11 Chews Lane
PO Box 10568
The Terrace
Wellington 6143
New Zealand

Genesis Energy Limited

Fax: 04 495 6363

13 March 2014

Brett Woods

Senior Analyst, Regulatory Branch

Commerce Commission

44 The Terrace

Wellington 6140

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

Dear Brett

Should the Commerce Commission review or amend the cost of capital input methodologies

Genesis Energy Limited welcomes the opportunity to provide a submission to the Commerce Commission ("the Commission") on the consultation paper "Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies" dated 20 February 2014.

Genesis Energy has a strong interest in ensuring that our customers[1] are charged a fair and reasonable cost for the infrastructure required to meet their energy needs. Therefore, we support the Commission undertaking an early review of the cost of capital input methodology ("the IMs"). However, we suggest that to provide real confidence to consumers, and regulated businesses, the review must be provided with sufficient resources and timeframe to deliver a robust result.

[1] Page 2, Genesis Energy Annual Report 2013, Genesis Energy Limited.

An early review of the cost of capital input methodologies is necessary

We consider that an early review of the IMs is necessary to address the concerns identified by the High Court,[2] namely:

- whether empirical evidence and theoretical results justify the Commission's use of the 75th percentile estimate of the Weighted Average Cost of Capital (WACC) to set price-quality paths;
- whether to adopt a 'split' (or 'tiered') cost of capital;
- the Commission's rational for a term credit spread differential (TCSD) allowance; and
- whether to retain the simplified Brenna-Lally Capital Asset Pricing Model (CAPM), given the effect of the 'leverage anomaly'.

We agree that starting the IM review now will provide greater confidence to consumers in how electricity lines charges are calculated,[3] at a time where there is increased public concern about the impact of such charges. An earlier start will allow flexibility with the implementation timeframe, and ensure sufficient time if amendments are needed. It will also provide an early benchmark for determining WACC, and enabling the Commission to better target the information necessary to be disclosed for future IMs.

Review must be robust

It is critical that any early review of the IMs is conducted in such a manner to provide a robust and fulsome result. We agree with the Commission that it is not possible to complete a full review of the IMs before November 2014. In fact, we consider that the indicative timetable stated in the consultation paper is too tight and risks providing a rushed analysis.[4] Comparable international experience is that a proper review of rate of return can take approximately a year.[5]

We do not see a longer timeframe as preventing the Commission from implementing changes that will bring long-term benefits for consumers. We suggest a well-designed transition plan can enable the review of the IMs, without

[2] Page 5 of the Consultation Paper.

[3] See the MEUG, EMA and ConsumerNZ positions described at paragraph 17 of the Consultation Paper

[4] Page 18 of the Consultation Paper.

[5] For example, see the AER timeframes at http://www.aer.gov.au/node/18859

compromising the timeframes required for such a review to be robust. A transition plan will also ease the pressure on the Commission to meet the set timeframes for Regulatory Control Period two (RCP2) and help minimise any distortions to the current market operating under the existing IMs.

In addition to allocating sufficient time and resources, we suggest that the Commission should also ensure the review:

- **Improves transparency for consumers and regulated businesses**. A more transparent process for IMs would reduce the transaction costs associated with having asymmetric information as between the regulator, regulated businesses and consumers. We suggest that transparency can be improved by providing plain English documents that attempt to explain the process, and calculations therein. Information should be aimed at ensuring that stakeholders have enough information to better understand the method used and do their own assessments if felt necessary.

- **Takes into account both qualitative and quantitative assessment of impacts.** We agree with the Commission's approach to considering a robust wide economic impact study. However, we suggest the Commission choose the best available empirical modelling to carry out this empirical assessment. As the objectives of Part 4 are hard to quantify, we also suggest that the Commission develop a qualitative assessment framework along with its quantitative assessment.

If you would like to discuss any of these matters further, please contact me on 04 495 6357.

Yours sincerely

Daisy Shen
Regulatory Advisor