



MAJOR ELECTRICITY USERS' GROUP

15 October 2009

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

Dear Karen

Post-conference cross-submission on Input Methodologies including cost of capital

1. This is a post-conference cross-submission by the Major Electricity Users' Group (MEUG) to the Commerce Commission in relation to the Input Methodologies conference held 15th to 17th September¹. MEUG draw the attention of the Commission to statements by Messrs Houston, Strong and Wattie during the conference and their relevance to the parallel work on cost of capital guidelines.
2. First, an extract of a statement by Mr Houston to the conference on 17th September²:

“And I think from a regulatory policy point of view it's preferable, actually, for the Regulator never to look at the gearing, the actual gearing of the entity, not to concern itself with how it's financed, in which case you don't need to look at the financing, you can be safe in the assumption that if you give a WACC on an asset value and you commit to giving, through if necessary a CPP process, you commit to providing that same WACC on future expenditure, and as a matter of principle that should be a perfectly financeable business.

The problem, to my mind, of getting drawn into the question of is that business financeable is that you start to have to consider the actual gearing decisions of real businesses. And as soon as you give some regulatory weight to those you become an implicit underwriter of particular levels of financing or particular financing policies. And we know that sometimes financing decisions of any business can go wrong, they over-gear themselves.

And when that happens if you have given weight to that then you can find yourselves as having to adjust prices because someone's over-gearred. I don't think that's, as a matter of principle, something that Regulators should be drawn into, it's certainly something that - it is actually a thing which Regulators are drawn into in the UK, it is something which Regulators have unambiguously stayed away from in Australia, and I would regard that as a merit of the Australian system”

3. The proposition by Mr Houston that regulators should not consider gearing supports a component of the MEUG submissions in relation to the draft cost of capital guidelines³.

¹ Refer <http://www.comcom.govt.nz/IndustryRegulation/Part4/DecisionsList.aspx#1271>

² Transcript p363 lines 1 to 19.

4. Later in the conference Mr Strong noted⁴ agreement with the statement by Mr Houston:

"I think I'd just concur with the excellent analysis that we heard from Mr Houston before."

5. In the session discussing tax Mr Wattie stated (extract)⁵:

"But I just wanted to re-emphasise a point that Jeff made, that within the New Zealand tax regime of course we have this assumption that enterprise value of a business should be indifferent to gearing. So whatever mechanism is adopted presumably it will create an indifference when setting prices."

6. This comment by Mr Wattie also affirmed the position of MEUG that the cost of capital should be indifferent to gearing. Note the mention by Mr Wattie to "Jeff" in the above quote may have referred to comments earlier that day by Mr Jeff Balchin⁶ or the day before⁷.

7. This submission is not confidential.

Yours sincerely



Ralph Matthes
Executive Director

³ The statements by Messrs Houston, Strong and Wattie at the Input Methodologies conference are relevant to the MEUG submissions to the Commission on cost of capital as part of Input Methodologies, ie

- MEUG to Commerce Commission, *Submission on Input Methodologies Discussion Paper*, 31 July 2009, attaching report to MEUG by Ireland, Wallace & Associates Ltd, *Input Methodologies Discussion Paper submission*, 31 July 2009, <http://www.comcom.govt.nz//IndustryRegulation/Part4/ContentFiles/Documents/MEUG%20-%20Report%20from%20Ireland%20and%20Wallace%20-%20875570.pdf>

- MEUG to Commerce Commission, *Cross-submission on draft Input Methodologies and draft Cost of Capital Guidelines*, 3 September 2009, refer http://www.comcom.govt.nz//IndustryRegulation/Part4/ContentFiles/Documents/MEUG%20-%20Cross%20subs%20WACC%20-%20889891_1.pdf

And attached Ireland, Wallace & Associates Ltd, report to MEUG, *Input Methodologies Discussion Paper Cross Submission*, 3 September 2009, refer http://www.comcom.govt.nz//IndustryRegulation/Part4/ContentFiles/Documents/MEUG%20by%20Ireland%20Wallace%20-%20cros%20subs%20WACC%20-%20889878_1.pdf

⁴ Transcript p369 lines 8 and 9.

⁵ Transcript p384 lines 32 and 33 and p385 lines 1 and 2.

⁶ Transcript p384 lines 6 to 16.

⁷ Transcript for 16th September 2009, p202 line 5 to p203 line 9