

# Commerce Commission Fibre Input Methodologies Further consultation draft

- Initial Value of Financial Loss Asset (Reasons Paper)

2degrees Submission, 10 September 2020





## Executive Summary

2degrees appreciates the opportunity to submit in response to the Commerce Commission's *Fibre Input Methodologies: Further consultation draft (initial value of financial loss asset) – reasons paper*.

Our key comments at this stage are as follows:

- We consider section 177 necessitates that the Commerce Commission define what a financial loss is from the outset.
- The 'financial loss' is the difference in profits supplying and not supplying relevant FFLAS.
- We do not agree with the Commission's new rationale for adopting ABAA to determine financial losses.
- We share the Commission's concerns about Chorus' cost allocation of pre-2011 assets.
- We consider that these concerns would best be addressed by:
  - Adopting an incremental cost approach;
  - Adopting a prescriptive set of rules that limit Chorus' discretion; and
  - Only allowing pre-2011 assets to be included when they are employed.
- We strongly support consideration of additional tools to address appropriate cost allocation of pre-2011 assets in the FLA calculation, including the three options the Commission has identified in para 2.98:
  - Excluding in their entirety any assets which are found to have been over-allocated;
  - Only allowing costs of an asset to be allocated to FFLAS when it is used primarily for FFLAS; and
  - Setting a cap on the maximum copper asset values transferred to fibre.
- These additional tools are potentially complementary and should not be seen as alternatives or substitutes.



## **We consider section 177 necessitates that the Commerce Commission define what a financial loss is from the outset:**

We do not agree with the Commission's position that it has "the ultimate discretion to determine the extent to which pre-2011 assets are included in the calculation of financial losses, subject to the requirement to do so in the manner which we consider best gives, or is likely to best give, effect to the purpose in s 162".

We consider that in order to determine the appropriate cost allocation to the Financial Loss Asset (FLA), in accordance with section 177, the Commission must first define what 'financial loss' actually means. The extent to which pre-2011 assets are relevant considerations to the calculation of the financial losses under s 177(2) depends on whether their inclusion is consistent with this definition.

## **The 'financial loss' is the difference in profits supplying and not supplying relevant FFLAS**

We consider 'financial loss' to mean the difference in profits between supplying and not supplying non-exempt FFLAS<sup>1</sup> during the transition period. We reiterate that:<sup>2</sup>

Deviation from an incremental or avoidable cost allocation methodology would be in violation of any reasonable or orthodox definition of "financial losses" and would result in Chorus being overcompensated in violation of the Commission's Financial Capital Maintenance (FCM) principle and the statutory purpose of limiting excessive profits.

We do not agree that the financial losses "incurred by the provider in providing fibre fixed line access services under the UFB initiative for the period starting on 1 December 2011 and ending on the close of the day immediately before the implementation date"(s 177(2)) includes pre-2011 assets that Chorus would have incurred regardless of whether it provided UFB services or not.

## **We do not agree with the Commission's new rationale for adopting ABAA to determine financial losses**

In responses to both the Emerging Views and Draft Reasons consultations we (and other submitters) have previously provided reasons as to why the Commission's rationale for preferring an ABAA approach over an incremental cost allocation approach is unsound. This consultation has not engaged with or addressed these reasons but details some new reasons why an ABAA approach should be adopted.

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<sup>1</sup> This takes into account the geographical/UFB area of service.

<sup>2</sup> 2degrees, Commerce Commission Fibre Input Methodologies Submission, 28 January 2020.



We do not consider the new reasoning provides adequate justification for adopting ABAA.

Our view remains that the Commission should adopt an incremental cost approach. We agree with the Commission that "... the FLA represents a wealth transfer from consumers to regulated providers where, if losses are overestimated, then this will not be to the long-term benefit of end-users in FFLAS markets (s 162(d))". An incremental cost approach is required to avoid overestimation of losses.

### **We share the Commission's concerns about Chorus' cost allocation of pre-2011 assets**

The Commission has sound reason to "continue to have heightened concerns with the treatment of pre-2011 assets" and concerns that "Chorus has strong incentives to allocate as high a volume and value as possible to pre-2011 assets". We agree with the reasons the Commission has detailed at paragraph 2.85 for the risk of potential 'gaming' to be heightened for the section 177(2) determination, i.e:

- The large number of assets involved and the extended life-time of some of these assets, which makes verification more difficult.
- The one-off nature of the exercise rather than a repeated exercise, where the asymmetry of information between the Commission and regulated providers is particularly pronounced.
- The potential for overallocation of assets to FFLAS, beyond what is necessary.
- Little downside from engaging in potential 'gaming'.

Our previous submissions detailed reasons why the Commission should be concerned about potential gaming, including the experience with Chorus' precursor Telecom's inflated TSO and TSLRIC cost estimates. The inflated TSO example highlights a poor track record when it comes to calculating losses.

This issue is not specific to FLA or allocation of pre-2011 assets.

### **We support additional tools for the Commission to address appropriate cost allocation of pre-2011 assets in the FLA calculation**

The Commission suggests it has "tools available to address 'windfall gains'" that might result from inappropriate treatment of pre-2011 assets, which "may have been overlooked by concerned submitters".



We do not consider the current tools or safeguards are adequate to ameliorate the Commission's (and other submitters') legitimate concerns about inflation of the financial loss determination.

We consider that these concerns would best be addressed by, for example:

- a. Adopting an incremental cost approach;
- b. Adopting a prescriptive set of rules that limit Chorus' discretion; and
- c. Only allowing pre-2011 assets to be included when they are employed.

2degrees are also very supportive of consideration of additional tools, including the three options the Commission has identified in para 2.98 of:

- a. Excluding in their entirety any assets which are found to have been over-allocated;
- b. Only allowing costs of an asset to be allocated to FFLAS when it is used primarily for FFLAS; and
- c. Setting a cap on the maximum copper asset values transferred to fibre.

These options are potentially complementary and should not necessarily be seen as alternatives or substitutes.