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27 October 2023

By email im.review@comcom.govt.nz

Cross-submission in response to Input Methodologies Review 2023: IM Review draft decision on the cost of debt wash-up of EDBs and GTBs

Dear Charlotte

Transpower welcomes the opportunity to cross-submit in response to the Commerce Commission's further consultation on its draft decisions relating to the cost of debt wash-up.

We welcome the expert report by Competition Economics Group (CEG)[1], submitted on behalf of the 'Big Six' EDBs. We consider that it addresses several concerns with the proposed adjustment.

We support CEG's assertion that *"[the majority] of the reason the current regime does not deliver compensation for a fixed nominal cost of debt is due to revaluation of the debt RAB using actual inflation."* Any deemed overcompensation[2] is driven by the inconsistency between the assumption that the cost of debt is fixed in nominal terms and the Commission's approach to index the entire RAB (including the debt-funded portion) for actual inflation.

As noted by CEG, *"the hybrid proposal does address this problem as does the Commission's "Blended CPI" method and, indeed, any method that used forecast inflation to roll forward the debt portion of the RAB."*[3] Resolving for any deemed over-/under-compensation via a

[1] Consumer Economists Group, 27Big-627-EDBs-CEG -Targetting-a-nominal-cost-of-debt-Submission-on-specific-matters-for-the-IM-Review-2023-Cost-of-debt-17-October-2023.pdf

[2] Or under compensation, in the case of lower than forecast inflation.

[3] Page 10 CEG report.

revenue adjustment seems counterintuitive when there are options available to resolve for it at source.

Additionally, we support CEG's view that the *"demonstration model's revenue wash-up will overestimate the value of the appropriate wash-up."*[4] A regulated supplier can, at best, only fix their expectation of their debt portfolio over a regulatory period at the start of a regulatory period. Any unexpected changes in the RAB (such as due to unexpectedly high inflation) will drive either a change in the entity's actual cost of debt and/or its leverage ratio. Section 4 of CEG's report[5] covers this in detail.

Finally, we agree with CEG with respect to the ramifications on suppliers who do not follow the Commission's assumed hedging strategy. As the Commission has stated *"[w]e recognise the efficient debt financing strategy of a supplier is to issue debt with staggered maturity dates to minimise the potentially significant refinancing risk associated with having to refinance a large portion of debt at any one particular time."*[6]

If you have any questions on our submission, please do not hesitate to contact me at

[redacted]

Kind regards,

Joel Cook

Head of Regulation

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[4] Page 15 CEG report.

[5] Page 14 CEG report.

[6] Commerce Commission, Part-4-IM-Review-2023-Draft-decision-Cost-of-capital-topic-paper-14-June-2023.pdf (comcom.govt.nz) para 3.26