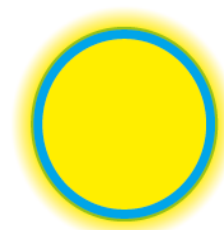


5 February 2016

Keston Ruxton  
Manager, IM Review  
Regulation Branch  
Commerce Commission  
PO Box 2351  
WELLINGTON 6140

**POWERCO**



Dear Keston

**Re: Scope and process for fast track amendments to the CPP input methodology requirements**

Thank you for the opportunity to comment on the Commerce Commission's Input Methodologies Review paper entitled "*Update paper on the cost of capital topic.*"

Powerco's submission is supported by a report from Houston Kemp. We asked Houston Kemp to specifically consider the following:

- asset beta, and evidence of the extent to which asset betas differ between: firms that are subject to different forms of regulatory control; and between electricity distribution businesses ('EDBs') and gas pipeline businesses ('GPBs');
- costs associated with raising debt and maintaining the credit rating assumed by the Commission; and
- incentives to apply for a customised price-quality path ('a CPP') for electricity and gas suppliers currently regulated under a default price-quality path ('a DPP').

We have reviewed in detail the submission by the Electricity Networks Association (ENA) and the accompanying expert analysis by CEG. Powerco supports the ENA submission.

The key points that Powerco would like to draw to the attention of the Commission are:

- There are strong theoretical and empirical reasons suggesting that the form of regulatory control will have an immaterial effect on the systematic risk and asset beta of a supplier.
- There is evidence that the use and transport of gas in New Zealand is subject to greater systematic risk than the use and transport of electricity.<sup>1 2</sup>
- To the extent that the IMs set a risk free rate that is fixed for the duration of the regulatory control period (which is an issue as expanded on in the ENA submission), it is efficient for suppliers to hedge their debt exposure to this

<sup>1</sup> Powerco Submission to the Commerce Commission 28 January 2016: Powerco submission on gas IM review and gas 2017 DPP reset matters vF.

<sup>2</sup> Concept Consulting report 28 January 2016: Relative long-term demand risk between electricity and gas networks (accompanying report to Powerco submission on gas IM review and gas 2017 DPP reset matters).

benchmark, regardless of the term of their debt, to mitigate the mismatch with this allowance. The IMs should fully compensate for transaction costs associated with implementing an efficient debt management policy.

- Powerco continues to consider that the divergence between the DPP and CPP WACC creates materially perverse incentives around CPP timing decisions. We do not support the proposal by Dr Lally that, as transitional measures, the DPP WACC is applied to existing assets and capex approved under a DPP while the CPP WACC is applied to all additional capex under a CPP. For reasons we have a previously submitted on, and further supported by Houston Kemp in their analysis, we support a policy of setting the CPP WACC equal to the DPP WACC.

Thank you for the opportunity to submit on this consultation. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact Richard Fletcher, tel. (04) 978 9910, email [richard.fletcher@powerco.co.nz](mailto:richard.fletcher@powerco.co.nz).

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Fletcher', written in a cursive style.

Richard Fletcher  
General Manager Regulation and Government Affairs