Vodafone Aotearoa: Submission on Chorus' initial price-quality regulatory asset base proposal

28 May 2021

Introduction

1. Nei rā te mihi ki ngā kaimahi o Te Komihana Tauhokohoko, mō te kōwhiringa, a ka taea, kia uruparetia ki te uiuinga e pā ana ki tēnei kaupapa hirahira.

2. Thank you for the opportunity to respond to the consultation on Chorus' initial price-quality regulatory asset base proposal (**Chorus' proposal**). We recognise the continuing work and effort by Commissioners and staff in connection with this consultation and the wider fibre regulation programme.

3. The Commission's decisions on Chorus' initial price quality RAB are of critical importance and require the consistent application of principles developed over the last decade of telecommunications regulation.

4. Chorus' proposal shows that Vodafone's previously expressed concerns about double-recovery of costs during the pre-implementation period were well founded. A number of major cost categories are allocated inconsistently with the approach applied in the copper Final Pricing Principle (**FPP**) analysis. Left unchecked this would result in a substantial value transfer from end-users to Chorus.

5. In the final input methodologies paper[1], the Commission agreed "*on the principle of no double recovery of shared costs between copper and fibre, as this would not best promote the s 162(d) purpose of limiting the ability of regulated providers to extract excessive profits.*"[2] This principle remains correct and it is critical that the Commission's commitment to it is now applied in practice.

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[1] Commerce Commission "Fibre input methodologies – Main final decisions reasons paper" (13 October 2020).
[2] Commerce Commission, "Fibre input methodologies; Financial loss asset final decision – reasons paper" (3 November 2020), paragraph 3.369.

6. Where the Commission has adopted a position that represents how it proposes to act in respect of an issue, such as the risk of double-recovery, it must maintain that position absent strong and compelling reasons for departing from it. No such reasons have been provided. More generally, it is critical that prior input methodologies decisions reached after robust analysis and thorough consultation are not cast aside. These decisions remain good and should be applied as intended. They should not be replaced by untested and unjustified shifts in approach.

7. In several places Chorus has proposed alternative allocation methods. The defined list of allocators in the input methodologies was established to avoid exactly this practice. They cannot just be discarded at their first outing.

Our position

Process update

8. We appreciate the update provided on the process and timeframe for determining Chorus' price quality RAB and its interaction with the first price quality path determination process.

9. This update confirms the Commission's proposed approach for amending fibre input methodologies. As the Commission observed in connection with any such amendment: "...*we must make the decision that we consider best gives effect to or is likely to best give effect to the s 162 purpose and the promotion of workable competition (where relevant), in addition to the s 174 purpose of the IMs discussed above. Consideration of promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunication services is unique to fibre (s 166(2)(b)) and could affect a decision to consider new IMs.*"[3]

10. In our view, this approach applies both to amendments that the Commission specifically recognises and addresses, and to changes in approach that are implied by a shift away from principles of approach expressed in prior decisions.

[3] Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for first regulatory period" 15 Sept 2020, paragraph A9.

Specific comments on Chorus' proposal

11. This submission raises four substantive issues arising from Chorus' proposal:

    a. Opex must be allocated on the ratio of connections, not totex.
    b. Exchange space must only be allocated to fibre where it is used for this purpose.
    c. Revenue must be better explained and should include other regulatory income earned.
    d. Differences between Chorus' estimate of attributable revenue and the Commission's estimate of revenue must be explained.

12. We also comment on some further matters at the end of the submission.

Opex must be allocated on ratio of connections, not totex

13. The most material issue in Chorus' proposal is the application of a totex approach to some opex costs. This approach is:

    a. inconsistent with the input methodologies; and
    b. would result in substantial double-counting of costs already allocated to copper services.

14. In terms of consistency, input methodologies are intended to provide process certainty for providers and end-users (consistent with promoting s 174). Any express or implied amendment to should only occur where the benefits in terms of s 166(2) demonstrably outweigh any detrimental impact on this certainty.[4]

15. The totex approach allocates opex to fibre based on how much total expenditure was spent on fibre. Much of the cost Chorus has proposed to allocate using totex relate to corporate overheads such as CTO overheads and corporate personnel cost. These costs are extremely material totalling a present value of more than $750m over the pre-implementation period.

16. Chorus' proposed approach would result in significant double-recovery of these costs, as they have already been recovered via copper services. In the FPP analysis, overhead costs were considered in a larger group of 'non-network' costs. These costs were set at equal to Chorus' actual expenditure.[5] A small portion of these costs were allocated to

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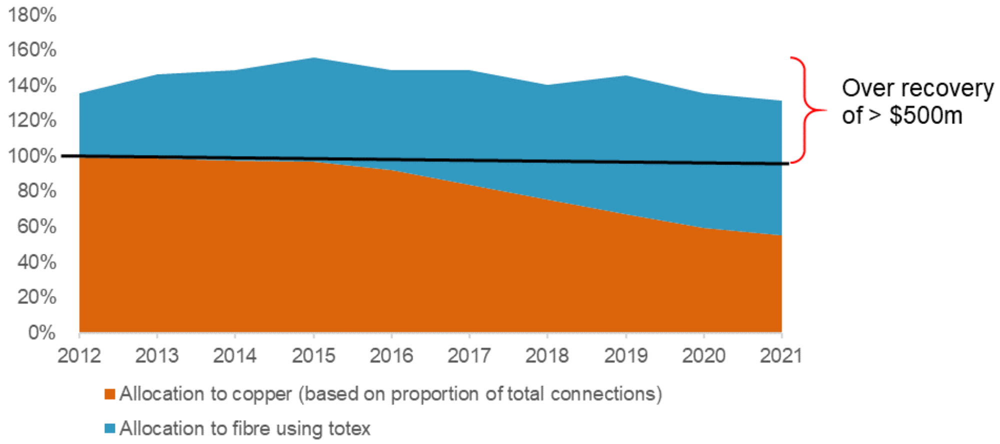
[4] Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for first regulatory period" 15 Sept 2020, paragraph A18.
[5] Commerce commission, 'Final pricing review determination for Chorus' unbundled copper local loop service' [2015] NZCC 37, paragraph 876.

co-location and non-recurring charges based on their proportion of revenue.[6] However, the bulk were fully allocated to copper services under the modern equivalent asset methodology. Adopting any different approach now highlights an analytical inconsistency that must be addressed and corrected.

17. Figure 1 below shows how the totex approach clashes with the allocation under the FPP - and the resulting over-recovery. Because much of the over-recovery happens early in the pre-implementation period, we estimate that the present value windfall gain for Chorus from this error exceeds $500m.

Figure 1: Over-recovery from applying a totex approach to some opex costs



18. To ensure consistency, fibre opex must be allocated based on the proportion of connections in the same way as copper opex was allocated. This is also the most appropriate approach to take for the period prior to the copper FPP. During most of this period, Chorus' copper revenues were higher than the final allowances in the FPP. Therefore, at minimum, Chorus was able to recover the same proportion of opex before 2015 as they were after.

Exchange space must only be allocated to fibre where it is used for this purpose

19. Chorus' exchange space has high value for applications such as edge computing and fibre unbundling. These applications will deliver competition and innovation in downstream markets. It is important that Chorus has the right incentives to make exchange space available for these applications for the benefit of New Zealanders.

20. As highlighted by the Commission, Chorus proposes that exchange space should be fully allocated between copper and fibre services. It says that when copper is eventually retired the entire exchange space will be allocated to fibre. We don't believe

[6] Commerce commission, 'Final pricing review determination for Chorus' unbundled copper local loop service' [2015] NZCC 37, paragraph N44.

this is correct on any sensible view of incremental fibre growth or actual operational need. If this view is accepted, it sets up the wrong incentives for Chorus.

21. Under Chorus' proposal, renting exchange space for edge computing or unbundling equipment would result in that revenue being counted as 'other regulatory income' and netted off the allowable revenue. It would have no direct benefit for Chorus. This makes it unlikely, therefore, that Chorus will have any real drive to use this space efficiently, which will ultimately load costs on to end-users and remove scope for innovation and competition at the retail layer.

22. Our alternative proposal is that exchange space is allocated to fibre based on used floor space. This would have two benefits:

    a. It would provide an incentive for Chorus to use any spare exchange space efficiently either by renting it for alternative uses or by downsizing.
    b. It would ensure that costs not related to fibre are not attributed to fibre, ensuring that end users are not paying for assets they gain no value from.

Revenue must be better explained, and include other regulatory income earned

23. Very little information has been provided by Chorus on its approach to revenue modelling. As noted by the Commission, there is reference to demand and revenue model documentation that has not been released. When this is released there must be a separate opportunity for stakeholders to comment.

24. Given the limited information provided, we make two in principle comments regarding revenues.

25. First we would expect to see 'field services' included in revenues. Chorus has described 'field services' as: "*...work performed by Chorus' service company technicians providing new services, chargeable cable location services, maintaining retail service provider networks and relocating or extending Chorus' network on request. As Chorus utilises service companies to perform field services work, there is a direct cost associated with all field services revenues recognised in the provisioning and network maintenance expense categories.*"[7] In other words, it is a revenue line that is directly related to a cost line, so the Commission needs to ensure that both are included (or that neither are).

26. Based on available information, we cannot tell whether field services are being treated correctly. As it relates to new connections, the vast majority of this cost is likely to be

[7] Chorus, 'Annual Report 2015' page 18

related to fibre services. It should therefore be recorded within revenue calculations. Alternatively, the corresponding network maintenance costs should be removed from the opex costs. Without further disclosure on this point, it is not clear to us whether either of these vital steps have been taken and we cannot effectively comment.

27. Second, given the proposed approach to exchange space, we would expect to see some of the 'infrastructure' revenue line from Chorus' annual reports allocated to fibre, and recorded as 'other regulatory income'. 'Infrastructure' revenue relates to the renting of exchange space for unbundling and other co-location.[8] As exchange space is allocated from copper to fibre based on connections, so too must exchange space revenue be allocated from copper to fibre based on connections. It is not clear whether this approach has been taken – so again we cannot effectively comment.

Differences in revenue estimates between Chorus and the Commission

28. There is a substantial discrepancy between the attributable revenue proposed by Chorus and the revenue assumptions used by the Commission. Chorus has calculated that $472m of revenue is attributable in 2021, whereas for the same year the Commission has assumed that Chorus will earn $623m.[9] The $150m discrepancy between these two figures is extremely material and requires explanation.

29. We understand that this discrepancy may be partially explained by the difference in scope between the pre-implementation period and the FFLAS service going forward. However, on Chorus' numbers this difference only accounts for about a 5% difference in the number of connections, compared to a more than 30% difference in revenue.

30. One potential explanation is that Chorus is not forecasting any increase in connection numbers between 2020 and 2021. If so, then we do not believe this is credible – and it is not consistent with Chorus' retail market activities (including direct to end-user marketing and incentive offers) which are expressly intended to increase connection numbers.

31. We also note that the total connections in Chorus model (UFB and voluntary) are consistently lower than those reported in their annual reports. The Commission must apply further scrutiny to these estimates and require Chorus to explain these differences.

[8] See Chorus Annual Report 2020, Note 9 – Operating revenue
[9] Commerce Commission, "Draft decisions on information disclosure for fibre and key elements of the price-quality path for Chorus: Stakeholder briefing" 27 May 2021, page 10

Other matters

32. We also make the following additional comments on the consultation:

Topic	Vodafone Comment
Allocation of shared assets inconsistent with ABAA	As noted by the Commission at paragraphs 4.11 -4.12, some "otherwise share" assets are directly attributed. We see no reason for this approach and recommend that the ABAA approach required in the input methodologies is applied.
Allocation of shared fibre cable assets	As noted by the Commission at paragraphs 4.23, Chorus is proposing to allocate shared fibre cable assets based on an estimate of the level of sharing from a survey of fibre assets. This value is then extrapolated to apply over the pre-implementation period. We do not agree with this allocation approach. Instead we propose that the survey is adjusted to reflect fibre uptake in the earlier periods.
Allocation of opex using methods not listed in the IMs	Further to the discussion above regarding totex, Chorus proposes a number of other allocation methods not within the scope of the input methodologies. These allocation methods must also be carefully considered against the costs already recovered for copper services. Without this cross-check, there is a high chance of double-recovery.
Asset life for FLA	We disagree with Chorus' proposed approach for determining the FLA life. The decision to depreciate the FLA in line with the average asset life helps spread the significant cost over a longer period of time and avoid a large burden for end-users. Chorus' proposed approach would load more of these costs to earlier recovery. We do not consider this is consistent with the Part 6 purpose, or s 166(2)(b).

Confidentiality

33. This submission does not contain any confidential information.

Contact

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