7 August 2025

Ben Woodham and Keston Ruxton
Commerce Commission
Wellington 6140

By email to: infrastructure.regulation@comcom.govt.nz

Dear Ben and Keston,

Submission to the Commerce Commission on the *Fibre IM Review issues paper – tranche 1*

Electricity Networks Aotearoa (ENA) appreciates the opportunity to make a submission to the Commerce Commission (Commission) on the consultation paper on the *Fibre IM Review issues paper – tranche 1* (issues paper).

ENA is the industry membership body that represents the 29 electricity distribution businesses (EDBs) that take power from the national grid and deliver it to homes and businesses (our members are listed in Appendix A).

EDBs employ over 7,800 people, deliver energy to more than two million homes and businesses, and have spent or invested $6.2 billion in network assets over the last five years. ENA harnesses members' collective expertise to promote safe, reliable, and affordable power for our members' customers.

A trailing average cost of debt is in the long-term best interests of consumers

This submission is focused on the Commission's proposal to review the methodology for the weighted average cost of capital (WACC) across both Part 4 and Part 6.

The current methodology means that consumers are exposed to volatile debt costs. The DPP4 reset impacts have highlighted how the current methodology doesn't deliver good outcomes for customers and can result in shocks. As we have argued in previous submissions, alternative methodologies, such as a trailing average, can improve outcomes for customers.

According to the Australia Energy Regulator (AER), who implemented a trailing average approach in Australia over a decade ago, they consider that it "promotes overall efficiency of investment, operation and use of, electricity and natural gas services for the long term interest of consumers" and that it "would result in lower price volatility (from one regulatory control period to the next) for energy consumers".[1]

As recently as this week, the AER has published a paper for its four-yearly review of the rate of return instrument, continuing to advocate for a trailing average cost of debt.[2] The AER reiterated its

[1] AER, AER Explanatory statement - rate of return guideline, December 2013, page 109
[2] AER, Rate of Return Instrument – Review discussion paper, August 2025

view that it would "smooth movements in the return on debt, leading to lower price volatility for consumers".[3]

Dr Martin Lally also agrees that a trailing average approach would "would produce a smoother price path for consumers than the hybrid approach"[4] and is "more stable (which benefits customers)."[5] The Commission has also conceded this point in the past: "The trailing average has the advantage of smoothing the volatility in the estimated risk-free rate between regulatory periods, which tends to lead to more stable allowed cost of debt and prices for consumers over time."[6]

As reflected in the joint letter submitted alongside this submission, a broad coalition of New Zealand businesses, industry associations, and consumer advocates share the view that the current WACC-setting mechanisms contribute to unnecessary volatility and price step changes. These outcomes are not in the long-term interests of consumers, as they undermine price stability, affordability, and confidence in regulatory outcomes.

ENA therefore continues to recommend that the Commission implement a trailing average cost of debt in order to smooth the WACC profile, resulting in less volatility for consumers.

Summary of key other reasons for changing to a trailing average

In addition to the consumer benefit case, ENA refers the Commission to previous submissions in New Zealand and Australia in relation to other rationales for migrating to a trailing average methodology.

ENA continues to submit that the Commission is relying too heavily on the view of one opponent of a trailing average approach to cost of debt, namely Dr Martin Lally.

We also understand that the Commission believes there are disadvantages beyond simply regulator effort, but this does seem to be one of the most heavily weighted arguments the Commission is attached to. Whilst we understand there is effort involved in implementation and transition, the long-term benefits outweigh the short-term disadvantages. Whilst the Commission is right that the price path would need updating every year to incorporate the new cost of debt rolling average,[7] we do not believe this is any more complex than current IRIS or washup calculations – once established, they are largely mechanistic.

Most importantly, we refer to the AER's conclusions upon implementing a trailing average (consumer-related extracts of which have already been quoted above):

> *Overall, we are satisfied that the trailing average portfolio approach provides service providers with incentives to engage in efficient debt financing practices. We consider this promotes overall efficiency of investment, operation and use of, electricity and natural gas services for the long term interest of consumers in a manner consistent with the objectives.*

[3] AER, Rate of Return Instrument – Review discussion paper, August 2025, page 23
[4] Dr Martin Lally, 27093_QCA-2014-Review-of-Submissions-on-Trailing-Average-Kd_FINAL807867_1-1.pdf, 27 January 2015, page 29
[5] Dr Martin Lally, Dr-Martin-Lally-Review-of-submissions-on-the-risk-free-rate-and-the-cost-of-debt-17-March-2023.pdf, 17 March 2023, page 3
[6] Commerce Commission, Part-4-IM-Review-2023-Draft-decision-Cost-of-capital-topic-paper-14-June-2023.pdf, 14 June 2023, page 34
[7] Commerce Commission, Part-4-IM-Review-2023-Final-decision-Cost-of-capital-topic-paper-13-December-2023.pdf, 13 December 2023, page 45, paragraph 3.114

Finally, we consider the trailing average portfolio approach is capable of providing the benchmark efficient entity with a staggered debt portfolio with a reasonable opportunity to recover at least the efficient debt financing costs. This implies that a service provider with a similar degree of risk is also provided with the same opportunity.

In addition to the considerations above, the trailing average portfolio approach provides the following benefits:

- *It smooths movements in the return on debt over a number of years. We consider this would result in lower price volatility (from one regulatory control period to the next) for energy consumers and more stable returns for investors than the "on the day" approach. Consideration of consumer price volatility is an important factor, since the price volatility affects intertemporal decisions of energy consumers and hence affects the overall efficiency of economic outcome.*
- *It minimises the consequences of a single measurement error.*
- *It may be more reflective of the actual debt management approaches of non-regulated businesses. It might, therefore, be more likely to represent efficient financing practice.*[8]

Moreover, the AER is currently reviewing its rate of return instrument as part of its regular four-yearly process. In its August 2025 consultation paper, the AER indicates it is considering an enhancement to its existing trailing average approach — moving from a simple trailing average to a weighted trailing average. This potential refinement reflects recommendations from its independent expert panel, stakeholder feedback, and "our own view that further consideration is warranted in light of evolving market conditions."[9] Rather than stepping back, the AER's direction reinforces its confidence in the trailing average framework and signals a willingness to strengthen it in response to market developments.

Further points and elaborations are included in the table below:

THEME	EXPLANATION & REFERENCE TO PREVIOUS SUBMISSIONS
More efficient debt funding strategy	A trailing average better reflects debt management realities. An efficient debt management strategy would likely apply a 10-year approach, in the absence of regulatory distortions.
Investment incentives	With both regulated businesses and experts advocating for the change and saying it better reflects debt management strategies, ENA submits that Dr Lally's concerns that a trailing average would disincentivise capex or opex is overstated.[10] Prevailing rates will inevitably be higher or lower than the trailing average, but that problem already exists with the current approach. A trailing average will smooth this impact for businesses as well as consumers, and is less likely to result in extremely high WACC rates or extremely low WACC rates, therefore reducing the risk of strong incentives to over or under invest.

[8] AER, AER Explanatory statement - rate of return guideline, December 2013, pages 109-110
[9] AER, Rate of Return Instrument – Review discussion paper, August 2025, page 15
[10] Dr Martin Lally, THE TRAILING AVERAGE COST OF DEBT, 19 March 2024, pages 42-43

10-year approach	ENA notes there is strong regulatory precedent for this approach with a 10-year term of debt adopted by the AER and all other Australian regulators along with several UK regulators. This paper from Queensland Treasury Corporation helps explain the debt and hedging benefits: QTC - A moving average approach for calculating the return on debt - July 2012. As we stated in our 2023 submission, a trailing average is hedgeable, implementable and has low transaction costs for the regulated business.[11] It has also been demonstrated that that Dr Lally has misquoted previous experts and mischaracterised their conclusions. This is particularly concerning in relation to conclusions claiming that cost of capital terms should match regulatory periods. The AER's arguments in 2022, when attempting to reduce the period from 10 years to 5 years, was predicated on Lally's views, but these were undermined when the key quoted source, Richard Schmalensee, argued in a strongly worded rebuttal that Lally's characterisation of him and his findings were "almost exactly backwards" and "fundamentally inconsistent" and that "Dr Lally is simply wrong".[12] Schmalensee rather states that "Efficient regulation generally requires that the allowed rate of return must be consistent with the return required by investors – however they determine it." [13] In the case of EDBs, and other Part 4 and Part 6 regulated businesses, investments are generally in long-life assets, with investments spanning regulatory periods and therefore where returns are expected over longer periods and debt is often matched. Realistically, no commercial business is likely to seek to refinance all their debt at once, as the current regulatory methodology implies. Regulated businesses are advocating for a 10-year trailing average, consistent with the return requirements of their investors. By Schmalensee's argument, a 10-year rate of return would therefore be efficient.
Greater stability	A 10-year moving average of the total return on debt will produce small annual changes for a given change in the spot return on debt, as only 10% of the portfolio is re-priced based on spot rates each year (assuming a simple trailing average approach). Even Dr Lally acknowledges that a trailing average approach "will yield more stable results." And even goes on to say that the trailing

[11] ENA, ENA-Rate-of-Return-Issues-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-3-February-2023.pdf, 3 February 2023, page 16.
[12] Richard Schmalensee, Microsoft Word - Schmalensee Expert Report - ENA - 29 Jul 2022.docx, 29 July 2022
[13] Richard Schmalensee, Microsoft Word - Schmalensee Expert Report - ENA - 29 Jul 2022.docx, 29 July 2022, page 8

	average approach "yields significantly lower volatility than the hybrid approach" consistent with claims from our previous CEG expert report.[14] You can find the CEG report, which we continue to support, here: Electricity-Networks-Aotearoa-ENA-CEG -Appendix-B-Response-to-2023-IM-draft-decision-on-cost-of-capital-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf
Transitional arrangements and calculating rates prospectively	The reasons for prospective application are explained well in the Incenta report from July 2022: Chorus-Measures-to-improve-the-stability-in-WACC-estimates-11-July-2022.pdf. Primarily, the reason for a prospective approach is to avoid windfall gains and losses, or 'gaming', based on the timing of transition. The AER also refers to gradual changes being more desirable for both regulated parties and consumers. It continues that a longer transition also reduces risk of high costs and practical difficulties arising from an immediate transition.[15] As stated in our 2023 submission to the Commission, we support the AER's transition methodology.[16] That said, with the extreme highs and lows of the last few years, we do wonder whether this averages out to a reasonable 'average' rate that might allow for a direct transition using historical rates. We would be open to that discussion.

As demonstrated by the joint letter submitted alongside this submission, many regulated businesses are advocating for an outcome that smooths WACC and pricing impacts. Therefore, arguments that it could disadvantage regulated businesses seem moot, as those businesses are willing to take that risk. It also mitigates several of the risks identified through the Australian experience, as discussed further below.

We know there is effort required in any change, but if the end result is less price shocks for consumers, surely there is value in making that change?

Australian experience

We understand that the Commission has reservations on implementing a trailing average approach, based on discussions with Australian regulators.

While we acknowledge the Australian experience involved a lengthy and complex transition to a trailing average WACC, much of that complexity stemmed from jurisdictional fragmentation, regulator-led change, and disputes over retrospective application. These conditions are not present in New Zealand.

A prospective, industry-supported transition applied uniformly across regulated suppliers avoids many of the pitfalls seen in Australia. In our view, the key risks that do translate—such as model

[14] Dr Martin Lally, Dr-Martin-Lally-Review-of-submissions-on-the-risk-free-rate-and-the-cost-of-debt-17-March-2023.pdf, 17 March 2023, pages 20-21
[15] AER, AER Explanatory statement - rate of return guideline, December 2013, page 122
[16] ENA, ENA-Rate-of-Return-Issues-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-3-February-2023.pdf, 3 February 2023, page 17

complexity and debt benchmark selection—are surmountable with transparent guidance and industry collaboration. The benefits of reduced price-volatility and a better alignment with actual financing practices outweigh these manageable implementation challenges.

RISK FROM AUSTRALIA	WHY IT LIKELY DOESN'T APPLY IN NZ
Fragmented regulatory landscape	Australia had multiple regulators (AER, IPART, ERA, ESCOSA etc.) adopting the trailing average at different times and with different methods. NZ has a single regulator (Commerce Commission) and it would be one coordinated transition.
Regulated entities resisting the change	In Australia, some firms resisted the change due to uncertainty around the transition. In NZ, the change is industry-led, with regulated parties actively advocating for it.
Appeals triggered by transitional disadvantage	Australian firms appealed based on perceived unfairness in how the transition impacted them (e.g. timing mismatches with actual debt portfolios). In NZ, if the change is prospective and uniformly applied, no party should be disproportionately disadvantaged.
Windfall losses/gains due to retrospective implementation	Retrospective application creates asymmetry—parties may benefit or lose based on known past rates. A prospective approach in NZ avoids this issue entirely.

Previous relevant submissions

Whilst we have tried to pull in the most relevant arguments to this submission, we encourage the Commission to include views raised in previous recent submissions on WACC, including discussions of alternative methodologies, as part of this review. We particularly refer the Commission to the following for further detail on the views stated in these submissions:

- ENA's February 2023 submission: ENA-Rate-of-Return-Issues-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-3-February-2023.pdf
- ENA's July 2023 submission: Electricity-Networks-Aotearoa-ENA-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf
- The report accompanying ENA's July 2023 submission: Electricity-Networks-Aotearoa-ENA-CEG -Appendix-B-Response-to-2023-IM-draft-decision-on-cost-of-capital-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf
- Report from Incenta from July 2022: Chorus-Measures-to-improve-the-stability-in-WACC-estimates-11-July-2022.pdf

Conclusion

In conclusion, ENA submits that a trailing average cost of debt will allow regulated business to recover efficient debt costs and will ensure consumers benefit from a more stable long-term price path that is not exposed to shocks. As stated in previous submissions, and still true today "ENA believes that the advantages of the trailing average approach […] deliver greater benefits in

achieving the purpose of Part 4 set out in the 52A more effectively than the proposed continuation of the on-the-day approach."[17]

We there recommend that the Commerce Commission proceed with the development of a transition to a trailing average cost of debt, with further technical consultations in due course to further refine the final methodology.

If you have any questions about ENA's submission please contact Gemma Pascall, Regulatory Manager ( ).

Yours sincerely

Gemma Pascall

Regulatory Manager

[17] ENA, Electricity-Networks-Aotearoa-ENA-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf, 19 July 2023, page 9

Appendix A: ENA Members

Electricity Networks Aotearoa makes this submission along with the support of its members, listed below:

- Alpine Energy
- Aurora Energy
- Buller Electricity
- Centralines
- Counties Energy
- Electra
- EA Networks
- Firstlight Network
- Horizon Networks
- Mainpower
- Marlborough Lines
- Nelson Electricity
- Network Tasman
- Network Waitaki
- Northpower
- Orion New Zealand
- Powerco
- PowerNet (which manages The Power Company, Electricity Invercargill, OtagoNet and Lakeland Network)
- Scanpower
- Top Energy
- The Lines Company
- Unison Networks
- Vector
- Waipa Networks
- WEL Networks
- Wellington Electricity
- Westpower