

Commerce Commission Fibre Input Methodologies Further Consultation Draft

– Reasons Paper & Determination 2020

2degrees Submission, 13 August 2020





Executive Summary

2degrees appreciates the opportunity to respond to the Commerce Commission's *Fibre Input Methodologies: Further consultation Draft Reasons Paper*, and *Further Consultation Fibre Input Methodologies Determination 2020*.

Given time and resources, 2degrees' response is necessarily limited in nature. This should not be taken as support or otherwise for areas not commented on. We appreciate the key role the Commission has in ensuring the fibre input methodologies of the new regulatory framework are appropriately set.

In summary:

- We welcome the Commission's further clarification to industry that ICABS are part of the FFLAS regulated service.
- We support robust Chorus assurance requirements to address the impact of information asymmetry and ensure Chorus data is reliable and does not result in excessive FFLAS returns. However, we do not agree that the requirement for director certification information to be 'true and correct' should be removed.
- We consider that financial information and performance measures, as well as capex proposals, should be required to be disclosed on a geographically disaggregated (UFB area) basis, not a Chorus all-of-FFLAS basis.
- If network services are excluded from FFLAS the Commission will need to ensure FFLAS costs are not inflated by the required transfer payments. This reinforces our view about the need for prescriptive and robust cost allocation and Related Party Transaction rules.
- We support:
 - The Commission's changes to the Capex IM (e.g. individual proposal requirements and assessment factors).
 - The Commission's confirmation that it will remove part of the value of the financial loss asset from the Regulated Asset Base (RAB) following deregulation of part of the FFLAS business.
 - The amendments to the re-opener "Error event" provisions (clause 3.9.6).
 - The Commission setting the ABAA cost allocation approach for FFLAS so that a regulated provider is not able to pick and choose cost allocation methodologies to allocate a disproportionate share of costs to FFLAS in PQ areas. (For the avoidance of doubt, this does not impact our view on the need to adopt an avoidable cost allocation methodology for the financial loss asset.)



The treatment of ICABS can be laid to rest

We welcome the Commission's further confirmation that ICABS is part of the regulated fibre fixed line access services (FFLAS). The draft reasons paper makes it clear that this is the correct approach, both in terms of how the regulated service is defined and from a policy perspective (regulation of monopoly access services). While we do not consider there should have been any question about this, with this clear at the legislative stage, we appreciate the Commission's clarification to industry given it is a matter Chorus has repeatedly raised in submissions.

Audit, certification and independent verification requirements are essential for ensuring the integrity of the regime

It is critical that the Commission puts in place robust assurance requirements to help ensure Chorus data can be relied on and does not result in excess returns and consumers paying more than they should need to for FFLAS.

Our previous submissions have highlighted the challenges and issues that the Commission has faced under Part 4 of the Commerce Act, notably with Asset Management Plan forecasts of capex. Our previous submissions also highlighted the specific issues the Commission has had with information previously provided by the wholesale telecommunications network operator. In particular, the Commission was not able to rely on its estimate of the TSLRIC cost of its copper services, which was grossly inflated compared to the Commission's final copper price determinations.

We fully agree with the Commission that assurance requirements are needed to "mitigat[e] the impact of information asymmetry between the economic regulator and a regulated business" and to "improv[e] confidence in the accuracy and quality of information that is disclosed to business external stakeholders". We also agree with the Commission that "For the first regulatory period, our primary concern is information asymmetry. Having access to a report by an independent auditor will increase the confidence in the information we will be evaluating" and "the part 6 purpose is best promoted by including compulsory audit requirements in the [capex] IM".

Audit, certification and independent verification are all key and essential assurance requirements.

While we are comfortable with the Commission's intention to clarify the audit requirements, and to draw on Part 4 of the Commerce Act precedent to do so, we do not consider the Commission should water down the director certification requirements by removing the requirement information provided is true and correct. We consider adoption of this requirement would help provide the Commission surety of information provided by Chorus, which it relies on, is true and accurate, and it is of concern Chorus has a problem with a requirement for information be true and correct. While we acknowledge the equivalent Part 4 Commerce Act provisions do not have true and correct certification requirements, the Transpower Capex IM



requires “Where ... a director or chief executive officer of Transpower has made a certification involving a matter of fact in accordance with this Part” and “he or she ... becomes aware that the fact is untrue ... or has significant cause to doubt the accuracy of that fact ... that director or chief executive officer must notify the Commission as soon as reasonably practicable”. If the Commission does not include the true and correct provision, it should revert to the Transpower Capex IM requirement cited above.

Disaggregation should apply on an individual UFB area basis

Given that the Part 6 fibre regime distinguishes between Chorus’ UFB areas (PQR and Information Disclosure) and other (LFC and non-UFB) areas (Information Disclosure-only) FFLAS, we consider that financial information and performance measures should be required to be disclosed on a similar disaggregated basis.

We consider that performance measures should also be disaggregated in relation to each individual UFB area. Similarly, we support requiring capex proposals being broken down by individual Chorus UFB initiative areas.

We do not support Chorus’ position that “they should be required to provide information on an all-of-FFLAS basis, with any more granular geographic breakdown agreed through the regulatory template and/or ID processes”.

Improvements have been made to the Capex IM

We welcome and acknowledge the improvements that have been made to the draft of Chorus’ Capex IM.

For example, there have been improvements to the individual Capex project proposals requirements, including in relation the key parameters in the proposal (e.g. provision of information in relation to the impact on quality, other determined or forecast based capex and operating expenditure, expected costs, benefits and risks and independent verification requirements¹) and information requirements².

We also welcome that the assessment factors for capex proposals have been enhanced (clause 3.8.6) including factors such as “quantitative or economic analysis”.

While we consider that the Commission should undertake consultation on all individual capex, we acknowledge if consultation is going to be on a discretionary basis the matters in clause 3.8.4(3)³ are relevant considerations. Other factors that

¹ Clause 3.7.23(3).

² Clause 3.7.26).

³ Clause 3.8.4(3) states the Commission must have regard to ‘at least’ the size and complexity of the proposal, previous relevant consultations, levels of commercial sensitivity and the impact on quality outcomes for access seekers and end-users.



should be included are the cost of the project (this needs to be more explicit than in (a)) and whether the proposal is likely to be contentious.

The proposed treatment of network services reinforces the need for robust cost allocation and Related Party Transaction rules

The Commission has not explained how it “reached the provisional view that [network] services do not qualify as FFLAS, as it appears that they do not enable or facilitate telecommunications in the sense of the definition of “telecommunications service” in s 5. The services are services that Chorus needs to use to provide telecommunications services.

If the Commission excludes “network services” from FFLAS one of the outcomes will be that the notional “network services” business will be providing services to FFLAS and there will, presumably, be transfer payments between the two businesses. The Commission will need to be careful to ensure the FFLAS costs are not inflated by the transfer payments. This reinforces our view about the need for prescriptive and robust cost allocation and Related Party Transaction rules.

Other matters

- The Commission should provide that during the transition period the requirement to determine the base capex allowance for each disclosure year no later than 6 months before the start of that regulatory period is loosened to ensure it has adequate time to assess, consult on and ultimately determine the capex allowance for the first regulatory period.
- We support the Commission’s confirmation that it will remove part of the value of the financial loss asset from the Regulated Asset Base (RAB) following deregulation of part of the FFLAS business.
- We support the amendments to the re-opener “Error event” provisions (clause 3.9.6).
- It is appropriate to apply ABAA for cost allocation purposes for the Price-Quality regulated and Information Disclosure only components of Chorus’ FFLAS. We agree that “If Chorus was able to select a particular cost allocation approach, it may choose a combination of approaches that result in a disproportionate share of costs being allocated to PQ areas which would flow through to higher prices for FFLAS end-users in PQ areas, and excessive profits”. For the avoidance of doubt, this does not impact our view on the need to adopt an avoidable cost allocation methodology for the financial loss asset.