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Tristan Gilbertson
Telecommunications Commissioner
Commerce Commission
Level 9, 44 The Terrace
PO Box 2351
WELLINGTON

Via online submission portal

Trustpower Limited
Head Office
108 Durham Street
Tauranga
Postal Address:
Private Bag 12023
Tauranga Mail Centre
Tauranga 3143
F 0800 32 93 02
Offices in
Auckland
Wellington
Christchurch
Oamaru
Freephone
0800 87 87 87
trustpower.co.nz

TRUSTPOWER SUBMISSION: FIBRE INPUT METHODOLOGIES: INITIAL VALUE OF THE FINANCIAL LOSS ASSET

1. Introduction

- 1.1.1 The Commerce Commission (**the Commission**) is continuing to progress with developing the new regulatory regime for fibre fixed line access services (**FFLAS**) as required under Part 6 of the Telecommunications Act 2001 (**the Act**).
- 1.1.2 The Commission recently published its further consultation draft on the initial value of the financial loss asset (**FLA**) (**the Reasons Paper**) and is currently seeking feedback.
- 1.1.3 This submission provides Trustpower Limited's (**Trustpower's**) feedback on the matters in the Reasons Paper most relevant to Trustpower's participation in the communications sector.

2. Interpretation of s177

- 2.1.1 Our submission primarily relates to the Commission's interpretation of s 177 of the Act.
- 2.1.2 In the Reasons Paper, the Commission expresses its position and view that "...s 177 permits (though does not require) pre-2011 assets to be included in the calculation of the FLA."¹
- 2.1.3 We continue to hold a different view to the Commission in this regard.

2.2. Context of pre-2011 asset investment

- 2.2.1 Pre-2011 assets were not constructed or acquired by Chorus Limited (**Chorus**)² to provide FFLAS under the Ultra-Fast Broadband (**UFB**) initiative. Rather, these were pre-existing assets that Chorus had acquired that were deployed under the previous regulatory regime that applied at that time. Many of these are likely to have been fibre-to-the-node assets, which Telecom committed to deploy under its operational separation undertakings with the Crown in 2008.
- 2.2.2 Importantly, under the previous regulatory regime at the time of that investment, there was no equivalent of s 177, and there was no regulatory assurance of recovery of any financial losses made by Chorus in making that investment.
- 2.2.3 In bidding for the UFB project, Telecom/Chorus sought to meet its contractual obligations to the Crown through using a mixture of pre-2011 fibre assets and new-build fibre assets. This made

¹ Reasons Paper, [2020] Commerce Commission, p. 15 (refer paragraph 2.22)

² We refer, in these submissions, to Chorus, but the same applies to the local fibre companies.

commercial common sense, as the reuse of existing assets allowed Chorus to reduce their overall capital expenditure spend and reach deployment milestones more quickly.

- 2.2.4 Under the Commission’s interpretation, while Chorus had no expectation of recovery of financial losses in its investments in pre-2011 assets when they were originally deployed, by shifting these assets into delivery of its obligations under the UFB contracts, it would be entitled to benefit from including those losses in the FLA.
- 2.2.5 This will be a windfall of sorts for Chorus, who would not have expected this benefit at the time of its original investment and would have had to live with any financial losses that it may have suffered from these earlier investments. The impact of this windfall will be felt by end-users.

2.3. Whether s 177(3) impliedly excludes pre-2011 assets

- 2.3.1 While s 177(2) may be interpreted as neutral on this point, the Commission considers that s 177(2) is constrained to a limited extent by s 177(3). The Commission states that:

...s 177(3) does not constrain us from taking account of pre-2011 assets that were used to provide FFLAS under the UFB initiative even if these investments do not qualify as “investments made by the provider under the UFB initiative”. There is no express exclusion of pre-2011 assets in the wording of s 177(3), nor is there an implied exclusion when the words are read in their context.³

- 2.3.2 We don’t agree with the Commission’s interpretation of s 177(3), which limits its significance in our view. We believe that the explicit reference to post-2011 assets in paragraph (a), with no corresponding reference to investments that were not made under the UFB initiative, implies that these pre-2011 assets must be excluded in calculating financial losses.
- 2.3.3 S 177(3) is a key provision in the legislation, limiting what may be included in financial losses. It expressly includes not only post-2011 assets, but also “actual financing costs”. The Commission appears to take an inconsistent approach in its interpretation: on the one hand, the Commission does not consider that it may take into account other financing costs in its interpretation of paragraph (b), but on the other hand it does consider it may take into account other investments in its interpretation of paragraph (a).
- 2.3.4 We believe the Commission should give s 177(3)(a) its due weight and exclude pre-2011 assets in its determination of financial losses.

2.4. Significance of the supplementary order paper

- 2.4.1 The Commission considers that guidance is provided by the supplementary order paper (SOP)⁴ in that a broader interpretation is possible. We do not see how the Commission can reach this conclusion from the SOP, however.
- 2.4.2 In discussing this aspect, the SOP moreorless repeats the text of s 177(3). We don’t believe the SOP assists the Commission in reaching its broader interpretation.

2.5. Whether investments made under the UFB initiative includes pre-2011 assets

- 2.5.1 Trustpower also does not accept the Commission’s view that “...“investments made by the provider under the UFB initiative” could include pre-2011 assets that were redeployed in whole or part to provide FFLAS under the UFB initiative...”.⁵ (paragraph 2.34). Investments in pre-2011 assets were not made under the UFB initiative.

³ Reasons Paper, [2020] Commerce Commission, p. 17 (refer paragraph 2.31)

⁴ Supplementary Order Paper (118) – Telecommunications (New Regulatory Framework) Amendment Bill, [16 October 2018] New Zealand Parliament

⁵ Reasons Paper, [2020] Commerce Commission, p. 17 (refer paragraph 2.34)

- 2.5.2 Chorus had previously made a similar point that “[the exclusion of pre-2011 investments] ignores the reality that the acquisition of pre-2011 assets by Chorus was itself undertaken as a condition of, and pursuant to, the UFB initiative.”⁶ We don’t believe this is correct.
- 2.5.3 Chorus did not acquire those pre-2011 assets as a condition of, and pursuant to, the UFB initiative. They may have participated in the UFB initiative in the expectation of using those pre-2011 assets to deliver on their contractual obligations to the Crown, but that is not the same thing.

2.6. Whether the s 162 purpose supports inclusion of financial losses from pre-2011 assets

- 2.6.1 In reaching its conclusion, the Commission considers the purpose in s 162.
- 2.6.2 We note that s 162(a) refers to “incentives to innovate and to invest, including in replacement, upgraded, and new assets”.⁷ However, the inclusion of the pre-2011 assets did not require innovation or investment. There was no replacement (quite the opposite), no upgrading, and no new assets.
- 2.6.3 If anything, we believe s 162 supports the conclusion that financial losses from pre-2011 assets should be excluded as further investment and innovation was not required by using pre-existing assets.

2.7. Whether other contextual arguments support the Commission’s interpretation

- 2.7.1 The Commission seeks to support its interpretation through a broader contextual review of s 177.⁸
- 2.7.2 The Commission refers to s 177(1), where, in calculating the regulated asset base (**RAB**), the value of pre-2011 fibre assets are included. The assets may be included in the RAB, but it does not follow logically that any financial losses incurred in respect of pre-2011 assets should be included in the FLA.
- 2.7.3 As mentioned above, inclusion of these financial losses will be a windfall of sorts for Chorus. We believe that, if Parliament intended this to occur, it would likely have explicitly provided for it, in the way that it has for inclusion of the value of those assets under s 177(1).
- 2.7.4 We are unconvinced by the Commission’s argument that there is a distinction between “for the period” and “in the period” in s 177(2) that supports its interpretation.⁹ We don’t consider there to be any difference between the two. Chorus either provided FFLAS from 1 December 2011 and the implementation date, or they did not.

2.8. Whether s 177(5) supports the exclusion of pre-2011 assets

- 2.8.1 Similar to s 177(3), s 177(5) draws a connection (“a direct result of”) between the asset and the “specific requirements of the UFB initiative”. The Commission downplays this connection in its Reasons Paper in deciding that s 177(5) does not restrict its ability to include pre-2011 assets.¹⁰
- 2.8.2 s 177(5) is an express statement of inclusion of certain costs, yet the Commission considers this to enlarge, but not restrict its interpretation. The Commission quotes from Ministry of Business Innovation and Employment’s (**MBIE**’s) Departmental Report: Telecommunications (New

⁶ Cross-submission in response to the Commerce Commission’s fibre regulation emerging views, [July 2019] Chorus, p. 15 (refer to paragraph 34)

⁷ Telecommunications Act 2001, s162(a)

⁸ Reasons Paper, [2020] Commerce Commission, p. 18 (refer paragraphs 2.35, 2.35.1-2.35.3)

⁹ Reasons Paper, [2020] Commerce Commission, p. 18 (refer paragraph 2.35.2)

¹⁰ Reasons Paper, [2020] Commerce Commission, pp. 18-19 (refer paragraphs 2.36-2.38)

Regulatory Framework) Amendment Bill (**Cabinet Paper**),¹¹ but we do not see how the reference supports the Commission's interpretation.

- 2.8.3 Indeed, the next paragraph in the Cabinet Paper makes it clear that a building blocks model (**BBM**) "regulatory approach ... is concerned with ongoing incentives to innovate, invest and improve efficiency".¹² Yet, as we state above in relation to s 162, with pre-2011 assets, there was no innovation or investment. The existing assets were reused.
- 2.8.4 We consider that s 177(5) supports an interpretation of s 177 that, while there may be no express exclusion of pre-2011 assets in calculating the FLA, in drawing a connection between the cost and the UFB initiative, there is in fact an implicit exclusion.

2.9. Conceptual basis of FLA

- 2.9.1 In concluding our submissions on section 177, we refer back to the Commission's statement of the conceptual basis for the FLA in the Reasons Paper:

The Ultrafast Broadband (UFB) partners – Chorus Limited (Chorus) and the other local fibre companies (LFCs) – were expected to incur financial losses during the UFB network's initial period of operation. This is because UFB partners made investments ahead of demand, and initial end-user uptake of UFB services and the associated revenues recovered in accordance with the UFB contracts were not sufficient to cover the fixed and/or variable costs that the UFB partners incurred during that period.¹³

- 2.9.2 Chorus' investments in the pre-2011 assets were not made subject to the UFB contracts. The investments in those assets were not made in pursuance of the Government's UFB initiative; they were made in another time, under a different regulatory regime.
- 2.9.3 Chorus did not invest in the pre-2011 assets (ahead of demand) in expectation of any regulatory assurance of recovery of financial losses.
- 2.9.4 We maintain our view that pre-2011 assets should be excluded in calculating the FLA.

3. Change from BBM to discounted cash flow methodology for calculating financial losses

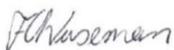
- 3.1.1 We have no particular comments to provide on the move to a discounted cash flow method.

4. Request for further information

- 4.1.1 While we thank the Commission for providing the illustrative workbook to enable participants to get a better understanding of the calculation of the financial loss asset, we would like to request that the Commission provides the industry with some indication of the significance of the financial loss asset in the RAB. Chorus and the LFCs will have this information of course, but it would be very helpful for us if we could better understand the magnitude of the likely impacts.

For any questions relating to the material in this submission, please contact me on 027-549-9330.

Regards,



FIONA WISEMAN
SENIOR ADVISOR – STRATEGY & REGULATION

¹¹ Refer Cabinet Paper, [22 May 2017] MBIE; <https://www.mbie.govt.nz/dmsdocument/1310-telco-review-cabinet-paper-may-2017-pdf>.

¹² Cabinet Paper, [22 May 2017] MBIE, paragraph 39

¹³ Reasons Paper, [2020] Commerce Commission, p. 9 (refer paragraph 2.4)