Chorus' proposed expenditure for PQP2

2degrees' Cross-Submission in response to Commerce Commission consultation

February 2024

PUBLIC

Introduction

2degrees welcomes the opportunity to cross-submit in response to Chorus' expenditure proposal for PQP2.

We note the submissions were limited in nature relative to the large volume of documentation that was released for consultation. We consider this reflects the limited timeframe (4 weeks) afforded for submissions and we reiterate our previous comment that this puts particular onus on the Commerce Commission to ensure all aspects of Chorus' expenditure proposal are well-justified and are to the long-term benefit of end-users (and do not simply result in higher Chorus expenditure and charges, and ultimately support higher prices for end-users).

The Commerce Commission and Chorus appear to have differing views about the Independent Verifier's conclusions

It appears Chorus has a different view about the conclusions the independent verifier reached from that of the Commerce Commission or that of the independent verifier itself. This should not detract from the substantial concerns the independent verifier raised that the Commerce Commission needs to ensure are resolved.

We agree with One NZ that "There are a number of areas where the independent verifier couldn't confirm whether Chorus' proposed expenditure is consistent with the capex Input Methodology (IM). 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."

There is large common ground amongst Chorus' customers

There is a lot of common ground in the RSP submissions (2degrees, One NZ, and Spark). In particular, 2degrees agree with and share the following concerns and views:

Resilience Expenditure

- Spark submitted that "It is unclear whether the [resiliency expenditure] proposal forms part of existing funded programmes – a concern One.NZ set out in its earlier submission."

  We share the concerns raised by Spark and One NZ that it is unclear whether: (i) Chorus' proposed resiliency expenditure should be expected to improve service quality (if so, this should be reflected in the regulated minimum service quality requirements); or (ii) it reflects maintenance of existing base-line resiliency expenditure requirements (in which case it is unclear why a substantial increase in expenditure requirements is justified).

- Consistent with 2degrees' submission, we also support Spark's comments that, particularly given other Government work and inter-dependencies, "...it will be difficult to determine... whether the proposal is well targeted to maximise the benefits to end users... 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."
- 2degrees agrees with Spark (and One NZ) that at a minimum, where an individual capex proposal is not undertaken Chorus should be required to undertake a "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." We agree with One NZ that "This approach will assist in providing transparency as to whether resilience expenditure is consistent with forecast demand."

Network Expansion

- We agree with Spark – in relation to network expansion – that "A cross-subsidy from regulated revenues will inevitably suppress competition as - in the long run - no firm can compete against guaranteed regulated returns" and "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".
- We agree with One NZ that:
  - "… [elsewhere] in the Fibre Frontier report, Chorus focuses on extension of fibre beyond these areas and into rural, sparsely populated locations more generally. Here, Chorus would need to demonstrate that in each area where fibre is extended on a standalone basis (i.e. without Crown grant funding), the incremental revenue exceeds the incremental costs (both capex and opex)."; and
  - "The Commission must avoid incentivising fibre expansion in areas where connectivity improvements can be provided efficiently by other technologies, and where demand is likely to be met by these technologies. This could be achieved by requiring Chorus to share specific areas where it plans to deploy fibre and, in each case, to satisfy the Commission that new fibre deployment will deliver incremental revenues that exceed costs on a standalone basis (without any assumption of external subsidy or demand stimulation)."

Marketing Expenditure

- We share One NZ's concern that "Chorus is increasing its level of influence in the retail market through direct-to-consumer marketing". This is consistent with the concern we raised "… about the use of regulated revenue from provision of monopoly services in order to 'compete' with RSPs using alternative technologies."

We agree with One NZ that these concerns could be mitigated if the Commission "ensure[d] that Chorus' marketing activity is limited to 'general awareness of fibre' or alternatively that Chorus is required to be subject to the same regulatory framework around broadband marketing as retailers. Enabling Chorus to be an 'active wholesaler' and engage in expanded market activity under asymmetric regulatory conditions has clear potential to distort competition contrary to the purpose in s166(2) of the Act."

- We agree with One NZ that "The Commission should request economic analysis to be carried out to support Chorus' proposed marketing expenditure to demonstrate that the level of expenditure is more than offset by the resulting increased revenue resulting from the marketing activity, as supported by the independent verifier." One of the problems the Commission needs to deal with is that – as a natural monopoly – Chorus is not adversely affected if its advertising is not productive or efficient as long as it is added to its maximum allowable revenue (MAR). In contrast, if RSPs – who are operating in competitive markets – undertake ineffective advertising it will result in lower profits.

Incentive Payments

- We agree with One NZ and Spark that Chorus incentive payments support the distortion of competition. This is at odds with the purpose of the regulatory regime and work being conducted by the Commerce Commission in the RSQ space.

- We agree with One NZ that incentive payments should not be allowed for in the MAR and that current "Chorus' incentives are not about creating awareness of availability of fibre services, they are aimed at influencing (and distorting) choices made by end users in a competitive downstream market". One NZ states "The Commission has no ability to control Chorus' future application of incentive payments and cannot reach a decision based simply on assurances about how its incentive payment scheme might operate."

- We agree with Spark that 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 Commerce Commission should review incentives and how they are being used, particularly where they are likely to disproportionately disadvantage specific subsets of retailers.

- We agree with Spark that "The regulatory framework anticipates competition determining retail outcomes rather than Chorus' pricing strategies" and that "...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". At a minimum, individual capex proposals must be required.

- We also note and support One NZ’s comment that “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.”

Chorus proposed Quality Standard Reduction

- We support One NZ’s concern about “Chorus' proposal to change the breach threshold of the performance quality standard from 90% to 95%.” It is not clear what benefit, if any, consumers could expect from the lower service quality or how this would better ensure FFLAS services are provided at a quality that reflects end-user demands.

  We understand that having considered this issue as part of PQP1, the Commission supported 95% port utilisation as the right measure and preferable to a 90% port utilisation threshold, and we don’t think there is justification for change from this position. Chorus appears to simultaneously be seeking substantial additional funding to improve network resilience while attempting to lower its service quality obligations.