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To: The Commerce Commission
Subject: Chorus - UCLL – feedback due 14 February 2014
From: John Duncan Limited

Dear Sir or Madam

John Duncan Limited (JDL) has reviewed various documents in relation to the above matter. This brief memo focuses on pages 42 to 45 of the Commerce Commission paper dated 6 December 2103 (CC paper) and refers to the EY report released 14 December 2013.

The CC paper provides a high level summary of approaches to cost of capital. There is no reference to the reality of financial markets. There is a fundamental difference between the theoretical cost of capital of a company and the reality of the markets to raise finance and the costs associated with that. Bluntly – in practice cost of capital analysis does not take into account the realities of market conditions and liquidity at the time of seeking finance. Depending on market conditions at the time, valuation of a company via cost of capital will be higher or lower than the ability to finance the company with equity and debt and the associated costs. JDL is happy to debate theory v practice with the CC.

JDL also notes that the terms of the EY report do not include consideration of the impact on the Chorus share price of the uncertainty on the cost of financing due to regulatory uncertainty, political mischief and other matters. The Chorus share price is around half the issue price so the required ROE has doubled. The credit rating on its debt has been down-graded. JDL would appreciate seeing any analysis done on the cost to Chorus and the NZ economy of the outcome of applying the CC approach to UCLL pricing.

Effective regulation should result in benefits to consumers and shareholders – increase certainty, reduce cost of capital leading to benefits for shareholders and customers. Chorus must earn an acceptable ROE reflective of the realities of the market. Regulatory uncertainty is a huge cost to it and other businesses in NZ operating under the CC umbrella.

Background on John Duncan Limited (JDL)

John Duncan was an Executive Director in the investment banking division at Macquarie Bank where he worked for 15 years in NZ and overseas. Sectors included communications infrastructure. More recently he sat on the board of the EPIC infrastructure fund and lead the restructure of that fund whose assets included stakes in Thames Water. The fund was marketed as a yield investment but had to cancel dividends.

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