

# Chorus' individual capex proposal for customer incentives 2023 – Final decision – Reasons paper

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Commerce Commission  
Wellington, New Zealand

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## Chapter 1 Introduction

### Purpose and structure of this paper

- 1.1 This chapter sets out our decision on Chorus Limited's (**Chorus**) individual capex expenditure (**capex**) proposal for customer incentives for 2023.
- 1.2 The paper is structured as follows:
  - 1.2.1 Chapter 1 is an introduction;
  - 1.2.2 Chapter 2 covers the legal framework for our decisions; and
  - 1.2.3 Chapter 3 discusses our decisions and the reasons for those decisions, including:
    - 1.2.3.1 summary of our decision;
    - 1.2.3.2 summary of our draft decision;
    - 1.2.3.3 submissions and cross-submissions received and our response; and
    - 1.2.3.4 our decision.
- 1.3 Please note that all dollar amounts quoted in this paper are in nominal terms unless otherwise stated.

### Our decision

- 1.4 Our decision is to determine an individual capex allowance for customer incentives in the regulatory year 2023 of \$12.5m. This is unchanged from our draft decision.
- 1.5 The effect of this decision will be to increase the revenues included as part of the price-quality (**PQ**) path (via the wash-up mechanism in the regulatory period that starts on 1 January 2025 (**PQP2**)). This decision does not inhibit Chorus from modifying or adapting any incentive offers to respond to market dynamics.

### Information we intend to request to support future assessments

- 1.6 In addition to determining an individual capex allowance, we intend to issue a request in Q1 2023 for Chorus to provide the following information:
  - 1.6.1 a Connection Forecasting Methodology Report by 30 March 2023, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and

1.6.2 quarterly updates during the regulatory year 2023 on:

1.6.2.1 incentives quantities and expenditure; and

1.6.2.2 connections.

## Background

- 1.7 As part of our final decisions for Chorus' first PQ path, which commenced on 1 January 2022, we decided to include \$18.6 million of incentive payment expenditure in the base capex allowance for regulatory year 2022 only.<sup>1</sup> Our decision was that Chorus would have to submit Individual Capex proposals to us if it wanted to seek approval for incentive payment expenditure for regulatory year 2023 and regulatory year 2024.<sup>2</sup>
- 1.8 Incentive payments are payments Chorus makes to Retail Service Providers (**RSPs**) to incentivise acquisition of new customers on its fibre network or to incentivise existing customers to upgrade to new services.
- 1.9 Any capex approved under an individual capex allowance will be used in calculating the "actual allowable revenue" component of the "wash-up account balance" for the corresponding regulatory year of Chorus' first price-quality path, which runs from 1 January 2022 until 31 December 2024 (**PQP1**).<sup>3</sup> This will then be available to be drawn down in future regulatory periods.<sup>4</sup> In effect, the value of the wash-up attributable to the individual capex allowance will be the return on and depreciation for that capex for the relevant regulatory years.
- 1.10 These incentive payments (also called customer retention costs) are capitalised as customer retention assets by Chorus in accordance with Generally Accepted Accounting Practice (**GAAP**).

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<sup>1</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraph C3.

<sup>2</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraph C4.

<sup>3</sup> *Fibre Input Methodologies Determination 2020, as amended on 29 November 2021*, clauses 3.1.1(7)-(9) and 3.1.1(11)(d).

<sup>4</sup> *Fibre Input Methodologies Determination 2020, as amended on 29 November 2021*, clause 3.1.1(2)(c) and 3.1.1(5).

- 1.11 As part of our final decisions for PQP1, we articulated an economic test that we would apply when carrying out our assessment of incentive expenditure.<sup>5</sup> The economic test we apply is whether the expected incremental revenue exclusively from the incremental end-users/upgrades that the incentive payments drive outweigh the incremental costs, including the incentive expenditure itself.<sup>6</sup> Our economic analysis of Chorus' proposed incentive payments for PQP1 (regulatory year 2022) concluded that the expenditure sought fell within the estimated range meaning that the amount of incentives approved was likely to support competition, efficiency and was unlikely to be overstated.<sup>7</sup>
- 1.12 Chorus has applied for \$16.8 million (nominal) of expenditure for incentive payments for regulatory year 2023 through its individual capex proposal. The proposed expenditure can be broken down into:
- 1.12.1 \$12.8 million for connection incentives;
  - 1.12.2 \$6.1 million for upgrade incentives; and
  - 1.12.3 offset by \$2.2 million for claw-backs.
- 1.13 For more information on what Chorus is seeking, please refer to Chorus' proposal. We have published Chorus' proposal alongside this decision on our website.<sup>8</sup>

### **Design proposal and individual capex**

- 1.14 The fibre input methodologies (**IMs**) splits the individual capex application process into two stages:<sup>9</sup>
- 1.14.1 the **notification stage** where Chorus must notify us of its intention to submit an individual capex proposal and submit a **design proposal**; and
  - 1.14.2 if we approve Chorus' design proposal, the **final proposal stage** where Chorus must submit an **individual capex proposal** to us that is consistent with the design proposal.

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<sup>5</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraph C57.

<sup>6</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraph C63.

<sup>7</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraph C124.1.

<sup>8</sup> Chorus "Chorus' individual capex proposal for customer incentives" (30 June 2022).

<sup>9</sup> *Fibre Input Methodologies Determination 2020, as amended on 29 November 2021*, clause 3.7.22(6).

- 1.15 Chorus submitted its individual capex design proposal for incentive expenditure for regulatory year 2023 (**design proposal**) on 6 April 2022. We approved Chorus' individual capex design proposal on 5 May 2022 with conditions.<sup>10</sup> Specifically:
- 1.15.1 we considered the key parameters of Chorus' design proposal were sufficient;
  - 1.15.2 we considered the breadth of information provided in Chorus' design proposal was appropriate but considered that greater specificity was required in some areas;<sup>11</sup>
  - 1.15.3 we waived the requirement for independent verification;
  - 1.15.4 we considered Chorus' proposed timeline was appropriate; and
  - 1.15.5 we decided to undertake a two-week consultation on our draft decision in Q3 2022.
- 1.16 Chorus submitted its individual capex proposal on 30 June 2022.<sup>12</sup>
- 1.17 We evaluated Chorus' individual capex proposal and issued a number of requests for information to assist with this evaluation. We released our draft decision on 18 October 2022.<sup>13</sup>

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<sup>10</sup> Commerce Commission "Approval of Chorus' individual capex design proposal for incentive payment capex 2023" (5 May 2022).

<sup>11</sup> Commerce Commission "Approval of Chorus' individual capex design proposal for incentive payment capex 2023" (5 May 2022), Attachment A.

<sup>12</sup> [Chorus "Chorus' individual capex proposal for customer incentives"](#) (30 June 2022).

<sup>13</sup> [Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper"](#) (18 October 2022).

## Chapter 2 Legal framework

### Purpose and structure of this paper

- 2.1 This chapter describes the legal requirements for determining an individual capex allowance. This chapter is structured as follows:
- 2.1.1 requirements under the Telecommunications Act 2001 (**the Act**);
  - 2.1.2 requirements under the capex IM; and
  - 2.1.3 requirements under s 201 of the Act and Chorus' non-discrimination obligations.

### Requirements under the Act

- 2.2 Under s 166(2) of the Act, we must make determinations that we consider best give (or are likely to best give), effect:
- 2.2.1 to the purpose in s 162; and
  - 2.2.2 to the extent that we consider it relevant, to the promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services.
- 2.3 As explained in our *Fibre input methodologies: Main final decisions - reasons paper (IM reasons paper)*,<sup>14</sup> we consider that by applying the evaluation criteria set out in the capex IM, our decision would best give effect to s 166(2) of the Act. We explain in paragraphs 2.8 to 2.10 below how we consider that an application of the relevant capex IM provisions would ensure that we have fulfilled our obligation under s 166(2). We note that this is consistent with our explanation of the requirements of the Act and application of the capex IM in *Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper*.<sup>15</sup>

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<sup>14</sup> Commerce Commission "Fibre input methodologies: Main final decisions – reasons paper" (13 October 2020), paras 7.135-7.139.

<sup>15</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision: Reasons paper" (16 December 2021), paragraphs 4.10-4.25.



## Requirements under the capex IM

- 2.4 The capex IM specifies that we will determine a capex allowance after Chorus submits an individual capex proposal.<sup>16</sup> After receiving an individual capex proposal, we will determine a capex allowance for each regulatory year of a regulatory period in accordance with the general evaluation requirements in Subpart 8 of the IMs and the specific requirements set out in section 4 of Subpart 7 of the IMs.<sup>17</sup>
- 2.5 When we determine an individual capex allowance after a regulatory period commences, it will be used to calculate a wash-up amount.<sup>18</sup>
- 2.6 We must evaluate Chorus' individual capex proposal by considering whether the proposed capex meets the capital expenditure objective and reflects good telecommunications industry practice.<sup>19</sup> The proposed capex would meet the capital expenditure objective if that expenditure reflects the efficient costs that a prudent fibre network operator would incur to deliver PQ fibre fixed line access services (**FFLAS**) of appropriate quality, during the relevant regulatory period and over the longer term.<sup>20</sup>
- 2.7 Good telecommunications industry practice means:<sup>21</sup>
- 2.7.1 the exercise of a degree of skill, diligence, prudence, foresight and economic management, that would reasonably be expected from a skilled and experienced asset owner engaged in the management of a fibre network under comparable conditions. A decision on good telecommunications industry practice should take into account domestic and international best practice, including international standards and factors such as the relative size, age and technology of the relevant fibre network and domestic regulatory and market conditions, including applicable law.

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<sup>16</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.7.1(1). The specific requirements for an individual capex proposal are set out in section 4 of Subpart 7 of the capex IM.

<sup>17</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.7.1(3).

<sup>18</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.7.1(4)(b).

<sup>19</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.5(1)(a).

<sup>20</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.5(2).

<sup>21</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 1.1.4(2), definition of "good telecommunications industry practice".

- 2.8 We must also evaluate Chorus' individual capex proposal by having regard to relevant assessment factors when considering whether the individual capex proposal has met the capital expenditure objective.<sup>22</sup> The assessment factors help us identify the different aspects of prudence and efficiency. We must have regard to as many of the assessment factors as are relevant when evaluating the individual capex proposal.<sup>23</sup> The assessment factors are specified in clause 3.8.6(1)(a)-(t) of the IMs.
- 2.9 As we stated in our IM reasons paper, through our evaluation of a capex proposal we aim to limit Chorus' ability to over-forecast its investment needs for a given regulatory period. This limits Chorus' ability to extract excessive profits while preserving incentives to improve efficiency (s 162(b) and (d)).<sup>24</sup> Through the use of our economic test, we are able to ensure Chorus' incentive spend is efficient (consistent with s 162(b)), while promoting workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services (consistent with s 166(2)(b)) by not allowing Chorus to engage in predatory pricing. Predatory pricing may not promote s 166(2)(b) as it may undermine workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services.
- 2.10 The evaluation criteria, including the assessment factors that support the evaluation of the proposed capex against the capital expenditure objective, allow us to identify and evaluate where good asset management has been applied. We consider that good asset management is important for Chorus to ensure capex meets the expenditure objective.<sup>25</sup>
- 2.11 Having scrutinised and evaluated Chorus' individual capex proposal in accordance with the capex IM, and in light of the s 166(2) purposes, we consider that the proposal provided sufficient information for us to consider whether the proposed capex met the capital expenditure objective and reflects good telecommunications industry practice under clause 3.8.5(1) of the IMs.

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<sup>22</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.5(1)(b) and 3.8.6.

<sup>23</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.6.

<sup>24</sup> Commerce Commission "Fibre input methodologies: Main final decisions – reasons paper" (13 October 2020), paras 7.135.

<sup>25</sup> Commerce Commission "Fibre input methodologies: Main final decisions – reasons paper" (13 October 2020), paragraph 7.137.

## Requirements under s 201 and Chorus' non-discrimination obligations

### Section 201

- 2.12 Section 201 of the Act requires Chorus to set prices that are geographically consistent:

#### **Section 201 Geographically consistent pricing**

A regulated fibre service provider who is subject to price-quality regulation must, regardless of the geographic location of the access seeker or end-user, charge the same price for providing fibre fixed line access services that are, in all material respects, the same.

- 2.13 A failure to comply with s 201 is a contravention of a price-quality requirement and could lead to penalties under Subpart 8 of Part 6 of the Act.<sup>26</sup>
- 2.14 We issued guidance on our intended approach to s 201 last year.<sup>27</sup> As we stated in our guidance note, Chorus bears the responsibility for ensuring its pricing decisions comply with the requirements of s 201 and we have the responsibility for maintaining oversight of Chorus' decisions and, if necessary, bringing enforcement action.<sup>28</sup>
- 2.15 We elaborated on this further in our final decisions for PQP1, where we outlined our approach to ex-ante and ex-post scrutiny of incentive payments in relation to s 201 and Chorus' non-discrimination obligations:<sup>29</sup>
- “We perform ex ante scrutiny before approving expenditure by assessing whether there are reasons to believe that the proposed expenditure would breach Chorus' legal obligations (ex ante scrutiny), and ex post scrutiny by subsequently monitoring and enforcing Chorus' compliance with legal obligations during the regulatory period (ex post scrutiny)”.
- 2.16 As stated in our guidance note, incentive payments made by Chorus to access seekers can form part of the price, and therefore come within the scope of s 201.<sup>30</sup>

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<sup>26</sup> Telecommunications Act 2001, s 215(2)(b)(iii) and sections 215-218 generally.

<sup>27</sup> Commerce Commission “Guidance on our intended approach to s 201 of the Telecommunications Act 2001” (30 September 2021).

<sup>28</sup> Commerce Commission “Guidance on our intended approach to s 201 of the Telecommunications Act 2001” (30 September 2021), paragraphs 30-31.

<sup>29</sup> Commerce Commission “Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), para C77.

<sup>30</sup> Commerce Commission “Guidance on our intended approach to s 201 of the Telecommunications Act 2001” (30 September 2021), paragraphs 46-48.

*Non-discrimination obligations*

- 2.17 Subject to any modifications under ss 206 and 230 of the Act,<sup>31</sup> Chorus' supply of PQ FFLAS must comply with the undertakings it has given under s 156AD (**fibre deeds**). Under Chorus' fibre deeds, it is required to meet equivalence and non-discrimination obligations in relation to the supply of certain PQ FFLAS.<sup>32</sup>
- 2.18 Non-discrimination obligations mean that Chorus must not treat access seekers differently to one another, or differently to itself. Equivalence obligations mean that Chorus must supply relevant PQ FFLAS to access seekers on the same basis that it supplies itself.<sup>33</sup>

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<sup>31</sup> Under s 206, on or after the implementation date, Chorus will not be required to achieve price equivalence in relation to the supply of an unbundled layer 1 service to the extent that the service is an input to a service that is subject to a prescribed maximum price under Part 6 that is not a cost-based price. In addition, under s 230, if services are declared under ss 228 and/or 229, then the Governor-General may make regulations discharging a regulated provider from its obligations to supply a service under a s 156AD undertaking.

<sup>32</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper" (16 December 2021), paragraph 7.47.

<sup>33</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper" (16 December 2021), paragraph 7.47.

## Chapter 3 Our decision

### Purpose and structure of this chapter

- 3.1 This chapter outlines our decision on Chorus' individual capex proposal for customer incentives for regulatory year 2023. This chapter is structured as follows:
- 3.1.1 summary of our decision;
  - 3.1.2 summary of our draft decision;
  - 3.1.3 summary of information that we intend to request to support future assessments;
  - 3.1.4 submissions and cross-submissions received and our response; and
  - 3.1.5 our decision.

### Summary of our decision

- 3.2 Our decision is to determine an individual capex allowance for customer incentives for regulatory year 2023 of \$12.5m. We consider our decision meets the expenditure objective and reflects good telecommunications industry practice. This is unchanged from our draft decision, and is based on:
- 3.2.1 a reduction of \$0.7m to reflect a change to calculating the forecast clawback to align with actual clawback amounts observed in 2020, 2021, and 2022;<sup>34</sup>
  - 3.2.2 removing \$0.58m in contingency expenditure; and
  - 3.2.3 a reduction of \$3.0m to reflect the incorporation of 12 months of actual incentive payments made from July 2021 to June 2022. We note this is equivalent to a reduction in the forecast number of incentive payments to be made in 2023 and reflects a change in the behaviour of the market in respect to the uptake of incentive payments.
- 3.3 Table 3.1 below summarises our decision on the individual capex allowance.

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<sup>34</sup> Clawbacks are payments made back to Chorus by RSPs for any incentive payments where the end-user did not stay connected within a specified timeframe.

**Table 3.1 Impact of our decision on the proposed individual capex allowance**

Component of the proposal	Chorus proposal	Draft decision	Final decision	Change from draft to final
Forecast clawback	-\$2.2m	-\$2.9m	-\$2.9m	\$0m
Unspecified expenditure	\$0.6m	\$0m	\$0m	\$0m
Forecast payments	\$18.5m	\$15.4m	\$15.4m	\$0m
<b>Total change (ex allocation)</b>		-\$4.3m	-\$4.3m	\$0m

### Summary of information we intend to request to support future assessments

3.4 In addition to determining an individual capex allowance, we intend to issue a request in Q1 2023 for Chorus to provide the following information:

3.4.1 a Connection Forecasting Methodology Report by 30 March 2023, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and

3.4.2 quarterly updates during regulatory year 2023 on:

3.4.2.1 incentive quantities and expenditure; and

3.4.2.2 connections.

3.5 Table 3.2 below summarises the change to the additional information we intend to request.

**Table 3.2 Impact of our planned information request**

Reporting requirement	Draft decision	Final decision	Change from draft to final
Connection Forecasting Methodology Report	Required	Required	No change
Quarterly updates on: incentive quantities and expenditure; and connections	Required for regulatory years 2023 and 2024	Required for regulatory year 2023	No longer a requirement for regulatory year 2024

## Summary of our draft decision

- 3.6 Our draft decision was to determine an individual capex allowance for customer incentives for regulatory year 2023 of \$12.5m. The reduction of \$4.3m from Chorus' individual capex proposal was based on:
- 3.6.1 a reduction of \$0.7m to reflect a change to calculating the forecast clawback to align with actual clawback amounts observed in 2020, 2021, and 2022;<sup>35</sup>
  - 3.6.2 removing \$0.58m in contingency expenditure; and
  - 3.6.3 a reduction of \$3.0m to reflect the incorporation of 12 months of actual incentive payments made from July 2021 to June 2022. We noted this was equivalent to a reduction in the forecast number of incentive payments to be made in 2023 and reflects a change in the behaviour of the market in respect to the uptake of incentive payments.
- 3.7 In addition to determining an individual capex allowance, we signalled our intention to request information from Chorus to provide:
- 3.7.1 a Connection Forecasting Methodology Report, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and
  - 3.7.2 quarterly updates during the regulatory years 2023 and 2024 on:
    - 3.7.2.1 incentive quantities and expenditure; and
    - 3.7.2.2 connections.

## Submissions and cross-submissions received and our response

- 3.8 We received three submissions in total from Chorus, Spark and Mercury. We received one cross-submission from Chorus.

### General points raised

- 3.9 Mercury submitted in favour of our draft decision and stressed how incentive payments benefit it and allow it to compete with the larger RSPs. Mercury also agreed with the analysis in our draft decision that incentive payments can benefit consumers in the long-term.<sup>36</sup>

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<sup>35</sup> Clawbacks are payments made back to Chorus by RSPs for any incentive payments where the end-user did not stay connected.

<sup>36</sup> Mercury "Submission on Chorus' individual capex allowance for customer incentives" (1 November 2022), page 1.

- 3.10 Chorus agreed with our analysis that incentive payments can promote competition, accelerate uptake, and can drive cost efficiencies.<sup>37</sup>

## Clawback

### *Draft decision and reasons*

- 3.11 Chorus calculated an expected clawback over regulatory year 2023 of \$2.2m. Our draft decision was to increase the clawback to \$2.9m from the \$2.2m proposed by Chorus. This reduced the total capex allowance by \$0.7m from that proposed by Chorus.
- 3.12 A clawback is a rebate paid back to Chorus from an RSP in the event that a connection that resulted in an incentive being paid is lost or downgraded within a specified period (typically 12 months).
- 3.13 After reviewing Chorus' clawback forecast and having regard to the assessment factors in clause 3.8.6(1)(c), (e), (p), and (t) of the capex IM,<sup>38</sup> we considered that the clawback forecast by Chorus under-estimated the clawback amount. For example, Chorus' calculation relied upon samples from mid-2019 and did not test the methodology against historical actuals.
- 3.14 Our review of the clawback as compared with actual total clawbacks made showed that the clawback rates are on average approximately [CCI]% of the actual clawbacks over 2020, 2021, and the forecast outcomes for 2023.<sup>39 40</sup>
- 3.15 Accordingly, for our draft decision, we utilised Chorus' methodology for determining clawback amounts, determining correct calculated weighted average clawback rates from the samples provided, and aligned the rates with the actual clawbacks.

### *Submissions and analysis of submissions*

- 3.16 Chorus submitted in favour of our draft decision to remove \$0.7m from the individual capex allowance.

"Chorus accepts the draft decision to increase the claw-back forecast, and thus reduce the expenditure allowance by \$0.7m".<sup>41</sup>

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<sup>37</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 4.

<sup>38</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.6.

<sup>39</sup> Back casting refers to forecasting backwards in time. In this case we have used Chorus' calculation methodology to forecast what the clawback would have been in 2021 and 2022 to determine how well the methodology performed against actual clawback payments made.

<sup>40</sup> CCI is Chorus Confidential Information.

<sup>41</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 10.



*Decision and reasons*

- 3.17 Our decision is to increase the clawback to \$2.9m from the \$2.2m proposed by Chorus. This reduced the total capex allowance by \$0.7m from that proposed by Chorus. We have made this decision for the same reasons as our draft decision and have not changed our draft decision.

**Inclusion of 12-month actual incentive payments***Draft decision and reasons*

- 3.18 Our draft decision was to reduce the individual capex allowance by \$3.0m to reflect the reduction in historical expenditure that resulted from an observed change in market behaviour in the 12 months from July 2021 to June 2022.
- 3.19 After reviewing the actual incentive payments during the 12 months from July 2021 to June 2022, Chorus' forecast growth in net connections, and having regard to the assessment factors in clause 3.8.6(1)(c), (e), (g), (j), (p), and (t) of the capex IM, we considered there was a high risk that the methodology over forecasted the expected requirement for incentive payments in 2023.<sup>42 43</sup>

*Submissions and analysis of submissions*

- 3.20 Chorus agreed "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".<sup>44</sup>
- 3.21 We consider it is important that any expenditure allowance is underpinned by actuals wherever relevant.

*Decision and reasons*

- 3.22 Our decision is to reduce the individual capex allowance by \$3.0m to reflect a change in market behaviour towards incentives as demonstrated in the 12 months from July 2021 to June 2022. We have made this decision for the same reasons as our draft decision and have not changed our draft decision.

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<sup>42</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.6.

<sup>43</sup> Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper" (16 December 2021), at paragraph 4.159.2.3. In this paragraph we highlighted the incentive regulated providers have to game expenditure forecasts by over forecasting.

<sup>44</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 12.

## **Additional incentives for flexibility (contingency expenditure)**

### *Draft decision and reasons*

- 3.23 Our draft decision was to remove \$0.58m which Chorus added for “incentives capex that we intend to spend in CY [Calendar Year] 23 but have not yet allocated to specific programmes”.<sup>45</sup> Chorus included \$0.8m in its proposal but the calculation methodology used by Chorus only resulted in a reduction of \$0.58m from the proposed allowance.
- 3.24 We did not consider the inclusion of an extra \$0.58m meets the capital expenditure objective as:
- 3.24.1 no indication has been provided as to the net benefit that an additional \$0.58m would provide in regard to additional connections or upgrades;
  - 3.24.2 Chorus has a high degree of flexibility in regard to incentive design and rates. Subject to the requirements of s 201 and non-discrimination requirements, Chorus has complete flexibility and nothing within the determination of an individual capex allowance restricts its ability to respond to the market; and
  - 3.24.3 the Christchurch International Airport Limited decision used by Chorus as a reason for including the additional expenditure is not analogous.<sup>46</sup> The quote Chorus cited came from a summary and analysis of information publicly disclosed under s 53B(2)(b) of the Commerce Act 1986. This is different from a capex proposal for a PQ path which is different to our summary and analysis of information publicly disclosed under information disclosure. It was also made in the context of fixed physical infrastructure development (terminal redevelopment) which, unlike incentive products, has limited inherent flexibility.
- 3.25 After reviewing Chorus’ additional incentive for flexibility and having regard to the assessment factors in clause 3.8.6(1)(b), (c), (e), (j), and (p) of the capex IM,<sup>47</sup> our draft decision was to remove the additional \$0.58m from the incentive allowance.

### *Submissions and analysis of submissions*

- 3.26 Chorus did not agree with our draft decision to remove \$0.58m of unallocated spending. Specifically:

“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

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<sup>45</sup> Chorus “Chorus’ individual capex proposal for customer incentives” (30 June 2022), section 2.3, page 12.

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".<sup>46</sup>

- 3.27 We agree with Chorus that the total amount of incentive capex that will be paid out is uncertain. However, uncertainty was not the reason for excluding the expenditure. The reason for excluding the additional expenditure (\$0.58m) was that Chorus did not justify the expenditure.<sup>47</sup> This is not the same as excluding expenditure that is uncertain or expenditure where there is a lack of specific information on how it will be spent. In our view Chorus failed to demonstrate why the addition of the contingency expenditure met the expenditure objective.

#### *Decision and reasons*

- 3.28 Our decision is to remove \$0.58m which Chorus added for "incentives capex that we intend to spend in CY [Calendar Year] 23 but have not yet allocated to specific programmes". We have made this decision for the same reasons as our draft decision and have not changed from our draft decision.

#### **The level of certainty required**

- 3.29 Chorus also raised concerns that our draft decision required too much certainty and stated this causes problems due to the "nature of incentives capex".<sup>48</sup> Specifically:

"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";<sup>49</sup> and

"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."<sup>50</sup>

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<sup>46</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 11.

<sup>47</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraph 3.29.

<sup>48</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 5.

<sup>49</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 5.

<sup>50</sup> Chorus "Submission on incentives ICP draft decision" (1 November 2022), paragraph 6.

- 3.30 We acknowledge Chorus' point that customer incentives are difficult to forecast. However, Chorus did not provide any representation about the level of uncertainty that is appropriate for such expenditure nor what risks there were around the expenditure or how these risks might be mitigated. As we noted in the draft decision, there was no indication as to the benefit that the additional \$0.58m would provide. We also note that Chorus did not demonstrate why the level of uncertainty already built into the incentive forecast (via the averaging and scaling methodology, and the assumptions that were utilised by Chorus to calculate the forecast incentive amount) was insufficient, and thus required an additional amount added to the total incentive capex allowance for uncertainty in the market.

**Additional information we intend to request from Chorus**

- 3.31 Our draft decision signalled our intent to request information from Chorus to provide:
- 3.31.1 a Connection Forecasting Methodology Report, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and
  - 3.31.2 quarterly updates during the regulatory years 2023 and 2024 on:
    - 3.31.2.1 incentive quantities and expenditure; and
    - 3.31.2.2 connections.
- 3.32 We stated that the purpose of this was to assist us in carrying out our functions and exercise our powers under Part 6 to determine any future individual capex allowance and to determine Chorus' price-quality path (PQ path) for the regulatory period that starts on 1 January 2025 (PQP2). This was necessary as we thought that Chorus needed to improve the quality of its reporting on connection numbers to assist with our assessment of any future capex proposal against the capital expenditure objective and good telecommunications industry practice. Assessment of any future capex proposal will involve analysis of Chorus' connection numbers, and we believe requiring further information will ensure future proposals are of a higher quality.

*Submissions and analysis of submissions*

- 3.33 Chorus submitted against our intent to request additional information. Specifically, Chorus stated:

"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.”<sup>51</sup> and

“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”.<sup>52</sup>

- 3.34 We disagree with Chorus that the information is unnecessary and a doubling of information that has or will be provided. During our assessment of Chorus’ proposal it became clear that the averaging and scaling forecast methodology utilised inadequately represented the structure of incentive payments. In a similar vein the basis for the connection forecasts was not clearly explained, and the analytical approach was undefined. Accordingly, given the fundamental nature of the connections to the incentive forecasts, we consider that the development of a connection forecasting methodology report is appropriate. In addition, due to the dynamic nature of incentive payments we consider that regular reporting of actual payments made is important. As such, due to the manner in which the incentive payments are structured, quarterly reporting is appropriate.
- 3.35 We consider that there is a long-term benefit in seeking this information from Chorus, and that to carry out our functions that further information is required. We consider the information from Chorus will:
- 3.35.1 provide a level of detail on the connection forecasting methodology, including detailing of assumptions and the analytical approach utilised, which to date Chorus has not provided. The connection forecast by product type is a fundamental component of the incentive capex forecasts; and
  - 3.35.2 provide us with a level of currency on the actual incentives payments made and clawback amounts.

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<sup>51</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 8(d).

<sup>52</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 22.

- 3.36 Chorus is correct that Schedule 24 of ID requires it to report information on incentive quantities, incentive expenditure and connections.<sup>53</sup> This information is to be provided twice annually with a monthly break down. Our concern is that the information requested under Schedule 24 will not be granular enough to assist our assessment of future expenditure proposals against the capital expenditure objective. To assist with assessing future capex proposals, we need a level of detail on the connection forecasting methodology, including detailing of assumptions and the analytical approach utilised as well as connection forecast by product type.
- 3.37 Chorus also raised some specific points on our intent to request further information. We respond to the points raised in Table 3.3 below.

**Table 3.3 Specific points raised by Chorus with respect to reporting requirements and our response**

Chorus' submission	Our response
<p><b>“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”.</b><sup>54</sup></p>	<p>Chorus has yet to adequately provide an appropriate level of detail on the mathematical formulation of its connection forecasting methodology. We also consider that providing the forecasting methodology late in 2023 with the PQP2 proposal limits the opportunity for potential improvements to be made prior to the PQP2 proposal. As such we do not consider that it is a double up of reporting, but rather assisting us in carrying out our functions under Part 6.</p>
<p><b>“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”.</b><sup>55</sup></p>	<p>We agree that the benefits of additional disclosures need to be clear and weighted against the costs. We consider that the additional reporting sought is beneficial and the information will be used to determine any future individual capex allowance and to determine Chorus' price-quality path for PQP2. The greater clarity on connection forecasting methodology will allow us and interested parties to assess the appropriateness of the methodology and to propose possible improvements. In any event, Chorus has identified it will develop its approach to forecasting. We think the reporting requirements will bring this forward.</p>
<p><b>“Chorus 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”.</b><sup>56</sup></p>	<p>We agree and have changed our intent to request information for regulatory year 2023 only.</p>

<sup>53</sup> *Fibre Information Disclosure Determination 2021* [2021] NZCC 24, clause 2.3.4

<sup>54</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 24.

<sup>55</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 27.

<sup>56</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 28.

**“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. 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”.<sup>57</sup>**

We agree and have changed our intent to request information for regulatory year 2023 only. We think that requiring Chorus to report on this information quarterly in a level of detail as outlined in paragraph 3.35 will streamline the individual capex process for both the Commission and Chorus by setting a clear expectation of what inputs are required for a capex proposal. This will assist Chorus as this information will be available when it is required for any future capex proposals.

**“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)”.<sup>58</sup>**

The Commission is mindful of the work that goes into compliance with the regulatory regime. Whenever we ask for further information, we consider whether the scrutiny is proportionate.

**“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”.<sup>59</sup>**

As required under s 173(1), we will only make a material amendment to a s 170 determination after we have consulted with interested parties

### *Updated view*

- 3.38 We still intend to issue a request for Chorus to provide the following:
- 3.38.1 a Connection Forecasting Methodology Report, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and
  - 3.38.2 quarterly updates during regulatory year 2023 on:
    - 3.38.2.1 incentive quantities and expenditure; and
    - 3.38.2.2 connections.

<sup>57</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 29.

<sup>58</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 26.

<sup>59</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 30.

- 3.39 This differs from what we set out in our draft decision reasons paper, in that we no longer intend to issue a request for Chorus to provide the quarterly updates during regulatory year 2024. We agree with Chorus that it is more appropriate to require quarterly updates only for regulatory year 2023 as this individual capex proposal only applies to regulatory year 2023.

### **Decision making framework**

- 3.40 Spark submitted on the Commission's approach to incentive payments. Specifically, Spark stated:

"the inclusion of incentive payments is inconsistent with Parliament's intention that the Commission should constrain a regional fibre monopoly from using that monopoly to undermine competition";<sup>60</sup>

"Chorus has incentives to undermine competition in adjacent and nascent competitive markets, and pricing practices will reflect Chorus interests rather than that of competition or end users";<sup>61</sup> and

"incentive payment structure undermines competition by applying solely to the point at which customers are most likely to adopt competitive alternatives and are not in consumer interests because they rely on customer inertia to increase prices over time".<sup>62</sup>

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<sup>60</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 3.

<sup>61</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 4.

<sup>62</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 5.



- 3.41 Spark’s submission on our draft decision repeated similar concerns it raised in its submission on our draft PQ decision in 2021.<sup>63</sup> We disagree with Spark that the inclusion of incentive payments (within the price path) undermines Parliament’s intention. As we noted in our final decisions for PQP1, incentive payments can result in lower average prices where the fixed network costs are recovered over more fibre end-users which can be efficiency enhancing and promotes the outcome in s 162(b) of the Act.<sup>64</sup> We also noted that “much like any proposed expenditure, Chorus may overstate it so that end-users pay for forecast incentive payments that are not made, which would detract from the outcome in s 162(d)”. In relation to s 166(2)(b), we observed that incentive payments are consistent with the behaviour we expect in workably competitive markets in that they can be pro-competitive and benefit end-users or they can be anti-competitive if the level of payment is excessive.<sup>65</sup>
- 3.42 We share Spark’s concern about the potential for Chorus to undermine competition. Therefore, we ensure all incentives pass our economic test: “whether the expected incremental revenue exclusively from the incremental end-users/upgrades that the incentive payments drive outweigh the incremental costs, including the incentive expenditure itself”.<sup>66</sup> As we noted in our final decisions for PQP1, our approach is to assess whether a rational, profit maximising firm could be expected to make the incentive payments absent any benefits that would accrue from anticompetitive or regulatory effects, such as expected higher future prices that result from a lessening of competition, or from the regime allowing recovery of excessive incentive payments.<sup>67</sup>
- 3.43 We do not share Spark’s concern that Chorus’ incentives apply only at “the point at which customers are most likely to adopt competitive alternatives”. As we noted in our final decisions for PQP1, incentive payments are consistent with the behaviour we expect in workably competitive markets as they can be pro-competitive and benefit end-users provided they are not excessive or overstated and provided the recoupment strategy is not to recover the cost of the incentive payments from the whole of the customer base over which the firm enjoys substantial market power.<sup>68</sup>

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<sup>63</sup> Spark “Fibre ID and PQ draft decisions” (5 August 2021), paragraph 36.

<sup>64</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), paragraph C58.

<sup>65</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), paragraph C59.

<sup>66</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), paragraph C62

<sup>67</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), paragraph C61.

<sup>68</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final decision – Reasons paper” (16 December 2021), paragraphs C59 and 62.

### Nature of Chorus' incentives

- 3.44 Spark submitted on the nature of some of Chorus' incentives on offer and the use of a hurdle requirement for participating RSPs. Specifically, the Mix it Up incentive that is paid to RSPs if 85% of new connections/upgrades are to a plan that is 300Mbps or higher.<sup>69</sup>
- 3.45 Spark submitted that the hurdle rate discriminates against RSPs that provide a full range of broadband services and "encourages service providers not to transparently provide services and prices to consumers". Spark argued this incentivises RSPs "to promote higher specification plans in the market".<sup>70</sup>
- 3.46 Spark states that "the hurdle may also undermine the claimed purpose of the incentive payments themselves" as "service providers can meet the threshold by steering customers towards 300Mbps plans, or by promoting alternative technologies such as wireless for customers who demand lower speed services".<sup>71</sup>
- 3.47 By determining an individual capex allowance for regulatory year 2023, the Commission is increasing the 2023 value of commissioned assets used when calculating the wash-up amount. This in turn increases the regulatory asset base (**RAB**) value when calculating the return on capital and depreciation; this influences the maximum allowable revenue in PQP2.
- 3.48 We outlined in our draft decision that the Commission had performed two ex-ante assessments of the proposed expenditure in the individual capex proposal: an economic analysis to assess whether the incentives proposed are likely to be anti-competitive;<sup>72</sup> and checking that the proposed incentives do not clearly breach s 201 of the Act or Chorus' non-discrimination obligations.<sup>73</sup>
- 3.49 It is worth noting that Chorus is not bound by the incentives it has proposed. Chorus is able to modify and adapt any incentives offers to respond to market dynamics.

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<sup>69</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 11.

<sup>70</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 12.

<sup>71</sup> Spark "Chorus' individual capex proposal for customer incentives – draft decision" (1 November 2022), paragraph 17.

<sup>72</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraphs 3.12 to 3.16.

<sup>73</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraphs 3.45 to 3.53.

### The economic test used

3.50 The economic test we apply is whether the expected incremental revenue exclusively from the incremental end-users/upgrades that the incentive payments drive outweigh the incremental costs, including the incentive expenditure itself.<sup>74</sup> Spark submitted on the economic test used to analyse the proposed incentives. Specifically, Spark stated:

“we do not believe that the Commission test is sufficient on its own for determining whether a decision promotes competition or is in end user interests”;<sup>75</sup> and

“even if the Commission were to apply the test as proposed, the proposed approach does not appear to capture all the costs of the pricing strategy” as “Chorus had pro-actively deployed fibre lead-ins to premises for which there was no end user customer service order as part of a fibre ready initiative. This is a significant \$100M+ investment that targets customers either served by alternative providers or likely to be actively considering their broadband options”.<sup>76</sup>

3.51 We disagree with Spark’s reasoning that Chorus’ investment in “fibre lead-ins to premises for which there was no end user customer service order” does not capture all the costs of the pricing strategy. These costs are not incremental as they would be undertaken irrespective of whether Chorus were offering incentives or not.

3.52 We disagree with Spark that our economic test does not promote competition. As we stated in our final decisions for PQP1, we settled on this economic test so we could “assess whether a rational, profit maximising firm could be expected to make the incentive payments absent any benefits that would accrue from anticompetitive or regulatory effects, such as expected higher future prices that result from a lessening of competition, or from the regime allowing recovery of excessive incentive payments”.<sup>77</sup> We believe the test encourages competition by allowing conduct that could be expected in a workably competitive market.

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<sup>74</sup> Commerce Commission “Chorus’ individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper” (18 October 2022), paragraph 1.11.

<sup>75</sup> Spark “Chorus’ individual capex proposal for customer incentives – draft decision” (1 November 2022), paragraph 20.

<sup>76</sup> Spark “Chorus’ individual capex proposal for customer incentives – draft decision” (1 November 2022), paragraph 21.

<sup>77</sup> Commerce Commission “Chorus’ price-quality path from 1 January 2022 – Final Decision – Reasons paper” (16 December 2021), paragraph C61.

### Out of scope submissions

- 3.53 In our draft decision, we specified what we were “not seeking views on the appropriateness of incentive payments within the PQ path”.<sup>78</sup>
- 3.54 Chorus submitted that “individual capex proposals are not well suited to the nature of incentives expenditure”.<sup>79</sup> In lieu of an ICP, Chorus suggested:

“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.”<sup>80</sup>

“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.”<sup>81</sup>

- 3.55 These points raised are out of scope for this decision and we will have regard to them when making our decisions on Chorus’ PQ path for PQP2, starting 1 January 2025.

### Our decision

- 3.56 Our decision is to determine an individual capex allowance for customer incentives for regulatory year 2023 of \$12.5m. We consider this decision meets the capital expenditure objective and reflects good telecommunications industry practice. In considering whether Chorus’ individual capex proposal has met the capital expenditure objective, we have also had regard to the assessment factors in clauses (b), (c), (e), (g), (j), (p) and (t) of the IMs. Chorus’ individual capex allowance is the same as our draft decision from 18 October 2022 and is a reduction of \$4.3m from Chorus’ individual capex proposal. Specifically, the Commission:

- 3.56.1 retains our draft decision for a reduction of \$0.7m to reflect a change to calculating the forecast clawback to align with actual clawback amounts observed in 2020, 2021, and 2022;
- 3.56.2 retains our draft decision to remove \$0.58m of contingency expenditure; and

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<sup>78</sup> Commerce Commission “Chorus’ individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper” (18 October 2022), paragraph 1.18.

<sup>79</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 32.

<sup>80</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 34(a).

<sup>81</sup> Chorus “Submission on incentives ICP draft decision” (1 November 2022), paragraph 34(b).

- 3.56.3 retains our draft decision to remove \$3.0m to reflect the incorporation of 12 months of actual incentive payments made from July 2021 to June 2022. We noted this is equivalent to a reduction in the forecast number of incentive payments to be made in 2023 and reflected a change in the behaviour of the market in respect to the uptake of incentive payments.

*Summary of our assessment to reach our decision*

- 3.57 We have applied the evaluation criteria from the capex IM during our assessment. This requires us to have regard to the relevant assessment factors when considering whether an individual capex proposal met the expenditure objective.<sup>82</sup> We have used the assessment factors to assess Chorus' proposal for prudence and efficiency. Following our assessment, we are satisfied Chorus' proposed expenditure meets the capital expenditure objective and reflects good telecommunications industry practice in all but the following areas:
- 3.57.1 the determination of the clawback amount proposed by Chorus;
  - 3.57.2 the inclusion of a contingency amount within the proposal; and
  - 3.57.3 overestimating the relative number of incentives to be paid in 2023.
- 3.58 As we outlined in our draft decision, our assessment of Chorus' individual capex proposal included:
- 3.58.1 an assessment of the need for the expenditure;<sup>83</sup>
  - 3.58.2 economic analysis including sensitivity and impact analysis of the proposed incentive expenditure;<sup>84</sup>
  - 3.58.3 an assessment of Chorus' approach and reasonableness of the methodology and assumptions used to forecast the proposed incentive expenditure;<sup>85</sup>
  - 3.58.4 assessment of the classification of proposed expenditure as capex;<sup>86</sup> and

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<sup>82</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.8.5(1)(b).

<sup>83</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraph 3.11.

<sup>84</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraphs 3.12 to 3.16.

<sup>85</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraphs 3.17 to 3.40.

<sup>86</sup> Commerce Commission "Chorus' individual capex proposal for customer incentives 2023 – Draft decision – Reasons paper" (18 October 2022), paragraphs 3.41 to 3.44.

3.58.5 compliance:

3.58.5.1 with s 201 and non-discrimination obligations at paragraphs 3.62 to 3.69 below; and

3.58.5.2 of the proposal with the capex IM at paragraphs 3.70 to 3.75 below.

3.59 In evaluating Chorus' individual capex proposal we have applied the evaluation criteria in the capex IM (including the assessment factors). We consider that by applying the evaluation criteria set out in the capex IM, our decision would best give effect to s 166(2) of the Act.

3.60 In addition to determining an individual capex allowance, we intend to issue a request in Q1 2023 for Chorus to provide the following:

3.60.1 a Connection Forecasting Methodology Report by 30 March 2023, which would set out how the connection forecast is calculated, the assumptions used along with how they are derived and the evidence that supports the assumptions; and

3.60.2 quarterly updates during the regulatory year 2023 on:

3.60.2.1 incentive quantities and expenditure; and

3.60.2.2 connections.

## **Section 201 and non-discrimination obligations**

### *Section 201 of the Act – geographically consistent pricing*

3.61 As we stated in our draft decision, we had no reason to consider that the incentives included in the individual capex allowance were likely to cause Chorus to fail to comply with s 201 as the incentives appeared to be available to all RSPs nationally. Further, the incentives did not appear to discriminate on a geographic location. However, we noted that our draft approval of the individual capex allowance did not in any way limit Chorus as to the form of the incentives it offers into the market. In making our decision, this analysis remains unchanged.

3.62 Chorus explained in detail the measures it took to ensure compliance with s 201 in its final proposal. Chorus subjected all proposed incentive offers to an internal legal review to ensure compliance with s 201. Specifically, this process involved:

3.62.1 assessing whether incentives are available to all RSPs on the same terms;

- 3.62.2 assessing whether any particular RSP or group of RSPs would be advantaged or disadvantaged by the incentive or the way the incentive is structured; and
  - 3.62.3 ensuring incentives are not determined by location but are available nationally.
- 3.63 Having subjected the proposed incentives to this legal review, Chorus certifies that the incentives proposed for 2023 comply with s 201.
- 3.64 Nevertheless we looked at the conditions associated with the proposed incentive payments for 2023. There appeared to be nothing in the conditions associated with the proposed incentives, as described by Chorus within the final proposal, to suggest they are not available to all RSPs nationally or discriminate on a geographic location.
- 3.65 In regard to the incentive offers currently in the market, we issued Chorus with a notice under s 193(2) of the Act as part of our final decisions for PQP1. The notice required Chorus to submit a half-yearly compliance statement signed by a director that included:<sup>87</sup>
- 3.65.1 a summary of the processes Chorus has taken to ensure its prices charged for FFLAS, including any incentives, comply with s 201; and
  - 3.65.2 a statement about whether Chorus has complied with s 201.
- 3.66 Chorus submitted its compliance statement for the half-year ending 30 June 2022 stating compliance on 29 July 2022. We have not done any further investigation into the validity of Chorus' statement at this time.
- 3.67 We note that Chorus stated that it plans its incentives for its financial year (July to June). Therefore, Chorus' incentive planning beyond June 2023 is limited, and further planning for incentives into financial year 2024 (July 2023 to June 2024) will be done closer to the time.

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<sup>87</sup> Commerce Commission "Notice to supply information to the Commerce Commission under section 193(2) of the Telecommunications Act 2001 – Compliance statements for the first regulatory period" (16 December 2021), clause A7 of Attachment A.

### *Non-discrimination and equivalence obligation*

3.68 As stated in our draft decision, we looked at the conditions associated with the proposed incentive payments for 2023. We are satisfied the information provided gives no evidence of access seekers being treated differently to one another with respect to incentive payments. However, as with our ex-ante s 201 assessment, we note that our ex-ante approval of the individual capex allowance does not in any way limit Chorus as to the form of the incentives it offers into the market.

### **Compliance with capex IM**

- 3.69 As we stated in our draft decision, the capex IM sets out the key requirements that an individual capex proposal must contain. The final proposal must be in accordance with the approved timeframes specified in the design proposal and consistent with the key parameters, information requirements, assurance processes and any conditions approved by the Commission in relation to the design proposal.<sup>88</sup> In making our decision, this analysis remains unchanged.
- 3.70 We approved Chorus' design proposal with conditions on 5 May 2022. Attachment A of our letter to Chorus specified the additional information we required as part of our approval.<sup>89</sup>
- 3.71 We assessed the information provided in the proposal against the following requirements:
- 3.71.1 approved timeframes;
  - 3.71.2 key parameters of the proposal;
  - 3.71.3 information requirements of proposal; and
  - 3.71.4 assurance requirements of proposal.
- 3.72 Following an assessment of the final proposal, we considered that the information provided within the final proposal provided sufficient information for us to consider whether the proposed capex meets the capital expenditure objective and reflects good telecommunications industry practice under clause 3.8.5(1) of the IMs.

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<sup>88</sup> *Fibre Input Methodologies Determination 2020*, as amended on 29 November 2021, clause 3.7.25.

<sup>89</sup> Commerce Commission "Approval of Chorus' individual capex design proposal for incentive payment capex 2023" (5 May 2022), Attachment A..



- 3.73 In a small number of instances, Chorus did not provide information or did not provide sufficiently detailed information. We are of the view that this is not a sufficient reason to decline the proposal as the information provided allowed us to consider whether the proposed capex meets the capital expenditure objective and reflects good telecommunications industry practice under clause 3.8.5(1) of the IMs. Some of the areas where information was not provided were less relevant to the nature of the capex incorporated within the proposal (for example, incentive payments do not affect PQ FFLAS quality).
- 3.74 We sought and were provided information via a subsequent request for information (RFI) issued to Chorus to clarify one of the requirements during our evaluation of Chorus' final proposal.