Chorus' Price-Quality Path for PQP2 (2025-2028)

Commerce Commission
2degrees Cross Submission

September 2024

PUBLIC

Introduction

2degrees welcomes the opportunity to cross-submit on the Commerce Commission's draft decision in relation to *Chorus' price-quality path for the second regulatory period (2025 – 2028)*, dated 18 July 2024.

We are mindful that New Zealand has been experiencing a period of high inflation and high interest rates and that this has impacted Chorus' cost of capital and other fibre costs, as well as other industry costs.

We are also mindful New Zealanders are facing increasing cost of living challenges.

Consumer price increases and avoiding price shocks

Chorus has already signalled significant wholesale price increases to retail service providers from 1 January 2025.

As the Commission will be aware, increases in wholesale prices are expected to increase retailer consumer pricing.

This Commission draft decision signals that the Commission supports allowing a c.17% increase in net allowable revenue in 2025 compared to 2024 (including allowing for forecast demand growth).[1]

As we've indicated previously, we consider it's important the Commission ensure that all Chorus spend is efficient and justified. This spend is ultimately borne by consumers.

As well as minimising price increases, 2degrees considers it important to smooth any price impact for end-users and mitigate against 'price shocks'. In support of this:

- **It's important RSPs can plan.**

  As Spark has commented, it is difficult to predict the Commission's anticipated PQP2 price path, and likely wholesale price increases that retailers will need to build into their plans. We support Spark's call for the Commission to provide "guidance on the MAR anticipated price increases (i.e., baseline price increases), price sensitivity to key variables such as demand, and how the Commission might curb any future price increases outside the expected range".

[1] The Commission has indicated that actual impact may be mitigated, including by forecast demand growth, because Chorus may choose not to price up to the allowable revenue, and given the delay in increasing of prices. The reality is Chorus can propose up to a 17% increase within the MAR.

- **We support deferral of depreciation**

  We are comfortable with the Commerce Commission accepting the proposal to defer depreciation (thereby reducing the maximum allowable revenue for PQP2): we are comfortable with regulated suppliers deferring revenue recovery if it helps to smooth prices for end-consumers, as long as the deferral is managed in a way that doesn't result in future price shocks.

Alternative price smoothing options warrant consideration

We note, even with the depreciation deferral, Spark has expressed concern about the potential size of the price increases that would be driven by an approximate 17% increase in net allowable revenue.

We consider it would be useful for the Commission to explicitly explore different rates of depreciation deferral to test the impact on prices for end-consumers and the extent to which they could contribute to smoothing prices/avoiding price shocks.

We also consider it would be useful for the Commission to review the best approach to price smoothing and minimisation of price volatility. We are aware, for example, that changes in interest rates resulted in a material drop in regulated electricity network prices in 2020 (when interest rates had bottomed out, with the regulated WACC set at 4.23%) followed by large increases in 2025 (with interest rates at around their peak used to set prices, with the draft regulated WACC set at 7.37%). It is notable that the WACC change was the single biggest contributor (responsible for 40%) of the increase in network prices. It may be that price volatility would be less pronounced if the Commission adopted a different approach to setting of WACC. As such, we would support the Commission considering alternative approaches to determination of the WACC/risk-free rate.

2degrees shares OneNZ, Spark and Vector's concerns and views about service quality settings

Service quality regulation is an integral part of price-quality regulation.

We agree with the views expressed by One NZ, Spark and Vector in relation to quality measures, including that:

- We agree that the average net unplanned down time threshold should be reduced (as is proposed by the Commission).
- We share One NZ's concern about setting the breach of the availability quality standards on the basis of 2 years rather than a single regulatory year (and that an availability quality standard can also be applied for a 1-year period).

- We agree that the Commission should retain the current availability of POI areas for availability quality standards.
- We agree that the Commission should retain the 90% port utilisation threshold for the performance quality standard, as the Commission has proposed.
- We support the Commission's proposed introduction of a provisioning quality standard. We also support Spark's recommendation that the Commission consider augmenting the proposed measure by monitoring the number and proportion of multiple reschedules, missed appointments and overall time to deliver a working fibre service to customers.
- We agree with Vector that the provisioning standard should "specify, in some form, a number of days by which different categories of connection must be delivered."
- We would be concerned that adopting Chorus' recommendations would risk degradation of service and provide Chorus with additional opportunity to increase its profits through reducing costs that could undermine consumer service quality.