



4 September 2015

Keston Ruxton
Manager, Market Assessment and Dairy
Regulation Branch
Commerce Commission
WELLINGTON

Dear Keston

Re: Cross submissions on the Commission's invitation to contribute to problem definition

Thank you for the chance to provide a cross submission. We appreciate the opportunity to contribute to the process, as you seek to identify the key topics and define the specific problems that will be addressed through the input methodologies (IM) review.

We are comfortable with the issue set identified by the Commission in the problem definition paper and note most respondents have commented in detail that these areas should be looked at. Below are some specific areas we believe require further investigation by the Commission, but where commentary was much lighter or absent in other submissions.

1. The scope of regulated services

Contact agrees with submitters that networks will increasingly face competition from new technologies owned by consumers and energy services companies. Current network regulation was not designed to facilitate a rapidly changing market environment, and the IM review should consider the following:

- The need for a clear line between “grid level” network investment and “behind the meter” investment to avoid the potential for cross subsidisation by distribution businesses, and to ensure consumers bear only the appropriate costs and risks of the regulated services.
- Where distribution businesses are involved in “behind the meter” services, ensuring their new technology businesses operate on an arm’s length basis from the traditional distribution businesses, to provide an open and level playing field in the market for energy services.
- Ensuring “grid level” network investment considers all alternatives, including new technologies and demand response as well as traditional network expansion, to ensure the lowest cost to consumers.
- Promoting an open and competitive market for “grid level” network investment, to ensure third parties as well as distribution businesses can identify and provide the most efficient options for network investment, such as demand management services.

2. The structure of network tariffs

Ensuring network tariffs reflect the underlying costs of providing the service is essential. Providing consumers with price signals which reflect the cost of using the network will result in lower costs to consumers over the longer term, and ensure an efficient uptake of new technologies.

As many submitters have outlined, electricity distribution businesses are currently subject to a price cap, which means distributors take volume risk and under-recover if demand is lower than forecast over the five year regulatory period. While the weighted average price cap (WAPC) has been effective where demand is able to be forecast accurately, a revenue cap may be more appropriate if distributors are to move to establish cost reflective pricing and assist consumers to make more efficient consumption and investment decisions. As part of this IM review the Commission must ensure the form of regulatory control is fit for the future.

3. Risk, reward and reviewing the cost of capital

Ensuring the correct alignment between risk and reward is essential, as is ensuring the IMs take an approach to estimating WACC that is consistent with how other regulatory settings allocate risk between distributors and consumers. Through the process of reviewing the IMs we see it as important that the Commission not only considers what the appropriate future IM should be, but to also consider what such a decision implies for the resulting cash flow risk and appropriate return. Rather than capturing WACC in isolation in the review, it would be valuable for ourselves and consumers to see the Commission's views on which IM settings or choices impact on cash flow risk and therefore which would warrant higher or lower resulting WACC.

Contact also supports the suggestion made in the submission of the Major Electricity Users' Group that the Commission should consider the use of additional methodologies, such as Black's Discounting Model (Black's). While in theory both Black's and the Capital Asset Pricing Model (CAPM) should provide the same valuation, the use of an alternative to CAPM would provide an additional complementary, cross-check and is worthy of consideration.

4. General comments

Having read the 25 submissions received by the Commission, we note the stark lack of a consumer advocate in this space. Given that the effect of any changes in the IMs is ultimately born by consumers, we believe a well-funded consumer advocate who can participate in this process is required in order for the regulatory regime to be effective.

Please contact me should you wish to discuss any matter raised in this cross-submission.

A handwritten signature in black ink, appearing to read "Louise Griffin".

Louise Griffin
Head of Regulatory Affairs and Government Relations