

5 May 2022

Julian Kersey
Chorus Limited
Level 10 Aon Centre
1 Willis Street
Wellington 6011

Dear Julian,

Approval of Chorus' individual capex design proposal for incentive payment capex 2023

Purpose of this letter

We write further to your letter of 6 April 2022 notifying the Commission of the intention of Chorus Limited (**Chorus**) to submit an individual capex proposal and including a design proposal for its incentive payments for 2023.

The purpose of this letter is to inform you of our decision to approve with conditions Chorus' individual capex design proposal (**design proposal**) for incentive payment capex for 2023.

Background

The Commission finalised Chorus' price-quality (**PQ**) path for the first regulatory period starting 1 January 2022 to 31 December 2024 (**PQP1**) on 16 December 2022. As part of our PQ decision we made decisions about Chorus' expenditure allowance. We decided to include incentive payment expenditure in the base capex allowance for 2022 only. We also decided that, for incentive payments for 2023 and 2024 to be included in its revenue path, Chorus would have to submit an individual capex proposal for approval.¹

Incentive payments are payments that Chorus makes to retail service providers (RSPs) to incentivise acquisition of new customers to its fibre network or to incentivise customers to upgrade to new services.²

¹ Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper" (16 December 2021), para C4.

² Commerce Commission "Chorus' price-quality path from 1 January 2022 – Final decision – Reasons paper" (16 December 2021), para C57.

The fibre input methodologies (**IMs**) outline the process for approving individual capex and prescribes a two-stage process.³ Chorus is required to notify the Commission of its intention to submit an individual capex proposal (**final proposal**) by first submitting a design proposal with the notice. The design proposal must include a description of the key parameters of the individual capex project; the proposed information to be provided in the final proposal; the assurance process to be undertaken; and the proposed timeframe for the final proposal.⁴

This process was designed to allow for flexibility to ensure the timely approval of the proposed individual capex. Given the potentially diverse nature of individual capex proposals, the design proposal stage enables the Commission to request the information required to assess an individual capex proposal on a case-by-case basis.

Chorus' individual capex design proposal

Chorus' design proposal:

- notifies the Commission of Chorus' intention to make a final proposal for customer incentive capex for 2023. Chorus expects that the amount will be slightly higher than the amount that was proposed for 2023 in its PQP1 expenditure proposal (~\$14.5m);
- summarises how customer incentives support Chorus' growth strategy and deliver benefits to end-users and retail service providers (RSPs);
- confirms Chorus' intention to roll over its current core incentive offers into 2023;
- confirms that Chorus will take steps to ensure the incentives are compliant with its non-discrimination and geographic consistent pricing obligations;
- proposes that the Commission waive the requirement for the final proposal to undergo independent verification on the grounds that:
 - this is not a technical capital investment, so the value added by a verifier review is minimal and does not justify the cost or delay;
 - the expenditure amount is low;
 - the proposal relates to a single expenditure type (which the Commission has considered for PQP1); and
 - this would expedite the process which will increase certainty;
- summarises the information that Chorus proposes to include in the final proposal; and

³ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.22.

⁴ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.23(2).

- proposes to submit the final proposal to the Commission by 30 June 2022.

Our decision

Our decision is to approve Chorus' design proposal with conditions in accordance with cl 3.7.24(1)(b) of the fibre IMs.⁵ The conditions attached to our approval of the design proposal require Chorus to provide additional information to that included in its design proposal. Attachment A of this letter specifies the additional information we require Chorus to include in its final proposal.

Having considered the material put to us:

- we consider the key parameters outlined in the design proposal are sufficient;
- we consider the breadth of information requirements proposed by Chorus to be appropriate. However, we consider greater specificity is required in some areas to enable evaluation of Chorus' individual capex proposal. We have therefore specified additional information requirements in Attachment A to this letter, in accordance with cl 3.7.26(1) of the fibre IMs;⁶
- we have decided to waive the requirement for independent verification in accordance with cl 3.7.24(2) of the fibre IMs;⁷
- we consider Chorus' proposed timeline to submit the final proposal to the Commission by 30 June 2022 is appropriate; and
- we have decided to undertake a two-week consultation on our draft decision on Chorus' final proposal in Q3 2022 in accordance with cl 3.8.4(2) of the fibre IMs.

Reasons for decisions

We consider that Chorus' design proposal sufficiently meets the fibre IM requirements for it to be approved with conditions. The specific reasons for our decision to approve with conditions are:

- general requirements for an individual capex design proposal – we consider Chorus' individual capex design proposal meets the eligibility criteria for individual capex and the specific requirements for a design proposal specified in the fibre IMs;⁸
- information requirements – we consider that additional detail is required to ensure Chorus' final proposal contains sufficient information for the Commission to assess the proposal against the evaluation criteria specified in the fibre IMs.⁹ The additional

⁵ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.24(1).

⁶ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.26(1).

⁷ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.24(2).

⁸ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.22-3.7.28.

⁹ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.8.5.

information we specify in Attachment A covers information required for the Commission to:

- undertake economic analysis of the proposed level of incentive payments;
 - test assumptions and inputs used by Chorus to forecast its forecast incentive capex allowance; and
 - test whether the proposed capex complies with all applicable legal and regulatory obligations associated with the provision of PQ FFLAS.
- independent verification requirement – we consider Chorus has provided sufficient information and reasons in its design proposal for the Commission to justify waiving the requirement for an independent verification. Specifically, we consider that:
 - the size and complexity of the proposed individual capex does not justify additional scrutiny by way of independent verification; and
 - a similar proposal for 2023 incentive capex was assessed in 2021 as part of the PQP1 evaluation. We consider that in this instance we will have sufficient information and assurance on Chorus’ proposal, and an independent verifier report is unlikely to add significant value to the Commission’s evaluation of the individual capex allowance.
 - draft consultation – we consider that the relative complexity, the size of the expenditure and the previous degree of consultation by the Commission on the issue of incentive payments in 2021 may warrant excluding consultation on a draft decision. However, Chorus’ design proposal and final proposals may introduce new information that other parties should have an opportunity to provide views on. Additionally, we consider this issue is of relatively high importance to stakeholders. We therefore consider a two-week consultation balances the need for transparency with the need to make decisions as quickly as practicable.

Next steps

Chorus must submit its final proposal for incentive capex by **30 June 2022**. The final proposal must meet the requirements specified in its design proposal as well as the additional information requirements specified in Attachment A to this letter.

Chorus’ final proposal must also include:¹⁰

- certification from the CEO of Chorus; and
- a statement from an external auditor:

¹⁰ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.7.27(4)-(5).

- that the individual capex proposal complies, in all material respects, with the information requirements, key parameters and conditions in the approved individual capex design proposal; and
- on whether the proposed individual capex is additional to and not a substitute for the determined base capex allowance.

Failure to meet the requirements above may delay the Commission's evaluation and potentially result in the final proposal being declined in accordance with clause 3.7.28(1)(c) of the fibre IMs.

Once we have received Chorus' final proposal, we will assess it against the evaluation criteria in the fibre IMs.¹¹ We will aim to consult on our draft decision on Chorus' final proposal in Q3 2022.

Please note that we will publish this letter on our website in accordance with our customary practice after it has been sent to you.

Yours sincerely



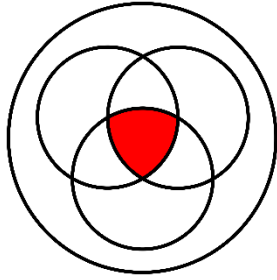
Tristan Gilbertson
Telecommunications Commissioner

Encl.

¹¹ *Fibre Input Methodologies Determination 2020* [2020] NZCC 21, clause 3.8.5.

Attachment A: additional information requirements to Chorus individual capex design proposal

1. When it submits its final proposal, Chorus must include the information specified below in accordance with cl 3.7.26 of the fibre IMs. This information must be provided in addition to the information requirements outlined in para 51 of its individual capex design proposal.
2. Chorus must provide the following information in its final proposal:
 - 2.1 an overview of the incentive payments capex Chorus proposes for 2023, including:
 - 2.1.1 an overview of the incentive payment plans Chorus intends to offer in 2023 including guiding design principles, and structure of the different incentive payments;
 - 2.1.2 an estimate of the individual incentive amounts offered to RSPs for each relevant incentive plan; and
 - 2.1.3 typical conditions related to the plans offered to RSPs;
 - 2.2 a description of the approach to forecasting customer incentives expenditure, including assumptions and information used to test the forecasts, including but not limited to:
 - 2.2.1 a description of the assumptions, inputs used and approach to determining the amount of incentive capex that Chorus expects to claw back from RSPs during 2023;
 - 2.2.2 a description of the assumptions, inputs used and approach to determining the forecast uptake (number of end-users acquired) that is expected as a result of the proposed incentive payment capex; and
 - 2.2.3 a description of the assumptions, inputs used and approach to determining the average expected retention for every successful end-user acquired/up-sold (ie amount of time);
 - 2.3 additional data to support our economic analysis of the proposed incentive payments. This will include:
 - 2.3.1 latest data on the proportion of premises that (A) are passed; and (B) are not connected; and (C) have an existing lead-in. For the avoidance of doubt, this is the intersection of A, B and C, denoted by $A \cap B \cap C$, represented by the red area in the figure below:



- 2.3.2 the latest forecast number of new connection incentives (ie number, not \$ amount). Or, if unavailable, forecast number of GPON connections; and
- 2.3.3 the latest forecast number of upgrade incentives (ie number, not \$ amount). Or, if unavailable, forecast number of upgrades (excluding the mass 100-to-300 Mbps upgrade);
- 2.3.4 the model/s Chorus has used to:
- (a) forecast the amount proposed in the individual capex proposal; and
 - (b) estimate the net benefit for incentive credits Chorus expect to offer in 2023;
- 2.3.5 the expected lifetime for connection lead-ins;
- 2.3.6 the average cost for every successful end-user acquired/up-sold. This should include the cost of a lead-in and any other material incremental costs; and
- 2.3.7 a description and breakdown of any cost escalation factors applied to the forecast individual capex and whether the approach has varied from the approach used by Chorus to calculate cost escalators for similar expenditure in its PQP1 expenditure proposal;
- 2.4 with respect to information provided by Chorus under paragraph 51(e) of its design proposal and information requirements included in para 2.3 of this attachment, Chorus must ensure all the costs and revenue estimates relate to the same time period and expressed in the same unit (e.g. monthly costs and ARPU).
3. Chorus must provide the following information instead of 51(e)(iv) in its design proposal:
- 3.1 The forecast uptake (number of end-users acquired) that is expected as a result of the proposed customer incentives capex for:

- 3.1.1 new connections;
- 3.1.2 intact new connections;
- 3.1.3 incremental upgrades; and
- 3.1.4 any other connection type used by Chorus to forecast incentive capex.