Better together.

Trustpower Limited
Head Office
108 Durham Street
Tauranga
Postal Address:
Private Bag 12023
Tauranga Mail Centre
Tauranga 3143
F 0800 32 93 02
Offices in
Auckland
Wellington
Christchurch
Oamaru
Freephone
0800 87 87 87
trustpower.co.nz

9 August 2019

Dr Stephen Gale
Telecommunications Commissioner
Commerce Commission
WELLINGTON

By email: TelcoFibre@comcom.govt.nz

TRUSTPOWER'S CROSS SUBMISSION ON FIBRE REGULATION EMERGING VIEWS – COST OF CAPITAL AND RISK

Introduction

The Commerce Commission (**the Commission**) has begun implementing the new regulatory regime for fibre fixed line access services (**FFLAS**) as per Part 6 of the Telecommunications Act 2001 (**the Act**).

Following the receipt of submissions from interested parties on the Commission's proposed approach to developing the new regime, as set out in its 21 May 2010 *Fibre Regulation Emerging Views* consultation paper (**Emerging views consultation paper**), the Commission has now issued a request for cross-submissions.

This cross-submission provides Trustpower's views on matters relating to cost of capital and risk raised in other parties' submissions that are most relevant to Trustpower's participation in the telecommunications sector.

Trustpower's perspective

Trustpower is a multiproduct retailer that offers a bundle of electricity, gas and telecommunications services to its customers. We currently retail to around 271,000 electricity connections, 93,000 telecommunication customers and 37,000 gas customers. As a market challenger in the telecommunications sector, Trustpower has established a reputation for developing disruptive service propositions and has made a significant contribution to the adoption of fibre services.

Submissions received on the Commission's Emerging views consultation paper reinforce our view that it is crucial that consumer interests and the impacts on competition are firmly at the forefront of the Commission's decisions on Fibre Input Methodologies.

General Comments

We note the imbalance in submissions, particularly with regard to the Weighted Average Cost of Capital (**WACC**) parameters and the treatment of risk. Trustpower urges the Commission not to be unduly swayed by the volume of submissions that focus on inflating Ultra-Fast Broadband (**UFB**) network investor returns. We recommend that the Commission and its experts carefully scrutinise the analysis put forward.

The reality is that Crown financing has put Chorus and Local Fibre Companies (**LFC**s) in a privileged position. It has allowed Chorus and the LFCs to benefit from costs of supply that are lower than those of other actual or potential entrant networks who would otherwise be as efficient aside from the advantageous Crown financing arrangement.

By lowering the overall cost of service provision, Government financing provides a competitive advantage to Chorus and the LFCs and reduces the likelihood of competitive entry and associated asset stranding. Moreover, the lower cost of service provision arising from Crown financing enables lower prices. This will bring forward demand growth, reducing the fibre investment risk faced by Chorus and LFC investors.

Granting Chorus its wish of WACC uplifts would lead to higher prices, an associated slower migration to fibre, and also has the potential to distort competition. The Commission should be very cautious about accepting arguments that WACC uplifts should apply or that Chorus should be allowed to earn a return on free financing provided by the Crown.

Trustpower has confidence that the Commission will

(i) undertake a rigorous analysis to determine the appropriate rate of return that will be consistent with the long-term interests of New Zealand consumers, and

(ii) it will not be swayed by the largely one-sided debate aimed at delivering Chorus shareholders higher returns than are necessary to encourage efficient investment.

We also note the suggestion from Chorus that the new fibre regulatory regime needs to appropriately take into account the potential for deregulation of Chorus's fibre network in the future:

> *"it's important to be upfront in the IMs that the overarching objective in applying these principles is to ensure that at the point of any deregulation of FFLAS, Chorus will in fact have been afforded the opportunity to have received a return on and of its capital since 2011... This aligns, as Professor Yarrow notes in his advice, with recognition of the need for a 'whole lifecycle' perspective to ensure revenues,* ***over the life of the assets****, are sufficient to cover efficient operating costs and a normal return on, and recovery of, capital invested [his emphasis] in the UFB GPS."*[1]

We note that this is not a simple matter to consider. Adopting Chorus's suggested objective would have the potential to change competitive outcomes more broadly and we urge the Commission to give this matter due consideration.

Comments on submissions regarding WACC uplift and asset stranding

Trustpower reiterates its views expressed in our July 2019 submission that an uplift to the WACC is not required. There are a number of specific points made on the issue of WACC uplift in submissions that we wish to provide comment on.

Cost of capital uplift will lead to higher prices and slower fibre uptake, with little or no improvement in outcomes

The HoustonKemp report describes the decision on the WACC uplift to address asymmetric risk as a trade-off between dynamic efficiency and allocative efficiency. In particular, a trade-off between:

(i) dynamic efficiency in the form of incentivising investment in reliable, efficient infrastructure services and innovations in the supply of those services; and

[1] Chorus *Submission in response to the Commerce Commission's fibre regulation emerging views dated 21 May 2019* p. 22

(ii) static, allocative efficiency in the form of higher prices.[2]

Relevant to any evaluation of this type of trade-off is that the UFB network is recently deployed.

As HoustonKemp notes, there is likely to be some ongoing capex. Importantly, however, this is likely to be reasonably small in the short to medium term relative to the size of the initial regulatory asset base (**RAB**).

If a WACC uplift were applied to the entire RAB, including initial losses, the uplift could have a material impact on prices and cause very large allocative efficiency losses. At the same time, dynamic efficiency gains from a WACC uplift would be limited due to relatively low levels of capex expected in the foreseeable future. It would be extremely concerning if a WACC uplift was applied to unrecovered losses, capex already incurred and shared assets relating to the copper network that were invested in many years ago.

Moreover, the reasoning presented by Oxera that there is a high elasticity of demand for fibre services implies that the higher consumer prices that result from a cost of capital uplift will significantly slow the rate of fibre uptake and further increase allocative efficiency losses.

Conclusions on asymmetric risk cannot be imported from the electricity sector

In asserting that the dynamic efficiency cost of under-investment is higher than the dynamic efficiency cost of over-investment, HoustonKemp refer to a quote from the Chairman of the Australian Energy Regulatory relating to electricity networks. As highlighted in Trustpower's July submission and the accompanying Link Economics report, there are a number of significant differences between the fibre and electricity sector.

Conclusions of the relative risks and cost of over- and under- investment for electricity networks cannot simply be imported to the context of fibre. For example, over-investment is likely to be substantially more harmful in a context such as fibre where there is a greater potential for some form of competitive entry.

In discussing dynamic efficiency, HoustonKemp state that:

> *"The dynamic efficiency costs associated with setting the WACC too high primarily relate to the value of additional resources committed to 'excess' investment, offset partially by the additional benefits to end-users of these additional investments."*[3]

This seems to ignore the distortions to competition that over-investment by the UFB supplier can cause, such as deterring competitive entry, and resulting in consequent losses of innovation.

Asset stranding risk may already be accounted for

We agree with the point made by Vodafone that the WACC may already adequately account for asset stranding risk.

As highlighted by Vodafone, a number of comparator firms utilised in the CEPA analysis face similar, or greater asset stranding risks than Chorus and the LFCs. Vodafone points out that regulatory frameworks that require access at a facilities-level to promote fibre network competition heighten this risk in some of the comparator countries. We agree and add the observation that the widespread deployment of cable networks in a number of European countries and the US would further raise the asset stranding risk faced by many of the comparator firms.

---

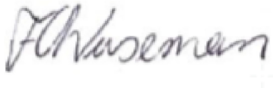
[2] HoustonKemp (15 July 2019), *WACC Uplift – Asymmetric Consequences of Underinvestment* p.7.

[3] HoustonKemp (15 July 2019), p. 27.

Contact information

If you have any questions regarding the matters raised in this submission, please do not hesitate to contact me at this email address: Fiona.wiseman@trustpower.co.nz

Regards,



FIONA WISEMAN
SENIOR ADVISOR, STRATEGY & REGULATION