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Commerce Commission
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Via online submission portal

TRUSTPOWER CROSS-SUBMISSION: FIBRE INPUT METHODOLOGIES: INITIAL VALUE OF THE FINANCIAL LOSS ASSET

1. Introduction

1.1.1 Various parties have provided submissions in relation to the Commerce Commission's (**the Commission's)** consultation draft on the initial value of the financial loss asset (**FLA**) (**the Reasons Paper**). This cross-submission provides Trustpower Limited's (**Trustpower**'s) observations on the commentary and arguments raised in participants' submissions.

2. Cross-submissions

2.1.1 A key theme of Chorus' submissions is that the regime should "recognise or compensate investors for the significant risks faced when the investment was undertaken in 2011"[1] and also that "[r]eturns are now being capped through the introduction of regulation when the project is successful, but no recognition is being provided for the real potential that things could have turned out differently"[2].

2.1.2 Chorus seeks to leverage these arguments, primarily in relation to a discussion of the cost of capital in the pre-implementation period (especially regarding Type II asymmetric risk and the 75th percentile).

2.1.3 We query the extent of the risk that Chorus assumed in committing to invest in the UFB network ahead of demand, particularly given:

a) that it was unlikely Chorus would face widespread overbuild once it was awarded the UFB contract, a motivating factor for it to participate in UFB in the first place; and

b) the demand risk, which was moderated by the trend for an uptake in digital services that had begun prior to 2011. More broadly we note that regulatory risk was moderated by the GPS in 2011.

Consequently, we believe Chorus overstates its case.

2.1.4 Analysis of Chorus' arguments requires the Commission to consider the risks and investor expectations that Chorus took on in 2011, which involves a forensic, and likely subjective, assessment.

[1] Fibre input methodologies – Further consultation draft (initial value of financial loss asset) submission, [September 2020] Chorus, p. 3 (refer to paragraph 6.1)
[2] Fibre input methodologies – Further consultation draft (initial value of financial loss asset) submission, [September 2020] Chorus, p. 4 (refer to paragraph 11)

2.1.5 In the Commission determining financial losses under s177, we don't believe there is sufficient room to consider these matters in detail. The legislation endeavours to delineate what should and should not be included in financial losses, while allowing the Commission some discretion in its application.

2.1.6 On the question of the extent to which the risks assumed by Chorus in building the UFB network should be taken into account by the Commission, we note the legislation does not provide for an underwrite of all of that risk: "It is not the intention of subsections (2) and (3) that regulated fibre service providers should be protected from all risk of not fully recovering those financial losses through prices over time"[3].

2.1.7 In discussing the Commission's discretion as to whether pre-2011 assets are included, Chorus says that "Rather, a plain reading of s177 requires the Commission to include in its calculation of the value of the FLA any <u>accumulated unrecovered returns on assets used to meet Chorus' UFB obligations</u>" (emphasis added).[4] Chorus is mistaken. s177(3)(a) does not say "used to meet" Chorus' UFB obligations; it states "investments made by the provider under the UFB initiative" and no pre-2011 assets fall into that category.

2.1.8 We generally accept Spark's interpretation of s177 when it states that financial losses should not be considered broadly, that "the "losses" relate only to losses arising from the incremental costs of employing a service to provide UFB services"[5] (Vodafone, Vocus and others make a similar point) and the direct losses are those that are relevant.

2.1.9 However, we do not believe that the Commission was correct when it stated "…"investments made by the provider under the UFB initiative" could include pre-2011 assets that were redeployed in whole or part to provide FFLAS under the UFB initiative…".[6] Investments in pre-2011 assets were not made under the UFB initiative.

2.1.10 We are not sure whether Spark is saying that it agrees with the Commission in this regard, but if it does then we disagree. Nevertheless, we do find Spark's discussion of the allocation of shared costs to be persuasive.

2.1.11 Our position is summarised in the below table:

	Pre-2011 assets	**Post-2011 assets**
Included in Regulated Asset Base	Yes, at value in financial statements at 1.12.11	Yes, at cost incurred in constructing or acquiring
Financial losses incurred	No, because investment not made under UFB	Yes, if investment made under UFB; otherwise no

For any questions relating to the material in this submission, please contact me on 027-549-9330.

Regards,

FMWiseman

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[3] Section 177(4), Telecommunications Act 2001

[4] Further consultation draft (initial value of financial loss asset) submission, [September 2020] Spark, p. 6 (refer to paragraph 21a)

[5] Fibre input methodologies – Further consultation draft (initial value of financial loss asset) submission, [September 2020] Chorus, p. 30 (refer to paragraph 114)

[6] Fibre input methodologies – Further consultation draft (initial value of financial loss asset) – reasons paper, [August 2020] Commerce Commission, p. 17 (refer to paragraph 2.34)