



CONSULTATION ON CHORUS' PRICE-QUALITY PATH FROM 1 JANUARY 2022 –
DRAFT DECISION

Submission to the Commerce Commission

PUBLIC VERSION

8 July 2021

EXECUTIVE SUMMARY

1. Vocus has the following comments on the draft Price-Quality Path (PQP) determination for Chorus' FFLAS business:
 - 1.1 **Vocus' supports the transitional approach the Commission is adopting:** The Commission is adopting a pragmatic approach by adopting a transitional Regulatory Asset Base (RAB) value that will help reduce the risk of locking/capitalising in excessive returns. As Chorus has warned *"Once set, the initial RAB does not change"*.¹
 - 1.2 **An important focus for the initial Price-Quality Path should be on limiting excessive returns, rather than IRIS and revenue-service quality mechanisms etc:** Both the Commission and stakeholders have highlighted significant issues with Chorus' RAB and expenditure proposals which will need to be resolved.
 - 1.3 **Chorus' approach to cost/asset allocation seems to align more with ACAM than ABAA:** There are significant cost allocation issues that need to be resolved for both the RAB and expenditure determinations. It is not appropriate, or consistent with the accounting based allocation approach (ABAA) requirements, for Chorus to allocate 100% of shared costs such as IT to the regulated FFLAS business. Chorus' statement: *"We have used a proxy allocator to better reflect these costs incurred to establish Chorus as a standalone fibre business, as required for the UFB initiative"* [emphasis added]² highlights that the approach they have adopted is more in line with the avoidable cost allocation methodology (ACAM).
 - 1.4 The argument *"Chorus was established to build the UFB network and this was the business' primary reason for existence"*³ was not one Chorus ran in relation to allocation of shared costs in the copper TSLRIC determination. The approach of allocating 100% of shared costs to Chorus would result in realisation of the fibre-copper double-recovery concerns we have previously raised.
 - 1.5 **Reasonable investor expectations will be met if there is no evidence suppliers would be unable to recover the costs of their past prudent and efficient investments:** Chorus has not provided evidence that would support its claim *"Decisions to date increase risk of under-compensation"*.⁴ We have pointed out a number of claims and assertions Chorus has made about cost-recovery through the development of the new fibre regime that were not well founded.
 - 1.6 **It is not the role of fibre regulation to guarantee costs incurred in providing other services e.g. exchange space that was established to provide copper services:** It seems somewhat contrarian for Chorus to argue the Commission should not address copper-fibre double-recovery issues, but it should ensure fibre cost

¹ Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

² Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

³ Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

⁴ Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

allocation enables full cost recovery of shared assets used to provide copper and other services.⁵

1.7 A broad set of service quality standards should be set with an end-user focus:

We consider that the regulated service quality standards should extend beyond the minimum elements in the Quality Dimensions Input Methodology and should capture customer-centric elements e.g.:

- (1) Vocus considers that there should be Ordering / Provisioning service metrics and standards as this impacts our ability to sign customers up and support them.
- (2) The current Service Level Agreement for faults is within 1 business day for restore time for Bitstream 2 and 2a. This should be reflected in the service quality standards as well as other fault metrics that would help end-users e.g. % of customers with faults in a day which would cover off fibre cuts to entire suburbs and regions.

1.8 Regulation of monopoly elements of FFLAS service quality under Part 6 should be the first step in ensuring service quality that meets the needs of end-users, rather than relying on powers to regulate (competitive) retail service quality under Part 7.

1.9 Customer and stakeholder engagement should be treated as an important part of 'business-as-usual': Looking towards future price resets and future Chorus engagement and consultation with stakeholders, the current experience and the consultation paper highlights substantial deficiencies which need to be addressed going forward. This in part reflects that we are going through development of a new regime and the short period of time for implementation. The Transpower experience highlights engagement is something that can and should evolve and improve over-time.

⁵ Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

INTRODUCTION

2. Vocus welcomes the opportunity to submit in response to the Commerce Commission *“Chorus’ price-quality path from 1 January 2022 – Draft decision”*, 27 May 2021.
3. If you would like any further information or have any queries about this submission, please contact:

Emily Acland
General Counsel and GM Regulatory
Vocus Group (NZ)
Emily.Acland@vocusgroup.co.nz

PROCESS ISSUES

4. Vocus recognises the challenges the Commission faces in developing and implementing the new fibre Part 6 Telecommunications Act regime within a substantially condensed period of time.
5. One of the concerns Vocus has raised throughout the development of the new regime is that *“the constrained timeframe for implementing the new fibre regime, and for the first price-quality determination, could result in Chorus’ costs and service quality not getting the level of scrutiny and review that is warranted and needed”* and *“The Commission needs to carefully manage the risks associated with a short implementation timeframe”*.⁶
6. Vocus supports the Commission’s approach of consulting on its draft decisions on Chorus’ price quality path for the first regulatory period (PQP1) in two tranches, with the draft decisions on the Regulatory Asset Base (RAB) and the approach to allocating costs and assets between Chorus’ PQ regulated FFLAS and the other services Chorus provides left for subsequent consultation.
7. We note this split in the process will allow Chorus more time to comply with some of the Commission’s audit requirements and that *“To date, Chorus has not provided an independent audit of its initial PQ RAB proposal that reconciles the fixed asset inputs of Chorus’ RAB model back to Chorus’ financial reports”*. We agree it is appropriate the Commission *“used Chorus’ proposed initial RAB value of \$5.5b (including a financial loss asset value of \$1.5b) for illustrative purposes in this draft decision”* [emphasis added].
8. The approach of adopting a transitional RAB for PQP1, with application of wash-up to account for differences between the transitional and final RAB values in the second regulatory period, is also a pragmatic way of addressing the time constraints the Commission faces. It will also help ensure a more robust RAB that is less likely to lock-in or capitalise excessive profits to the long-term detriment of end-users.⁷

⁶ https://comcom.govt.nz/_data/assets/pdf_file/0028/161938/Vocus-Fibre-emerging-views-submission-16-July-2019.pdf

⁷ Our submission on the proposed Input Methodologies amendment consultation includes more details on these points.

EXPENDITURE COST ALLOCATION ISSUES EXACERBATE OUR CONCERNS ABOUT THE RAB

9. In our submission in response to Chorus' RAB proposal, we raised concern about the *"Risk that Chorus' RAB proposal is substantially inflated"*. We have noted *"The experience with Chorus' grossly over-estimating its copper TSLRIC and TSO net cost has been raised a number of times in submissions"*.⁸
10. We raised issues about the risk of relying on Chorus' proposals from the outset of the development of the new regulatory framework for fibre in 2018.⁹ InternetNZ similarly commented *"Chorus' incentives are to seek the highest possible cost figures ... Any data provided by Chorus should be thoroughly audited ..."*¹⁰
11. Our submission on the RAB proposal noted the allocation method used by Chorus to determine the RAB appeared to be closer to the avoidable cost allocation methodology (ACAM), than the required accounting-based allocation approach (ABAA). We also raised, for example, that *"The issues Spark raised about excessive cost allocation to FFLAS in Chorus' expenditure proposal appear to manifest in the allocation of shared assets, and the estimate of the Financial Loss Asset (FLA) value"*.
12. The submissions the Commission has received on Chorus' RAB and expenditure proposal, as well as the Commission's consultation material, highlight issues with cost allocation and potential inflated expenditure.
13. For example, Chorus' statement *"the Commission should apply a proxy allocator that allocates 100% of the relevant shared costs"*¹¹ to FFLAS would result in an ACAM type approach. Likewise, Chorus' statement *"We have used a proxy allocator to allocate a subset of the IT assets that are shared between FFLAS and non-FFLAS; this subset is the IT assets associated with standing up Chorus immediately post-demerger. Our allocator apportions 100% of the value of these assets to FFLAS, which reflects: (i) limitations with our data which means it's difficult to identify utilisation; (ii) the driver of the investment – the need to establish Chorus as a standalone business to undertake the UFB initiative; and (iii) the service which is intended to benefit from the assets over their useful life – FFLAS. We could not find a suitable causal allocator which accounts for these factors"*.¹²
14. The Commission needs to ensure the 100% cost allocation/ACAM type approach is expunged from the RAB and expenditure allowances Chorus has proposed.
15. Another example is the upward adjustments Chorus has applied to its forecasts from its five-year business planning process, which Chorus euphemistically termed *"regulatory overlays"*. We do not consider there is legitimate basis for Chorus to reinstate

⁸ https://comcom.govt.nz/data/assets/pdf_file/0019/226711/Vocus-Submission-on-PQID-process-and-approach-paper-14-October-2020.pdf

⁹ https://comcom.govt.nz/data/assets/pdf_file/0024/111984/Vocus-Group-Submission-on-new-regulatory-framework-for-fibre-21-December-2018.PDF

¹⁰ InternetNZ, InternetNZ Cross Submission: Further Consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the Final Pricing Principle, 30 April 2014, page 7.

¹¹ Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

¹² Chorus, Submission on Commission's consultation on Chorus' initial PQ RAB, 28 May 2021.

expenditure *“which was removed from its five-year plan as a result of a management and board challenge process and reassessed some of the assumptions underlying its forecasts”*. Chorus should not be proposed expenditure the Chorus’ Board does not consider appropriate.

16. A lot of the elements of the expenditure allowances and forecasts are treated as confidential which has limited the extent to which we could review the draft decision internally.

CHORUS HASN’T PROVIDED EVIDENCE THAT JUSTIFIES CLAIMS ABOUT UNDER-COMPENSATION

17. Chorus has not provided evidence that would reasonably support or justify its claim *“Decisions to date increase risk of under-compensation”*.¹³ The Commission can safely rely on the direction provided in the High Court Part 4 Input Methodologies decision that if the Commission’s decisions would result in under-recovery the regulated suppliers would have incentives (and the information) required to demonstrate this,¹⁴ and *“Where a proposition is simply asserted ... we give it little or no weight”*.¹⁵
18. We note and agree with the High Court statement that *“The setting of the initial RAB does ... have an impact on the general investment environment for regulated industries and industries subject to the possibility of regulation. It sends signals about the behaviour of the regulator. This is a question of reasonable investor expectations. In our view, reasonable investor expectations should be met by following a carefully considered approach when setting a RAB, subject to there being no evidence that suppliers would be unable to recover the costs of their past prudent and efficient investments”* [emphasis added].¹⁶

CONCERNS ABOUT SERVICE QUALITY

19. We have previously raised concerns about service quality, including the example of problems with Chorus’ UFB roll-out and subcontracting model, and our direct experience with resolving copper service performance issues.¹⁷
20. Our concerns about service quality are heightened by Chorus’ attempt at proposing the Commission regulate revenue-only and not service quality.
21. There are a lot of dimensions to service quality in the provision of fibre services where Chorus could seek to cut its costs and increase profitability. This is not just limited to the

¹³ Chorus, Submission on Commission’s consultation on Chorus’ initial PQ RAB, 28 May 2021.

¹⁴ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [589].

¹⁵ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [1745].

¹⁶ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [605].

¹⁷ https://comcom.govt.nz/_data/assets/pdf_file/0024/111984/Vocus-Group-Submission-on-new-regulatory-framework-for-fibre-21-December-2018.PDF

availability and performance measures the Commission proposes to include, but also extends to the “*optional quality dimensions*” in the Input Methodologies, in relation to: faults; ordering; provisioning; switching; and customer service. These “*optional*” dimensions are particularly relevant to the end-user experience e.g.:

- 21.1 Vocus considers that there should be Ordering / Provisioning service metrics and standards as this impacts our ability to sign customers up and support them; and
- 21.2 The current Service Level Agreement for faults is within 1 business day for restore time for Bitstream 2 and 2a. This should be reflected in the service quality standards as well as other fault metrics that would help end-users e.g. % of customers with faults in a day which would cover off fibre cuts to entire suburbs and regions.
- 22. Regulation of monopoly elements of FFLAS service quality under Part 6 should be the first step in ensuring service quality that meets the needs of end-users, rather than relying on powers to regulate (competitive) retail service quality under Part 7.
- 23. The adoption of an initial limited set of service quality dimensions could extend Chorus' incentives to “*degrad[e] quality prior to quality standards being set (as a low base for the standards) or degrading quality in not directly observable ways*”.
- 24. While the Commission points out that there are “*serious enforcement consequences of a breach of a quality standard*”, the reasons for reaching the initial judgement that applying quality standards for the optional quality dimensions, “*at this stage*”, would not be “*proportionate*”.
- 25. We support the Commission's intention that “*Where any standard is breached, Chorus would also have to publish a breach report in respect of all exceedances of the quality standards during that year. Chorus would be required to produce this report following the end of the year where the breach occurred. The report must contain an explanation of the breach, including the cause and action taken to remedy the breach*”