1 March 2018

Dane Gunnell
Acting Manager on behalf of Matthew Lewer
Commerce Commission
By email to regulation.branch@comcom.govt

Dear Dane

Wellington Electricity CPP draft decision – cross submission

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions by Wellington Electricity Lines Ltd and Transpower in relation to the Commerce Commission draft decision "Wellington Electricity's proposal to customise its prices to better prepare its network for an earthquake", 1 February 2018 (the WELL CPP draft decision).[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. Nothing in the submissions of other parties changes the submissions made by MEUG on 22 February 2018 including the advice of NZIER attached to that submission.
4. The following sections comment on:
   a) High Impact Low Probability (HILP) Cost-Benefit-Analysis (CBA); and
   b) Rebuttal of arguments to delay return of pass-through and recoverable costs.

High Impact Low Probability Cost-Benefit-Analysis

5. As previously submitted MEUG does not support the draft decisions in respect of how those costs should be recovered and who pays.[2] Nevertheless, MEUG agrees with the view that the quantitative benefits of the proposal support works being undertaken, refer NZIER advice to MEUG:

   > "Overall WELL's business case analysis seems to be proportionate to the modest scale of the proposed resilience expenditure."[3]

6. It's a case of all parties agreeing the work needs doing but who will pay for it and at what cost is where we differ. There is also a question of whether parties relied on their view the

[1] Refer http://comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/wellington-electricitys-2018-2021-cpp/
[2] MEUG submission, paragraph 5. If the decision is that WELL customers should pay that leads to another question on which of WELL's customers should pay given the advice of NZIER (21 February 2018), referring to proposed resilience expenditure of $15.25m (table 1) that "Most of the benefit is achieved in parts of the Hutt Valley which are expected to be worst affected by the loss of transport links" (section 1.3).
[3] NZIER advice to MEUG 21 February 2018, section 3.3.

work is needed using unquantified benefits. MEUG does not rely on unquantified benefits whereas others, in our view erroneously, have.

7. Transpower, referring to paragraph 43 in the draft submission, submitted:

> "We agree there are 'substantial unquantified benefits along with the quantified benefits [which] justify the proposed expenditure as prudent to meet service standards.' (para. 43)."[4]

8. MEUG differs from Transpower's view above in that we reject any justification of the proposal based on unquantified benefits. For WELL to claim, the draft decision to accept and Transpower to agree claimed unquantified benefits are also "substantial" without any evidence of an assessment of the range and likelihood of those claimed benefits being realised against possible costs is, in our view, neither "Good Electricity Industry Practice" or good regulatory practice.

9. Transpower also submitted:

> "New Zealand has many unique geological and geographical characteristics which create challenges for ensuring network resilience, including fault lines, volcanic activity, and population centres predominantly based near the coast. Because of these challenges we view network resilience as a relevant issue for all network infrastructure regulated by the Commission."[5]

10. This view by Transpower reinforces our concern that regulated industries will not view the WELL CPP application as a unique one-off proposal but will seek to use it as a precedent across the industry for other HILP projects where unquantified benefits are accepted uncritically as trumping opposing views. For example, WELL's submission references investigations into the Central Park grid exit point, likely to require a significantly larger investment than this CPP proposal, to be considered as a HILP project.[6]

Rebuttal of arguments to delay return of pass-through and recoverable costs

11. WELL's submission proposed the return of pass-through and recoverable costs of around $10m over the 3-years of the CPP. MEUG proposed the return be made in the first year. We rebut WELL's submissions as follows:

    a) First, WELL submit the 'sawtooth' effect of a decrease in line charges with return of the $10m in year one followed in year two with an increase in line charges "is likely to cause price uncertainty".[7] MEUG is unclear what uncertainty customers may have about the fact they have been overcharged $10m and the proposal that customers be repaid their money as soon as possible aligns with normal business practice for unregulated goods and services.

       We think the risk WELL allude to isn't about price impacts on customers; rather it is the heightened risk to WELL of public exposure on why there is a large increase in line charges with the sawtooth effect in the second year of the CPP. MEUG does not see why customers should have deferred payment of their monies to protect WELL from being accountable for having over-charged in the first place.

       There are other aspects to the price path changes we think need to be transparent that would be smothered with smoothing these repayments. For example, the Commission decision to shift from weighted average price cap (WAPC) regulation to

[4] Transpower submission, paragraph 3.
[5] Transpower submission, paragraph 5.
[6] WELL submission, paragraph 18.
[7] WELL submission, paragraph 7.

revenue cap regulation. MEUG opposed that change and argued if the change was made an adjustment be made to the asset beta to reflect the lower risk to line companies. While the Commission agreed conceptually with the argument no decrease in the asset beta and hence decrease in WACC was made.[8] Naturally WELL would like to avoid having to explain this background to customers and the windfall WELL has already gained by changing from WAPC to revenue cap without an adjustment to beta.

b) Second, WELL submit "price uncertainty could become exacerbated by repackaging by retailers who deliver the final price to consumers."[9]

   If there were a systemic problem by retailers repackaging line charges that is an issue for the Electricity Authority rather than using Part 4 regulation.

   Note WELL provide no evidence there is a systemic problem with repackaging and MEUG is unaware of any other line company tabling such evidence.

c) Third, WELL submit their price smoothing proposal "… will also be more efficient for retailers to pass through line charges, reducing the need for annual rebalancing of retail prices and margins over time."[10]

   This apparent benefit may be true for some but not necessarily for all retailers. Retailers with less adaptable legacy back-office operations would likely prefer a smoothed approach whereas others, that are more adaptable and use that flexibility as a competitive advantage to fully or mainly pass through line charges, may not. MEUG suggests the Commission give no credence to this argument by WELL unless there is supporting analysis of current and prospective existing and new entrant retailer behaviour with and without smoothing.

12. Our view remains unchanged that the return of pass-through and recoverable costs should be in the first year of the CPP. That view relied on the argument that immediate payment is preferable because the longer payments are deferred the greater the misalignment between customers that overpaid and payment recipients.[11] We will wait to see if WELL have a solution to that issue in their cross-submission.

13. The treatment of the repayment of $10m raises the question of the pros and cons of improved visibility to customers and hence greater accountability for non-routine line charge credits or one-off increases. An option WELL could consider is posting for all tariffs an explicit value of the credit so that customers will understand that it is a single one-off adjustment compared to all other line charge components.

Yours sincerely

Ralph Matthes
Executive Director

[8] Commerce Commission, Input methodologies review decisions, Topic paper 4: Cost of capital issues, 20 December 2016, paragraph 231.
[9] WELL submission, paragraph 7.
[10] Ibid, paragraph 8.
[11] MEUG submission, paragraph 21 b).