hale & twomey

ARETÊ CONSULTING LTD

13 March 2012

Brett Woods
Senior Analyst
Regulation Branch
Commerce Commission

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

Dear Brett

Re: Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies – Commerce Commission Paper dated 20 February 2014.

1. This following submission is made on behalf of the Major Gas Users Group (the Group):

    a. Ballance Agri-Nutrients Ltd
    a. Carter Holt Harvey Ltd
    a. Fonterra Co-operative Group Ltd
    b. New Zealand Sugar Company Ltd
    c. New Zealand Steel Ltd
    d. Refining NZ

2. Thank you for the opportunity to make this submission. While these views are expressed on behalf of Group, we note that members may have views specific to their own businesses that they may choose to convey separately to the Commission.

3. Members of the Group are significant users of natural gas. Collectively they consume about 25 PJs per annum of gas or about 16% of the gas supplied to the market in New Zealand.

4. Natural gas is used for energy and as a raw material for transformation. It is a preferred fuel because of its:

    - Low capital cost for utilities compared to other forms of energy (coal, biomass)
    - Lower operating cost and ease of operation
    - Cleaner burning characteristics with lower emissions than coal
    - Ease of handling and consenting

5. Most significantly members of the Group make up a significant proportion of New Zealand's productive sector (as exporters or in import substitution). They are energy intensive industries and delivered energy costs are a significant proportion of input costs. Supplies of competitively priced natural gas are a key input to their operations.

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6. The efficiency of these industries is directly influenced by competition in international markets and hence they are constrained in their ability to pass on costs. Hence any inefficiencies in the provision of services from monopolies directly affects these businesses, including for gas supply.

7. We make these comments in the context of the first Default Price Path (DPP) for Gas Pipeline Businesses which began in 2013, with the first reset due for 2017. We have also followed closely the High Court decision on the Merit Review with respect to the cost of capital input methodologies (IM's). We believe the Court has raised valid questions with respect to the application of 75th percentile of the WACC range when setting the DPP. We are also aware of the request from Consumer NZ, the Employers and Manufacturers Association Northern (EMA) and the Major Electricity Users Group (MEUG) to urgently review those IM's in light of the High Court decision.

8. We answer the following questions asked by the Commission.

Are the positive incentives provided by using the 75th percentile now weakened?

9. The High Court decision has significantly undermined confidence that using the 75th percentile range in the cost of capital input methodologies is reasonable. 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". In other words we believe the uncertainty on what the WACC should be is creating widespread and significant uncertainty for both monopolies and end consumers that the Commission must urgently issue a Notice of Intent to amend the cost of capital input methodologies in order to reach a decision as quickly as possible.

Should we do a review of the cost of capital IMs early?

10. We agree a review of the entire cost of capital input methodologies is not possible before the end of the third quarter this year. Such a review is unnecessary because possible changes other than to the mid-point can be considered in the review prior to January 2018. Consideration of a change to the mid-point is feasible because there are no flow on effects and desirable because of the material uncertainty to the current 75th percentile assumption.

11. We note the Commission's comments on page 10 that the review of IM's relevant to the gas DPP reset needs to be completed a reasonable amount of time before the end of May 2017 so that any changes can be incorporated in the next reset. We don't believe the process at that date for considering any amendments to IMs specifically for gas is the appropriate time to amend the cost of capital IM. It is more effective and efficient to address this question sooner as part of the IMs underpinning the electricity default price path (DPP) and individual price path (IPP) resets next year. If the changes to the mid-point can be made without flow on effects and can be done more quickly then, in the interests of certainty we believe it is better to undertake the review of the mid-point sooner rather than later.

Should we consider an amendment solely to the 75th percentile?

12. Yes definitely.

Are there any other options for addressing the Court's concerns?

13. There are no other options that we are aware of.

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

14. There is no evidence that we are aware of.

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

15. For members of the Group, the potential mispricing of WACC for regulated pipeline services is very important given the international markets that members compete in (as explained in Paragraphs 3 and 4 above).

Yours sincerely

Hale & Twomey Ltd/Arete Consulting Ltd
<u>On behalf of the Major Gas Users Group</u>