

13th March 2014

www.chh.com

Brett Woods
Commerce Commission

By email to regulation.branch@comcom.govt.nz

Dear Brett,

Submission on reviewing or amending the cost of capital input methodologies paper dated 20 Feb

1. This is a submission by Carter Holt Harvey Pulp & Paper Ltd on the Electricity Commerce Commission paper “Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies” dated 20th February 2014.
2. This submission is not confidential except for the approximate annual cost of our electricity and gas referred to in paragraph 5 .
3. CHH Pulp & Paper is a New Zealand pulp, paper and packaging products processing company with substantial direct investment in the New Zealand economy with annual sales of approximately \$1B. CHH Pulp & Paper makes a significant contribution to New Zealand's foreign exchange earnings, primarily by way of exported pulp and paper products (approximately 72% of total sales volume) , but also in the form of avoided imports of paper and packaging utilised by New Zealand's agricultural and horticultural industries, which are themselves export focused. CHH Pulp & Paper exports to global markets, predominantly in Asia, with major competitors based anywhere from Australia to China to Russia to USA to Chile. CHH Pulp & Paper is a substantial employer, with the majority of that employment being regionally based.
4. CHH Pulp & Paper uses approximately 900GWh per annum of electricity, of which some 400 GWh per annum is internally generated.
5. Electricity and gas at approximately []pa, is our highest input material cost after wood cost so the price paid for electricity and gas impacts significantly on the company's operating costs and hence ability to compete in the international market.
6. Since CHH Pulp & Paper is an export earning business for the New Zealand economy, it is essential to the viability of our operations that electricity supply is obtained at a fair and reasonable price.
7. CHH is a member of the Major Electricity Users Group (MEUG) and supports the more detailed MEUG submission and expert advice from NZIER.

8. Our response to the questions in your paper follow:

8.1 Are the positive incentives provided by using the 75th percentile WACC significantly weakened until we address the concerns raised by the Court?

The High Court decision in our view has significantly undermined any confidence there may have been that using the 75th percentile range in the cost of capital input methodologies is reasonable and sustainable into the future. We agree with the Commission that “until we decide whether to retain, reduce or remove the existing uplift to the mid-point WACC estimate, using the 75th percentile WACC is unlikely to provide the intended incentives for efficient investment”. CHH Pulp & Paper believes that the uncertainty on what the WACC will be in the future is creating sufficient uncertainty for transmission and line companies as well as end consumers such that consideration and a decision on this issue should be taken as soon as possible.

8.2 Should we bring forward a review of the cost of capital IMs?

We agree that a full review of the entire cost of capital input methodologies is not practical before the end of the third quarter this year. In any case bringing a full review forward appears to us to be unnecessary because possible changes other than changes to the WACC estimate used for setting price-quality paths can be considered in the review prior to January 2018, and the High Court decision specifically commented on the use of the 75th percentile as requiring further consideration by the Commission. Consideration of a change only to the WACC estimate used for setting price-quality paths is feasible because there are no flow on effects, and desirable because of the material uncertainty attached to the current 75th percentile assumption. CHH Pulp & Paper supports an urgent amendment to the cost of capital input methodologies to change the specification from the 75th percentile to the mid-point.

8.3 If not, should we consider an amendment to the cost of capital IMs solely of the 75th percentile WACC estimate used for setting price-quality paths?

Yes.

8.4 Is there any other option that avoids the risk of locking in higher prices for electricity consumers, if we were to later conclude that the uplift should be reduced or is not warranted?

We cannot identify any other viable option to avoid locking in unnecessary higher prices for electricity consumers.

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

We are not aware at present of any evidence to support either the 75th percentile or other credible alternatives. We note however the comments made by NZIER in their expert advice.

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

For CHH Pulp & Paper, the potential mis-pricing of WACC for regulated lines services is of great significance to us for two reasons.



As an exporter, we cannot pass on any excessive monopoly charges to our customers and so must rely on the regulator to determine fair and reasonable costs for the relevant monopolies.

As a pulp and paper producer, we have access to significant amounts of biomaterial that can be converted at our processing plants into more electricity than we generate at present as well as replace to a large degree our present use of natural gas. The trend to energy self sufficiency is evident worldwide in our industry and we are regularly reviewing our options in this area. The amount and future perceived stability of regulated transmission and distribution charges both for electricity and gas will have an impact on our investment decision making in this area in particular.

We appreciate the opportunity to make a submission on this very important issue.

Yours Sincerely

A handwritten signature in blue ink, appearing to read "L Haugh".

Lyndon Haugh
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