MAJOR ELECTRICITY USERS' GROUP

12 October 2012

John G. McLaren
Chief Advisor
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear John

Cross-submission on Revised Draft Reset of the 2010-15 Default Price-Quality Paths for EDB

1. This cross-submission refers to submissions by other party's on the Commerce Commission paper "Revised Draft Reset of the 2010-15 Default Price-Quality Paths" dated 21 August 2012[1].

2. MEUG agrees with the submissions by Contact Energy that:

   (a) On the use of operating and capital forecasts sourced from EDB, Contact Energy submitted with emphasis added by MEUG:

   "*The Commission states that it has reduced the risk of this data and these forecasts being inflated by taking forecasts and data from before the time that EDBs would have known the data or forecasts would be used in this way. Contact questions this assumption, as <u>those forecasts and data could already have been conservative</u>, in order to reduce financial risk for the EDBs, or because of unconscious decisions by those involved in making the forecasts or gathering the data. In our view it is possible that the low-cost forecasting techniques used by the Commission, may actually be resulting in consumers paying more*."

   We agree with Contact Energy that this bias may exist and will always favour suppliers. One solution is to use a forward looking opex partial productivity factor that has some incentive for all EDB to improve consistent with improvements observed in Australia[2]. MEUG suggest the Commission use a positive value of "X" in the CPI-X formula for resetting prices in RCP1 to offset the bias in data sourced from EDB that may already be overstated or inefficient and consistent with observed improvements overseas by distributors.

[1] http://www.comcom.govt.nz/2010-2015-default-price-quality-path/

[2] Paragraph C21

(b) To avoid price shocks changes be capped at 10% rather than 15%. The rationale for the Commission using 15% as opposed to say 10% needs to be explained. If as Contact say a 15% increase in EDB charges will lead to a 4.5% increase in retail prices; then a lower cap may be preferable to keep the rate of retail price inflation closer to expected CPI.

(c) On claw back Contact Energy submitted:

"*Contact's view is that EDBs should be allowed to claw-back past under-recovery only if the EDB was prevented from charging higher prices because of the existing DPP and they would have charged higher without the DPP. That is under-recovery occurred simply because of pricing decisions an EDB made or would have made, rather than being limited by a regulatory requirement, the EDB should not be permitted to use Commission-sanctioned claw-back to put themselves in a better position than they would have been in. This sort of revisionism is counterproductive to EDBs making and living with their decisions. Any EDB claiming claw-back for under-recovery should therefore have to prove these matters.*

The Commission should also not allow any under-recovery to be carried forward to the next regulatory period for the following reasons:

- *This is inconsistent with section 53P(4), which prevents carrying-forward of past overrecovery. Under the Commission's proposal, EDBs would get all the benefits of underrecovery, but the ability to claw-back over-recovery is limited. This does not seem consistent with outcomes in competitive markets, where companies face risks and benefits that are more symmetrical;*

- *There is no economic rationale for consumers in the future to pay for a discount received by past consumers.*

Contact recommends that the Commission review its decision on claw-back from a first principles basis and ensure that it is not unduly swayed by the EDBs' submissions (or lack thereof) on this issue."

MEUG agrees with this view.

3. If consumers have been over-charged on the basis of full WACC then we see no reason why they should not be compensated for the time value of money on clawed back monies at full WACC.

4. MEUG note the following broader policy issues raised in submissions. While not part of this price reset decision process; nevertheless they need to be kept in mind for further evolution of regulation under Part 4 of the Commerce Act:

(a) We agree with the submissions of most other parties that investigations should continue into the possibility of an incremental rolling incentive scheme for DPPs in future regulatory control periods. To the extent this goes beyond a low cost approach for DPP and closes the gap with CPP; then MEUG suggests other equivalent additional features for DPP should also be investigated.

(b) We agree with the submission by Contact Energy that:

"*we suggest that the Commission bring to the attention of Government the desire for the removal of the prohibition contained in section 53P(1) of the Act on the Commission using comparative benchmarking on efficiency in order to set starting prices, rates of change, quality standards, or incentives to improve quality of supply*."

Yours sincerely

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