

12<sup>th</sup> September 2014

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Dear Brett,

**Cross-submission on the paper “proposed amendment to the WACC percentile for electricity lines services and gas pipeline services” dated 22<sup>nd</sup> July 2014**

1. Carter Holt Harvey Pulp & Paper Ltd welcomes the opportunity to make a cross-submission on the Commerce Commission’s consultation on the paper “Proposed amendment to the WACC percentile for electricity lines services and gas pipeline services” dated 22<sup>nd</sup> July 2014. We did not make an earlier submission though we were consulted on and agreed with the submission by MEUG including the expert advice of NZIER and Ireland, Wallace & Associates dated 29<sup>th</sup> August 2014. We also have been consulted on and agree with the concurrent cross-submission of MEUG and further expert advice of NZIER and Ireland, Wallace & Associates and new advice by Franks & Ogilvie being lodged on 12<sup>th</sup> September 2014.
2. Carter Holt Harvey 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 which are 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.

3. CHH Pulp & Paper uses approximately 900GWh per annum of electricity, of which some 400 GWh per annum is internally generated and approximately 3PJ of gas per annum .
4. Electricity and gas 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.
5. The electricity and gas transmission and distribution charge portion comprises approximately \$17M pa of these costs.
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 and gas supply is obtained at a fair and reasonable price.
7. Of course as well as price, reliability of supply is of considerable importance to us as an interruption of electricity or gas supply can result in large production losses.
8. Our experience in ensuring a high degree of reliability in our own capital intensive manufacturing plant and observing and in some cases participating in reliability improvement work in electricity transmission and distribution to our plants, provides the following observations.
  - a. The most effective way to maintain and improve reliability is to set performance targets that will result in proactive maintenance of existing plant and equipment i.e. operational expenditure combined with world-class maintenance systems. We consider that a good example of this approach is the performance targets set in the Transpower RCP2 plan.
  - b. While in the final analysis, replacement capital expenditure will be necessary in some cases to maintain the required level of reliability of supply, it is always the option of last resort.
9. We have considered the likely cost increase for CHHPP between setting WACC at the 50<sup>th</sup> or 67<sup>th</sup> percentile which as we understand it would amount approximately to a 3% increase in transmission and distribution costs i.e. additional \$500,000 pa ( \$2.5M over the RCP2 period) and asked ourselves the question – would this be a cost effective way to maintain and improve supply reliability?
10. Our answer to this question is no at least for the upcoming RCP2 period.

11. We have reviewed the NZIER report dated 9 September 2014 on “Valuing investments in network reliability” recently submitted by MEUG. While perhaps this could not be considered as a complete work, we consider that it supports the conclusions in the summary. i.e.

“Advice to MEUG:

- ◇ *WACC uplift is not necessarily the right instrument for dealing with concerns about the welfare costs of reduced investment. If any additional incentive is required to safeguard consumer welfare that incentive is most likely to be found elsewhere.*
- ◇ *The more fundamental point is that the Commission needs to adopt a more structured and disciplined way for thinking about its own rule-making under uncertainty. The current approach – to estimate WACC and add an adjuster motivated largely by intuition – is too ad hoc to promote certainty.*

*We suggested that the interim decision is left at the mid-point and that time needs to be taken to consider the longer term issues between now and 2017 when the IM review is due. “*

We fully agree with these recommendations and appreciate the opportunity to make a cross-submission on this very important issue.

Yours Sincerely



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