Economic principles potentially relevant to our new regime

- Economic principles help us make decisions that promote the long-term benefit of end-users and provide regulatory predictability. These can help when we set the fibre input methodologies (IMs).
- Economic principles help us regulate utility sectors under Part 4 of the Commerce Act 1986 (Part 4).
- The purpose of Part 6 of the Telecommunications Act 2001 (Act) already guides our decision-making.
- We want your views on whether, and to what extent, having economic principles is beneficial in developing and applying the regulatory regime for fibre to give effect to the purpose.

In the invitation to comment on our proposed approach, we asked stakeholders:

Q7 How relevant to the fibre IMs are the three key economic principles used under Part 4?

Q8 How does the prospect of infrastructure-based and access-based competition affect the application of the three economic principles in the fibre IMs?

Q9 What other economic principles should we have regard to when developing the fibre IMs? Eg, should we include pricing efficiency as an economic principle for fibre?

What principles have we applied in Part 4?

- **Real financial capital maintenance (FCM):** a regulated supplier can earn profits that compensate for its cost of capital over time (considering its exposure to risk)—ie, to earn a 'normal return'. Allowing a regulated supplier the opportunity (but not guarantee) to earn normal returns over the lifetime of an investment provides it with a chance to maintain the financial capital it has invested, thus maintaining incentives to invest.
- **Allocation of risk**: ideally, we allocate risks to suppliers or consumers depending on who is most able to manage the risk, unless doing so would be inconsistent with the Part 4 purpose. Appropriate risk allocation and compensation maintains incentives to invest and promotes efficient behaviour.
- **Asymmetric consequences of over and under-investment:** we apply FCM recognising the asymmetric consequences to consumers of regulated energy services, over the long term, of under-investment versus over-investment.

What are the main differences between fibre and utilities regulated under Part 4?

- The potential for infrastructure-based competition to emerge is generally greater in the telecommunications sector. For example, wireless services may be substitutes for fibre access services in certain market segments.
- There is also greater potential for access-based competition. As fibre service providers offer a suite of access products, the relative prices for wholesale services will affect RSPs' decisions on how to deliver retail services to end-users.
- The Act gives us sole responsibility for pricing methodologies. This contrasts with electricity lines services, where the Electricity Authority has the power to set pricing methodologies.
- Along with the s 162 purpose, Part 6 of the Act contains an additional purpose provision in s 166(2)(b). This additional purpose may influence how we apply economic principles.

How do these differences affect our principles?

- Allocation of economic stranding risk and application of FCM may be particularly challenging. Eg, we may need to identify and remove relevant assets from the regulated asset base if:
    - ex ante compensation is provided for asset stranding risk, and some assets are subsequently stranded; or
    - workable competition develops in certain areas, leading to de-regulation.
- The appropriate allocation of, and compensation for, the risk of economic stranding is likely to be an important factor when considering whether suppliers have a reasonable ex ante expectation of a normal return (consistent with the FCM principle).
- Pricing efficiency may be more relevant for fibre than other sectors we regulate.
- Ideally, prices should promote efficient investment from fibre service providers, retail service providers (RSPs), and alternative network operators, to the extent this promotes the long-term benefit of end-users. Also, there are several provisions in the Act that are likely to impact on pricing efficiency by Chorus, especially in the initial regulatory period(s).