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SUBMISSION ON WHETHER THE COMMERCE COMMISSION SHOULD REVIEW OR AMEND THE COST OF CAPITAL INPUT METHODOLOGIES

Introduction

1. This submission is made by Pacific Aluminium on behalf of Rio Tinto Alcan (New Zealand) Limited and New Zealand Aluminium Smelters Limited (NZAS). It is made in response to the Commerce Commission's (the Commission) paper on whether the Commission should review or amend the cost of capital input methodologies (the paper) of 20 February 2014. Nothing in this submission is confidential.
2. Pacific Aluminium supports the Commission reviewing the cost of capital input methodologies with a view to amending them. In particular we support a review that focuses on the continued desirability of using the 75th percentile weighted average cost of capital (WACC) instead of a lesser percentile. We would be comfortable with the Commission's review only looking at this element of the cost of capital input methodologies as we consider it severable from consideration of the other elements.

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Are the positive incentives provided by using the 75th percentile WACC significantly weakened until the concerns raised by the Court are addressed?

3. Pacific Aluminium considers that the incentives are significantly weakened as there appears to be an expectation that the use of the 75th percentile will be overturned in favour of using the 50th percentile¹.

Should the Commission bring forward a review of the cost of capital IMs to resolve the uncertainty that compromises the purpose of the uplift?

4. Yes. Given the recent decision of the High Court, it is now necessary for the Commission to at least review the appropriateness of setting WACC at the 75th percentile.

Should the Commission determine before November this year whether consideration of the Court's concerns warrants an IM amendment solely to the use of the 75th percentile?

5. Yes. This is the most material item at issue and the Court has raised concerns about the appropriateness of setting WACC at the 75th percentile. Further, consideration of this is severable from consideration of other elements of the IMs and so the Commission could focus solely on this issue at this time.

Given the Commission must reset EDBs' and Transpower's price-quality paths for five years by November this year, is there any other option that avoids the risk of locking in higher prices for electricity consumers, if the Commission were to later conclude that the uplift should be reduced or is not warranted?

6. Pacific Aluminium is not aware of any other suitable options.

¹ For example see Macquarie Private Wealth Research Report on Vector Limited of 7 February 2014 - <http://www.macquarie.com.au/dafiles/Internet/mgl/au/apps/retail-newsletter/docs/2014-02/VCTNZ070214e.pdf?cid=&spMailingID=7930867&spUserID=NzE1ODM1Nzg2MgS2&spJobID=120776687&spReportId=MTIwNzc2Njg3S0>

What evidence is there in support of either the 75th percentile or credible alternatives?

7. Pacific Aluminium is not aware of any evidence to support the 75th percentile. However, the Commission's estimate of the 50th percentile does come from empirical observations and estimates and thus does have an evidential basis.

In selecting an appropriate WACC percentile, how significant is it that regulated outputs are inputs to other sectors of the economy?

8. It is very significant. Inefficiently high input costs inevitably lead to a reduction in consumption of that input by productive sectors of the economy. In the case of regulated monopolies such inefficiencies cannot be countered through the use of alternative inputs as there are no close substitutes. Inefficiently high costs from regulated monopolies will lead to a loss in the overall efficiency of an economy.

General

9. We would be happy to discuss our submission in more detail and please contact me if the Commission so desires.



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