



Fibre ID and PQ draft decisions

Cross-submission | Commerce Commission

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Executive Summary

Thank you for the opportunity to provide feedback on the draft Price-Quality (PQ) path and Information Disclosure (ID) draft decisions (**the draft**).

Chorus connection incentives appear to be inconsistent with the Act's requirement for geographically averaged pricing

We support the Commission omitting Chorus connection incentives from approved expenditure.

As the Commission notes in the draft, it cannot determine an expenditure item that is inconsistent with the Telecommunications Act 2001 (**the Act**). As the Commission also notes, this means that the Commission cannot approve a proposed expenditure that is inconsistent with the s201 requirement that Chorus must charge the same price regardless of the geographic location of an access seeker or end-user.

- Chorus' connection incentives are inconsistent with s201 in that they result in different prices for the same service based on an end-user's location.

And by the same reasoning, the Commission also must not approve an expenditure that is inconsistent with other Chorus obligations under the Act, including Chorus' non-discrimination and equivalence obligations.

- Chorus' connection incentives are also inconsistent with the Act's non-discrimination and equivalence requirements. They target selected access seeker's customers (that is, customers of access seekers that operate competing broadband networks to Chorus' fibre network) while shielding Chorus' own copper business.

Finally, the Commission also must not approve an expenditure item that does not promote competition in the long-term interests of end-users.

- Chorus' connection incentives promote competitive activity that is detrimental to end-users' interests. In particular they promote:
 - the withdrawal of entry-level low-speed fibre services from the market, which broaden the reach of fibre services to end-users that might not otherwise be able to afford them; and
 - a "two-speed" market where "active" customers see the benefits of competitive pricing but inactive customers do not.

For these reasons, we expect the Commission has no choice but to omit these incentives from approved expenditure. Further we expect the Commission will want to explore further whether Chorus is offering these incentives, and has offered them in the past, in breach of the Act.

In our submission we also:

- Agree that determining the scope of FFLAS is important. The draft FFLAS scope the Commission has requested comments on appears to include competitive and legacy data services that are not FFLAS. Further, the expenditure proposal will likely over-build competitive fibre transport routes and risks undermining the industry transport fibre investment model.

- Agree that the Commission has discretion to accelerate depreciation and to manage Chorus' revenue path to mitigate perverse regulatory outcomes but believe this should be done transparently and through an adjustment across all assets.
- Further support comprehensive information disclosure requirements and have made minor suggestions that we believe would improve their effectiveness.

Introduction

1. Thank you for the opportunity to provide feedback on the draft Price-Quality (PQ) path and Information Disclosure (ID) draft decisions (**the draft**).
2. The draft decisions are based on Chorus' RAB proposal¹ estimated initial PQ RAB and cost allocations. These parameters have yet to be determined, though, and we note that Chorus' proposed expenditure and RAB proposals are likely to materially over-state the actual FFLAS costs.
3. At this stage, the Commission is consulting on PQ draft decisions that will apply to Chorus':
 - a. Revenue path.
 - b. Expenditure.
 - c. Quality standards, and
 - d. Indicative allowable revenue.
4. The Commission is also consulting on ID requirements that will apply to Chorus and LFCs.

The expenditure proposal

5. The Commission has released estimated forecast allowable revenue, noting that it may change parameters based on submissions and the August 2021 draft decisions². However, it is unclear what the purpose of the expenditure proposal is when a significant number of dependent decisions are yet to be made.
6. The Commission plans to make key decisions later in the year that may further amend claimed expenditure. Figure 1 from the draft shows the key decisions expected later this year prior to the updated process. Final decisions will now be made in December and will have to resolve key RAB uncertainties.

¹ Draft at X11

² Draft at 3.17

Figure 1: planned decision timetable prior to most recent updated process

Table X1 **Decisions in our current processes and when we will decide them**

Regulatory instrument	May 2021	August 2021	November 2021
Price-quality path (PQP1)	Draft decisions Revenue path Expenditure Quality standards Including indicative allowable revenue	Draft decisions Cost and asset allocation for expenditure Updated forecast allowable revenue Final decisions Chorus' transitional initial PQ RAB	Final decisions Revenue path Expenditure Cost and asset allocation for expenditure Quality standards Forecast allowable revenue
Chorus' initial PQ RAB		Draft decisions Chorus' initial PQ RAB	
Information disclosure (ID)	Draft decisions Disclosure requirements from 1 January 2022		Final decisions Disclosure requirements from 1 January 2022
Input methodology amendments	Draft decisions All proposed IM amendments	Final decisions Process IM amendments	Final decisions All other IM amendments

7. The draft largely applies Chorus' RAB and expenditure proposals, with minimal adjustments for transfers to individual capex proposals, updated demand forecasts, and to apply Chorus current run rate costs, i.e.,
 - a. Omitting "innovation" (\$37M over three years) and "connection incentives" (\$43.7M overall) from the forecast (for which Chorus can make individual capex proposals).
 - b. Adjusting for updated demand forecasts (\$28.8M capex and \$9M opex).
 - c. Reducing claimed costs to reflect actual unit cost trends and efficiency gains (\$63.5M).
8. The adjustments have not been made in light of IM compliance, allocation, and double recovery concerns. Chorus' proposal has yet to be scrutinised and assured as anticipated by the process and approach paper, and likely has key gaps. For example:
 - a. Chorus has applied a top-down approach that deconstructs its current costs, allocating all costs to its copper and fibre businesses.

As set out in our submissions on Chorus' expenditure and RAB proposals, any approach based solely on deconstructing existing costs will inevitably bring the costs and complexity of Chorus' legacy operating model and commercial decisions in to regulated FFLAS services, and result in double recovery. Chorus further would not face efficient incentives in providing FFLAS services, nor in other non-FFLAS businesses as these costs in part would be built in with guaranteed recovery through the BBM.
 - b. Chorus has not adequately defined the boundary of the FFLAS and wholesale fibre business it is claiming costs for, meaning the proposal includes competitive services and builds significant legacy complexity in to claimed fibre costs.
 - c. Chorus has not applied the IM protections anticipated by the Reasons Paper such as a proportionate allocation of costs and shared cost allocation caps.

- d. High level benchmarking suggests Chorus has claimed wholesale fibre costs far in excess of the actual costs we see incurred by other wholesale fibre providers.
 - e. Chorus has not applied any consideration of the promotion of competition as required by the Act.
9. We note that the draft acknowledges the proposed values and results are subject to future Commission decisions. However, it also appears to apply some limited assurance to the cost estimates. For example, it has taken a top-down approach based on the CutlerMerz report³ and Chorus' 5-year budget⁴. However, CutlerMerz specifically exclude consideration of cost allocation⁵ and did not consider the requirements for a wholesale only fibre business, i.e., it applies the review criteria to Chorus as a multi-service integrated provider. Chorus' business plans are likewise based on its requirements as an integrated provider.
10. Therefore, the expenditure estimates will still require the Commission to, for example, apply the IM protections, consider the sanity check model outcomes as set out in the September 2020 process and approach paper⁶, and consider competition implications of FFLAS definitions and cost allocations. These are significant considerations that are being pushed late in to the process timetable.

Scope of FFLAS

11. The Commission has requested views on the completeness, accuracy and categorisation of Chorus proposed FFLAS services⁷.
12. We agree that defining FFLAS is central to setting the scope of the PQ regulation, and support the Commission considering this further as part of its August 2021 draft decision⁸. The impact of these services goes beyond cost allocation concerns. For example, Chorus' residential gateway service is not specified as part of UFB services and is not a FFLAS, and supporting the service adds significant complexity and costs to an end-to-end service that will be built in to the otherwise less complex and cheaper to support FFLAS.
13. In the absence of a clear definition, regulated providers have an incentive to optimise between in and out of scope services, maximising functionality and costs that are attributed to the regulated services.
14. We have concerns with the indicative FFLAS scope set out in table 1 that appears to include:
- a. Competitive services that are not FFLAS and arguably not permitted by Chorus' line of business restrictions such as Chorus' optional WiFi residential gateway service.
 - b. Legacy data services that have been withdrawn or are in their sunset phase. To the extent that these services are related to FFLAS, this can only be through the use of a DFAS access input.
15. Further, there does not appear to have been any consideration of our concerns that the Chorus expenditure proposal anticipates over-building competitive transport routes that we have made significant investments in, and risks undermining the industry transport fibre investment model.

³ Draft at 4.32

⁴ Draft at 4.58

⁵ CutlerMerz report at page 4

⁶ Commission Proposed process and approach for the first regulatory period 15 September 2020

⁷ Draft at 2.31

⁸ Draft at 2.35

16. At a time when authorities such as the Infrastructure Commission seek more investment in resiliency infrastructure, the draft risks undermining the model that supports this investment.
17. Our comments on the draft Attachment are set out in the table below.

Table 1: Chorus services and proposed IM service categories

Service name	IM Service category	Comment
Fibre Credit Amortisation	Bitstream PON	It is unclear what this is, but if it relates to connection incentive schemes should be excluded from FFLAS.
Fibre Credit Amortisation - Business	Bitstream PON	
Government Contribution	Bitstream PON	
Hyper Fibre Business Monthly Rental	Bitstream PON	
Hyper Fibre Residential Rental	Bitstream PON	
NGA Assure	Bitstream PON	
Small Business Fibre Rental	Bitstream PON	
Wifi ONT Monthly Rental	Bitstream PON	This is a commercial “additional” service that Chorus offers. We have reservations that it is compliant with LOB requirements. It should not be part of FFLAS.
Commercial Co-location	Co-location and interconnection	Commercial location is a competitive service – it’s unclear why this would be considered FFLAS.
Commercial Co-location Non-Rental	Co-location and interconnection	
Commercial Property Lease Co-Location	Co-location and interconnection	
Legacy Handover Links	Co-location and interconnection	This is to support legacy services, below, and is not a FFLAS.
Small Business Fibre Installation	Connection services	
Wifi ONT Installation	Connection services	This is a commercial “additional” service that Chorus offers. We have reservations that it is compliant with LOB requirements. It should not be part of FFLAS.
HSNS Other	Point to Point	These are legacy Wholesale Products and is unclear why it could be FFLAS. At most, the service could use a DFAS access or share transport fibres.
HSNS Premium Access	Point to Point	
CNS Ethernet	Transport	These are legacy Commercial Services and, again, it’s unclear why this would be a DFAS. At most, the service could use a DFAS access or share transport fibres.
CNS SDH/PDH	Transport	
CRT	Transport	This is a commercial transport service that is not part of FFLAS. Chorus only makes this service
CRT Installation	Transport	

Service name	IM Service category	Comment
		available on competitive transport routes.
E1s and E3s	Transport	This is a legacy Commercial Service. The E1 access has been withdrawn, and we are not aware of any customer purchasing E3s (we don't).
HSNS Tail Extension	Transport	Again, this is a legacy Wholesale Product
STM1s and STM4s	Transport	Again, these are legacy Commercial Services that customers are migrating off. Legacy Commercial Service
Wholesale ATM	Transport	

The Connection incentive payments

18. As the draft notes, Chorus currently offers a number of “connection incentive” initiatives. These are a significant concern. Chorus’ incentive scheme has been designed and applied in a way that we believe is inconsistent with the Act, detrimental to end-user interests, and intended to undermine nascent competition from alternative network providers.
19. The connection incentive discount means that, in effect, end-users face different prices for the same service based on their location. In particular, a number of the Chorus incentives only apply if their location has an alternative broadband network connection present. If it does not, those incentives do not apply. This is a direct contravention of s201 of the Act. Further, the differentiated incentives target customers most likely to adopt other networks’ services while protecting Chorus’ own copper business. We believe that this is discriminatory and acts to exclude or limit the expansion of actual or potential rivals – again, in contravention of the Act.
20. Accordingly, we agree that the incentive payments should be omitted from the expenditure proposal⁹ and their legality investigated further by the Commission. .

The proposed framework

21. The draft sets out the Commission’s proposed preliminary thresholds that need to be met for any individual capex proposal related to incentive payments, and an indicative framework that the Commission envisages using for evaluating the proposal¹⁰.
22. The Commission proposes to ask two preliminary questions:
 - a. Do the proposed incentive payments comply with the geographically consistent pricing requirement under s 201? We do not consider that Chorus’ proposed incentive payments comply with this requirement for geographically consistent pricing¹¹.

⁹ The Commission proposes to omit \$34.7M of base capex (at 4.146) and \$10.2M (\$9.2M following the demand adjustment) for new connections for which the incentive payments would apply (at 4.183)

¹⁰ See Attachment G at page 198 of the draft

¹¹ Draft at G7

- b. Do the costs Chorus incurs in making incentive payments to obtain contracts with RSPs meet the definition of "capex"?
- 23. If the two preliminary thresholds are met, the Commission would then apply the following test when assessing incentive payments:

is there evidence to show that the expected incremental revenues exclusively from the incremental end-users outweigh the incremental costs?¹²
- 24. The Commission's proposed approach to the substantive question is based on two concerns:
 - a. That while Chorus would otherwise be best placed to manage demand from promoting incentive payments (i.e., by considering demand benefits, setting of the payment and the risk end-users switch), the BBM provides an incentive for Chorus to make excessive payments and take excessive risks. This is because Chorus' return is guaranteed by the capitalisation of incentive payments and revenue cap¹³.
 - b. That the incentive payments may pose a threat to competition from competing infrastructure. The individual capex proposal approach would allow the Commission to consider the proposal and competition concerns at a more granular level¹⁴. In the meantime, Chorus is free to spend as it sees fit within the other regulatory constraints.

A PQ decision needs to be consistent with the Act and Fibre Deeds

- 25. We agree that the Commission cannot determine an expenditure that is inconsistent with the Act, including whether Chorus is charging the same price regardless of the geographic location of the access seeker or end-user as required by s201. However, this requirement to make PQ decisions that are consistent with the Act goes to all Chorus obligations.
- 26. While the Commission notes that incentive payments must comply with the non-discrimination obligations, which it notes together with competition law mitigate to some extent risks to competition¹⁵, the Commission must also make decisions that are consistent with other regulatory obligations and promote end-user benefits and competition. For example, the Commission can also not determine an expenditure that is inconsistent with Chorus' non-discrimination and equivalence obligations. The Commission needs to keep front-of-mind that PQ decisions today will affect the future competitive landscape.
- 27. Therefore, the Commission preliminary question should ask whether the proposed incentives are consistent with requirements under the Act, i.e., s201 and non-discrimination and equivalence obligations.

The Commission should consider whether the incentives are in end-user interests and promote competition

- 28. The Commission proposes to ask whether is there evidence to show that the expected incremental revenues exclusively from the incremental end-users outweigh the incremental costs.

¹² Draft at G3

¹³ Draft at G16 – G20

¹⁴ Draft at 4.187

¹⁵ Draft at G37

29. The Commission identified that incentive payments can be consistent with behaviour in workably competitive markets, but if the level of payments is excessive they can be anti-competitive. Chorus may have an incentive to excessively use these payments in an anti-competitive way. The extent to which it has the ability to do so is influenced by the Commission's regulation¹⁶.
30. To consider whether Chorus' proposed incentive payments may harm competition, the Commission proposes to examine whether the incentive payments have the intent or effect of lessening competition¹⁷. Incentive payments can be beneficial as a means of growing demand, that in turn may result in lower prices. However, the Commission noted it would be concerned if recoupment of the incentives relies on expected higher future prices that result from a lessening of competition or the regulator allowing Chorus to recover the incremental costs from the whole of the 'captive' customer base.
31. Accordingly, the Commission proposes to ask the question¹⁸: *would the incentive payments make economic sense in the absence of any harm to competition or regulatory effects?* If the answer is yes, then these payments are likely pro-competitive. If the answer is no, then they may represent exclusionary conduct which harms competition.
32. The Commission notes that applying the proposed test should help it answer that question. That is, is there evidence to show that the expected incremental revenues (exclusively from the incremental end-users) outweigh the incremental costs?
33. Chorus would be required to show that the proposed incentive payments are at a level where it would expect incremental net benefits, without relying on an expectation of future higher prices (which could result from a lessening of competition), nor do they rely on the regulator allowing the recovery of the incremental costs (ie, allowing incremental revenues) from the whole of the 'captive' customer base (rather than from the incremental end-users)¹⁹.
34. The Commission needs to take a closer look at Chorus's activity in this space, rather than create a presumption that incentive payments are benign if marginal revenue is more than their marginal cost. Even where marginal revenue exceeds marginal cost, there may still be incidental effects on competition. We would expect the Commission to examine the likely effect of the incentive payment, with the net marginal revenue but one factor. There is a risk otherwise that the test ends up similar to the courts' approach to s 36 of the Commerce Act, where a dominant firm can show that they have not "taken advantage" of market power if they can point to the conduct being rational for a smaller firm. The Commission has been critical of this test and has advocated for a test that focusses on the likely results of the behaviour.
35. The Commission has already set out concerns with Chorus's 1G or Hyperfibre incentive payments²⁰.
36. We support the Commission considering the competition implications of Chorus's proposed incentive payments. However, we believe the Commission should apply broader consideration that reflects the Part 6 requirements that the Commission makes decisions that are in end-user interests and promote competition. In this case, that means:
 - a. The pricing practice is in end-user interests.
 - b. Promotes competition which, in addition to predatory or pocket pricing concerns, the Commission has considered but also whether the approach best promotes

¹⁶ Draft at G36

¹⁷ Draft at G40

¹⁸ Draft at G45

¹⁹ Draft at G47

²⁰ Draft at G48

competition over alternatives available to it. In this case, we believe that the Commission should not accept incentive payments in the BBM.

Current Chorus incentive payments

37. Chorus currently offers fibre connection incentives/payments based on whether an individual end-user's location already has a higher-speed fibre connection or if the end-user is at a location that is currently connected to the fibre network or not. Incentive payments range from \$50 per new connection or fibre speed upgrade (requiring more than 85% of an RSPs service orders to be for plans 100M or more) through to \$450 to connect a fibre connection at a location that has been inactive for 6 months or more. The incentives are additive so the connection incentives can be up to \$800 per connection as noted by the Commission.
38. The incentive payment scheme targets specific segments and service providers *as well as specific premises/locations* by applying specific criteria. For example, Chorus offers an incentive of \$500 to connect a fibre connection at a location that has been inactive for 6 months or more and this targets active end users who may be using an alternative network's service. Alternatively, the 85% hurdle rate segments service providers who support a range of broadband speeds in the market (a service provider cannot realistically achieve this target and support the 50M option in the market).
39. As the Commission notes, price discrimination can be beneficial where a large number of consumers would be priced out of the market if the firm charges a uniform price – there can be a more efficient recovery of shared costs and increased output. Price discrimination can be part of normal competitive market behaviour.
40. However, price differentiation can also have costs where:
- a. It represents price discrimination that has been prohibited by the regulation framework. In some cases, discrimination and competition concerns are such that the practice has been prohibited – as it has through the Act and Fibre Deeds.
 - b. It constitutes predatory conduct that undermines competition or, in the case of Part 6, fails to best promote competition.
 - c. The pricing is in the form of loyalty penalties – or inertia pricing – that is detrimental to end consumers.
41. Overall, Chorus is seeking to influence consumer and market outcomes through connection and other incentives. The key issue is whether that influence is beneficial, consistent with other regulatory protections, or – rather than promoting – whether it detracts from end-user and competition outcomes.
42. The draft suggests²¹ that Chorus' proposed \$44.4m expenditure on incentive payments is intended to increase both the quantity of new fibre connections (i.e., through migration of customers to the fibre network), and the intensity of usage of the network by existing customers (i.e., by up-selling existing end-users to higher speed plans). However, there are indicators that these are unlikely to be the sole motivations. For example, Chorus offers a connection incentive of \$50 to connect an inactive fibre connection when that customer is served by the Chorus copper network and \$450 for the same connection when the premises is served by an alternative network provider. If Chorus' motivation were solely as suggested and the focus was on maximising fibre demand, then it would not maintain this sort of differentiation.

²¹ Draft at G2

43. Nonetheless, we should expect Chorus to act on its natural incentives, and this is in part the purpose of the additional competition protections that form part of the regulatory framework.
44. Therefore, the Commission in considering an individual capex proposal would need to consider: whether the incentive payment:
- a. results in different access seeker and end-user prices for the same service;
 - b. results in different prices at different geographic locations;
 - c. is discriminatory between RSPs and Chorus's own copper business;
 - d. discriminate against RSPs who offer entry level fibre services (and whether this is in those end-users' interests);
 - e. promotes competition when considered alongside proactive fibre installs; or
 - f. is efficient and fair to consumers.
45. Not only are each of these matters significant concerns in their own right, but when combined they will have an even bigger impact on the competitive landscape.

Whether the price differentiation resulting from the incentive schemes results in differing access seeker and end-user prices for the same service

46. As set out in our response to the s201 draft guidelines, we believe the s201 is a requirement that end-users face the same prices for the same FFLAS services.
47. In its October 2019 determination of Specified Fibre Areas, the Commission considered the meaning of the words "geographic areas" in the context of s69AB, which is central to setting out the protections that will apply to end-users as the copper network is progressively withdrawn. In that determination, the Commission concluded that the protections intended to be imparted by the part of the Act were of a nature that they should provide protection for each individual end-user. And therefore, that the term "geographic areas" could be interpreted in a granular way to apply at a premises-by-premises level.
48. We believe the situation is the same here: s201 clearly seeks to protect all end-users from pocket pricing and should therefore should also be applied on a premises-by-premises basis. In fact the drafting of s201 is even more clear in this respect that that of s69AB – s201 refers in the singular to "the geographic location" of "the end-user", making it very clear it was intended to prevent pocket pricing at a micro level – premises-by-premises – as well as at a macro level.
49. The connection incentives though, explicitly and by design result in prices that are not the same for all end users' locations. The size of Chorus' incentive payments differ based on a customer's geographic location – the incentive is much larger for a locations that have connections to an alternative network than for locations that do not. This is prohibited by the Act.

Whether incentive payments reflect Chorus discrimination between RSPs and its own copper business through Bonus Credits.

50. Chorus is prohibited from treating access seekers differently from its own business. However, as noted above, the incentive scheme offers \$50 per new fibre connection where the end-user is currently served by Chorus copper and \$450 per new fibre connection where the end-user is currently served by any other network provider.

51. Chorus is, on the face of it, treating access seekers differently to itself by defining a fibre incentive scheme that advantages its own copper business over access seekers who also use other technologies.
52. There is no justifiable reason for Chorus to favour its own copper business in this way. If the purpose of the incentive is to encourage connections to "fibre ready" premises, this objective would equally apply to off-fibre-net customers on copper as it does to wireless or cable.
53. Even if the practice could be objectively justified, it likely harms competition and consumers by limiting wireless providers' ability to enter or expand, reducing competition for Chorus' copper services by withholding incentive payments for converting these customers to fibre, and reducing the speed that copper customers migrate to fibre. The copper to fibre migration is seen as beneficial in itself, as well as reducing future fibre prices by building fibre demand more quickly. Chorus is shielding its copper business by offering minimal migration incentives and this is not in consumers' long term interests.

Whether the incentive thresholds discriminate against RSPs who offer entry level fibre services and whether this is in end-users interests

54. Chorus "Connect to 100M+" and "Get to Gig" incentives are only paid where the retail service provider meets certain thresholds on sales to 100M+ plans (currently 85%+ of fibre connections must be on plans 100M and above) and Gig plans (minimum of 15% of fibre connections must be on these plans).
55. While Chorus suggests it is providing an incentive to adopt higher specification plans (and more expensive plans once the incentive falls away), the incentive also has the effect of reducing support for entry level plans in the market. The "natural" Spark end user demand for entry level services is around []SPKCI of all new connections. Spark would need to reduce or withdraw support for the entry level variant in the market in order to make the current 85% threshold for incentive payments.
56. Further, the threshold construct results in significant incentive payments at the margin as, when an RSP adds incremental customers to reach the threshold, the credit is then applied across all demand. This means that seeking to increase higher specification demand from, say 75% to 85% of all connections, requires a Chorus subsidy of around \$500 per customer actually incentivised to adopt a higher specification plan. On the face of it, incentives of this level make little sense if not for other drivers.
57. As concerning, the threshold provides a significant RSP incentive to minimise (or withdraw) support for the 30M service in the market. Many RSPs no longer offer the cheaper entry level 30/50M variant, and this means these consumers face less choice and higher prices over time.

Chorus Connect Incentives and proactive deployment is anti-competitive.

58. The incentives are structured to target customers that are most likely to adopt wireless services, and in doing this deprives wireless providers from building scale and becoming more effective competitors for Chorus copper services and lower quality fibre services.
59. Chorus has further undertaken a programme to pro-actively install fibre lead-ins to premises even though there is no fibre service order. If not for the BBM, the pro-active programme is unlikely to make financial sense for Chorus on its own as, for example, Chorus is unlikely to recover the costs of a pro-active installation and incentives at current market penetration rates (and given early adopters have already taken up fibre, take-up amongst the residual targeted premises is likely to be lower).

60. Chorus suppressing available demand for wireless networks is rational behaviour because it is able to recoup foregone fibre revenues through the BBM while shaping competition in the market.
61. Overall, in targeting these customers, current and potential competing operators are limited in their ability to expand and build scale in their businesses, reducing competition for fibre services and copper services. Switching costs mean that - once an active customer is connected to the fibre network - they are no longer a potential wireless customer.
62. We believe that the incentive scheme structure has the effect of reducing current competition for copper services, and future competition for fibre services, from wireless and other network providers. In which case, the schemes are unlikely to be consistent with s166 of the Act.

Whether the incentives are efficient and fair to consumers.

63. Further, the Commission should consider whether the approach is efficient and fair to consumers. As noted above, price discrimination can be beneficial for consumers and normal competitive behaviour.
64. However, authorities²² have identified that price discrimination can be a particular concern when:
 - a. it excludes or limits the expansion of actual or potential rivals.
 - b. It targets customers that are not active in the market (a loyalty penalty or inertia pricing) and market characteristics suggest it is likely to increase prices to consumers. It could also lead to harmful distributional effects when the product or service is considered 'essential' or constitutes a large proportion of people's expenditure.
65. Whether these outcomes are a concern depends on the nature of the market. For example, consumer detriment can arise where there are different competitive/market conditions between the initial acquisition of the service and ongoing purchasing of the service, i.e., there might be greater competition for the acquisition of the service relative to ongoing provision of the service, as switching costs make it difficult for customers to switch once they have adopted fibre.
66. For the provider to do this, they must be able to segment the market, price discriminate between consumers, and consumers must face switching costs or over-weight the up-front discount relative to ongoing high prices (i.e. due to a lack of transparency relating to the future costs).
67. Within this framework, Chorus' behaviour is concerning in that:
 - a. Chorus has segmented the market through connection incentives that target active customers and set different prices.
 - b. Consumers likely face switching costs once they have adopted fibre.
 - c. The discounts are structured to apply for a defined period or instance (i.e. off-net) and not to subsequent periods.
68. This means that we should expect lower specification fibre prices to be higher than would otherwise be the case, i.e., higher than the price of competing technologies for entry level consumers, because switching costs mean customers are no longer active in the market. This is likely rational behaviour where Chorus, through this, is able to recover its costs through BBM, while avoiding the need to reduce prices for fibre variants that compete with wireless networks

²² The UK CMA and FMA have both provided guidance on these concerns.

and unplanned cannibalisation of copper revenues, and mitigating the risk of unplanned failure to recover the MAR.

69. Ongoing fibre prices for entry level variants will remain sustainably higher than their equivalent wireless service, and this means consumers on fibre face inefficient price signals, i.e. because the price is higher than the efficient competitive price for that quality.
70. This approach creates a credible risk of a “two-speed” broadband market where the benefits of competition are restricted to those customers active enough to adopt alternative competing broadband technologies.

Innovation

71. The Commission has proposed to exclude \$37M of highly uncertain and subjective innovation investment²³ from the expenditure proposal. It considers that there is a strong incentive (and therefore risk) for Chorus not to spend the capex and/or apply the required effort to make innovations succeed, since it will not monitor innovation expenditure under base capex, given its fungible nature. Accordingly, the Commission considers that an individual capex proposal is a more appropriate mechanism for this investment.
72. We agree. There was little, if any, transparency provided on the nature of the innovation expenditure, and a high risk that it would be applied to activities in competitive telecommunications markets. These initiatives should not be funded from the regulated service. Rather, Chorus should face efficient investment incentives for this activity outside the BBM.

Depreciation

73. The Commission proposes to accelerate depreciation of the FLA, increasing permitted revenue in early years²⁴. This means that the FLA will depreciate at a faster rate than the expected life of the UFB funded assets.
74. We agree that the Commission should have discretion over asset lives, but it is unclear why the FLA should be separated from other UFB assets. There is no compelling driver to differentiate in this way. For example, the Commission notes in support of front-loading FLA capital recovery²⁵ that:
 - a. The approach is not inconsistent with what we expect to observe in a workably competitive market – firms would try to recover a financial loss asset as soon as possible by charging what the market will bear²⁶. UFB demand is higher than expected and, therefore, there is an opportunity for faster recovery of the FLA.

However, in this case the Commission is determining Chorus prices precisely because there is a lack of competition. There is no market-based price-finding behaviour from which the efficient recovery of the investment can be implied.
 - b. The historic and sunk nature of the FLA may make it more vulnerable to any asset stranding risk as it has no ability in and of itself to generate future revenue²⁷. However, the ability to recover the FLA comes from being attached to assets that generate income and, as it is centrally help, is significantly less prone to stranding

²³ Draft at 4.154

²⁴ Draft at B47

²⁵ Draft at B57

²⁶ Draft at B19 and B42

²⁷ Draft at B43

than specific assets at, say, the edge of the network. In any case, the Commission's IM approach is premised on the tangible assets also being sunk.

- c. Allowing a faster recovery of the FLA will partially alleviate concerns that the forecast allowable revenue determined for the first regulatory period should not curtail revenue growth or FFLAS uptake. We appreciate that the Commission may wish to avoid Chorus revenue shocks when setting allowable revenue and the Commission could do this through overall depreciation rates or other revenue smoothing mechanisms. In any case, it is unlikely that the adjustment would have any effect as, with the Commission not proposing to set planned incentives for the first regulatory period, Chorus should be expected to act on the natural incentives it has with a pure revenue cap model to increase price while minimising its actual spend. The proposal does not change this incentive.

- 75. Nonetheless, we support the Commission applying a depreciation profile that manages or smooths revenues over time. Accelerated depreciation is likely a more transparent and flexible means of managing the revenue profile over other tools available to the Commission. The Commission has discretion in how it applies accelerated recovery, but we recommend if it does accelerate recovery this is applied across all the relevant assets.
- 76. In principle, the recovery of an investment is akin to the recovery of common costs. The Commission must determine what the recovery of the upfront asset cost should be for each of the years of the life of the asset. The factors the Commission should consider in determining the recovery in each of the years would include consumption impacts, relative recovery risk between period, inter-generational equity, regulatory incentive effects and implementation requirements. For example, in applying these considerations, a regulator may conclude that boosting current revenues and prices may result in less efficient outcomes than lower prices now (to grow consumption) in the expectation of higher future prices.
- 77. Further, the Commission is not required to apply a particular accounting approach, although an accounting method may happen to best reflect these considerations.

Limit on under-charging

- 78. The Commission notes that under-charging measures were introduced in Part 4 for EDBs, where it was concerned that trust-owned EDBs would build up substantial wash-up balances as they pass-on lower prices to their consumer/owners. It does not consider this a risk with an investor-owned provider²⁸.
- 79. It further observes that there is a risk, however, of Chorus artificially lowering prices in the short term on certain products in an effort to limit competition from FWA providers. Chorus has the ability to temporarily under-recover with a future wash-up, giving it an advantage over FWA providers. In submissions on the process and approach paper, Spark and Vocus supported this control, citing the competition risks discussed above.
- 80. The Commission considered that, given Chorus has indicated it intends to maintain stable prices in real terms and the investment needs it faces, it does not consider the risk likely in the first regulatory period. However, it would reconsider this decision in future periods.
- 81. However, Chorus has artificially lowered prices to segments in the short term in an effort – we believe – to limit competition from alternative network providers. The Commission has observed that Chorus' 1G and HyperFibre incentives are at risk and, as we note above, the hurdle rate

²⁸ Draft at 3.63

incentives have the effect of significant subsidies to secure incremental demand that risk pricing below cost for these services. Vector, Vodafone and Vocus have likewise laid complaints with the Commission relating to Chorus' PONFAS pricing which, if considered as a margin squeeze, would also indicate that Chorus' layer 2 prices are inefficiently low.

82. We recommend that the Commission separately consult on requirements that would mitigate the under-charging risk.

Information Disclosure

83. We support the Commission implementing comprehensive ID - transparency for interested parties of the effectiveness of Part 6 is a key part of the framework – and flexibility to amend requirements as the framework beds down. It is likely that amendments will be required over time.

84. In addition to the proposed ID, we recommend that the Commission consider:

Providing guidance on how the related party transactions should apply to social tariffs

85. Enable has recently asked Ministers to agree to Enable providing free end-to-end broadband services to Christchurch community housing tenants and that the Christchurch City Council be permitted to retain their Enable shareholding although they will be a telecommunications retail service provider (through their housing trust). Enable's constitution prohibits it providing layer 3 and 4 services and having retail service provider owners without the Minister's agreement.
86. Enable has already built the necessary retail service provider capability and will provide a free broadband service to up to 2500 eligible tenants, with the housing trust directly working with customers. Enable has not disclosed the financial arrangements for the initiative, but there will be costs to provide the service to be born somewhere.
87. It is unclear whether the related party transactions arrangements – which are predominantly concerned with over rather than under-pricing services - cater well for this scenario. For example, what value an arm's-length transaction²⁹ would ascribe to a social tariff service between Enable and the Council. We believe that other Christchurch social housing providers and philanthropic retail service provider programmes should be able to access the initiative and have asked that the Minister require Enable to provide the social tariff on a non-discriminatory basis.
88. Whatever the approach we believe the costs should be made transparent, i.e., whether the cost is seen as part of the financial return taken by the Council, Enable revenue at the reference offer price or allocated to Enable's other end-users.

Requiring additional information for PQ quality measures and additional reporting measures

89. We further recommend that the Commission consider providing more transparency of how the PQ utilisation measure is derived, including³⁰:
- a. A clear specification of the scope of the network, including the demarcation point for reporting purposes, ports in the network at which utilisation is measured and explicitly state what parts of the end-to-end service are not measured or reported on. This will make transparent whether reported ports reflect an uncongested

²⁹ ID draft at 4.69

³⁰ See our March 2021 submission at page 15

https://comcom.govt.nz/_data/assets/pdf_file/0021/248070/Spark-Submission-on-ChorusE28099-Expenditure-Proposal-for-PQP1-12-March-2021.pdf

network in practice, and the elements not reported on where congestion can also occur.

- b. A testing programme to validate that the utilisation threshold supports the target performance characteristics. The Commission should identify the performance characteristics it is expecting to see – such as defined in UFB Contracts - and this could then be related to the utilisation threshold. Chorus already has probes deployed in the network and must provide reporting on request.

90. Further utilisation transparency could be improved by:

- a. Identifying ports exceeding the utilisation threshold to make transparent that the same ports or regions are sitting consistently congested, i.e. Chorus is working to clear congested ports.
- b. Adding an “errors” reporting measure. The level of network errors is another indicator of network quality that captures, for example, degradation of the network across layer 1 and 2 elements. The expenditure proposal includes provision for lifecycle replacement of legacy fibre cable and, therefore, the measure should reflect improvements in the underlying infrastructure.
- c. In light of future demand, a similar OLT port utilisation measure.

[End]