

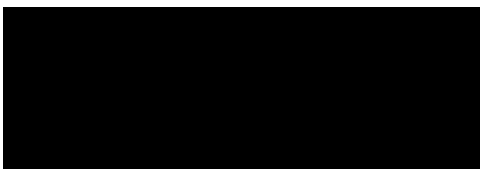
Cost of capital determination for disclosure year 2025 for information disclosure regulation

For First Gas' gas pipeline businesses and Powerco's gas distribution business

[2024] NZCC 24

The Commission: Vhari McWha
 Bryan Chapple
 Dr Derek Johnston
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Date of decision: 31 October 2024



Vhari McWha, Commissioner

Dated at Wellington this 31st day of October 2024

COMMERCE COMMISSION

Wellington, New Zealand

Associated documents

| Publication date | Reference | Title |
|------------------|------------------------|--|
| 1 August 2024 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2025 for information disclosure regulation – For Transpower, gas distribution businesses and suppliers of specified airport services (with a June year-end) [2024] NZCC 15 |
| 27 June 2024 | ISBN 978-1-869457-90-7 | Guidelines for WACC determinations under the cost of capital input methodologies - Regulation under Part 4 of the Commerce Act 1986 and Part 6 of the Telecommunications Act 2021 (Pre-IM review version) |
| 13 December 2023 | ISBN 978-1-991085-69-6 | Cost of capital topic paper, Part 4 Input Methodologies Review 2023 – Final decision |
| 31 October 2023 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2024 for information disclosure regulation – For First Gas’ gas pipeline businesses and Powerco’s gas distribution business [2023] NZCC 28 |
| 1 August 2023 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2024 for information disclosure regulation - For Transpower, gas distribution businesses and suppliers of specified airport services (with a June year-end) [2023] NZCC 20 |
| 1 November 2022 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2023 for information disclosure regulation – First Gas and Powerco gas pipeline businesses [2022] NZCC 34 |
| 2 August 2022 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2023 for information disclosure regulation – For Transpower, gas pipeline businesses and suppliers of specified airport services (with a June year-end) [2022] NZCC 28 |
| 1 November 2021 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2022 for information disclosure regulation – First Gas and Powerco gas pipeline businesses [2021] NZCC 20 |
| 2 August 2021 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2023 for information disclosure regulation – For Transpower, gas pipeline businesses and suppliers of specified airport services (with a June year-end) [2021] NZCC 10 |

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| 30 October 2020 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2021 – First Gas and Powerco gas pipeline businesses [2020] NZCC 22 |
| 31 July 2020 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2021 – For Transpower, gas pipeline businesses and suppliers of specified airport services (with a June year-end) [2020] NZCC 15 |
| 31 October 2019 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2020 – First Gas and Powerco gas pipeline businesses [2019] NZCC 14 |
| 31 July 2019 | ISSN 1178-2560 | Cost of capital determination for disclosure year 2020 for Transpower, gas pipeline businesses and suppliers of specified airport services (with a June year-end) [2019] NZCC 8 |

Commerce Commission
Wellington, New Zealand

WACC estimates for disclosure year 2025 for First Gas’ gas distribution business and gas transmission business and Powerco’s gas distribution business

1. This cost of capital determination has been made under the Cost of Capital Input Methodologies (IMs).^{1,2}
2. This determination specifies the weighted average cost of capital (WACC) estimates that will apply for disclosure year 2025 for First Gas Limited’s (First Gas) gas distribution business (GDB) and gas transmission business (GTB) and Powerco Limited’s (Powerco) GDB for information disclosure (ID) regulation.³
3. The timing of our WACC determinations for ID regulation differs depending on the disclosure year of the regulated companies. Vector and GasNet’s GDBs have disclosure years of 1 July to 30 June with disclosure year 2025 being the year ending 30 June 2025. First Gas and Powerco’s GPBs have disclosure years of 1 October to 30 September, with disclosure year 2025 being the year ending 30 September 2025. We determine an ID WACC for Vector and GasNet’s GDBs in July due to their different disclosure years.
4. Vanilla and post-tax WACC estimates for disclosure year 2025 for First Gas and Powerco’s GPBs are summarised in Table 1.

Table 1: Summary of vanilla and post-tax WACC estimates for First Gas and Powerco’s GPBs

| | Vanilla WACC | Post-tax WACC |
|-----------------------------|--------------|---------------|
| Mid-point | 7.00% | 6.35% |
| 25 th percentile | 6.29% | 5.64% |
| 67 th percentile | 7.46% | 6.81% |
| 75 th percentile | 7.71% | 7.06% |

5. Further detail regarding the parameter values used to generate these WACC estimates is contained in the paragraphs below. The WACC estimates have been calculated as at 1 October 2024, which is the first day of disclosure year 2025.
6. This determination should be read together with our guidelines for WACC determinations under the cost of capital input methodologies.⁴ These guidelines

¹ Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27 (as amended). An unofficial consolidated version incorporating amendments to the determination is [available on the Commission’s website](#).

² Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28 (as amended). An unofficial consolidated version incorporating amendments to the determination is [available on the Commission’s website](#).

³ Unless appears otherwise from the context, we have used the phrase “gas pipeline business” (GPB) in this determination to refer to First Gas’ GDB and GTB and Powerco’s GDB.

⁴ Commerce Commission, [Guidelines for WACC determinations under the cost of capital input methodologies \(pre-IM review version\)](#) (27 June 2024).

form part of this determination. The guidelines explain our methodology for calculating WACC estimates, including:

- 6.1 the formulas used (including for different WACC percentiles);
 - 6.2 the values for WACC parameters which are fixed under the IMs; and
 - 6.3 our methodology for determining the risk-free rate and average debt premium.
7. The Part 4 IMs Review 2023 resulted in changes to some fixed WACC parameters, including leverage, asset beta and equity beta. For GPBs, these new parameters will apply for ID regulation from the commencement of disclosure year 2026.^{5,6}

⁵ Commerce Commission, [Gas Distribution Services Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 37.

⁶ Commerce Commission, [Gas Transmission Services Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 36.

Further details regarding the WACC estimates

WACC parameter values for First Gas and Powerco's GPBs

8. The parameter values used to generate the mid-point WACC estimates for disclosure year 2025 for First Gas and Powerco's GPBs are summarised in Table 2 below.⁷

Table 2: Values used to calculate WACC estimates for First Gas and Powerco's GPBs*

| Parameter | Estimate |
|--|--------------|
| Risk-free rate | 3.99% |
| Average debt premium | 1.31% |
| Leverage | 42% |
| Asset beta | 0.40 |
| Equity beta | 0.69 |
| Tax adjusted market risk premium | 7.5% |
| Average corporate tax rate | 28% |
| Average investor tax rate | 28% |
| Debt issuance costs | 0.25% |
| Cost of debt | 5.55% |
| Cost of equity | 8.05% |
| Standard error of midpoint WACC estimate | 0.0105 |
| Mid-point vanilla WACC | 7.00% |
| Mid-point post-tax WACC | 6.35% |

*The numbers are rounded to two decimal points, except tax adjusted market risk premium and standard error of the mid-point WACC estimate.

Risk-free rate

9. The risk-free rate reflects the estimated bid yield to maturity on New Zealand government bonds with a term to maturity equal to the length of the regulatory period.
10. Our estimate of the four-year risk-free rate is based on data reported by Bloomberg for the three-month period ending 30 September 2024 in respect of the May 2028 and April 2029 maturity bonds.
11. The daily data reported by Bloomberg is linearly interpolated, annualised (to reflect the six-monthly payment of interest) and averaged to produce the estimate of a

⁷ All parameter values except the estimate of the risk-free rate and the average debt premium are set in the IMs.

3.99% interest rate on New Zealand government bonds with a four-year term to maturity, as estimated at 1 October 2024.⁸

Average debt premium

12. The average debt premium for GPBs of 1.31% is the average of the debt premium values for the current debt premium reference year (DPRY) and the four previous DPRYs, as shown in Table 3 below.
13. The DPRY for First Gas and Powerco's GPBs starts on 1 March and ends on 28 February.⁹ DPRY 2025 is the current DPRY for First Gas and Powerco's GPBs as it contains the start of disclosure year 2025 (1 October 2024). The IMs state that the calculation of the debt premium for a DPRY is estimated for each business day in the 12 months preceding the start of the DPRY.

Table 3: Average debt premium for First Gas and Powerco's GPBs (%)

| | DPRY 2021 | DPRY 2022 | DPRY 2023 | DPRY 2024 | DPRY 2025 | Average |
|-----------------|--------------|--------------|--------------|--------------|--------------|---------|
| Debt premium | 1.45 | 1.35 | 1.10 | 1.45 | 1.20 | 1.31 |

14. The debt premium values are taken from the following sources:
 - 14.1 The debt premium value for the 2021 DPRY was estimated in the ID WACC determination published on 31 July 2020 for Transpower, GDBs and airports.¹⁰
 - 14.2 The debt premium value for the 2022 DPRY was estimated in the ID WACC determination published on 2 August 2021 for Transpower, GDBs and airports.¹¹

⁸ We interpolate between the two closest bonds surrounding a four-year remaining term. This requires taking the yields of the bonds with a remaining term immediately before and after the four years term to maturity on that day. The target term to maturity is constant but the bonds' remaining terms to maturity decrease over time so the bonds immediately before and after the target term may change over time.

⁹ For example, DPRY 2025 for First Gas and Powerco's GPBs is 1 March 2024 to 28 February 2025.

¹⁰ Commerce Commission, [Cost of capital determination for disclosure year 2021 for information disclosure regulation. For Transpower, gas pipeline businesses and suppliers of specified airport services \(with a June year-end\)](#) [2020] NZCC 15.

¹¹ Commerce Commission, [Cost of capital determination for disclosure year 2022 for information disclosure regulation. For Transpower, gas pipeline businesses and suppliers of specified airport services \(with a June year-end\)](#) [2021] NZCC 10.

- 14.3 The debt premium value for the 2023 DPRY was estimated in the WACC determination for the third price-quality path for the gas pipeline businesses published on 1 April 2022.¹²
- 14.4 The debt premium value for the 2024 DPRY was estimated in the ID WACC determination published on 1 August 2023 for Transpower, GDBs and airports.¹³
- 14.5 The debt premium value for the 2025 DPRY was estimated in the ID WACC determination published on 1 August 2024 for Transpower, GDBs and airports.¹⁴

WACC range and 67th percentile estimate for First Gas and Powerco's GPB

15. In addition to the mid-point estimate, we are also required to determine a WACC range and 67th percentile estimate for each GPB. These estimates are outlined in Table 1.
16. The WACC range means the values falling between the 25th percentile and 75th percentile, inclusive of the mid-point estimate of WACC. The methodology for estimating different WACC percentiles is set out in clause 2.4.5 of the Gas Distribution Services IMs and the Gas Transmission Services IMs.^{15,16}

¹² Commerce Commission, [Cost of capital determination for gas pipeline businesses' 2022-2026/2022-2027 default price-quality path](#) [2022] NZCC 10. In this determination we had two sets of WACC estimates – one reflecting a five-year period and the other reflecting a four-year period. We did this because we had not yet produced our final decision on the term of the regulatory period for the GPB default price path (DPP).

¹³ Commerce Commission, [Cost of capital determination for disclosure year 2024 for information disclosure regulation. For Transpower, gas pipeline businesses and suppliers of specified airport services \(with a June year-end\)](#) [2023] NZCC 20.

¹⁴ Commerce Commission, [Cost of capital determination for disclosure year 2025 for information disclosure regulation. For Transpower, gas pipeline businesses and suppliers of specified airport services \(with a June year-end\)](#) [2024] NZCC 15.

¹⁵ Gas Distribution Services Input Methodologies Determination 2012 [2012] NZCC 27 (as amended). An unofficial consolidated version incorporating amendments to the determination is [available on the Commission's website](#). The same methodology applies to both vanilla and post-tax WACC estimates. The mid-point estimate of WACC is treated as the 50th percentile. The required estimates are set out in Table 1.

¹⁶ Gas Transmission Services Input Methodologies Determination 2012 [2012] NZCC 28 (as amended). An unofficial consolidated version incorporating amendments to the determination is [available on the Commission's website](#). The same methodology applies to both vanilla and post-tax WACC estimates. The mid-point estimate of WACC is treated as the 50th percentile. The required estimates are set out in Table 1.

Changes in the risk-free rate and debt premium over time

17. The cost of capital input methodologies for regulated services (including for Transpower, GDBs and airports) reflect that both the risk-free rate and the debt premium on bonds change over time. Figure 1 shows, as at 1 October 2024, changes over time in:

- 17.1 The four-year risk-free rate;
- 17.2 The five-year risk-free rate;
- 17.3 The estimated debt premium on bonds rated BBB+ with a remaining term to maturity of five years.

Figure 1: Changes in the risk-free rates and estimated debt premiums over time

