



MAJOR ELECTRICITY USERS' GROUP

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Media release by the Major Electricity Users' Group (MEUG)

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MEUG appeal on cost of capital

The Major Electricity Users' Group (MEUG) has elected not to apply for special leave to appeal the High Court decision on the cost of capital used for regulated energy transmission and distribution services.

Executive Director, Ralph Matthes, said that while it was disappointing that consumers would not have the chance to test important principles and possibly claw back past overcharged prices, MEUG had to rationalise its resources. MEUG members considered there were more potential gains for energy consumers if it maximized its contribution to the Commission's current review of the WACC range. The review would reset the cost of capital for future price-quality control. MEUG also wanted to ensure it could participate fully in any subsequent appeal against the Commission's review.

Mr Matthes also noted that there was an asymmetry of risk for consumer representatives who wanted to participate in court process. MEUG faced full-scale opposition from deep-pocketed monopolists and an oppressive threat of multiple cost awards. In light of its experience, MEUG would be pushing for reforms to Part 4 to encourage a stronger consumer voice and limit the ability for suppliers to game the system.

Background

The Commerce Commission determines rules, requirements, and processes known as "input methodologies" (IMs) which it then applies to regulated goods and services under Part 4 of the Commerce Act 1986. The Commission's cost of capital input methodology in January 2011 set the weighted average cost of capital (WACC) at the 75th percentile rather than the midpoint. Its rationale for what it acknowledged would likely lead to excess profits, was that a higher WACC would provide incentives for investment and innovation.

MEUG appealed to the High Court. It argued that the Commission had shown no foundation in logic for assuming that higher returns incentivised more desirable levels of investment. It pointed out that the record of the Commission's process lacked empirical evidence to support the assumption. In December 2013, the High Court agreed in principle with MEUG's arguments, but did not substitute the midpoint WACC for the 75th percentile nor refer the IM back to the Commission for amendment. Instead the Court urged the Commission to take its findings into account when next reviewing the IM. Had the High Court substituted the mid-point WACC as argued by MEUG then electricity and gas charges would have been approximately \$155m per year lower than actually charged and the line monopolies would have been required to pay back excessive charging since 2010.

The Commission has since brought forward (from prior review planned in 2017) its review of the WACC estimate and is likely to issue a final decision later this year. Any change will apply to future regulated prices but not to past ones. The Commission's draft decision published 22nd July 2014 proposes changing the WACC percentile from the 75th to the 67th percentile. MEUG estimate the change in electricity line charges will be approximately \$49m per annum from 1st April 2015 onwards. The WACC for monopoly gas line charges will change in 2017.

MEUG applied for leave to appeal the High Court decision. A successful appeal could have led to the reset of regulated price-quality paths in the energy sector and the clawback of overcharged prices.

On 28th July 2014, the High Court who delivered the original judgment (Clifford J, and lay members Messrs Shogren and Davies) declined MEUG's application for leave to appeal to the Court of Appeal.

End
