



MAJOR ELECTRICITY USERS' GROUP

7th July 2015

Keston Ruxton
Manager Market Assessment and Dairy, Regulation Branch
Commerce Commission
By email to keston.ruxton@comcom.govt.nz

Dear Keston

Black's simple discounting rule material

1. MEUG's submission¹ to the Commerce Commission "Comments on scope, timing and focus for the review of input methodologies" of 20th March 2015 mentioned in the appendix "Fischer Black's 'Simple Discounting Rule'". I should have given a reference for that approach. It can be found at Fischer Black, A Simple Discounting rule, Financial Management, Vol. 17 No. 2 (summer, 1988) pp. 7-11, http://www.jstor.org/stable/3665521?seq=1#page_scan_tab_contents.
2. MEUG's submission also noted Professor Myers has been a supporter of this approach. That article can be found at Stewart C. Myers, Fischer Black's Contributions to Corporate Finance, Financial Management, Vol. 25, No. 4 (Winter 1966) pp. 95-103, http://www.jstor.org/stable/3665592?seq=1#page_scan_tab_contents.
3. The article that alerted our experts to this approach as a possible solution to several problems with the cost of capital Input Methodologies was by Claudio F. Loderer, John B. Long, and Lokas Roth, Black's Simple Discounting Rule, August 2008, last revised in 2013, refer http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1135276.
4. A copy of the article by Loderer et al. is attached to this letter. Advisors to MEUG have replicated the worked example in appendix A of the article and we believe it can be applied as an alternative to or complement to the current approach of WACC using the Simplified Brennan-Lally Capital Asset Pricing Model. Our advisors can discuss replication of appendix A and application to regulated energy line services as needed.
5. The Commerce Commission's paper of 16th June 2015 in paragraph 286.1 acknowledged the suggestion of using Black's simple discounting rule as an alternative for cross-checking analysis as a complement to the CAPM.

¹ Document URL

http://www.meug.co.nz/system/files_force/MEUG%20to%20CC%2C%20Comments%20on%20scope%2C%20timing%20and%20focus%20for%20revei%20of%20IM%2C%2020-Mar-15.pdf?download=1

6. For their information MEUG has copied this letter to all other parties that submitted on the Commerce Commission's letter of 27th February 2015.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. Matthes', with a long horizontal stroke extending to the right.

Ralph Matthes
Executive Director