

15 April 2026

Kirsty Bennett, Fibre Manager
Ben Woodham, Electricity Distribution Manager

By email to: infrastructure.regulation@comcom.govt.nz

Dear Kirsty and Ben,

Submission to the Commerce Commission (Commission) on the *IM Review cost of capital draft decision*

Electricity Networks Aotearoa (ENA) appreciates the opportunity to make a submission to the Commission on its consultation paper on the *IM Review cost of capital draft decision* as part of the Fibre Input Methodologies (IM) review process.

ENA is the industry membership body that represents the 28 electricity distribution businesses (EDBs) that take power from the national grid and deliver it to homes and businesses (our members are listed in Appendix A).

EDBs employ over 7,800 people, deliver energy to more than two million homes and businesses, and have spent or invested \$6.8 billion in network assets over the last five years. ENA harnesses members' collective expertise to promote safe, reliable, and affordable power for our members' customers.

1 Introduction

This submission focuses on:

- Process and engagement
- Weighted average cost of capital (WACC), including the cost of debt
- Tax-adjusted market risk premium (TAMRP).

ENA's submission should be read alongside:

- the expert report on WACC from NERA, on behalf of ENA, Chorus and Transpower (attached)
- the expert report from CEG, on behalf of the Big 6
- previous advice from Oxera on TAMRP (particularly [Big-Six-EDBs-Oxera-report-Review-of-the-NZ-Commissions-WACC-setting-methodology-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-3-February-2023.pdf](#) and [Big-6-EDBs-Oxera -Response-to-Commissions-draft-decision-for-IM-Review-2023-on-the-cost-of-capital-Submission-on-IM-Review-2023-19-July-2023.pdf](#)); and
- our previous recent submissions, including [ENA's August 2025 submission](#) and [the August 2025 joint stakeholder letter](#).

2 Process and engagement

ENA would like to acknowledge the Commission's approach to engagement throughout this review.

We appreciate the depth of analysis undertaken, and the transparency in making both the Commission's modelling and the supporting expert reports publicly available. This has enabled meaningful engagement on complex and technical issues.

We also want to thank the Commission for its direct engagement with stakeholders following the joint industry letter, including writing to signatories and speaking directly with Chief Executives.

That level of engagement is valuable. It is particularly important where there are differences in views on substance. Even where we do not agree with aspects of the draft decision, the quality of engagement supports a more constructive and informed process.

3 WACC and cost of debt

3.1 Overall position

ENA continues to support further consideration of a trailing average approach to the cost of debt (TACD), consistent with our previous submissions. ENA's concern is that the current framework results in avoidable price shocks for customers at regulatory reset points.

While the Commission has assessed this issue primarily through the lens of in-period revenue smoothing and incentives to invest, ENA considers that the more fundamental issue is how the framework:

- affects price stability for customers, particularly at regulatory resets;
- allocates risk between customers and suppliers; and
- reflects efficient financing practices over time.

The attached NERA report steps through these issues in more detail, but the key points are summarised in the sections below. Some key findings in the NERA and CEG reports include:

- NERA concludes that to achieve a similar initial price shock (37%) at the start of DPP4, the Commission's prevailing approach with an 8% X-factor requires allowable revenue to increase by 101% by the end of DPP4, compared to a rise of only 53% under a 10-year TACD.
- NERA reminds us that well-specified Weighted Trailing Average models already exist (like the QTC and AER models) and adopting a WTA mechanically eliminates the Commission's concern that a simple unweighted trailing average would misalign with actual costs if there is a 'material uplift' in capex alongside rising interest rates by ensuring all new RAB growth is compensated at prevailing rates.
- The draft decision raises a concern that a 10-year TACD performs poorly in limiting excessive profits because 10-year interest rates are generally higher than 5-year rates (by an average of 0.46% since 2010). NERA argue that this term premium is not a costless 'rent' that suppliers can risklessly arbitrage; rather, it represents the efficient, necessary compensation for transferring re-pricing risk to bond purchasers.
- CEG also conclude that the status quo had the highest tracking error (Root Mean Square Error of 2.16%) during DPP3, while the 10-year TACD was the most accurate (1.80%).

3.2 Between-period price shocks

ENA's primary concern remains price shocks between regulatory periods, rather than smoothing within periods.

The Commission's analysis focuses on:

- the aggregate impact on revenues; and
- the extent to which alternative tools can smooth revenue paths.

However, this does not address the core issue identified in our previous submission or in the NERA analysis.

NERA shows that the choice of cost of debt methodology has a material impact on changes in allowable revenue at regulatory reset points, even where the cost of debt is a relatively small share of total revenue. In particular:

- trailing average approaches result in materially smaller changes in allowable revenue between regulatory periods; and
- the differences are most pronounced when interest rate movements are largest.

NERA also demonstrates that outcomes under the prevailing approach are highly sensitive to the timing of the regulatory reset. This introduces variability in prices that reflects arbitrary timing, rather than underlying efficient costs.

In ENA's view, this is a key limitation of the prevailing approach.

The Frontier report emphasises that the allowed return on debt should reflect the costs incurred under a prudent and efficient debt management strategy adopted by a benchmark efficient entity, and that regulatory allowances should align with those costs in each period.¹

It also identifies refinancing risk and mismatch risk as central considerations in assessing alternative approaches.²

Taken together, these principles highlight that a regulatory approach which produces outcomes that vary materially depending on the timing of regulatory resets — rather than underlying efficient financing costs — is unlikely to provide a close match to the costs incurred by a benchmark efficient entity.

In this context, the key issue is not simply the level of revenue or the ability to smooth it within a regulatory period, but the extent to which the cost of debt methodology introduces avoidable volatility at reset points. This suggests that the choice of cost of debt methodology is not simply a smoothing question, but determines how interest rate risk is transmitted to customers over time.

These effects translate into step changes in prices for customers at reset points, which can be material and difficult for households and businesses to manage.

3.3 Limits of in-period smoothing tools

The Commission places reliance on its ability to smooth revenues using other tools.

ENA considers that these tools do not address the core issue.

¹ Frontier Economics, [Frontier-Economics-on-behalf-of-NZCC-Expert-report-Return-on-debt-and-risk-free-rate-July-2025.pdf](#), pages 8-10.

² Frontier Economics, [Frontier-Economics-on-behalf-of-NZCC-Expert-report-Return-on-debt-and-risk-free-rate-July-2025.pdf](#), pages 8-10.

In ENA's view, this reflects a difference in approach: the Commission focuses on smoothing outcomes, whereas the choice of cost of debt methodology determines the volatility of the underlying input itself.

As demonstrated in the NERA report:

- these mechanisms reprofile revenue, rather than smoothing the underlying cost input; and
- they can require higher prices later in the regulatory period, due to the time value of money applied to deferred revenues.

Achieving similar reductions in initial price increases under the prevailing approach can therefore result in:

- very large increases in prices within the regulatory period.

This highlights an important distinction:

- trailing averages smooth the input to the model;
- existing tools smooth the timing of recovery, often shifting impacts rather than reducing them.

We also want to emphasise that we are not suggesting that a TACD does not replace the need for all other smoothing mechanisms. It's not an 'either/or' scenario – they can both work concurrently. A TACD would just mean the other smoothing mechanisms do not have to do so much heavy lifting and could help improve the transparency and predictability of revenue paths and prices faced by customers.

3.4 Risk allocation

ENA considers that the choice of cost of debt methodology is appropriately assessed through the lens of risk allocation, consistent with the Commission's broader approach to setting input methodologies.

Frontier identifies refinancing risk and mismatch risk as central considerations when assessing alternative approaches to estimating the cost of debt.³ These risks arise where there is a divergence between:

- the regulatory allowance; and
- the actual costs incurred by a benchmark efficient entity.

Under the prevailing or point-in-time approach, the allowed cost of debt is determined based on market conditions at the time of the regulatory reset. As Frontier notes, this type of approach is akin to a single tranche strategy, which exposes firms to extreme refinancing risk and does not reflect efficient financing practice.

As a result, customers bear a significant share of pricing risk associated with movements in interest rates at reset points.

In practice, firms manage these risks by issuing debt on a staggered basis over time, rather than refinancing their entire portfolio at a single point. A trailing average approach better reflects this behaviour and reduces exposure to refinancing risk.

The NERA analysis further demonstrates that, under the prevailing approach, movements in interest rates at the time of the reset are transmitted directly into allowable revenues, resulting in material variability in prices between regulatory periods.

In ENA's view, this results in a misallocation of risk:

³ Frontier Economics, [Frontier-Economics-on-behalf-of-NZCC-Expert-report-Return-on-debt-and-risk-free-rate-July-2025.pdf](#), pages 8-10.

- customers are exposed to price volatility arising from regulatory timing effects, which they are not well placed to manage;
- while suppliers are better placed to manage debt pricing risk through financing strategy.

A trailing average approach is therefore more consistent with allocating risk to the party best able to manage it, while also aligning the regulatory allowance more closely with efficient financing costs.

3.5 Investment incentives and financing alignment

The Commission's draft decision places weight on the responsiveness of the prevailing approach to current market conditions, and the role this plays in supporting investment incentives. ENA considers this is a very narrow interpretation and has mischaracterised stakeholder rationales for opposing the status quo approach, failing to fully reflect the customer impacts of price volatility.

ENA considers that investment incentives should be assessed in the context of whether the regulatory framework provides a reasonable opportunity to recover the costs incurred by a benchmark efficient entity.

Frontier emphasises that the allowed return on debt should reflect the costs incurred under a prudent and efficient debt management strategy, and that regulatory allowances should align with those costs in each period.⁴

This implies that:

- the regulatory framework should reflect how firms actually finance themselves in practice; and
- the timing of regulatory resets should not drive material divergence between allowed and incurred costs.

Under a prevailing approach, the cost of debt allowance is highly sensitive to market conditions at a single point in time. As the NERA analysis shows, this can result in material differences in allowable revenues depending on the timing of the reset, rather than underlying efficient costs.

By contrast, a trailing average approach:

- better aligns the regulatory allowance with the costs incurred under staggered debt issuance strategies; and
- reduces the likelihood of material over- or under-recovery driven by timing effects.

NERA also notes that concerns regarding the transition to a trailing average approach, or potential misalignment in the short term, can be addressed through appropriate transition mechanisms, as adopted in other jurisdictions. As both NERA and Frontier note, trailing average approaches are widely used in other jurisdictions.

In ENA's view, a framework that more closely aligns allowed returns with efficient financing costs is more likely to support stable and predictable price paths for customers, while maintaining appropriate investment incentives.

3.6 ENA's view

Taking these factors together, ENA considers that the draft decision places too much weight on:

⁴ Frontier Economics, [Frontier-Economics-on-behalf-of-NZCC-Expert-report-Return-on-debt-and-risk-free-rate-July-2025.pdf](#), pages 8-10.

- investment incentives;
- in-period smoothing;
- aggregate revenue comparisons; and
- perceived administrative burden,

and insufficient weight on:

- between-period price shocks for customers;
- timing-driven volatility; and
- efficient allocation of risk between customers and suppliers.

ENA therefore considers that the Commission should revisit its conclusion that the prevailing approach better promotes the IM objectives, and give further consideration to whether a trailing average approach would better support:

- more stable price paths for customers; and
- alignment with efficient financing practices.

4 TAMRP

ENA acknowledges and supports the Commission's proposed changes to the TAMRP methodology.

The Commission has taken on board a number of key points raised in earlier submissions, including:

- removing weight on survey evidence;
- reducing reliance on the dividend growth model; and
- placing greater emphasis on ex post historical estimates.

ENA considers these changes to be sensible refinements.

Overall, we consider that the Commission has responded constructively to previous feedback on TAMRP, and we support the direction of travel in the draft decision.

5 Conclusion

ENA appreciates the Commission's work on this review and the constructive engagement with stakeholders.

In summary:

- we value the Commission's transparent and proactive engagement;
- we support the proposed refinements to the TAMRP methodology; and
- we consider that the current approach to the cost of debt does not adequately address between-period price shocks or align risk with those best placed to manage it, resulting in negative customer outcomes.

ENA encourages the Commission to revisit its assessment of the cost of debt framework in light of these considerations.

If you have any questions about ENA's submission please contact Gemma Pascall, Regulatory Manager ().

Yours sincerely

Gemma Pascall
Regulatory Manager



Appendix A: ENA Members

Electricity Networks Aotearoa makes this submission along with the support of its members, listed below:

- Alpine Energy
- Aurora Energy
- Buller Electricity
- Centralines
- Counties Energy
- EA Networks
- Electra
- Electricity Invercargill
- Firstlight Network
- Horizon Networks
- MainPower
- Marlborough Lines
- Network Tasman Limited
- Network Waitaki
- Northpower
- Orion New Zealand
- Powerco
- PowerNet (which manages The Power Company, Electricity Invercargill, OtagoNet and Lakeland Network)
- Scanpower
- Top Energy
- The Lines Company
- Unison Networks
- Vector
- Waipa Networks
- WEL Networks
- Wellington Electricity
- Westpower

Trailing average vs prevailing approach to the cost of debt

Transpower, ENA and Chorus

16 April 2026

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1. Introduction and Summary

1. On 10 March 2026 the New Zealand Commerce Commission published a draft decision on the cost of capital Input Methodologies (**IMs**) that are common to regulated fibre suppliers and suppliers regulated under Part 4 of the Commerce Act.
2. The draft decision contains a consideration of the merits of moving away from the current "prevailing" or "on the day" approach, to a "trailing average" approach. This is in response to submissions by stakeholders concerned with the price volatility and step changes caused by the current approach taken to the estimation of risk free rate component of the weighted average cost of capital.¹
3. The Commission notes at X26 that the relative merits of each approach are finely balanced. We understand the Commission's decision to be based on the following conclusions:
 - A. The real cost of debt makes up only a small portion of the total revenues, and therefore smoothing the cost of debt allowance would have a limited impact volatility and step changes in total allowable revenue.²
 - B. The Commission has more effective tools for smoothing revenue between regulatory periods,³ and can achieve similar or smaller changes in revenue between periods using these tools.
 - C. A trailing average approach would not better promote the Commission's objectives (incentives to invest, limiting the ability to extract excess profits and promoting workable competition in telecommunications markets):
 - i. A five-year trailing average would perform similarly to the prevailing approach
 - ii. A 10-year trailing average would perform worse than the prevailing approach on these objectives
 - D. A trailing average approach would add administrative complexity to the regulatory regime.
4. We have been asked by Transpower, Electricity Networks Aotearoa (ENA) and Chorus to review the Commission's conclusions and the analysis/evidence underlying them.
5. A summary of our conclusions is as follows:
 - A. A trailing average results in materially smaller changes in allowable revenue between periods when interest rates move materially, and this effect is greater with a longer trailing average;
 - B. Under the prevailing approach the start date of a regulatory period has significant impact on allowable revenue and therefore between period shocks;
 - C. The trailing average cost of debt is an alternative allocation of interest rate repricing risk away from consumers, rather than a "smoothing tool". The Commission's risk allocation principle is that risk should be allocated to those who can best manage it. A trailing

¹ See 7 August 2025 letter the Commission from Chorus, Consumer NZ, Contact Energy, ENA, Enable, MEUG, Meridian, PowerCo and Transpower.

² See, e.g. X15 and X19.

³ See, e.g. X16 and X19.

average would be consistent with this since regulated firms have tools to manage interest repricing risk while consumers do not.

- D. The Commission's smoothing tools involve delaying initial price increases at the expense of much higher price increases within the regulatory period.
- E. Concerns around incentives to invest are driven by volatile interest rates and a material uplift in capex in upcoming regulatory periods. These concerns can be addressed by:
 - i. A weighted average trailing average (WTA);
 - ii. Implementing the transition mechanism the AER used, which places a high weight on prevailing rates during the initial years of the transition.
- F. A view that a 10-year trailing average would lead to excess profits given 10 year rates are higher than 5-year rates implies that this difference is a rent that suppliers can obtain without cost or risk. The term premium efficient represents compensation for transferring re-pricing risk, which the Commission has recognised through its TCSD allowance.
- G. Concerns around administrative complexity do not appear significant:
 - i. Many other regulators with similar regimes apply trailing averages. The Commission is therefore not solving a novel or new problem and can draw on the learning of other regulators when designing its own solution.
 - ii. Once the design decisions are made, the ongoing application of trailing average will be relatively mechanical.
 - iii. Regarding transition mechanisms:
 - a. A transition mechanism is likely only required if the estimated cost of debt under a trailing average would differ materially from the prevailing approach at the time it is implemented.
 - b. Even if this isn't the case, if firms are already issuing staggered debt, as their hedges roll off, they will have a trailing average cost of debt that may be close to the regulatory trailing average cost of debt.
 - c. Any transition mechanism could therefore be conditional on the prevailing and trailing average approaches yielding materially different results and regulated suppliers not already financing themselves in a way that corresponds to the trailing average approach.
 - d. If a transition mechanism is needed, then the AER's transition mechanism is an internally consistent approach for transitioning suppliers from one approach to another.

2. The approach taken to the cost of debt can have a meaningful impact on price shocks between regulatory periods

2.1. The trailing average results in materially smaller changes in allowable revenue between periods when interest rates move materially

6. While it is correct that the real cost of debt makes a small proportion of total revenue (~10% by the Commission's calculation⁴), this does not necessarily mean the scope for a trailing average to smooth revenues is limited. This is because large changes in relatively small components can have a meaningful impact on total revenue.
7. To illustrate, we have adapted the Commission's modeling to produce a stylised model of the "aggregate EDB" that assesses price shocks between DPP periods on a like for like basis over a much longer time period. Specifically, we aggregate all EDBs and then average the building block inputs (RAB, capex, opex etc...) across DPP4. This allows for a comparison over time if the only change *within* and *between* regulatory periods is the risk free rate and the approach used to estimate the risk free rate for the cost of debt. We set out our assumptions more fully in the appendix, but note here that for simplicity of making comparisons across time, we have examined the building blocks revenue (BBAR) rather than the maximum allowable revenue (MAR), where the latter includes incentive payments and washups.
8. This analysis shows that:
 - A. The trailing average approach can result in material differences in the change in required revenue between regulatory periods; and
 - B. The difference between the prevailing approach and trailing averages is largest when interest rates movements are largest (i.e. between DPP2/DPP3 and DPP3/DPP4)
9. Specifically, as set out in Table 1 below, our stylized calculations show that a trailing average could have resulted in changes in allowable revenue 6% smaller for DPP3 and 8-10% for DPP4. The differences are much smaller for earlier periods, given interest rates were more stable.

Table 1: BBAR change (%) between regulatory periods

	DPP0	DPP1	DPP2	DPP3	DPP4
Status Quo 5-year	-4%	-3%	1%	-13%	22%
5-year trailing	-4%	-1%	3%	-7%	14%
10-year trailing		-1%	3%	-7%	12%

Notes: We calculated BBAR inputs for the aggregate EDB averaged over DPP4 (all BBAR inputs are the same within a 5 year DPP period) and then calculated the BBAR for sequential 4 year DPP periods going back to 1999.

⁴ See Figure 4.2 of the draft decision.

2.2. Under the prevailing approach the start date of a regulatory period has significant impact on allowable revenue

- 10. Under the prevailing approach, the cost of debt is very sensitive to the start date of the regulatory period. This is demonstrated by Figure 1 below which shows the nominal cost of debt calculated for different start dates for a regulatory period, compared to the nominal cost of debt estimated at the start of each DPP period (including hypothetical historic DPP periods).
- 11. To illustrate the impact of this allowable revenue, we have taken our stylized modelling and shifted the start year of the regulatory period one year later or one year earlier. Figure 2 demonstrates that the between period price shock is very sensitive to when the regulatory period starts.

Figure 1: Nominal cost of debt by DPP period vs applicable rate for different DPP start years

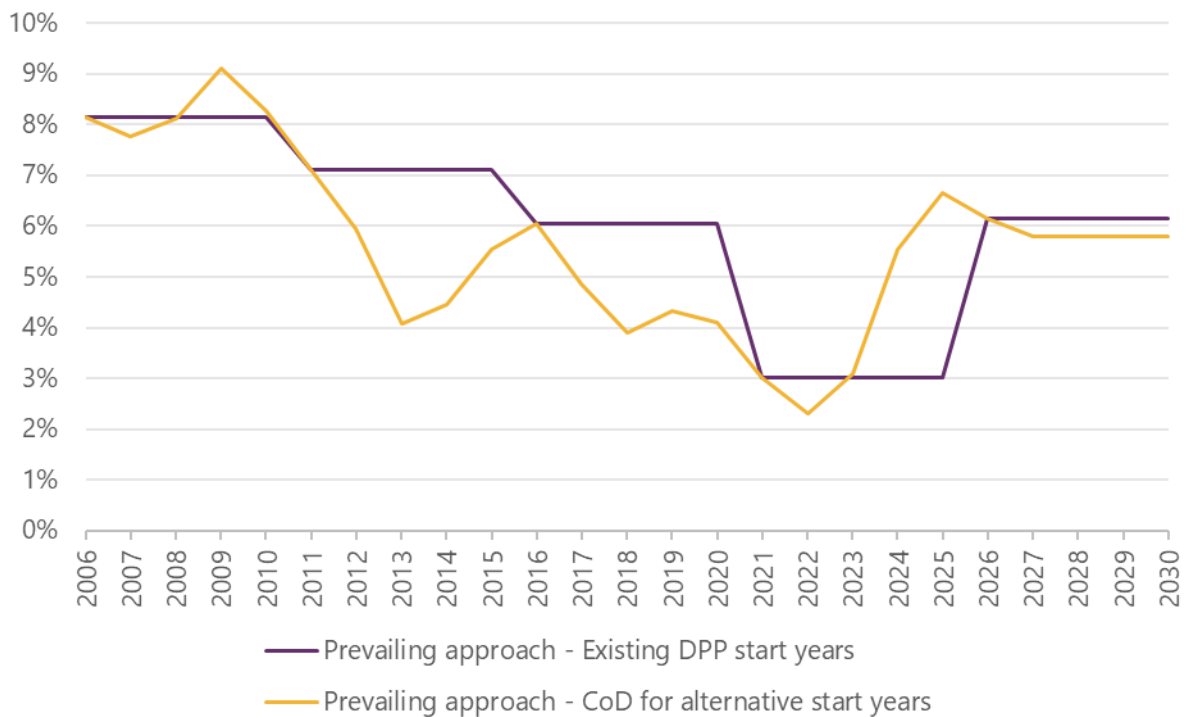
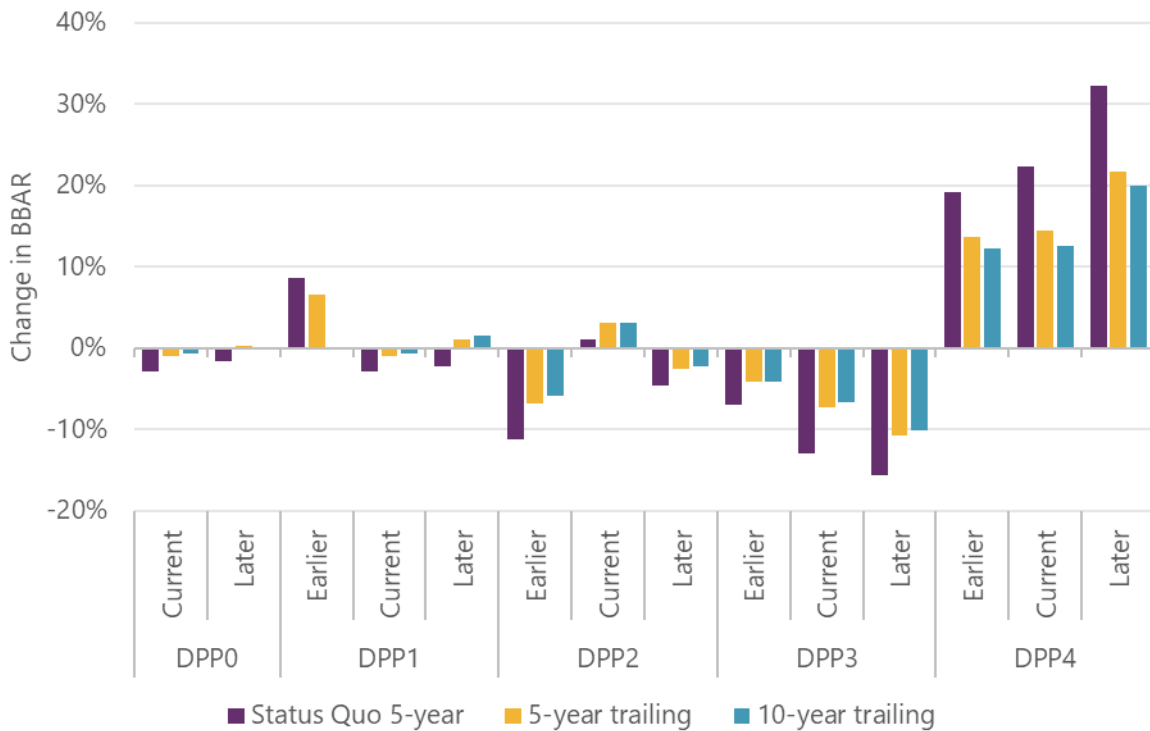


Figure 2: % Change in BBAR Household Bills Between Regulatory Periods: DPP period starting 1 year earlier or 1 year later



3. Risk allocation vs Smoothing

3.1. Interest rate pricing risk should be allocated to firms, since they have a means of managing it

12. The Commission notes at [4.20.5] that it has “more effective” tools for smoothing revenue. Characterized this way, there is logic to the Commission’s view that smoothing the cost of debt only smooths one component of overall revenue and this is less effective than smoothing the aggregate revenue allowance (though we return to the relative “smoothing” merits in section 3.2).
13. However, the choice between the prevailing approach and a trailing average is better considered as a question of appropriate risk allocation rather than assessing its merits as a smoothing tool compared to the other smoothing tools available.
14. Appropriate risk allocation is one the Commission’s “key economic principles” that it applies in IM reviews. The appropriate risk allocation principle is described at [3.46] of the Fibre IM review decision making framework paper:

Our risk allocation principle is that, ideally, particular risks should be allocated to suppliers or consumers depending on who is best placed to manage them. Workably competitive markets tend to manage risks efficiently by allocating identified risks to the party considered best placed to manage them.

15. The Commission notes in Table 4.3 draft decision that consumers ultimately bear interest rate pricing risk under current settings:

"To the extent that we believe the regulatory allowance can be matched by regulated suppliers, this repricing risk is borne by consumers as firms are compensated for changing interest rates through the revenue allowance."

16. Issuing debt on a staggered basis is a method that suppliers have available to manage interest rate pricing risk. The Commission acknowledges at 5.15 of the draft decision that "it is prudent and efficient to issue debt on a staggered basis to mitigate refinancing risk".
17. Consumers, by contrast, have no means to mitigate the interest rate pricing risk component of their utility bills.
18. Viewed through this lens, adopting a trailing average cost of debt would be shifting some interest rate pricing risk from consumers to regulated suppliers. We therefore think it is more accurate to consider the choice between a trailing average approach and the prevailing approach as alternative risk allocations, as compared to considering the trailing average a "smoothing" tool.
19. Smoothing tools and the trailing average also "smooth" revenue and prices through different channels, with different effects, as we now discuss.

3.2. Smoothing tools involve reprofiling revenue, which can result in much higher prices later

20. The Commission's smoothing tools combined with the prevailing approach and an alternative allocation of interest rate risk would "smooth" allowable revenue through different channels. To illustrate, consider how each would deal with a situation of rising interest rates (noting the opposite would of course occur with falling interest rates):
- A. **Prevailing + Smoothing tools:** full amount of increase would be included in the revenue allowance, but to limit the initial price increase, recovery would be backloaded to mitigate the immediate impact. This reprofiling delays cost recovery and therefore accounts for the time value of money.
 - B. **Trailing average:** Under a trailing average approach, the cost input to the building blocks model itself is smoothed. Because of this, the full increase in interest rates is not included in the revenue allowance and subsequent reprofiling accounting for the time value of money is not required.
21. Which is to say, a trailing average approach smooths revenue through changes in the underlying cost allowance, whereas smoothing tools involve reprofiling a higher aggregate cost allowance. In simple terms, this means lower prices at start of a regulatory period require higher prices later.
22. This is demonstrated by expanding the Commission's analysis of the change in Vector's MAR between the end of DPP3 and the beginning of DPP4. We have taken the Commission's analysis underlying Figure 4.1 of the draft decision and extended it to include smoothing scenarios using alternative "X factors" of -4% and -8% (the latter being the alternative X factor set for Vector for DPP4).

23. The Commission smooths revenue *within* a regulatory period using a "CPI-X" approach. If the X factor is set at 0%, then revenues will grow with expected inflation over the regulatory period. The Commission sometimes sets an "alternative" X factor to smooth revenue *between* periods. Specifically, a negative X factor would require revenues to grow at more than CPI. For the revenue path to be equivalent in NPV terms to the path with a standard X factor, a negative X factor requires year 1 revenue to be lower, and this is compensated for by revenue growing at higher rate in subsequent years.
24. Figure 3 below shows our extension of the Commission's Figure 4.1. This demonstrates that:
- A. In order to reduce the initial price increase at the start of DPP4, very large within period price increases are required over the rest of DPP4 (i.e. the alternative X Factor introduces a substantial "tilt" to the revenue path.
 - B. Because the trailing average smooths the actual cost input to the BBM, the same mechanical effect of subsequent large within period price increases doesn't apply.
 - C. A trailing average approach reduces required revenue in DPP4 and increases it in DPP3, this "compression" reduces the jump at the start of DPP4 and provides a flatter revenue profile overall.
25. In Table 2 we have recreated the Commission's calculations in Table 4.1 of the % change in allowable revenue between the end of DPP3 and the start of DPP4. We have used BBAR instead of the MAR, so that we can look at changes over the entirety of the DPP4 period (i.e. calculate the % increase in revenue between 2025 and 2030, rather than just 2025 and 2026). This shows that:
- A. Both a 10 year trailing average and an 8% alternative X factor would achieve a similar initial price shock at the start of DPP4 (37%);
 - B. By the end of DPP4, the prevailing approach with an 8% X factor would require allowable revenue to have risen 101%, compared to 53% under a 10 year trailing average.
26. This illustrates that during periods of rising interest rates, the Commission's smoothing mechanisms simply delay the increase in prices, with consequential larger increases in the future.

Figure 3: Revenue path under various approaches to the risk free rate extended to include including status quo smoothing

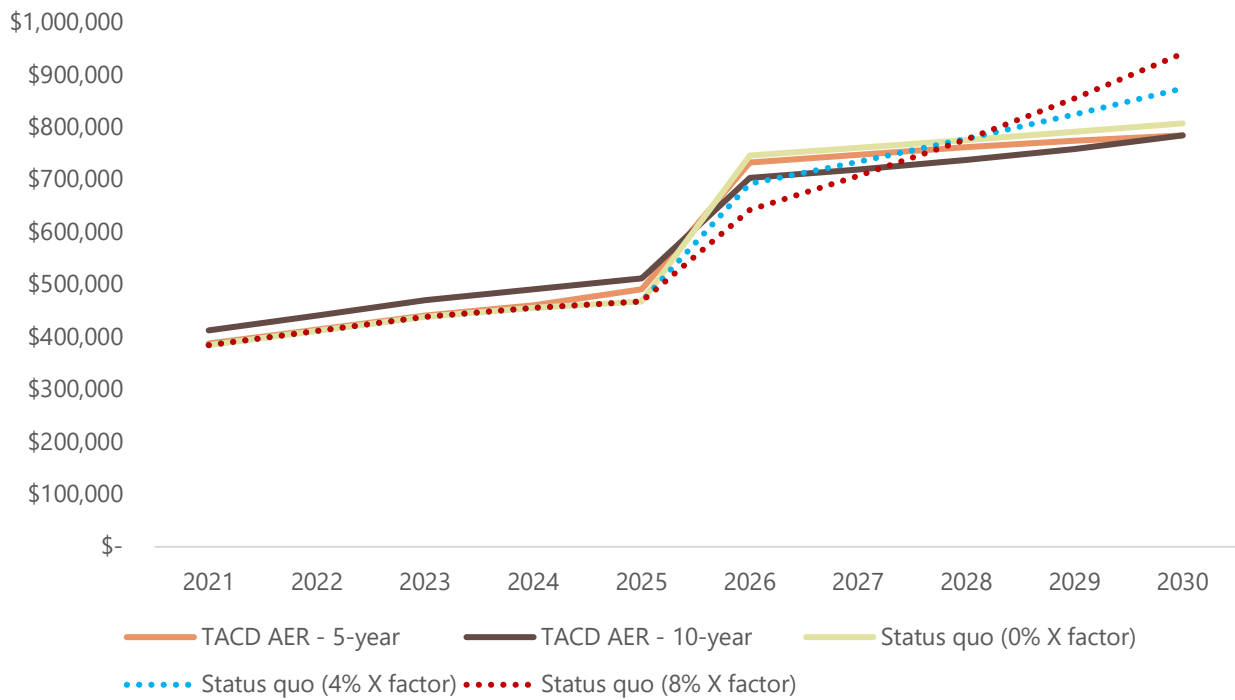


Table 2: BBAR revenue paths under various approaches to the risk-free rate, extended to include status quo smoothing

	2025	2026	2030	2025 -> 2026 %	2025 -> 2030 %
TACD AER - 5-year	491,996	733,604	784,803	49%	60%
TACD AER - 10-year	511,978	703,531	784,778	37%	53%
Status quo (0% X factor)	467,899	746,175	807,684	59%	73%
Status quo (4% X factor)	467,899	692,494	874,258	48%	87%
Status quo (8% X factor)	467,899	642,656	940,913	37%	101%

4. Promotion of the statutory objectives

4.1. Incentives to invest

27. The Commission's conceptual concerns around incentives to invest, expressed at [4.69] are that a trailing average can result in poor investment incentives when current interest rates differ materially from their historical average **and** the financing/expenditure profile differs from the assumed 10%.
28. We firstly note that under a TACD, **both** of these conditions need to occur for there to be misalignment between the regulatory allowance and the actual cost of debt. If interest rates are stable and expenditure is varying, an un-weighted TACD and a weighted TACD yield similar results. Likewise, if interest rates are varying but the expenditure/financing pattern is stable, then a weighted and un-weighted TACD yield similar results.
29. The Commission is therefore concerned that the current environment is one of both rising interest rates and an upcoming "lump" in capex requirements [4.73] and therefore that an unweighted TACD would perform poorly.
30. In this regard we note:
- A. a weighted trailing average (**WTA**) as the AER is currently consulting would address this; and
 - B. the transition mechanism the AER adopted when moving to a trailing average would address any immediate concerns about misalignment, since it would place a high weight on prevailing rates in the earlier years of the transition.
31. Under a weighted trailing average, instead of assuming a constant 10% per year refinancing assumption, the weight each year varies with capex. The Commission disagrees with Frontier that such an approach would be simple and cites the AER's August 2025 discussion paper as evidence of the complexity of such an approach.
32. The issues the AER is considering are:
- A. **Threshold:** should the WTA apply to all regulated suppliers or only those whose increase in debt during a regulatory period exceeds a materiality threshold?
 - B. **Assumed yields:** in each year what bonds are issued to finance the new investment? The AER proposes a mix of tenors between 1 and 10 years
 - C. **Actual vs forecast capex:** Should the cost of debt allowance be based on forecast capex or actual capex?⁵
33. These are all questions of design and once a decision is made, the WTA approach is mechanical to implement. This is particularly the case if there was no threshold and the "QTC approach" is used (assuming the new debt each year is financed with a single 10 year bond, rather than the mix of tenors under the AER's proposal).⁶

⁵ The latter would be implemented via a wash-up on the cost of debt.

⁶ Queensland Treasury Corporation, *Submission to the 2026 Rate of Return Instrument review Discussion Paper*, 19 December 2025.

34. Returning to the transition mechanism, if the NZCC is concerned that there will be a “material uplift” in expenditure requirements at the next regulatory reset, the transition mechanism adopted by the AER when it implemented the unweighted trailing average would address these concerns. The transition mechanism, which is a variation of the QTC method already discussed, assumes that 100% of the debt is financed at prevailing rates in year 1, and then every year after that 10% of the debt is refinanced.⁷ As result, a very high weight is placed on prevailing rates during the early years of the transition, which would mitigate any concerns about uplifts in expenditure at the upcoming resets.

4.2. Limiting ability to extract excess profits

35. The Commission considers that a 10 year TACD would perform worse regarding limiting excess profit than the prevailing approach and a 5 year TACD (which it considers would perform similarly to each other).
36. The Commission’s concern with a 10 year TACD appears to be driven by its observation that 10 year rates generally exceed 5 years rates (by 0.46% since 2010).⁸ The implication of a view that providing a 10 year interest rate would not limit excess profits is that this gap between the 5 year and 10 year rates is a “rent” and that firms could costlessly and without risk, arbitrage the regulatory cost of debt allowance by issuing shorter term debt.
37. Firms that issue shorter term debt are taking on repricing risk, so this strategy is not costless/riskless. In effect, firms taking on short term debt are betting that rates do not rise as quickly as the market expects.⁹ They thus face the risk that future rates are higher than expected and their interest rate costs end up being higher than if they had issued longer term debt.
38. When firms issue longer term debt, they are transferring this risk to the purchaser of the bond, and pay a premium for doing so. The Commission has recognised that this term premium is efficient compensation for issuing longer term debt in the context of the TCSD allowance. Indeed, for firms that currently issue the majority of their debt with a term close to 10 years, this point is invalid as the Commission is already effectively providing a cost of debt with a 10 year term.
39. Therefore, while prices may be higher under a 10 year trailing average, this would reflect consumers transferring some repricing risk to regulated suppliers, rather than excess profits.
40. If the Commission was concerned that firms were systematically, costlessly, and without risk arbitraging a 10 year term for the cost of debt, it could implement an inverse of the current TCSD and reduce the cost of debt allowance in proportion to the volume of debt with a term less than 10 years.

⁷ If a WTA is implemented, then this 10% could vary in line with expenditure requirements.

⁸ [4.86].

⁹ Or in a falling rate environment that rates will fall more quickly than the market forecasts.

4.3. Promotion of competition workable competition in telecommunications markets

41. Regarding the promotion of workable competition in telecommunications markets, the Commission considers that the prevailing approach would better reflect the financing conditions faced by a new entrant.
42. This logic assumes that:
 - A. The only relevant competition under the act is greenfields new entry; and
 - B. That the new entrant would adopt an “on the day” financing strategy and build their entire network straight away.
43. Regarding the first point, we note that Chorus faces competition from mobile networks offering fixed services using their mobile networks. These networks already exist and investments to compete against Chorus will be incremental. The cost of debt faced by the MNOs is therefore much more likely to resemble a trailing average approach, as the Commission recognizes at 4.94.2, where it states that once firms are in the market they will stagger their debt issuance.
44. In addition, even in the case of a greenfields new entrant, if the roll out of the network occurs over time rather than all at once, that firm’s cost of debt is more likely to resemble a trailing average, though it would likely initially bear more resemblance to a shorter term trailing average.

5. Administrative complexity

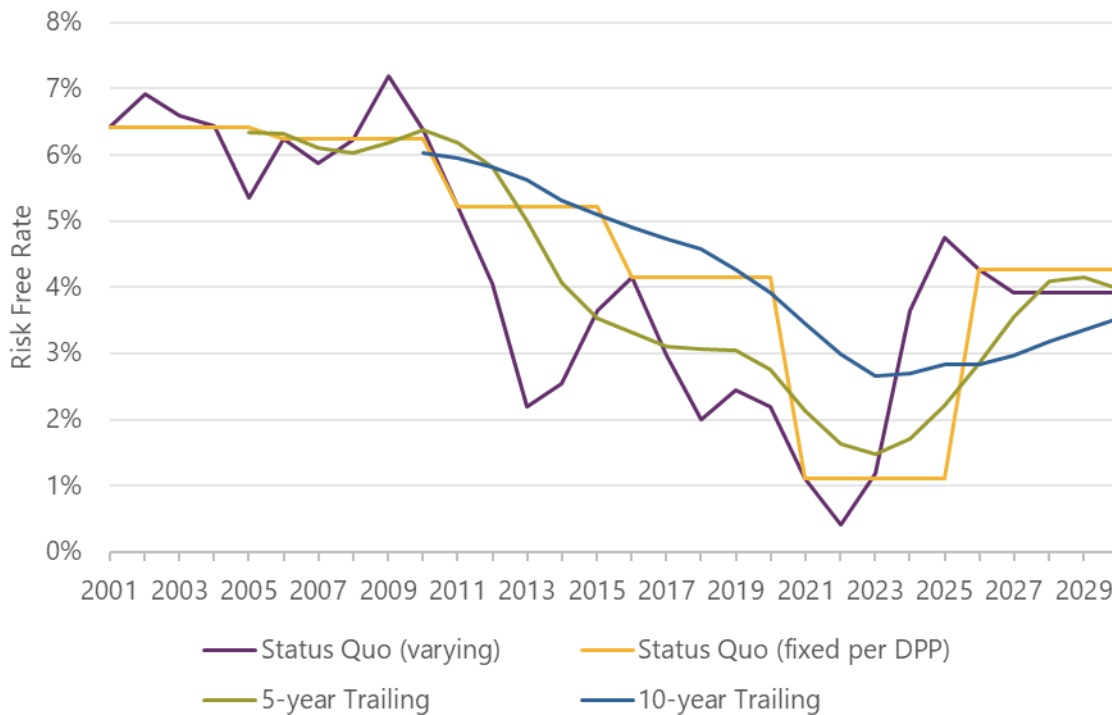
45. The Commission’s consideration of administrative complexity is in three areas:
 - A. The initial design of the regime
 - B. Ongoing administrative effort; and
 - C. The design of any transitional arrangements.
46. On the first two points, it is not obvious that once design decisions are made and models are updated, a trailing average would be significantly more complicated than the current process, which already requires annual updates to the MAR to account for wash-ups and incentive payments. Indeed, the Commission notes at 4.106 that it agrees with stakeholders that the ongoing updates of the revenue path would be “manageable”.
47. In terms of the design decisions it must make, given the prevalence of a trailing average in other regimes, including the AER’s regime which is very similar to the Commission’s, there is much regulatory precedent that can be drawn on.
48. Which is to say, while the Commission must reach its own decisions on the various trade-offs it highlights, implementing a trailing average is not a novel/new issue the NZCC would need to solve that nobody else has considered. The Commission can draw on the learnings of other regulators when designing its own regime.

49. Regarding transitional arrangements, a key input into whether one is needed is the difference in the estimated cost of debt under the current approach and the chosen trailing average at the time it is implemented. If both approaches yield a similar estimate, then a transition mechanism may not be needed, as the expected regulatory cost of debt allowance over the coming regulatory period would not differ materially.
50. Even in situations where the regulatory cost of debt at the next reset would differ under the two approaches, if firms are already issuing debt on a staggered basis, as their hedges roll off their actual cost of debt will be a trailing average. In this situation, firms will naturally transition to a trailing average cost which may not differ materially from the regulatory trailing average.
51. This suggests the Commission could implement a conditional approach, whereby the default is no transition, unless it is demonstrated that both:
 - A. The estimated cost of debt at the time of implementation differs substantially between the prevailing and trailing average approaches; and
 - B. Firms are not already financing themselves in a manner that is consistent with the trailing average approach.
52. If a transition mechanism is needed, that adopted by the AER would be internally consistent with an assumption that suppliers are currently hedging one way in response to the current prevailing allowance and would need to change their behavior over time to adjust to the new regime. This would give existing hedging arrangements time to unwind and allow firms that are not issuing debt on a staggered basis to build up a portfolio.

Appendix A. Methodology for stylized BBAR

53. To isolate the impact of different CoD approaches on BBAR and customer bills, as well as the sensitivity of those results to a DPP period starting one year later or earlier, we have adapted the Commission's DPP4 financial model.
54. To do this, we create separate models for the WACC allowance and the other terms of the BBAR.
55. For WACC, we have varied the application of the risk-free rate as it applies to the CoD, broadly following the same approach the Commission has in the calculations accompanying the draft decision:
 - A. Under the "Status Quo" approach used by the NZCC, we estimate the RFR consistent with the NZCC's approach under the Input Methodologies for EDBs. In line with the NZCC's methodology, we fix this in place for the entire DPP period, based on the 5-year yield measured in the year prior to the start of the DPP.
 - B. Under the 5-year trailing average approach, we use the same measure of five-year bond yields, but take an average over the five years prior to each year. This updates each year throughout the DPP period.
 - C. Under the 10-year trailing average approach, we use the 10-year government bond yield, measured on average over the ten years prior to each year. This also updates each year throughout the DPP period.
56. In the Figure below, we show these three approaches to the risk-free rate over time. Note that the figure separately shows how the Status Quo approach varies from one year to the next (showing the evolution in the forward-looking 5-year bond yield), as well as fixing it in place for each DPP period.

Figure A.1: Nominal Risk-free Rate under different approaches



57. The overall CoD is then calculated by adding several additional components to the risk-free rate, such as a debt premium, in line with the Commission’s approach.
58. Under the sensitivities of starting the DPP period one year earlier or one year later, the Status Quo CoD is locked in at different levels, depending on the start year of the DPP. However, the CoD under the 5-year and 10-year trailing average approaches does not change under these sensitivities, because they are not sensitive to when the DPP begins.
59. We do not vary the Commission’s approach to calculating the cost of equity (CoE), which also relies on a snapshot of the risk-free rate (like the Status Quo CoD approach). Thus, we model slightly different levels of WACC in the One Year Earlier and One Year Later sensitivities under the 5-year and 10-year Trailing approaches. This comes through a different CoE rather than through the CoD. We also do not vary the leverage.
60. These WACC estimates then feed through into a BBAR as follows:
 - A. We extend the Commission’s financial model for DPP4 from a 5 year to 30-year model, with six five-year DPPs starting in 2000/01 and extending to the end of DPP4 in 2029/30. Under sensitivities, we shift the starting date of each DPP forward or backward by one year, but hold everything else constant. This extended period allows us to demonstrate inter-period dynamics.
 - B. We sum the inputs across all EDBs to create an aggregate EDB, for example comprising the entire RAB and opex of all EDBs.
 - C. We define the Opening RAB as the total opening RAB as reported by the Commission for 2023/24. We apply this value as the opening RAB in 2000/01.

- D. In each year, we revalue the opening RAB, based on the forecast inflation from the beginning of the DPP. Since DPP1 (commencing in 2010/11), the Commission has published annual inflation rate forecasts, which we use. Prior to DPP1, we use forecasts from RBNZ, made one year before the beginning of each DPP, using the 1-year ahead forecast for the first year of the DPP, and the 2-year ahead forecast for all subsequent years.¹⁰ As per the dynamics of the DPP, this revaluation increases the RAB and is also used as an offset to the BBAR.
- E. We set initial depreciation equal to the total depreciation reported across all EDBs in the DPP4 model. We do not explicitly model the asset base, and instead assume that depreciation grows with forecast inflation each year. We do not separately model disposals.
- F. We set the annual value of commissioned assets equal to annual depreciation. This ensures that RAB growth over the 30-year period is driven only by inflation, rather than the net real additions, and allows us to model a regime in steady state without a RAB that increases to unreasonable levels (since DPP4 is a period with a substantial uplift in capex, assuming a continuation of this level of capex for 30 years would result in a very large RAB by the end of the period).
- G. We set the 2000/01 value of commissioned assets (i.e. capex) equal to the average across the seven years reported in the Commission's DPP4 model, in total across all EDBs. Each year this inflates with forecast inflation.
- H. We set 2000/01 opex equal to the average forecast in total across all EDBs during the five years of DPP4, and inflate with forecast inflation.
- I. We apply several other smaller components of BBAR in the same way the Commission does.
- i. The Term Credit Spread Differential Allowance (TCSD) is based on the original level across by all EDBs, and then grows with inflation. This is equivalent to assuming the TCSD is a constant percentage of revalued RAB, which is consistent with the Commission's approach.
 - ii. We assume that deferred taxes are zero. In practice, the balance of deferred taxes, which can be positive or negative, affects the return on capital. Because any assumption of a non-zero deferred tax balance would affect all years in all scenarios in parallel, this term has no material impact on our conclusions, which compare between years and scenarios.
 - iii. There are three adjustments to the regulatory tax allowance:
 - a. *Amortisation of initial differences in asset values.* EDBs collectively report around \$99 million per year, which the Commission applies in each year. These result in an increase in taxable profits by that amount, and accordingly an increase in the tax component of the BBAR, based on the 28% corporate tax rate. We apply this same value across all years, though it has little impact on our conclusions because it applies equally to all years and scenarios.

¹⁰ We extrapolate the 2 year out forecast because RBNZ forecasts at the time only went out two years.

- b. *Amortisation of revaluation.* EDBs' taxable profit is based, in part, on depreciation without revaluation. Therefore, in each year, we strip out the level of depreciation which is as a result of inflation. Because we assume that depreciation is flat in real terms, this effectively means we calculate the difference between depreciation in each year and depreciation in the first year. This difference yields an increase in taxable profits by that amount, and accordingly an increase in the tax component of the BBAR, based on the 28% corporate tax rate. This value has little impact on our conclusions because it applies equally to all scenarios.
 - c. *Notional deductible interest.* EDBs can deduct interest payments on debt from their taxable profits, resulting in a reduction in the tax component of BBAR. This is a function of the RAB, the leverage, and the CoD in each year and each scenario. This value does vary across scenarios because the CoD varies across scenarios.
 - d. The regulatory tax allowance is otherwise calculated using the same formulae as in the Commission's DPP4 model.
61. As in the Commission's model, BBAR is thus the sum of return on capital, depreciation, regulatory tax allowance, deferred taxes (negative), operating expenditure, and revaluation (negative).
62. We calculate nine different iterations: three RfR approaches (Status Quo, 5Y trailing, 10Y trailing), times three DPP dates (Prevailing, One Year Later, One Year Earlier). Aside from the WACC estimate, each of these iterations uses the same values for all parameters. This approach allows to demonstrate how the different approaches to the cost of debt are more or less sensitive to volatile financing conditions.



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