Chorus' price quality path letter with revised depreciation proposal

PUBLIC VERSION

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Introduction

1. Thank you for the opportunity to provide feedback on Chorus' 24 September 2024 letter[1] setting out a proposed approach to setting the revenue path depreciation for the 2025 to 2028 regulatory period.

2. To mitigate concerns at the impact of a potentially higher Maximum Allowable Revenues (**MAR**) for the second regulatory period, the Commission proposes in the draft to bridge the gap between forecast revenues and expected MAR by applying an alternative depreciation profile to selected core fibre assets.

3. As we understand it, Chorus proposes to:

    a. Update its original May estimate for finalised inputs such as WACC, forecast CPI and final expenditure allowance decisions, and Chorus' latest fibre revenue forecast, and

    b. Add "headroom" to the modelled MAR each year for new revenue opportunities. It is unclear whether Chorus' proposed $40M to $70M uplift relates to the proposed headroom or the sum of all proposed changes.

Comment

4. The lack of transparency relating to the proposal makes it difficult to understand the implications of Chorus' proposal or provide substantive comments. Key financial information and commentary relating to the proposal – including proposed revised MAR, revenue forecasts and allocation of headroom between years – has been redacted from the letter.

5. Nonetheless, on the face of it, there are issues with Chorus' proposed MAR headroom overlay. It's unclear how the overlay relates to the BBM revenue forecasting process and could be a substantive change to the regulatory framework. The proposal likely requires standalone consideration, and we recommend that the Commission consider it further in early 2025.

The headroom overlay proposal lacks transparency and its place in the current BBM framework is unclear

6. The Part 6 regulatory framework should be implemented in a way that doesn't undermine incentives to grow FFAS revenues and connections. However, in terms of the proposal to add headroom to the calculated MAR:

    a. It's unclear how the approach relates to the BBM revenue forecasting process, the constraint this is intended to place on FFLAS prices, and whether it will - in practice - promote innovation or simply leave more headroom for price increases.

    b. May put the Commission in a position of inadvertently foreclosing competition in potentially competitive markets. We have already raised concerns about this effect occurring in fibre transport markets, and would further concerned if the untested "new revenue opportunity" in practice foreclosed a potentially competitive bypass and/or commercial partnering opportunity in the market, and

[1] https://comcom.govt.nz/__data/assets/pdf_file/0026/362582/Chorus-Revenue-path-and-alternative-depreciation-for-PQP2-24-September-2024.pdf

c. More broadly, adding a headroom overlay to maximised in period prices appear to take us further away from the approach set out in the original IMs and PQ regulation Reasons Papers whereby the Commission determines an efficient MAR within and across regulatory periods, ensuring efficient costs are recovered over time.

   Adding headroom to permitted calculated revenues – i.e., so that the in-period MAR is no longer a revenue and pricing constraint – may well be a fundamental change to the regulatory framework.

7. Chorus' proposal has come at a late stage in the process, and it is unclear from the information provided whether an ad hoc approach to the matter is warranted or the best option for addressing innovation concerns. The Commission may wish to consider the issue, for example, through a s209 review that would include implementation of a price cap approach[2].

8. Rather than finalise a view at this stage, we recommend the Commission consider a review early in 2025.

The proposal adds further pricing uncertainty for retailers and consumers

9. Further, as set out in our earlier submission, we are concerned that draft – and/or this proposed amendment - may imply significant price increases over the four-year period and ask that the Commission be more transparent relating to forecast modelled price increases and volumes. While Chorus is increasing wholesale prices from 1 January 2025, it is unclear whether this closes the forecast MAR gap or future catchup price increases are anticipated.

10. Chorus' letter highlights the risk of further price increases. At the same time as Chorus has indicated the 1 January 2025 price increases are lower than anticipated by the draft MAR for that year, Chorus' proposed MAR headroom could increase the gap as it could equally be applied to price increases as to new revenue opportunities.

11. Chorus noted in its cross-submission on the PQ draft that forecast MAR is not the same as wholesale prices and that Chorus is only permitted by wholesale service agreements to a single price increase each year. We agree. However, the lack of transparency relating to how MAR increases translate to wholesale prices makes it difficult to predict wholesale price increases over the remainder of the regulatory period. The Commission should provide guidance on how it sees the MAR flowing through to wholesale prices over the regulatory period, and any mitigations it may apply.

END

[2] The MAR approach has known limitations relating to incentives to grow demand and these were canvased at the time of the original IMs.