



**Submission to the
Commerce Commission**

On

**Reviewing or Amending the Cost of
Capital Input Methodologies**

13 March 2014

Introduction

Alpine Energy Limited welcomes the opportunity to submit on the Commerce Commission's *Invitation to have your say on whether the Commerce Commission should review or amend the cost of capital input methodologies*.

We do not support the proposal to review or amend the cost of capital input methodology (the IM) before the next scheduled review in 2017. As we are of the view that there is not enough evidence to warrant a review before the dates previously agreed upon.

In all respects we agree with the Electricity Networks Association's (ENA) submission to your six questions. Of particular importance to us is the matter of investment incentives and accordingly our submission focuses on this issue.

No part of our submission is confidential.

Key points

The key points of our submission are as follows:

- Greater emphasis should be placed on dynamic efficiency gains where conflict occurs between sections 52A(1)(a) to (d) of the Commerce Act. As previously argued in prior ENA submissions¹, the Commerce Commission is obligated to place sections 52A(1)(a) to (d) of the Commerce Act into a hierarchical order, where conflict occurs between these sections.
- The 75th percentile is more likely to lead to dynamic efficiency gains than a mid-point estimate, as the Commission itself states in its Reasons Paper². While excessive profits may occur at the higher range, excessive profits can be managed through other regulatory tools available to the Commission in the input methodologies.
- No strong evidence has come to light since the publication of the IMs that shows that a change to the WACC should occur, there is not a legitimate reason for the Commission to address this issue now. To do so would be at odds with section 52R of the Act.

Overview

The Commission is tasked with promoting the purpose of Part 4 of the Act in order that suppliers have an incentive to invest while limiting their ability to earn excessive profit. The Commission must make a judgement when balancing the competing aims for providing incentives to invest against aims to limit excessive profit, where higher prices will lead to greater profit and hence a greater incentives to invest.

While the Act does not indicate itself that there is a hierarchy between sections 52A(1)(a) to

¹ Electricity Networks Association, *Submission 1 Regulatory Framework*, (9 August 2010)

² Commerce Commission *Input Methodologies (EDBs and GPBs) Reasons Paper* (22 December 2010), paragraph H11.62

(d) this submission agrees with the earlier ENA submission that it was the legislators intent for the Commission to rank these sections. This places a greater emphasis on 52A(1)(a) than (d). Therefore the Commission is tasked under Part 4, with promoting dynamic efficiency gains over static or short run allocative efficiencies where a trade-off occurs. This latter point is made in the Commission's own Reasons paper.

When determining an appropriate percentile to use for the WACC, it is acknowledged that a lower percentile will reduce an investor's willingness to invest because there is potential that a lower WACC will lead to lower prices, unless future investment is guaranteed through other means.

This is one of the reasons that the Commission chose the 75th percentile over a mid-point estimate. The higher estimate promotes incentives to invest, while in combination with other regulatory tools, excessive profits can be limited, such as:

- using the building blocks approach to pricing
- the use of Asset Management Plans to assess an EDBs ability to plan and reinvest profit.

Where excessive profit may not be limited, the greater need for dynamic efficiency wins over short run losses to allocative efficiency. The fact that the recent High Court judgment noted no empirical evidence for either the mid-point or 75th percentile, or that no new evidence has come to light since the publication of the IM means that there is a not a legitimate reason to re-investigate this issue at this time.

In fact doing so would seem contradictory to the purpose of s52R of the Act, which is to promote certainty for suppliers and consumers in terms of relevant rules.

Closing remarks

We hope that our submission is helpful to the Commission in regards to reviewing or amending the IM. We are happy to discuss our opinions further with the Commission if it would find it useful.

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