



Two Degrees Submission - Regulatory Rules & Processes: Reasons Paper & Draft Input Methodology

Executive summary

2degrees appreciates the opportunity to respond to the Commerce Commission's Regulatory Processes and Rules Reasons Paper, and Draft Decision document.

We welcome the Commission's efforts to clearly respond to the views put forward by stakeholders in its Reasons Paper.¹

2degrees submits:

- As the Commission suggests, the circumstances in which a price path can be reopened should be limited to help maintain the certainty provided by the IMs.
- We support the Commission's rejection of Chorus' position that the change event reopener should be broadened to include things like changed market conditions and Government policy.² Chorus appears to be seeking an asymmetric regime where underspend is treated as an efficiency gain but overspend is able to be recouped on the basis of loose "market change" provisions.
- We support the removal of the 1% threshold for error event reopeners. However, the error event reopener should be reworded so as to apply to circumstances where "incorrect data, unintended by the Commission to be included, has a material impact on the price path." It must also remove the requirement for false and misleading information to be "knowingly" provided. We disagree with the Commission draft decision not to omit the "knowingly" requirement: whether known or not, if incorrect or misleading information has been provided, this needs to be corrected.
- We support the Commission's position that pass-through and recoverable costs should only be allowed in limited circumstances. In line with the Commission's draft, the decision to limit pass-through costs to industry telecommunication levies is appropriate, however, only the FFLAS related portion of the levies should be treated as a pass-through cost.
- The form of control specified in the IM should be revisited under section 181(1) before the second regulatory period, given that the revenue cap (as opposed to price cap mechanism) is reflective of legislative requirements for the first regulatory period only.
- We reiterate our support for the Commission's proposal that "all regulated suppliers have the same disclosure year so interested parties can assess performance more easily".

¹ There are exceptions, for example the Commission is yet to respond to the query about whether the Starting Price Adjustment methodology should be included in the Regulatory Processes & Rules IM.

² Our views on this matter are detailed in our Cross-Submission on Commerce Commission Regulatory Processes and Rules Input Methodology Topic Paper, September 2019.



Reopeners must be appropriately limited

2degrees supports the Commission’s view that the circumstances in which a price path can be reopened should be appropriately limited.

If the criteria for allowing a reopener is too broad, the certainty provided by the IMs will be undermined.

As the Commission rightly identifies, if the scope to seek a reopener is too wide, Chorus may not take steps to reduce risks that it is best placed to manage and will instead be incentivised to seek reopeners, shifting those risks onto consumers by increasing prices and lowering quality standards. This would certainly be a problem with the reopeners Chorus has proposed, such as changed market conditions.

In addition, changes as a result of reopeners can impact other obligations, which the Commission will need to be cognisant of. For example, reopener provisions impacting quality standards may affect RSPs’ ability to meet requirements under a retail service quality code made under section 239. RSPs would have to be given notice of any proposed changes to quality standards and the opportunity to consult on how those changes will impact their ability to deliver the quality of service expected by end-users.

The error event reopener should be reworded

2degrees supports the Commission’s draft decision to remove the 1% threshold for error event reopeners. However, we do not support the Commission’s decision not to remove the “knowingly” provided requirement from the false and misleading information reopener.

Our concerns regarding the need to reopen a price path where Chorus has overstated its capex or opex requirements, remain. 2degrees reiterates that the “false or misleading” reopener provision should apply regardless of whether the incorrect information “has been knowingly provided” by Chorus and irrespective of the reason the information is incorrect. The Commission should remove the requirement for false or misleading information to be “knowingly” provided and only require that the information was “false or misleading”. We note that Vocus and Spark expressed similar views in their submissions.³

It should be noted that the suggestion to adopt “a ‘reopener’ that would allow the price-quality path to be adjusted if Chorus’ provides “false or misleading” information would not capture, or penalise, efficiency gains. Rather it is targeted at the problem we are aware the Commission has faced with the last two Electricity Distribution Businesses (EDB) price resets, where some EDBs substantially over-forecasted their capex requirements.

³ Spark Regulatory processes and rules: topic paper submission, 9 September 2019, at 1 and 6; Vocus Fibre input methodologies – regulatory processes and rules submission, 9 September 2019 at [9].



As the Commission set out in the Commission’s Final Decision on default price-quality paths for EDBs, “Distributors have incentives to inflate forecasts, or to not apply rigorous practices when preparing their forecasts. We therefore must consider the risk that their forecasts may not be entirely reliable”.⁴

For example, in one case Network Tasman’s forecast was over 300% higher than historic (actual) expenditure. A consequence was that the Commission only accepted 47% of Network Tasman’s consumer connection and system growth forecast for the 2020-2025 price reset.⁵

In these types of situations it would be more appropriate for the Commission to reopen the price-quality path when the issue is identified, rather than trying to address the matter at the subsequent price reset (potentially a much later date).

Telecommunication levies must only be passed through where they relate to FFLAS

2degrees supports the Commission’s decision to limit pass-through costs to industry telecommunication levies.

However, in line with the Commission’s criteria for assessing pass through costs, it is only appropriate to pass through the portion of the levies that relate to FFLAS. If levies are passed through wholesale without first identifying which aspects relate to FFLAS, there will be a risk of double recovery for portions that relate to other services, such as copper.

Form of control needs to be revisited under section 181(1) before the second regulatory period

2degrees reiterates that the Commission should invoke the section 181(1) Telecommunications Act provisions to determine whether a price or revenue cap should be specified in the IM after the first regulatory period has commenced.

We consider that the Commission should commit to a review of the use of a price versus revenue cap review now, to make clear that the revenue cap may only be a short-term element of the IMs (potentially only applying for a single regulatory period). While the IMs should only be reviewed outside of the statutory IMs review process in limited circumstances, the review is justified by the fact that a revenue cap is being included in the IM to give effect to the legislative requirements for the first regulatory period.

⁴ Commerce Commission, Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision Reasons paper, 27 November 2019.

⁵ Six EDBs spent over-forecast their expenditure, however for four of these the differences were below the Commerce Commission’s tolerance threshold.



Matters the Commission has not addressed in the draft Reasons Paper

2degrees reiterates the following views and welcomes a Commission response on these matters:

- ***No wash-up mechanism in the IM:***

The Commission has not explained the inconsistent treatment of wash-up between Part 4 of the Commerce Act (which is included in the IMs) and Part 6 of the Telecommunications Act (that the Commission has proposed to exclude from the IMs). Including a wash-up in the IMs would aid regulatory certainty and promote the long-term interests of end-users.

If the Commission disagrees with the Part 4 approach and that the inclusion of a wash-up mechanism aids regulatory certainty and promotes long term end-user interests, it should explain why. If not, we consider the wash-up mechanism should be included in the IM as it is under Part 4 of the Commerce Act.

- ***Proposal / Evaluation Processes should be in the Regulatory Rules & Processes IM:***

On the matter of regulated supplier PQR proposal / evaluation processes, we reiterate that we consider these processes should be covered within the Regulatory Rules and Processes IM.

The Commission's view that "it would be difficult to consult on the draft IMs for proposal / evaluations when we have not yet begun the consultation process for PQR" is a matter of implementation timing rather than whether proposal / evaluation processes should be covered within the Regulatory Rules and Processes IM.

Recognising the time constraints under which the Commission is working in this transition period, it may be that the IM proposal / evaluation processes are initially higher level, and refined with further detail in conjunction with the development of the PQR for the first regulatory period.