

One NZ submission on the draft decision on Chorus' expenditure allowance for PQP2

16 May 2024

Introduction

1. We welcome the opportunity to comment on the Commerce Commission's (the Commission) draft decision on Chorus' expenditure allowance for the 2025-2028 price-quality path regulatory period (PQP2). Our submission is focused on the aspects of Chorus' proposal relating to marketing, resilience, customer incentives and access capex.
2. To the extent that the Maximum Allowable Revenue (MAR) enables increased charges by Chorus, the dynamics of competitive markets mean that these will typically be passed through to end users of fibre services. In its determination of Chorus' for PQP2, the Commission therefore needs to be convinced that all elements of expenditure deliver real and tangible end user benefits, as well as ensuring that the expenditure best gives, or is likely to best give, effect:
 - a. to the purpose in s 162 of the Telecommunications Act 2001 (the Act), as specified in s 166(2)(a) of the Act; and
 - b. to the promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services, as specified in s 166(2)(b) of the Act.

Product, sales and marketing

3. Chorus has proposed to spend \$115.3m on product, sales and marketing over the 2025-28 period. Total proposed opex spending in this area is greater than both network operations and technology opex. It appears that marketing spend will constitute a significant chunk of this, with Chorus historically spending around \$13m on marketing annually.
4. We welcome the Commission's draft decision that Chorus' advertising expenditure should not be trended in accordance with connection growth. Chorus' advertising activity must be

limited to raising consumer awareness of the existence of fibre technology. There is therefore no justification for Chorus to link the level of advertising spending to connection growth.

5. Nevertheless, this draft decision represents a reduction of less than 4% of Chorus' total advertising spend. We are disappointed that the Commission did not 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.' The independent verifier concluded that 'such a piece of analysis is necessary in definitively determining if prudence and efficiency are satisfied.'¹ The Commission appears to accept that this is a necessary exercise, with the draft decision paper stating that 'Chorus should be looking to improve the economic analysis that supports the proposal. We expect Chorus to consider developing approaches in the lead up to PQP3 to illustrate the economic benefit from expenditure such as marketing including incorporating aspects such as the expected return on investment.'²
6. However, despite accepting that a full economic analysis of marketing expenditure is required, the Commission's assessment of this part of the proposal only extended to testing it 'at a high level' and comparing Chorus' proposed advertising spend with Spark's advertising spend on a per connection basis. The Commission has concluded that 'Spark's advertising spend was greater, suggesting that the Chorus proposal was not obviously excessive.' This is not sufficient to determine if the prudence and efficiency tests are met, as required under the Act. This 'ready reckoner' approach also misses the point that Spark occupies a fundamentally different position within overall market structure to Chorus. Spark and other service providers must win broadband end users within a highly competitive downstream market. In contrast, Chorus is an inevitable trading partner for any service provider who wants to provide national broadband services. It is in a fundamentally different

¹ https://comcom.govt.nz/_data/assets/pdf_file/0025/334249/13.-Chorus-C2A0Report-from-the-Independent-Verifier.pdf, p. 234

² Chorus' expenditure allowances for the second regulatory period (2025 – 2028), Draft decision – Reasons paper, p. 154

position and, in this context, there is no justification for testing Chorus' proposed marketing spend against that of Spark or any other retail service provider.

7. As we said in our previous submission on Chorus' proposed expenditure, 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. At a minimum, if the Commission is minded to accept Chorus' proposals without independent supporting evidence, it must take steps to ensure that Chorus is subject to the same broadband marketing rules that apply to retailers. As we've raised on multiple occasions, Chorus generates a vast quantity of direct-to-consumer advertising that is specifically intended to influence the choices made by end users regarding alternative broadband services. Chorus' expenditure proposal does not suggest any reduction in this activity. In fact, Chorus' strategy to be an 'active wholesaler' and to promote consumer uptake of Hyperfibre implies an increase in direct-to-consumer marketing that is specifically intended to induce end users to move to higher cost fibre services that they may or may not need.
8. For example, in a recent speech at the TUANZ Rural Connectivity Symposium, Chorus' General Manager, Fibre Frontier said that as copper is withdrawn across New Zealand, Chorus is contacting end users directly by mail asking if they want to sign up to fibre,³ and Chorus is currently sending letters directly to end users that make a number of claims regarding the comparative benefits of different technologies (see Annex A). Chorus is not currently subject to the Commission's guidelines relating to marketing of alternative services during copper transition, nor the TCF Copper/PSTN Transition Code that was developed in response to these guidelines. As a retailer that is subject to these rules, we would not be able to communicate with end users to promote one access technology over another. For example, we cannot send communications to end users asking if they want to sign up to a fixed wireless service and promote the merits of a fixed wireless service over other technologies (such as

³ TUANZ Rural Connectivity Symposium, speech by Anna Mitchell, General Manager, Fibre Frontier at Chorus, 7 May 2024

ease of install, price and end users' usage needs). Instead, in our communications to end users, we are required to provide details of all of the alternative technologies available to the customer and not promote one technology over another⁴. On the other hand, Chorus is clearly promoting fibre over other technologies in its communications, and is referring customers to a 'Broadband Compare' webpage that is disguised as a Chorus website and displays fibre plans as the only options, even though other technologies are available to consumers.⁵ For there to be a genuine level playing field, Chorus must also be required to tell end users that other alternative technologies may be available to them when sending direct-to-consumer communications and not actively promote fibre over other options. This is yet another example (in addition to the others outlined in our previous submission) of how the asymmetric regulatory conditions are showing up in the market and are distorting competition, which is contrary to the purpose in s166(2) of the Act. As a steward of the overall regulatory scheme for telecommunications, this isn't a reality that the Commission should continue to enable or tolerate.

9. The Commission cannot on the one hand allow Chorus to offset significant marketing spending against the MAR while on the other hand continuing to allow Chorus to conduct its direct-to-consumer marketing activity outside of the broadband marketing regulatory framework that retailers are subject to. As we've previously stated, setting conditions around marketing standards on expenditure in this area would be consistent with the purpose of the Act being to promote competition in telecommunications markets for the long-term benefit of end-users.

⁴ The Commission's guidelines state that it 'is important so that consumers are made aware of the full range of options available to them when being presented with offers to move to alternative telecommunications services.' *Marketing alternative telecommunications services during the transition away from copper, Guidelines to the telecommunication industry under section 234 of the Telecommunications Act 2001*, p. 7

⁵ www.chorus.co.nz/get-fibre

Incentive payments

10. While we believe that the Commission shouldn't allow incentive payments to be included in Chorus' capex allowance, we welcome the Commission's draft decision to include this for the first year of PQP2 only. We continue to hold the view (backed by independent experts Frontier Economics, as shared with the Commission previously⁶) that allowing incentive payments as part of capex for the purpose of determining the MAR would enable Chorus to earn monopoly profit by resulting in increased revenue allowance exceeding the normal rate of profit. Allowing Chorus to include incentive payments as part of capex 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.
11. As outlined in our previous submission, Chorus' incentives have to date not been about creating awareness of fibre availability, but instead aimed at influencing (and distorting) choices made by end users in a competitive downstream market. PQP2 outcomes that enable Chorus to distort competition in favour of its own fibre network are inconsistent with the purpose of the Act. This is the case regardless of whether incentives are attractive to access seekers: they distort competition in favour of one access technology relative to other technologies (e.g. by subsidising or reducing 'list price' for Layer 2 services). Allowances need to be considered in light of Chorus' 'active wholesaler' intent and desire to grow hyperfibre connections. This strategy creates high potential to fund and enable misselling.
12. Allowance for incentives is also not consistent with relevant criteria as set out in Fibre IMs. They are not an efficient cost that a prudent fibre network operator would incur to deliver PQ

⁶ https://comcom.govt.nz/_data/assets/pdf_file/0038/339968/One-NZ-Chorus-PQP2-expenditure-proposal-submission-14-December-2023.pdf

FFLAS of appropriate quality, during the relevant regulatory period and over the longer term and not consistent with good telecommunications industry practice.

Resilience

13. As noted in our previous submission, we support investment in the telecommunications sector to achieve resilience outcomes and support Chorus' proposal to fund resilience in principle, subject to spending being allocated to projects and programmes that have genuine resilience outcomes. We welcome the Commission's recognition that 'significant investment in resilience should still consider the costs and benefits of the investment and where the costs are significantly high, better alternatives may be appropriate.'⁷
14. We continue to hold the view that Chorus should be required to engage with access seekers on specific proposed projects and programmes to establish demand/support ahead of committing spend - Chorus should run a written consultation process on resilience initiatives before they are finalised. This approach will assist in providing transparency as to whether resilience expenditure is consistent with forecast demand.
15. We have also previously suggested that Chorus could be required to submit an 'individual capex' proposal for expenditure on resilience projects. We note that the Commission's draft decision includes a 33% reduction in Chorus' proposed investment in resilience. The reduction is specific to dual fibre paths projects. We consider that an individual capex proposal would be suitable for this expenditure as it will need to be scoped out and evaluated on a project-by-project basis.

Network capacity: access capex

16. We welcome the Commission's draft decision to reduce Chorus' proposed ONT access capex by \$56.1m in PQP2, based on the Commission's own hyperfibre demand forecasts. We agree
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⁷ Chorus' expenditure allowances for the second regulatory period (2025 – 2028), Draft decision – Reasons paper, p. 121

with the Commission and the independent verifier that there is significant uncertainty in relation to timing and rate of hyperfibre uptake. Chorus forecast a significant increase in hyperfibre demand in PQP2. This does not appear to be consistent with the actual historic hyperfibre demand levels, as recognised by the Commission.

17. We note the Commission’s decision not to adjust expenditure allowance for new connections in light of the changes to Chorus’ fibre frontier programme, which will result in 9,958 fewer new connections in the PQP2 period than anticipated by Chorus in its initial expenditure proposal. The draft decision paper states that the Commission considers ‘that the reduction in connections included in the new information regarding Chorus’ fibre frontier investment may have a flow on impact on access capex. However, we consider that we don’t have a good basis for estimating the change in capex associated with the reduction in connections.’⁸ We agree with the Commission’s view that the reduction in connections is likely to have a flow on impact on access capex as there will be fewer new installations required hence resulting in a reduced capex required for this activity. It would not be prudent for the Commission to approve Chorus’ initial proposal based solely on the fact that it doesn’t have a ‘good basis’ for determining the level of capex adjustment required. We urge the Commission to carry out appropriate analysis and request additional information from Chorus if that is needed to make a fully informed decision on this matter.
18. Please contact the following regarding any aspect of this submission.

[Redacted]

Head of Legal and Regulatory

[Redacted]

[Redacted]

Senior Public Policy Advisor

e [Redacted]

⁸ Chorus’ expenditure allowances for the second regulatory period (2025 – 2028), Draft decision – Reasons paper, p.97

ANNEX A

Examples of direct mail communications that Chorus is currently sending directly to end users

**Farewell
the freeze face
with fibre.**



New Zealand Permit No. 245749



If undelivered please return to:
Chorus, PO Box 6640, Auckland 1010

<Code>

To The Householder
<Sample Street>
<Sample Suburb>
<Sample City XXXX>

**NEW ZEALAND
RUNS ON FIBRE**
CHORUS

CHORUS

Farewell the freeze face with fibre.



Hi there,

We've all been there. You're in the middle of an important video call and – bang – freeze face. It's not ideal – meaning a fast, reliable internet connection is more important than ever. And while it can be easy to think that all internet is the same, not all broadband is created equal.

Get connected to fibre broadband for a fast, reliable internet connection.

Recent reports^A show that when it comes to performance, that faster fibre broadband plans lead the way. That's because as a direct and dedicated line, fibre hits your place with little interruption and interference. It might be that you're on wireless broadband right now, which might work just fine most of the time. However in peak hours when lots of households are online, performance can be impacted. That's because wireless broadband uses mobile data from the nearest cell tower, which gets shared between your neighbourhood.

Similarly, bad weather can also impact wireless technology, as the radio waves that carry the mobile data to households are unprotected and open to the elements.

Find a fibre plan to suit you – from as little as \$50 a month.*

With over 90 fibre providers out there, we know choosing one can feel a little overwhelming. Broadband Compare is an easy way to check plans and prices. Visit them at www.chorus.co.nz/get-fibre or call them on 0800 000 305 and choose a fibre broadband plan that works for you.

Regards,
The team at Chorus



Fibre offers the fastest broadband plans available but there's a lot that contributes to actual speeds experienced. Learn more at chorus.co.nz/broadband-performance

^A MBNZ Spring 2024 report.

*Fibre plan cost indication based on availability as at 11 April 2024 of a fibre plan bundled with another service from the same provider.

CHORUS

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Get connected to fibre broadband for a fast, reliable internet connection.

Recent reports^A show that when it comes to speed and reliability, that faster fibre broadband plans lead the way. This superior performance comes from a direct and dedicated line that connects straight to your fibre box. The good news is it looks like you already have a fibre box installed, which means you're just one step away from fast and reliable internet.

Find a fibre plan to suit you – from as little as \$50 per month.*

With over 90 fibre providers out there, we know choosing one can feel a little overwhelming. Broadband Compare is an easy way to check plans and prices. Visit them at www.chorus.co.nz/get-fibre or call them on 0800 000 305 and choose a fibre broadband plan that works for you.

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