



11 April 2014

Keston Ruxton
Chief Adviser
Regulation Branch
Commerce Commission
WELLINGTON

By email: telco@comcom.govt.nz

Dear Keston,

Cross-submission: determining the cost of capital for the UCLL and UBA price reviews

We appreciate the opportunity to provide a cross-submission on the Commerce Commission's technical consultation paper "Determining the cost of capital for the UCLL and UBA price reviews", dated 7 March 2014. No part of our submission is confidential.

We had previously recommended the Commission sequence the reviews by undertaking the Part 2 Telecommunications Act review first, and then using this decision as a precedent for subsequent review of the cost of capital input methodologies (IMs).¹ Given the Commission is now aiming for completion of the Part 4 and Part 2 reviews in similar time frames, November and December respectively, we would note that submissions made under Part 2 are likely to have relevance to Part 4 and vice versa.

In this respect, we have the following comments on the submissions made in relation to the consultation paper to determine the cost of capital for UCLL and UBA price reviews.

Chorus and CEG propose a new approach to determining the cost of debt

Chorus and CEG raise "new material" that wasn't considered by the High Court in its Merit Appeal decision which suggest the cost of capital IMs should be revised and that they presently may set the regulated WACC too low. We agree with Chorus that "It is important that the Commission retains an open mind to the prospect of changing aspects of its cost of capital approach under the input methodologies where improvements can be identified, and where these are consistent with the recent High Court decisions."²

CEG, for example, has raised the prospect of a departure from setting the cost of debt allowance based on interest rates prevailing over a narrow window of one month at the beginning of the regulatory period. Instead, Chorus has proposed that the cost of debt allowance reflect interest rates (or, potentially, just risk premiums) over a historical period consistent with the period an infrastructure business could be assumed to have efficiently raised its debt. Chorus has cited regulatory precedent from Australia, the UK and the US

¹ Page 3, Transpower, Determining the cost of capital for the UCLL and UBA price reviews, 28 March 2014.

² Paragraph 86, Chorus, Submission in response to the Commerce Commission's Process and issues paper for determining a TSLRIC price for Chorus' unbundled copper loop service in accordance with the Final Pricing Principle, 14 February 2014.

energy sector in support of this approach – international precedent which has changed since the Commission developed the IMs. Chorus has cited support from both service providers and customers for this approach.

In the two weeks allowed for cross-submissions we have not had time to fully consider the merits of CEG’s proposals nor the potential implications for any future amendment to the IMs. However, these are matters that should be considered as part of the review of the IMs. This should not prevent the Commission considering the application of such an approach to Chorus in the meantime.

Further consideration warranted of the distinctions between sectors

In our submission we observed that “Adopting a consistent approach to generic regulatory matters, such as the determination of WACC across the different services and regulatory regimes is conducive to a stable and predictable regulatory environment” and “the Commission should favour consistency unless there are good reasons to differ. Those reasons may be substantive, for example the economics or competitive dynamics of the sector may differ, or procedural, for example while the policy objectives of the governing legislation overlap they are not identical.”³

Several submissions to this consultation, notably Telecom (and a report it commissioned from PricewaterhouseCoopers) and Callplus, comment on relevance of Part 4 precedent to Part 2 services including the circumstances where, and reasons why, different approaches may be appropriate. We note, for example, comments by PricewaterhouseCoopers at paragraphs 32-34 in relation to the relative merits of adopting a 75th percentile estimate of WACC for services regulated under the cost of capital IMs with the UCLL and UBA services.

We do not have a well-developed view at this point of the circumstances where, and reasons why, different approaches between these sectors may be appropriate. However, we do consider that this is a theme that will continue to develop as the FPP and cost of capital IM percentile review processes progress and is something the Commission should turn its mind to.

Please let me know if you would like clarify or discuss any of the points made in this submission.

Yours sincerely



Jeremy Cain
Chief Regulatory Advisor

³ Page 1, Transpower, Determining the cost of capital for the UCLL and UBA price reviews, 28 March 2014.