



BARNZ
VOICE OF THE AIRLINE INDUSTRY

Submission

Fibre IMs Draft Decision - TAMRP

To Commerce
Commission

24 January 2020

Introduction

1. This is the response of the Board of Airline Representatives New Zealand (BARNZ) to the Commerce Commission's fibre input methodologies draft decision. We comment only on the draft decision as it relates to the tax adjusted market risk premium (TAMRP).
2. This submission is made on behalf of our 28 airline and 5 associate members as listed in the Appendix. Some members may make their own submissions.

TAMRP should be set at the estimated value, not rounded

3. We will leave to other submitters to comment on the detail of Dr Lally's analysis. This submission will focus on the practice of rounding the TAMRP estimate to the nearest 0.5%.
4. Assuming that Dr Lally's analysis and conclusions regarding the TAMRP remain unchanged following submissions and cross-submissions, we consider that the TAMRP for the fibre input methodologies should be set at 7.3%.
5. Having reviewed the issue in more detail, we consider the approach of rounding the TAMRP to the nearest 0.5% is flawed.
6. Dr Lally has advised the Commission in favour of rounding the TAMRP on the following grounds:

*"rounding saves regulators from the need (and hence the cost) to estimate the TAMRP to a very high degree of precision and this is desirable because high levels of precision in this area are spurious. For example, a claim that the TAMRP is 7.1% rather than 7.2% would be spurious precision. A consequence of rounding would be to discourage self-interested lobbying by regulated businesses or consumer groups over small variations in the TAMRP estimate. These advantages outweigh the disadvantage of a very small increase in the mean squared error."*¹

7. We do not find these points persuasive. In terms of 'spurious precision', the same point could be made for other WACC parameters. There is no principled reason we can see for rounding the TAMRP alone of all of the WACC parameters.
8. Input methodologies (for regulated fibre, energy and airport services alike) are usually reviewed on a 7-year cycle. It is expected that interested parties will make representations to the Commission in favour of changes (in either direction) to WACC parameters at each IM review, just like other important input methodologies. We do not understand why the TAMRP should be treated differently from the other key input methodology decisions and given a level of "protection" against change.
9. If the aim of rounding was to avoid changes to the TAMRP, then this has clearly failed – despite the rounding, the Commission is proposing to now apply a 7.5% TAMRP rather than the 7.0% applied previously. Thus regulated suppliers and their customers can expect

¹ Dr Martin Lally, *Review of further WACC issues*, 22 May 2016, page 66.

occasional future changes in the TAMRP, which erodes one of the supposed benefits of rounding the estimate.

10. The impact of rounding in this case has also been to exacerbate the impact of a change to the TAMRP. The TAMRP that is applied (here we are assuming that, as a market-wide metric, the new TAMRP may be applied to other regulated industries in time) will change from 7.0% to 7.5%, even though the change in the median estimate is only from 7.1% to 7.3%, relative to Lally's 2015 estimate.² To put it another way, the WACC estimate will have been changed by 0.3%, despite the median estimate only changing enough to justify a 0.12% change in the WACC. This creates a very material financial impact for regulated suppliers and their consumers based on an arbitrary rounding decision.
11. Ultimately, the choice is between:
 - a. The current approach where rounding is applied, meaning there are fewer changes to the TAMRP but those changes are larger when they occur; and
 - b. An alternative approach where rounding is not applied, meaning there will be more regular changes to the TAMRP but those changes will be smaller and have a lower impact on the resulting WACC estimate. It is also likely that the TAMRP estimate will be more accurate under this approach.
12. We consider that an approach that does not include rounding is clearly more desirable.

² Dr Martin Lally, *Review of submissions on the risk-free rate and the TAMRP for the UCLL and UBA services*, 13 October 2015, page 47.

Appendix: List of BARNZ Members

Airline Members	
Air Calin	Air Canada
Air Chathams	Air China
Air New Zealand	Air Tahiti Nui
Air Vanuatu	Airwork
American Airlines	Cathay Pacific Airways
China Airlines	China Eastern Airlines
China Southern Airlines	Emirates
Fiji Airways	Jetstar
Korean Air	LATAM Airlines
Malaysia Airlines	Philippine Airlines
Qantas Airways	Qatar Airways
Sichuan Airlines	Singapore Airlines
Tasman Cargo Airlines	Thai Airways International
United Airlines	Virgin Australia Airlines
Non-airline Members	
AirCenter One	Glidepath
Menzies Aviation (NZ)	OCS Group NZ
Swissport	