Submission on proposed amendment to fibre input methodologies (TAMRP)

10 April 2024

CHORUS

Executive summary

1. This is Chorus' submission on the Commerce Commission's (**Commission's**) draft decision paper[1] which proposes to amend the fibre input methodologies (**IMs**) to change the tax-adjusted market risk premium (**TAMRP**) for price-quality (**PQ**) and information disclosure (**ID**) regulation from the second PQ path (**PQP2**) onwards.

2. To achieve a materially better IM for the cost of capital, we recommend:

   a. The IMs should not be amended at this time to decrease the TAMRP from 7.5% to 7.0%. Changing the TAMRP outside of the 7-year IM statutory review cycle is unnecessary and creates uncertainty. Our view is that the proposed amendment does not:

      i. best promote the purpose of Part 6 of the Telecommunications Act 2001 (**Telco Act**); and

      ii. promote certainty for fibre suppliers, access seekers or end-users under section 174 of the Telco Act.

   b. If, contrary to our recommendation above, the Commission does decide to amend the TAMRP at this time, then Chorus' ID TAMRP should be made consistent with our PQ TAMRP for the 2025 disclosure year. The Commission's draft decision reduces comparability between PQ and ID for Chorus since it takes effect in 2025 for PQ but in 2026 for ID.

3. We confirm this submission can be published on the Commission's website and contains no confidential information.

Submission

Changing the TAMRP outside of the IM statutory review cycle is unnecessary and creates uncertainty

4. In its draft decision paper, the Commission proposes to amend the TAMRP estimate specified in the fibre cost of capital IM, for the purposes of both PQ and ID regulation, from 7.5% to 7.0%. The Commission's reason is that this would align the TAMRP for fibre with the estimate obtained from the 2023 IM review for firms regulated under Part 4 of the Commerce Act 1986 (**Commerce Act**).

5. Changing the TAMRP at this time does not best promote the Part 6 purpose and it reduces predictability for investors, access seekers and end-users. In setting the fibre cost of capital IM in 2020 the Commission specifically made the decision to hardcode the TAMRP value in the IMs rather than specify it in individual PQ determinations. This change was made on a clear understanding that changing the

[1] Commerce Commission, Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025 – 2028): update to the tax adjusted market risk premium: Draft decision – Reasons paper, 12 March 2024.

TAMRP more regularly, as the Commission is effectively proposing with this amendment, did not better promote the Part 6 purpose:[2]

> *Overall, it is not clear that a move to more frequent estimations is an improvement and better promotes the Part 6 purpose. We consider that setting the TAMRP in the IMs promotes certainty for regulated suppliers and consumers without eroding incentives for investment. Therefore, we maintain our decision to specify the value of TAMRP within the IMs.*

6. In addition, reducing the TAMRP to 7.0% does not necessarily better promote section 162(d) in the long term compared to retaining the status quo of 7.5%. The Commission states that it believes the proposed change is urgent and compelling because it would "expect that providers of regulated FFLAS would earn excessive profits from a WACC estimate that would be higher than our best estimate of the cost of capital"[3]. However, this is not necessarily correct since the TAMRP estimate will always vary from the 'true' value. The Commission previously considered deviations in the TAMRP when considering how frequently it should update it and whether it should round to the nearest 0.5%. In both cases, the Commission believed that the deviations were acceptable:

    a. In the case of update frequency, the Commission acknowledged that the actual TAMRP would vary from the estimate, but that if there is no bias in the direction of the error then an expectation of normal returns over the lives of assets is maintained. [4]

    b. In the case of rounding, the Commission accepted that there would be larger moves in the TAMRP but that these would generally cancel out over the lives of assets.[5]

7. An amendment to change the TAMRP at this time also does not achieve the certainty required by section 174 of the Telco Act. In setting the fibre IMs in 2020 it was known that the TAMRP is an economy-wide WACC parameter that can vary over time with new data, and that the Part 6 fibre IMs would be reviewed at least every 7 years,[6] likely on a different cycle to statutory reviews of Part 4 IMs. Clearly then, at the time the fibre cost of capital IM was established, an out-of-cycle amendment to Chorus' TAMRP in advance of a PQ reset – even if this were to be based on recent data or follow a recent IM review for Part 4-regulated firms – was not expected to promote certainty for regulated fibre service providers, access seekers and end-users.

8. Further to this point, the draft decision could have a detrimental effect on investment incentives, contrary to section 162(a). Incentives for investment are formed with an understanding of regulatory settings at the time of the investment, as well as expectations of how the regulatory settings will evolve over the life of the

[2] Commerce Commission, Fibre Input Methodologies Main Final Decisions Reasons Paper, 13 October 2020 at [6.581].
[3] Commerce Commission, Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025 – 2028): update to the tax adjusted market risk premium: Draft decision – Reasons paper, 12 March 2024 at [3.18].
[4] Commerce Commission, Fibre Input Methodologies Main Final Decisions Reasons Paper, 13 October 2020 at [6.579].
[5] Commerce Commission, Fibre Input Methodologies Main Final Decisions Reasons Paper, 13 October 2020 at [6.568-6.569].
[6] See s 182, Telco Act.

investment. This means that unexpected changes to settings – such as the out-of-cycle IM change to the TAMRP proposed without any explicit rules about when such changes to the TAMRP should occur – will be detrimental to investment incentives. As discussed above, changing the TAMRP for PQP2 at this time is clearly contrary to the expectations established at the time the fibre IMs were originally determined.

9. In this respect, the Commission incorrectly implies in its draft decision paper[7] that it is making an acceptable trade-off in promoting the objectives in sections 162 and 166(2)(a), while detracting from the certainty referred to in section 174– the Commission's draft decision unnecessarily reduces certainty for fibre suppliers, access seekers and end-users without providing a clear net benefit.

10. Lastly, we see no other urgent or compelling reason to amend the TAMRP outside the Part 6 statutory IM review cycle. As the Commission has previously noted,[8] there is a considerable amount of judgement in setting the TAMRP, which uses the median of five estimates and is then rounded to the nearest 0.5%. Given the uncertainty inherent in the estimate and the size of the error band implicit in the Commission's practice of rounding to 50bp, it is hard to see that there is an urgent and compelling reason to amend the IMs at this time. Furthermore, the proposed change is not aimed at fixing an error or addressing any unexpected issue that has been identified.

11. In summary, the proposed change to the TAMRP at this time is unnecessary and creates uncertainty, and a materially better IM for the cost of capital would maintain the current TAMRP of 7.5% for both PQ and ID from 2025 to 2028.

The Commission's draft decision reduces comparability between PQ and ID for Chorus

12. The Commission is proposing to change the TAMRP used for ID from 3 March 2025, but change the TAMRP for PQ with immediate effect.[9] Doing so will result in the estimate of Chorus' PQ weighted average cost of capital (**WACC**) for the 2025 regulatory year incorporating a lower TAMRP than that used to determine Chorus' ID WACC for its 2025 disclosure year (see Table 1).

13. We expect this inconsistency will make it more difficult for interested persons to compare Chorus' performance in providing PQ and ID-regulated services contrary to section 186 which is intended to ensure that sufficient information is available to interested persons under ID to assess whether the purpose of Part 6 is being met.

14. Maintaining the current TAMRP of 7.5% for both PQ and ID from 2025 onwards, as recommended in our submission above, would better achieve comparability between PQ and ID. However, if the Commission changes the TAMRP for PQ to 7.0% for PQP2 then we consider the next best option is to align Chorus' TAMRP to 7.0% for ID

[7] Commerce Commission, Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025 – 2028): update to the tax adjusted market risk premium: Draft decision – Reasons paper, 12 March 2024 at [2.12-2.13].
[8] Commerce Commission, Fibre Input Methodologies Main Final Decisions Reasons Paper, 13 October 2020 at [6.560].
[9] Commerce Commission, Proposed amendment to input methodologies for Fibre ahead of the price-quality path for Chorus' second regulatory period (2025 – 2028): update to the tax adjusted market risk premium: Draft decision – Reasons paper, 12 March 2024 at [3.26].

purposes from the 2025 disclosure year onwards. We are open to discussing workable solutions with the Commission.

15. Although this appears to create a divergence in TAMRP between Chorus and the other LFCs for the 2025 disclosure year, the Commission's past decision to allow LFCs to adopt their GAAP financial reporting year for ID purposes means that Chorus' 2025 disclosure year actually has most overlap with other LFCs' 2026 disclosure years.[10] In other words, comparability across LFCs is enhanced by aligning the TAMRP for Chorus' 2025 disclosure year with other LFCs' 2026 disclosure years.

Table 1: The Commission's proposed timing creates an inconsistency in 2025

Provider and disclosure year	PQP1	PQP2			
	2024	**2025**	**2026**	**2027**	**2028**
Chorus PQ (Jan-Dec)	7.5%	**7.0%**	7.0%	7.0%	7.0%
Chorus ID (Jan-Dec)	7.5%	**7.5%**	7.0%	7.0%	7.0%
Enable ID (Jul-Jun)	7.5%	7.5%	7.0%	7.0%	7.0%
Tuatahi ID (April-Mar)	7.5%	7.5%	7.0%	7.0%	7.0%
Northpower ID (April-Mar)	7.5%	7.5%	7.0%	7.0%	7.0%

[10] For example, Chorus' 2025 disclosure year overlaps by only three months with the 2025 disclosure year for Tuatahi and Northpower Fibre, but shares nine months in common with the 2026 disclosure years for those entities.