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Brett Woods
Senior Analyst
Regulation Branch
Commerce Commission
By email: regulation.branch@comcom.govt.nz

Review of cost of capital input methodology

Meridian welcomes the opportunity to provide feedback on the Commerce Commission's consultation paper 'Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies'.

We agree that the High Court decision provides a rationale for undertaking a review of the cost of capital input methodology (IM). Meridian considers that the value at stake for New Zealand consumers of an amendment to the Weighted Average Cost of Capital (WACC) means the Commission should seek to complete a review prior to setting new price paths for Electricity Distribution Businesses and Transpower for the 2015-2020 period.

Given the likely complexity of a full review of the cost of capital IM, we agree with the Commission's preferred option of consulting only on amending the WACC percentile to be used in price-quality regulation, with the aim of completing this work prior to end-November. The potential benefits to consumers to be gained over the next regulatory period from such a review are likely to outweigh any disadvantages from not being able to fully consider any inter-dependencies within the cost of capital IM.

More broadly, Meridian considers that it is critical that efficiency improvements continue to be sought in the regulated parts of the electricity industry, as well as in the competitive parts, so that electricity consumers can have confidence that the costs they face are reasonable for the quality of service provided.

With respect to evidence in support of choosing a particular percentile, Meridian notes that, to date, we have not given much focus to the development of an appropriate WACC for monopoly lines businesses. However, we do calculate and use our own WACC for a number of purposes, including setting investment thresholds. The process of setting a WACC takes into account industry and systematic risks. It is therefore difficult to see any compelling rationale for selecting a WACC at anywhere other than the mid-point: the 50th percentile.

Please contact me if you have any questions regarding this submission.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'M. Hall', written in a cursive style.

Matthew Hall
Regulatory Analyst

DDI 04 382 7516

Mobile 021 081 66 979

Email matthew.hall@meridianenergy.co.nz