

Cross-submission on Part 4 input methodologies review – draft decisions

9 August 2023

C H ● R U S

Cross-submission

1. This is Chorus' cross-submission in respect of the draft decisions published by the Commerce Commission (**Commission**) on 14 June 2023 for its 7-yearly review of input methodologies (**IMs**) under Part 4 of the Commerce Act 1986 (**Part 4**).
2. We **recommend** the Commission revisits its proposal for applying new screening criteria to the asset beta comparator set to more thoroughly consider the material impacts on Part 4 regulation, and the potential impact on regulated fibre providers.
3. We confirm that this submission can be published on the Commission's website, and that no part of this submission contains confidential information.

Improving financing cost estimates

4. The asset beta is a key input into determining the weighted average cost of capital under the cost of capital IM for Part 4-regulated firms. The Commission has proposed applying four new screening criteria to exclude comparator firms from its reference set when estimating the asset beta for Part 4-regulated firms:¹
 - a. a new test for liquidity of firms;
 - b. beta estimate reliability;
 - c. market comparability; and
 - d. negative gearing.
5. A number of submissions raised concerns about whether the application of the screening criteria will improve the accuracy and/or stability of financing cost estimates under the cost of capital IM. We share some concerns, particularly as they relate to the possible application of the new approaches to estimating asset betas for fibre companies under Part 6 of the Telecommunications Act 2001.
6. Our key concerns are:
 - a. **The new criteria are not yet backed by economic theory** – we agree with the view of Incenta that many of the new criteria have “not been fully described or justified against financial economic principles”.² If applied to regulated fibre companies at the next 7-year fibre IM review, the proposed criteria could lead to a material change in the comparator sample set. Without economic justification or evidence, it is unclear that the asset beta estimates would in fact be more accurate or promote the purpose of regulation more effectively.
 - b. **Approach may result in unintended volatility for beta estimates** – a basic application of the Commission's criteria implies a reduction in the size of the comparator sample sizes used across multiple industries, including for regulated fibre companies. Reducing sample sizes could lead to additional volatility in beta estimates for two reasons: first, each firm within the sample will be given more weight in a smaller sample and therefore beta estimates will vary more with individual firms' circumstances; and secondly, with additional criteria it is likely that firms could enter and exit the sample at each IM review. This could result in additional volatility across pricing periods, contrary to promoting price stability.

¹ Commerce Commission, Draft decision Cost of capital topic paper, 14 June 2023 [at paras 4.31-4.48]; Incenta, Airport comparator sample selection, July 2023 [at para 1]. The Commission also proposes adjustments to asset betas to account for the COVID-19 period.

² Incenta, Airport comparator sample selection, July 2023 [at para 3]