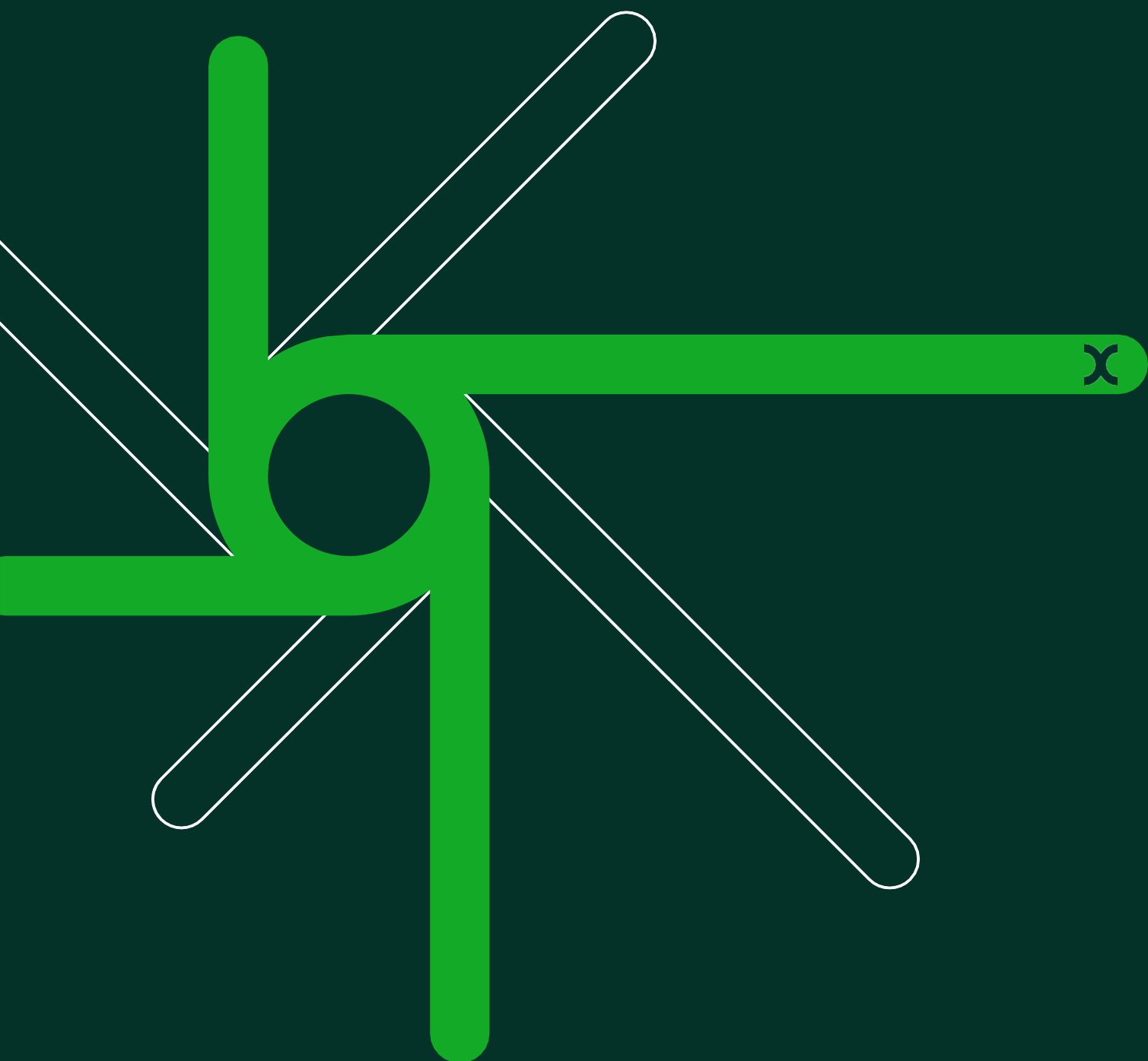


Prepared for Vector Limited

15 September 2023



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# 1 Introduction

Vector Limited (Vector) has recently requested, and subsequently received, from the New Zealand Commerce Commission (NZCC) the information relating to the financeability assessments that the Commission undertook for the latest electricity default price-quality path reset (DPP3). Vector has asked Oxera to review the received information, and comment on whether we consider the NZCC's analysis to be sufficient in its assessment of the financeability of electricity distribution businesses (EDBs) under the NZCC's DPP (default price-quality path).

In particular, we have reviewed the following documents:

- a letter from James Mulrennan to Part 4 Division, dated 21 October 2019, with the subject 'Other inputs to the financial model and cashflow analysis' (the NZCC letter);
- a Microsoft Excel file, titled 'Electricity Distribution Businesses Price Quality Regulation 1 April 2020 Reset Financial model. Draft Determination. Published 29 May 2019 v1';
- a Microsoft Excel file, without a title, containing information about historical cashflow analysis (the NZCC Excel model).

The rest of the note is structured as follows.

- In section 2, we provide the context of the issue.
- In section 3, we describe the NZCC's financeability analysis as outlined in the NZCC letter.
- In section 4, we assess whether we consider the NZCC's analysis to be comprehensive.
- In section 5, we conclude.

## 2 Context for the NZCC's financeability analysis

In the 2023 Input Methodologies (IMs) review responses, as well as in earlier submissions, EDBs have raised concerns about cashflow pressures over the regulatory period.<sup>1</sup> In particular, EDBs have

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<sup>1</sup> For example, see Vector (2023), 'Consultation on Input Methodologies Regulatory Draft Decision', 19 July.

highlighted that the nature of the RAB-WACC regime set by the NZCC significantly backloads regulatory cashflows, i.e. companies receive more cashflows towards the end of the regulatory periods than towards the beginning. The backloading arises, in part, because the cost of debt that the benchmark company is assumed to incur is fixed in nominal terms, while the cost of debt allowance is effectively provided in real terms (which is lower than nominal as long as inflation is positive) and inflation compensation is provided via regulatory asset base (RAB) indexation (i.e. at a later period).<sup>2</sup>

The backloading of cashflows does not, in and of itself, reduce value to investors, i.e. it can maintain long-term net present value (NPV) neutrality relative to a frontloaded cashflow series. However, it is more likely to create short-term concerns over companies' abilities to finance their operations sustainably compared with regimes with frontloaded cashflows.

The impact of the cashflow pressures is particularly significant during times of high CAPEX, such as the investment phase that is currently planned by EDBs, to meet the demands for electrification, as part of delivering New Zealand's net zero objectives. This is because companies have to incur CAPEX before they can recover it from regulated revenues via depreciation allowances. To alleviate cashflow timing concerns and ensure that the industry is ready to meet its goals, EDBs have encouraged the NZCC to include financeability tests as a part of the IMs review.<sup>3</sup> We note also that the NZCC considered a potential reprofiling of cashflows by removing inflation indexation of the RAB (combined with a nominal WACC allowance) as part of this IMs review process, but decided against introducing such a change to the regulatory process for EDBs.<sup>4</sup>

In the NZCC letter on the financeability assessment in DPP3 that we have reviewed, the NZCC has accepted that conducting cashflow analysis could be useful to assess EDBs' ability to invest in the near- to medium- term.<sup>5</sup> However, to date, the NZCC has not explicitly incorporated a financeability framework and testing within the IMs

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<sup>2</sup> See additional discussion on cashflow backloading in Oxera (2023), 'Response to the New Zealand Commerce Commission's draft decision for Part 4 Input Methodologies Review 2023 on the cost of capital (cross-submissions stage)', 8 August, section 2.2.1.

<sup>3</sup> Vector (2023), 'Consultation on Input Methodologies Regulatory Draft Decision', 19 July.

<sup>4</sup> New Zealand Commerce Commission (2023), 'Financing and incentivising efficient expenditure during the energy transition topic paper. Part 4 Input Methodologies Review 2023 - Draft decision', 14 June, paras 3.4 and 3.7.

<sup>5</sup> New Zealand Commerce Commission (2019), 'Other inputs to the financial model and cashflow analysis', 21 October.

review process. Instead, it explains that it can consider financeability where it deems it to be necessary, and encourage companies to apply for a customised price-quality path (CPP).<sup>6</sup>

The lack of an explicit financeability framework appears to be underpinned by an a priori expectation that the NZCC holds—that as long as network investors can expect normal returns, this should be sufficient to secure financing of the business.<sup>7</sup> The NZCC has stated, for example: ‘We expect that the ex-ante expectation of normal returns enables sufficient financing of the business. [...] we expect that an ex-ante expectation of a real return is sufficient to garner finance [...]’.<sup>8</sup>

Hence, the NZCC appears to undertake its cashflow analysis while maintaining the implicit prior assumption that the regime provides sufficient allowances for all companies to remain financeable, and any deviation is a result of management choices. This is inconsistent with an understanding of the need and purpose for financeability analysis, as expressed by other regulators.<sup>9</sup> For example, the UK energy regulator, Ofgem, explains the purpose of financeability assessment below.

We use a financeability assessment to ensure that, when all the individual components of our determination are taken together (including TOTEX, allowed return, notional gearing, depreciation, and capitalisation), a notional efficient operator is able to generate cash flows sufficient to meet its financing needs. [Emphasis added]<sup>10</sup>

Financeability analysis and cashflow considerations are important for assessing the real-world conditions faced by companies. Moody’s, for example, considers cashflow timing under a regulatory regime as part of its credit rating assessment. It considers that deferral of allowed revenue (i.e. slow recoupment of CAPEX, through regulatory cashflow

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<sup>6</sup> New Zealand Commerce Commission (2023), ‘Financing and incentivising efficient expenditure during the energy transition topic paper. Part 4 Input Methodologies Review 2023 – Draft decision’, 14 June, paras X14 and X39.

<sup>7</sup> New Zealand Commerce Commission (2020), ‘Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision’, Reasons paper, 27 November, paras D63 and D64.

<sup>8</sup> New Zealand Commerce Commission (2020), ‘Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision’, Reasons paper, 27 November, paras D63 and D64.

<sup>9</sup> This prior belief, that a sufficient level of allowed returns should produce a price control package that is financeable, is also manifest in how the NZCC refers to remedies when it identifies a cashflow concern for a network operator. Specifically, in its letter, the NZCC implies that the remedial options available to those companies which have not applied for a CPP, and face potential financeability concerns, are for ‘investors to meet the costs’, or ‘to reduce capex’. See New Zealand Commerce Commission (2019), ‘Other inputs to the financial model and cashflow analysis’, 21 October, para. 24.

<sup>10</sup> Ofgem (2022), ‘RIIO-ED2 Final Determinations Finance Annex’, 30 November, para. 5.3.

backloading) places negative pressure on companies' creditworthiness.<sup>11</sup>

### 3 Description of the NZCC's financeability analysis

In the 2023 IMs review draft decision, the NZCC defines financeability as the 'ability of a business to raise and repay debt and raise equity in financial markets, readily and on reasonable terms'.<sup>12</sup> As part of setting the DPP3, the NZCC has conducted financeability analysis by augmenting the DPP financial model.

As key metrics for its analysis, the NZCC assesses **free cashflows** and a **ratio of free cashflows to maximum allowable revenue (MAR)** for each company over the regulatory period, both on the basis of the notional and actual leverage. In its financial model, the NZCC defines free cashflow as: funds from operations (FFO) minus interest and CAPEX. This means that the NZCC assesses free cashflows at the level available to equity holders.<sup>13</sup>

While the NZCC does not specify a threshold above which it would consider the company to be financeable, the NZCC implicitly tests for whether the cashflows are negative, by highlighting the number of firms with cashflows falling below zero. At the same time, the NZCC argues that having the overall negative free cashflow within a period is not inconsistent with its objectives, and may be expected when there is significant CAPEX growth. The NZCC also explains that companies' cashflows depend on company-specific factors such as CAPEX programmes, accrued incentives payments amounts and the leverage ratios adopted by companies on an actual basis.

As an additional check, the NZCC estimates EDBs' **interest cover ratios**, defined in the NZCC Excel model as:  $(\text{FFO} + \text{tax payable for the deferred tax approach} - \text{CAPEX}) / \text{interest}$ . Specifically, it tests whether interest cover ratios are above or below 1.0. In the NZCC letter, the NZCC indicates that an interest cover below 1.0 may signify that the company

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<sup>11</sup> Moody's (2022), 'Rating Methodology: Regulated Electric and Gas Networks', 13 April, p. 10.

<sup>12</sup> New Zealand Commerce Commission (2023), 'Financing and incentivising efficient expenditure during the energy transition topic paper. Part 4 Input Methodologies Review 2023 - Draft decision', 14 June, para. 2.19.

<sup>13</sup> The NZCC defines FFO as maximum allowable revenue before tax in revenue-date terms for applicable X factor + total incentive amounts - operating expenditure - tax payable for the deferred tax approach.

would not be able to service its debt obligations over the medium term. In other words, an interest cover ratio below 1.0 implies that the company may not have enough cash to meet its operating cash outflow requirements without having to raise additional capital.

Finally, the NZCC conducts ‘**scenario testing**’ where it assesses the impact that WACC allowance assumptions, CAPEX forecasts, CPI and actual cost of debt have on the ratio of free cashflows to MAR. The findings are as follows.

- A higher WACC allowance leads to higher notional free cashflows.
- CAPEX forecasts have a significant impact on notional free cashflows. The NZCC highlights that this effect is particularly strong for companies that forecast CAPEX programmes that are higher than allowed under the DPP. The NZCC suggests that these companies should apply for CPP or other reopeners.
- The outturn CPI being lower than the forecast leads to lower notional free cashflows, and vice versa—when outturn inflation is higher than the forecast, cashflows increase.<sup>14</sup>
- The actual cost of debt directly affects the estimated free cashflows, in that the higher the cost of debt, the lower the cashflows.

These observations help the NZCC to understand the impact of specific parameters on EDBs’ cashflows, and may be useful in informing the potential regulatory tools that can be used to alleviate cashflow pressure(s). As noted above, the importance of checking the cashflow implications of the price control package, with reference to financeability, is recognised by regulators internationally. For example, the Utility Regulator in Northern Ireland highlights that regulatory cashflows are a key determinant of the creditworthiness of the business that is in the hands of the regulator rather than the companies’ management.<sup>15</sup>

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<sup>14</sup> This effect is related to one of the two debt compensation issues highlighted by the EDBs. This particular effect may be in part offset by the recently proposed adjustment to the cost of debt indexation wash-up mechanism.

<sup>15</sup> Utility Regulator (2017), ‘Northern Ireland Electricity Networks Ltd Transmission & Distribution 6th Price Control (RP6)’, 30 June, para. 12.59.

## 4 Assessment of the NZCC's analysis

In this section, we consider whether the NZCC's assessment is comprehensive and could be used to determine whether EDBs would be able to 'raise and repay debt and raise equity in financial markets, readily and on reasonable terms', as defined by the NZCC.<sup>16</sup>

In section 4.1, we explain our concerns in relation to the NZCC's approach. We then outline an approach that the NZCC could follow to undertake a more comprehensive assessment in section 4.2.

### 4.1 Concerns about the current approach adopted by the NZCC

Having reviewed the NZCC's financeability assessment, we have noted the following concerns.

- The test for negative free cashflows is not well-specified.
- The 1.0 threshold for the interest cover ratio is too low.
- The NZCC does not model how cash requirements affect leverage in a dynamic way, which is key for financeability assessments.
- The NZCC does not assess the effectiveness of (any potential) remedies in a quantitative way.
- The NZCC undertakes the analysis only at the stage of DDP3 Draft Determinations, and does not check whether its findings hold under the Final Determinations.

We discuss these in turn below.

#### The test for negative free cashflows is not well-specified

Negative free cashflows (to equity holders, as used by the NZCC), or the negative ratio of free cashflows to MAR, indicate that no cash made available by regulated revenue would be left to equity holders after meeting operating, capital and financing expenditure. This can be seen as a negative and extreme outcome, especially if it persists over time.

These free cashflow metrics are highlighted by the NZCC in the context of financeability assessment. The conclusions that are to be drawn from this analysis are unclear. The ambiguity of the thresholds/conclusions is

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<sup>16</sup> New Zealand Commerce Commission (2023), 'Financing and incentivising efficient expenditure during the energy transition topic paper. Part 4 Input Methodologies Review 2023 - Draft decision', 14 June, para. 2.19.



implicit when the NZCC states that the outcome of negative free cashflows is not necessarily an ‘inappropriate outcome’.<sup>17</sup>

Therefore, an assessment of the company’s *ability* to raise debt is required in addition to the NZCC’s analysis of the level of free cashflows.

### **The 1.0 threshold for the interest cover ratio is too low**

The requirement for the interest cover ratio to be above 1.0 tests companies’ ability to service their debt obligations. However, the threshold implicitly applied as part of this test is too low.

The interest cover ratio of 1.0 shows that the company has just enough funds to service its debt. However, at this level, the company has no capacity to raise new debt (as more debt would lead to higher interest expenses and would bring the ratio to a level below 1.0) or profits to finance its growth or absorb shocks.

Indeed, under Moody’s credit rating methodology, the FFO interest coverage ratio (defined similarly to the ratio used by the NZCC) of below 1.0 is rated Caa.<sup>18</sup> The Caa rating corresponds to ‘speculative of poor standing’ and ‘very high credit risk’.<sup>19</sup> Even allowing for some differences in the definitions of ratios, the 1.0 threshold is too low to assess that a utility network is financeable.

### **The NZCC does not model how cash requirements affect leverage in a dynamic way, which is key for financeability assessments**

When undertaking its modelling, the NZCC assumes EDBs’ leverage to be constant (for both the actual and notional capital structure types of modelling). This approach of using a constant level of leverage has limitations when applied to the assessment of cashflows, and the ability of EDBs to keep their leverage levels under control.

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<sup>17</sup> New Zealand Commerce Commission (2019), ‘Other inputs to the financial model and cashflow analysis’, 21 October, para. 19.

<sup>18</sup> Moody’s (2022), ‘Rating Methodology: Regulated Electric and Gas Networks’, 13 April, p. 8. See p. 14 for the definition of the FFO interest coverage ratio. In particular, the numerator of the ratio is FFO plus interest expense, and the denominator is interest expense. However, our interpretation is that the interest expense is added to the FFO only to the extent FFO was estimated net of interest expense. Given that the NZCC does not subtract interest expense to estimate its FFO and the numerator of the interest cover ratio (see section 3 for the definition), we consider the NZCC’s and Moody’s ratios to be broadly comparable.

<sup>19</sup> Moody’s, ‘Ratings Definitions’, <https://ratings.moody.com/rating-definitions> (accessed 5 September 2023).

A dynamic approach to modelling changes in leverage would indicate whether the DPP allowances are sufficient to finance the activities without companies having to increase their debt portfolios in a disproportionate and uncontrollable way. The importance of gearing modelling is related to the fact that external financing requirements are linked to the current level of debt via interest expense. The higher the debt amount, the higher the interest expense; and the higher the interest expense, the greater the need for additional financing. It may be undesirable from a treasury management perspective for a company to (routinely) need new debt to service its existing debt portfolio.

Moreover, the level of gearing has implications for the ratios and free cashflows that the NZCC already tests.

Therefore, we consider it important to model debt requirements, and hence gearing, in a dynamic way when testing for financeability. This is further supported by the UK regulatory precedent—both energy regulator, Ofgem, and water regulator, Ofwat, undertake annual modelling of debt financing requirements.<sup>20</sup>

### **The NZCC does not assess the effectiveness of (any required) remedies in a quantitative way**

In its letter, the NZCC implies that the remedial options available to those companies which have not applied for a CPP, and face potential financeability concerns, are for ‘investors to meet the costs’, or ‘to reduce capex’.<sup>21</sup> However, the NZCC does not specify the details of the mechanisms it envisages, or indeed, where relevant, consider how it would quantify the impact of the remedies, i.e. whether the EDBs would pass the financeability test once these remedies are applied.

Also, it is not a priori evident that a reduction in CAPEX requirements would be consistent with other regulatory and policy objectives—such as maintaining sufficient investment levels for network reliability, or for delivering network growth in line with New Zealand’s net zero policy objectives.

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<sup>20</sup> For example, see Ofwat’s financial models at Ofwat, ‘Final determinations models’, <https://www.ofwat.gov.uk/final-determinations-models/> (accessed 6 September 2023); and Ofgem (2019), ‘Financeability Assessment for RIIO-2: Further Information’, 26 March, p. 5, [https://www.ofgem.gov.uk/sites/default/files/docs/2019/03/financeability\\_assessment\\_for\\_riio2\\_further\\_information\\_20190326.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2019/03/financeability_assessment_for_riio2_further_information_20190326.pdf) (accessed 1 September 2023).

<sup>21</sup> New Zealand Commerce Commission (2019), ‘Other inputs to the financial model and cashflow analysis’, 21 October, para. 24.

We consider that a quantitative assessment of the impact of any specific proposed remedial actions—when the need for such actions is identified—is almost as important as the primary financeability analysis. This is because the NZCC needs to ensure that any remedies it suggests are effective and proportionate with reference to the quantitative evidence.

### **The NZCC undertakes the analysis only at the stage of DDP3 Draft Determinations, and does not check whether its findings hold under the Final Determinations**

Finally, the NZCC has shared only the assessment conducted at the Draft Determination stage. It would be reasonable to expect the NZCC to update its analysis at the stage when the DPP3 Final Determination has been set, to test that the final arrangements allow for EDBs to be financeable. However, we have not seen evidence of such analysis being undertaken. Instead, the Final Determination from April 2020 explains that the NZCC has a prior expectation that the control would be financeable, without undertaking tests for this directly. For example, as observed in Section 2, the NZCC notes:

**We expect that the ex-ante expectation of normal returns enables sufficient financing of the business. [...] we expect that an ex-ante expectation of a real return is sufficient to garner finance [...].<sup>22</sup>**

#### **4.2 Alternative financeability assessment framework**

In calibrating its approach to financeability testing, the NZCC could more explicitly follow the framework(s) applied by credit rating agencies (CRAs). CRAs routinely assess companies' financial health, while their ratings reflect the terms on which companies may be able to raise debt financing—both within the scope of NZCC's definition of financeability. For example, Ofgem follows CRAs' methodologies for its financeability analysis.<sup>23</sup> Similarly, the UK Civil Aviation Authority uses a combination of CRAs' rating thresholds in its analysis, as well as qualitative factors that are likely to affect credit quality, when determining price controls for Heathrow Airport and NATS.<sup>24</sup>

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<sup>22</sup> New Zealand Commerce Commission (2020), 'Default price-quality paths for electricity distribution businesses from 1 April 2020 - Final decision', Reasons paper, 27 November, paras D63 and D64.

<sup>23</sup> Ofgem (2022), 'RIIO-ED2 Final Determinations Finance Annex', 30 November, para. 5.25.

<sup>24</sup> Civil Aviation Authority (2023), 'Economic regulation of Heathrow Airport Limited: H7 Final Decision. Section 3: Financial issues and implementation', March, para. 13.13; and Civil Aviation Authority (2023), 'Economic regulation of NATS (En Route) plc: Provisional Decision for the next price control review ("NR23")', July, para. 6.57.

The following steps would be required to move towards a methodology that is closer to CRAs and other regulators.

1 Define the target credit rating that the NZCC requires/intends companies to achieve.

The target rating would be the level at which companies are able to raise debt financing on reasonable terms. Targeting an investment-grade credit rating would be sensible to ensure the financial resilience of utility networks. Moreover, the lower the rating, the more expensive the EDBs' debt would be, which may eventually need to be passed on to customers as allowed debt costs. In any case, given the importance of power networks as strategic infrastructure (providing an essential service), it would be consistent with good regulatory practice to seek to minimise risks of default for network operators and to target a strong credit rating.

The use of BBB+/Baa1-rated bonds in setting the debt premium makes the BBB+/Baa1 rating threshold a natural level for the target credit rating. This is also consistent with the UK regulatory practice—Ofgem and Ofwat both target the BBB+/Baa1 credit rating.<sup>25</sup>

2 Define the relevant metrics that will be measured and, where appropriate, the thresholds that will apply to indicate whether or not the financeability test is passed.

For example, the Moody's rating methodology for regulated energy networks accounts for the following ratios:<sup>26</sup>

- Adjusted Interest Coverage Ratio (AICR) or FFO interest coverage;
- net debt/RAB or net debt/fixed assets (leverage);
- FFO/net debt;
- retained cashflow (RCF)/net debt.

<sup>25</sup> Ofgem (2022), 'RIIO-ED2 Draft Determinations - Finance Annex', 29 June, para. 5.6; Ofwat (2022), 'Creating tomorrow, together: Our final methodology for PR24. Appendix 11 Allowed return on capital', December, p. 73.

<sup>26</sup> Moody's (2022), 'Rating methodology: Regulated electric and gas networks', 13 April, p. 3, [https://www.moodys.com/research/doc--PBC\\_1322720?docid=PBC\\_1322720](https://www.moodys.com/research/doc--PBC_1322720?docid=PBC_1322720) (accessed 1 September 2023).

In addition to the ratios mentioned above, Ofgem asked companies to assess the following in their businessplans:<sup>27</sup>

- nominal Post-Maintenance Interest Coverage Ratio (PMICR);
- EBITDA to Regulatory asset value;
- Return on Regulatory Equity (RORE);
- dividend cover;
- dividend to regulated equity.

Notably, the list includes equity metrics such as RORE, dividend cover and dividend to regulated equity. These are informative for the assessment of equity financeability, which is within the NZCC's definition of financeability.

Ofgem exercised judgement in putting different weight on each of these metrics when drawing conclusions. In particular, in RIIO-2, Ofgem replicated Moody's methodology and made conclusions based on simulated credit ratings.<sup>28</sup>

To assess whether the metrics indicate a sound financial position, or whether there are financeability concerns, the NZCC would also need to have some benchmarks or thresholds, against which to assess the reasonableness of the estimated metrics. These thresholds could be informed by those used by the CRAs in undertaking their analysis of utilities' credit ratings.

### 3 If financeability concern is identified, propose a remedy.

If the assessment shows potential concern with companies' financeability, the NZCC should propose remedial actions. While actions such as the company's application for a CPP or reducing its CAPEX programme, as proposed in the NZCC letter, may be effective in certain cases, there are alternatives that the NZCC could consider. The key remedial instruments to consider are the use of equity instruments and regulatory mechanisms.

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<sup>27</sup> Ofgem (2019), 'Financeability Assessment for RIIO-2: Further Information.' 26 March, p. 6, [https://www.ofgem.gov.uk/sites/default/files/docs/2019/03/financeability\\_assessment\\_for\\_riio2\\_further\\_information\\_20190326.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2019/03/financeability_assessment_for_riio2_further_information_20190326.pdf) (accessed 1 September 2023).

<sup>28</sup> For example, see Ofgem (2020), 'Final Determinations – ETL license model', 8 December, downloadable within the 'Final Determinations: Technical Annex part one', <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator> (accessed 1 September 2023).

- Equity instruments, such as reducing dividends or injecting new equity capital, support credit ratios. However, the consequences of cutting dividends (e.g. on EDBs' ability to raise new equity), and how plausible it is to raise equity within the given market conditions or if there are repeated calls for equity injections, could be considered.
- As for the regulatory mechanisms, the NZCC has a wide range of options to support companies' cashflow positions if there is a need, from removing RAB inflation indexation (combined with a nominal WACC allowance) and other means of accelerating regulated cashflows, to increasing the WACC allowance.

As discussed above, the effectiveness of any remedy would then need to be established.

## 5 Conclusions

The free cashflow analysis conducted by the NZCC is a useful first step, in recognising the importance of financeability for ensuring the long-run health of the EDBs, and their ability to sustainably finance the ambitious CAPEX programmes that are required to deliver New Zealand's net zero objectives. However, the NZCC's analysis remains limited in nature, and does not present a comprehensive assessment of the financeability of the regulatory regime. There are several key issues with the analysis as listed below.

- The test for negative free cashflows is not well-specified. Negative free cashflows to equity holders can be seen as a negative and extreme outcome, especially if this persists over time. Also, an assessment of the company's *ability* to raise debt is required in addition to the NZCC's analysis of the level of free cashflows.
- The interest cover metric threshold of 1.0 corresponds to Moody's Caa credit rating, and therefore is too low for a meaningful assessment of whether EDBs are able to raise debt financing on reasonable terms.
- The NZCC does not test for dynamic changes in the leverage level within the regulatory period, which is an important indicator of the company's ability to have control over its leverage level. Moreover, an upward leverage trend may increase the pressure on other credit metrics.
- The NZCC does not assess the effectiveness of (any required) remedies in a quantitative way.

- The NZCC undertakes the analysis only at the stage of DDP3 Draft Determinations and does not check whether its findings hold under the Final Determinations.

The following steps could be taken by the NZCC in its financeability assessments to make its approach more robust.

- 1 First, define the target credit rating that the NZCC requires/intends companies to achieve.
- 2 Second, define the relevant metrics that will be measured and, where appropriate, the thresholds that will apply to indicate whether or not the financeability test is passed.
- 3 Finally, should a problem be identified, propose financeability remedies, and then test whether they are effective in remediating the modelled cashflow shortfall by running the same financeability analysis, but with the remedy applied.



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