



MAJOR ELECTRICITY USERS' GROUP

15 December 2017

Matt Lewer
Manager, Price-Quality Regulation
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Matt

Wellington Electricity CPP proposal

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission, "Have your say on Wellington Electricity's proposal to change its prices – process for determining Wellington Electricity's customised price-quality path", 6 December 2017 (the "WELL stage 1 CPP proposal").¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. The Commission has asked:

"In particular, we are interested in consumers' willingness to pay for improvements to resilience and whether Wellington Electricity has chosen the best options to address earthquake risks"²

Consumers' willingness to pay for improvements to resilience

4. Two factors affect customers willingness to pay:
 - a) There is a clear benefit to consumers; and
 - b) There is a fair balance of risk and return between consumers and WELL.
5. MEUG believes WELL's estimate of the expected Net Present Value (NPV) of a Cost-Benefit-Analysis (CBA) of the proposal of \$26m is overstated because the counterfactual is not the status quo over the 20-year CBA time-frame³.
6. The counterfactual should be the status quo for the next 2 or 3 years until stage 2 and then stage 3 comprehensive resilience work is approved in a future CPP process. Once those later stages are in place the benefits of the stage 1 expenditure to shorten recovery times

¹ Document URL <http://comcom.govt.nz/dmsdocument/15989> at <http://comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/wellington-electricitys-2018-2021-potential-cpp/>.

² Commerce Commission paper, paragraph 26.

³ WELL, Business Case report, p3, refer <http://comcom.govt.nz/dmsdocument/15985>.

will have diminished materially; hence the NPV for stage 1 will be less. Therefore, WELL have not established that there is a clear and material benefit to consumers.

7. In terms of whether there is a fair balance of risk and return between consumers and WELL, MEUG's prior submission discussed our view the standard CPP Weighted Average Cost of Capital (WACC) was excessive relative to the project risk to WELL for stage 1. On this point the response in the Commission paper states⁴:

Submitter	Submission	Topic	Commission response
Major Electricity Users' Group	Suggest the Commission needs to consider if assets purchased for the stage 1 earthquake readiness phase are subject to the risk of stranding, justifying a lower WACC, or need an uplift on WACC as an incentive to invest and innovate	WACC	We are constrained by the IMs, which set out the WACC applicable to a CPP.

8. The Commission response is silent on whether conceptually we are correct or not. MEUG will raise this matter in the post-decision review of this application.
9. Nevertheless, we don't think the Commission should give up on reaching a compromise with WELL to adjust the WACC on this application either. In our view, WELL would derive an unanticipated economic rent from the approval of these stage 1 capital expenditures at the standard CPP WACC. WELL can voluntarily agree to a lower rate. If the Commission has not already done so, then we recommend WELL be formally asked to consider a lower WACC by pointing out the material differences between the standard CPP WACC at the 67th percentile, the mid-point WACC and the current actual marginal cost of borrowing. MEUG believes WELL will likely fund the capital works using existing credit lines and hence the effective wealth transfer to the owners of WELL will be material.⁵

Has the best option been proposed?

10. Substantial engineering analysis has been undertaken on various options. For this consultation MEUG has not commissioned experts to assess those engineering options. However, we do think an important part of considering options is to ask customers. WELL asked several parties and some customers for their views. The customers surveyed can pass-through all or most cost increases such as the proposed higher WELL charges compared to businesses in workably-competitive-markets.⁶ The other parties surveyed either have an indirect relationship with an end customer (eg subsidiaries of local government that are large users of electricity) or pass-through costs (eg electricity retailers). If WELL asked a few end customers operating in competitive markets we think several options for how they deploy operational self-insurance strategies would have emerged.⁷

⁴ Commerce Commission paper p8.

⁵ Every 1% difference in the WACC (in this submission WACC is assumed to be expressed as the post-tax WACC), the difference in capital charges paid by WELL customers on the total requested capital expenditure budget for stage 1 of \$30.07m, equals \$450,000 per year. MEUG observes that the current difference between the likely actual corporate rate of borrowing for WELL and the IM set 67th percentile WACC is significant.

⁶ WELL, Stakeholder engagement, and Further stakeholder engagement reports, refer <http://comcom.govt.nz/dmsdocument/15983> and <http://comcom.govt.nz/dmsdocument/15981>

⁷ For example, Progressive Enterprises Ltd (PEL), a member of MEUG, is listed as one of the top 10 largest customers for WELL (refer WELL 10-year Asset Management Plan, 1 April 2017 – 31 March 2027, p46, <http://comcom.govt.nz/dmsdocument/15982>). We are not aware of WELL approaching PEL for their views on options.

11. Following on from the discussion in the preceding section, we think had WELL and the Commission had a discussion with customers that pay final line tariffs at an early stage of developing this proposal, the issue of an imbalance in risk and reward in applying the 67th percentile WACC to stage 1 approved expenditure would have been identified earlier.
12. MEUG suggest in the post-decision review of this application the steps and timing used by WELL and the Commission to decide and consult with selected interested parties in preparing an application be reviewed. Lessons may be learned on when to best cast the net wider for feedback from interested parties than seems to have been the case with this application.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. Matthes', with a long horizontal stroke extending to the right.

Ralph Matthes
Executive Director