We thank the Commerce Commission for the opportunity to provide our feedback on its Emerging Views papers.

TelstraSuper is Australia's largest corporate super fund with over $21 billion in assets invested on behalf of around 92,000 members. We have been a significant investor in Chorus for 3 years, having been attracted to its infrastructure-like qualities.

As the Emerging Views papers recognise, real financial capital maintenance is a core principle for the new regulatory regime to uphold. Investors have provided billions of dollars in capital to enable the upgrade of Chorus' network and, since 2011, have foregone the level of return that would otherwise be expected on that capital investment.

The Commerce Commission now needs to set an appropriate level of return on that investment. Admittedly this is not a straightforward task, but the market's negative reaction – an approximately $200 million reduction in market cap - following the release of the Emerging Views papers, is clear evidence that investors were negatively surprised by the low level of return being implied.

As investors across a range of assets, we make the following observations:

1. **The WACC needs to reflect the risk involved in fibre network investment**

Investors, through Chorus, took on substantial risks to invest in fibre ahead of demand and New Zealanders now have the benefit of a network that will deliver substantial socio-economic benefits for decades to come. This risk was specifically acknowledged by Government (e.g. section 18(2A) and policy statements) back at the very outset of the fibre rollout.

European regulatory guidelines and decisions (e.g. Ofcom on BT's fibre investment; the Belgian regulator with higher WACC for fibre vs cable/DSL) also support this view of escalated risk for the long term capital investment required.

Crown Fibre Holdings, as the NZ Government's fibre network investment arm, said its assessment of local fibre companies was that their WACC sat somewhere between electricity companies and integrated telecommunications operators. This is consistent with how we, as investors in telecommunications and electricity companies, would consider Chorus. We would also note that the Crown Fibre assessment is likely to now be understated insofar as it pre-dated the subsequent emergence of the increased technology risk from fixed wireless broadband and future 5G.

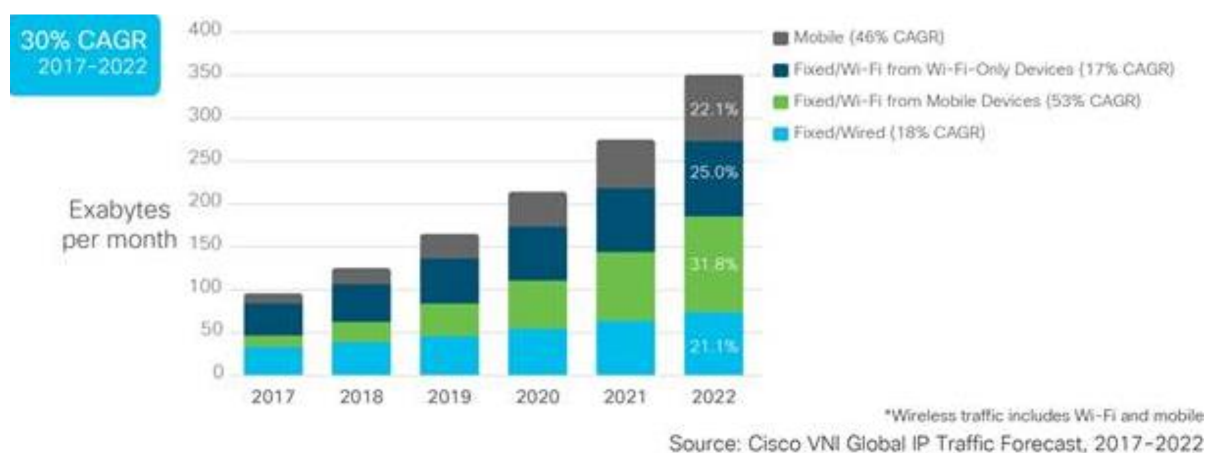
2. **Pre 2022 WACC should not be discounted for hindsight**

We are concerned that the proposed averaging of the risk free rate annually through the network investment period discounts the risk taken in 2011 and is, in effect, averaging investor returns downwards with the benefit of hindsight. New Zealand, like other countries, requires significant ongoing investment in infrastructure and we encourage the Commerce Commission to be cognisant of the importance of setting a fair rate of return for investments already made, if investors are to be encouraged to make similar leaps of faith in future infrastructure projects.

3. **Percentile adjustment is needed to encourage ongoing investment**

We are surprised the Emerging Views paper suggested the WACC for Chorus would be kept at the 50th percentile, while other regulated industries in New Zealand have apparently been set at the 67th percentile.

Our understanding as investors in telecommunications networks is that investment does not stop with the initial rollout of the backbone network. The dynamic nature of telecommunications technology means investment demands are ongoing and consumer reliance on telecommunications networks is increasing exponentially. As the Cisco VNI forecast shows, data usage will continue to be dominated by fixed line networks, whether via fixed networks directly or indirectly via wifi/wireless connections. Even 5G networks will require multitudes of small cell towers connected by fibre backhaul.



While broadband is now an essential utility, the 50th percentile setting means Chorus's chances of earning an adequate return on ongoing investment are skewed to the downside because of the many market risks and regulatory restrictions it must operate within. This will inevitably shape our expectations of future capital allocation decisions by the company. We would not want additional capital invested where there is a chance it does not earn an adequate return. On the face of it, funds would be better invested in unregulated parts of the business, or as a shareholder, in unregulated businesses elsewhere in the sector – mobile network operators, for example, have relatively light touch regulation and can earn much higher returns on investment.

4. **Comparator companies should reflect fixed line access services**

Another surprise to the market was the comparator group of companies in the Cambridge Economic Policy Associates paper and the resulting suggested asset beta of 0.46. Market analyst expectations appear to have been of an asset beta of more than 0.5 and, importantly, this view is consistent with the Crown Fibre Holdings assessment of a 0.50 to 0.65 range in 2010. Similar ranges derived for NBN Co and Openreach were cited by Crown Fibre Holdings in support.

The Cambridge range seems to have been skewed by the inclusion of tower and satellite companies in the comparator set. We would make the following observations:

- As investors, we consider tower and satellite companies to be a different investment prospect from Chorus. As the Cambridge paper acknowledges, those companies tend to have long dated contracts with their customers. Satellite companies carry their own

peculiar technology risks, while tower companies are regarded more as income producing real estate. We see that as very different from the position of Chorus which contracts fixed line access services with customers on a monthly basis and operates under constraints including nationally averaged and anchor product pricing.

- The Cambridge paper acknowledges that a higher asset beta range of 0.51 to 0.63 would be derived by excluding integrated telecommunications providers that earn less than half their revenues from fixed line services. This seems only logical given the services being considered by the Commerce Commission are fixed line fibre access services. The range is also consistent with that referenced by Crown Fibre Holdings.

- The Emerging Views paper suggests that a BBB+ credit rating flows from the comparator group findings. We note that the Cambridge paper says a finding of BBB/BBB+ is possible on its broad comparator group. Chorus operates with a BBB credit rating and we consider this provides sufficient margin above the minimum BBB- rating identified by the Commerce Commission.

5. Treatment of Crown financing

We disagree with the Commerce Commission's Emerging View that the Crown financing provided to Chorus resulted in no "actual financing cost". Although there was no 'sticker price' attached to this financing in the way that debt funding has an explicit interest rate attached to it, actual cost is implicit in the fact that the funding must be repaid and the multitude of conditions attached to the funding. The sheer size and weight of the Telecom demerger scheme book and contracts with the NZ Government are in themselves testament that this funding arrangement was, as one analyst has written, no "free lunch".