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Paul Mitchell
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Dear Paul

SUBMISSION ON CRA DISCUSSION PAPER: COST BENEFIT ANALYSIS OF OPTIONS FOR SWITCHING ARRANGMENTS

1. Thank you for the opportunity to comment on the CRA discussion paper regarding gas industry switching arrangement options.

Summary of Vector's view

2. As stated in our response to the GIC consultation paper of October 2005, Vector prefers option three (the formation of a Central Registry) of the four options presented. This submission answers the particular questions in the discussion paper, below, and also provides our views on specific issues with CRA's analysis in the *Appendix* at the conclusion of this submission. We also comment on the context in which the alteration and development of switching procedures should take place.

Vector Prefers Option Three

3. The central registry (option three) is our preferred option. We currently see a large number of discrepancies between retailers' ICP data, which causes confusion every monthly billing cycle. A central registry system, if properly applied, could not only speed up the switching process but also help ensure that ICP data is correctly captured (ensuring that billing to the correct customer occurs).

4. We agree with CRA's opinion that option four would be ideal - a central registry could provide the allocation agent with a lot of ICP data to better profile downstream allocations between retailers. However Vector suggests that with current resourcing, tying back allocations to the 230,000 gas ICPs in New Zealand may be untenable without significant cost or additional investment.

Do you agree with the methodology applied by CRA international in determining the relevant costs and benefits of the options previously consulted on?

5. While Vector generally agrees with the report in this area, the methodology serves to illustrate the difficulties in quantifying the benefits to consumers and the industry generally on reputational issues.

6. Vector also believes the report illustrates the need for a cautious and tightly managed approach to resolving the issues, as to try to solve all things at once could result in a net cost to the industry. Completing construction of a central registry and then moving on to assess and resolve the remaining allocation and reconciliation issues is clearly the prudent approach.

Do you agree with the identification and quantification of the costs and benefits of switching arrangements contained within CRA International's report?

7. Vector broadly agrees with CRA's identification and quantification of costs, but please see the *Appendix* for specific issues we have with details of CRA's analysis. In particular, we suggest that the CRA report overstates the benefits of option two, and understates the benefits of option three.

8. We agree that operating costs should be broadly in line with those for electricity. However, the costs of developing an application that caters for 230,000 customers (for example) is approximately the same as it does for 1.7 million customers – the complexity of the processes determines the cost, not the data volumes. The costs of development are likely to be comparable to the electricity model.

9. In developing applications and processes to serve option three, it may be possible to utilise components from other registries already in use, as some of the work that has already been done could be transferable.

Are there any other factors you are aware of that should be taken into account in assessing the costs and benefits of the preferred option?

10. Our experience with other software projects (such as the Maui operating system) makes Vector very wary of early estimates of IT costs. We believe that everything should be done to simplify the project at the initial stages, while providing for possible developments at a later date.

<u>Electricity vs. Gas Registry software development costs comparison possibly inaccurate</u>

11. Section 4.4 compares costs of the proposed gas registry with final software development costs of the electricity registry. The costs quoted ($507,000) relate to a major project to improve the functionality of the electricity registry in 2002, and to extend its coverage to ICPs managed by incumbent retailers. However, there was already significant investment in version 1 of the registry, during 1999 and 2000. We believe that these development costs may have been ignored, even

though the current registry was essentially an extension of version 1. Total development costs during the period 1999-2002 may therefore be significantly higher than $507,000.

General comments

12. The overall objective of implementing new gas switching arrangements should be to reduce costs per consumer and per consumer switch, to the same level as already achieved for electricity consumers. Any costs faced by the industry in developing new switching arrangements will be borne by 230,000 gas customers, not 1.7 million as in electricity. It is therefore important that the net benefits of the chosen option are NPV positive - further fixed costs appearing on customers' power bills is undesirable.

Context Within Which Switching Arrangements Are To Be Established

Gas Policy Statement

13. The GPS contains an explicit statement on switching arrangements while making non-specific references to promoting efficiency and thereby keeping prices down. The Gas sector in general faces escalating costs, and there is a need to coordinate any one-off cost increases very carefully.

Vector Faces Price Control

14. In particular, Vector's Auckland gas network is currently facing price control; any increased costs borne by Vector will need to be carried out in a manner that ensures the Commerce Commission is informed and approves generally of the increased costs.

15. While Vector generally agrees that some expenditure in the area of switching arrangements and mechanisms is needed, it would be of great assistance if the GIC, as a relative independent, could ensure the Commerce Commission is made aware of these costs.

Concluding Remarks

16. Vector is happy to provide further information as required, and would welcome the opportunity to work with the GIC further on this matter. Please contact me in the first instance.

Kind regards

Ewan Gebbie

Industry Policy Manager

Appendix: Specific Issues With CRA's Analysis Regarding Question 2

Issues With Information Contained In Table 1 (Page 7)

Table 1 tends to take an optimistic view of which issues are resolved by option 2. In particular the table claims that issue 1 *"information exchange processes are inefficient"* would be resolved by reconciliation code enhancements. Vector believes however that this alone will do little to increase the efficiency of information exchange processes, as long as they are based on independent business-to-business flows of data.

Also in Table 1, option 3 states that issue 8 *"no linkage with the allocation and reconciliation process"* is not resolved by a Central Registry. However, by providing key information from the Central Registry to the Allocation Agent this issue could be at least partially resolved, regardless of whether the allocation mechanism was actually part of the Central Registry functionality.

The effect of the debatable conclusions reached in Table 1 may be to overstate the benefits of option 2, and understate the benefits of option 3.

Exclusion Of Outlier From Cost Analysis

Vector is concerned by the approach that CRA has used to eliminate the significant "outlier" from the cost analysis in section 4.3 of the report. Is it possible that this company, with development costs of $1.5 million, and ongoing costs of $600,000 per annum, has understood the requirements more thoroughly than the company that provided the lowest estimated costs? If so, then the costs of the outlier should have been included in the averaging process.

Process Used To Establish Costs For A Central Registry With Allocation Mechanism

Only two companies quoted for this option (Four). However, both of these quotes have been ignored, and replaced by a mathematical calculation to determine the *"appropriate costs"*. Vector considers this approach to be inappropriate. Assuming that companies A and B have a realistic concept of the work involved in developing this option, their quotes should form the basis of the cost analysis.