge from the review of Parts 4, 4A and 5 of the Act ("**the review**"). In particular, Vector supports:
  - (a) The repeal of Part 4A and its replacement by a default/customised price-quality path within Part 4;
  - (b) The insertion in the purpose statement of the new Part 4 of a requirement that any regulation under this part will promote incentives to innovate and invest, including in related businesses. It is extremely important that multi-utility businesses, such as Vector, are able to leverage their activities to improve economies of scale and scope and that shareholders are able to retain these benefits;
  - (c) The introduction of a wider range of regulatory tools and the inclusion among these of the low cost default price/quality arrangements and the customised control option;
  - (d) The provision that any regulation should be the least intrusive necessary to meet the objectives of the purpose statement;
  - (e) The proposal that the Commerce Commission ("**the Commission**") should, to the extent practicable, determine 'whether' to regulate and 'how' to regulate at the same time;
  - (f) Input methodologies being set in advance and subject to merits review;
  - (g) The ability for individual businesses to propose customised control terms to meet their specific circumstances, especially in relation to investment; and
  - (h) Provision for the Commission to take into account in the event of breaches of the price/quality path such extenuating circumstances as whether the firm took all reasonable steps to comply with the path and any actions taken to remedy the breach.
10. Vector is, however, concerned about elements of the proposed reform package; particularly in relation to the transitional arrangements, the timeframes indicated for finalising input methods in the new framework and the lack of merits review of substantive Commission decisions.
11. Vector submits that, unless these are dealt with, investor confidence will remain subdued and the ability of New Zealand's infrastructure to support the Government's economic growth and transformation objectives and to provide quality services at reasonable prices to the consumer will be impaired.
12. In particular, Vector submits that the new input methods should be completed before further detailed decisions are made on electricity and gas prices. Vector recognises that the consumer's interests must be protected, but these will not

be served by the imposition of price controls using input methodologies which the markets regard as flawed.

13. The reality for the infrastructure markets is that there has never been a proper process for putting in place input methodologies. For example, even within the Gas Draft Final Authorisation, there has been no discussion of how the regulatory environment is intended to encourage and reward rationalisation of New Zealand's fragmented infrastructure sector. To proceed on the basis of "current" input methods would invite a further protracted period of regulatory uncertainty and lack of confidence.

## RECOMMENDATIONS

14. The Cabinet Paper proposes that the reset thresholds will be the first price control terms for large electricity lines businesses ("ELBs") and that the final authorisation for gas will continue until 2012. In this context Vector's main recommendations are as follows:
15. Transitional arrangements should be put in place to defer further substantive decisions on prices that apply to regulated businesses, pending a focused effort on determining input methods. Vector submits that three years is an unduly long timeframe.
16. If the Government insists on reset thresholds as the first default terms for ELBs, it is critical that:
  - (a) The new purpose statement is introduced as soon as the legislation is passed (mid 2008) so that it is in force as the non-statutory Guidelines and reset thresholds are developed. (It would apply to Part 4A in addition to Part 4 until Part 4A is repealed);
  - (b) The criteria for considering alternative proposals are set out in legislation (the Cabinet Paper proposes that the Commission develop these as one of the input methods). This would ensure there are transparent and certain terms for considering proposals from 1 April 2009; and
  - (c) As with the preferred option, there should be strict timeframes for the Commission to set the input methods.
17. Should the Commission proceed to the Final Authorisation, gas companies under price control (Vector and Powerco) should be able to propose alternative terms to their authorisations as soon as the new input methods are determined provided that:
  - (a) The statutory input methods differ from those used in the Final Authorisation; and
  - (b) No new information is used to determine prices for the remaining years of the price path until 2012, given the significant efforts that have gone into data/forecast validation in the current control process.
18. The transitional provisions should make an exception for Vector and Powerco (as individual firms) to propose alternative terms before default terms for the gas pipeline sector are set.
19. The Commission should be subject to statutory time limits for setting the input methods (12 months in total, subject to the ability to apply for extensions in accordance with set criteria). Timeliness for this fundamental first stage will be critical for confidence in, and workability of, the new regime.
20. Full details of these and Vector's other recommendations are set out in the body of the submission at the end of each section.

## **STRUCTURE OF SUBMISSION**

21. Vector's concerns about the proposed transitional arrangements, and their potential effect upon Vector's business, are severe. The submission will therefore deal with these first. Subsequently, it will follow Appendix B in the Cabinet Paper.
22. For efficiency, and because Vector is aware that the MED is working to tight timelines, we will deal only with those areas in which we have concerns. We would not want this focus to obscure Vector's support for the broad thrust of the Cabinet's decisions and for the great majority of the design specifications outlined in the Paper.

## **TRANSITIONAL PROVISIONS**

23. As previously stated, the transitional provisions as now drafted could mean that Vector's gas pipelines and its electricity business would effectively be governed by the existing regime until 2012, occasioning a long period of regulatory uncertainty.

### **Electricity**

24. The first default terms for ELBs will be determined without reference to the input methods set under the new regime. Vector submitted that the current price/quality thresholds should roll over (with a CPI price path from 2009) until the new framework, including input methods, is in place. Instead the proposal is that the Commission reset the thresholds and these become the default path from 1 April 2009.
25. Vector submits that thresholds, which are designed to be screening mechanisms rather than final control terms, may be inappropriate as default arrangements.
26. Customised proposals in the first years of the new regime will be considered on the basis of input methods that the Commission must establish under the current framework without any transparent process or direction from the new purpose statement.
27. The Commission estimates that it will require three years to develop the new input methodologies. This suggests that it is not confident that its existing approaches (as used, for example, in the Gas Final Authorisation and Intention to Declare Control procedures) are sufficiently robust to transfer to the new regime.
28. As discussed in greater detail below, three years is an extremely long timeframe by international comparison. If the workload of the Commission is the reason then more resources should be put in place so that the objectives of the reform can be achieved.
29. In the interim, firms will be able to access the customised control option via "non-statutory Guidelines" to be developed by the Commission. The intention is to speed the transition to the new structure. However the effect could be to carry the current lack of regulatory certainty and confidence through to the new regime, at least until the new input methods have been established. The Cabinet Paper states that these Guidelines, which are likely to represent the inputs the Commission currently applies, "can be regarded as a pre-cursor to statutory input methodologies".
30. Given the Commission's projected three year timeframe to set inputs, and that non-statutory Guidelines have yet to be developed, the risk is that the

Commission will rush to complete the 2009 reset. This would increase the probability of error, which could not be corrected for some time.

31. The Commission needs to consider only four applications per sector per year and can prioritise as it sees fit. If all 11 ELBs seek customised terms, which may be likely given the default thresholds will have been set under the old regime, any single lines business may be exposed to sub-optimal outcomes until 2012. Capital markets will not find palatable the prospect of continued uncertainty over such an extended length of time.

### ***Recommendations***

32. Vector submits that the existing price-quality thresholds, indexed to the CPI, be carried over as default terms and that the Commission be required/resourced to complete the statutory methodologies to apply under the new regime within a reasonable timeframe (one year for setting the input methods and one year for setting the default terms). Firms could then propose alternative terms.
33. In the event that the first default terms are the reset thresholds, the following recommendations are critical.
34. A major concern for Vector is how the pre-set criteria will be developed for the transitional period so that firms can propose alternative terms to the reset thresholds from 1 April 2009.
35. The Discussion Document sets out statutory requirements to govern the Commission's consideration of customised control proposals but the Cabinet Paper proposes instead that the Commission set the criteria as part of input methods. (Note that, as they relate to an option not provided for in the existing Act, they cannot be developed now as a non-statutory Guideline under current law).
36. This approach creates two problems:
  - (a) Either the criteria will not be completed by 1 April 2009, delaying firms' access to the customised control provisions;
  - (b) Or, if the Commission is required to complete them by 1 April 2009, there will be limited opportunity for development and consultation with the result that they may be poorly considered. This would undermine the confidence regulated firms' would have in the new regime and potentially lead to litigation.
37. Vector submits that these issues could be readily addressed by providing statutory direction for the pre-set criteria as was originally proposed. This would:
  - (a) Provide the transparency and certainty needed for this process (particularly where there is to be no merits review of the Commission's decision to accept or reject a customised terms proposal); and

- (b) Ensure that the default/customised regime can operate from 1 April 2009 and achieve its intended objectives.
38. The proposed criteria from the Discussion Document are set out below with Vector's proposed additions underlined and deletions bracketed in italics:
- (a) Compliance with the input methodologies;
  - (b) It covers the prices and quality of supply of the regulated services;
  - (c) [*(Evidence that full and proper consultation with customers has been undertaken on the need for the expenditure and that the customers or a reasonable proportion of them agree with the company's proposals and price/quality trade-offs)*]
  - (d) [*Evidence that significant capital expenditure of a different level and character than in the recent past (say, 10 years) is needed to meet customers' quality requirements and/or significant changes in customer demand;*]
  - (e) Evidence that the [*expenditure cannot be financed*] adequate returns are unlikely to be earned;
  - (f) [*Evidence that the firm is efficient and that the scope for further efficiency gains is limited*];
  - (g) Evidence that the proposed quality terms are too stringent;
  - (h) Evidence that the proposed capital and operating expenditure plans have been robustly prepared using good industry practices and independently scrutinised for their reasonableness in aggregate [*A requirement for evidence to be certified by independent experts approved by the Commission (prior to the 90 day timeframe commencing)*]; and
  - (i) Evidence of materiality from the perspective of the business; and
  - (j) There is sufficient information to evaluate the reasonableness of the proposal in totality.
39. The Cabinet Paper suggests that the Commission should be able to prioritise proposals as it sees fit (page 12). However, the Paper also lists criteria for the Commission's decisions on priorities (to replace section 27K(2) which include (page 31):
- (a) Quality and completeness of proposal;
  - (b) Urgency of any proposed additional investment (compared to historic rates of investment) required to meet consumer requirement on quality; and
  - (c) Materiality of the proposal relative to size and revenues of the firm.

40. Vector strongly submits that the Commission be required to consider only these factors (e.g. that the Commission “shall” consider or “may only” consider).

## **Gas**

41. Vector (and Powerco) will not benefit from the legislative reforms in relation to their controlled gas pipelines until 2012 as the Cabinet Paper proposes that the authorisations set by the Commission run through to the end of the initial regulatory period.
42. It would seem inconsistent with the objective of the reforms for Vector to be subject to an authorisation which is based on input methods set under a regime acknowledged to be flawed and insufficiently supportive of investment.

### ***Authorisation for Controlled Gas Pipelines based on Approaches that are Inconsistent with the New Purpose Statement***

43. Vector submits that the Commission’s proposed approach to the Final Authorisation<sup>1</sup> is not consistent with the new regime as it is based on input methods that do not promote incentives to invest and innovate as will be required by the new purpose statement.
44. Issues with the Draft Authorisation are:
- (a) Rather than adopt the June 2005 ODV value for the starting asset valuation, the Commission is seeking to amortise the difference between the 2005 valuation and the flawed 2003 valuation against Vector’s future allowable revenues. The Commission proposes this clawback approach even though it and its advisors have acknowledged that the 2003 valuations are unreliable. The proposal results in a price decrease of 14.6% compared to price increases if this approach is not followed;
  - (b) This proposed clawback is not consistent with the Commission’s previous statements and decisions, is retrospective and is not in accordance with good regulatory practice (unprecedented);
  - (c) The Commission’s approach focuses on a narrow theoretical NPV=0 formula and disregards the timing of cashflows, which are the lifeblood of a business, by consistently adopting methods which result in short-term price reductions that will be off-set by higher prices over the longer-term;
  - (d) The Commission’s proposed approaches to cost allocation would require Vector to reallocate overhead costs to other business units within the Vector Group which cannot recover those costs. This reduces incentives for the efficient rationalisation of infrastructure across related sectors; and

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<sup>1</sup> *Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Draft Decisions Paper, dated 4 October 2007*

- (e) The proposed WACC is insufficient to compensate for the risk that Vector would bear in recovering the costs of gas assets over their physical lifetimes (50 plus years) when consumers can and do disconnect at any time.
- 45. Under the new regime, the input methods would be set in advance limiting inconsistent and opportunistic regulatory action. Setting input methods independently of a detailed regulatory process will enable the development of approaches that reflect a broader appreciation of the relevant commercial and capital market context for infrastructure investment, which has not occurred to date.
- 46. Given the risk of serious problems with the Final Authorisation, early access to the new regime is crucial.

### ***Recommendations***

- 47. Vector's preferred approach would be that the Provisional Authorisation continues until the input methods under the new regime are established. Vector has asked the Commission to use its discretion in this regard. Section 70C of the Act provides that the Commission may effectively back-date the effect of a Final Authorisation to 2005, so holding the Provisional Authorisation until input methods have been set would not create adverse circumstances for firms or consumers. Vector submits that the legislation should give support to this approach.
- 48. Should the Commission proceed to the Final Authorisation, gas companies under price control (Vector and Powerco) should be able to propose alternative terms to their authorisations as soon as the new input methods are determined provided that:
  - (a) The statutory input methods differ from those used in the Final Authorisation; and
  - (b) No new information is used to determine prices for the remaining years of the price path until 2012, given the significant efforts that have gone into data/forecast validation in the current control process.
- 49. This approach would give the controlled gas businesses early access to necessary changes in input methodologies while also minimising the costs of re-establishing the appropriate path.
- 50. This solution relies on the Commission being subject to statutory timelines to set input methods as detailed below.
- 51. The transitional provisions should make an exception for Vector and Powerco so that they are entitled to propose alternative terms before default terms for the gas pipeline sector are set.

## **TIMELINESS OF COMMISSION DECISIONS**

52. A key source of frustration with the existing regime is that it is too often characterised by time lags. For example, the Minister decided to impose control on Vector's and Powerco's gas pipeline businesses on 25 August 2005 yet a final authorisation is still pending. The usual timeframe for such decisions in Australia is around 16 and half months.
53. The Commission estimates that it will require three years to prepare the input methods for the new regime. A study of regulatory authorities in comparable overseas jurisdictions shows that in Australia it takes between ten and eighteen months to determine input methodologies and that the norm in the United Kingdom is one to two years.

### **Australia**

54. The Australian Energy Regulator (AER) is responsible for regulating the revenues of transmission network service providers in the National Electricity Market in accordance with the National Electricity Rules. The AER has recently released final decisions on three regulatory methodologies: a post-tax revenue model, an efficiency benefit sharing scheme and a roll forward model. All three were completed within the space of 10 months.

### **Victoria**

55. The Office of the Regulator-General<sup>2</sup> completed within 18 months the methodology for a price control review. The broad regulatory approach had to meet the objectives of: facilitating efficient regulatory markets, ensuring that users and consumers benefit from competition and efficiency, facilitating the maintenance of a financially viable electricity supply industry and preventing misuse of monopoly or market power.

### **United Kingdom**

56. Ofgem, which is responsible for considering gas and electricity licence applications in the United Kingdom,<sup>3</sup> takes between a year and two and a half years to determine their methodologies. Three of the Authority's recent price control decisions and its timeframes for them are summarised below:
  - (a) Developing network monopoly price controls: this project took around 12 months and was aimed at developing a more consistent approach to price

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<sup>2</sup> The Office of the Regulator General's functions have now been subsumed by the Essential Services Commission.

<sup>3</sup> See <http://www.ofgem.gov.uk/About%20us/Authority/Pages/TheAuthority.aspx>

control and at laying the foundations for the next distribution price control review;

- (b) Electricity distribution price control review: the project plan took two years and had four stages. The first stage, from March to May 2003, was encompassed in the work on network monopolies. The second stage, from June 2003 to March 2004, involved mainly customer research, a regulatory impact assessment and a review of the key policy decisions so far. The third stage began in January 2004. It finalised the work on efficiency analysis and assessed the forecast cost information submitted by the distribution network operators.<sup>4</sup> Final proposals were published in November.<sup>5</sup> The fourth stage, from June 2004 to February 2005, was the implementation stage; and
- (c) Gas distribution price control review: the timeframe for this project was slightly longer at two years but the review was for two control periods. Moreover, the Gas and Electricity Market report notes that the timetable diverges from previous Ofgem timetables in order to address specific issues arising in the context of the review.<sup>6</sup>

57. It should be noted that both the Victorian and Ofgem reviews have also involved detailed implementation issues and numeric analysis, beyond establishing input methods, so the 2 year timeframes need to be seen in that context.

### **Recommendations**

- 58. Vector submits that timeliness is essential to a well-functioning regime and should be built into the new regime's design to the greatest extent possible. This would allow the Commission to plan its resources, including seeking further resources if necessary, and would give firms and investors greater confidence and certainty.
- 59. The Commission should be able to seek an extension of time but extensions should be granted only under prescribed conditions and for prescribed periods to ensure that the benefits of setting timeframes are not lost.

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<sup>4</sup> Gas and Electricity Market Authority *Open Letter in Developing Network Monopoly Price Controls and the Next Price Review of the Electricity Distribution Network Operators (DNOs)* 13 March 2003, 4

<sup>5</sup> Gas and Electricity Market Authority *Electricity Distribution Price Control Review Final Proposals* November 2004 265/04

<sup>6</sup> *Ibid*, 65

60. While statutory timeframes must allow for some flexibility so, arguably, are an imperfect solution; they provide a discipline in that there is an expectation that the parties will work to deadline. An extension process also ensures that the regime is transparent as reasons must be given for any delay. Indefinite timeframes are likely to seriously undermine the credibility of the new regime at its outset, particularly given the Commission's timing issues to date.
61. On commencement of an inquiry (or in relation to sectors/firms already under control); the Commission should be required to commence a consultation process to develop the detail of how the generic input methodologies will be applied, any changes or new methodologies necessary for that inquiry<sup>7</sup> and which criteria would apply to which firms. In particular, the process would provide that the Commission:
- (a) Undertake an investigation as to whether it is necessary to add a new methodology or amend an existing methodology (four months, not necessary for the first input methods);
  - (b) Issue a draft report to the public (six months);
  - (c) Receive submissions on the report (three months);
  - (d) Convene workshops (rather than conferences) involving relevant experts (within one month of the closing date for the submissions);
  - (e) Prepare a final report for the Minister taking into consideration:
  - (f) Submissions made on the draft report and proposals included within those submissions; and
  - (g) Information and opinions presented or expressed at the workshops;
  - (h) Make a recommendation to the Minister (two months from the public hearing).
62. On the basis of these timescales, the Commission would recommend input methods within 12 months. Vector submits that these timeframes are more than adequate. The key timeframe for the Commission is for the publication of the draft input methods. Six months should be more than sufficient given the amount of work already undertaken on input methods both in New Zealand and overseas. Vector notes and supports the proposal in the Cabinet Paper that the Commission should be able to adopt overseas input methods.
63. Vector also proposes that the Commission recommend methodologies at the commencement of each inquiry with the following legislative directions:

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<sup>7</sup> The process is similar to the process for setting methodologies one set out in the third schedule to the Telecommunications Act 2001 ("**Telecommunications Act**")

- (a) The Commission may set more than one methodology in relation to the input methods;
- (b) The Commission shall set more than one methodology in relation to any specific input where more than one reasonable methodology has been used historically by firms; and
- (c) In relation to a firm inquiry, the Commission shall set a reasonable methodology that has been historically used by a firm provided certain statutory criteria are met.

## OTHER ISSUES

### Purpose Statement

64. Vector strongly supports the introduction of a new purpose statement for Part 4 of the Act to better reflect the Government's pro-investment policy as set out in the GPS.

The purpose of this Part is to provide for regulation of prices and quality of goods and services to promote the long term benefit of consumers in markets where there is little or no competition and prospect of competition. Any regulation provided for under this Part should **promote outcomes** such those suppliers:

(a) Have incentives to innovate and to invest, including in replacement, upgraded and new assets and in related businesses;

(b) Face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands;

(c) Share the benefits of efficiency gains with consumers, including through lower prices;

(d) Are limited in their ability to extract excessive profits.

65. The Commission must not "thwart or run counter" to this purpose<sup>8</sup>. The use of the word promote is significant and requires that the Commission must progress and move forward these objectives.
66. Vector submits that the Commission should also be expressly required to apply the purpose statement when developing input methods as these are the foundation of the new regime. Given the importance of this process, it is better that this is explicit rather than implied. A similar direction can be found in section 57H (c) which requires the Commission to take account of the purpose of the sub Part when determining whether to declare control of an ELB which breaches a threshold. The direction should also be at a high level such as "give effect to" rather than "have regard to".
67. Vector remains concerned that the Commission will continue to set input methods that do not incentivise investment in other businesses. The Commission was required to have regard to the GPS for the Draft Authorisation for controlled gas pipelines yet adopted a cost allocation approach that disadvantaged Vector's interests in its other businesses by allocating a

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<sup>8</sup> *Padfield v. Minister of Agriculture, Fisheries and Food* [1968] AC 997 (Lord Reid at 1030)

disproportionate amount of its corporate overhead costs to these businesses (i.e., above a level that could be competitively recovered) and away from the regulated gas business. Although merits review will be available for input methods, Vector submits the objectives of the new regime will be best achieved if there is clearer statutory direction on this issue.

68. Vector submits that this risk would be addressed by inserting the words marked in bold in paragraph C of the purpose statement:

c share the benefits of efficiency gains **achieved within the business** with consumers, including through lower prices

69. Finally, paragraph A refers to incentives to invest and innovate in related businesses. The term "related businesses" could be interpreted to mean only those businesses directly related to the services regulated (i.e. connected with electricity or gas).

70. Clause 7 (c) of the GPS refers to "other infrastructure and services ":

...regulated businesses being confident they will not be disadvantaged in their regulated businesses if they invest in **other** infrastructure and services  
(emphasis added)

71. Vector submits that the purpose statement should refer to "other infrastructure and services" as this better reflects the Government's objectives as set out in the GPS.
72. Vector's ability to leverage off its regulated assets is critical for new investment including in new generation telecommunications. The amendments above would provide Vector with some confidence that its regulated businesses will not be disadvantaged if it proceeds with new investments.

### **Merits Review**

73. Current thinking is that only Commission decisions on input methods should be subject to merits review. Vector accepts that it would be cumbersome to have merits review at every stage of the regulatory process. However, Vector considers that the facility should also be available where the Commission rejects a firm's proposal for customised terms and imposes its own terms. This is important to ensure reasonableness, as the Commission's terms can be more onerous. It would also strengthen the incentives on the Commission to accept firm proposals where the criteria for acceptance are met.
74. In the Draft Final Authorisation for Vector's Auckland Gas Pipelines, the Commission proposes to substantially reduce the allowance for the management fee that Vector pays to its contractor for maintenance and other services. Such a proposal is of immense concern to Vector, because it attempts

to unwind a single contract item, without taking into account the nature of the contract or the mix of risks and rewards it entails.

75. If the Commission proceeds as indicated, infrastructure businesses will be reluctant to enter into long-term contracts lest the Commission judge these “inefficient” ex post, leaving the business exposed, unable to renegotiate the contracts and forced to absorb the costs. Short-term contracting will raise costs overall because no party will have any certainty. Vector submits that it would be undesirable for decisions like this not to be subject to review.

### **Energy Efficiency**

76. The Cabinet Paper proposes that the Commission be required to provide incentives to improve energy efficiency/demand side management “when administering the regime” for ELBs. The Paper explains that this is because the way thresholds are currently set incentivises firms to encourage consumption because this improves rates of return. It is suggested that alternative approaches, such as using revenues or volume weighted prices, would not have the same effect. The Paper notes that “other creative ways” are likely to be available.
77. Vector strongly supports the promotion of energy efficiency, and looks forward to developing creative solutions that complement demand side innovation. Vector believes that any regime should be proactive in rewarding businesses for promoting energy efficiency outcomes. A system of rewards is likely to better focus businesses on finding innovative ways of reducing demand, compared to revenue cap approaches which can have unintended consequences.

### **Expiry of Breaches**

78. The Paper proposes that historic breaches expire if older than six months when the new legislation “comes into force” unless the Commission has notified an intention to investigate. Vector submits that to come under the new regime, an investigation must already have been initiated when the Act is passed (mid 2008). This change would provide businesses with greater certainty. It is also important that the focus is on making the new regime work for all stakeholders, rather than looking backwards at historic breaches arising under the current regime, which has acknowledged deficiencies.