CHORUS

PO BOX 632
Wellington 6140

10 September 2021

CHORUS' CUSTOMER INCENTIVE EXPENDITURE

1 The Commission has indicated it will request further information on our incentive programmes for the purposes of determining Chorus' incentives allowance as part of the final price-quality determination.

2 To support the Commission's request, we are providing additional context in relation to our incentive programmes. As well as providing an accurate description of our incentives offers, we thought it would be useful to set out our understanding of the Commission's task when assessing Chorus' incentives expenditure.

3 Chorus operates under a complex set of legal and regulatory requirements and we dedicate significant resource to ensuring our ongoing compliance. While we understand that there is heightened interest in incentive expenditure by some parties, we are concerned about a blurring of the Commission's role in its *ex ante* assessment of an envelope of expenditure with its *ex-post* enforcement role.

4 In summary:

a. When setting an expenditure allowance for incentives, the Commission's task is clear. It must determine whether:

(a) Chorus' incentive programmes are, in general, justifiable with reference to the expenditure objective and commercial rationale test; and

(b) The proposed level of expenditure is adequately substantiated by Chorus' forecast models and supporting documentation.

b. It is both unnecessary and unworkable for the Commission to reach an *ex ante* compliance view of current or future incentive offers when evaluating incentive expenditure. The Commission has a parallel *ex post* enforcement role and legal compliance is an ongoing post-approval obligation.

c. The Commission has the information it needs to approve our incentive expenditure including our calculations of the incremental net benefit from incentive investment which demonstrates we meet the Commission's commercial rationale test.

d. Chorus has a range of RSP consumer and business incentive offers in market. Our core consumer offer, 'Mix it Up', was introduced in 2019. It has been developed in consultation with RSPs who have endorsed the core features of the offer. Spark and Vodafone, both active participants in Mix it Up, have mischaracterised the offer in their submissions on the draft price-quality decision.

e. Concerns which have been raised about compliance with various legal obligations risk distracting the Commission from its task of setting an appropriate expenditure allowance for incentives.

f. Chorus will need to adapt its incentive offers over the course of the first regulatory period to continue to drive demand as market dynamics change. As with all our offers, any new initiatives will be subject to rigorous competition and compliance testing before going live.

The Commission's task in evaluating incentive expenditure

5 In its cross-submission on the Commission's draft price-quality decision,[1] Spark argues that Chorus' incentive payments should not be included in any expenditure allowance unless the Commission is satisfied the payments comply with s 201 of the Telecommunications Act 2001 (the **Act**) and Chorus' non-discrimination obligation.[2] Spark appears to suggest that the Commission is required to reach a view on whether each incentive that Chorus has previously offered, or might in future offer, complies with those obligations.

6 That mischaracterises the Commission's task when setting an appropriate expenditure allowance for incentives (and other expenditure). When evaluating Chorus' base capex and connection capex baseline proposals, the starting point is the evaluation criteria in the Capex IM.[3] This includes considering whether the proposed expenditure meets the expenditure objective and reflects good telecommunications industry practice. Proposed capital expenditure will meet the capital expenditure objective if the expenditure reflects the efficient costs that a prudent fibre network operator would incur to deliver PQ FFLAS of appropriate quality, during the upcoming regulatory period and over the longer term.[4]

7 The Commission has also proposed that an appropriate 'commercial rationale' test for assessing incentive payments is to evaluate whether there is evidence to show that the expected incremental revenues exclusively from the incremental end-users outweigh the incremental costs.[5] We accept that an assessment of whether the incremental revenue from the incentive payment exceeds its incremental cost may be relevant in the context of implementing the expenditure objective, but a broader test that also focused on wider social costs and benefits would better promote the purpose of the Act.[6]

8 The Commission should have regard to the best available information when applying the expenditure objective and commercial rationale test. That includes

---

1 Spark, *Cross-submission on Fibre ID and PQ draft decisions,* 5 August 2021.

2 Russell McVeagh, *Opinion on legal risks of including incentive payments as capex for Chorus' price-quality path,* 5 August 2021 at paragraphs 5 and 33.

3 Commerce Commission, *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, 13 October 2020, at clauses 3.8.5 & 3.8.6.

4 Commerce Commission, *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, 13 October 2020, at clauses 3.8.5(2).

5 Commerce Commission, *Chorus' price-quality path from 1 January 2022 – Draft decision Reasons Paper,* 27 May 2021 at paragraph G46.

6 See Chorus, *Submission on price-quality path draft decision,* 8 July 2021, at paragraph 129. Also see NERA Economic Consulting, *Customer incentive payments and the long-term benefit of end-users,* 7 July 2021 at 6.1.

understanding our forecast expenditure on customer incentives in light of historic expenditure levels.

9 However, the Commission isn't required to form an *ex ante* compliance view of every past or future incentive offer, or to assess whether every incentive is justifiable with regard to a specific business case. Consistent with its usual practice when setting allowances, the Commission should determine that Chorus' incentive programmes – in general – are justifiable with reference to the criteria the Commission has outlined, and that the proposed level of expenditure is adequately substantiated by Chorus' forecast models and supporting documentation.

10 Furthermore, forming an *ex ante* view on compliance of individual incentives is both unworkable and unnecessary. The Commission's expenditure allowance does not constrain the types of incentives Chorus can offer during the regulatory control period. Rather, the Commission has a parallel *ex post* enforcement role and can choose to investigate any incentive that it considers may breach Chorus' obligations. Compliance is an ongoing post-approval obligation, not a reason to decline high-level capex allocation.[7]

11 Our incentive programmes are well-established and we have robust processes for competition and compliance testing for individual initiatives. These continuing safeguards mean that it is unnecessary (in addition to being unworkable) for the Commission to analyse and approve each incentive offer on an *ex ante* basis.

Our proposed incentive expenditure is beneficial and well justified

12 The Commission has the information it needs to approve our proposed incentive expenditure:

a. We are proposing a continuation of our existing approach to incentive investment. This context means that we have an efficient starting point and an incentive spend that has proven effective at supporting uptake and upgrades.

b. As the Commission has previously acknowledged, incentive payments benefit end-users and are consistent with behaviour in workably competitive markets.[8]

c. Offering incentive payments is consistent with s 162 and s 166(2) of the Act.[9] In particular, incentive payments affect our incentives to innovate and invest by providing a mechanism to offer new and innovative products in the face of customer inertia, and may accelerate the withdrawal of the copper network.

d. We have calculated the incremental net benefit from uptake and upgrade incentive investment which demonstrates we meet the Commission's commercial rationale test. This information has been provided in our

---

[7] Chorus, *Submission on price-quality path draft decision,* 8 July 2021, at paragraph 131.2.

[8] Commerce Commission, *Chorus' price-quality path from 1 January 2022 – Draft decision Reasons Paper,* 27 May 2021 at paragraphs G16 – G19 and G36.

[9] NERA Economic Consulting, *Customer incentive payments and the long-term benefit of end-users,* 7 July 2021 at 3.3.

submission on the draft price-quality decision and in response to the Commission's requests for information earlier this year.[10]

13 Chorus is at risk of asset stranding because we are still extending our network footprint. We need to do everything we can to drive demand uptake and the use of customer incentives is key to us meeting our connections targets.

Overview of Chorus' incentive payments

14 To assist in the preparation of the Commission's information request, we set out below additional context in relation to our incentive programmes.

15 Chorus offers two broad categories of incentive payments:

a. uptake incentives: payments to RSPS to increase the quantity of fibre connections, including migrating customers to fibre from copper; and

b. upgrade incentives: payments to RSPs to increase the intensity of usage on the network by existing customers, through moving them onto higher-speed plans.

16 The table below shows the key consumer and business incentive offers that are currently in market.

Incentive name	**Offer start date**	**Offer end Date**
Consumer		
Mix it Up	1 April 2019	31 Dec 2021
Intact ONT Incentive	1 July 2021	31 Oct 2021
Budget Fibre	1 March 2021	31 Dec 2021
MOE C19 Support Package	1 April 2020	31 Dec 2021
Hyperfibre Install	13 Jan 2020	31 Dec 2021
RGW ONT	23 Nov 2020	31 Dec 2021
Business		
Small Business ADVANTAGE	1 July 2021	30 June 2022
Business ADVANTAGE	1 July 2021	30 June 2022
Premium Business ADVANTAGE	1 July 2021	30 June 2022

Our key consumer offer – Mix it Up

17 Chorus' Mix it Up offer was introduced in early 2019 to encourage uptake of faster speed fibre plans. It offered credits for achieving a certain proportion of orders at 100Mb+, as well as higher credits for achieving a certain proportion of

[10] Chorus, *Submission on price-quality path draft decision,* 8 July 2021, Appendix 2 paragraphs 15-22 and RFI005.

Gig orders. Since then, it has remained Chorus' key RSP consumer offer in-market, and those two components are still its core elements.

18 At a high level, if an RSP's fibre orders of 100Mb+ plans are a sufficient proportion of its total fibre orders (currently 85%), it is eligible for a per-connection credit on any new connections.[11] Separate thresholds make an RSP eligible for a higher credit on any new connections or upgrades to a Gig plan. RSPs have flexibility to aim for one or both: an RSP who does not meet the 85% threshold but has a high proportion of Gig connections can still earn credits. Credits are also payable on any new connections or upgrades to Hyperfibre. Across all credits, there is a clawback mechanism where the connection churns off-net in the subsequent 12 months.

19 Since Mix it Up was introduced, we have continued to assess its effectiveness to ensure the offer reflects good market outcomes and have made tweaks to:

a. include different types of upgrade activity;

b. adjust credit levels;

c. separately offer credits on business as well as consumer plans;

d. introduce credits on Hyperfibre; and

e. test other mechanisms that might help to stimulate incremental (above BAU) activity such as "bonus" credits where RSPs have managed to convert connections on a specified address list consisting of copper or longer-term off-net customers.

20 The evolution of Mix it Up has taken place in consultation with RSPs. We have asked RSPs if we're pulling the right levers before we have committed to further offer periods. RSPs, including Spark and Vodafone, have provided feedback that the core structure of the Mix it Up offer works for them and we should retain it.

21 The current iteration of Mix it Up began on 1 July 2021 and runs to 31 December 2021. We introduced a new eligibility criterion which requires participating RSPs to undertake fibre focused marketing using the words "Fibre" and/or "Hyperfibre". The rationale for this criterion is to avoid paying credits for BAU activity by requiring RSPs to undertake activity which benefits Chorus. It also helps to reduce end-customer confusion about technology choices that can occur when a technology agnostic marketing approach is adopted.

22 A total of 28 RSPs have participated in Mix it Up since it was introduced. The graph below shows the top eight RSPs which have received the largest share of total Mix it Up credits paid.

[CHORUS CI

[11] The current per connection credit is $60 but we have just announced that this will be increased to $100 effective 1 October.

]

23 The concerns that have been raised about Mix it Up credit amounts are unwarranted because:

a. The higher credits that Spark has pointed to are available for Hyperfibre connections which have a higher monthly rental than other consumer Bitstream services. Hyperfibre is a relatively new product and we are trying to stimulate demand.

b. While these higher credits are available in a limited set of circumstances, they are rarely paid. **[CI]**% of Mix it Up credits paid since the offer began in 2019 were **[CI** $ **]** per connection and **[CI]**% of all Mix it Up credits paid were **[CI** $ **]** per connection or less.

24 Similarly, concerns which have been raised about s 201 compliance are unfounded. Spark's characterisation of the address-list based incentives which we have offered is incorrect. These offers are wholly unrelated to the geographic location of RSPs or end-users. Rather, they have targeted connections of a particular status irrespective of geography for example, copper or off-net for specified time periods.

25 Chorus will need to adapt our incentive offers over the course of the first regulatory period to continue to compete effectively as market dynamics change. As with all our offers, any new initiatives will be subject to rigorous competition and compliance testing before going live (including for compliance with s 201 which comes into force on 1 January 2022).

Next steps

26 We hope this is of assistance to the Commission. Please let us know if you would like to discuss any of the points raised.