MAJOR ELECTRICITY USERS' GROUP

14 March 2008

Tracey Edwards
Information Disclosure Review
Network Performance Branch
Commerce Commission
By email to electricity@comcom.govt.nz

Dear Tracey

Cross-submission following the Authorisation of Gas Distribution Services conference

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on matters arising from the Commerce Commission's Authorisation of Gas Distribution Services Conference. The comments below cover three questions asked by the Commission of MEUG at the conference on 19 February 2008[1].

Amortising revaluation gains

2. The Commission's proposes amortising revaluation gains associated with the 2005 Optimised Deprival Valuations over the remaining lifetime of the assets. An alternative has been suggested where the re-valuation gain is amortised over a shorter period.

3. MEUG support the Commission's original view because at the close of any authorisation period the company will still have an asset that can provide services at a price that would include residual gains not recovered during the amortisation period. Allowing full recovery of revaluation gains, for example, over the next 5 years as an authorised price component would require the Commission to have ongoing authorisations to ensure companies did not double dip after the end of the authorisation period and price to keep recovering those gains.

Tax payable or deferred tax approach

4. Line monopolies have an incentive to maximise tax. MEUG is sceptical about Vector's suggestion to use a deferred tax or actual tax basis. A tax payable approach is transparent and replicable and therefore favoured by MEUG. Other tax approaches become complicated partly because of the complex inter-woven nature of the companies various businesses other than just their gas distribution business.

Benefits of companies taking on debt

5. Dr Lally noted there may be benefits of companies taking on debt not captured by CAPM and WACC models, eg having some debt costs provides information to equity investors. Having some debt is more efficient than having no debt. Therefore using an estimate of the optimal leverage for each company is appropriate.

[1] Refer Conference transcript http://www.comcom.govt.nz/IndustryRegulation/Gas/draftdecisionsconference.aspx.

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6. The fact that companies in competitive markets borrow rather than use just equity supports the case for some debt being efficient. However MEUG continues to support a zero leverage WACC for the purposes of authorising prices for a controlled monopoly because:

   a) There are limited equivalent peer companies to derive statistically robust values for the necessary factors in the full WACC formula. In particular the estimation of debt beta as noted by Cameron Partners[2]; and

   b) There is an incentive on monopolies to maximise gearing in WACC, not because it's an efficient level if they were in a competitive industry, but simply because it results in the greatest regulated return. Leaving the leverage risk to the companies would create the right incentives on them to find the efficient level.

7. On balance given the lack of precision in estimating an efficient level for debt for each regulated company and the problems in getting good data when all monopolies have an incentive to maximise leverage, MEUG recommends the Commission use a zero leverage WACC.

Yours sincerely

Ralph Matthes
Executive Director

[2] Refer Cameron Partners submission to Commerce Commission, 2 December 2005, refer http://www.comcom.govt.nz//IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/MEUG%20submission%20-%20Cameron%20Partners.pdf.