



T R A N S P O W E R

Waikoukou
22 Boulcott Street
PO Box 1021
Wellington 6140
New Zealand

+64 4 495 7000
www.transpower.co.nz

Commerce Commission

By Email: infrastructure.regulation@comcom.govt.nz

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Cross Submission: Common cost of capital input methodologies review

Transpower New Zealand Limited (Transpower) welcomes the opportunity to make a cross-submission on issues raised in submissions by other parties on the Commerce Commission's (Commission's) draft decision on the common cost of capital input methodologies.

This cross-submission focuses on submissions addressing the Commission's draft decision regarding the adoption of a trailing average cost of debt (TACD). Our comments build on our submission dated 16 April 2026.

We consider that the cumulative weight of submissions and supporting expert evidence challenges the draft decision's conclusion that the prevailing approach better promotes the Commission's statutory objectives. We consider the evidence is clear that adopting a TACD will result in a better long-term outcome for consumers.

Beyond TACD, submitters also raised issues about the tax-adjusted market risk premium (TAMRP) methodology (including the weight on Siegel 2 versus Siegel 1 and Ibbotson, the role of conditioning variables and rounding, and whether foreign data and survey evidence should be used), and the role of WACC reasonableness checks. This cross-submission is focused on TACD; however, we note these matters remain important to overall WACC stability and predictability.

We consider the evidence across submissions supports the Commission:

- revisiting its draft decision on the treatment of the cost of debt; and
- recognising that a longer trailing average approach is appropriate for large, long-life infrastructure providers such as Transpower.

We note that there are two consistent themes across the submissions, included our own, which support a TACD:

- **Risk allocation is the central issue, not merely revenue smoothing.** CEG, Powerco, and Vector all submit that under current settings interest-rate repricing risk is largely borne by consumers. That consumers are not well placed to manage this risk; and regulated suppliers are better

placed to manage this risk through staggered issuance and portfolio-based debt strategies.

- **Existing smoothing tools are not a substitute for reforming the cost-of-debt methodology.**

ENA, Powerco, Vector, Chorus, Unison and Centralines all note that existing tools such as CPI-X profiling and alternative X-factors operate by reprofiling revenue rather than smoothing the underlying cost input; can result in higher prices later within the regulatory period due to time-value-of-money effects (even if net present value neutral); and do not address the core issue of reset-driven volatility.

Hedging practices for a trailing average cost of debt

The CEG report, “Economic assessment of status quo and TACD debt methodologies” (prepared for the Big Six EDBs, 16 April 2026), highlights a key aspect of the Commission’s decision that was not addressed in our submission nor the NERA report.

In paragraph 4.79.2 of its draft decision the Commission stated:

***Hedging:** If regulated suppliers would like to continue issuing longer-term debt to manage refinancing risk under a five-year TACD, it is unclear whether a matching between the regulatory allowance and actual debt costs can be achieved. For example, hedging the risk-free rate exposure to a single, prevailing rate which is current at the time of hedging is manageable. To the best of our knowledge, financial instruments which hedge to an average of previous rates do not exist. Alternatively, suppliers could simply hedge the portion of their debt which is maturing in each year to the current five-year risk-free rate, but this introduces a mismatch between the portion of their debt exposed to that risk-free rate, and the weighting it is given in the regulatory allowance.*

In section 4.6 of its report, CEG note that it considers that the Commission has misunderstood how regulated suppliers would hedge a TACD. CEG state in paragraph 101:

An EDB [or regulated supplier] does not need a “financial instrument which hedges to an average of previous rates” under the TACD anymore than it needs one under the status quo. Similarly, there is no requirement to fix rates at the time that debt is raised. All that is required is that when debt is raised it be converted into floating rate creating a 100% floating rate underlying portfolio. This can then be fixed at any future time consistent with the incentives created by the regulatory regime (e.g., 100% every five years, 20% every year (5-year TACD), 12.5% every year (8-year TACD), 10% every year (10-year TACD) etc).

We agree with CEG’s statement. If a TACD was adopted, Transpower would undertake a hedging approach similar to that set out by CEG. We would not need a financial instrument to hedge an average of previous rates, nor would we need to adopt a hedging approach that would introduce a mismatch between the portion of debt exposed to that risk-free rate and the weight it is given in the regulatory allowance.

This clarification goes to one of the Commission’s arguments around the administrative burden of shifting to a TACD. We consider, and supported ENA, Powerco, Vector, Chorus, and CEG, that the Commission has overstated the administrative costs of a TACD.

A 10-year trailing average is more suitable for large, long-life infrastructure providers

While submitters have varying preferences regarding the optimal length of a trailing average, several submissions present evidence favoring a longer averaging period for capital-intensive, larger networks. Both Vector and the Big Six EDBs (through CEG) emphasize that:

- large infrastructure providers usually issue long-term debt to effectively manage refinancing risks;
- a longer trailing average is more representative of portfolio-based financing strategies;
- extending the averaging period significantly lessens sensitivity to reset timing and short-term market fluctuations.

Transpower argues these factors are especially pertinent for transmission companies and other large network operators, whose assets last for decades and require investment planning far beyond the duration of a single regulatory cycle.

In such cases, adopting a 10-year TACD would likely align allowed revenues more closely with efficient financing costs for larger organizations compared to a shorter averaging period, without reducing incentives to invest or the ability to control excessive profits.

Sectoral differences justify tailored approaches rather than a one-size-fits-all method

According to submissions from NZ Airports (15 April 2026) and BARNZ (16 April 2026), concerns about using a trailing average often stem from sector-specific features like lower leverage, shorter asset durations, or alternative financing arrangements.

Transpower maintains that these differences strengthen the argument for recognising variations in scale, asset lives, and financing practices across regulated sectors. Permitting a longer trailing average for major electricity and transmission networks would enhance the regulatory framework and remain consistent with Part 4 objectives.

Yours sincerely,

Joel Cook

Head of Strategy and Regulation