Submission on incentives ICP draft decision

1 November 2022

Public version

CHORUS

Introduction

1. This is Chorus' response to the consultation document "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper", dated 18 October 2022 (**draft decision**).

2. This submission contains some confidential information and we have provided a public and a confidential version.

3. Our incentives individual capex proposal (**ICP**) for 2023 is the first ICP prepared by Chorus and we have learnt a great deal from the process, including the level of detail required and the evidence expected by the Commission. These learnings will inform our future proposals, as we seek to improve over time.

4. We agree with the Commission's view that "incentive payments can promote competition, accelerate uptake and can drive cost efficiencies." [1] The draft decision to approve an individual capex allowance for customer incentives is procompetitive and will ensure the benefits are passed on to consumers.[2]

5. However, this process has highlighted that ICPs are not well suited to the nature of incentives capex. The draft decision effectively imposes cuts that have been applied based on uncertainty about whether some incentives capex will be spent. But incentives capex is inherently uncertain; it depends on uptake decisions by RSPs, which we seek to influence through our incentive offers but are ultimately not in Chorus' control.

6. The Commission's approach seems to be that where there is a lack of specific information about how incentives capex will be spent, it cannot be approved. This is problematic in principle for this type of expenditure – incentives must change and adapt based on market circumstances. It is good for end-users that we update incentives quickly to better meet their needs. However, those needs will change and are unpredictable, hence there will always be a level of uncertainty.

7. The regulatory settings should allow for a more dynamic approach to incentives capex that supports innovation by Chorus to meet end-user demands. At the end of this submission, we suggest alternative options for approving incentives capex that could apply from our second regulatory period (**PQP2**).

8. In summary, our views on the key elements of the draft decision are:

    a. The proposed $0.7m increase in forecast clawback, and hence reduced capex allowance, is reasonable.

    b. The proposed reduction of $3.0m from the allowance to reflect actual incentive payments is not unreasonable given the information in front of the Commission. However, the Commission should be mindful of the market circumstances and, as noted above, it is not realistic to assume precise forecasts in a dynamic market.

[1] Draft decision, paragraph 3.11.

c. We disagree with the rejection of $0.58m unallocated expenditure and this should be reinstated into our capex allowance – flexibility to develop new incentive offers in response to events is essential and the Commission should not require a level of certainty regarding incentive plans that is not commercially sensible or necessary for end-users.

d. The proposed reporting requirements are unnecessary as we already provide, or have provided, all of the information specified and are seeking to improve our reporting for PQP2. We do not support adding additional reports to an already significant volume of disclosures which Chorus has to provide.

Expenditure allowance

9. The draft decision is to approve $12.5m of customer incentives capex for Chorus in regulatory year 2023. This is a reduction of $4.3m from our ICP, comprising:

   a. $0.7m of clawback

   b. $0.58m of unallocated expenditure

   c. $3.0m of forecast spend on consumer incentives, based on updated actual spend data for 2022.

Claw-back

10. Chorus accepts the draft decision to increase the claw-back forecast, and thus reduce the expenditure allowance, by $0.7m. **[**

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Unallocated expenditure

11. The draft decision to decline the allowance which was not allocated to any specific incentive is disappointing because it does not reflect commercial realities. The Commission should recognise that Chorus requires the ability to change incentive offers quickly to respond to new information and meet new consumer demands. The draft decision implies Chorus should plan our incentives as much as 18 months in advance, for a purely regulatory reason, even though there is no commercial rationale. That will not deliver better outcomes for end-users.

Forecast consumer incentive payments

12. In the context of this ICP, we agree it is reasonable to adjust the expenditure allowance to reflect information on recent market conditions which was not available at the time of the proposal. However, if market circumstances change again and the volume of incentives capex increases significantly, we may make a further ICP for the necessary additional allowance.

Context on incentives capex forecasting

13. Incentives capex forecasting is inherently uncertain as it depends on uptake decisions by RSPs, which we seek to influence through our incentive offers but are ultimately not in Chorus' control or something we can perfectly forecast. Chorus has forecast as best we can during a global pandemic and unprecedented economic situation, but there will always be a level of uncertainty.

14. Chorus is keen to promote fibre, as the best broadband technology available, and to encourage upgrades where they are in end-users' interest, given the increasing range of uses for fibre services and the growing data requirements of applications. We design incentives in consultation with RSPs and seek their feedback on the design. However, uptake does not always match our expectations that are based on RSP feedback.

15. As a result, Chorus' outturn customer incentives capex can vary from forecast, as has been observed this year. But our customer incentives remain essential (particularly for non-MNO RSPs) to promote continued fibre uptake and upgrades, considering the business models of vertically integrated MNOs who have an incentive to encourage customers to take up an inferior FWA product.

16. We therefore intend to continue with our incentive programmes, provided they are economically rational. Our 2022 spending rates have shown that we will not simply spend money to hit a budget target – we will only pay incentives where we believe they will drive uptake or upgrades of a greater value than their cost.

17. Chorus intends to review our incentive offers to ensure they are fit for purpose and will drive good outcomes for end-users. However, in the meantime, the Commission should be cautious about cutting our incentives allowance as the ability to pay incentives is essential to promoting competition in telecommunications markets, as they help support smaller, non-vertically integrated, RSPs to compete for customers.

Reasons for lower incentives spend in 2022

18. As the draft decision notes, total incentives and clawback amounts in the 2022 regulatory year are below what we had originally sought in our expenditure proposal for our first regulatory period (**PQP1**). This is due to some unexpected and unprecedented circumstances:

    a. Field service workforce shortages, which are slowing the rate of new connections. This has had a corresponding impact on the number of incentive payments made.

    b. Commercial decisions by RSPs. Where a large RSP chooses not to participate in an incentive offer or take up a new offer, this is largely out of our control and will lead to noticeable decline in incentives payments (it is also a good example of why we need to be able to review and amend incentive payments quickly when the market changes). However, the vast majority of RSPs, especially smaller RSPs, remain supportive of incentives and participate strongly in our incentive offers. The decline in incentive payments in 2022 **[** **CCI]**

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Allocation between upgrade and connect incentives

20. The draft decision is to set the individual capex allowance for 2023 at $12.5m, a reduction of $4.3m from our proposal. However, it is not stated in the decision how the $4.3m would be allocated across upgrade and connect incentives. This could be specified in the final decision, or assessed by Chorus as part of our wash-up calculations for 2023. It could, for example, be based on the proportions of upgrade versus connect incentives in our proposal. We are happy to work with the Commission to confirm this as needed.

Reporting requirements

21. The draft decision would require Chorus to provide reports and disclosures on our connection forecast method, incentive quantities and expenditures, and connections.

22. We would like to better understand what information the Commission is seeking and how the information will be used. From our perspective, we have already provided information on our connection forecasting methodology (and this will be updated for PQP2), and quarterly information on incentive quantities, incentive expenditure and connections will be provided from next year in accordance with ID Schedule 24. If the Commission is looking for more information, we are not clear about what that information is.

23. Specifically, in terms of the items suggested:

    a. Connection Forecasting Methodology Report, including how the connection forecast is calculated, assumptions used, how they are derived and the supporting evidence – we believe this information has been provided in:

        i. The response to Incentives ICP RFI1, 10 August 2022

        ii. The Forecasting Methodology section of our price path compliance statements for 2022 and 2023 (in summary form)

        iii. The Demand section of our PQP1 proposal document 'Our Fibre Assets' – and we plan to improve and enhance this report for our PQP2 proposal, which the Commission will receive in October 2023.

    b. Incentive quantities – this is already required by ID schedule 24(ii) columns M and O

    c. Incentive expenditure – this is already required by ID schedule 24(ii) columns Q-X

    d. Connections – this is already required by ID schedule 24(i) columns O and Q.

24. There is no need to require updated demand forecasting information in early 2023, as Chorus intends to provide this as part of our PQP2 proposal. It would be doubling up on reporting to require the same information twice in the 2023 calendar year.

25. Therefore Chorus does not agree with the imposition of further reporting requirements as they duplicate existing reports and are unnecessary.

26. More broadly, the Commission should be mindful of the very large reporting burden that now applies to incentives, even though incentives only comprise a small portion of our expenditure (the suggested allowance is around 3% of Chorus' total expenditure allowances for 2023).

27. The benefits of additional disclosures need to be clear and weighed against the costs. Before any more reporting requirements are added, it must be clear what the information will be used for and that the Commission has the capacity to make timely assessments based on the information. We are unconvinced that adding extra reporting is justified or the best use of resources for Chorus or the Commission.

28. We also feel it is inappropriate to add reporting requirements for 2024 when the ICP applies to 2023 only. If Chorus makes a further ICP for customer incentives capex for 2024, the Commission could consider attaching reporting requirements to that approval.

29. As a final point, the draft decision (paragraph 3.61) states the reporting will be used to help determine any future individual capex allowance and Chorus' price-quality path for PQP2. However, the draft decision proposes reports that could not possibly be used for that purpose. Only the reports for the first two quarters of 2023 would likely be available in time to influence a decision on an ICP for incentives in 2024.[3] And only reporting up to the second quarter of 2024, perhaps not even that, would be timely enough to influence the PQP2 decision. Based on the Commission's own description of what this information will be used for, at the least the reporting should not continue beyond the second quarter of 2024.

30. We request the Commission engages with Chorus before finalising any new disclosure requirements so we can provide feedback on whether they would deliver information that is useful and additional to what is already being provided. We would be happy to make our modelling teams available to discuss with the Commission.

Other aspects of the draft decision

31. We support the other aspects of the draft decision, including these conclusions:

    a. The need for the customer incentives capex is justified and the expenditure (with a few exceptions due mainly to recent market developments) meets the capital expenditure objective and reflects good telecommunications industry practice in all but a few areas.

    b. The expenditure meets the Commission's economic test. We agree that the expected incremental revenues from end-users outweigh the incremental costs of the incentives capex.

[3] Also, Chorus may not make an ICP for incentives in 2024 – that decision has not yet been made. To apply a reporting requirement to support the Commission's review of a proposal that may not happen is not justifiable.

c. There are no significant concerns that the proposed incentive payments would contravene Chorus' geographically consistent pricing or non-discrimination obligations.

d. The expenditure qualifies as capex.

e. Chorus' cost escalators are acceptable.

Future improvements

32. As discussed above, the process to develop this ICP has highlighted that individual capex proposals are not well suited to the nature of incentives expenditure.

33. We propose reconsidering the process in advance of PQP2, with the aim of having a more fit-for-purpose methodology in place by 1 January 2025.

34. We suggest the following as options to consider:

    a. Including customer incentives capex in the connection capex category, such that there would be a connection capex variable adjustment to apply to incentives. This would be beneficial because the Commission could specify a reasonable unit rate up front, which can be confirmed as being lower than the expected incremental revenues per added connection. Chorus then bears the risk of any commercial need to spend more than that amount per connection, but the volumes are washed-up – removing the risk associated with forecasting incentives uptake.

    b. Specifying a ring-fenced 'use-it-or-lose-it' fund at the start of PQP2. Chorus could then draw down on the fund to the extent that it is efficient for us to do so. But the Commission does not risk approving more funding than will be spent.