

# **Amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025 – 2028): update to the tax-adjusted market risk premium**

**Final decision - reasons paper**

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## Associated documents

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12 March 2024	ISBN 978-1-991085-80-1	<a href="#">Draft Fibre Input Methodologies (tax adjusted market risk premium) Amendment Determination 2024</a>
12 March 2024	ISBN 978-1-991085-83-2	<a href="#">Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025-2028): update to the tax adjusted market risk premium – Draft decision: reasons paper</a>
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Commerce Commission  
Wellington, New Zealand

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## Glossary

Acronyms	Definition
<b>the Act</b>	Telecommunications Act 2001
<b>BBM</b>	Building Blocks Model
<b>FCM</b>	Financial Capital Maintenance
<b>Fibre IMs</b>	Fibre Input Methodologies Determination 2020 [2020] NZCC 21
<b>FFLAS</b>	Fibre Fixed Line Access Services
<b>ID</b>	Information disclosure
<b>IMs</b>	Input Methodologies
<b>LFC</b>	Local fibre company
<b>MRP</b>	Market Risk Premium
<b>PQ</b>	Price-quality
<b>PQP1</b>	Chorus' first price-quality path (from 1 January 2022 to 31 December 2024)
<b>PQP2</b>	Chorus' second price-quality path (from 1 January 2025 to 31 December 2028)
<b>SBL-CAPM</b>	Simplified Brennan Lally-Capital Asset Pricing Model
<b>TAMRP</b>	Tax-adjusted market risk premium
<b>UFB</b>	Ultra-fast broadband
<b>WACC</b>	Weighted average cost of capital

# Chapter 1 Introduction

## Purpose of this paper

- 1.1 This paper provides our final decision on and supporting reasons for amending the tax-adjusted market risk premium (“TAMRP”) in the *Fibre Input Methodologies Determination 2020* [2020] NZCC 21 (“Fibre IMs”).
- 1.2 This decision is made ahead of our determination of the price-quality (“PQ”) path for Chorus Limited’s (“Chorus”) second regulatory period between 2025-2028 and to calculate the information disclosure (“ID”) weighted average cost of capital (“WACC”) for all Local Fibre Companies (“LFCs”). The amendments to the Fibre IMs to implement our final decision come into force on 28 May 2024 and apply as follows:
  - 1.2.1 for the purpose of determining an ID WACC estimate for disclosure year 2026, the change to clause 2.4.2(7) of the Fibre IMs will apply from 3 March 2025; and
  - 1.2.2 for the purpose of determining the WACC for Chorus’s PQP2, the change to clause 3.5.2(7) of the Fibre IMs will apply from the same date as the date of this final decision on the amendment (28 May 2024).

## Structure of this paper

- 1.3 This paper forms part of a package of decision papers on price-quality matters and amendments to the Fibre IMs ahead of setting the PQ path for Chorus’ second regulatory period, including:
  - 1.3.1 IM amendment determination – to give effect to the amendment discussed in this paper, we have published an IM amendment determination;<sup>1</sup> and
  - 1.3.2 expenditure-related PQ decisions and determinations, as well as quality and revenue-related PQ decisions and determinations.<sup>2</sup>
- 1.4 The paper’s chapters are as follows:

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<sup>1</sup> Commerce Commission, ‘Amendments to the fibre input methodologies for the 2025-2028 fibre price-quality path’, <https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-fibre/projects/amendments-to-the-fibre-input-methodologies-for-the-2025-2028-fibre-price-quality-path>

<sup>2</sup> Commerce Commission, *Chorus’ 2025-2028 Fibre price-quality path*, <https://comcom.govt.nz/regulated-industries/fibre/projects/chorus-fibre-price-quality-path-from-2025>

- 1.4.1 Chapter 1 is an introduction to the scope and approach for this work and the amendment to the Fibre IMs to update the TAMRP in the WACC calculation, and background on the Market Risk Premium and recent update to the TAMRP in the Part 4 IM Review;
- 1.4.2 Chapter 2 summarises the statutory context and key aspects of the decision-making framework we have applied in arriving at the specific Fibre IM amendment set out in this paper;<sup>3</sup> and
- 1.4.3 Chapter 3 sets out the amendment to the Fibre IMs, and our reasons for the amendment in terms of the framework summarised in Chapter 2.

## Our role

- 1.5 The Commerce Commission (“Commission”) regulates services provided over fibre networks in New Zealand. These networks are critical to social and economic life in New Zealand.
- 1.6 Since 1 January 2022, PQ and ID regulation has applied to providers of fibre fixed line access services (“FFLAS”) that are regulated under Part 6 of the Telecommunications Act 2001 (“Act”):
  - 1.6.1 PQ regulation applies to certain fibre services provided by Chorus;<sup>4</sup> and
  - 1.6.2 ID regulation applies to all providers of fibre services regulated under Part 6: Chorus, Enable Networks, Northpower Fibre and Tuatahi First Fibre.<sup>5</sup>

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<sup>3</sup> Our decision-making framework is set out in full at paras B7 to B25 of Attachment B of our [Fibre price-quality regulation proposed process and approach for the 2025-2028 regulatory period](#) and substantially reflects the framework we applied for our most recent fibre IM amendments, [Amendments to Fibre Input Methodologies: final decision \(28 June 2023\)](#).

<sup>4</sup> Regulation 6 of the Telecommunications (Regulated Service Providers) Regulations 2019 (“the Regulations”) provides that Chorus is subject to PQ regulation in respect of all fibre fixed line access services, except to the extent that a service is provided in a geographical area where a regulated fibre service provider (other than Chorus Limited) has installed a fibre network as part of the UFB initiative, available at: <https://legislation.govt.nz/regulation/public/2019/0275/latest/LMS185122.html>.

<sup>5</sup> Regulation 5 of the Regulations, available at: <https://legislation.govt.nz/regulation/public/2019/0275/latest/LMS185122.html>.

- 1.7 PQ paths are intended to create incentives for Chorus to act in ways that are consistent with the long-term benefit of end-users, such as creating incentives to invest in its network, to innovate and improve efficiency, and to deliver services at a level that meet end-user demands.<sup>6</sup> The Commission sets PQ paths to limit the total revenue that Chorus can recover from providing regulated fibre services, and regulate the quality at which those services are provided.
- 1.8 We also require providers of FFLAS in New Zealand to disclose information detailing their performance. This includes data on pricing, current and future expenditure, quality performance and financial statements.
- 1.9 This regime for fibre services works alongside our work to ensure fixed line (broadband) and mobile markets are competitive through regulation of wholesale telecommunication services and our monitoring of how the retail telecommunications market.

## **Our process**

- 1.10 We are currently in the process of setting Chorus' second PQ path that will run from 1 January 2025 to 31 December 2028 ("PQP2").
- 1.11 Alongside our consideration of the PQ path for Chorus, we have been assessing discrete potential Fibre IM amendments in three tranches:
- 1.11.1 tranche 1a: relates to the TAMRP for the WACC;
  - 1.11.2 tranche 1b: relates to expenditure proposals; and
  - 1.11.3 tranche 2: relates to revenue and quality proposals.
- 1.12 Our consideration of potential Fibre IM amendments are aligned to our decision-making framework, which states we should consider those potential amendments that are:
- 1.12.1 necessary to make now in advance of the second PQ path for Chorus; and
  - 1.12.2 address discrete issues that are appropriate to resolve now, rather than waiting for the statutory IM review (scheduled for 2027).

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<sup>6</sup> See section 162 of the Telecommunications Act ('the Act') for the purpose of Part 6, available at: <https://www.legislation.govt.nz/act/public/2001/0103/latest/LMS131919.html>

- 1.13 To date, we have followed the proposed approach and timeline as set out in the notice of intention that the Commission published on 18 January 2024 stating that we would begin work to consider an amendment to the TAMRP in the Fibre IMs.<sup>7</sup>
- 1.14 On 12 March, we published our draft decision on a proposed amendment to input methodologies for updating the TAMRP, and invited submissions from stakeholders.<sup>8</sup>
- 1.15 We received one submission on our draft decision to update the TAMRP in the Fibre IMs by the due date of 10 April 2024.<sup>9</sup>
- 1.16 We received no cross submissions on updating the TAMRP in the Fibre IMs by the due date of 2 May 2024.

## Background for amendment to TAMRP in Fibre IMs

- 1.17 The Market Risk Premium (“MRP”) represents the additional return, over and above the risk-free rate that investors look for to compensate them for the risk of holding a portfolio of average risk (more precisely the market portfolio which is the average risk portfolio).<sup>10</sup>

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<sup>7</sup> Commerce Commission, 'Notice of Intention: Potential amendment to Input Methodologies for Fibre Fixed Line Access Services', 18 January 2024, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0021/340743/Notice-of-Intention-Fibre-IM-Amendments-18-Jan-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0021/340743/Notice-of-Intention-Fibre-IM-Amendments-18-Jan-2024.pdf); 'Re-issued Notice of intention: Potential amendment to Input Methodologies for Fibre Fixed Line Access Services' <https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-fibre/projects/amendments-to-the-fibre-input-methodologies-for-the-2025-2028-fibre-price-quality-path?target=documents&root=347828> 'Notice of intention: Potential amendment to Input Methodologies for Fibre Fixed Line Access Services', 2 May 2024, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/351290/Fibre-input-methodologies-Notice-of-Intention-2-May-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/351290/Fibre-input-methodologies-Notice-of-Intention-2-May-2024.pdf)

<sup>8</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>9</sup> Chorus “Submission on proposed amendment to fibre input methodologies (TAMRP)” (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf).

<sup>10</sup> Commerce Commission, “Fibre input methodologies: Main final decisions – reasons paper” (October 2020), at [6.35], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf)



- 1.18 Under the Simplified Brennan Lally-Capital Asset Pricing Model, the MRP is adjusted for tax faced by the investor on equity returns. The standard version of the Capital Asset Pricing Model (CAPM) assumes that all sources of investment income are equally taxed at the personal level. This is not a good description of the New Zealand tax regime, because both capital gains and dividends are less onerous taxed than interest. Consequently, the tax-adjusted MRP (TAMRP) is used in estimating the cost of capital to recognise the favourable tax treatment of equity returns.<sup>11</sup>
- 1.19 TAMRP is one of the parameters in the Cost of Capital Fibre IMs that is used when we determine the WACC for regulated FFLAS. The TAMRP is the additional expected financial return over and above the risk-free rate to compensate investors for investing in the market as a whole. The current TAMRP in the Fibre IMs is 7.5%.<sup>12</sup>
- 1.20 WACC estimates are used in conjunction with regulatory asset values to determine the return on capital for each regulated provider that is subject to PQ path regulation. The return on capital is one component of the building blocks allowable revenue for each regulated provider. The TAMRP is one of the parameters in the WACC calculation.<sup>13</sup>

### Recent update to the TAMRP

- 1.21 The Commission's final decision on the Part 4 IM Review published on 13 December 2023, was to use a TAMRP of 7.0% for businesses regulated under Part 4 of the Commerce Act.<sup>14</sup> We published our analysis and consulted on that decision as part of the process.

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<sup>11</sup> Commerce Commission, "Fibre input methodologies: Main final decisions – reasons paper" (October 2020), at [6.36], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf)

<sup>12</sup> *Fibre Input Methodologies Determination 2020*, as amended on 28 June 2023, Part 2 and Part 3; Commerce Commission, "Fibre input methodologies: Main final decisions – reasons paper" (October 2020), at [6.408.4], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf)

<sup>13</sup> Commerce Commission "Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper" (12 March 2024) [3.12], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>14</sup> Commerce Commission, 'Cost of capital topic paper: Part 4 Input Methodologies Review 2023 - Final Decision', 13 December 2023, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/337612/Part-4-IM-Review-2023-Final-decision-Cost-of-capital-topic-paper-13-December-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/337612/Part-4-IM-Review-2023-Final-decision-Cost-of-capital-topic-paper-13-December-2023.pdf)

- 1.22 The Commission received submissions on the TAMRP from Chorus (and Incenta on behalf of Chorus) in response to the Part 4 IM Review.<sup>15</sup>
- 1.23 We also considered determining TAMRP estimates for both four-and five-year regulatory periods. We found that the TAMRP estimate does not vary between these two potential terms, concluding that a single rate for TAMRP is appropriate for all regulatory periods.<sup>16</sup>

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<sup>15</sup> Chorus (and Incenta, on behalf of Chorus) submitted on the Part 4 input methodologies review, *see* Chorus, 'Submission on Part 4 input methodologies review' 11 July 2022: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0036/287991/Chorus-Submission-on-IM-Review-Process-and-Issues-paper-and-draft-Framework-paper-11-July-2022.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0036/287991/Chorus-Submission-on-IM-Review-Process-and-Issues-paper-and-draft-Framework-paper-11-July-2022.pdf); Chorus, 'Submission on Part 4 input methodologies review – draft decisions', 19 July 2023: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0012/323112/Chorus-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0012/323112/Chorus-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf); Incenta Economic Consulting (on behalf of Chorus), 'Measures to improve the stability in WACC estimates', July 2022, [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0042/287988/Chorus-Measures-to-improve-the-stability-in-WACC-estimates-11-July-2022.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0042/287988/Chorus-Measures-to-improve-the-stability-in-WACC-estimates-11-July-2022.pdf); Chorus, 'Cross-submission on Part 4 input methodologies review – draft decisions', 9 August 2023: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0016/326104/Chorus-Cross-submission-on-IM-Review-2023-Draft-Decisions-9-August-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0016/326104/Chorus-Cross-submission-on-IM-Review-2023-Draft-Decisions-9-August-2023.pdf)

<sup>16</sup> Commerce Commission, 'Cost of capital topic paper: Part 4 Input Methodologies Review 2023 - Final Decision' (13 December 2023), at [4.358], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0024/318624/Part-4-IM-Review-2023-Draft-decision-Cost-of-capital-topic-paper-14-June-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0024/318624/Part-4-IM-Review-2023-Draft-decision-Cost-of-capital-topic-paper-14-June-2023.pdf)

## Chapter 2 Regulatory framework

### Purpose and structure

- 2.1 This chapter summarises the statutory context and key aspects of our decision-making framework for considering amendments to the Fibre IMs, covering:<sup>17</sup>
  - 2.1.1 the background for the decision-making framework;
  - 2.1.2 the statutory context and powers to amend the Fibre IMs; and
  - 2.1.3 the decision-making framework we have applied in making Fibre IM amendments.

### Background

- 2.2 Before the end of the current regulatory period, the Commission must make a determination under section 170 of the Act specifying how PQ regulation applies to Chorus during the following regulatory period.
- 2.3 A relevant input methodology relating to the supply of FFLAS must be applied by each relevant regulated fibre service provider in accordance with the relevant section 170 determination.<sup>18</sup>
- 2.4 Additionally, a relevant IM must be applied by the Commission in recommending, deciding or determining how regulation under Part 6 of the Act should apply to FFLAS, or the prices or quality standards applying to FFLAS.<sup>19</sup>
- 2.5 The Commission is currently setting the PQ path this year for the second regulatory period for Chorus.
- 2.6 We included the decision-making framework for the Fibre IMs in our *Proposed process and approach for the 2025-2028 regulatory period* paper.<sup>20</sup> We considered it may be necessary for us to consider amendments to the Fibre IMs as part of our process to set Chorus' PQ path for PQP2.

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<sup>17</sup> Our decision-making framework is set out in full at paras B7 to B25 of Attachment B of our [Fibre price-quality regulation proposed process and approach for the 2025-2028 regulatory period](#) and substantially reflects the framework we applied for our most recent fibre IM amendments, [Amendments to Fibre Input Methodologies: final decision \(28 June 2023\)](#).

<sup>18</sup> Section 175 of the Act, available at: <https://www.legislation.govt.nz/act/public/2001/0103/latest/LMS131919.html>.

<sup>19</sup> Section 175 of the Act, available at: <https://www.legislation.govt.nz/act/public/2001/0103/latest/LMS131919.html>.

<sup>20</sup> Commerce Commission, "*Fibre Price-Quality Process and Approach Paper for the 2025 – 2028 regulatory period*", 31 August 2023, [https://comcom.govt.nz/data/assets/pdf\\_file/0017/327014/Fibre-price-quality-regulation-Process-and-approach-paper-for-the-2025-2028-regulatory-period.pdf](https://comcom.govt.nz/data/assets/pdf_file/0017/327014/Fibre-price-quality-regulation-Process-and-approach-paper-for-the-2025-2028-regulatory-period.pdf)

- 2.7 The next section describes the (limited) circumstances in which we consider IM amendments, and the framework we apply to such amendments.

## Summary of regulatory framework

### *Statutory context*

- 2.8 The purpose of the input methodologies under section 174 of the Act is to promote certainty for regulated fibre service providers, access seekers and end-users in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of FFLAS under Part 6 of the Act.<sup>21</sup>
- 2.9 We are cautious about making amendments to the Fibre IMs outside of the Fibre statutory IM review process given the importance of certainty and predictability in the regime. However, as recognised in sections 181 and 182, these rules, processes and requirements may change. We must follow the process under section 179 – including publishing a notice of intention with our proposed time frames.<sup>22</sup>
- 2.10 We recognise that there may be a tension between making changes to improve the regime and promoting the purpose of sections 162 (the Part 6 purpose) and 166 and promoting certainty under section 174.
- 2.11 While we have regard to the section 174 purpose, and other indications of the importance of promoting certainty, ultimately, under section 166(2), we must make recommendations, determinations and decisions that we consider best give, or is likely to best give effect to:
- 2.11.1 the Part 6 purpose in section 162 of the Act,<sup>23</sup> as set out in section 166(2)(a); and
  - 2.11.2 to the extent that we (or the Minister) consider it relevant, the promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services, as set out in section 166(2)(b).

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<sup>21</sup> See section 174 of the Act, available at: <https://www.legislation.govt.nz/act/public/2001/0103/latest/LMS131919.html>

<sup>22</sup> [Notice of Intention – 18 January 2024 - Potential amendment to input methodologies for Fibre Fixed Line Access Services.](#)

<sup>23</sup> Section 162 provides that the purpose of Part 6 of the Act is to promote the long-term benefit of end-users in markets for FFLAS by promoting outcomes that are consistent with outcomes produced in workably competitive markets so that regulated fibre service providers:

- (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and
- (b) have incentives to improve efficiency and supply FFLAS of a quality that reflects end-user demands; and
- (c) allow end-users to share benefits of efficiency gains in the supply of FFLAS, including through lower prices; and
- (d) are limited in their ability to extract excessive profits.

- 2.12 Section 166(2) governs our decision-making process for all recommendations, determinations and decisions under Part 6 of the Act. The other purpose statements within Part 6 are relevant matters, but they should be applied consistently with section 166(2).<sup>24</sup>

*Amendments outside the IM review cycle*

- 2.13 All Fibre IMs must be reviewed at least once every seven years, as mandated by section 182.
- 2.14 Given the certainty purpose of the Fibre IMs and the scheme set out in the Act to promote this purpose, we must carefully assess what amendments are appropriate to consider outside the Fibre IM Review cycle. Additionally, the predictability that the Fibre IMs provide are key to promoting the section 162 purpose (as required under section 166(2)(a)) and, in particular, incentives to invest.
- 2.15 It will not generally be appropriate to consider changes to ‘fundamental IMs’ outside of the periodic Fibre IM Review cycle, which takes place every seven years. Fundamental IMs are generally those that define the fundamental building blocks used to set PQ paths under section 176(1)(a) and that are central to defining the balance of risk and benefits between regulated providers and end-users.
- 2.16 This distinction is not absolute. We can, and have, reconsidered fundamental IMs outside of the IM review. However, there needs to be an especially compelling and urgent rationale for doing so.

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<sup>24</sup> We note that the High Court in *Wellington International Airport Ltd & Ors v Commerce Commission* considered that the purpose of IMs, set out in section 52R of the Commerce Act, is “conceptually subordinate to the purpose of Part 4 as set out in section 52A. See *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289, at [165].

## Chapter 3 Amendment to TAMRP in Fibre IMs

### Purpose and structure

- 3.1 This chapter sets out:
- 3.1.1 our final decision on and supporting reasons for amending the TAMRP in the Fibre IMs from 7.5% to 7.0% for the purposes of estimating the WACC for PQ regulation and ID regulation; and
  - 3.1.2 the commencement and application dates for the above IM amendments, including our reasons for these dates.

### Amendment of TAMRP in Fibre IMs

#### Final decision

- 3.2 Our final decision is to update the economy-wide parameter, the TAMRP, in the Fibre IMs from 7.5% to 7.0% to align with the most up-to-date information from the final decision on the TAMRP estimate in the Part 4 Input Methodologies Review Cost of capital topic paper in December 2023.<sup>16</sup>
- 3.3 This final decision maintains our draft decision and the reasons for our draft decision. These are set out below.
- 3.4 When setting the Fibre IMs in 2020, we considered that the most relevant outcomes of the section 162 purpose for the Cost of Capital IMs were section 162(a) and (d). In reaching our decisions on the Cost of Capital IMs in 2020, our regulatory challenge was to determine the cost of capital for the supply of regulated FFLAS consistent with the cost of capital that would be faced by firms in workably competitive markets ie, neither too high, nor too low, such that we best give, or are likely to best give, effect to the outcomes in section 162(a)-(d).<sup>25</sup>
- 3.5 Section 162(a) and (d) promote the long-term benefit of end-users in markets for FFLAS by promoting outcomes consistent with outcomes produced in workably competitive markets so that regulated fibre service providers:<sup>26</sup>

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<sup>25</sup> Commerce Commission, “Fibre input methodologies: Main final decisions – reasons paper” (October 2020), at [6.46]; [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf)

<sup>26</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.13], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

- 3.5.1 section 162(a): have incentives to innovate and to invest, including in replacement, upgraded, and new assets;
- 3.5.2 section 162(d): are limited in their ability to extract excessive profits.
- 3.6 The most recent evidence supported a lower estimate of TAMRP than was set out in the Fibre IMs.<sup>27</sup> We sought to align with the most up-to-date information from the final decision on the TAMRP estimate in the Part 4 IM Review Cost of capital topic paper in December 2023.<sup>28</sup>
- 3.7 We noted that, the TAMRP is neither a regulated provider-specific parameter nor an industry-specific parameter, but rather it is common to all assets in the economy. Having regard to this, we increased the TAMRP for Gas Pipeline Businesses from 7.0% to 7.5% as part of the Gas Default Price-Quality Path, outside the statutory IM review process, to reflect the then most recent decision in 2020 Fibre IMs.<sup>29</sup>
- 3.8 We considered that updating the TAMRP to align with the most recent estimate will better promote the outcomes in section 162(a) and (d) primarily, because:<sup>30</sup>
- 3.8.1 the estimate of the TAMRP should result in a high enough expected rate of return to ensure that providers of regulated FFLAS have incentives to innovate and invest, but also a sufficiently reasonable rate to ensure the providers are limited in their ability to extract excessive profits; and

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<sup>27</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.21], [https://comcom.govt.nz/data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>28</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.3], [https://comcom.govt.nz/data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>29</sup> Commerce Commission, “Amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths weighted average cost of capital reasons paper” (25 March 2022), at [3.4] in Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.20], [https://comcom.govt.nz/data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>30</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.14], [https://comcom.govt.nz/data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

- 3.8.2 leaving the current TAMRP unchanged (at 7.5%) will provide the regulated providers of regulated FFLAS with a higher than reasonable expected return which may lead those providers to earn excessive profits.
- 3.9 We considered that updating the TAMRP to align with the most recent estimate will likely best give effect to the promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services under section 166(2)(b). The best estimate of the cost of capital, including the TAMRP, provides an expectation of a return which can attract investment necessary to compete for both the regulated providers and their potential competitors, at least cost to end-users.<sup>31</sup>
- 3.10 The estimate of the cost of capital is also used to assess the profitability of regulated FFLAS for all LFCs, in line with the ID purpose under section 186 of the Act.<sup>32</sup> Therefore, updating the TAMRP estimate for the ID WACC to align with the most recent estimate:
- 3.10.1 will ensure that we have the best cost of capital estimate for the purpose of assessing profitability; and
- 3.10.2 reflects that the TAMRP is neither a regulated provider-specific parameter nor an industry-specific parameter, but rather it is common to all assets in the economy – so it is preferable to apply the same TAMRP for the ID WACC and the PQ WACC.
- 3.11 We considered the update to the TAMRP is urgent and compelling to justify an IM amendment outside of the statutory Fibre IM Review, for the reasons set out below.
- 3.12 As outlined under the “regulatory framework” chapter (chapter 2), we generally will not make changes to fundamental IMs outside of the statutory Fibre IM Review process given the importance of certainty and predictability in the regime under section 174 purpose of the IMs. However, we can and have

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<sup>31</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.15], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>32</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.16], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf); under section 186 of the Act, the purpose of information disclosure regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose (section 162) of Part 6 is being met.



reconsidered fundamental IMs in the past where there was an urgent and compelling rationale for doing so.<sup>33</sup>

- 3.13 We consider the amendment to the TAMRP in the Fibre IMs for PQ purposes is sufficiently urgent and compelling. This is for the reason that, if we maintained the status quo, we would expect that providers of regulated FFLAS would likely earn excessive profits from a WACC estimate that would be higher than our best estimate of the cost of capital. This would effectively undermine the promotion of section 162(d) of the Act – that is, limiting the ability to extract excessive profits for the long-term benefit of end-users.<sup>34</sup>
- 3.14 For providers of regulated FFLAS that are subject to ID regulation, the potential amendment is sufficiently urgent and compelling because it will ensure that our best estimate of the cost of capital is used for assessing profitability, in line with the section 186 purpose of ID regulation - to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 6 is being met.<sup>35</sup>
- 3.15 We therefore proposed to amend the Fibre IMs to decrease the TAMRP from 7.5% to 7.0% to promote the section 162 purpose under the Act more effectively than the current Fibre IMs, as we considered using the latest estimate of this parameter better promoted the outcomes in section 162(a) and (d).

## Stakeholder views

- 3.16 We received one submission from Chorus on our draft decision.<sup>36</sup>
- 3.17 Chorus submitted it did not support the proposed change to the TAMRP of 7.5% to 7.0% outside of the statutory Fibre IM Review cycle. Its reasons included:

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<sup>33</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.17], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>34</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.18], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>35</sup> Commerce Commission “Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus’ second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper” (12 March 2024) [3.19], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>36</sup> Chorus “Submission on proposed amendment to fibre input methodologies (TAMRP)” (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf)

- 3.17.1 changing the TAMRP now does not achieve the certainty required under section 174 of the Act and reduces predictability and certainty for investors, access seekers, and end-users;
- 3.17.2 it does not better promote section 162(d) and the TAMRP estimate will always vary from the 'true' value;
- 3.17.3 amending the TAMRP now could have a detrimental effect on investment incentives contrary to section 162(a) from the unexpected changes in settings; and
- 3.17.4 it sees no other urgent or compelling reason to update the TAMRP outside the statutory Part 6 statutory IM review.

## Analysis

- 3.18 We engage with Chorus's submission below and explain why we consider the reasons for our draft decision hold for the purposes of our final decision.
- 3.19 Chorus submitted that changing the TAMRP now outside of the statutory Part 6 Fibre IM Review does not achieve the certainty required under section 174 of the Act and reduces the predictability and certainty for investors, access seekers, and end-users.<sup>37</sup>
- 3.20 Chorus also submitted that it sees no other urgent or compelling reason to amend the TAMRP outside the Part 6 statutory IM review cycle.<sup>38</sup> It submitted that, given the uncertainty inherent in the estimate and the size of the error band implicit in the Commission's practice of rounding to 50bp, it is hard to see there is an urgent and compelling reason to amend the IMs at this time. Furthermore, it submitted, the proposed change is not aimed at fixing an error or addressing any unexpected issue that has been identified.
- 3.21 Our view on the above points Chorus raised is as follows:

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<sup>37</sup> Chorus "Submission on proposed amendment to fibre input methodologies (TAMRP)" (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf)

<sup>38</sup> Chorus "Submission on proposed amendment to fibre input methodologies (TAMRP)" (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf)

- 3.21.1 as outlined above, we generally will not make changes to fundamental IMs outside the periodic IM review process given the importance of certainty and predictability in the regime. However, we can and have reconsidered fundamental IMs in the past where there was an urgent and compelling rationale for doing so;
- 3.21.2 we consider the reasons outlined in the draft decision (relating to section 162(d) of the Act and ensuring the economy-wide WACC parameter is based on the most recent evidence for PQ and ID purposes) provides such urgent and compelling reasons. In particular, the statutory Fibre IM Review is scheduled for completion in 2027 and Chorus could earn excessive profits until such time as the TAMRP is updated. While we have regard to the section 174 purpose, ultimately, under section 166(2), we must make recommendations, determinations and decisions that we consider best give, or is likely to best give effect to the Part 6 purpose in section 162 of the Act and the extent that we consider it relevant, the promotion of workable competition as set out in section 166(2)(a); and
- 3.21.3 moreover, given there is precedent to update the TAMRP in 2022 for the gas sector as part of Gas DPP4 to reflect the then most recent update in Fibre IMs, we do not consider that this update is unexpected or that it materially reduces predictability and certainty for investors, access seekers, and end-users.<sup>39</sup>
- 3.22 Chorus submitted that, as the TAMRP will always vary from the ‘true value’, updating the TAMRP to 7.0% does not necessarily better promote section 162(d) in the long-term.<sup>40</sup> Chorus stated that, as the Commission believed the deviations were acceptable when we considered the update frequency issue and rounding issue, it is not urgent and compelling to amend the Fibre IMs at this time.<sup>41</sup>

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<sup>39</sup> Commission, ‘2022 Gas Default Price-Quality Path’, available at: <https://comcom.govt.nz/regulated-industries/gas-pipelines/gas-pipelines-price-quality-paths/gas-pipelines-default-price-quality-path/2022-2027-gas-default-price-quality-path>

<sup>40</sup> Chorus “Submission on proposed amendment to fibre input methodologies (TAMRP)” (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf)

<sup>41</sup> Chorus “Submission on proposed amendment to fibre input methodologies (TAMRP)” (10 April 2024), [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf).

- 3.23 Chorus also indicated that the draft decision could have a detrimental effect on investment incentives, contrary to section 162(a). It submitted that incentives for investment are formed with an understanding of regulatory settings at the time of the investment, as well as expectations of how the regulatory settings will evolve over the life of the investment. It submitted that unexpected changes to settings, such as out-of-life cycle IM change to TAMRP proposed without any explicit rules about when such changes should occur will be detrimental to investment incentives. Changing TAMRP for PQP2 is clearly contrary to expectations established at the time Fibre IMs originally determined.
- 3.24 In reaching decisions on the cost of capital, we aim to strike an appropriate balance between section 162(a) and section 162(d). If the WACC is too low, regulated providers will not have adequate incentives to innovate and to invest, including in replacement, upgraded, and new assets. Equally, if the WACC is too high, providers may extract excessive profits. If we did not adopt the most recent TAMRP, based on up-to-date data, regulated providers could extract excessive profits from the provision of regulated FFLAS through higher maximum revenues, undermining the long-term benefit of end-users. We explain above why this reasoning also supports an IM change outside the statutory IM review cycle.
- 3.25 We consider that amending the TAMRP from 7.5% to 7.0% will promote the Part 6 purpose more effectively than the current IMs, as using the latest estimate of this parameter better supports the provision of ex ante real FCM. We agree that there is judgement involved when estimating and rounding the TAMRP, however, the final decision of the TAMRP reflects our best current estimate.

### **Commencement and application dates**

- 3.26 The amendments to the Fibre IMs to implement our final decision come into force on 28 May 2024 and apply as follows:
- 3.26.1 for the purpose of determining an ID WACC estimate for disclosure year 2026, the change to clause 2.4.2(7) of the Fibre IMs will apply from 3 March 2025; and
- 3.26.2 for the purpose of determining the WACC for Chorus' PQP2, the change to clause 3.5.2(7) of the Fibre IMs will apply from the same date as the date of this final decision on the amendment (28 May 2024).

- 3.27 Our final decision maintains our position on the application dates in the draft decision.<sup>42</sup>
- 3.28 We also considered the alternative option in the draft decision of having the change to clause 2.4.2(7) apply immediately so that the most recent estimate of TAMRP is reflected in the ID determinations earlier.<sup>43</sup> However, we did not receive any submissions on this alternative option and decided not to progress this alternative option.

### Stakeholder views

- 3.29 Chorus also submitted on the proposed commencement and application dates.
- 3.30 It submitted that its current ID TAMRP of 7.5% should be made consistent with its PQ TAMRP from the 2025 disclosure year onwards.<sup>44</sup>
- 3.31 Chorus considered that maintaining the current TAMRP of 7.5% for both PQ and ID would better achieve comparability between PQ and ID.<sup>45</sup>
- 3.32 Chorus submitted that the Commission's proposal will result in the estimate of Chorus' PQ WACC for the 2025 regulatory year incorporating a lower TAMRP than that used to determine Chorus' ID WACC for its 2025 disclosure year. It expected that this inconsistency will make it more difficult for interested persons to compare Chorus' performance in providing PQ and ID-regulated services contrary to section 186 which is intended to ensure that sufficient information is available to interested persons under ID to assess whether the purpose of Part 6 is being met.<sup>46</sup>

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<sup>42</sup> Commerce Commission "Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper" (12 March 2024) [3.26], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>43</sup> Commerce Commission "Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025-2028): update to the tax-adjusted market risk premium: Draft decision – reasons paper" (12 March 2024) [3.28], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/346412/Fibre-input-methodologies-TAMRP-reasons-paper-draft-12-March-2024.pdf).

<sup>44</sup> Chorus "Submission on proposed amendment to fibre input methodologies (TAMRP)" (10 April 2024) [2b, 14], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf).

<sup>45</sup> Chorus "Submission on proposed amendment to fibre input methodologies (TAMRP)" (10 April 2024) [14], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf).

<sup>46</sup> Chorus "Submission on proposed amendment to fibre input methodologies (TAMRP)" (10 April 2024) [12, 13], [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/349935/Chorus-Submission-on-fibre-IM-amendment-TAMRP-10-April-2024.pdf).

**Analysis**

- 3.33 The application date of 3 March 2025 for the amendment to clause 2.4.2(7), in effect, means that the same TAMRP would be applied across all LFCs from disclosure year 2026.
- 3.34 If the change to clause 2.4.2(7) applied immediately, this would mean the most recent estimate of TAMRP – representative of the current market conditions – is reflected in the ID determination earlier. However, it would also mean that different TAMRP estimates would apply to different LFCs' ID WACC determinations for disclosure year 2025, which would undermine:
- 3.34.1 the scope for interested persons to understand and assess and compare LFCs' profitability for disclosure year 2025; and
  - 3.34.2 the section 186 purpose of ID regulation by impairing the scope for interested persons to assess whether the section 162 purpose of Part 6 is being met.
- 3.35 Our final decision is not to change our draft decision on the application dates as we consider using the same TAMRP across all LFCs from disclosure year 2026 will enable us to treat all companies the same and better enable comparison of their profitability, which would better promote the section 186 purpose of ID regulation.