



# MAJOR ELECTRICITY USERS' GROUP

3 September 2009

Karen Murray  
Chief Adviser  
Network Performance Branch  
Commerce Commission  
By email to [NPB@comcom.govt.nz](mailto:NPB@comcom.govt.nz)

Dear Karen

## **Cross-submission on draft Input Methodologies and draft Cost of Capital Guidelines**

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) to the Commerce Commission in relation to submissions on draft Input Methodologies and draft Cost of Capital guidelines<sup>1</sup>.

### **Cost Allocation and sharing efficiency gains from expansion into non-regulated activities**

2. In relation to cost allocation and sharing of efficiency gains from expansion into unregulated businesses, Mighty River Power note<sup>2</sup>:

"If a regulated firm, such as Vector, can gain economies of scope from entering into telecommunications/broadband services this is not an efficiency gain in the supply of the regulated goods or services. The cost of supplying the regulated goods or services will not have reduced one iota. We, accordingly, do not agree with the Commerce Commission's interpretation of the sharing of efficiency gains."

3. MEUG has a contrary view. We think the overall purpose of Part 4 and in particular subsection 52A(c) of the Act requires an Input Methodology that will ensure Vector share with customers of its regulated services the benefits of economies of scope of entering the unregulated business.

### **Cost of capital**

4. Telecom<sup>3</sup> submitted a paper by Graeme Guthrie "Incorporating Real Options in Regulated prices" that would significantly increase the cost of capital compared to that proposed by the Commission. MEUG note exposure to real options is a driver in observed market behaviour and hence equity beta from which asset beta is derived. There is a risk of double counting if a real options multiplier is included in the cost of capital formula.

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<sup>1</sup> Commission discussion papers and submissions on those, including a submission by MEUG dated 31<sup>st</sup> July 2009, are available at <http://www.comcom.govt.nz/IndustryRegulation/Part4/DecisionsList.aspx>

<sup>2</sup> Refer paragraph 76,

[http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Mighty%20River%20Power%20-%20sub%20on%20IMS%20&%20default%20price%20quality%20-%200875179\\_1.pdf](http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Mighty%20River%20Power%20-%20sub%20on%20IMS%20&%20default%20price%20quality%20-%200875179_1.pdf)

<sup>3</sup> Refer [http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Telecom%20-%20sub%20on%20WACC%20-%200881158\\_1.pdf](http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Telecom%20-%20sub%20on%20WACC%20-%200881158_1.pdf) and paper by Graeme Guthrie [http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Telecom%20-%20Graeme%20Guthrie%20-%20WACC%20sub%20-%200881160\\_1.pdf](http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Telecom%20-%20Graeme%20Guthrie%20-%20WACC%20sub%20-%200881160_1.pdf)

5. Setting aside the question as to whether there is a case for any multiplier in favour of regulated business owners, the paper by Graeme Guthrie is unclear whether a multiplier should apply to all regulated assets or only new assets and not irreversible or sunk assets. Air New Zealand also raised a similar point and we agree with their view<sup>4</sup>:

“If an increment above WACC mid-point range is deemed appropriate then this should apply only to incremental investment and not to the entire RAB.”

6. PricewaterhouseCoopers on behalf of 17 EDBs<sup>5</sup> and Synergies Economic Consulting on behalf of Vector<sup>6</sup> proposed leverage of 60% rather than the 40% in the draft Guidelines. MEUG has proposed nil leverage per the report by Ireland, Wallace & Associates Limited (IWA) attached to our original submission. IWA have reviewed the impact on cost of capital if the proposals by PricewaterhouseCoopers and Synergies Economic Consulting were adopted. A copy of the IWA analysis dated 3<sup>rd</sup> September 2009 is attached and should be read as part of the MEUG submission.

#### **Concluding comments**

7. This submission is not confidential. We look forward to participating in the Input Methodology conference in two weeks time and the Cost of Capital conference in November.

Yours sincerely



Ralph Matthes  
Executive Director

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<sup>4</sup> Refer [http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Air%20NZ%20-%20sub%20on%20IMs%20paper%20-%20875668\\_1.pdf](http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Air%20NZ%20-%20sub%20on%20IMs%20paper%20-%20875668_1.pdf), paragraph 211, p72.

<sup>5</sup> Refer [http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/PWC%20-%20WACC%20-%20881199\\_1.pdf](http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/PWC%20-%20WACC%20-%20881199_1.pdf)

<sup>6</sup> Refer <http://www.comcom.govt.nz/IndustryRegulation/Part4/ContentFiles/Documents/Appendix%203%20Synergies%20Economics%20WACC%20report0.pdf>