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Commerce Commission
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By email: infrastructure.regulation@comcom.govt.nz

5 February 2024

Dear Keston

Notification of material change to PQP2 capex proposal

Introduction

1. This letter notifies the Commission, in accordance with clause 3.7.3 of the Fibre Input Methodologies, of a material change to Chorus' PQP2 capex proposal (**proposal**) in relation to proposed network extension capex.
2. Our proposal as submitted to the Commission on 31 October 2023 sought approval for \$201m of capex to extend fibre coverage to an additional ~40,000 premises beyond the existing UFB footprint over the four-year period of PQP2 under a 'Fibre Frontier' initiative conditional on positive outcomes in terms of pricing, market and regulatory development and subject to business casing.
3. In December 2023, Chorus entered into a contract with Ventia to complete build to 10,000 premises (**Phase 1 Fibre Frontier**).
4. On 2 February 2024, Chorus' Board decided that Chorus can currently commit only to this first phase of Fibre Frontier during PQP2. The key factors informing the Board's decision are outlined below.
5. Consequently, we notify the Commission of a reduction in Fibre Frontier capex sought in PQP2 to \$13m and have amended the Fibre Frontier chapter of our proposal to reflect that.
6. We explain this change and justify the revised amount of PQP2 capex sought for Fibre Frontier below.

Rationale for Chorus' decision that we can currently only commit to a reduced level of Fibre Frontier investment

7. In discussions with the Commission ahead of submitting our proposal, and in the proposal itself, we highlighted that the \$201m of proposed Fibre Frontier capex was conditional on positive outcomes in terms of pricing, market and regulatory developments and subject to future business casing.
8. We entered into an agreement with Ventia in December 2023 to complete a \$40m build to an additional 10,000 premises beyond the current footprint, with build to start this month and be completed by June 2025. Of this tranche \$13m will fall into RP2.
9. As we developed detailed business casing and undertook market testing for the Phase 1 Fibre Frontier build, it became very clear that conditions for making further investment are too uncertain. Our investors, who have been asked to support a huge investment programme that, from 2011, deferred returns into the future, are not comfortable with Chorus taking on another substantial capex programme, without more certainty on future regulatory and policy frameworks and market evolution. Given the significant investments

made to date, the further investment proposed over PQP2, and the potential for increased competition over the lifetime of our assets, caution is required to ensure we remain confident we can make a normal return.

10. Since we began the development of our proposal, we had hoped to see greater line of sight to regulatory and policy settings that will allow a sensible transition away from legacy copper services (freeing capital to invest in fibre), provide a more level playing field across the industry and allow greater flexibility to make a normal return on the significant investment that has been made to date.
11. We continue to believe that the network expansion capex included in our original proposal is strongly in the interests of consumers and New Zealand generally, meets the capital expenditure objective and reflects good telecommunications industry practice. Fibre remains the best long term technology choice for most New Zealand consumers. Closing the rural/urban digital divide will bring significant economic benefit to New Zealand.
12. We now consider the most appropriate regulatory mechanism for seeking approval for any further fibre frontier investment would be via the individual capex proposal mechanism once we have more certainty on future framework and market development. We will continue to engage with the Government, the Commission and policy makers on appropriate settings to support further investment.

Revision to Phase 1 Fibre Frontier investment

13. We are therefore seeking funding in PQP2 for our Phase 1 Fibre Frontier build programme, which we forecast to be \$13m in PQP2 and will see an additional 10,000 New Zealanders with access to fibre by June 2025.
14. This is explained in more detail in the **attached** mark-up to the Fibre Frontier chapter which shows how our Fibre Frontier investment proposal has changed following the Board's decision.
15. As discussed with Commission staff, we will update for other consequential impacts (connections, bandwidth) post draft decision.

Why the revised investment is prudent and efficient

16. As noted above, the original network expansion proposal meets the capital expenditure objective and reflects good telecommunications industry practice. This revised proposal puts forward a subset of the original proposal for approval, incorporating Phase 1 of network expansion. Our original network expansion proposal was prudent and efficient; we consider the revised proposal clearly meets the expenditure objective, as:
 - 16.1. The cost per premises of deployment for Phase 1, based on the agreement with Ventia, is now confirmed and is lower than the average cost we had forecast for the originally proposed 40,000 premises;
 - 16.2. The urban fringe areas being targeted are amongst the most efficient areas for Chorus to expand into, generally being close or adjacent to existing UFB footprint;
 - 16.3. Areas highlighted by the Independent Verifier have been resolved or are substantively mitigated:
 - 16.3.1. in relation to the market testing of programme costs, this has been completed for Phase 1 and the agreed build costs, as noted, are lower; and

16.3.2. in relation to the implications on deliverability of the broader capex programme, we remain confident the original proposal could have been delivered successfully. However, in the revised proposal the extent of field services and other work for network extension is substantively reduced which mitigates any risk there might have been regarding deliverability.

17. The revised proposal meets the economic tests described in the proposal:

17.1. For the workably competitive market test, the breakeven wholesale price for 2024 of the proposed investment is █████ per connection per month, lower than our estimated average revenue per user for 2024. This is lower than estimated for the full network extension programme in the original proposal and well within what we estimate end-users are willing to pay.

17.2. The telecommunications networks optimisation test presented in our proposal remains valid. Extending fibre provides a materially higher net benefit stream than the next best alternative of extending FWA.

18. The key sensitivities described in the proposal remain valid though we note the breakeven wholesale price for the revised proposal is now significantly lower given the much greater likelihood that Phase 1 Fibre Frontier end-users will not only fully pay for the Fibre Frontier investment over the assets' life but also contribute to paying back the cost of the existing network.

19. The Phase 1 network extension investment has been subject to several rounds of review and challenge by Chorus' Board to ensure the investment is justified and cost effective. This included two Board reviews and the governance processes outlined in the PQP2 proposal chapter including senior management review and Executive Steering Group oversight.

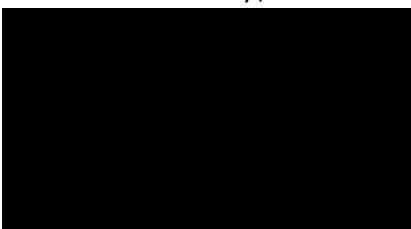
Other engagement

20. Today Chorus will issue a market release advising of the plan to progress with Phase 1 Fibre Frontier and the associated capex amount, which is spread across PQP1 and PQP2, and the shifting of the remaining proposed investment to potential future individual capex proposals. We will also contact Ministers, CIP, MBIE, larger RSPs and other stakeholders with this information. There will be further public communications issued later in February with information about the planned locations for the investment.

21. We are committed to working with the Government, policy-makers and the Commission to find settings that will allow a sensible transition away from legacy copper services (freeing money to invest in fibre), provide a level playing field and allow greater flexibility to make a fair return on the significant investment we have made to bring world class fibre services to 87 percent of New Zealand homes and businesses.

22. If you have any questions in relation to this letter, please do not hesitate to contact me.

Yours sincerely,



Chief Corporate and Regulatory Officer
Chorus