



MAJOR ELECTRICITY USERS' GROUP

12 October 2009

David Healy
Chief Adviser
Network Performance Branch
Commerce Commission
By email to NPB@comcom.govt.nz

Dear David

Submission on draft decision for Initial Reset of Default Price-Quality Path for Electricity Distribution Businesses

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission draft decisions paper, "Initial Reset of Default Price-Quality Path for Electricity Distribution Businesses," published 8th September 2009¹ (the "Draft Decisions Paper").
2. In choosing "X" to be used in the CPI-X formula, the Draft Decisions Paper notes²:

"Overall, the Commission considers that its choice of an appropriate X-factor will include a degree of regulatory discretion. That choice should be made in light of the Part 4 Purpose and informed by an appropriate assessment of relevant long-run average productivity improvement rates."
3. MEUG agrees with this approach provided the Commission has reasonably taken full account of all available information and analysis to inform that decision. The draft decision proposes X=0%. MEUG suggest there is a case for an X that has a positive value, ie the price cap on electricity distribution businesses (EDBs) should incentivise greater productivity gains than other sectors of the economy on average. In support of this view MEUG note:
 - a) For the prior threshold regime the Commission found, on average, "X" should be 1%³. MEUG is not aware there has been any systematic under-investment or deterioration of quality with the "X" used for the threshold regime. The proposed change in "X" from 1% to 0% will be a material increase in costs to consumers of approximately \$10m per annum.

Under the thresholds regime with "X" being positive there has been merger and acquisition activity with implied business values greater than Optimised deprival Value. This is not an indicator that the prior thresholds regime was onerous.

The Commission needs to be sure such a large step change from the status quo is justified given there are no systematic problems with the more stringent CPI-X under the existing thresholds regime.

¹ Refer <http://www.comcom.govt.nz/IndustryRegulation/Electricity/PriceQualityPaths/20102015defaultpricepath.aspx>

² Draft Decisions Paper, paragraph 6.28

³ Ibid, paragraph 6.33

b) Not all EDB will be subject to CPI-X. The analysis by the expert advisor to the Commission shows that excluding consumer owned EDBs leads to an "X" of 0.6%⁴. MEUG suggests this result should be the starting point from which the Commission should then consider any intangible factors.

c) In referring to the state of the economy, the draft decision notes⁵:

"The Commission acknowledges the state of the current economic climate and the concerns expressed by EDBs. The Commission will have regard to these issues when making decisions on the Reset DPP, in particular when setting an appropriate rate of change."

MEUG suggests the impact on households and businesses of the state of the current economic climate is also a material issue. Every competitive sector of the economy understands the need for renewed emphasis on superior productivity gains to ensure their long term survival. Businesses target for superior not average productivity gains. The incentives and pressure on EDB to perform should be no different.

The average business and household would consider monopoly EDBs to work in an environment where incentives to be productive and innovative have been and are likely to very weak for some time. The average business and household would therefore find it difficult to understand why the Commission has by proposing a target productivity gain equal to the economy wide average "let the EDBs off the hook" when first, the empirical evidence suggests "X" should be 0.6% and second, individual EDB can seek a Customised Default-Price Quality regulation in cases of hardship.

4. The only other point MEUG wishes to comment on is the timing for re-openers⁶. The Draft Decisions Paper proposes no re-opener provisions are needed until the input methodology determinations are published. MEUG suggest re-openers need not be considered until after initial price resets are made (ie after input methodologies are published) because it will only be at that point that EDBs will be able to assess the effect of the new regime in its entirety.

Yours sincerely



Ralph Matthes
Executive Director

⁴ Economic Insights, report prepared for Commerce Commission, Electricity Distribution Industry Productivity Analysis: 1996-2008, 1 September 2009, section 5.3, page 42

⁵ Draft Decisions Paper, paragraph 32

⁶ Ibid, paragraph 3.48