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Ms Tricia Jennings
Project Manager, Regulation Branch
Commerce Commission
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20 February 2014

Dear Ms Jennings,

Investors Mutual Limited (IML) is an Australian based fund manager with over AUD 5 billion that it manages on behalf of a wide range of investors including many retail investors. IML takes a long term approach to investing and we look to invest in companies which generate a high level of recurring income, have competent management, and that can grow their earnings and dividends over time.

Since our inception in 1998, we have been a long term shareholder in many New Zealand listed companies, including Sky City, Fletcher Building and Chorus. We are attracted to New Zealand because of its relatively stable economy, and in the past, its generally predictable and transparent legal system. However, recent regulatory uncertainty has threatened this reputation.

Draft FPP Pricing

The draft FPP review determinations for Chorus' UCLL and UBA services, while an improvement on the IPP prices, have still resulted in prices far below the long-run cost of providing these services, in our opinion. It is instructive that the UFB tender showed that in practice no party was able to supply network access at these prices.

The entry level wholesale price for UFB services that Chorus assumed in its tender was approximately $40 per month ($37.50 in 2014, increasing to $42.50 by 2019). The combined TSLRIC UCLL and UBA prices for a national network must be substantially higher than this figure given that:

1. the entry level UFB price is subsidised, to a large extent, by the uptake of higher speed and higher priced offers;
2. Chorus' UFB construction costs are subsidised to a large extent by the re-use of existing assets such as pits, ducts, and exchanges;
3. Chorus' UFB build is focused on metropolitan areas and does not include the higher cost rural areas; and
4. Chorus' UFB tender included government financing support.

The draft cost of capital appears to be a major cause of this pricing inadequacy. We believe the proposed WACC of 6.47% is insufficient for any infrastructure project, especially a project of this nature.

Looking to other recent regulatory decisions, such as the recent Gas regulatory decision for Vector and Gasnet made in December 2014, the Commission set a mid-point WACC estimate reflecting a larger premium over the risk free rate than that proposed in the UCLL and UBA draft determinations. This seems perverse given that Telecommunications investors face greater threats from substitution and technological change than other infrastructure assets, such as a gas utility.

We also note that the measurement of asset beta does not adequately capture stranding risks, yet the Commission's TSLRIC modelling explicitly includes fixed wireless technology replacing copper. Telecommunication network investors face greater threats from substitution, and technological change than other infrastructure investments and this should be reflected in the WACC.

Chorus investors would rationally have expected the WACC to be set at least at the 67th percentile of the Commission's estimates, as has been used for other regulated industries. To decide otherwise again heightens regulatory risk and leads to investment uncertainty.

We do not agree with the Commission's assertion that a generous allowance has been made elsewhere in the draft FPP determinations to offset this low WACC decision. Explicitly we note:

1. the operating cost assumptions are very low, compared to Chorus' operating costs in practice;
2. the extremely high aerial deployment assumption, compared to the practical difficulties and ongoing costs of aerial deployment; and
3. the assumption that volumes will not fall, when other UFB operators (Enable, Northpower, and Ultrafast Fibre) will obviously take share from the UCLL network.

Backdating

Once the more accurate FPP prices are established it is only fair that they should be backdated to the respective dates on which the prices were originally intended to take effect (3 December 2012 for UCLL, and 1 December 2014 for UBA). Particularly given the precedent set by the Commission's April 2014 decision to backdate UCLFS charges.

Any regulatory framework that allows RSPs to receive a windfall gain at Chorus' expense simply because of delays in the process will not incentivise future investment, resulting in extreme volatility in Chorus share price, and causing investors to repeatedly question the veracity of NZ's regulatory process. Any such future investment, of course, ultimately benefits consumers. Perversely, it would also incentivise RSPs to complicate and delay the process as long as possible.

Backdated payments could be spread over a period of time, as long as the net present value is preserved. This may assist smaller RSPs in meeting their cash flow requirements.

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The UCLL and UBA pricing processes have repeatedly surprised investment markets. The FPP process is seen as the last right of appeal, and as such it is critical that this outcome restore our, and the broader investment community's, faith in the treatment of sunk capital.

Yours sincerely,

Simon Conn
Portfolio Manager

Nigel Hale
Equities Analyst