



## Market Announcement

2 December 2014

### Commerce Commission proposes material increase to regulated input charges

The Commerce Commission has announced today its draft Final Pricing Principle (FPP) determinations in relation to two regulated input products that Retail Service Providers (RSPs) purchase from Chorus, the Unbundled Copper Local Loop (UCLL) product and the Unbundled Bitstream Access (UBA) product. Spark New Zealand purchases UBA and a Baseband product which is priced equivalent to UCLL.

The FPP determinations, which are being derived using a replacement cost methodology, will supersede earlier Initial Pricing Principle (IPP) determinations, which were derived using an international benchmarking methodology.

Under the draft FPP, it is proposed that the UCLL wholesale charge increase from \$23.52 to \$28.22 per customer connection, per month. This draft determination is subject to further industry consultation and the Commerce Commission is seeking views from submitters to see if the final UCLL price should be backdated to no earlier than 1 December 2014.

It is proposed that the UBA wholesale charge under the FPP be \$10.17, compared with the IPP charge of \$10.92 which took effect from 1 December 2014. The Commission has also indicated the earliest the FPP could apply is 1 December 2014.

These charges are set out in the table below.

	Pre 1 Dec 2014	IPP effective 1 Dec 2014	Draft FPP
UCLL / Baseband	\$23.52	\$23.52	\$28.22
UBA	\$21.46	\$10.92	\$10.17
Total	\$44.98	\$34.44	\$38.39

The FPP charges would increase Spark New Zealand's input costs by approximately \$60 million on an annualised basis, relative to the IPP charges that came into effect yesterday.

### FY15 Financial Guidance

Spark New Zealand's FY15 financial guidance is based off the IPP charges. FPP charges, if implemented in line with the draft, will materially increase Spark New Zealand's input costs and will have a negative impact on FY15 financial guidance if the new charges take effect during the current financial year. The extent of the impact in FY15 will be dependent on both the final determinations,

timing of implementation (including possible backdating) and any revenue impacts resulting from competitive market dynamics. We are not in a position to provide updated guidance at this time, but will provide an update when more information becomes available.

### **Spark Comments on Draft FPP**

Spark New Zealand Managing Director Simon Moutter commented:

“Today’s announcement is unexpected and we are now facing costs substantially above the levels we previously anticipated. These higher costs will affect all our fixed services, not just broadband services.

“For the past two years, we have been anticipating a \$10 reduction in broadband costs, which has been reflected in our current customer pricing. But what we didn’t expect was a \$5 increase in the cost for a residential or business line – for both broadband and standalone voice services. All of this comes on top of recently implemented increases in Chorus connection charges for broadband services.”

Mr Moutter said intense market competition meant the anticipated reduction in wholesale broadband charges (signalled as far back as December 2012), had already flowed through into retail broadband prices.

“For instance, what you get in our basic \$75 broadband plus home phone plan today would have cost you \$105 three years ago. In that time, our wholesale costs have barely moved until the new charges came into effect yesterday.”

“Given today’s decision, we feel we have no choice but to undertake an urgent review of our current pricing across both fixed voice and broadband plans.

“As well as the surprise increase in line charges, there is now considerable uncertainty about when these new charges will take effect – with the possibility of backdating any increase to 1 December 2014. This means we will need to take a conservative view now to hedge against any financial exposure from the final decision.”

Mr Moutter said today’s announcement highlights the challenges as retail broadband providers fiercely compete to give consumers the best possible deals, yet face a continually shifting outlook in terms of their underlying costs.

“This is not a criticism of the Commerce Commission, which as the regulator is required to follow due process – or of the process itself which is inevitably complex given the transition from the previous regulatory regime.

“Over the last two years, we have consistently called for more certainty to ensure retailers can plan appropriately and deliver customers the best competitive deals. We led an initiative seeking an agreed industry solution for wholesale broadband charges, and we also welcomed the Government’s attempt to provide this certainty through legislation.

“Neither came to pass, meaning we - and the rest of the industry - were left with only the initial schedule of charges set out by the Commission in 2012 and 2013 to guide our budgeting and retail pricing. These initial charges were finalised by the Commission in November 2013, upheld by the

High Court in April 2014 and by the Court of Appeal in September 2014. They have been anticipated by Spark and other providers in our existing customer pricing.”

**Note:**

In addition to the proposed changes in UCLL and UBA charges, effective 1 December 2014 RSPs will be charged for both UBA and UCLL, even if they resell PSTN services via Spark Wholesale. As this means Spark Wholesale will no longer face UCLL charges from Chorus, it will reduce revenues by approximately \$70 million on an annualised basis. This will have no impact on EBITDA.

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