We appreciate the opportunity to provide an investor perspective on the Commission's draft fibre input methodologies decision from November 2019.

As noted in our prior submission, 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.

We welcome the Commission's acknowledgement in the draft decision that there is debt-like cost attached to the Crown financing and we look forward to further clarification on how this will be calculated.

We remain concerned by the negative implications of key aspects of the Commission's proposed approaches. These concerns are focused on:

- Ensuring the pre 2022 WACC methodology does not optimise away, with the benefit of hindsight, the risks taken on by Chorus and its investors through the roll-out of the fibre network
- Providing a future (post January 2022) WACC that adequately reflects ongoing risk and encourages further investment in the fibre network

Asset beta is a fundamental element of both of those areas of concern. While the Commission has proposed increasing the asset beta from 0.46 to 0.49, this still does not adequately reflect the nature of a fixed line access wholesale business. It also does not acknowledge the elevated asset beta that would be expected during the fibre network roll-out.

Ofcom's recently published assessment of the cost of capital for the Wholesale Fixed Telecoms Market Review 2021-26 in the United Kingdom is highly instructive on a number of levels. Ofcom helpfully identifies the asset beta of Openreach, a business closely comparable to Chorus even if it isn't directly listed, and articulates the reasons why fibre to the premises services require a higher asset beta than copper services. Ofcom identifies Openreach's asset beta as 0.57 versus 0.65 for a fibre service provider.

We strongly recommend the Commission consider these independently established benchmarks in the context of the reasonableness check diagram – Figure 3.8 – of the draft regulatory decision.

Consistent with the Commission's 0.35 and 0.40 for New Zealand electricity and gas providers, the Ofcom analysis notes the asset beta of 0.38 provided by Ofgem for gas and electricity networks in the United Kingdom.

However, Ofcom's assessment Openreach (copper wholesaler) and fibre network service asset betas are significantly higher. Yet they are consistent with all of the following:

- Crown Fibre Holdings' past analysis of an asset beta range of 0.5 to 0.8
- Broker estimates referred to in the Commission diagram as averaging 0.54, but presumably only reflecting their valuation of Chorus' total business today, rather than the higher asset beta of a fibre only provider
- Belgium's regulator setting 0.71 for copper and 0.9 for fibre as per Chorus presentation of 24 September 2019
- CEPA's indicated asset beta range in the Emerging Views paper of 0.49 to 0.63 for telco companies with at least 50% of revenues derived from a fixed line network

Our views on the need to ensure comparator groups are reasonable proxies also applies to assessment of the appropriate leverage and credit rating applicable to Chorus. The Ofcom assessment is again instructive in this respect with Openreach (with its copper based services) said to be closer to a BBB+ credit rating, while Other UK telecoms (where fibre services were considered to sit) are proposed to share a BBB rating with BT Group given the higher systematic risk. Further, as Chorus noted in its 24 September presentation, the Commission's use of BBB+ suggests a cost of debt assumption below Chorus' actual cost of debt through the pre-implementation period. This hardly seems a fair approach, particularly when the cost of debt being used to finance the fibre rollout actually increased during the period because of regulatory impacts on the business.

As we stated in our prior submission, 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. Chorus took on that risk (initially as part of Telecom) in the nature of a long term commitment to rolling out the fibre network and it was specifically established as an independent business for this purpose.

We, therefore, fundamentally disagree with the proposal in the draft decision that the WACC through the pre-2022 period should somehow be adjusted on an annual basis. That is the antithesis of the commercial reality. The risk was taken on in 2011 when Chorus started the rollout and began building the fibre network and were articulated in the demerger Scheme Book on pages 202-207. The UFB investment decision was not subsequently revisited each year.

The Commission's proposed approach is in stark contrast to the 'fair bet' approach articulated in the context of Openreach's superfast broadband (i.e. fibre to the cabinet) investments where Ofcom said there should be an opportunity to make higher than expected returns given the chance of failure. Price regulation would follow only when the investment had proven a success.

In Chorus' case, quasi price regulation has applied from the start, in the form of price paths agreed with the NZ Government. Crown Fibre Holdings recorded in their *CFH Response to Select Committee Questions* (2011) that the expected WACC for fibre companies where Telecom NZ participated in UFB was between 7.72% to 8.97% and their WACC analysis was being used to establish wholesale pricing. Investors have worn the ups and downs of market developments and Chorus' performance since. While some of the downside experienced by investors may be said to relate to regulatory impact on Chorus copper revenues, that impact would have been substantially reduced if Chorus had not been obligated to build the fibre network and provide fibre services at the contracted prices. The two are therefore intertwined.

Based on the above, an averaging approach to the WACC consequently sets a poor precedent for future infrastructure investors to consider in the New Zealand context. Would the same approach be applied if risk free rates increased through the period?

We would also note that one of the risks identified by Chorus at the start of the rollout, mobile substitution, has indeed become a reality with Spark encouraging its customers on to its fixed wireless service since 2016. The Commission noted 10% of broadband customers were on fixed wireless in its Annual Market Monitoring Report 2018. This has obviously continued to grow in the time since. Vodafone is now reported to be planning to have 25% of its customers on fixed wireless within the next few years. We cannot reconcile the Commission's proposed stranding risk uplift of 10 basis points with the real risk evident in these existing data points. New Zealand's relatively unique telecommunications industry structure means fibre networks face substantially higher competitive risk from vertically integrated mobile networks. This is unlikely to be adequately reflected in the

systematic risk of the comparator group the Commission has previously used to derive an asset beta for Chorus.

Crown Fibre stated in 2011 that:

> *CFH believes that the business risk of an LFC is less than a normal Telco but greater than a utility such as an Electricity lines company. This is the same philosophy Ofcom has used in the UK where is deconstructs the equity and asset betas of British Telecom between OpenReach (LFC equivalent) and the rest of the BT Group.*

This statement was before the advent of Spark's 4G fixed wireless push. Substitution risk is now even higher and could increase further with the emergence of Vodafone's stated ambition and 5G technology. Yet, the Commission is proposing a WACC of 4.88% for regulated FFLAS versus a WACC of 4.23% for electricity businesses (Figure 3.7: WACC reasonableness check, Draft Determination). This relative comparison, versus risk and reward, is the backdrop against which investors will ultimately determine the allocation of capital between different companies across different countries. As Crown Fibre also noted to the select committee in 2011:

> *The WACC is the minimum return that a company must earn on an existing asset base to satisfy its creditors, owners, and other providers of capital, or they will invest elsewhere.*

We encourage the Commission to consider this viewpoint in its assessment of the various parameters under the new framework.