



Fibre input methodologies review
(Tranche 1)
Draft decision reasons paper

Submission | Commerce Commission
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Introduction

1. Thank you for the opportunity to provide feedback on the Commission's Fibre input methodologies review 2027 draft decision (**draft decision**).
2. In this submission we focus on the Commission's approach to competition objectives, the proposed cost–benefit investment test for network expansion capex (including end-user willingness-to-pay assumptions), the proposed \$30m threshold for individual capex proposals, and the proposal to recover contractual penalties and rebates through the Building Block Model (**BBM**).

The promotion of competition

3. In our earlier submission, we recommended that the Commission promote certainty and competition by setting out the competition outcomes it is seeking to achieve through the regulatory settings.
4. We agree with the Commission that competition considerations are relevant to its decisions—particularly where expenditure proposals may affect competitive dynamics in the wider telecommunications sector—and that competitive effects are inherently complex and highly context-dependent.
5. However, without clarity on the medium-term competition outcomes the Commission is seeking to achieve, it is difficult to see how the input methodologies can meet their statutory purpose to promote certainty for all parties. The independent Governance and Effectiveness Review of the Commerce Commission¹ highlights the importance of setting a strategic direction when regulating critical services.
6. Richard Feasey further notes in his report that telecommunications regulation and markets are highly path-dependent: decisions taken in the past constrain the choices available today and in the future. Accordingly, where key incremental decisions are left to Chorus without longer-term Commission competition objectives front of mind, Chorus effectively determines the framework outcomes rather than the Commission.
7. The Richard Feasey report is a useful starting point on the key competition issues faced by the Commission and parties. We recommend the Commission consider how these issues and objectives could be supported by the Fibre input methodologies.

Investment test for network expansion capital expenditure

8. The Commission proposes to assess large Chorus network expansion proposals by applying an investment test based on a cost–benefit analysis (**CBA**) that considers the costs and benefits of the proposal.
9. The Commission expects the primary benefit from network expansion capex to be an end-user benefit, represented by the notional revenue Chorus would receive from FFLAS end-

¹ <https://www.mbie.govt.nz/dmsdocument/31120-governance-and-effectiveness-review-of-the-commerce-commission-final-recommendations-report-proactiverelease-pdf>

users in the area, expressed as end-user willingness to pay (**WTP**), rather than the incremental revenue Chorus expects to gain in practice. Other potential benefits include competition effects, subsidies, and efficiency gains.

The Commission is making decisions best made by policy makers

10. By using a notional end-user WTP price and revenue, the Commission is seeking to adjust for the geographically consistent pricing (**GCP**) requirements in the Act. The GCP requirement prevents Chorus from charging higher prices in potential network expansion areas and this may limit otherwise beneficial network expansion.
11. However, in applying this model, the Commission is also making decisions relating to socially optimal investment, cross-subsidies between consumers, distributional effects, and market structure. In our view, these are decisions for policy makers and not the Commission. The GCP constraint may limit otherwise beneficial Chorus investment, but this would be one of the factors policy makers consider alongside other costs and benefits in setting the overall framework. Providers in competitive markets are constrained in the beneficial investments they can make by regulation.
12. In any case, the Government has now agreed to consider whether geographically consistent pricing should be retained, repealed, or modified². In our view, this review is where the effects of geographically consistent pricing should rightly be considered. We recommend that the Commission postpone decisions relating to fibre expansion until after that review has been completed.

Incremental end user benefits of expanding fibre coverage

13. Nonetheless, if the Commission continues with the proposed approach, we recommend that it provide more guidance on how it expects the CBA test to be applied. As set out in the draft, we agree that the CBA should be incremental, i.e., the incremental benefits to end users should exceed the incremental costs to expand the fibre network.
14. Where end-users already have access to a broadband service – as is the case for proposed overlay fibre networks - the incremental end-user benefits relate to service quality improvement over their current broadband connection. In other words, the incremental benefits to consumers from service performance improvement exceed end-user costs to expand the network. This is where investment is efficient and likely to be in end-users' interests.
15. However, in adapting current BBM processes for the CBA, the draft CBA departs from these principles and likely overstates end-user benefits. For example:
 - a. **Overstatement of benefits:** The draft IM amendments specify that the CBA proposal be based on the notional revenue Chorus receives end users in the network expansion area, calculated using customers' willingness to pay. In other words, the CBA assumes that the total value of the broadband service is a benefit attributable to the fibre investment even though the customer already has

² [Cabinet paper: Telecommunications Regulatory Review recommendations | Ministry for Regulation](#)

a broadband service. While WTP as defined is what the customer might notionally pay for a broadband service, the actual benefit is the improved service quality that fibre delivers over the existing broadband service. The proposed approach will inevitably overstate end-user benefits from fibre deployment and result in the Commission funding inefficient fibre expansion.

- b. **Inconsistent use of WTP:** Conversely, the notional WTP based price appears to be applied inconsistently in the model. For example, while Chorus' revenue estimate is based on a notionally (high) WTP price, the BBM base process would see estimated end-user demand based the (lower) averaged BBM price. In other words, while notional revenue per customer is high, forecast demand is based on the lower average BBM prices. If the CBA is used to determine whether the expansion is efficient, it will overstate demand and result in inefficient expansion of the network.

- 16. We support the Commission focusing on end-users' incremental benefits using a "with and without" approach. However, the proposed implementation through current BBM processes is unlikely to do and likely overstate end-user benefits. On the face of it, the Commission would be asking existing fibre customers to pay higher prices to fund network expansion beyond the value end users place on the service.
- 17. We recommend the Commission provide more detailed guidance on the proposed incremental approach, including key assumptions for incremental revenue and demand. The Commission may wish to consider assessing the incremental costs and benefits of fibre expansion through a standalone cost benefit analysis and—where that analysis is positive—then consider the changes that would need to be made to the BBM inputs.

Individual capex proposal threshold

- 18. The Commission further proposes to amend the Individual Capex Proposal process, including the introduction of a \$30m threshold for proposals.
- 19. It is unclear whether these new thresholds will apply to Chorus expenditure that has proven controversial, such as Chorus' connection incentive programme. Retail service providers are concerned that Chorus uses these incentives to undermine or distort competition from alternative network providers, and Chorus incentive expenditure proposals have previously been considered by the Commission.
- 20. We recommend the Commission preserve, in any amendments, the ability to require individual capex proposals for a class or nature of expenditure where there are specific concerns (for example, the competition concerns relating to connection incentives).

Funding of Chorus contractual rebates through the BBM

- 21. Finally, the Commission proposes to reverse an earlier proposal to stop netting off penalties and rebates that Chorus pays to retail service providers for failure to meet obligations under the contractual arrangements. The Commission saw this as providing a better incentive for Chorus to manage its quality performance by ensuring it faces the costs of contractual non-

compliance, rather than those costs being picked up by FFLAS customers. However, Chorus and Enable successfully argued that it is accepted practice for firms to set prices that account for additional costs such as this, and that doing so is part of the cost of doing business.

22. We agree with 2degrees that it is a perverse outcome for consumers to bear the cost of penalties for Chorus' failure to meet contractual obligations. Chorus has no real incentive to meet performance obligations where any penalties are recovered through the BBM.
23. We recommend the Commission continue to monitor the level of contractual penalties across Chorus and other LFCs and consider this issue further if performance declines.

[End]