

11 July 2022

Dane Gunnell
Head of Price-Quality Regulation, Infrastructure Branch
Commerce Commission
By email to im.review@comcom.govt.nz

Dear Dane

IM review process and issues

1. This is a submission from the Major Electricity Users' Group (MEUG) on the Commerce Commission "Part 4 Input Methodologies Review 2023, Process and Issues paper" dated 20th May 2022.¹ In parallel the Commission is consulting on a draft Framework paper that MEUG has separately submitted on.
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.
3. The process and issues paper initiates the first of two conceptual elements as set out in the draft decision framework paper. The first is the "Review element: reviewing the IMs and identifying which IMs we should consider changing and why?"² The process and issues paper lists issues identified by the Commission to date and seeks two things.
 - First, additional information on issues to help the next step of the Review element to prioritise issues to consider in the second element, the "Change element: deciding whether, and if so how, to change an IM after completing the review element." Three additional information sources are listed in paragraphs 4 to 6 and some detail on the WACC percentile issue in paragraphs 7 and 8.
 - Second, any issues not listed. MEUG has no additional issues to add.

Three additional sources of information and or cross-checks

4. First, Eastland Group has commenced a process to sell Eastland Energy.³ The outcome of that process will be a useful check on the existing IM settings and issues identified to date.

¹ Document https://comcom.govt.nz/_data/assets/pdf_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf at <https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-electricity,-gas-and-airports/input-methodologies-projects/2023-input-methodologies-review>

² Draft Framework paper paragraph [X16].

³ <https://www.eastland.nz/2022/06/23/announcement/>

5. Second, information may emerge from the concurrent appeals by the Major Gas User's Group of the recent gas IM and gas DPP3 decisions. We suggest the Commission and appellant agree it would be in the public interest that materials lodged with the court through the course of that appeal should be published promptly.
6. Third, there is an apparent inconsistency in estimating economic profits in market studies and the approach used for Commerce Act Part 4 regulation. Part 4 regulation has two decades of experience and is economic principles and analytical approaches settled, whereas market studies have been implemented for less than 5-years. We see risks of inappropriate precedents flowing from market studies to Part 4 regulation. To avoid the risk interested parties will seek to use poor precedents from market studies, MEUG recommends the Commission reconcile the methodology for calculating ex post and estimating ex ante economic profits between Part 4 and market studies.

Additional information on the WACC percentile for electricity and gas

7. We have now had over a decade of experience with a WACC percentile above the expected regulatory WACC set at the 50th percentile and capital investment decisions by regulated suppliers. The dollar value uplift paid to date is calculable. Conceptually it is an insurance or an up-front reserve payment to avoid the asymmetric investment risk of the regulated WACC being less than the true required WACC. That insurance paid to date or financial reserve is likely to be close to a billion dollars. The question arises as to whether that insurance or reserve was used, or some other dollar value of insurance or reserve would have sufficed. Given the quantum paid to date by consumers and, if the percentile WACC IM is unchanged, the ongoing high dollar uplift that will continue for up to another seven years from 2024, it is beholden on the Commission to find at the least a range of plausible values of benefits that accrued to justify the insurance or reserve payments to date. Armed with an evaluation of how well targeted and aligned the WACC percentile decisions in the past have been to address the asymmetric risk issue, will allow the Commission to consider changes going forward.
8. Another aspect of the WACC percentile issue to consider is whether a change in the type of regulatory instrument will better achieve the desired policy issue to avoid a mis-specified WACC leading to under-investment. We may be able to consider experience gained from other decisions on IM. For example, the policy for EDB to have a one-time only option to seek accelerated depreciation to manage the risk of asset stranding. Using that approach, the regulated WACC could be set at 50th percentile and EDB given the option to apply for a WACC with a higher percentile. The onus of proof for a percentile higher than the 50th percentile would then lie with EDB.

Yours sincerely



Ralph Matthes
Executive Director