

Promoting fibre and supporting broadband competition in 2023

Chorus' individual capex proposal for customer incentives

PUBLIC VERSION

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1.0 Introduction and Benefits

1.1 Introduction

This is Chorus' individual capex proposal for customer incentives in calendar year 2023 (**CY23**).

We propose to invest \$15.2¹ million capex across the year to continue customer incentive programmes that support retail service providers (**RSPs**) to promote fibre uptake and plan upgrades. This proposal relates to Chorus' regulated price-quality fibre service (**PQ FFLAS**) only.

This proposal describes:

- The benefits of customer incentives – how and why they deliver benefits for end-users of fibre services, both directly and through their pro-competitive impact
- Our proposed investment – what we will use the money for, including detail of the timing and composition of forecast expenditure
- The economic case – how we have tested that the investment will benefit end users
- Competition and compliance – why we believe incentives remain pro-competitive, and compliant with input methodologies (**IMs**) and other legal obligations
- Governance – the process and governance structure we adopt to ensure our expenditure plans are robust and well-founded
- Stakeholder engagement – how we have sought RSP and end-user views to inform our customer incentives capex
- The details of the expenditure – why it is capex and additional to RP1 base capex, deliverability, and the impact on other expenditure of the customer incentives capex
- Assurance – our supporting audit report and CEO certification.

We encourage the Commission to reach a decision on this individual capex proposal as quickly as possible, to provide certainty to Chorus, RSPs and consumers.

While earlier would be preferred, if a decision is available by 1 October 2022, that would give us a reasonable amount of time to confirm to RSPs that we will (or will not) be offering incentives from 1 January 2023.

This proposal complies with the requirements of the approved individual capex design proposal, including the conditions set out in the Commission's letter of 6 May 2022.

Appendix A provides updated data that is relevant to the competition assessment. **Appendix B** describes the design principles and offer criteria of our incentives.

Appendix C lists the models supporting this proposal.

Appendix D lists the other documentation (assurance material and expert reports) supporting this proposal.

Appendix E provides an index of material in this proposal against the design proposal requirements.

1.2 Executive Summary

We are confident our proposed investment will continue to benefit end-users because the uplift in revenue from additional new customers and upgrades will exceed the costs.

We will achieve this outcome because our incentive programmes are effective at enhancing uptake and upgrades, and because the incremental cost of serving additional customers within our existing network footprint is low for fibre networks. In other words, our incentive programmes remain an effective way of promoting efficient utilisation of our network, as summarised below.

Proposed expenditure: Our proposed expenditure of \$15.2m is somewhat lower than in previous years, consistent with completion of UFB build and maturing of network uptake. This includes \$11.7m of connection incentives and \$5.6m of upgrade incentives, offset by \$2.0m of claw-back.

Proposed incentives: We intend to invest the majority of this capex in incentives that are consistent with those in market and for which funding was approved by the Commission for 2022. The main incentives we intend to offer in 2023 are Mix it Up, Business Choice (successor to 'Advantage'), and Hyperfibre Install.

Economic test: The Commission approved Chorus' incentive capex for 2022 on the basis that the incremental revenues from end-users resulting from the incentives exceeded the incremental costs.² In this proposal we show that the expected incremental revenues from incentives in CY23 also exceed the expected incremental costs, across a range of sensitivities.

Our economic test includes scenarios which show that our incentives achieve outcomes consistent with those in workably competitive markets under a range of conditions. The proposed incentives for CY23 are beneficial to end-users and improve efficiency. Our assessment is that our incentives deliver clear net benefits:

- For connection incentives, we estimate a net benefit of [**CCI**] per customer over 4 years

¹ Historical and planned expenditure values in this proposal are generally presented in real December 2021 terms. Some nominal values are also presented to aid understanding. This \$15.2m equates to \$16.8m forecast nominal expenditure.

² Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C5.3.

1.0 Introduction and Benefits

- For upgrade incentives, we estimate a net benefit of [**CCI**] per customer over 4 years.

Effectiveness: The programmes are effective because they enable us to work with RSPs to reduce consumer inertia, including by reducing the cost barrier to fibre uptake or upgrades. Because there is still a sizeable number of end-users who have not signed up to fibre, and there are others for whom faster speeds would be beneficial, and there is active competition from other technologies, it is critical that these valuable programmes continue.

Wider benefits: More broadly, incentives support connection growth, improve customer retention and service quality, and assist Chorus to meet our contractual obligations to promote fibre. They are a core part of our commercial offering. Consultation feedback from smaller RSPs and end-users support the continuation of incentives as they improve competition in retail broadband markets and help overcome cost barriers to uptake.

Competition effects: We are confident our CY23 investment will remain pro-competitive – including because the expenditure still satisfies the Commission’s preferred economic test, and because the retail market has the same relevant dynamics as prevailed when the Commission approved our 2022 customer incentives capex. RSP feedback has demonstrated the value of Chorus’ incentives programme to competition, innovation and choice within the broadband market.

Legal compliance: Our incentive programmes remain compliant with geographically consistent pricing and non-discrimination obligations.

Governance: This proposal has been subject to robust governance. The forecast builds on our FY23 Board-approved business plan, which in turn builds on our governance processes that we apply when developing and approving incentive offers. We also apply robust monitoring of incentives delivery against budget across each year to ensure expenditure is successful and on track.

Stakeholder engagement: Our proposal has been supported by various stakeholder consultations, carried out by Chorus and the Commission. There is clear support for incentives from RSPs who are not mobile network operators (**MNOs**). Feedback from end-users and RSPs demonstrates the value of incentives.

Capex test: Our proposed investment is capex and is additional to previously approved base capex. Accounting standards and treatments have not changed and it remains appropriate for our incentives investments to continue to be treated as capex

1.3 Benefits of customer incentives capex

Our incentives are well established having been in the market in various forms for around six years. Our incentives are essential because of the unique market structure created through the UFB initiative and the fibre regulatory framework. The incentives complement our own marketing, market research and branding activities that raise awareness of the availability and benefits of fibre. They are designed to leverage RSP product design and marketing capabilities and support active participation by a wide range of RSPs.

The incentives have helped foster healthy competition in retail broadband markets, supporting challenger RSPs to play a key role in promoting fibre services and delivering better outcomes to end-users.

Incentives help us to quickly grow our fibre connections and increase the utilisation of the network, which is in the interests of Chorus, RSPs and end-users across multiple consumer, operational and financial dimensions:

- **Overcome inertia:** Our connection incentives help to mitigate the barrier to fibre adoption associated with the fibre install process. Upgrade incentives similarly reduce inertia associated with switching plans.
- **Growth:** Since their inception, we have continuously evolved the design of our incentives to respond to market dynamics and to test and learn from new ideas. This investment has played a key role in delivering UFB uptake that has been well ahead of predictions and remains strong, as well as stimulating significant uptake of 1Gb (and better) connections.
- **Service quality for end-users:** We know from operational experience that fibre networks deliver a higher performance and a better consumer experience with faster speeds, fewer faults and more reliability than alternative networks. This allows end-users to do more with existing applications, for example better quality video streaming and access to applications that are not feasible on alternative technologies.
- **Customer retention:** Once customers experience the performance and reliability of fibre services, they tend to remain on fibre. Similarly, consumers on faster fibre plans are more likely to remain on fibre than those on slower speed plans. Moving end-users to higher performance plans improves their experience and increases our average revenue per user (**ARPU**).

1.0 Introduction and Benefits

- Awareness of fibre: We are not a traditional monopoly utility and consumers have other choices for broadband services. As such, the incentives we provide to retailers are critical to supporting greater awareness of the benefits of fibre and maintaining a level playing field for more diverse and effective retail competition. This benefits consumers through better retail offers and choice, and, as more consumers connect to fibre, secures the sustainability of the fibre network.
- Cost efficiency and lower prices: Increased utilisation of the fibre network, by attracting new customers and increasing the intensity of usage by existing customers, improves the average cost per connection. As the Commission has recognised, incentives can result in lower average prices where fixed network costs are recovered over more fibre end-users and this can be efficiency enhancing.³
- A key driver of the positive outcome from incentives is that our network architecture, agreed with the Crown as part of the UFB arrangements, is designed for high uptake. This makes the most of the inherent capacity of fibre optics and means the incremental cost of a new connection is low.
- Competition: The costs of Chorus' fibre network are largely fixed and sunk. Therefore, providing incentives which result in an expansion of demand (relative to a counterfactual of offering no incentives) is efficient, so long as the incremental revenue from the incentive exceeds the cost of the incentive. We invest in incentives at a level that provides a net positive return on investment. We recognise fibre adoption generates consumer surplus over and above our return, but our investment case does not rely on this.
- We also agree with the Commission that customer incentives can improve efficiency, be pro-competitive, and are consistent with the behaviour expected in workably competitive markets.⁴
- Similarly, incentives make it less risky for us to introduce new plans to meet end-user demands, as we will be better able to encourage end-users to switch to the new plans when incentives are available.
- Incentives support a vibrant retail market, with successful entry and growth from challenger brands. **Appendix A** shows that incentive uptake is strong among RSPs with smaller market share.
- Encourage investment by reducing stranding risk: Chorus faces stranding risk on our fibre network. As NERA discusses, where incentives drive uptake this will reduce the risk of economic stranding and provide Chorus with greater confidence to keep investing in the fibre network.⁵
- Contractual obligations: We have a contractual commitment with the Crown to prioritise the fibre network. This includes continuing obligations to promote fibre and support fibre uptake, and a marketing commitment now applicable to UFB2 under the UFB2/+ contract. Our incentive programme and marketing activities support these obligations. Our pre-Part 6 context means we would not have prioritised incentives investment if it were not cost-effective.

Approval of our proposal will ensure these positive outcomes will be realised for CY23.

The established nature of our investment programme means that the benefits described above that result from the customer incentives capex are not uncertain.

Further, we are certain that disruption to our investment (due to partial or declined approval) would cause harm through:

- Loss of internal momentum as our resources are stood down or redeployed
- Loss of retail market momentum as RSP promotions are paused or scaled back
- Reducing the ability of challenger RSPs to compete with vertically integrated MNOs - noting continuation of incentive programmes is likely factored into RSP business plans
- Slowdowns in installations and upgrades, meaning foregone consumer benefits from superior connectivity, and a higher maximum allowable revenue (**MAR**) per connection (and hence higher prices) over time.

³ Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C58.

⁴ Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraphs C5.2, C59.

⁵ NERA, Customer incentive payments and the long-term benefit of end-users, 7 July 2021, pages 2 & 9.

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The damage that would be caused by removing incentives was highlighted by RSP submissions on the PQ draft decision:

any adverse change to the Chorus incentive framework will mean that retailers are most likely to pass on the change by way of higher prices to end user⁶

Should incentives no longer feature in the market, or be harder to guarantee, it would make it considerably more challenging for Sky to make further innovation investments like we have done in launching Sky Broadband and WiFi6 and indeed compete with larger RSPs who are able to offer both fibre and FWA services. The same applies when it comes to designing attractive, competitive prices and offers in market that

drive the uptake of fibre services as well as increasing the intensity of usage⁷

If Chorus fibre incentives are negatively impacted by the Commission's proposals, the ability of independent retailers to promote fibre services and compete with wireless alternatives by MNOs will be put at risk. Given the technology specific nature of the Part 6 regime, broadband markets are already distorted in favour of vertically integrated, unregulated MNOs and the proposed additional regulation of the fibre incentives serves to exacerbate this distortion.⁸

The benefits discussed in this section provide a strong case for approving ongoing incentives capex. Our proposal is for continuation of a successful formula that has delivered clear benefits for modest outlay.

⁶ Devoli Consultation on the treatment of Chorus incentives as part of Chorus' fibre price quality determination, 15 September 2021.

⁷ Sky, Submission to Commerce Commission Draft decision on Chorus' price-quality path, 24 September 2021.

⁸ Vocus, Chorus incentives – regulatory approval process, 31 August 2021.

2.0 Proposed Incentives

2.1 Customer incentives: background

This section discusses the types of customer incentives offered by Chorus and summarises those that are currently in market or under development. This is presented for context and not all incentives currently in market will necessarily be offered in CY23. Our intended customer incentives for CY23 are discussed in section 2.3.

Chorus offers two main categories of incentives:

- **Connection incentives:** payments to RSPs to increase the quantity of fibre connections, including migrating customers to fibre from copper. The credits are capitalised and amortised over four years.
- **Upgrade incentives:** payments to RSPs to increase the intensity of usage on the network by existing customers, through moving them onto higher speed plans. These aim to “move

customers up the stack”, providing them with higher speed services where that meets their needs. These incentives drive revenue growth and long-term retention, increasing the average revenue per customer. The upgrade credits are capitalised and amortised over one year against revenue.

The core incentives Chorus has in market in 2022 are Mix it Up (consumer), Choice (business, previously ‘Advantage’) and Hyperfibre Install. We also have a number of smaller incentives targeting particular commercial objectives. **Appendix B** summarises the design principles and typical conditions for the existing incentives and provides links to publicly available information about the incentives.

The incentives we currently provide and which are under development are described in Table 1 and Table 2:⁹

Table 1

Current incentives in market

Incentive	Description
Mix it Up (MiU)	Our core consumer incentive programme, Mix it Up focusses on providing incentives to RSPs for new residential connections, and encourages users on consumer plans to upgrade to higher-speed plans.
Choice ¹⁰ (successor to Advantage)	This package of incentives applies to business plans, encouraging offnet customers to move to fibre, and particularly encouraging upgrades to Hyperfibre and our fastest/high value Next Generation Access (NGA) premium plans.
Hyperfibre Install	A one-off credit of \$399 for new Hyperfibre connections where a new ONT is required at the premises. We plan to reduce this to \$199 on 1 October 2022. ¹¹ The incentive offer encourages customers to sign up for Hyperfibre. [CCI]
Home Fibre Starter	The Home Fibre Starter is a new incentive launched in April 2022 to encourage new connections, particularly for consumers who may be late-adopters to fibre and are looking for a more basic plan. The plan provides RSPs an upfront credit of \$75 for connection to a 50Mbps service, conditional on a maximum retail price of \$60/month. We have not yet decided if this incentive will be extended into CY23.

⁹ Another incentive we currently have in market, and have previously described to the Commission, is the Ministry of Education (**MoE**) support package, which provides connectivity to support remote learning during the pandemic. The MoE incentive is not discussed here as we are not seeking funding for it in this proposal. The incentive is due to cease in January 2023.

¹⁰ Business Choice will replace the three Advantage incentives as from 1 July 2022, but is based on those incentives and is substantively similar, with a

move away from credits for some lower value plans towards higher credits for faster plans, plus new incentives for the new NGA Business Premium (EBS4) plans being introduced later in 2022.

¹¹ This will be confirmed in early July 2022. [

CCI], but this decision will not be finalised/confirmed until next year.

2.0 Proposed Incentives

Table 2

Incentives under consideration for second half of CY22

Incentive	Description
[CCI] Direct to consumer	[CCI] Up to FY19, all incentives were paid directly to RSPs. From FY20, Chorus has made very small scale [CCI] incentive payments directly to consumers (for example using Prezzy cards). Direct to consumer incentives are not being offered at this time and we are assessing whether they will be offered in the remainder of 2022 and beyond.

2.2 Planned and historical customer incentives capex

Chorus proposes to invest \$15.2m¹² customer incentives capex in CY23. This includes \$11.7m for customer connection incentives and \$5.6m for customer upgrade incentives.

The \$15.2m is net of \$2.0m of clawbacks, which are applied when the RSP repays a portion of the incentive if the end-customer does not stay on the service for a full 12 months after receiving the incentive. It relates

to PQ FFLAS expenditure only and does not include forecast customer incentives capex in ID-only areas.

This level of expenditure is comparable to prior years, with the exception of CY21 where we paid additional incentives for the Mix it Up offnet kicker campaign.¹³ We expect, and are forecasting, total incentives to decline over time, [

CCI]

Table 3

Nominal FFLAS historical and forecast incentives expenditure¹⁴

Nominal \$'000	H2 CY18	CY19	CY20	CY21	CY22*	CY23**
Connection	4,289	16,628	12,881	21,644	17,356	12,823
Upgrade	1,156	5,099	5,682	4,836	4,281	6,107
Clawback	(91)	(1,658)	(2,981)	(4,272)	(3,066)	(2,178)
Total	5,354	20,069	15,582	22,208	18,571	16,752

* CY22 is actuals for January – April 2022 and budget for May – December 2022

** Proposed expenditure for CY23

¹² In real CY2021 terms. \$16.8m in nominal terms.

¹³ The offnet kicker campaign was an additional incentive launched in CY20 to respond to competition from alternative access technology. This incentive was in the market for a limited time (less than six months) and is not currently in the market.

¹⁴ Table 3 shows total expenditure for connection and upgrades with clawbacks identified. CY22 and CY23 are PQ FFLAS.

2.0 Proposed Incentives

Table 4

Real FFLAS historical and forecast incentives expenditure¹⁵

Real \$'000	H2 CY18	CY19	CY20	CY21	CY22*	CY23**
Index	1.068	1.057	1.039	1.000	0.952	0.909
Connection	4,582	17,579	13,388	21,644	16,519	11,657
Upgrade	1,235	5,390	5,906	4,836	4,075	5,552
Clawback	(98)	(1,753)	(3,098)	(4,272)	(2,918)	(1,980)
Total	5,719	21,216	16,196	22,208	17,675	15,229

* CY22 is actuals for January – April 2022 and budget for May – December 2022

** Proposed expenditure for CY23

Nominal FFLAS historical expenditure vs budget

Table 5

Nominal FFLAS actual spend (net connections and upgrades) vs budget

\$'000	CY19	CY20	CY21
Actual	20,069	15,582	22,208
Budget	20,950	23,200	23,967
Variance	(881)	(7,618)	(1,759)
Variance %	(4%)	(33%)	(7%)

Table 6

Real FFLAS actual spend (net connections and upgrades) vs budget

\$'000	CY19	CY20	CY21
Actual	21,216	16,196	22,208
Budget	22,149	24,114	23,967
Variance	(933)	(7,918)	(1,759)
Variance %	(4%)	(33%)	(7%)

Historical customer incentives capex

Table 5 shows Chorus' actual incentives expenditure was within 7% of budget for CY19 and CY21, which we consider to be a reasonable variance given the inherent uncertainty in forecasting connection volumes and representative of 'normal' performance. CY20 and CY22 were abnormal.

In CY20, actual expenditure was \$7.9m (33%) below our budget. This was driven by the impact of Covid lockdowns, which caused a substantial negative demand shock and meant we were unable to deliver the budgeted growth in connections. This should therefore not be seen as indicative of likely future variances from forecast.

Updated forecast customer incentives capex for CY22

In CY22, we are forecasting a range of expenditure, between \$16.2m and \$19.1m (around a point estimate of \$17.7m, shown in Table 4). This is broadly consistent with the Commission's expenditure allowance for incentives this year. This forecast is presented as a range because:

- In the first half of CY22, our incentive capex has been below forecast due to a transition to new field service provider contracts, which has affected our ability to maintain connection rates. This effect has been exacerbated by the Omicron wave of early 2022, which made it harder to carry out direct marketing activities, dampened demand and hindered the connection of new customers.
- We have responded to these challenges [

¹⁵ Table 4 shows total expenditure for connection and upgrades with clawbacks identified. CY22 and CY23 are PQ FFLAS.

2.0 Proposed Incentives

[CCI]

- Given the uncertainty of uptake from these initiatives, it makes sense to present the expenditure as a range. This also provides a clear example of the flexibility Chorus needs for our incentives expenditure – when events occur that affect demand and network connections, we will consider other initiatives to respond to those events and meet our commercial objectives.

Forecast customer incentives capex for CY23

As noted, we are forecasting customer incentives capex of \$15.2m in CY23. Our approach to forecasting CY23 customer incentives capex is described in detail in section 2.5: 'Method of Forecasting Incentives for 2023'. We are comfortable that our forecast is robust and we expect to spend that level of customer incentives capex:

- For our FY23-FY32 business case (including CY23) we have sought to improve our

forecasting process by tying forecasts more closely to expected connection growth and the nature of the incentive plans.

- We now provide RSPs with better advanced notice of new incentives, signalling our intended incentives several months in advance. Relative to our standard 6-week formal notice of incentive changes, this early signalling helps ensure RSPs are ready to take-up incentives from day one and this should improve uptake of the incentives.
- The field service challenges we have experienced are largely resolved and the new field service arrangements will be operating as expected well before the start of CY23. We also do not expect further major Covid lockdowns, although this remains an area of uncertainty.

Historical actual connection growth vs budget

The chart below shows the variance between actual and forecast connection volumes. The impact of Covid-19 and covid lockdowns is seen in CY20 where fibre broadband connections were significantly below budget. We were much closer to budget in both CY19 and CY21.

[CCI]

2.0 Proposed Incentives

Comparison of PQP1 forecast expenditure to the Incentives ICP

Our expenditure forecast for the first price-quality path (**PQP1**), prepared in June 2022, included \$15.3m (nominal) for CY23 customer incentives. Now we are closer to the CY23 period, we have more and better information about the connection forecast and the incentives we expect to have in market in CY23. We have now revised our (nominal) forecast expenditure to \$16.8m, a \$1.5m increase.

We are still expecting total customer incentives capex to trend downward as our network build nears completion. However, [

CCI]

we believe that the quantum of incentives needs to increase to further encourage late adopters and laggards to switch networks¹⁶

Fibre is now entering the late-adopter market and it is increasingly more expensive to acquire customers, with growth steadily slowing. As the copper withdraw process commences, this will drive costs further to contact and move customers to a fibre-based solution. It is crucial that we have sufficient margin to adequately invest in network performance, bandwidth growth and customer service. Fibre incentives are fundamental to operating in this segment of the market to acquire customers, grow fibre uptake and to compete against the growing strength of the MNOs.¹⁷

Cost escalation

Our proposal is presented in real and nominal terms. December 2021 is used as the base year as this is the most recent full calendar year for which inflation data is available. Numbers are converted into real terms based on the actual and forecast CPI, using the quarterly releases by Statistics New Zealand (for actuals) and Reserve Bank New Zealand (for forecast). This is consistent with the approach used in the PQP1 proposal and regulatory templates.

2.3 Intended incentives for CY23

We propose to largely continue our major existing incentives through CY23. This means that we have an efficient starting point and are proposing incentives that have proven effective at supporting fibre uptake and

upgrades. However, although the plans presented in this proposal represent our current intentions and expectations, the fibre broadband market is dynamic and we may need to change our incentives to react to market circumstances. This was recognised by RSP submissions on the draft PQ decision:

In a highly competitive and dynamic market like consumer broadband, being able to respond with agility to competitors is critical. Chorus equally need to be able to respond to changes in market conditions.¹⁸

We have already publicly signalled to RSPs that we plan to extend Mix it Up and Business Choice for the rest of FY23 (i.e. to 30 June 2023), but that this is dependent on factors not yet known, primarily regulatory approval for an incentive allowance for CY23. We retain the ability to not extend or to vary the terms, dependent on market conditions, but we do not expect to exercise our right to withdraw these incentives as long as this proposal is approved.

Incentive planning for the second half of CY23 (ie first half of FY24) is less advanced. Planning is generally done in the previous financial year, to ensure that the incentives are designed to meet prevailing market conditions. We routinely monitor and continually assess incentive performance, including whether there is a better strategy to increase connections. Committing to incentives too far in advance is less likely to result in incentives that are optimised for the maximum number of new connections and upgrades, especially given the fast-moving nature of the market and the need to respond to market dynamics. We note the mix of incentives may change and individual credits, thresholds, eligibility criteria and incentive amounts may also change within each incentive, as we monitor performance of specific incentives and make adjustments accordingly.

However, in order to give the Commission as much certainty of our intentions as possible, we can confirm that our current intention is to extend the current Mix it Up, Business Choice and Hyperfibre Install offers through until the end of CY23. We will also offer smaller-scale targeted incentives, [

CCI], but the details of these have

not been confirmed.

Disaggregated by incentives type, the expenditure we expect to make in CY23 is summarised in Table 7.¹⁹

¹⁶ Devoli, Consultation on the treatment of Chorus incentives as part of Chorus' fibre price quality determination, 15 September 2021.

¹⁷ Vocus, Chorus incentives – regulatory approval process, 31 August 2021.

¹⁸ Sky, Submission to Commerce Commission Draft decision on Chorus' price-quality path, 24 September 2021.

¹⁹ Note that our business planning forecasts customer incentives capex at a more aggregated level – for connections and upgrades incentive types. These forecasts by incentive type have been developed based on business cases for individual incentives and expected connection rates.

2.0 Proposed Incentives

Table 7

Intended incentives for CY23

Incentive (\$'000)	CY23 Nominal	CY23 Real 2021 \$
Mix it Up	14,198	12,907
Business Choice	1,622	1,474
Hyperfibre Install	2,270	2,064
Clawbacks	(2,178)	(1,980)
Other (details tbc)	840	764
Total	16,752	15,229

The Mix it Up, Business Choice and Hyperfibre Install expenditure forecasts and the claw-back forecasts are based on our current 10-year company business plan and business cases for relevant incentives.

The balance (\$0.8m, or 5% of total incentives expenditure) is for incentives capex that we intend to spend in CY23 but have not yet allocated to specific programmes. Retaining flexibility to respond to market dynamics in this way is consistent with good telecommunications industry practice. Importantly, it is not uncertain that the incentives capex will be invested, just the specific incentives it will be allocated to.

It would not be reasonable for the Commission to expect Chorus to develop business plans for our incentives ahead of when it is commercially rational, just to meet regulatory requirements. There is also precedent for the Commission being comfortable with a regulated firm (Christchurch International Airport) setting aside funds for a type of expenditure where the exact projects have not been confirmed.²⁰

[

²⁰ In its 2017-2022 aeronautical pricing proposal, Christchurch International Airport Ltd (CIAL) set aside \$10.4m for unspecified "terminal redevelopment" project(s). CIAL argued that this was reasonable on the grounds that it was confident that it would invest the funds on terminal redevelopment but did not, at the time of developing the pricing proposal, have certainty over what project(s) the terminal redevelopment would cover. The Commission ultimately concluded that CIAL's proposed spend was "not unreasonable" and did not raise concerns over the lack of certainty about the terminal redevelopment project(s). See paragraphs B16, B167-B169 and B176-B179 of the final review report: [https://comcom.govt.nz/_data/assets/pdf_file/0026/103994/Final-report-Review-of-Christchurch-International-Airports-pricing-decisions-and-](https://comcom.govt.nz/_data/assets/pdf_file/0026/103994/Final-report-Review-of-Christchurch-International-Airports-pricing-decisions-and-expected-performance-July-2017-June-2022-1-November-2018.pdf)

CCI]

2.4 Premises passed and forecast incentives

Last year, we provided data to the Commission on the proportion of end-user premises where fibre is available but are not connected. To update this information: [

21

CCI]

Table 8 provides an estimate of total connection and upgrade incentives that will be paid in CY23. Note that Chorus does not directly forecast the number of incentives as part of our business planning, but we have derived this forecast as part of this proposal.

Table 8 also provides an estimate of incremental connection and upgrade volumes, driven by our incentive programmes, for CY23.

https://comcom.govt.nz/_data/assets/pdf_file/0017/6082/1/CIAL-Cross-submission-on-process-and-issues-paper-on-the-review-of-Auckland-and-Christchurch-Airports-third-price-setting-for-airport-services-issues-and-questions-raised-19-December-2017.pdf. Also paragraph 36.2(b) of this submission by CIAL, which shows the Airport had not confirmed the projects at the time of the pricing proposal: https://comcom.govt.nz/_data/assets/pdf_file/0017/6082/1/CIAL-Cross-submission-on-process-and-issues-paper-on-the-review-of-Auckland-and-Christchurch-Airports-third-price-setting-for-airport-services-issues-and-questions-raised-19-December-2017.pdf.

²¹ This has been calculated using some assumptions – there is not a simple 1:1 relationship between end-users whose premises have been passed, and so are able to connect to fibre, and the number of connections. A premises is a land parcel which may contain a single dwelling unit (connection) or could be a multiple dwelling unit with many connections.

2.0 Proposed Incentives

Table 8

Category	Total	Incremental
Forecast new connections	[CCI]	[CCI]
Forecast intact new connections	[CCI]	[CCI]
Forecast upgrades	[CCI]	[CCI]

2.5 Method of forecasting incentives capex for CY23

Summary of forecasting approach

Our forecasting approach for customer incentives capex remains similar to the approach used for the PQP1 expenditure proposal. Customer incentives capex is forecast as part of our yearly planning process, subject to company-wide governance.

When we forecast uptake and upgrade incentives capex we forecast the dollar amount, not the quantity of incentives paid – as we do not plan campaign activity in detail until closer to the campaign launch. We include as much detail as possible about the incentives in our forecasting – when developing our CY23 incentives as part of the 10-year business plan we forecast customer segments for connection and upgrade incentives. When individual incentives are going through our internal governance process a business case is prepared and a forecast of how many incentives will be paid under the incentive is included.

The general structure of the expenditure calculation is cost per unit x quantity, where cost is the average forecast gross credit per net connection and quantity is net new connections. To calculate clawbacks we take actual and forecast expenditure and apply historic clawback rates phased across the 12 months following payment.

We have considered the following areas of uncertainty as part of our forecasting approach:

- We cannot directly measure what uptake and upgrade volumes would be without incentive programmes. However, our programmes are mature, designed by telecommunications product specialists and subject to oversight by suitably expert management that applies professional judgement through the processes described in the Governance section of this proposal. We have also used sensitivity

analysis to test the breakeven level of additional uptake or upgrade that would justify the investment in customer incentives capex.

- Our programmes pay out based on volumes, so our forecast expenditure is sensitive to forecast connection demand. Operationally, we closely monitor volumes and expenditures on a monthly basis against budget and fine-tune our activities to target forecast volumes and/or spend.
- As this proposal relates to a single calendar year and regulatory settings assume that expenditure is spread evenly across the year, the timing of the customer incentives capex is not uncertain. We intend to make the incentives available within CY23. As the expenditure consists of payments to RSPs for meeting certain requirements, it is not dependent on physical network build or contractor availability uncertainties that may apply to other types of capex. The regulatory model assumes the expenditure is spread evenly across the year and this is a reasonable approach.
- Our expenditure forecast assumes continued participation by existing RSPs in the incentives programme. If RSPs were to exit one or more of our incentive programmes then our investment could be lower than forecast. We would seek to mitigate this outcome through, for example, engagement with the affected RSP(s), review of the incentives and, if needed, increased marketing to end-users. However, we see this risk as minimal – our incentive programmes have been operating for several years with strong RSP participation. The programmes deliver benefits to RSPs and we expect their participation to continue.

How credits are forecast

The credit forecast for our core incentives consists of two key tasks, which are required for the PxQ calculation: forecasting connections and forecasting the credit unit cost.

Forecasting connections: Net connections are the change in connections (ie $connections_t - connections_{t-1}$) from our connections forecast. The connections forecast is, broadly speaking, produced in three steps:

- We forecast total broadband connections based on market factors such as dwelling growth,

2.0 Proposed Incentives

broadband penetration and competitor connections.

- We forecast FFLAS connections using forecast premises passed, uptake rates and expected strategy. Within this we forecast plan groups (eg 300Mbps, 1Gbps) based on historical growth, expected growth and business strategy.
- Forecasts are checked and refined taking into account feedback from Chorus business experts (eg product managers, finance).

Forecasting credit unit cost: The initial estimate for forecast gross credit per net connection is based on the historical average gross credit per net connection and is calculated as: gross connection expenditure / net connection growth.

The initial estimate (for FY23)²² is escalated for each subsequent year based on inflation, market assumptions and business strategy, as follows:

- Connection credits increase by 3% for inflation and an additional 7% to account for the expected amount required to incentivise end-users as uptake increases

- Upgrade credits change by -7% which accounts for CPI but mostly reflects a reduction in the price gap between our plans over time

How clawbacks are forecast

Clawbacks are forecast for each month and are split by customer segment. There is some uncertainty as our forecasts are developed for 10 years and we have to make assumptions regarding the future structure of the incentives in market, including the clawback provisions. There are \$2m of clawbacks forecast for CY23, which is 11.5% of the pre-clawback total incentives capex planned for the year.

Key assumptions for the clawbacks forecast are:

- The structure of clawbacks remains materially the same
- Customer behaviour does not vary significantly to the period used to estimate the clawback proportions. For example, an increase in end-user retention over time could be expected to decrease future clawback amounts.

Table 9

Method of forecasting clawback

Step	Description
Estimate clawback proportion	This is the percentage of credits that are clawed back for each month over the following 12 months. The clawback proportion is estimated using available historical clawback data where it has been at least one year since the credit was paid. This means that the latest data uses clawbacks from credits paid in February 2021 ²³ since the clawbacks after 12 months are only fully known in February 2022.
Use customer incentives expenditure forecast	The forecast as described above of incentive payments. This is reliant on the forecast credit per net connection and the forecast of connections.
Time series	We take a monthly time series of actual incentive payments from at least 12 months prior to the first forecast month.
Apply proportion of spend by month	For each month we apply the proportion of spend clawed back over the following 12 months. Currently we estimate that close to [CCI] of credits are clawed back and this is spread over the 12 months from the credit being paid. As a result the forecast for clawbacks for CY23 will include a mix of forecast clawbacks from actual incentive payments in CY22 and forecast incentive payments to the end of CY23. It also means that some of the clawbacks from payments in CY23 are forecast for CY24.

²² This is a description of our forecasting method. For the purposes of this proposal, values are then converted into 2021 real terms.

²³ As these were the most up-to-date values available for Chorus' FY23-FY32 business planning process.

3.0 Economic Test

3.1 The proposed incentives are economically efficient

In its final Price-Quality determination, the Commission concluded that incentives can improve efficiency and be pro-competitive. The Commission approved the incentives capex for 2022 on the grounds that it met the economic test:

*since the expected incremental revenues from incremental end-users outweighs the incremental costs. Therefore, in the aggregate and on balance, it is likely to improve efficiency and be procompetitive.*²⁴

Our assessment, described in this section and the supporting economic model listed in **Appendix C**, is that our proposed incentives capex for CY23 similarly meets the economic test because the expected incremental revenues from incremental end-users outweigh the incremental costs. Further, there are additional social benefits from the incentives expenditure that are not captured by the Commission's test. We have provided scenarios which show that under a range of conditions our incentives are consistent with workably competitive markets. Therefore, there is a strong case that the proposed incentives for CY23 are beneficial to end-users and improve efficiency.

The costs of Chorus' fibre network are largely fixed and sunk. Providing incentives which result in an expansion of demand²⁵ (relative to a counterfactual of offering no incentives) is clearly efficient, where the incremental revenue from the incentive exceeds the cost of the incentive. Because FFLAS is revenue controlled, the benefit of lower costs per connection will flow to end users:

- If we expect to reach our MAR, we scale prices for that year
- If we do not expect to reach the MAR, we carry a smaller washup through to future regulatory periods such that (all things being equal) prices will be lower in future.

If the incentive offer is rational and financially profitable from Chorus' perspective, it will also provide net benefits to consumers, where the net increase in revenue from incentives will mechanically flow through to RSPs and, ultimately, all end-users in the form of lower prices.

3.2 Details of the economic test

Our incentives are beneficial to end-users and remain consistent with outcomes in workably competitive markets. To prove this, we have refreshed the economic test we provided to the Commission as part of the Price Quality Period 1 (PQP1) expenditure proposal²⁶ using updated information.

In this assessment we have estimated that both connection incentives and upgrade incentives provide an incremental benefit:

- For connections, we estimate that it is a net benefit of [**CCI**] per customer over 4 years. This is based on incremental revenue from moving end-users from off network (eg cable) to fibre, and copper to fibre, which would provide an ARPU uplift, while incurring incremental costs from the incentive credits provided and new lead-ins.
- For upgrades, we estimate this is a net benefit of [**CCI**] per customer over 4 years. This is based on the ARPU uplift provided by current incentives being partly offset by the incremental costs from the credit.
- For both incentive types, positive results hold under a range of scenarios.

The structure of the test we provided previously as part of the PQP1 process remains suitable for assessing our CY23 incentives because the structure of the incentives covering the majority of the spending remain the same. We anticipate over [**CCI**] of the expenditure in this capex proposal will be spent through the Mix it Up incentive.

We assume connections and upgrades are retained for four years (48 months) on average. This is based on experience and is consistent with the treatment in our audited accounts. Previous decisions by the Commission appear to accept that the four year assumption is reasonable.²⁷ Our programmes incentivise customer retention by RSPs by including 'claw back' provisions, and we have used sensitivity analysis to test the breakeven duration of uptake retention.

The 'four-year retention assumption' is based on the following assessment:

²⁴ Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraphs C5.2 & C5.3.

²⁵ In this context expanding demand means both attracting new customers and increasing the intensity of usage of the network by existing customers.

²⁶ In response to RF1005.

²⁷ For example, Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C70.

3.0 Economic Test

- We focus on the RSP-end user relationship (average timeframe in which an end-user will change RSP or change address).
- The data is sourced from the Chorus Data Warehouse (**CDW**) from July 2015. Data on the age of connections prior to that date cannot be established, so those prior connections are excluded from the analysis.
- We take an average connection life from the data. This is [**CCI**].
- However, this average will be a low estimate because [**CCI**] connections remain active and have not changed since July

2015 or their initial connection. For these connections, our method uses the current life (eg years connected since July 2015). This will be a low estimate as most of these connections will remain connected for longer – ie [**CCI**] is only an accurate estimate if we assume that all of the [**CCI**] of connections will change their connection immediately after the estimate is carried out.

- On this basis, we believe a four-year assumption of the average life of a new or upgraded connection is reasonable.

Table 10

Summary of key metrics

Reference to Design Proposal	Metric	Connection credit	Upgrade credit
51(e)(i)	Credit unit cost (one off)	\$75.30	\$83.78
51(e)(ii)	Expected ARPU (monthly)	\$46.13	\$52.73
51(e)(iii)	Expected customer lifetime (months)	48	48
51(e)(iv)	Forecast uptake (proportion of incremental connections)	[CCI]	[CCI]
51(e)(v)	Estimated net benefit to Chorus (monthly)	[CCI]	[CCI]
Approval letter 2.3.6	Average cost for each successful user acquired/up-sold (monthly)	[CCI]	[CCI]

Table 11

Main inputs to economic tests (see economic model for further detail)

Input	Description
Inputs for connection credits	
Incremental connections forecasts	We recognise that not every connection we pay a credit to is connecting to Chorus' network because of the incentive. Our test incorporates the cost of all credits paid, even to those that would have connected without a credit. However, we only recognise the ARPU from the incremental connections as a benefit in our economic case. The incremental connection proportion is based on business case assumptions.
Expected retention time for end-users acquired	We assume incremental customers will remain on the network for four years on average. Beyond this, it is assumed customers will churn to other networks or potentially require a new incentive.
Credit unit cost	This is the average cost for every end-user acquired, whether or not they are incremental and retained.

3.0 Economic Test

Input	Description
Average incremental cost of connecting an end-user to the fibre network	This is a subset of the cost per premises passed (CPPC) and consists of materials and labour costs related to installing a new lead-in and ONT. We have excluded service desk costs which we include in our published CPPC on the basis that they are not incremental to the customer incentives expenditure, rather they are part of the overall cost of the network build.
Expected ARPU across our fibre connections for end-users acquired	We have modelled this based on the average ARPU across Mix it Up plans. It likely understates fibre ARPU driven by connection credits since we use the total revenue and connections across Mix it Up plans to calculate an ARPU, however the current Mix it Up incentive does not provide credits to plans below 100Mbps
Expected copper broadband ARPU	The difference between this and the GPON ARPU is the incremental ARPU we expect from existing copper broadband users (assuming revenue is below the MAR). This likely overstates the ARPU for copper customers (therefore understating incremental ARPU) since some customers will move from voice services which have a lower price than copper broadband.
Expected percentage of connections that require a lead-in	Connections that require a lead-in incur a CPPC cost, the rest do not. Over time, as more users connect to the fibre network we expect the number of connections requiring a lead-in to decline as they will already have intact infrastructure to the premises.

Inputs for upgrade credits	
Incremental upgrades forecast	The percentage of upgrades we expect to achieve as a result of the incentive. We recognise that not every upgrade we pay a credit to is upgrading because of the incentive. Our test is designed to recognise the cost of all credits paid, even to those that would have upgraded without a credit. However, we only recognise the ARPU from the incremental upgrades in our economic case. The incremental upgrade proportion is based on business case assumptions.
Average expected retention time for end-users upgraded	We assume upgraded customers will remain on the network for four years. Beyond this, it is assumed customers will downgrade, churn to other networks or require a new incentive.
Credit unit cost	The average cost for every successful end-user upgraded.
Expected increase in ARPU when customers upgrade	We have modelled this on customers moving from 100Mbps and 300Mbps services to 1Gbps.

Key assumptions for the economic case are:

- We use the regulatory post-tax WACC, which is a conservative assumption as it is lower than our commercial WACC.
- Uptake benefits for copper to fibre migration only count the revenue difference between copper and fibre plans. They do not count avoided copper costs as a benefit. This is considerably more stringent than required to satisfy the Commission’s preferred economic test.
- Benefits are only counted for an uplift in connections relative to a no-incentive counterfactual.
- Revenue uplift is assumed to last four years on average. In practice, creation of a new intact installation will tend to have lifetime benefits as future end users are more likely to connect.

3.0 Economic Test

Similarly, a new consumer at an intact premises is more likely to use fibre again in future premises. This is therefore a conservative assumption.

- We only model monthly rental revenue and have not included revenue that flows from backhaul services or installation services (in the case of business customers).
- The four-year customer lifetime is based on limited internal data. As we noted in our submission on the draft IAV decision,²⁸ the data used for this calculation only goes back to 2015.
- Our modelling estimates are assessed on the basis of programme-level expenditure, not at an initiative, RSP or customer level. This is appropriate for evaluating overall capex allocation over the PQP1 forecast horizon. Ongoing governance processes then prioritise use of the allocated capital at a more granular level.
- Our analysis includes customers across PQ and ID areas. As our incentives are not based on geographic location we have not differentiated the test parameters by geography and this is consistent with the approach we use for internal analysis. [

CCI]

3.3 Scenario testing shows our economic case is robust

The economic case for both connection credits and upgrade credits is robust to variations in the forecast values.

We have chosen conservative values for parameters. For example:

- The FFLAS ARPU we have tested would likely be too low since we use the total revenue and connections across Mix it Up plans to calculate an ARPU, however the current Mix it Up

incentive does not provide credits to plans below 100Mbps.

- The copper price used in our economic case modelling is for copper broadband only rather than broadband and voice. Since copper voice plans are currently lower priced than broadband then it is likely that the incremental ARPU of moving copper customers to fibre is higher than our modelling assumes.
- Our economic case nets off the lost copper revenue from those end-users who move from copper to FFLAS services. This is valid for our commercial business case, but for regulatory purposes is very conservative as the lost copper revenue is not a loss to users of FFLAS services.

Many parameters are likely to change over time in a way that improves our economic case. For instance, as more customers connect to fibre (due to incentives and market conditions) then the likelihood of new customers needing a lead-in will reduce.

A 10% unfavourable movement in any single parameter would still yield a net benefit. We have tested the key parameters individually and these tests are provided alongside our economic test.

The breakeven point for most parameters is considerably less than the values we have used – these low end values would not be credible (ultimately to fail the economic test would require implausible assumptions to be adopted).

- For upgrades, parameters would have to worsen by over 25% for the incentives to breakeven.
- For connections, all but one parameter would have to change by at least 19% for the incentives to break even. The exception is FFLAS ARPU, which would only have to decrease by 12%. However, this is very unlikely in CY23 given that most prices have risen with inflation which is historically high this year. The movement of each parameter is in Table 12 under "Break-even point (variance)".

²⁸ Chorus, Submission on draft decision for initial RAB and fibre input methodology amendments (16 September 2021), [63]-[67]

3.0 Economic Test

Table 12

Connections

Parameter	Base case value	Net benefit sensitivity to 10% increase	Break-even point value	Break-even point (variance)
Incremental connection %	[CCI]	[CCI]	[CCI]	[CCI]
FFLAS ARPU (monthly)	[CCI]	[CCI]	[CCI]	[CCI]
Copper ARPU (monthly)	[CCI]	[CCI]	[CCI]	[CCI]
Customer lifetime	[CCI]	[CCI]	[CCI]	[CCI]
Cost per premises connected (CPPC) (one-off)	[CCI]	[CCI]	[CCI]	[CCI]
Lead-in lifetime	[CCI]	[CCI]	[CCI]	[CCI]
Proportion of connections requiring lead-ins	[CCI]	[CCI]	[CCI]	[CCI]
Credit unit cost (new connection) (one-off)	[CCI]	[CCI]	[CCI]	[CCI]
Copper % of incremental	[CCI]	[CCI]	[CCI]	[CCI]

Table 13

Upgrades

Parameter	Base case value	Net benefit sensitivity to 10% increase	Break-even point value	Break-even point (variance)
ARPU uplift from upgrades (monthly)	[CCI]	[CCI]	[CCI]	[CCI]
Incremental upgrade %	[CCI]	[CCI]	[CCI]	[CCI]
Credit unit cost (upgrade) (one-off)	[CCI]	[CCI]	[CCI]	[CCI]

3.4 Additional benefits: excluded from our analysis

Our economic analysis excluded broader benefits from providing customer incentives. We did not quantify the reduced risk of fibre network asset stranding or the reduced long run costs due to shutting down the copper network which are significant factors in Chorus' decision making. Additional commercial benefits such as reducing end-user inertia, improving fibre installations through bulk processes and improving the customer experience have also been excluded.

A more complete assessment of benefits would also consider:

- Non-monetised end-user benefits – these include benefits due to the superior performance and attractive pricing of fibre services relative to alternatives. The Covid pandemic has demonstrated the value of fibre to households and businesses – as people can work from home and stay connected during times of disruption. Incentives grow these benefits by helping overcome consumer inertia, meaning more consumers begin enjoying these benefits earlier than would otherwise occur.
- Market competition benefits – including benefits that flow from challenger RSPs

3.0 Economic Test

exerting pressure on incumbent MNOs to innovate, improve efficiency, sharpen prices, and improve service quality. All of this is driven by a healthy pressure to deliver value for end-users of telecommunications services.

- Non-quantified cost reductions – including efficiency gains from stimulating more efficient and consistent installation volumes, and improving cost per connection.
- Lower non-premium prices – greater uptake of premium (high speed) plans by willing end-users reduces the residual MAR per connection across other users, which also flows through to lower prices over time which itself may support further uptake longer-term, including by households otherwise unable to afford fibre services.

4.0 Legal Compliance and Competition Effects

4.1 Legal compliance of customer incentives capex

In its PQ decision reasons paper of December 2021, the Commission concluded that it did:

"not consider that there are any obvious concerns that suggest that Chorus' proposed incentive offers... are likely to breach s 201 or the non-discrimination obligations." [C98]

As our intended incentives for CY23 are very similar to those assessed by the Commission in the PQ decision, we do not see any grounds for the Commission to reach a different view in relation to the legal compliance of our proposed CY23 customer incentives capex. We agree with the Commission that:

*Chorus is incentivised to ensure that it does not breach section 201 or the non-discrimination obligations given our ex post compliance monitoring and enforcement functions and the ongoing nature of our approvals of incentive expenditure under the fibre input methodologies.*²⁹

To give the Commission further assurance, this section describes Chorus' processes for ensuring our incentives are compliant.

All incentive proposals are legally reviewed to ensure they comply with our obligations, including under the Open Access Deeds and section 201 of the Telecommunications Act.

Legal advice feeds into approval of incentive proposals in our Initiative to Market (**I2M**) process³⁰ at two points:

- Written legal advice is given to the owner of the proposal prior to the Gate 2 stage of the I2M process
- A legal report is provided at the approval meeting to ensure the approvers get first-hand confirmation that the relevant proposal is legally compliant.

In particular, [

CCI]

Any proposal that was assessed as unlikely to comply with our non-discrimination or section 201 obligations would not be approved.

Chorus has also undertaken internal education and dissemination of guidance on our legal obligations to ensure that our product, sales and marketing team are aware of, and understand, Chorus' legal obligations. In this way, we ensure legal compliance is integrated into design processes for incentives within Chorus.

The individual assessment of each incentive proposal (as part of planning and approval) is supported by Chorus' separate disclosure and assurance processes:

- The established process for Open Access Deeds certification to the Commission
- The new requirements for twice-yearly disclosure of incentives information and director certification as to section 201 compliance.

Chorus dedicates extensive resource to legal compliance and treats these disclosures seriously. They require Chorus' executive and board to be satisfied that its pricing and other incentive terms are compliant and a comprehensive process is applied in order for management and directors to be able to assess compliance. This process is specific to each disclosure and can include:

- A report of incidents that merit review
- Investigation of any incidents/situations that may indicate non-compliance, including involvement of internal audit

²⁹ Commerce Commission, Chorus' price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C106.

³⁰ The I2M process is described in the Governance section of this proposal.

4.0 Legal Compliance and Competition Effects

- Legal advice which may recommend changes to proposals.

In addition, prior to section 201 coming into effect in January 2022 and the Commission's confirmation in the final PQ decision that it considered incentives to be part of FFLAS prices and therefore subject to section 201, we undertook a comprehensive review of our incentive offers for section 201 compliance. Generally all incentives are available to all RSPs wherever the relevant fibre product is sold, without any geographically-based determinant.

4.2 Competition effects of customer incentives capex

We have assessed our incentive offers against sections 162 and 166(2) of the Act and are confident they are consistent with these requirements. In particular, incentives support our ability to innovate and invest by reducing the inherent risk of offering new and innovative products in the face of customer inertia.

As the Commission has previously acknowledged, incentives benefit end-users and are consistent with behaviour in workably competitive markets.³¹ RSPs have themselves described the importance of our incentives to the Commission.³² It is clear that incentives are important to our customers. They help RSPs to achieve their customer acquisition ambitions, which is critical for vigorous retail competition. In terms of section 166(2) considerations, our incentives are particularly important in helping non-MNO RSPs compete with vertically integrated MNOs:

- **Appendix A** shows that [

CCI]

- MNO's end-users are still paying considerably more per gigabyte for mobile broadband than

for fixed-wireless broadband. This implies a cross-subsidy between MNO customer groups which puts broadband providers which do not have access to a mobile network at a structural disadvantage, distorting competition and reducing benefits to end-users.³³ Fibre incentives help competition in this context.

As described by NERA, incentives and other types of promotions to attract and retain customers are common in workably competitive markets. Further, incentives are common in industries where there is an ongoing customer relationship, such as telecommunications, as this gives a greater time period over which the cost of the incentives can be recovered.³⁴ This has been recognised by regulators globally, and by the Commission in the context of market development expenditure by New Zealand's major airports.³⁵

Competition benefits of customer incentives capex include:

- A positive impact on downstream competition. Correspondence to the Commission from smaller RSPs during the PQ decision process demonstrate that incentives make it easier for smaller RSPs to compete with the larger MNOs.³⁶
- Any incentives offered by Chorus could be expected to trigger competitive responses by operators of competing networks, which would be a pro-competitive response.
- Making incentive payments is a way of driving uptake for new products – they therefore make it less risky for us to innovate and develop new products for end-users.

NERA's report provides strong analysis to demonstrate there is limited risk of incentives being set "too high" to distort competition, including:³⁷

- Chorus' competition – the fixed wireless services provided by MNOs – use mobile broadband technology which is being built to

³¹ Commerce Commission, Chorus' price-quality path from 1 January 2022 – Draft decision Reasons Paper, 27 May 2021, at paragraphs G16 – G19 and G36.

³² These letters can be found in RSP submissions to the Commission on the draft Chorus PQ decision, at this link: <https://comcom.govt.nz/regulated-industries/telecommunications/projects/fibre-price-quality-path-and-information-disclosure?target=documents&root=253591>.

³³ See paragraphs 36-41 of this report: https://comcom.govt.nz/_data/assets/pdf_file/0019/158410/Chorus

[_Submission-on-mobile-market-study-preliminary-findings-28-June-2019.PDF](#). Although the data presented is now some years old, our analysis is that there remains a substantial per-GB price difference between mobile and fixed wireless.

³⁴ NERA report, section 3.1.

³⁵ NERA report, section 3.2.

³⁶ Some of this correspondence is quoted in Section 6: Stakeholder Engagement.

³⁷ NERA report, section 5.

4.0 Legal Compliance and Competition Effects

supply general mobile broadband services. As such, there is no rational basis for Chorus to “overpay” incentives to drive out competition, because the competing technology will be built anyway and the MNOs will retain the ability to re-enter the market at any point that Chorus’ prices increased.

- Applying the Commission’s economic test (where incremental revenue > incremental cost) addresses the question of whether the incentive programme is anti-competitive, as an efficient competitor would provide an equivalent incentive programme that passes this test.

Chorus conducts compliance testing of all incentives to ensure they do not create risk under section 36 of the Commerce Act. We do this by conducting regulatory price testing of proposals to ensure that we are not pricing below cost in a manner that could be predatory. As described in our section on the economic test, incentives are not priced below the cost of the FFLAS to which they relate, based on our assumptions about connection life, which tend to be conservative.

As a further safeguard, we ensure that Commerce Act price testing is done by an analyst separately to the financial analysis and approval of an incentive. We recognise that there are different drivers and considerations needed in a regulatory pricing analysis and we deliberately separate these steps.

In the PQ final decision, the Commission assessed the different potential competition effects of inappropriately disallowing or approving incentives expenditure.³⁸ The Commission concluded that:

even if Chorus were to contravene s 201 and/or the non-discrimination obligations in respect of some of the incentive expenditure, this would likely cause less harm to competition and consumers than the harm that would be caused by disallowing the incentive expenditure that would be compliant... We also consider that our ex post oversight of Chorus’ decisions (and, if necessary, bringing enforcement action) will enable us to reduce potential harm from any non-compliant expenditure by taking ex-post enforcement action when it becomes apparent

Chorus submits that the same analysis holds for our proposed CY23 customer incentives capex – the harm to competition from disallowing the expenditure is likely to be higher than any harm from allowing non-compliant expenditure, especially as the existing reporting requirements for our incentives would minimise any potential harm. The safeguards we have in place and the nature of incentives mean that our incentives are more likely to be pro-competitive than to have any anti-competitive effect.

³⁸ Commerce Commission, Chorus’ price-quality path from 1 January 2022 - Final decision Reasons paper, paragraphs C109-C115.

5.0 Governance

5.1 Governance relating to customer incentives capex

We have well-established governance processes in place for our incentive programmes. This is relevant to IM assessment factors and statutory obligations (Telecommunications Act and Commerce Act) and includes:

- Testing for legal and regulatory compliance – this includes economic and legal testing against general competition law, geographically consistent pricing (section 201) and Deeds of Open Access Undertaking
- Customer engagement – designing incentive programmes in consultation with RSPs is good practice and improves their adoption and effectiveness
- Financial governance – oversight of the resources allocated to initiatives and their performance against expectations
- Strategic alignment – governance ensures incentive programmes are not designed and operated in isolation but tie in with wider business objectives and priorities
- Audit of accounting treatment – our treatment of incentive payments as NZ IFRS 15 capex is robust and well established.

Chorus has developed this individual capex proposal alongside our most recent business planning round. This means our proposal (and its delivery) benefits from our wider corporate governance and key management frameworks we use to run our business.

Corporate governance

Chorus is a New Zealand-based company listed on the New Zealand and Australian stock exchanges, with an independent board chair and members. Our company constitution and other key documents are publicly available.

Our board works with and through our CEO and executive team to exercise its responsibility for strategy, culture, governance and performance. Our board delegates authority to the CEO to allow for effective operational management and leadership. The CEO further delegates authority within the company subject to the limits of a board-approved delegation policy.

The board's responsibilities include ensuring Chorus has effective management frameworks in place.

Accountability for developing, operating and enhancing management frameworks rests with the CEO and their executive team.

Responsibility for certifying this individual capex proposal rests with the CEO, but the business plans reflected in the proposal have been approved by the Chorus board and the proposal has been developed in conjunction with key board processes:

- **Business planning** – our board approves business plans, including setting opex and capex budgets and revenue targets for the coming year. Business planning begins in each functional unit and is subject to challenge by the responsible member of the executive team, and subsequently to scrutiny by the CFO and CEO. The business planning round spans six months of direction setting, forecast preparation, challenge and approval activities.
- **Financial reporting** – the Board Audit and Risk Management Committee oversees preparation of audited annual and interim reports, and the board approves their release. These reports form the basis for the historical financial information used in our proposal.

Product management

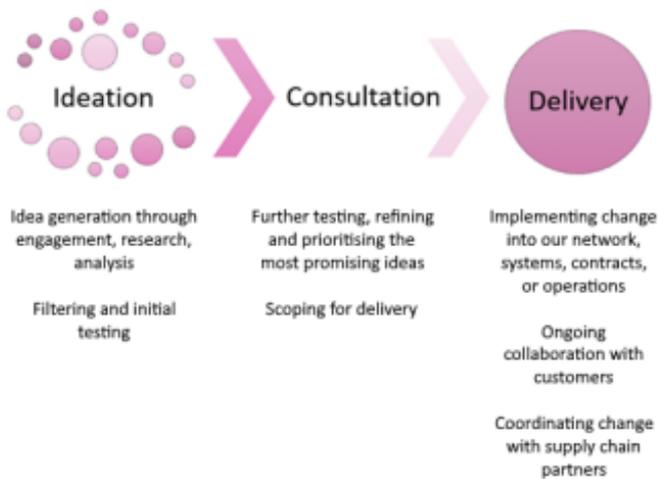
Product management is concerned with bringing new products to market, improving existing products, and managing products through to retirement. This process is critical for:

- Ensuring our services are attractive, competitive and compliant
- Prioritising product efforts to make best use of limited change capacity
- Linking product priorities into asset management to drive network capability
- Linking product priorities into financial, regulatory and wider management activities.

'Product' in our context includes the development of customer incentives.

Product management starts with ideation and moves through consultation and into delivery, which can involve commercial, operational, information technology and network technology changes. Delivered products are then managed through their lifecycle and into retirement.

5.0 Governance



Our Chief Customer Officer is accountable for the operation of this process. Key components of the product management system are:

- Initiative to Market (I2M) process** – this involves a three-step approval process which is designed to ensure review by, and input from, all areas of the business that are impacted by product proposals, including incentives. This is a regular forum that reviews initiatives and operates an approval gate following initial ideation before detailed development, and a full approval process for taking initiatives from proposal to confirmed launch. At the approval gate, the I2M forum examines each proposal in a question-and-answer format, with final approval given according to our delegated authority requirements (which for incentive proposals usually involves executive sign-off). There is then a further implementation approval to ensure that when a proposal is implemented it is done in accordance with the approved parameters, including any conditions. Proposals cannot receive approval without legal advice confirming regulatory compliance. For incentives this includes specific consideration of the geographically consistent

pricing requirement in the Telecommunications Act (section 201) and our non-discrimination obligations in the Open Access Deeds.

- Business case** - The I2M process requires all proposals to include a business case. For incentive proposals this must specifically address the “economic rationale” to illustrate that the incentive will generate incremental revenue from the incremental connections that is higher than the incremental cost of the incentives. The business case also sets out the assumptions on which such conclusions are based, which are then internally reviewed and tested for robustness, including sensitivity analysis.
- RSP engagement** – we have around 90 RSP customers (as at May 2022) who are critical to the success of our products. We coordinate our engagement through multiple channels that include the TCF Product Forum, Product Roadmaps, account management, Chorus Live roadshows and Chorus Informer updates made available on our service provider website.
- Product, sales and marketing technology delivery** – we run an integrated technology and business delivery programme to bring new product capability and changes to market. The technology office is responsible for the coordination and delivery of network, IT and integration business change.

Once incentive proposals are approved and implemented, we monitor spend through regular reporting to ensure expenditure is effective and close to budget. Where variances are identified, this feeds into our planning. The terms of our incentive offers enable us to amend existing incentives on notice to the market, but for reasons of certainty we try and limit changes to incentives in the market. Variances are taken into account in planning future incentives to maximise the impact of the incentives.

6.0 Stakeholder Engagement

6.1 Consultation on the proposed customer incentives capex

Chorus' customer incentives are of particular interest to RSPs and are subject to ongoing engagement with our stakeholders.

Incentives do not involve tailoring service quality to consumer expectations, or trading off between price and quality. Instead, they are primarily a business-to-business initiative aimed at improving efficiency and pricing outcomes. As such, Chorus' engagement on incentives is primarily with RSPs rather than direct engagement with end-users.

We have sought to understand stakeholder views on our incentives programme through three consultation processes:

- The views expressed about incentives in the consultation on the draft PQ decision in mid-2021, which largely focused on in-principle support for or opposition to Chorus making incentive payments.
- Ongoing formal and informal engagement with Chorus' RSP customers as we develop incentives, which mostly relate to the design of particular offers although broader feedback is also received.
- A targeted consultation of end-users and stakeholder representatives on the barriers to fibre uptake and upgrades.

6.2 PQ draft decision consultation – views on the principle of incentives

RSP views on the value or otherwise of incentives are well known. These views were clearly expressed through the consultation process in mid-2021 on the draft PQ decision, where 47% of content was devoted to customer incentives,³⁹ and our ongoing discussions with RSPs suggest those views have not changed.

The MNOs are generally opposed to Chorus' incentives programme (even though the MNOs are major participants in our incentive schemes). Other RSPs support the incentives on the grounds that they support competition in the retail broadband market.

Smaller RSPs have made it clear how essential incentives are for them to be able to compete against the unregulated, vertically-integrated MNOs:

Chorus' current process and quantum of incentives appear to be benefiting competition and end user. From our perspective, the incentives play a critical role in the development of our go to market activities and wholesale pricing which, almost always, the benefits of the incentives are passed onto the end user by way of reduction of up-front transition costs.⁴⁰

Chorus' ability to incentivise all RSPs gives challenger RSP brands, who don't stand to realise the same commercial upside as MNOs, the ability to genuinely compete while offering a superior performing product.⁴¹

The fibre sector of the broadband market offers less barriers to entry, supported by stable incentive programs which can be confidently forecasted against. Margins are slim in the broadband market, in part due to the underlying costs and competitiveness of the broadband market. The availability of incentives supported the business case and decision for Sky to enter the fibre segment of the broadband market. Incentives from Chorus support Sky as well as delivering a high-quality product to our customers... the combination of quality and value could not be delivered without a superior fibre network and the support of incentives from Chorus.⁴²

It is clear that a decision to prevent or restrict Chorus' customer incentives expenditure would reduce competition and consumer choice in the retail broadband market and increase prices to end-users, while entrenching the market position of the current dominant players.

These RSP views have supported our proposal to continue incentives capex in CY23.

6.3 Commercial engagement with RSPs on the design of incentives

Chorus' Product, Sales and Marketing Group (**PSM**) is responsible for relationships with our RSP customers. PSM key account managers and others have regular discussions with RSPs on issues of interest and concern, including Chorus' incentives programme and changes we may make to that. PSM also generally carries out consultations when developing new or changed incentives.

Chorus ran separate consultations for the main consumer and business incentives that will be in place

³⁹ Excluding Chorus submissions. Chorus calculation, based on page count.

⁴⁰ Devoli, Consultation on the treatment of Chorus incentives as part of Chorus' fibre price quality determination, 15 September 2021

⁴¹ Now, Submission on Chorus' price-quality path from 1 January 2022 draft decision, 1 September 2021

⁴² Sky, Submission to Commerce Commission Draft decision on Chorus' price-quality path, 24 September 2021

6.0 Stakeholder Engagement

from 1 July 2022 (and will continue into CY23 subject to market conditions and Commission approval of this proposal). Although the dates and some details of these consultations differed, the general process for RSP incentive consultations is:

- An informal preliminary survey is used to seek views from current incentive participants on whether participants are happy with the (at the time) existing incentives structure or if change is needed
- A few weeks later, this is followed by a short (eg 2-week) consultation on proposed incentives that would apply from 1 July 2022
- This consultation is promoted through Chorus “Informer” messaging sent to all RSPs
- Key account managers also raise the consultation with their contacts at the RSPs and encourage responses
- Responses are received in a variety of methods, which could include verbal feedback through the account managers or written email responses
- Responses are then integrated into the I2M approval process (described in the Governance section of this proposal).

Feedback from RSPs to these consultations is generally consistent over time (eg RSPs support incentives that are straightforward and easy to implement). We take this into account when designing incentives even before the consultation stage, thus the impact of RSP feedback on incentive design is generally better viewed over time than as the result of any single consultation.

Feedback received on the proposed FY23 Mix it Up and Business Choice incentives included:

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As this feedback was largely not focused on the design of the incentives, it has not materially affected the incentives we intend to offer through FY23. Feedback was not more extensive because the incentive offers put forward were very similar to existing offers, RSPs understood them and have already made their views known in previous consultations.

6.4 Consultation on reasons for not taking up fibre or moving to a faster speed service

To build on the existing RSP-focused consultation and engagement, Chorus considered seeking views on the incentive programme from end-users and other stakeholders. However, assuming they work as intended, the ultimate effect of incentives is that more connections are added to the network, sharing costs across more users and thus reducing average prices. This outcome is clearly desirable, so there is limited value in seeking views from end-users on whether they support it.

We have therefore sought to test the value of incentives by seeking views on the reasons why customers have not signed up to fibre or upgraded to higher-speed fibre plans.

We sought views through a Kantar survey of 1001 randomly selected end-users. We also sent a similar survey (using Qualtrics) to selected stakeholder groups, and made it available on our website and on social media channels. We received 263 responses to the Qualtrics survey.

Our questions tested whether the customer had fibre and:

- If they did not, what was the main reason they had not adopted fibre.
- If they did, what speed service they had and what was the main reason they had not upgraded to a higher speed.

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6.0 Stakeholder Engagement

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These survey results support our view that offering customer incentives are likely to support fibre uptake and upgrades by helping to address a key barrier to customers either adopting fibre or moving to a faster fibre plan. They therefore support our proposal to continue customer incentives capex in CY23.

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Importantly, customer incentives are already in place, so their effect on price would have been factored into the survey responses. We are not able to assess the extent to which cost would be a barrier to fibre uptake or upgrade if incentives were not in place, but we can assume it would be even higher than the results presented. It is also likely that lower cost services tend to assist overcoming other barriers to uptake.

Our Qualtrics survey size was smaller and thus the results need to be treated with more caution. However, the results were consistent to those in the Kantar survey:

⁴³ The totals on this chart exceed 100% as respondents were able to select more than one option.

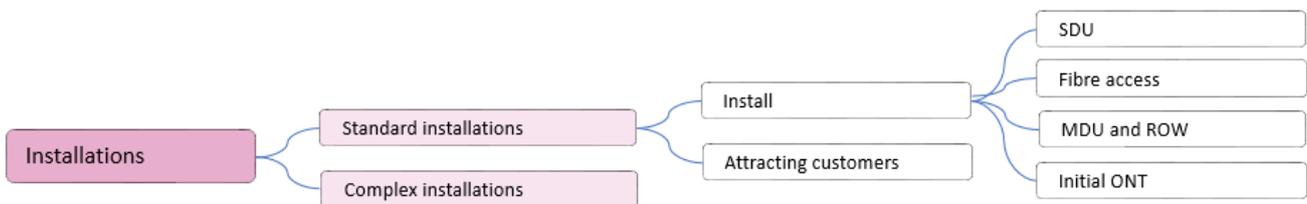
7.0 Expenditure Details

7.1 Accounting treatment of customer incentives capex

The proposed customer incentives expenditure is capex. As the Commission described in the final PQ decision, the question of “whether the customer retention assets will qualify as fibre assets must be answered by reference to the Act and the fibre IMs.”⁴⁴ The IMs, the Act, the nature of the customer incentives and our accounting treatment have not changed since the final PQ decision, so the Commission’s analysis in the final PQ decision still holds and the customer incentive payments remain capex.

Customer incentives capex is a subset of customer retention capex. Customer retention capex is an internal management categorisation used by Chorus to group all expenditure that is capitalised under the NZ IFRS 15 accounting rules. The non-incentives part of this category of expenditure relates to costs of provisioning our services, eg call centres, ordering systems and truck-rolls. Customer incentives are the ‘attracting customers’ capex in the graphic below.

This individual capex proposal solely covers customer incentives capex that is specifically aimed at retaining/attracting PQ FFLAS end users.



We consider the customer incentive payments are core fibre assets because they can be recognised as assets in accordance with GAAP and are acquired in connection with and to support the provision of FFLAS.⁴⁵ Chorus is continuing to capitalise the investments under GAAP.

Incentives are recognised as assets when the expenditure is incurred, the assets are then adjusted for any claw-back amounts at the time they are received. The same accounting treatment is applied to incentives paid to RSPs and direct to consumer incentives.

As evidence that the incentive payments are capex, we point the Commission to note 3 of Chorus’ 2021 annual report⁴⁶ relating to customer retention assets which includes customer incentives. Also, to our asset capitalisation policy as provided with our PQP1 Proposal in December 2020 (document PUBLIC C.RP1.23 C1. A30 annex - Asset Capitalisation Policy January 2020.pdf), particularly section 6.2 regarding customer retention assets.

Our proposal is additional to previously approved base capex, as the Commission specifically excluded

customer incentives capex for CY23 from the RP1 expenditure allowances.

7.2 Deliverability of the customer incentives capex

Customer incentives capex does not face the deliverability challenges associated with most capex projects, such as finding a suitably qualified and resourced contractor to deliver the project on time and on budget.

To deliver the customer incentives capex involves making payments to RSPs for meeting specified criteria related to customer acquisition and upgrades. The systems and processes for doing this are well-established and functional. The RSPs who accept an incentive offer are loaded into our customer management system (**CMT**) as eligible for the relevant incentives, which are then automatically calculated on the basis of connections and upgrades, and paid out (generally monthly once eligibility criteria are met). Our CMT system also identifies “clawback” situations (where a credit has been paid for a connection but the connection disconnects or undergoes a product downgrade within twelve months, triggering a pro-rated

⁴⁴ Commerce Commission, Chorus’ price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C47.

⁴⁵ Commerce Commission, Chorus’ price-quality path from 1 January 2022 - Final decision Reasons paper, paragraph C53.

⁴⁶ <https://company.chorus.co.nz/file-download/download/public/2295>.

7.0 Expenditure Details

clawback of the incentives that are paid out. This assists in ensuring that connections obtained through incentives are “true” connections and sufficiently sticky that we can reasonably expect at least a standard connection life.

The only material concern regarding deliverability is the risk that uptake of customer incentives is lower than expected and, as such, customer incentives capex will be lower than forecast. As noted in section 2 of this proposal, there was a significant underspend of incentives in CY20 due to unforeseen impacts of Covid-19 lockdowns. In CY22 we have experienced challenges with moving to a new field service provider model, exacerbated by the effect of Omicron (CY22). Both of these we consider to be one-off events that are not expected to be repeated in CY23.

Chorus’ starting point is that our forecast for CY23 is robust. There is no evidence for or reason to believe that similar unforeseen events will occur in CY23 and the Commission should consider the underlying level of deliverability rather than the particular, unusual, events of CY20 and CY22. Also, we can dynamically respond to under- or over-spending of incentive payments relative to forecast during the year, which enhances our ability to meet expenditure targets – this is demonstrated by the [

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Our incentives are carefully targeted and modelled to minimise the risk of under-delivery, by building on previous years’ uptake, assessment of likely numbers and scope of RSPs joining, and fine-tuning of credits within incentives (for Mix it Up and Business Choice) so we meet anticipated targets. The forecasts are adjusted to reflect changes in market conditions [

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7.3 Impact on previously determined expenditure allowances

The final PQ decision excluded customer incentives from base capex for CY23. The proposed incentive spend is therefore incremental to the determined base connection capex allowance. The only other incremental cost we expect is connections capex, resulting from incremental connections. This connections capex is excluded from this capex proposal, it will be washed-up with any other variations to connections as part of the

standard connection capex variable adjustment wash-up in PQP2.

There will also be immaterial changes to other allowances due to cost allocation. Higher FFLAS connections will increase the opex that is allocated to FFLAS in CY23 and CY24, where the cost uses the connections allocator type. We expect incremental connections across PQ and ID areas such that the proportion of cost allocated between them does not change. There will also be immaterial changes where opex is allocated via allocators such as net book value (**NBV**) and total expenditure (**totex**) which include the value of customer incentives and connection capex. The proposed capex will increase these allocator values resulting in a small increase in allocated opex during CY23, which is very unlikely to be material. This will be included in the revenue impact for the PQP2 wash-up.

8.0 Appendices

8.1 Appendix A: Comparison of incentive credits and market share

The chart below shows the allocation of incentive credits against the market share of RSPs. It is an updated version of the chart provided in the NERA report *Customer incentive payments and the long-term benefit of end-users*, 7 July 2021.

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8.0 Appendices

8.2 Appendix B: Incentive design principles and offer criteria

Table 14 sets out the Design Principles and Offer Criteria for each incentive currently in market. It also provides a link to the product offer web-page for each incentive, which contains more details of the structure of and typical conditions for each incentive. Attached to this ICP are print outs of the relevant offer information from our service provider website ('ICP offer details.pdf').

In general, payments are made to RSPs for migrating offnet customers, customers on existing copper and lower speed fibre connections. For Mix it Up incentives, payments are only made if the RSP's order mix meets specified quarterly thresholds.

Table 14

Incentive	Design principles and offer criteria	Offer documents
Mix it Up (MIU)	<p>Design principles</p> <p>Mix it Up has been offered in various iterations since April 2019 and is the primary incentive for consumer products. The core objectives of Mix it Up are to grow existing fibre connections by incentivising RSPs to sell more than their organic BAU connections, and to encourage upgrades so that end-users can see the full benefits of a fibre connection.</p> <p>We believe this incentive has had a positive impact on driving incremental connections and want to continue delivering outcomes that support our fibre connection goals. Mix it Up has also delivered significant speed upgrades for end-users which we intend to continue.</p> <p>[</p> <p style="text-align: center;">CCI]</p> <p>We have extended Mix it Up for the first six months of FY23, making a single change – to reduce the 1Gb upgrade thresholds. This reflects the impact of the Big Fibre Boost on Gig upgrades (in line with both RSP feedback that the boost made it harder for them to sell 1Gb plans, and our own market observations). We also communicated our intention to continue Mix it Up for the second half of FY23 subject to market developments and regulatory approvals.</p> <p>Offer criteria</p> <p>At the end of each three-month period, we assess participating RSPs' total fibre orders to work out their quarterly order mix. There are two tiers of credit based on percentage thresholds, and a per-connection credit for Hyperfibre.</p> <p>If 85% or more of an RSP's orders are for a Chorus plan of 300Mb or faster, then the RSP is eligible for a \$60 payment on each of those connections (regardless of whether they are new-to-Chorus-fibre connections with a first-time install, or an intact that has been offnet for >1 month, or upgrades to a higher-speed plan).</p>	<p>https://sp.chorus.co.nz/product-offer/mix-it-1-july-31-december-2022</p>

8.0 Appendices

Incentive	Design principles and offer criteria	Offer documents
	<p>A second tier, which RSPs can aim to satisfy either in addition to or instead of the above 85% threshold, aims to encourage upgrades to higher-speed services. If between 15% and 35% of an RSP's quarterly order mix is for plans of Gig speed or faster, then they are eligible for an \$80 credit on each of those connections. If the 35% threshold is exceeded, then the RSP would receive \$95/connection.</p> <p>Lastly, there is also a per-connection credit for Hyperfibre orders, of \$200 for 2Gb plans, and \$300 for 4Gb and 8Gb.</p> <p>Across all incentives, there is a clawback mechanism where the connection either downgrades to a lower-speed plan or disconnects from the Chorus network in the subsequent 12 months.</p> <p>There is no longer any requirement around RSP marketing.</p>	
Business Choice	<p>Design principles</p> <p>The Business Choice incentives are designed to support the promotion of high performing fibre services to businesses. In particular, they aim to incentivise our high bandwidth fibre services and upgrading existing fibre connections to faster business fibre plans, with a focus on Hyperfibre and point-to-point plans.</p> <p>The FY22 Advantage incentives end on 30 June 22. Monitoring indicated these continued to drive uptake of business fibre products, especially for BS2, resulting in a growth in ARPU for the business portfolio.</p> <p>The Choice proposal intends to build on this uptake and continue to grow ARPU, by utilising credit to achieve three particular objectives (which align with our strategic fibre product strategy):</p> <ol style="list-style-type: none"> Expediting Evolve (being grandfathered) to Small Business Fibre uptake Increase the number of RSPs selling Hyperfibre Increasing uptake of higher bandwidth plans including Business Max, Hyperfibre and point to point EBS4 variants (including new variants being offered from October 2022, which we want to encourage RSPs to productise). <p>This incentive focusses on high bandwidth business connection growth to ensure New Zealand businesses have the best connectivity to meet their needs.</p> <p>We believe the use of these incentives will push RSPs to calibrate their sales efforts towards superior business fibre offerings which will reduce churn risk and drive higher revenue.</p>	<p>https://sp.chorus.co.nz/product-offer/choice</p>

8.0 Appendices

Incentive	Design principles and offer criteria	Offer documents
	<p>Offer Criteria</p> <p>Credits are available for new connections and upgrades from offnet or lower-grade plans for BS2 (Small Business Fibre 100, Small Business Fibre Max and Small Business Hyperfibre) of between \$50 and \$500 and for BS3 moving to Hyperfibre of between \$600 and \$800. For BS4, moves from offnet or non-premium plans to NGA Premium receive an installation credit of \$1000 or \$2000 as applicable, plus free managed provisioning and hot cutovers. Some standard exclusions apply, and there is a pro-rated clawback for disconnections or downgrades within 12 months.</p>	
Hyperfibre Install	<p>Design principles</p> <p>Hyperfibre is expected to form an important part of Chorus' long-term strategy, [</p> <p style="text-align: center;">CCI]. We consider that providing an incentive encourages uptake. It also helps overcome the barrier to uptake of Hyperfibre that is created by the need for a physical change of the ONT. In May 2022 Chorus decided to extend the existing ONT upgrade promotion from 01 July to 31 December 2022. This sits alongside the plan to reduce the ONT upgrade fee from \$399 to \$199 permanently in October 2022 (to be confirmed in early July 2022).</p> <p>We expect the following benefits from this incentive: [</p> <p style="text-align: center;">CCI]</p> <p>Offer criteria</p> <p>The offer is available for orders for new connections to Hyperfibre, and is subject to clawback if the service disconnects within 12 months.</p>	<p>https://sp.chorus.co.nz/product-offer/hyperfibre-ont-upgrade-offer-0</p>
Home Fibre Starter Incentive	<p>Design principles</p> <p>We want all New Zealanders to have the best possible broadband experience but understand there are many households where affordability is a real issue.</p> <p>To ensure that consumers with less disposable income have a fibre option we launched the Home Fibre Starter plan (available 1 April 2022), with an accompanying incentive which offers RSPs an upfront \$75 credit for residential</p>	<p>https://sp.chorus.co.nz/product-offer/home-fibre-starter-plan-and-introductory-incentive</p>

8.0 Appendices

Incentive	Design principles and offer criteria	Offer documents
	<p>connections to a 50mbps service conditional on a maximum price to the end consumer of \$60 per month.</p> <p>The credit is based on the difference between the standard price of HFS (\$44.22) and the special price of \$38.00 for RSPs which sell it at or below the retail price cap of \$60 per month.</p> <p>The structure of this incentive enables us to test the impact of a retail price cap in driving consumer uptake, as well as encouraging RSPs to onboard and promote this entry-level plan.</p> <p>Offer criteria</p> <p>Each new-to-Chorus-fibre connection (first-time install or an intact that has been offnet >1mth) to the Home Fibre Starter plan, where the RSP is publicly advertising the applicable monthly retail price at \$60 or less (including GST), will receive a credit of \$75.</p> <p>Should the connection disconnect, or re-price above \$60 within 12 months of the credit being paid, a clawback (on a pro-rata basis) will apply.</p>	
[CCI]	[CCI]	

8.0 Appendices

8.3 Appendix C: List of models provided

Models used to forecast the amount proposed in the individual capex proposal:

- Incentives forecast: '5. ICP connection data – Final for Commission (Confidential).xlsx'
- Business forecast: '6. Incentives plan workings BUSINESSv7 – Final for Commission (Confidential).xlsx'
- Consumer forecast: '7. Incentives plan workings CONSUMERv6 – Final for Commission (Confidential).xlsx'.

Economic model used to estimate the net benefit for incentive credits Chorus expects to offer in CY23:

- '8. Incentives economics workings – Final for Commission (Confidential).xlsx'.

8.4 Appendix D: List of accompanying documents

- NERA, *Customer incentive payments and the long-term benefit of end-users*, 7 July 2021 (confidential and public versions of this report are provided)
- CEO certificate
- KPMG, Chorus ICP RY23 Assurance Report
- ICP offer details – PDF versions of our incentive offer details from the service provider website.

8.0 Appendices

8.5 Appendix E: Index of information required by approved design proposal

Table 15

Requirement	Reference	Location in this proposal
The confirmed amount of customer incentives capex requested. This amount will be net of expected claw-back.	Chorus design proposal, paragraph 51(a)	Section 2.2, Table 4
A description of the governance processes that have been applied in planning and approving the proposed capital expenditure.	Chorus design proposal, paragraph 51(b)	Section 5
The historical amounts of customer incentives capex (from FY2019 only).	Chorus design proposal, paragraph 51(c)	Section 2.2, Table 3 and Table 4
A description of the approach to forecasting customer incentives expenditure, including assumptions and information used to test the forecasts.	Chorus design proposal, paragraph 51(d)	Section 2.5 Also Consumer forecast and Business forecast models. (Sheets: Summary – Calendar years, Rates annual adjustments, Upgrade calcs, NationalLines (Actual and plan))
Economic analysis, consistent with the test used for the customer incentives in the expenditure proposal, which demonstrates the benefit of customer incentives expenditure. This will include: i. The average cost for every successful end-user acquired / up-sold. This is the estimated average cost of the credits provided to each end-user. ii. The expected ARPU across our GPON connections for end-users acquired / up-sold.	Chorus design proposal, paragraph 51(e)	Section 3. Also, Appendix C: Economic model Table 10 (Also Economic model, Scenarios_Notes!Q26 and Scenarios_Notes!Q27) Table 10 (Also Economic model, Scenarios_Notes!Q18, Net benefits!E83)

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Requirement	Reference	Location in this proposal
iii. The average expected retention time for end-users acquired or up-sold (i.e. assumed expected total life of end-users).		Table 10 (Also Economic model Net benefits!D22)
iv. [superseded by approval letter – see below]		n/a
v. Estimates of the net benefit for incentive credits we expect to offer in 2023 (this will be a conservative estimate as these net benefits would be calculated using the economic test; the narrow economic test is unnecessarily stringent because it ignores consumer benefits of enhanced connectivity).		Table 10 (Also Economic model, Net benefits!E78, Net benefits!E79)
A description of the competition effects of the customer incentives expenditure, including potential impacts on competition in PQ FFLAS and other telecommunications markets.	Chorus design proposal, paragraph 51(f)	Section 4.2
A description of the process Chorus applies to ensure that the proposed incentives comply with Chorus' non-discrimination and geographically consistent pricing requirements.	Chorus design proposal, paragraph 51(h)	Section 4.1
Confirmation, by reference to our annual reports, that incentive payments are capitalised as part of customer retention costs under NZ IFRS 15 (Revenue for Contracts with Customers).	Chorus design proposal, paragraph 51(h)	Section 7.1
Description of the uncertainties related to the need for, economic case justifying, and the timing of the proposed customer incentives expenditure.	Chorus design proposal, paragraph 51(i)	Sections 2.5 and 3
A description of the consultation by Chorus on the proposed customer incentives expenditure, how input from consultation is incorporated into the forecast capital expenditure and what impact it has had on the individual capex proposal.	Chorus design proposal, paragraph 51(j)	Section 6
An assessment of the deliverability of the proposed customer incentives	Chorus design proposal, paragraph 51(k)	Section 7.2

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Requirement	Reference	Location in this proposal
capex, including details of past incentives spend compared to budgets.		
A description of the impact, if any, the proposed customer incentives capex would have on the previously determined base capex allowance and operating expenditure for PQP1.	Chorus design proposal, paragraph 51(l)	Section 7.3
Assurance materials – CEO certification and external audit report.	Chorus design proposal, paragraph 51(m)	Listed in Appendix D
Any expert reports or advice that contributed to the proposal.	Chorus design proposal, paragraph 51(n)	Listed in Appendix D
an overview of the incentive payments capex Chorus proposes for 2023, including:	Commission design proposal approval letter, Attachment A, clause 2.1	Section 2.2
an overview of the incentive payment plans Chorus intends to offer in 2023 including guiding design principles, and structure of the different incentive payments;	Commission design proposal approval letter, Attachment A, clause 2.1.1	Section 2.3 and Appendix B
an estimate of the individual incentive amounts offered to RSPs for each relevant incentive plan; and	Commission design proposal approval letter, Attachment A, clause 2.1.2	Section 2.3
typical conditions related to the plans offered to RSPs	Commission design proposal approval letter, Attachment A, clause 2.1.3	Appendix B
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	Commission design proposal approval letter, Attachment A, clause 2.2.1	Section 2.5
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	Commission design proposal approval letter, Attachment A, clause 2.2.2	Section 3.2
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)	Commission design proposal approval letter, Attachment A, clause 2.2.3	Section 3.2 (Also Economic model Net benefits!I22)
latest data on the proportion of premises that (A) are passed; and (B) are not connected; and (C) have an existing lead-in.	Commission design proposal approval letter, Attachment A, clause 2.3.1	Section 2.4

8.0 Appendices

Requirement	Reference	Location in this proposal
the latest forecast number of new connection incentives (ie number, not \$ amount). Or, if unavailable, forecast number of GPON connections	Commission design proposal approval letter, Attachment A, clause 2.3.2	Table 8
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)	Commission design proposal approval letter, Attachment A, clause 2.3.3	Table 8
the model/s Chorus has used to: <ol style="list-style-type: none"> a. forecast the amount proposed in the individual capex proposal 	Commission design proposal approval letter, Attachment A, clause 2.3.4(a)	Listed in Appendix C
the model/s Chorus has used to: <ol style="list-style-type: none"> a. estimate the net benefit for incentive credits Chorus expect to offer in 2023 	Commission design proposal approval letter, Attachment A, clause 2.3.4(b)	Listed in Appendix C
the expected lifetime for connection lead-ins	Commission design proposal approval letter, Attachment A, clause 2.3.5	Table 12 (Also Economic model, Net benefits!D38:I38)
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	Commission design proposal approval letter, Attachment A, clause 2.3.6	Table 10 (Also Economic model, Net benefits!E80:81)
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	Commission design proposal approval letter, Attachment A, clause 2.3.7	Section 2.2 (at end of section)
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).	Commission design proposal approval letter, Attachment A, clause 2.4	Tables 10, 12 & 13. Items are generally expressed in monthly terms, except where this is not a sensible way to present the information.
Chorus must provide the following information instead of 51(e)(iv) in its design proposal:	Commission design proposal approval letter, Attachment A, clause 3	Table 8

8.0 Appendices

Requirement	Reference	Location in this proposal
<p>The forecast uptake (number of end-users acquired) that is expected as a result of the proposed customer incentives capex for:</p> <p>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.</p>		
<p>the proposed capex must be additional to any base capex allowance and connection capex baseline allowance for the regulatory years of each regulatory period relevant to the individual capex proposal</p>	IM determination clause 3.7.22(3)(a)	Section 7.1. Also, Design Proposal page 5.
<p>the proposed capex must relate to one or more base capex subcategories included in the base capex proposal for the first regulatory period relevant to the individual capex proposal</p>	IM determination clause 3.7.22(3)(b)	Design Proposal page 5.
<p>the proposed individual capex must relate to a project or programme, where the forecast capital expenditure for PQ FFLAS on that project or programme is at least \$5 million over the life of the project or programme</p>	IM determination clause 3.7.22(3)(c)	Section 2.2
<p>A characteristic of the proposed capex is that: it was unreasonable to accurately forecast the capex for the project or programme at the time of the base capex proposal, due to uncertainty in the need for, economic case for or timing of the project or programme</p>	IM determination clause 3.7.22(3)(d)	Design Proposal page 5.