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Vanessa Howell

Head of Fibre Regulation

Commerce Commission

Lodged on Commission web site

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Dear Vanessa

Feedback on advice to the Commission by Dr Lally on Fibre Input Methodologies

1. This is the Major Electricity Users' Group's (MEUG's) feedback on the expert advice of Dr Lally to the Commerce Commission "Further issues concerning the cost of capital for Fibre Input Methodologies" dated 25th May and published 27th May 2020.¹ This is referred to as "*Dr Lally's advice of May.*" Relevant are:
 - a) The Commission's memorandum "Questions to which Dr Lally's report (published 27 May 2020) responds" dated 10th July 2020.² This is referred to as "*the Commission's questions to Dr Lally.*"
 - a) MEUG submission to the Commission "Fibre Input Methodologies draft decision – submission on the Tax Adjusted Market Risk Premium" dated 28th January 2020.³ This is referred to as "*MEUG's submission in January*"
2. MEUG's interest, as explained in *MEUG's submission in January*, is in relation to the proposal to change the Tax Adjusted Market Risk Premium (TAMRP) from 7.0% to 7.5%. In that earlier submission [paragraph 15] MEUG recommends that the Commission accept the median point estimate of 7.30% as the appropriate TAMRP.
3. *The Commission's questions to Dr Lally* did not address TAMRP so we are unsure if the Commission considers that a topic still with a high degree of uncertainty in its deliberations or not. This brief submission is made in case the Commission might consider a lack of submissions in response to *Dr Lally's advice of May* as being interested parties agree with Dr Lally.

¹ Document URL https://comcom.govt.nz/_data/assets/pdf_file/0017/217412/Dr-Martin-Lally-expert-report-Further-issues-concerning-the-cost-of-capital-for-fibre-input-methodologies-25-May-2020.pdf at <https://comcom.govt.nz/regulated-industries/telecommunications/regulated-services/fibre-regulation/fibre-input-methodologies?target=timeline>

² Document URL https://comcom.govt.nz/_data/assets/pdf_file/0014/220631/Questions-to-which-Dr-Lallys-report-published-on-27-May-2020-responds-10-July-2020.pdf at same web page as footnote 1.

³ Document URL https://comcom.govt.nz/_data/assets/pdf_file/0021/206850/MEUG-Submission-on-Fibre-input-methodologies-Draft-decision-28-January-2020.pdf at same web page as footnote 1.

4. Two aspects of *Dr Lally's advice of May* are discussed below.
5. First, there is agreement between MEUG and Dr Lally that over time, irrespective of the estimation methodology, all estimation methodologies will have estimation errors and frequent reviews of estimates and long-enough time, over and under estimations from rounding will tend to net out over time. That holds true if the Commission decides to adopt MEUG's suggested median point estimate or Dr Lally's rounding to nearest 50bps approach. Why then the need for a mechanical step of rounding of TAMRP to nearest 0.5% when instead, taking the median result (7.3%) itself also will average out without the redundant rounding step? The Commission should also consider if there are other material factors that distinguish the benefits and detriments between the choice if using a rounded estimate with the median result.
6. *Dr Lally's advice of May* acknowledges other factors need to be considered and states [p12 in critique of BARNZ (2020, paras 10-11)] "As with many things in life, the best course of action involves trade-offs. The only meaningful critique that could be offered here would be to identify further disadvantages of the Commission's approach ..." MEUG notes *Dr Lally's advice of May* did not consider the important factor of materiality in the trade-off between the different approaches to estimating the TAMRP as set out in the appendix of *MEUG's submission in January*.
7. Second, *Dr Lally's advice of May* states, with underling of text added by MEUG, [p10] "So, the QCA is now implicitly rounding to the nearest 0.5%, which essentially matches the Commission's current practice. So the QCA's approach supports rather than contradicts the Commission's position." No evidence is provided to support the claim the QCA "implicitly" rounds. The QCA may have multiple other reasons to support its recent decisions that may or may not have included an implicit use of rounding. Unless the QCA explicitly says so one way or the other, nobody knows for sure if rounding was implicit or explicit. MEUG's understanding is that the QCA does not bind its decisions to being either based wholly or in part on an explicit rounding principle but may choose to do so or not depending on the current circumstances, evidence and any other parameters being considered.
8. In conclusion nothing in *Dr Lally's advice of May* has persuaded MEUG to change the submissions made in *MEUG's submission in January*.

Yours sincerely



Ralph Matthes
Executive Director