

Commerce Commission submission on WAAC

Introductory remarks

The Auckland Energy Consumer Trust (AECT) welcomes the opportunity to provide a submission on the paper “Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies” issued by the Commerce Commission and dated 20 February 2014.

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The Commerce Commission is seeking views on how to best address any regulatory uncertainty created by the High Court judgement that identified four aspects of the cost of capital input methodology that should be reviewed.

We agree that the questions raised in the High Court judgement are important and indicate that the methodology may need to be changed. However we argue that any regulatory uncertainty created by the expectation to review elements of the cost of capital IM is largely mitigated by the fact that the High Court decision:

- did not accept that the evidence provided by the appellants met the required test of demonstrating that the proposed changes to the capital cost IM would deliver ‘a materially better’ regime
- did not set or recommend an earlier time frame for the review of the cost of capital IM than the latest date already allowed under the Commerce Act.

Most importantly the regulatory uncertainty created by the High Court decision is limited as it:

- adds additional factors to the review of the WACC along with changes in the WACC formula parameters (for example risk free rate and beta co-efficient)
- acknowledges that the evidence of the effect of adjustment of the cost of capital IM in response to the additional factors does not meet the test of delivering a materially better outcome
- does not require these factors to be considered ahead of the existing review timeline, which always meant a degree of uncertainty.

Response to questions

Question	AECT submission
20.1 Are the positive incentives provided by using the 75th percentile WACC significantly weakened until we address the concerns raised by the Court?	No for the following reasons: • the concerns raised by the Court do not imply a high likelihood of reduction of the 75th percentile as the High Court judgement noted that evidence presented did not demonstrate that replacement of the 75th percentile test with a midpoint test would be a ‘materially better’ outcome. Our quick scan of the literature on the related issues of distribution of WACC estimates, asymmetric investment responses to

	WACC changes by regulated entities and loss functions suggest definitive evidence of the effect of this type of change is hard to find. • short term investment decisions i.e. over the period between an immediate review and a review before 2018 would be driven mainly by network maintenance and service demand projections rather than the variations in the rate of return. The variations in the rate or return will affect longer term profitability projections.
20.2 Should we bring forward a review of the cost of capital IMs?	No, bringing forward the review was not recommend in the High Court decision and doing it quicker increases current uncertainty. Moreover, bringing forward the review now increases uncertainty about the regime as it sets a precedent about ad hoc timing of future reviews.
20.3 If not, should we consider an amendment to the cost of capital IMs solely of the 75th percentile WACC estimate used for setting price-quality paths?	No, the evidence presented to the High Court did not meet the test of delivering a 'materially better' outcome. Such an ad hoc response to the High Court decision via special reviews undermines the vital sustainability of the regime. And then completing another review of the cost of capital IM as is required, seems to maximise the regulatory uncertainty of the review process. It makes it harder to consider the interdependencies between components of the WACC, the effect of these components on price paths and ultimately the investment response of the regulated suppliers.
20.4 Is there any other option that avoids the risk of locking in higher prices for electricity consumers, if we were to later conclude that the uplift should be reduced or is not warranted?	The Commission already has exercised its ability to reduce the starting point for price paths where it determines excessive returns have been earned. This mechanism should be more than adequate to fairly compensate consumers for any proven excessive uplift given both the time required for a review, the legislative standard for change, and the paucity of evidence on an appropriate rate of uplift.
20.5 What evidence is there in support of either the 75th percentile or credible alternatives?	Both the Commission's initial research on the cost of capital IM and the High Court decision, suggest a lack of evidence on the use of either the 75 th percentile or alternatives. Our initial review of the literature has not revealed any improvement on this position.
20.6 In selecting an appropriate WACC percentile, how significant is it that regulated outputs are inputs to other sectors of the economy?	This is not a matter for the Commission to consider. The test in Part 4 is the effect on consumers.