Chorus' expenditure allowances for the second regulatory period (2025 – 2028)

2degrees' Cross-Submission in response to Commerce Commission consultation

June 2024

PUBLIC

Introduction

2degrees welcomes the opportunity to cross-submit on the Commerce Commission's draft decision in relation to *Chorus' expenditure allowances for the second regulatory period (2025 – 2028)*, dated 18 April 2024. In summary:

- We share the other Retail Service Providers (RSPs) concerns about Chorus' marketing expenditure and the ('unregulated') nature of that expenditure when compared with alternative technologies.
- We share the RSP concerns about incentive payments.
- Chorus has not substantiated its assertions that:
  - Its costs and expenditure proposal are efficient;
  - The Commission's draft decision would undermine its ability to provide world-class fibre services or Chorus' ability to fund further fibre investment; and
  - the draft cost allocators would "require too much cost to be recovered from our declining copper business would have an overall negative impact on continued operations and Chorus' ability to fund further fibre investment."
- We consider the Commission has been subject to unjustified criticisms by two of Chorus' shareholders. We don't support L1 Capital and Yarra's suggestions of "Constant tinkering", "'left field' changes", ignoring the independent verifier, adopting "non-sensical" approaches or "blatantly" ignoring "economic reality".

Retail Service Providers share common concerns

We share the views and concerns raised by One NZ and Spark, including:

- We agree with One NZ that the Commission should "undertake a full review of Chorus' marketing spend within the PQP2 evaluation process, particularly because the independent verifier's report highlighted the lack of 'economic analysis demonstrating the level of expenditure is more than offset by the resulting increased revenue resulting from the marketing activity.'"
- We agree with One NZ that "where the independent verifier has expressed doubt or didn't reach a firm conclusion that supports Chorus' proposals, the Commission should be extremely cautious accepting those proposals and should only do so if there is strong and compelling evidence that they are justified."
- One NZ's concerns about Chorus not being subject to the same broadband marketing rules that apply to retailers align with the concerns we have expressed. We agree the Commission should "take steps to ensure that Chorus is subject to the same broadband marketing rules".

- We agree with One NZ that “allowing incentive payments as part of capex for the purpose of determining the MAR would enable Chorus to earn monopoly profit” and “creates asymmetry in the market: a level playing field between providers of broadband infrastructure requires that any incentive offered by Chorus to drive fibre demand comes off its bottom line and does not create headroom that Chorus can recoup from captive customers. In a normal market, a rebate or other discount would come off the provider's bottom line.”
- We agree with Spark that the quality of the supporting information provided by Chorus to justify connection incentive payments, including errors in the financial model and lack of explanation for key assumptions, “provided to the Commission on its own is a red flag that puts into question the purpose of the incentives and end-user benefits from this expenditure over the many other options available to Chorus to promote fibre uptake.”
- We agree with Spark that “the Commission make it a condition of core fibre route investment expenditure approval that Chorus undertake a written consultation for each project with potential partners [interested stakeholders] and report back the outcomes of that consultation to the Commission.”

Chorus’ assertions that its expenditure proposals are efficient and the draft decision would harm Chorus’ financeability are not well supported

Chorus’ submission repeatedly relies on claims that Chorus is efficient and its expenditure proposal is efficient. While Chorus claims this is “supported by evidence”, Chorus relies heavily on assertion and does not adequately substantiate its claims.

Chorus appears to be presenting its views on its on efficiency in absolute terms. It simply states that “Chorus operates efficiently” as if the section 62 purposes that regulated fibre services provides “have incentives to innovate” and “have incentives to improve efficiency” have already been achieved.

Instead of simply asserting that it is efficient, Chorus should acknowledge efficiency as part of continuous improvement and that it is not binary. All firms in all markets should be striving to be more efficient. If a firm, particularly a monopoly, asserts in absolute terms that it is efficient, as Chorus does, then it almost certainly is not. We consider a mature conversation would not be around whether Chorus is efficient or not, but around the extent and rate at which it should be expected to further improve efficiency during the regulatory period.

We consider Chorus’ assertions and claims about “already” being efficient have parallels with its fibre deregulation submission in which it repeatedly claimed Chorus had “overwhelming” evidence competitive circumstances have changed without

providing sufficient evidence.[1] We support the High Court view that "Where a proposition is simply asserted …, we give it little or no weight.[2]

Chorus similarly implies the Commission's draft decisions would "produce unexpected and unnecessarily severe outcomes" and this "sends a strong negative signal to investors and is counter to the Government's objectives".

It appears a specific example Chorus is trying to rely on to support these claims is that the draft decisions on cost allocators "require too much cost to be recovered from our declining copper business would have an overall negative impact on continued operations and Chorus' ability to fund further fibre investment." Chorus also claims that "Our proposed PQP2 allocators are objectively justifiable and demonstrably reasonable". Our previous submission and the Commission's draft decisions provide strong basis that not all the allocative are justifiable or reasonable. We note concerns about Chorus' cost allocation is not new e.g. the Commission had concerns bout the treatment of pre-2011 assets.[3]

We refer the Commission back to submissions 2degrees and other RSPs made in relation to determining whether double-recovery has/is occurring between copper and fibre. The same approach would be needed to substantiate Chorus' claims that too much costs are being recovered from copper.

If Chorus' assertions are correct it should be able to demonstrate the draft decisions would prevent them from earning at least a normal return. They have not done so.

If Chorus' believes the draft decisions would result in "undue financial hardship" or impact 'financeabilty' it is beholden on Chorus to provide evidence to support this. The Commerce Commission has been similarly dismissive of unsupported claims of financial hardship under Part 4 Commerce Act.

The Commission has been subject to unjustified criticisms by Chorus shareholders

We feel that some of the commentary against the Commission, in the Chorus/Chorus shareholder submissions is unfair. It is important to recognise the Commission faces a challenging job in balancing a number of considerations and require expert judgments when making decisions on price resets. The Commission has undertaken significant work in evaluating Chorus' expenditure proposal for the second regulatory period.

We do not agree the various claims and criticisms are reasonable or justified, including that the Commission is "Artificially constraining the MAR" (L1 Capital), the

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[1] https://comcom.govt.nz/__data/assets/pdf_file/0026/348740/2degrees-deregulation-draft-assessment-framework-cross-submission-March-2024.pdf
[2] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [1745].
[3] https://comcom.govt.nz/__data/assets/pdf_file/0022/224833/Two-Degrees-Submission-on-consultation-draft-initial-value-of-financial-loss-asset-10-September-2020.PDF

Commission is engaging in “Constant tinkering”, making “‘left field’ changes”, it is “shocking that the Commission has seemingly ignored the findings of [the] independent report”, the Commission has adopted a “frankly non-sensical approach to the appropriation in of shared costs”, and the “draft proposal blatantly ignores … economic reality” (Yarra).

We are not clear shareholders or financial investors have made extraordinary claims like these in price setting under Part 4 of the Commerce Act, and don’t consider they serve the interests of shareholders, Chorus or the long-term interests of end-users well.