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Dear Ben and Kirsty

IM review: cost of capital draft decision (fibre and regulated suppliers under Part 4)

1. This is Vector's submission on the Commerce Commission's (Commission) draft decision on the common cost of capital IM review for fibre and regulated suppliers under Part 4.
2. No part of this submission is confidential, and we are happy for it to be published on the Commission's website.
3. The Big Six EDBs engaged CEG to consider the Commission's analysis into the trailing average cost of debt. CEG's report has been provided in response to this consultation.

Executive summary

4. We appreciate the Commission has put significant thought and analysis into its draft decision on the trailing average cost of debt and has recognised stakeholder concerns about volatility between resets.
5. We also appreciate the Commission's willingness to engage with stakeholders about the draft decision. This has added to our understanding of the issues and, hopefully, resulted in more informed submissions and relevant empirical evidence.
6. We consider a trailing average cost of debt will better support the long-term benefit of consumers. We support a 10-year trailing average cost of debt consistent with Australian regulatory precedent. However, we also consider a 5-year trailing average cost of debt would be materially better than the status quo.
7. We note the Commission has stated its decision is "finely balanced." We consider – even without the additional evidence provided to this consultation - there are at least two factors that should tip the scales in favour of a trailing average:
 - **International regulatory precedent:** As explained in the Commission's expert report from Frontier Economics, nearly all Australian regulators have now

implemented some form of trailing average.¹ We understand regulators in the UK also use a trailing average cost of debt. There are regulatory certainty benefits to having consistent regulation with similar jurisdictions; and

- **Stakeholder support:** There is significant support from stakeholders to implement a trailing average cost of debt. Both regulated parties and their customers (e.g. MEUG and energy retailers) have advocated the Commission implement a trailing average. All other things being equal, we consider the durability of the regulatory framework is better supported by pursuing the methodology that all stakeholders appear to support (although we do recognise this may depend on the smoothing benefits expected by stakeholders – in our view the Commission’s modelling under-states these benefits).

8. CEG’s expert report for the Big Six provides additional evidence for the Commission that:

- A TACD has significant smoothing benefits;
- The investment incentive problems identified by the Commission in relation to a 10-year TACD actually apply to all methods. However, what the Commission may have overlooked in its analysis is that the status quo method sees the greatest divergence between the prevailing cost of debt and regulatory allowance; and
- Weighting by net capex can eliminate the investment incentive problem. It would be simplest to weight under a TACD.

9. We’ve summarised our understanding of the Commission’s reasoning for its draft decision not to implement a trailing average cost debt and our response in the table below. We have not addressed telecommunications specific issues.

Topic	Vector response
Draft decision not to implement a trailing average cost of debt	
Smoothing and volatility The Commission considers stakeholders may have over-estimated the smoothing benefits of a trailing average cost of debt as the Commission’s modelling shows the <i>“differences between the current approach and a trailing average approach have very small differences on the revenue allowances we set.”</i> ²	We consider the Commission’s reasoning under-weights the smoothing benefits shown in its own analysis: • Table X1 in the Draft Decision shows a 45% revenue increase under the status quo (25% once smoothed) versus a 36% increase for a 5-year TACD and 27% 10-year TACD. • These are not insignificant differences.

¹ Frontier Economics, *Return on debt and risk free rate: Report for New Zealand Commerce Commission* (July 2025), para 85

² Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at X14

	From an investment point of view, if Vector faced a 45% revenue reduction (i.e. if the situation was reversed), this would have an impact on our ability to invest. If the Commission did not apply smoothing, we would experience a significant difference between a 45% reduction and a 36% reduction. We recognise that price increases have multiple drivers, however, we consider there remain significant benefits to consumers in reducing areas of volatility that can be addressed by regulation. CEG has reviewed the Commission's modelling. CEG has found and corrected some modelling errors and extended the analysis with sensitivity testing and Monte Carlo simulation. CEG's report found the Draft Decision: <i>"understates the potential for the status quo to generate very unstable revenues between regulatory periods and understates the potential for a TACD to materially reduce this volatility."</i>³
Use of existing tools for smoothing The Commission noted it achieved similar smoothing to a TACD using the tools available and that, in addition to the IM review objectives, <i>"our draft decision is to retain the current hybrid approach because we can use other existing tools to alter the revenue profile between and within regulatory periods"</i>⁴	We agree the Commission has existing discretionary tools which are not set out within the IMs that it can use to reduce price shock and these were used to significantly reduce price shock in the last DPP reset. We consider these tools are complementary to a TACD rather than an alternative. They could have delivered greater benefits if a TACD had been in place.

³ CEG, *Economic assessment of status quo and TACD debt methodologies: A report for the Big Six EDBs* (April 2026) para 18

⁴ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at X20

	Consumers would have benefited from a lower starting point (i.e. 36% or 27%). This would have reduced the amount of smoothing applied and therefore less revenue would need to be recovered later in the period (assuming the Commission would still have targeted a 25% increase). We consider there are significant limitations from a regulatory certainty perspective if the Commission relies solely on the existing discretionary smoothing tools. We are unclear and uncertain what would have occurred if the situation was reversed and EDBs faced a significant decrease in revenue. The precedent of DPP3 appears to suggest an immediate and full reduction in revenue. In the absence of a financeability IM, stakeholders have no certainty how the Commission will manage significant price changes in future (particularly any significant price decreases). This would undermine incentives to invest. Accordingly, we consider a TACD better supports investment incentives by providing better certainty around step changes between periods. It also better supports the certainty purpose of the IMs.
Complexity The Commission also expressed concern that a TACD would introduce complexity and transition costs. The Commission considered implementing a weighted TACD could be complex, noting <i>“the AER’s recent discussion paper highlights that there is uncertainty about just how complex this issue can be. On this basis, we do not consider this to be a settled issue, and we are uncertain</i>	We consider the benefits that a TACD could provide (in terms of smoothing and promoting incentives to invest) are likely to outweigh complexity and transition costs. We do not consider that complexity is a reasonable reason for not implementing regulations that are clearly in the long-term interests of consumers and suppliers. Many of the current regulatory settings are complex for example IRIS however the Commission has implemented such regulations as they deliver better outcomes.

<i>that we could simply and effectively implement such a weighting mechanism if we were to adopt a TACD.”⁵</i>	CEG’s report provides two methods proposed in Australia to implement a weighting mechanism. CEG found, <i>“these models are clearly presented and, in our view, easy to understand.”⁶</i> We note Frontier’s expert report for the Commission also considered implementing a weighted TACD would be simple (as acknowledged in the draft decision).
Part 4 purpose: Incentives to invest The Commission considered the cost of debt should enable an efficient EDB to reasonably align (hedge/refinance) its actual debt costs with the regulatory allowance. It found – • A 5-year TACD and the status quo perform similarly; but • A 10-year TACD performs worse (i.e. under a “simple” 10-year TACD if interest rates shift materially and the financing / expenditure profile differs from the constant 10% assumed.	CEG’s report explains the Commission’s concern about mismatching undermining investment incentives applies to all methods (i.e. the status quo, a 5-year TACD and a 10-year TACD). Most notably, CEG’s empirical analysis found the greatest divergence between prevailing debt costs and the regulatory allowance under the status quo. Incentives to invest are best supported by weighting to RAB growth. This is more easily done under a TACD.
Part 4 purpose: Incentives to invest under a 5 year trailing average The Commission found a five-year trailing average and the status quo can provide regulated suppliers with incentives to invest. However, the Commission considered a shorter trailing average could raise the following risks: • Refinancing risk: If regulated suppliers must shorten their debt portfolios to match a five-year trailing average, this	The Commission’s refinancing statement implicitly assumes a trailing average allowance forces firms to shorten their debt portfolio. That is not necessarily true. A trailing average cost of debt method is not a debt maturity mandate. CEG’s report explains these concerns are based on a misunderstanding of how EDBs hedge. How EDBs hedge under the status

⁵ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at 4.75

⁶ Ibid para 86

may introduce a level of refinancing risk they are not comfortable with • 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	quo and how to hedge under a 5-year TACD are “largely identical.”⁷ We don’t agree a 5-year TACD cannot be hedged by a firm that issues longer-tenor debt. Efficient firms routinely manage interactions between issuance tenor and hedge tenor through portfolio strategies. While Vector’s preferred approach remains a longer-tenor trailing average, we consider a 5-year TACD would be materially better than the status quo.
Part 4 purpose: limiting supplier ability to extract excessive profits The Commission considered retaining the prevailing approach better promotes the objective to limit supplier ability to extract excessive profits over a 10-year trailing average The Commission stated: <i>“Given longer-term interest rates tend to be greater than shorter-term interest rates, adopting a ten-year trailing average is likely to result in higher prices over the long-term for consumers. This is because the bonds we would use to estimate the RFR would more likely be ten-instead of five-year</i>	Ultimately, the Commission’s draft decision appears to be driven materially by the fact that 10-year yields tend to be higher than 5-years We recognise this is an important consideration to support the long-term benefit of consumers and the regime should avoid overcompensation and outcomes that could be characterised as excessive profits. The higher cost of 10-year debt reflects a market premium for stability. Investors prefer lower cash flow volatility with long term investments and are willing to pay a term premium to avoid re-investment risk.

⁷ Ibid, section 4.6

bonds, which would result in a higher risk-free rate, and ultimately higher allowed revenues and prices”⁸

Accordingly, we consider the question is whether consumer interests are better served by an overall slightly lower cost of debt or less volatility in pricing at resets.

Based on recent experience, we consider consumer interests can be best supported by reducing volatility through a 10-year TACD. Under the status quo –

- Consumers faced significant price increases in DPP4. These would have been mitigated by a 10-year TACD (particularly combined with existing smoothing tools); and
- In DPP3, EDBs faced material under-compensation and financeability stress driven by very low real risk free rates in DPP3 (including a negative real risk-free rate in the lead up to DPP3).

We also note all Australian regulators use a 10-year term (as set out in Frontier’s report). This should provide comfort to the Commission that the use of a 10-year TACD would not result in excessive profits given these regulators have a similar mandate to the Commission.

In any event, we consider the status quo represents the worst of all worlds given it has higher volatility than the 5-year TACD but no cost savings relative to the 5-year TACD (plus TCSD and hedging costs).

We also note that supplier’s issue longer dated debt as it transfers repricing risk to the counterparty. The Commission recognises a premium is required for this risk transfer under the TCSD. We are therefore uncertain why the Commission considers this premium as excessive profits. We consider it would be

⁸ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at 4.89

	better characterised as the cost to consumers of that repricing risk transfer.
Tax Adjusted Market Risk Premium (TAMRP)	
The Commission has proposed a number of changes to the TAMRP that will move the TAMRP closer to a 'conditional' rather than 'unconditional' TAMRP.	Overall we welcome the changes to the TAMRP to – • Remove the hard coded value and recalculate it at each reset; and • remove the DGM and surveys. CEG's report considers implications in the cost of equity calculation and how changes to the cost of equity could also impact smoothing/volatility.

Revenue smoothing benefits of a TACD

1. The Commission's view is that stakeholders may have over-estimated the smoothing benefits of a trailing average cost of debt. Table X1 in the draft decision (reproduced below) provides the Commission's modelled revenue increases in DPP5 under various approaches.

Table X1 Modelled revenue figures under various approaches (nominal, \$000's)

Approach	2025	2026	Increase
Prevailing approach prior to smoothing	539,899	782,175	45%
Prevailing approach post-smoothing	539,899	674,874	25%
Five-year trailing average cost of debt	563,996	769,604	36%
10-year trailing average cost of debt	583,978	739,531	27%

2. In our view, the Draft Decision under-states the smoothing impact of a TACD shown in the Commission's modelling. A 45% revenue increase is significantly larger than under the 5-year (36%) and 10-year (27%) TACD.
3. The Draft Decision notes that the Commission used its existing tools to achieve a similar result to a TACD. However, as acknowledged in the Draft Decision, these tools could also be applied under a TACD.

4. Consumers would have benefited from a lower starting point (i.e. 36% or 27%) if a TACD had been in place. This would have reduced the amount of smoothing applied and therefore less revenue would need to be recovered later in the period (assuming the Commission would still have targeted a 25% increase).

5. NERA's report for the ENA, Transpower and Chorus explains:

*"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."*⁹

6. Accordingly, we consider a TACD combined with smoothing would have delivered a better outcome for consumers in DPP4 in terms of reducing volatility and bill shock.
7. It is worth noting that the significant price increases in DPP4 came off the back of very low prices in DPP3 which was set during a period of historically low bond rates (including a negative real risk-free rate in 2019). This resulted in under-compensation for EDBs and financeability concerns.
8. We consider consumer interests are harmed by these swings in electricity pricing. Regulatory certainty (for both consumers and suppliers) would benefit from more smoothing included in the rules. Incentives to invest would certainly be compromised if suppliers faced another price-path set on the back of a negative risk-free rate for the cost of debt. Extreme volatility in the eyes of consumers and law makers only challenges the durability of the regulatory framework, the effectiveness of which, may ultimately be called into question if consumers repeatedly experience price volatility, such as that observed for DPP4 in future periods. Our strong preference would be for the Commission to act to reduce the size of such volatility by adopting a relatively orthodox regulatory input such as trailing average cost of debt and thereby serve to lift consumer confidence in the regime.

The Commission's model understates the smoothing effect of a TACD

9. CEG has analysed the Commission's modelling and extended the analysis with sensitivity testing and Monte Carlo simulation.
10. We have not reproduced the analysis here as CEG's report has been submitted to the consultation.
11. CEG found that:

⁹ NERA, *Trailing average vs prevailing approach to the cost of debt: Transpower, ENA and Chorus* (April 2016), para 21

- a. *“Shifting the DPP start date by one year, causes the relative smoothing advantage of the TACD to be substantially larger than that observed at the actual DPP3-to-DPP4 transition. Monte Carlo analysis calibrated to New Zealand’s historical interest rate dynamics confirms that the TACD consistently outperforms the status quo across a wide distribution of outcomes. The maximum revenue jump simulated under the status quo was 148%, compared with 68% and 59% under the 5 year and 10 year TACD respectively. At the 90th percentile these figures are 53%, 40% and 37% respectively; and*
- b. *Since within-DPP smoothing can be applied equally under either approach, the NZCC’s comparison of the smoothed status quo against the unsmoothed TACD does not inform the question of which underlying cost of debt methodology is preferable. The correct like-for-like comparison, with both approaches assessed without additional within-DPP smoothing, shows the status quo produced a 45% revenue jump from the end of DPP3 to the start of DPP4 compared with 36% and 27% under the 5 year and 10 year TACD respectively. This is a material difference.”¹⁰*

12. We consider the evidence provided by CEG should be sufficient to provide comfort to the Commission that the smoothing benefits of a TACD are material and are worth pursuing to reduce volatility for consumers and preserve incentives to invest.

Regulatory certainty and the use of smoothing

13. The Draft Decision notes that the Commission achieved similar results (in terms of minimising price increases) to a TACD by applying the smoothing tools available to it.
14. As described above, these smoothing tools could have performed better from the starting point provided by a TACD.
15. While these tools performed well in DPP4, regulatory certainty is not supported by solely relying on the Commission’s discretion. Stakeholders cannot be sure how the Commission will apply its smoothing tools in future (indeed, the Commission applied them slightly differently between GDB DPP3 and EDB DPP4). The Commission cannot provide these assurances given the potential for staff change and political/legislative change.
16. From an investment perspective, we are unclear how the Commission would handle a significant decrease in allowed revenues (and in the current macroeconomic climate a significant decrease is within the realm of potential outcomes next DPP). This makes investment planning difficult since economic conditions continue to be volatile.

¹⁰ CEG, *Economic assessment of status quo and TACD debt methodologies: A report for the Big Six EDBs* (April 2026), para 4

17. While a TACD would not remove all uncertainty associated with changes in the WACC, the benefits it would provide are material. Accordingly, we consider they would have a material beneficial impact on incentives to invest.
18. If the Commission does not implement a TACD, we consider an alternative mechanism to support investment certainty around volatility between regulatory periods (such as a financeability IM) will be needed to maintain incentives to invest.

A weighted TACD best supports the Part 4 purpose

Incentives to invest

19. The Draft Decision explains that incentives to invest are promoted where, *“regulated suppliers can broadly match our regulatory allowance, achieving the necessary alignment to promote incentives to invest.”*¹¹
20. The Commission considered a 10-year simple TACD could undermine incentives to invest due to mismatch between the prevailing cost of debt and regulatory allowances.
21. The Draft Decision stated:
- “Although actual interest rates on new borrowing can move away from the regulatory allowance throughout the regulatory period, the regular resetting of prices (and the allowed cost of debt) should allow changes in financial markets to flow through to the regulatory allowance relatively quickly, minimising these mismatches.*
- This may not be the case under alternative approaches such as a simple ten-year TACD, under circumstances where interest rates shift materially and the financing / expenditure profile differs from the constant 10% assumed, due to the long length of the averaging period assumed.*¹²
22. CEG’s report explains the potential for prevailing interest rates to shift materially from the regulatory allowance exists under all methods (not just a 10 year TACD). This may be most pronounced under the status quo based on historical performance.
23. This is supported by empirical analysis from CEG on matching between the prevailing cost of debt and 5 and 10 year TACD.
24. CEG’s report explains:

¹¹ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at 4.67

¹² Ibid, 4.69

“The NZCC’s discussion is found in paragraphs 4.67 to 4.78. In these paragraphs the NZCC proceeds on the basis that it is an empirical fact that:

- a. The 5 year TACD and the status quo regulatory methodologies will result in similar deviations from the prevailing cost of debt; and*
- b. The 10 year TACD will result in materially larger deviations.*

*However, no empirical analysis is performed to determine whether this is, in fact, the case. In this section we perform such an analysis and find that, on the contrary, **the status quo methodology result in the largest deviations between the prevailing cost of debt and the regulatory allowance.** The 5 year TACD has the lowest deviations and the 10 year TACD lies between the other two (but closer to the 5 year TACD).¹³ [emphasis added]*

25. Accordingly, we do not consider the status quo best promotes incentives to invest. Based on CEG’s empirical analysis, the status quo has had the greatest deviation between the prevailing cost of debt and regulatory allowance.

26. CEG further explains:

“The fact that the status quo was a less accurate predictor of prevailing rates even in the first year of the DPP illustrates that one cannot presume that just because it relies more heavily on the most recent risk free rate estimates that this means that it is more representative of costs during the first year of the DPP (let alone in the latter years). This is because the status quo risk free rate is estimated over the three months to August 2019 while the regulatory year only begins 7 months later and ends 19 months later. Even in the first year of the DPP there is a material probability that the status quo risk free rate will be “stale” (not representative of prevailing debt costs).

The same is, of course, true of the 5 and 10 year TACDs. However, the key point of this analysis is that one cannot assume that this makes the TACD methodologies less accurate reflections of the prevailing cost of debt than the status quo.

...

we are still relying on a limited data set of 15 years of comparisons and it is possible that this period is not representative. However, this analysis strongly suggests that the NZCC’s presumption that the status quo method will result in cost of debt estimates most similar to the prevailing cost of debt is not supported by the available evidence. That evidence suggests that, if anything, it is the least accurate methodology of those considered.”¹⁴

27. CEG’s report concludes:

¹³ CEG, *Economic assessment of status quo and TACD debt methodologies: A report for the Big Six EDBs* (April 2026), para 30 - 31

¹⁴ *Ibid*, 39-45

“contrary to the draft decision conclusion, the status quo is a less accurate proxy for the prevailing cost of debt than either the 5 year or 10 year TACD, and therefore has worse investment efficiency properties.”¹⁵

28. CEG’s report explains the solution to these issues is weighting the cost of debt to net capex so that RAB growth is compensated at prevailing rates.

Weighting by net capex and complexity

29. The investment incentives problem would be solved by weighting the RAB by net capex so RAB growth is compensated at prevailing rates. This approach will best promote incentives to invest by regulated suppliers.

30. The Draft Decision acknowledged that weighting *“could in theory achieve a closer match between actual debt costs and the regulatory allowance, especially when actual financing practices differ from the constant refinancing assumption.”¹⁶*

31. However, the Commission was concerned about complexity. The draft decision noted that, *“Although the Frontier Economics report considers this to be simple, the AER’s recent discussion paper highlights that there is uncertainty about just how complex this issue can be. On this basis, we do not consider this to be a settled issue, and we are uncertain that we could simply and effectively implement such a weighting mechanism if we were to adopt a TACD.”¹⁷*

32. CEG’s report sets out two models of a weighted TACD proposed in Australia (one proposed by the AER and one by the Queensland Treasury Corporation). CEG found, *“these models are well presented and, in our view, easy to understand.”¹⁸*

33. We consider these models represent a simple way to implement a weighted TACD that the Commission could adopt. CEG recommends the Queensland Treasury Corporation as preferable.¹⁹

34. Accordingly, it is not clear to us that implementing a weighted TACD is necessarily complex. Both Frontier’s expert report for the Commission and CEG consider it can be done simply.

35. In any event, we don’t consider complexity is a reason for the Commission to avoid implementing a weighted TACD. There are many aspects of the regime that have been

¹⁵ Ibid, para 2

¹⁶ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026) at 4.18

¹⁷ Ibid at 4.75

¹⁸ CEG, *Economic Assessment of TACD: A report for the Big Six EDBs* (April 2026), para 86

¹⁹ Ibid, para 87

complex to implement but deliver outcomes that support the long-term benefit of consumers (e.g. IRIS). We expect the benefits provided by a weighted TACD would similarly outweigh any complexity in implementation.

Ability to hedge under a 5-year TACD

36. The Commission sought feedback from stakeholders on whether a shorter length of trailing average would raise issues for suppliers in terms of re-financing risk and hedging.

37. We do not consider re-financing risk or hedging would be an issue under a 5-year TACD.

38. CEG's report explains:

"The only difference to a 5-year TACD is that the regulator is fixing the rate of compensation for the regulatory allowance – every year for 20% of the debt RAB. It follows that the hedging strategy to the 5-year TACD nearly identical to under the status quo.

- a. Creating an underlying floating rate portfolio (identical to the status quo); and*
- b. Fix 20% of the underlying portfolio for 5 years every year*

Put simply, issuing 10 year debt and hedging the simple 5 year TACD is the same as issuing 10 year debt and hedging the simple hybrid. The 5 year TACD can be thought of as dividing the debt RAB into fifths and then applying the simple hybrid to each fifth but on a one year staggered time line. Indeed, an N-year TACD is the same as dividing the RAB into N^{th} s and applying the simple hybrid to each N^{th} but on a one year staggered time line.

An EDB 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)."²⁰

A 10-year TACD would not result in "excessive profits"

39. Our understanding is the Commission ultimately ruled out a 10-year TACD on the basis 10-year debt tends to be more expensive than 5-year debt.

40. The Draft Decision stated, "One benefit of the prevailing approach is that regulated suppliers can hedge their exposure to a shorter-term interest rate, which means that

²⁰ Ibid, para 97-99

consumers will be exposed to lower prices on average than they would under longer-term rates being used.

If we were to adopt a ten-year TACD, and suppliers wanted to match the regulatory allowance on their existing debt portfolio, this would require that they roll over 10% of their debt portfolio in each year (commensurate with the weighting that each year's interest rate receives in the allowance). This would require the chosen term on their debt issued, and allowed for in the TACD, to be 10 years.

Given longer-term interest rates tend to be greater than shorter-term interest rates, adopting a ten-year trailing average is likely to result in higher prices over the long-term for consumers. This is because the bonds we would use to estimate the RFR would more likely be ten-instead of five-year bonds, which would result in a higher risk-free rate, and ultimately higher allowed revenues and prices.

Furthermore, based on our confidential debt surveys, many of our regulated suppliers issue debt with a maturity shorter than the current allowance (which is typically five years for EDBs / Transpower / airports, aligning with the length of their regulatory periods). If they continue to issue shorter-term debt, whilst being compensated for longer-term debt under a ten-year TACD, this would likely result in them earning excessive profits.

On balance, we consider our draft decision promotes the statutory purpose by limiting suppliers' ability to extract excessive profits better than a ten-year TACD does.”²¹

41. We agree this is an important consideration and the regulatory framework should not enable stakeholders to extract excessive profits.
42. We acknowledge the 10-year cost of debt is likely higher than the 5-year cost of debt. It is important to consider whether the long-term benefit of consumers is supported by these costs.
43. The higher cost of 10-year debt reflects a market premium for stability. Investors prefer lower cash flow volatility with long term investments and are willing to pay a term premium to avoid re-investment risk.
44. Accordingly, the question is whether consumer interests are better served by an overall slightly lower cost of debt or less volatility in pricing at resets.
45. Based on recent experience, we consider consumer interests can be best supported by reducing volatility through a 10-year TACD. Under the status quo –

²¹ Commerce Commission, *Common cost of capital input methodologies review (fibre and regulated suppliers under part 4: Draft decision reasons paper* (10 March 2026), 4.87 – 4.91

- Consumers faced significant price increases in DPP4. These would have been mitigated by a 10-year TACD (particularly combined with existing smoothing tools); and
- In DPP3, EDBs faced material under-compensation and financeability stress driven by very low real risk free rates (including a negative real risk-free rate in the lead up to DPP3).

46. In relation to the Commission's concern that suppliers could extract excessive profits by issuing short-term debt while being compensated for longer-term debt, NERA's report for the ENA, Chorus and Transpower explains that, *"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."*²²

47. CEG's report also considered:

"NZCC reporting of EDBs with WATMI of less than 5 years are outliers from an Australian perspective. It is possible that this is because, unlike in Australia, there are numerous very small EDBs who are not able to efficiently issue into the investment grade bond market. These EDBs likely are forced to rely on relatively short term bank debt."

Given that the NZCC leverage assumption is based on observed leverage of large, listed firms and the cost of debt is based on the observed yield on investment grade bonds it would be internally inconsistent if the NZCC sought to set its benchmark debt management practice based on small EDBs who do not have access to the investment grade bond market. Moreover, given that small scale EDBs lack of access to bond markets is a symptom of higher costs, it would be peculiar to form the view that adopting a benchmark consistent with what larger more efficient EDBs actually do would lead to "excessive profits" for small EDBs...

*More generally, firms can choose to depart from the regulatory benchmark but, if they do so, they take on risk. One would expect that if the regulatory benchmark was based on the issuance of 10 year debt rather than 5 year debt then suppliers would tend to raise the tenor of their debt issuance. If some suppliers who could, but chose not to, align their debt management practices with the benchmark, they may indeed realise gains relative to the allowance. But they do so at the cost of higher risk. Moreover, that possibility is not unique to a 10-year TACD. Any benchmark methodology can create gains or losses for a supplier that chooses to manage its debt in a manner that differs from the benchmark assumption. A benchmark allowance is not invalid merely because some suppliers may choose not to hedge or not to align with it."*²³

²² NERA, *Trailing average vs prevailing approach to the cost of debt: Transpower, ENA and Chorus* (April 2016) Para 40

²³ CEG, *Economic Assessment of TACD: A report for the Big Six EDBs* (April 2026), paras 108-110

Allocation of risk to consumers

48. A related consideration is the appropriate allocation of risk to consumers.
49. Under the prevailing approach, the allowed risk-free component for the cost of debt is set using a single relatively short window ahead of the regulatory period. This creates timing risk: the single sample period from the yield curve in that window could be unusually low or high relative to the period that follows. A TACD reduces this sensitivity by replacing “one sample period” with an average of multiple past sample periods so the allowance becomes less dependent on any single window or start-date.
50. A TACD reduces the variance of the interest-rate component passed into allowed revenues between regulatory periods. This can benefit consumers who have less ability to manage that risk than suppliers
51. NERA’s report for the ENA, Transpower and Chorus explains:
“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.”
- Consumers, by contrast, have no means to mitigate the interest rate pricing risk component of their utility bills.*
- 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.”²⁴*
52. Frontier’s expert report for the Commission makes substantively similar points.
53. Frontier explains that the move away from spot-rate and rate-on-the-day approaches was driven by the need to avoid windfall gains and losses caused by interest rate timing effects and to better align allowed returns with efficient financing costs.²⁵ Frontier further explains that trailing average approaches smooth movements in the return on debt, resulting in lower price volatility for consumers, while ensuring that allowed revenues reflect efficient debt costs on an ongoing basis rather than resetting all exposure to prevailing rates at a single point in time.²⁶ By setting the allowed return on debt equal to benchmark efficient financing costs in each regulatory period, a trailing average approach

²⁴ NERA, *Trailing average vs prevailing approach to the cost of debt: Transpower, ENA and Chorus* (April 2016), paras 16 - 18

²⁵ Frontier Economics, *Return on debt and risk-free rate* (July 2025) paras 67–70

²⁶ Ibid, para 81

avoids intertemporal over- or under-recovery and prevents different cohorts of consumers from bearing the consequences of short-term interest rate movements.²⁷

Conclusion

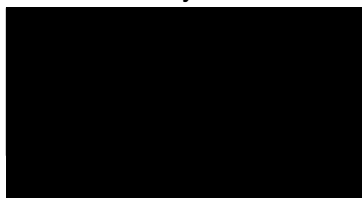
54. We have appreciated the Commission's willingness to engage on this issue and that the Commission is live to stakeholder concerns about volatility between periods.

55. We consider the additional evidence provided by CEG's report, and by NERA for the ENA, Chorus and Transpower, should provide the Commission confidence that implementing a weighted trailing average will best support the Part 4 purpose and support regulatory certainty. As explained by CEG:

- The smoothing benefits of a TACD are material; and
- The investment incentives problem identified by the Commission (where prevailing rates diverge from the regulatory allowance) apply to all methods. Arguably, this applies most strongly to the status quo. Weighting by net capex would address this issue and would be more simple to implement under a TACD.

56. In our view, the status quo performs the worst of the three options (status quo, 5-year TACD or 10-year TACD) and the relevant question should be what form of TACD to adopt. In our view a 10-year TACD is the best approach given it will have the most material impact on volatility between periods.

Yours sincerely



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²⁷ Ibid, para 78 - 80