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Major Electricity Users Group Inc
Wellington

By email: ralph@meug.co.nz

Attention: Ralph Matthes

**COMMERCE COMMISSION REVIEW OF WACC PERCENTILE – SPECIFIC LEGAL ISSUES ARISING FROM SUBMISSIONS**

## Executive Summary

1. You have asked for advice on legal issues which arise from the primary submissions to the Commerce Commission ("Commission") on its proposed amendment to the WACC percentile for electricity lines services and gas pipeline services.

2. In summary, our advice is:

   (a) The purpose statement in s 52A requires the Commission to use a consumer welfare standard when making determinations under Part 4. The Commission would err in law were it to apply a total welfare standard, as it would fail to take proper account of welfare transfers between suppliers and users of the regulated services.

   (b) The Commission cannot rely on the promotion of incentives to invest to justify setting a regulatory WACC above the best estimate of a normal return, as that would not be consistent with outcomes produced in competitive markets and contrary to the purpose of part 4..

   (c) If that opinion is wrong, and it is permissible for the Commission to promote a permanent or indefinite extraction of excess profit with a view to incentivising investment, it must still operate within the legislative parameters. This means:

      (i) It needs first to conduct a disciplined assessment of the effects of assured excess returns on innovation. There is no legislative indication that incentives to invest outweigh incentives to innovate. For example, that assessment should consider the particular costs of excess investment incentives on an RAB with an average life of many decades, and an absence of competitive market effects of obsolescence.

(ii) It must find that there is a real and not theoretical asymmetry, which needs detailed real world examination of the scale of investment (and its proportion of the RAB, on which excess returns are earned) that is relevant to likely causes of consumer loss.

(iii) It must find that supplier investment behaviour is likely to be affected in the intended way by the incentive:

(iv) It must find that the incentive is the best way to produce the desired outcome, having regard to the range of regulatory tools available, and their intended and unintended costs.

3. From what we have seen of the advice of NZIER and IWA none of the above conditions for justifying an uplift have been satisfied to the standard the High Court would have expected. You ask whether that means the mid-point estimate for WACC represents a position from which the Commission cannot safely depart without discharging an onus established by the tests outlined above. In our opinion a Court would not express the question in those terms, but for practical purposes that is the effect of the material before the Commission. This is despite the Commission's problem in having expert advisors who have started from a critically under-examined position that asymmetry is likely, material, and determinative.

4. In our opinion the described outcomes in s 52A(1)(a) to (d), do not allow the Commission to trade away from the best estimate of a normal return for suppliers in the absence of real world evidence that a midpoint WACC is likely to result in uncompensated costs to users. We do not see that evidence in the submissions. NZIER's advice is also to that effect.

5. We correct some previous advice to you. Partly in reliance on the High Court's emphasis on the progressive refinement possible under regulatory resets, when declining MEUG's application for leave to appeal to the Court of Appeal[1], we had suggested that the Commission should take account of its opportunity to revisit the uplift issue in 2017 when the scheduled complete review takes place. We indicated that the Commission might therefore be more bold in dropping the uplift completely, because it would be able to consider the effect on suppliers and investor reaction, and in effect make adjustments in two years in that light.

[1] *Major Electricity Users Group Inc* v *Commerce Commission* [2014] NZHC 1765

6. Prompted by the BARNZ focus on the centrality of certainty as the appropriate investment incentive, we have reconsidered the significance of the possibility of input methodology reviews. We now advise that in our opinion it would be improper for the Commission to rely, expressly or implicitly, on the possibility of future 'correction'.

7. As the Commission pointed out when it invited comment on the need for an interim review of the uplift after the High Court merit review decision, the very likelihood of change on review tends to negate whatever investment incentives lie in an uplift. Worse, it tends to nullify the primary benefit of certainty so well highlighted by BARNZ. The threat of change in the WACC formula may affect investor perceptions of risk and the certainty of expected returns in a way that is uncompensated.

8. Accordingly, in our opinion, the least cost/risk regulatory principle in this area would be to move immediately to the point best supported by the available firm data and most consistent with making the formula predictable, particularly against downside changes for investors. In our view, taking account of the strong steer in the High Court decision against un-anchored generosities or allowances for theoretical elements not established empirically, the estimate mid-point is the prudent choice.

9. The Commission may, or may not, acknowledge that it has to consider the likelihood of merit review challenges, and the cost/benefit calculations that impinge on supplier decisions on merit review expenditure. Whether or not it feels that it should do so, we think that under the law as it stands the suppliers have disproportionate incentives to appeal against any determination that falls below the favourable (to them) parts of the ranges of uplift favoured by the Commission's advisors. If a merit review appeal is likely, we think the Commission's strongest ground would lie in a starting position that is least reliant on discretion or 'guesswork' about factors that may have no empirical foundation.

**An uplift is not an outcome found in competitive markets**

10. First, we support BARNZ's focus on the primacy of the requirement to pursue consistency with the outcomes produced in competitive markets. That is not just a criterion to be balanced against the competing objectives of the following subsections. It is not optional or discretionary. The legislation is clear: consistency with competitive market outcomes is a necessary condition.

11. We are instructed that competitive markets do not offer indefinite or long term expectations of above normal returns. Competitive market conditions are to be replicated precisely because they are expected to see excess profits competed away. They are to be replicated because the prospect of a normal return is expected to result in the right

incentives for optimal investment: not too much and not too little. Accordingly we think that s 52A(1), properly read, invalidates a deliberate uplift per se.

12. The Commission may use other tools from its regulatory tool-box to address demonstrated or even suspected inadequacy of investment, or lack of efficiency or poor quality of service. But the law does not permit the Commission to use a long term super-profit for that purpose, if excess returns into an indefinite future are not consistent with competitive market outcomes.

13. In our opinion section 52A has a clear result. Methodologies must promote outcomes that are consistent with competitive market conditions. Until that preliminary purpose test is satisfied, the subsidiary and descriptive criteria cannot be applied. The Commission and the Court should apply them only after determining that that the base condition is satisfied. The condition cannot be displaced by a speculation of asymmetric social cost from putative under-investment. Even if the submissions and the opinions from the Commission's experts had established that:

    (a) There was underinvestment or a real world likelihood of it; and that

    (b) It affected consumers with costs that exceeded the compensation **to them** from the corresponding lowering of excess profit; and that

    (c) There were not mechanisms to address the putative inadequacy of investment other than by permitting a degree of excess profit;

    the Commission would not be authorised to offer that incentive by way of excess profit. Otherwise, it would promote conditions that were inconsistent with competitive market outcomes.

14. Even if we are wrong about the conclusive nature of that requirement, in the result, the submissions reveal no evidence of the kind mentioned in the preceding paragraphs. Despite the warning in the High Court merit review decision, suppliers have offered no material internal real-world information presumably available to them on those issues. We go into more detail below, but note that the suppliers have chosen not to:

    (a) Provide empirical evidence of under-investment adversely affecting consumers, in the absence of the uplift.

    (b) Explain why alternative elements of the regulatory regime are insufficient to protect against the loss risks of lowered reliability (which appear to be the only significant form of relevant loss).

(c) Address the High Court scepticism (necessity, not plenty, is the mother of invention) about any positive linkage between innovation and expectations of excess returns.

15. The Commission's duty to devise a methodology that first promotes outcomes consistent with competitive market outcomes does not mean that it must pursue the impossible. A methodology need not result in a perfect replication of competitive market outcomes. The constraint of the purpose provisions is on what the methodology promotes – not what is an unavoidable result of the absence of competition. The legal problem with the 67% uplift is that it is expressly explained as intended to result in an incentive level of return that is inconsistent with competitive market conditions. In our opinion, the purpose makes it unlawful.

**Welfare transfers matter**

16. Some economists engaged by the regulated suppliers would have the Commission interpret the purpose of Part 4 as though it mandated a net public benefit (*NPB*) test, or "total welfare standard" as it is now reframed.[2]. Those submissions are inconsistent with the wording of s 52A and wrong in law.

17. Section 52A reads:

> *(1) The purpose of this Part is to promote the long-term benefit of <u>consumers in markets referred to in section 52</u> by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—*
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> *(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
>
> *(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
>
> *(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
>
> *(d) are limited in their ability to extract excessive profits."*
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> *[emphasis ours]*

18. We endorse BARNZ's criticism of approaches that in effect adopt total welfare of net efficiency approaches to the regulatory purpose statements and the objectives of the

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[2] CEG on behalf of NZ Airports at paras 8-11, (endorsed by NZ Airports at para 44); Frontier Economics on behalf of Transpower at para 25(2) and section 3; Houston Kemp on behalf of Powerco at p(111) , sections 4.3, 4.6 (endorsed by Powerco at paras 7.8(b), 53.3, 100.2); Incenta at paras 2.1, 2.4; PWC at para 21; QIC at p 4

regulation. These approaches are arguably an unlawful attempt to resuscitate an indifference to wealth transfer issues that were the express target of the law changes that resulted in the current form of Part 4, as outlined by BARNZ. They may be an unconscious product of professional conservatism or resistance to the legislative objectives (that is not uncommon among experts in a discipline in which the law is thought to be intruding), or it may be conscious and opportunistic, but in either case it conflicts with the clear expression of the law.

19. The words highlighted in the chapeau to s 52A(1) "*consumers in markets referred to in section 52*" underscore the legislative intention to distinguish the objective from formulations that could be translated into total welfare terms. In the present context, the specific consumers are the users of electricity lines and gas pipeline services[3]. A total welfare appraisal would look at overall efficiency for consumers and producers generally, not just those that are immediately involved in "*markets where there is little or no competition and little or no likelihood of a substantial increase in competition*".

20. In *Powerco* v *Commerce Commission*[4] (*Powerco case*), Powerco argued that a reference to the interests of acquirers of particular services should only take into account "*net efficiencies*". The Court of Appeal, upholding a decision of Wild J in the High Court, disagreed. It said:

> *[21] We find no substance in this point. It is an attempt by Powerco to cast its argument for the primacy of NPB in terms of acquirers so as to give the argument traction within an expressly acquirer-centric test. It amounts to the proposition that what is good for the economy as a whole is good for any sub-set of it, and therefore good for a particular sub-set, in this case acquirers. That method of argument subsumes all particularised interests within the global interest of NPB, and is implausible in light of the expressly stated acquirer-based test of s 52. The Act's particular contemplation of the interests of acquirers in s 52(b)(i) would be vacuous if those interests amounted to no more than the interests of all (and any) other discrete subset(s) of the economy. NPBs, by their nature, do not discriminate between discrete groups in the economy. They are truly utilitarian, with each economic actor counting for no more or less than any other.*
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> …
>
> *[31] Part 4 provides a statutory remedy for markets in which there is inadequate competition and where the mechanisms in Part 2 (which apply to markets in which there are multiple participants, and which prohibit trade practices that substantially lessen competition) cannot apply.*

[3] Sections 52C, 54C and 55D of the Act; s 2(1) of the Electricity Act 1992; s 2(1) of the Gas Act 1992

[4] *Powerco* v *Commerce Commission* [2008] NZCA 289

> *[32] Section 52(b)(i) requires the Commission and/or the Minister to evaluate the costs and benefits of control with reference to acquirers. It would seem to subvert the purpose of this cost-benefit exercise not to consider the value of the monopoly (or monopolistic) company's excess returns and the extent to which their transfer would be in the interests of acquirers.*
>
> *…*
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> *[35] In the absence of express provision for NPB in s 52, and in light of the view we have taken of Powerco's submission that "the interests of acquirers" are to be construed with reference to net economic efficiencies only, we reject a reading of s 52 which includes a requirement that NPB be positive before control may be declared. We do not consider that "the interests of acquirers" can properly be construed without reference to wealth transfers, which are an obvious and significant benefit to acquirers.*

21. The *Powerco* case predates Part 4. However, in the merit review appeal decision, the High Court was satisfied that the case was still relevant and Parliament had chosen not to adopt an NPB (or total welfare) standard when enacting Part 4[5].

22. In short, section 52A means that embedding a general prophylactic generosity is not an authorised exercise of the Commission's discretion or judgement. It conflicts with the express intention of Parliament, reinforced by the legislative attention to Part 4 after the leading case on the significance of the purpose tests. Wealth transfers still matter and must be taken into account for all decisions under part 4 of the Act. There is also nothing in the legislative objective which would justify giving less than full weight to these wealth transfers.

23. Sapere is critical of the Commission for adopting a mix of consumer welfare and total welfare approaches for the purpose of any loss analysis[6]. The Commission's justification for this approach is that, when deciding whether to recommend the control of goods and services under part 4, it is required by s 52I(3) to "*quantify material distributional and welfare consequences on suppliers and consumers*".[7] However, s 52I(3) is context specific, and concerned only with determining whether to regulate goods and services. Section 52I(3) does not apply to services that have been regulated by Parliament nor to price-quality regulation. It is also itself subject to the overriding purpose of part 4 in s 52A, which precludes the use of an NPB test. We agree with Sapere that the Commission's approach is

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[5] High Court decision at [222], [660] to [666]

[6] Sapere, at section 4 is critical of the lack of clarity around this hybrid approach, albeit they do not endorse a consumer welfare standard

[7] CC para 2.17

ambiguous and uncertain. It is likely to cause unnecessary debate and unpredictability, contrary to the central purpose of part 4, which is to promote certainty.

**Absence of evidence that risk of under-investment exists**

24. Part 4 price-quality paths for Transpower and EDB have been set for almost five years and gas pipeline services have been subject to a default price-quality path since 1 July 2013. During these regulatory periods, the WACC estimate has been set at the 75th percentile.

25. The review of the primary submissions and other information before the Commission has found little to satisfy NZIER that there is a sufficient correlation between earning higher returns and providing incentives to invest or innovate. Asset management plans and other evidence of investment choices by regulated suppliers during these regulatory periods do not suggest that even the prospect of earning excess regulatory returns will necessarily incentivise suppliers to increase capital expenditure.

26. Despite recent relevant experience, the primary submissions contain little or no evidence about the specific circumstances of industry suppliers. For example, there is no *ex post* analysis or evidence of actual investment decisions undertaken during the current regulatory periods; nor of the extent to which different WACC estimates could have impacted on these decisions. The suppliers themselves make general, sometimes sweeping claims about hypothetical investment decisions, but provide no real evidence about their own operations:

    (a) The Electricity Networks Association (ENA) makes a general claim that the risks of natural disaster in New Zealand are substantial and there may be increasingly cheaper options for consumers[8] but provides no evidence to show that a WACC below the midpoint carried a real risk of socially-undesirable under-investment.

    (b) Powerco criticises the Commission for an alleged failure to consider evidence as to whether current investment levels are optimal[9], while apparently acknowledging that it has not itself provided any such evidence to help plug the gap[10].

    (c) While Orion refers to its own circumstances after the Christchurch earthquake, it does not provide evidence of any inability to fund new investment in light of that disaster nor as to how that might have been different had WACC been set at the

[8] ENA submission, at para 4 - 6

[9] Powerco submission, at paras 71 - 78

[10] Powero at 7.8(c), 71, 1, 100(3)

midpoint[11]. Orion is subject to a customised price-quality path determination until 31 March 2019 which will continue to use a WACC at the 75th percentile[12].

(d) Vector argues against the Commission relying on evidence of the actual circumstances of the regulated suppliers. It claims that the Commission should not assume that recent substantial investments and future investment plans by EDBs and Transpower are indicative of future investment[13]. Vector does not provide any alternative asset management or other plan in support of its submission.

(e) Transpower describes issues it might have when refinancing debt if the WACC were too low, but provides no evidence of any real refinancing risk were the WACC to revert to the midpoint[14]. Significantly, Transpower also confirms an earlier acknowledgement[15] that it would have proceeded with its substantial investment programme irrespective of the rate of the regulatory cost of capital[16].

27. In contrast, MEUG's 6 March 2014 response to the Commission's *Invitation to have Your Say on Whether the Commerce Commission Should Review or Amend the Cost of Capital IMs*, drew the Commission's attention to real data. You pointed out:

> *The scale of future capital expenditure can be observed in financial disclosures. For example Vector plans expenditure on network assets of $154m in 2013/14[2]. This planned capital expenditure is 6.1% of the closing RAB[3] at 31st March 2013, of $2,536m. An estimate of net new capital spending planned by Vector for 2013/14 can be approximated by netting of depreciation of $85m (assuming the same as for 2012/13[4]) to give a value of $70m ($154m - $85m). This estimate of net new capital expenditure is equal to just 2.7% of the RAB. The current "uplift" of 0.73% on Vector's RAB of $2.5 billion constitutes an enormous incentive for a disproportionately small amount of net new capital expenditure of $70m.* [17]

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[11] Orion submission

[12] Orion customised price-quality path determination [2013] NZCC 21

[13] Vector, executive summary at 7(e), para 67

[14] Transpower, executive summary, p 5; section 7

[15] At its 2010 AGM, before the first input methodology determinations, then Chief Executive Patrick Strange acknowledged that Transpower's planned capital expenditure would go ahead irrespective of the regulatory cost of capital

[16] Transpower, section 8.3.2

[17] MEUG submission to CC dated 13 March 2014, *Views on whether to review or amend the cost of capital input methodologies* at p 6

28. Submissions on the proposed amendment provided the first opportunity for suppliers to respond to MEUG's assessment of forecast net capital expenditure. As none of them appear to take issue with MEUG on this point[18], the Commission is entitled to assume that this is an accurate assessment of the scale of future capital expenditure.

29. You have asked us for advice on the implications of there being insufficient empirical evidence before the Commissions from a legal perspective, particularly in light of the purpose of Part 4 under s 52A of the Act and the High Court's interest in empirical testing of the asymmetric social cost speculation.

*There needs to be some causative link between excess return and incentives to invest and innovate*

30. Some submitters argue that the Commission's starting point in this review is the status quo, ie an uplift of WACC to the 75th percentile[19]. We disagree. In light of the purpose of part 4, the starting point must be to determine whether, or to what extent, there is in fact a positive correlation (in legal terms, a causal nexus) between excess returns and incentives to invest and innovate. Otherwise, any balancing exercise of one outcome against another will be carried out on a false or faulty premise.

31. The High Court found that the midpoint WACC was "*'right' ie free from bias*" and that departing from the midpoint "*involves the likelihood that suppliers will earn excess returns*". The High Court went on to say that this was "*clearly at odds with the s 52A(1)(d) purpose of limiting the ability of regulatory suppliers to extract excessive profits*". We understand that the Commission accepts these observations.

32. The core issue is whether the real risk of excessive returns over the long term is outweighed by the interest of consumers in investment and innovation– an outcome promoted by s52A(1)(a). Paragraph (a) is itself qualified by the chapeau of s 52A(1), which would incentivise only investment and innovation that is in the long term interests of consumers and consistent with outcomes produced in competitive markets. The Commission considers that after balancing the factors in paragraphs (a) and (d), it is justified in setting a WACC above the midpoint.

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[18] Although note Vector's submission at 7(e) and 67 that the Commission should give little weight to investment plans and forecasts

[19] Powerco, paras 25 – 32; Orion, paras 8-18; Transpower, executive summary at p 5, section 2.2; Unison, p 2; Vector at para 93

33. The High Court was particularly critical of the lack of evidence supporting a correlation between excess returns on the one hand and incentives to invest or innovate or other efficiency gains on the other[20]. It also challenged the logic of such an assumption, observing:

> *[1472] In the first place, the expectation of earning (only) a normal return on new investment ought to be an attractive proposition for a regulated supplier. In the price control regulatory framework, the return is almost guaranteed. Each supplier is a monopoly. The normal regulatory imperative in such circumstances is to prevent suppliers from over-investing. Why then, should higher likely returns be provided?*
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> *[1473] Secondly, it is far from obvious that higher than normal expected returns would stimulate greater efficiency of any kind. On the contrary, they would render excess profits likely, even if less effort were made by suppliers to generate efficiencies than in a workably competitive market. In monopoly enterprises, the concern is always to prevent inefficiency creeping in. Providing a revenue cushion is not the way to create the right incentives.*
>
> *[1474] If dynamic efficiencies are, as the Commission believes, most important, how exactly are higher expected returns supposed to stimulate them? Dynamic efficiency implies finding better ways to meet customer needs and adapting to changes in market circumstances. But necessity, not plenty, is the mother of invention. Utility industries – and certainly electricity transmission and distribution companies - are unlikely to be leaders in dynamic efficiency, precisely because they do not need to be.*

34. The Court specifically considered the intention behind including s 52A(1)(a) in the purpose statement. It concluded that promotion of these incentives would be primarily met by the increased regulatory certainty, over time, which Part 4 was designed to achieve. It said in particular:

> *[686] [The] overall purpose of Part 4 is to promote the long-term benefit of consumers of regulated goods and services, and not the interests, for example, of consumers of unregulated services or to provide more general incentivising effects which may be considered to be in the interests of the wider New Zealand economy. The incentives to innovate and invest to which s 52A(1)(a) refers are ones that are consistent with those provided by workably competitive markets. Similarly, in the August 2006 GPS, the Government's goal was that infrastructure be provided at the quality required by consumers and at an efficient price.*
>
> *[687] It is also important to understand how the purpose of providing incentives to invest was to be achieved by the new Part 4. Here, the legislative history is also of assistance. What that history, and in turn the provisions of Part 4, shows is that the increased certainty which the new regime was seen as providing was central to ensuring appropriate*

[20] IM Appeal Decision [1460] to [1481]

*incentives to invest in infrastructure and to innovate would exist. The Explanatory Note, when referring to the particular objective of the Bill as being to "provide specifically for incentives to invest in infrastructure", observes:*

"Certainty is considered a pre-requisite for this."

*[688] The certainty which was a specific purpose of setting IMs in advance was "expected to help to improve the climate for investment in infrastructure". The advantages of the new regime over Part 4A were seen to be that "firms will have greater certainty as to their obligations (including the consequence of breaches)"*

*…*

*[691] Overall, the certainty to be provided over time by the new Part 4 is central to the promotion of appropriate incentives to invest.*

35. The Commission has purported to rely on s 52A(1)(a) to justify an uplift from the WACC estimate that would otherwise be inconsistent with its statutory mandate under s 52A(1)(d). However, without an established causative link or at the very least an evidence based positive correlation between investment excess returns and investment that reduces the putative loss inducing conditions in the supplier's networks, the Commission appears to be relying on a non-sequitur. Any decision to uplift WACC on this premise would be inconsistent with the purpose of Part 4 and vulnerable to legal challenge. We read the NZIER advice as confirming that no such link has been established.

*Absence of Industry Evidence*

36. The High Court gave a strong steer to the Commission that when reviewing the input methodologies it ought not to rely solely on abstract theory but should carry out "*robust empirical examination, well-guided by theory, of the "actual facts of any particular case*" [21]. The High Court's approach echoes sentiments by the Court of Appeal twenty two years ago[22], when Richardson said of a similar economic decision-making process:

*[Pure] speculation as to the impact of constraints and simply intuition are no substitute for hard data drawn from empirical studies and evidence from participants in the industry. In the end the value judgment should be as informed by practical evidence as possible.*

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[21] [1486]

[22] *Telecom Corporation of NZ Limited* v *Commerce Commission* [1992] 3 NZLR 429

37. The High Court directed that the Commission pay particular attention to a decision of the Australian Competition Tribunal which related to the setting of a WACC for Telstra[23].

> *[1468] In the light of the absence of supporting material for the 75th percentile approach – and more fundamentally, beliefs about the asymmetric social costs – the Telstra case cited by MEUG is of some interest. In that decision, the Australian Competition Tribunal refused an adjustment to recognise asymmetric error costs. The relevant passage is as follows:*
>
> > We accept that it is possible that there may be asymmetric consequences associated with setting a WACC too high or too low. However, it is not clear to us that the asymmetry would always imply that overestimation of the WACC led to a lesser social cost than underestimation of the WACC. The nature of the asymmetric consequences of incorrectly setting a WACC is likely to depend on the circumstances of a given matter that may be before the Tribunal. Telstra and Professor Bowman submitted that the long-term social costs of underestimating the WACC would be greater than the long-term social costs of overestimating it in this particular instance, largely because in circumstances where the WACC was set too low, there was a risk that this would lead to the cessation of services, or a failure to develop services at a socially desirable rate. In order to convince us of this submission, however, it was incumbent upon Telstra to provide evidence that these circumstances actually existed or would exist in relation to the ULLS. Professor Bowman assumed that they did, but he did not provide any evidence or support for the proposition that this was, or would be, the case.
>
> *[1469] Suppliers pointed out that the case related to a telecommunications company in a different regulatory regime. Nevertheless, we consider that, even approaching it with caution, two things can be taken from the case:*
>
> > *(a) the Australian Competition Tribunal was far from accepting that there was any general view prevailing in Australia at the time that overestimation of the WACC leads to a lesser social cost than underestimation of the WACC in regulated businesses; and*
> >
> > *(b) the Tribunal would only have been convinced by evidence, as opposed to assertion.*

38. In the context of this review, a proper examination would be expected to include

    (a) consideration of actual investment decisions or plans within the context of the electricity lines and gas pipeline services industries; and

[23] *Re Telstra Corporation Ltd (No 3)* [2007] ACompT 3

(b) how perceptions about the regulatory WACC impacted, or might otherwise have impacted on those decisions.

39. The Commission is not precluded from taking into account the absence of empirical evidence of relevant investor behaviour changes in reaction to signalled changes in the regulatory WACC. We expected the production of evidence of market apprehension showing reduced willingness to invest and a necessity for suppliers to increase investor returns. We would have been surprised if they amounted to more than impressionistic indications of investor alertness to the issues, but the absence of even that kind of evidence from the submissions should be material to the Commission.

40. If the regulatory WACC changes foreshadowed in the High Court's merit review decision, and the subsequent Commission review, had appeared to be likely to reduce supplier profits below levels needed to attract investment in the RAB, the Commission could have reasonably expected: evidence from the suppliers of reduction of implicit RAB multiples to less than one; or for highly geared suppliers to report refinancing difficulties. The suppliers, who would benefit financially if the Commission was to be persuaded that such circumstances exist, are also the ones most able to provide this evidence. The Commission is entitled to infer that the absence of this evidence either does not exist or was unhelpful to the suppliers[24].

Yours faithfully
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[24] See for example: Wigmore on Evidence (Chadbourn, rev. 1979) at para 285; *Jones* v *Dunkel* [1959] HCA 8; (1959) 101 CLR 298; *Ithaca (Custodians) Ltd* v *Perry Corporation Ltd* [2004] 1 NZLR 731 at [153] to [154]