Fibre price-quality regulation: process and approach for the 2025-2028 regulatory period

Submission | Commerce Commission

14 December 2023

Contents

Introduction

1. Thank you for the opportunity to provide feedback on the Commission's proposed approach to determining Chorus' price-quality path for the 2025 – 2028 regulatory period (**the draft**).

2. In this submission we have focused on:

   a. The importance of considering the implications of the expenditure proposal in the context of the current regulatory framework.

   b. Consideration of proposed resiliency and fibre expansion investment, and

   c. Proposes to wind back competition protections through blanket approval of connection incentive expenditure.

Chorus expenditure proposal

3. The Commission earlier set out some of the key decisions it expects to make in its process and approach paper – i.e., setting efficiency incentives, cost allocations, revenue smoothing and approving major new investments – and Chorus' proposal highlights the importance of those decisions.

4. Chorus' expenditure proposal signals a business-as-usual approach that – on the face of it - anticipates no real change in the fibre service delivery model and increasing costs and prices over the second regulatory period.

5. However, at the same time as the Commission has signalled an increased MAR[1], Chorus plans to transition to a fibre only operating model, commentators are starting to question consumer prices delivered by the current regulatory settings[2], we face uncertain demand[3] and current regulatory settings are being challenged. For example:

   a. Chorus is already well down the path to a fibre only business. Chorus reports that copper connections fell by 30% last financial year (from 345,000 to 240,000), 30,000 copper withdrawal notices have been submitted, and 544 broadband cabinets closed[4]. Chorus also stopped selling new copper voice and broadband services in fibre areas from June 2023, stopped accepting new copper build requests nationally in July 2023, and in November Chorus gave RSPs notice that it intends to retire CMAR and countryset systems by the end of 2025.

   b. The Government and critical infrastructure providers are expected to undertake substantive resiliency programmes: Government will have implemented a new resiliency framework and reforms[5].

[1] The Commission signalled in its process and approach paper that higher-than-expected inflation (higher value RAB), increased WACC, anticipated repayment of Crown financing, exhaustion of regulatory tax losses and changes to the allocation of shared costs as end-users migrate from the copper business all contribute to a higher MAR for the second regulatory period.
[2] For example, Mike Hosking - referencing a Picodi benchmarking study - observed that NZ prices stack up poorly against many countries. Mike Hosking Breakfast at 06:56 a.m. 28 Nov 2023
[3] For example, the ACCC earlier this week reported total Australian fixed broadband internet connections falling and a slowing down in fixed data demand growth.
[4] Chorus FY23 annual report at 1.3
[5] The Government is currently implementing a new resiliency framework - including through the Cyclone Gabrielle Recovery taskforce, Emergency Management Bill and DPMC Critical Infrastructure reforms – that better recognises the inter-connected nature of critical infrastructure and anticipated risks

c. Operators are deploying next generation broadband technologies. We will likely see the impact of new wireless and satellite broadband technologies on the market over PQP2. Operators are currently deploying several competing 5G and satellite systems and, while we do not know the full extent of their impact, the upgraded services will likely be attractive option for an increasing number of end-users. Spark has committed to accelerating deployment of its 5G network, aiming to expand 5G connectivity to all towns with a population of more than 1,500 people by the end of June 2026 using the recently allocated C-band spectrum, and

d. Chorus has indicated that it does not expect to achieve its MAR in the second regulatory period due to anchor service prices constraining revenues and has expressed concerns at the outcomes delivered by a competitive fibre retailer market.

6. We agree there are increasing uncertainties and tensions within the regulatory framework and that, in our view, Chorus' regulatory approach and past Commission decisions have likely contributed to these tensions.

7. As set out in our previous submission, we believe the Commission should take a cautious approach in considering the expenditure proposal, informed by benchmarking and a view of a future wholesale only fibre operating model and likely cost structure. It should also consider how it might ensure it has the flexibility within the current regulatory framework to respond to these uncertainties. For example, we are also concerned that the regulatory framework leaves Chorus unable to achieve the MAR and the Commission should review anchor service pricing.

Resiliency

8. Chorus proposes to spend $79.7 million to – primarily – instal dual fibre cable routes to UFB service areas.

9. We support Chorus' increased focus on resiliency. We also see increasing demand for resilient services from our customers and Government. Accordingly, resiliency is a priority for our business, and we invest over $100 million annually to improve the resiliency of our services. However, the expenditure proposal risks being disconnected from wider reforms and may result in inefficient investment. For example:

a. As detailed earlier, the Government is implementing a new resiliency framework that recognises the inter-dependency between critical infrastructures[6]. However, while the Commission is being asked to approve Chorus expenditure, the necessary critical infrastructure engagement and planning to implement the reforms has yet to occur. We can't be assured the proposed investment remains focused on the highest value projects as the planning has yet to be done.

b. It is unclear whether the proposal forms part of existing funded programmes – a concern One.NZ set out in its earlier submission. The proposal refers[7] to the IM availability quality standard and service level agreements as key drivers which, on the face of it, are already funded through the current price path.

c. The proposal does not appear to recognise co-investment opportunities. Other critical infrastructure providers are also investing to improve the resiliency of their

[6] Proposals are set out in the Emergency Management Bill and DPMC Strengthening Resiliency consultation paper. The Te Waihanga infrastructure strategy and New Zealand's National Adaptation Plan for climate change both recommend taking a coordinated, systematic approach to building infrastructure resilience.
[7] At 7.6.3

networks and there are likely to be synergies that will make the proposed investment go further. For example, Spark also has a fibre investment programme and, depending on the route, may co-invest in a project that would enable FFLAS resiliency investment to go further, and

10. We believe it will be difficult to determine – considering these uncertainties - whether the proposal is well targeted to maximise the benefits to end users. As set out in our earlier submission, our preference is that the Commission consider substantive new resiliency investment via an individual capex proposal once the necessary government reforms and supporting planning have been completed. The reforms and planning are likely to be completed through 2024.

11. Nonetheless, if the Commission decides to determine notional resiliency investment for PQP2 purposes, this could be accompanied by a Chorus obligation to undertake written consultation on individual proposed initiatives with RSPs and other critical infrastructure sectors before projects start. This would promote efficient investment by reducing costs - identifying co-investment - and ensuring any investment is directed towards the highest value opportunities. The transparency would, for example, facilitate co-investment and support ongoing conversations with local authorities to identify and prioritise investment in regions.

Network extension

12. Chorus also proposes to invest around $201 million (2022 constant prices) to expand the fibre footprint to a further 40,506 premises in areas adjacent to the existing UFB fibre footprint. We support sensible fibre expansion, and the current regulatory framework should be able to provide for incremental expansion to adjacent areas as proposed (particularly the peri-urban areas suggested by the proposal).

13. Chorus proposes a range of regulatory tests to support the proposal, including approval of the expansion where incremental revenues exceed incremental costs, end-user willingness to pay exceed costs, the proposal uses the lowest cost (optimal) technology and wider public benefits exceed costs. The Commission has requested feedback on what its decision framework should be.

14. The Commission should be able to consider sensible fibre expansion proposals where expected incremental revenues exceed cost, and the expansion will not distort competition in any market nor put the regulatory framework under stress. At this stage, it is not clear whether it is open to the Commission to consider the application of the additional tests proposed by Chorus out in the expenditure proposal. In particular, we consider that - even where end-user willingness to pay is modelled to exceed costs, or where modelled public benefits apparently exceed costs - the Commission should exercise caution in regard to these tests, especially as there are more susceptible to other transfers and/or unintended consequences.

15. Chorus proposes to extend fibre coverage to relatively dense[8] peri-urban areas adjacent to existing UFB deployments. It notes that the break-even wholesale price[9] for customers in the expansion area is $57 per month (at 70% take up) and that this is closely aligned to the expected wholesale price path for the second regulatory period. A higher take up of say 80% would result in the proposed investment contributing to shared costs. In other words, the proposed investment is NPV positive on an incremental basis and sensitivity analysis suggests the proposal is more likely to contribute to shared costs than incur a loss.

[8] Along the lines suggested by the independent verifiers, see page 176 of the report.
[9] See 15.7.6

16. If this is the case, then this is a commercial choice for Chorus and an investment the Commission could consider if the outcome is likely to result in reduced overall costs to end-users more broadly. The Commission should consider the proposal further, applying the wider criteria required by the Act.

17. However, we don't support Chorus' proposed alternative end-user notional willingness to pay or optimised technology tests that:

    a. Imply substantive cross-subsidy or technology optimisation in isolation from end-user demand or benefits. A cross-subsidy from regulated revenues will inevitably suppress competition as - in the long run - no firm can compete against guaranteed regulated returns. We do not believe the Act supports a cross subsidy in the way proposed by Chorus.

    b. Are inconsistent with the Government policy framework. The Government framework anticipates geographically consistent pricing and the Government considering proposals for any substantive fibre expansion and funding arrangements (including the balancing of higher prices for end users and Government funding). It would be a significant Commission step to determine an approach that displaces the Government regulatory framework and - instead – anticipates the Commission determine the nature of pricing and funding arrangements,

    c. Have significant information requirements to implement. For example, Chorus' analysis appears to assume that uncapped wireless broadband services have limited if any available in the expansion areas, when this is unlikely the case in the proposed peri-urban fringe expansion areas.

18. There are difficulties with the additional information provided by Chorus and, if the Commission decides to consider the alternative tests, it should consult further on the key parameters. For example, the Commission would need to:

    a. Develop an accurate picture of the uncapped wireless broadband service availability. Chorus assumes that uncapped wireless broadband services have limited if any availability in the proposed expansion areas[10]. However, this is unlikely to be the case. Spark's unlimited Everyday Wireless plan is widely available across urban and rural addresses for and – while do we do not know the exact location of the proposed expansion – unlimited wireless broadband services are highly likely to be available in the proposed peri-urban expansion areas.

       We have already provided information to the Commission relating to the availability of our unlimited service in the context of the rural study. This data could be correlated with Chorus' expansion proposal to identify any service overlaps. We would be happy for the Commission to use the data for this purpose. Alternatively, Spark would be open to running a separate analysis if the Commission were able to provide us with the fibre expansion locations, and

    b. Identify the incremental wider benefits of the proposal. The NZIER identified $1.65 billion benefits cannot be fully attributed to fibre deployment. We agree that making broadband available to rural communities has significant benefits. However, the NZIER study that Chorus refers to identifies broadband benefits across a range of use cases supported by alternative technologies. When we considered these use

[10] For example, see page 271 assumption that home wireless broadband in these areas usually come with data caps and higher prices and Table 15.9.

cases in turn - i.e., the ability to shop online and connect with friends through social media – they were likely supported by existing fixed wireless and satellite-based broadband services in the expansion areas (see attachment 1).

Incentive payments

19. Chorus proposes to spend $54.1 million on incentive payments over PQP2 and that the Commission no longer consider the incentives through individual capex proposals.

20. We do not support Chorus' proposed approach. We continue to have concerns relating to the potential use of incentive payments to suppress competition, and as a tool to implement inertia pricing that inefficiently locks in high end user prices over time. It is important that the Commission approve investment as, even if proposed levels of investment are consistent with prior (or planned) years:

    a. The incentive to undertake such practices remains. The ability to recover customer retention incentives through regulated revenues creates an incentive for a dominant firm to engage in predatory conduct with a guarantee of future recoupment, and

    b. Pricing structure is as important from a competition perspective as the overall level of investment. The Commission is reviewing the level and structure of connection incentives through the individual capex proposal process.

21. The Commission should continue to monitor how Chorus engages in - and seeks to shape - retail markets through initiatives such as incentives payments and retail price caps. The regulatory framework anticipates competition determining retail outcomes rather than Chorus' pricing strategies. This oversight has further importance where Chorus engages directly with consumers through its marketing, but is not subject to RSQ oversight and consumer protections.

[End]

Attachment: Analysis of NZIER benefits

NZIER Benefit	Description	Annual household benefit	Annual business benefit	Required functionality	Availability technologies
Time saving	Time saving from online government transactions, and online banking	$378	$1,053	Internet browsing	Fibre, copper, FWA and satellite
	Time saving from avoiding 1 trip to town per fortnight	$1,404	$1,404	Internet browsing, video conferencing	Fibre, copper, FWA and satellite
Individual earnings	Value of increase in earnings from digital access	$1,510		Accessing information from websites, download and fill out forms	Fibre, copper, FWA and satellite
Health	Reduction in demand on health services	$80		Accessing information on websites, e-prescriptions and online booking,	Fibre, copper, FWA and satellite
Social connection	Greater social connection, reducing loneliness.	$2,180		Emails, video chat and social media	Fibre, copper, FWA and satellite
Retail transactions	Savings from shopping online	$952		Internet browsing	Fibre, copper, FWA and satellite
Total		$6,505	$2,457		
	households/businesses	275,496	140,028		
Total benefit		$1,791,963,732	$344,048,796		