

Commerce Commission Fibre Input Methodologies Further Consultation

– Draft Reasons paper & Determination 2020

2degrees Cross-Submission, 3 September 2020





Executive Summary

2degrees appreciates the opportunity to cross-submit in response to the Commerce Commission's *Fibre Input Methodologies: Further Consultation Draft Reasons Paper*, and *Draft Fibre Input Methodologies Determination 2020*.

We have reviewed industry submissions and make the following comments¹:

- **The financing rate should be set independently:**

We support Spark, Vocus and Vodafone submissions. The Commission should set the financing rate independent of Chorus' actual financing costs (Option 3). This is a more efficient, lower cost way of addressing potential perverse Chorus regulatory incentives and does not undermine Chorus' UFB contract with the Crown.

- **Regulatory certainty should not be undermined by allowing further flexibility:**

We do not support multiple Chorus suggestions for further changes to the draft IMs to "improve the balance of workability, flexibility and certainty". Such proposals increase regulatory uncertainty. Greater prescription reduces this.

- **Timing challenges do not justify relaxation of long-term IM requirements:**

We do not support proposed relaxation of Capex IM and audit requirements to meet timeframes. If it is found relaxation is required for the first PQR determination, this supports additional transitional factors, not changes to the IMs.

- **The proposed two-step cost allocation process should be retained:**

We do not consider a two-step process should be problematic or is of little value.

- **The proposed cap on allocation of shared costs should stay:**

We agree with Spark that the proposed cap on allocation of shared costs should not be removed: above-cap allocations would result in excess FFLAS returns and/or other unregulated activities being subsidised. The materiality threshold should also consider the impact on workable competition in non-FFLAS markets.

- **Assets should only enter the RAB when in use:**

We agree with Vodafone that assets should only enter the RAB when in use. The proposal to add assets when "available for use" would create perverse incentives to deploy assets ahead of the date required and pass these costs on to consumers.

- **The Part 6 WACC IM review should not be brought forward:**

We agree with Vector that bringing forward the Part 6 WACC IM to align with the Part 4 IM would increase regulatory uncertainty and is not necessary.

- **Network Services are necessary for provision of FFLAS:**

We agree with Spark and Vodafone that Network Services need to be reflected in the regulatory framework. These services, including site investigations, are required as part of FFLAS connection processes.

¹ This cross-submission does not respond to all issues raised by submissions. These comments should be read in conjunction with our previous submissions.



We are unconvinced by the Commission's proposed approach to determining the financing rate

It is unclear that the issues the Commission has raised about avoiding incentivising early Chorus repayment should be addressed by setting the finance rating at WACC with a 25 basis point discount. The issues could be better addressed, including by ensuring end-users share the benefits of Crown financing, by setting the financing rate independent of Chorus' actual financing. The Commission does this already with matters such as prescribing a set debt:equity ratio in the WACC IMs.

This does not undermine the UFB contract between the Crown and Chorus, as suggested in the consultation paper, and is arguably more consistent than the Commission's current proposed approach: Chorus is able to choose to make early payment options where it considers this efficient/beneficial.

We support the submissions of Spark, Vocus and Vodafone on this matter. For example, Spark comments²:

....While the proposed approach results in end users paying an unquantified premium in order to mitigate a regulatory incentive, it also distorts efficient Chorus funding decisions by bringing actual financing decisions in to the BBM.

16. We recommend that the Commission consider the third option discussed in the consultation paper whereby the benefits of Crown financing are locked in irrespective of whether or not this is repaid ahead of the agreed repayment dates...Locking in the value of Crown financing specifically addresses the regulatory incentive risk, while leaving regulated providers efficient incentives to reduce their overall financing costs in practice. Accordingly, this approach is likely a more effective and lower cost means of mitigating perverse regulatory incentives.

Regulatory flexibility should not be promoted at the expense of regulatory certainty

Chorus suggests that its proposed changes to the draft IMs would "improve the balance of workability, flexibility and certainty in the IMs". While Chorus relies predominantly on workability issues (for example, suggesting the removal of the shared cost cap) the changes it is advocating increase flexibility and act to reduce, not improve, regulatory certainty.

A more prescriptive set of IMs would improve regulatory certainty. Regulated suppliers understood this when the Part 4 Commerce Act IMs were being developed.

Regulatory certainty is promoted by clear rules and criteria for capex proposals. In contrast, by way of example, Chorus does not support mandatory assessment factors in the Chorus Capex IM. This position would create considerable uncertainty, including for Chorus, as there would be scope for potentially different rules and evaluation criteria to be used for each of its capex proposals and for this to change over time.

² Spark submission, Fibre Input Methodologies: further consultation draft, 13 August 2020, para 16.



The Commission would have the freedom to shift the goal-posts for how capex proposals are evaluated, even after Chorus has prepared its proposal and supporting evidence.

We continue to support the considerable improvements the Commission has made to the draft Chorus Capex IM.

Chorus is attempting to use time pressures to further water down regulatory requirements and checks

Chorus is advocating watered down Capex IM and audit requirements to meet the challenges of providing information to the Commission by the end of the current calendar year.

For example, Chorus claims “If the capex IM remains as currently drafted, we face a real risk of not being able to meet the deadline” and that audit requirements “mean our goal of a pre-Christmas sign-off would not be realistically achievable”.

We are not sure how these positions align with Chorus opposition to the extension for implementing the new Part 6 fibre regulatory regime. We are not persuaded the changes Chorus is seeking are needed. At best, Chorus’ arguments would support additional transitional factors rather than changes to the IMs.

Deviation from the Commission’s proposed two-step cost allocation process has not been justified

Chorus has proposed a rewrite/substantial deletion of the provisions for “Allocation between regulated FFLAS and services that are not regulated FFLAS”, stating they “are concerned with the potential modelling implications of the proposed two-step approach, driving unnecessary costs and complexity that are passed on to consumers in return for little or no benefit, and puts timeframes at risk”.

Chorus’ supplementary submission has not provided an explanation or evidence to support this position. We are not persuaded that the two-step process should be problematic, or that it is of little value, and support the Commission retaining the proposed two-step allocation process.

We are uneasy that Chorus wants the shared cost cap removed

The cap on shared costs the Commission is proposing is the most generous that is reasonably conceivable. It essentially allows allocation up to the stand-alone cost of the FFLAS business.



We agree with the concerns outlined by Spark: any allocation above the proposed cap would result in excess returns being disguised in the FFLAS cost allocation, and/or other unregulated/competitive business activities being subsidised.

It is consequently of considerable concern Chorus is advocating that the proposed cap should not be adopted, and is claiming they do not have the financial systems needed to determine what costs are unavoidable or to prevent over-allocation of costs.

If the proposed cap “is not workable because it would require information that does not exist” then Chorus should resolve this by making improvements to its financial systems.

Given concerns regarding the impact on competitive services, we also support Spark’s recommendation that the Commission consider adding a second requirement to the proposed materiality threshold so that materiality is determined not only by having a material effect on total costs allocated to regulated FFLAS, but by whether it has a material effect on workable competition in any market.

As noted above we also have concerns about Chorus’ objections to an orthodox two-step process to allocate costs between PQ and ID-only FFLAS, due to “potential modelling implications” and (unsubstantiated) assertions that it is unnecessary.

These examples accentuate our concerns about the Commission’s reliance on high level principles-based rules rather than prescriptive rules for cost allocation etc.

Assets should only enter the RAB when in use

We agree with Vodafone that “Assets should only enter the RAB when in use” and that the proposal to add assets into the RAB when they are “available for use” would create “perverse incentives on the LFCs to deploy assets well ahead of the date they are needed, and simply pass the cost on to other end-users”.

We do not support review of the Part 6 WACC IM being brought forward

Vector has submitted that “Certainty for Chorus and LFCs is more important than consistency between Part 4 and Part 6 cost of capital IMs” and has noted the Commission didn’t align Part 4 and Part 6 WACC IM elements such as TAMRP when it made its 2020 EDB price determinations.

We support Vector’s position on regulatory certainty.

The IMs will not achieve regulatory certainty if they are reviewed regularly and are subject to potential change within regulatory periods. This is why the Commerce and Telecommunications Act prescribe that the statutory reviews of the IMs should occur every 7 years. If the Commission wants to align the the Part 4 Commerce Act and Part 6 Telecommunications WACC IM reviews it should not do so by bringing forward review of the Part 6 WACC IM.



Network Services are necessary for provision of FFLAS

We share Spark and Vodafone concerns with the Commission's proposal to exclude Network Services from the scope of regulated services.

Network services are required in order to operate a telecommunications service as defined in s 5. This includes multiple FFLAS services used for both fixed and mobile services to end-users.

We are not clear why these services have been excluded but they need to be reflected in the new regulatory framework. This includes site investigations, which are required as part of FFLAS connection processes.

As 2degrees noted in its previous submission, excluding these services is excluding services necessary to provide FFLAS. If this proposed treatment of network services continues, this reinforces the need for prescriptive and robust cost allocation and Related Party Transaction rules.