FURTHER CONSULTATION: FIBRE INPUT METHODOLOGIES DETERMINATION 2020

Cross-submission to the Commerce Commission

PUBLIC VERSION

2 September 2020

INTRODUCTION

1. Vocus welcomes the opportunity to cross-submit in response to the *"[Further consultation] Fibre Input Methodologies Determination 2020"* and *"Fibre Input Methodologies: Further consultation draft - reasons paper"*, 23 July 2020.

2. If you would like any further information or have any queries about this submission, please contact:

Quentin Reade
Head of Communications
Vocus Group (NZ)
Quentin.Reade@vocusgroup.co.nz

OUR COMMENTS IN RESPONSE TO OTHER SUBMISSIONS

3. We have the following comments in response to the other submissions:

   (i) **Scope of the current consultation:** The Commission was very clear about what is in and out-of-scope for the current consultation. We have ignored the numerous material in Chorus' submission that is out-of-scope, including relitigation of the setting of WACC percentile.

   (ii) **Consistency with the approach that applies to Transpower:** The Part 6 Telecommunications Act arrangements that will apply to Chorus are most closely aligned to the Part 4 Commerce Act arrangements applying to Transpower rather than other regulated suppliers, so naturally there has been a lot of reference to the Transpower precedent. Our observation of Chorus' submissions is that they selectively support adopting the Transpower approach when it suits them, but object to other elements such as specification of clear evaluation criteria for capex proposals. We reiterate, consistent with Part 4 precedent, that the Chorus Capex IM should include mandatory assessment factors including a requirement for quantified CBA/Investment Test to support any capex proposals.

   (iii) **Crown financing benefit:** We note the Vodafone and Spark submissions support our view that the Commission should adopt the paragraph 3.48.3 option, and this would be consistent with debt:equity ratio settings in the WACC method. We agree with Spark, for example, that *"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"*.

   (iv) The L1 Capital submission conflates CFH restrictions that need to be meet to bid in the UFB tender with the cost of Crown financing. If the L1 Capital submission was taken at face value and the costs of equity and debt were higher under Crown

financing it would not have been commercially rational for Chorus to rely on Crown financing.

(v) **Unsubstantiated assertions:** We would expect Chorus to provide evidence to support its claims, if it genuinely believes *"The revised approach to the treatment of Crown financing is wrong in fact, does not provide us the opportunity to recover real FCM and is inconsistent with the Act"* and the impact of the Commission's position is so severe *"Had investors been aware of this before the network was built it is unlikely the project would have ever proceeded"*. In order for Chorus to substantiate these claims, it would need to quantify the extent to which it would be unable to recover *"real FCM"*. Instead Chorus offered nothing more than unsubstantiated assertions. Chorus is well aware of the High Court position in the Part 4 IMs Merit Appeal that *"Where a proposition is simply asserted … we give it little or no weight"*.[1]

(vi) **Value of the Initial RAB:** Chorus has asserted *"The starting Regulatory Asset Base (RAB), including the financial losses, cost of capital and the MAR will significantly affect incentives ahead"*. It is worth noting the High Court comments on initial RAB in the Part 4 IMs Merit Appeal decision: [2]

> *[598] … in a regulated industry, unless the RAB is set at less than the scrap value, the asset owner will rationally keep the assets in operation, and indeed operate them as efficiently as possible.*
>
> *[599] Moreover, the asset owner will still have just the same incentives to invest in new assets and asset replacement (so long as those new investments are taken into the RAB at cost) because the regulatory environment provides for new investments to return the regulated cost of capital.*

(vii) **When assets can be included in the RAB:** We agree with Vodafone that assets should be included in the Regulatory Asset Base (RAB) when they are actually employed rather than 'available for use'. The Commission's proposed approach appears to be inconsistent with the Transpower Capex IM which allows assets into the RAB after they have been *"commissioned"* ie *"used by Transpower to provide electricity transmission services".*

(viii) **Cost allocation and capex:** We do not support Chorus' advocacy for *"less prescriptive cost allocation processes"* and *"more flexible and targeted capital expenditure information requirements"*. The proposed IMs are already high level and principles-based without further changes to weaken them. This is highlighted clearly by comparison of the draft Chorus Capex IM against the Transpower Capex IM, even with the improvements the Commission has made to the Chorus version. The clear and consistent theme of RSP submissions throughout the

[1] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC, [11 December 2013], paragraph [1745].
[2] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC, [11 December 2013], paragraphs [598] and [599].

development of the IMs and the Part 6 fibre price-quality regulartory regime is that the Commission should be adopting a more prescriptive approach.

(ix) **Alignment with Part 4 reviews:** While we agree with the Commission that there may be some benefits in aligning cost of capital IM reviews across Part 4 Commerce Act and Part 6 Telecommunications, any alignment should occur as part of the 7-year statutory review of the Part 6 IMs, rather than be sequenced to occur as part of the Part 4 IMs review. This would address the legitimate issues Vector raised in its submission; particularly in relation to the need for the IMs to provide certainty. If the Commission reviewed the Part 6 WACC IM at the same time as it next reviews the Part 4 IMs, the Part 6 WACC IM settings may not last beyond a single, 3-year, regulatory period.[3]

(x) **Alignment of review of WACC should not apply to WACC percentile:** While most elements of the Part 4 and Part 6 WACC IMs, and CAPM model that is applied, are essentially the same, the two diverge in relation to WACC percentile. Submissions we and others have made, including in relation to the copper access price determinations, and the Commission's own analysis and decisions, have determined that the appropriate percentile for telecommunications (50th) and for electricity and gas (67th) are different. We see no synergy or benefit in aligning review of this element of the WACC IMs.

(xi) **COVID-19 and WACC:** We welcome Enable and Ultrafast's acknowledgement that *"no changes to the IMs are required at this stage arising from the Covid-19 pandemic"*. The Vodafone submission provided robust evidence to support this position.

[3] The last Part 4 statutory review of the IMs was completed by December 2016. This means the next review needs to be completed by December 2023. The Commerce Commission completed the last review a year earlier than it needed to, meaning the next Part 4 IMs review could potentially be completed by December 2022.