COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

WELLINGTON
Level 9, 44 The Terrace
PO Box 2351, Wellington 6140
New Zealand
Tel: +64 4 924 3600

AUCKLAND
Level 12, 55 Shortland Street
PO Box 105-222, Auckland 1143
New Zealand
Tel: +64 4 924 3600

www.comcom.govt.nz

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Questions to which Dr Lally's report (published on 27 May 2020) responds

The questions we asked Dr Lally to provide advice on that he responded to in his report are set out below.[1]

Question 1

On the avoided cost of Crown financing:

(a) the submissions by Chorus and investors to use Chorus's actual credit rating rather than the benchmark credit rating

(b) instead of being concerned about the specific nature of Crown financing, should we assume the funding to all providers was at the benchmark cost of capital? Is this more consistent with the assumption that the discount rate for calculating the present value of losses is based on a benchmark provider?

(c) clarify whether it is appropriate to say that Chorus bears a residual risk in relation to investments funded with Crown financing (see Chorus p 44)

(Please note that Dr Lally's response to questions (a) and (c) are respectively contained in paragraphs 2.5 and 2.3 of his report discussing submissions and cross-submissions, rather than in the part of the report setting out the questions posed by the Commission.)

Question 2

In your original advice to the Commission (21 May 2019) you state "…the choice must be between a beta estimate of zero and that for the regulatory situation. Using a beta estimate of zero would be too low whilst using the same beta applied to the regulatory situation may be too high or too low. The latter is likely to produce a smaller estimation error and is

[1] Questions 1 and 2 are the precise questions asked. Questions 3 and 4 have been paraphrased as they arose from a series of discussions/conversations with Dr Lally.

therefore preferable”. Can you provide further reasoning as to why the range’s lower bound may be zero and upper bound may be the beta applied to the regulatory situation?

Question 3

The Commission was concerned that there would not be equivalence between a net cashflow and building block approach when the cost of capital changes across the pre-implementation period and requested further advice on equivalence between these two approaches under these conditions.

Question 4

Should the same risk-free rate be used for both the cost of debt and the cost of equity for compounding the losses forwards to 2021?