

Cost allocation

- We must set an input methodology (IM) for evaluating or determining the "allocation of common costs (for example, between activities, businesses, access seekers, regulated services, or geographic areas)".
- This IM will help identify the portion of asset values and operating expenses associated with fibre fixed line access services (FFLAS).
- The cost allocation IM will be applied in setting information disclosure (ID) regulation, as well as providing a cost element for price-quality regulation (PQ).
- Different approaches to cost allocation may have materially different outcomes.
- Cost allocation can have an impact on how efficiency gains from providing multiple services are shared for the long-term benefit of end-users, and also via the amount of cost allocated to other services on the level of competition in other markets.

In the invitation to comment on our proposed approach, we asked stakeholders:

Q21 How should costs be allocated between regulated FFLAS and other services? Are there features of suppliers or services that require particular consideration (eg, business structure, presence of other forms of economic regulation, accounting systems etc)?

Q21 What views do you have on whether an IM for allocating costs between different FFLAS should be set for information disclosure and/or price-quality regulation?

Proposed approach based on what we applied in Part 4

- In our invitation to comment paper, we proposed to adopt the approach to cost allocation we have used under Part 4 of the Commerce Act 1986 (Part 4) when allocating costs between **regulated FFLAS and 'other services'**.
- Under this approach the cost of FFLAS services will comprise of:
 - **'directly attributable'** costs that are the costs solely associated with FFLAS, plus
 - A portion of **'common costs'** which relate to both FFLAS and 'other services'.

What are common costs?

- Common costs can include:
 - costs incurred in providing specific multiple services (eg, shared /joint costs relating to physical assets such as local exchanges or ducting); and
 - costs that do not relate to specific services (eg, corporate overhead costs).
- The 'other services' may be regulated under other parts of the Act, such as legacy copper-based services). They may also be regulated under Part 4 (eg, electricity distribution businesses) or be unregulated services.

Need to allocate common costs between types of FFLAS?

- It may be necessary to allocate costs between types of FFLAS.
- This could be challenging due to the number of FFLAS services offered, and the interaction of this issue with cost allocation with other services (non-FFLAS).
- This may be relevant to some of our responsibilities such as reviewing maximum prices for anchor services, direct fibre access services (DFAS) and unbundling after implementation date.
- It may require us to consider economic principles such as pricing efficiency.
- There is potential for any such methodologies to differ depending on the context. For example, they may differ by product type, or by whether the methodology is to be applied for ID or PQ.