

Chorus' price-quality path from 1 January 2022

Consultation on Chorus' proposed expenditure for PQP1

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Associated documents

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13 October 2020	[2020] NZCC 21	Fibre Input Methodologies Determination 2020
16 December 2020	-	Chorus Limited “Our Fibre Plans”
16 December 2020	-	CutlerMerz “Independent Verification - Chorus Expenditure Forecast 2022 to 2024”
16 December 2020	-	Notice to supply information to the Commerce Commission under section 221 of the Telecommunications Act 2001 - Requirements for base capital expenditure, connection capex baseline expenditure, and operating expenditure proposals
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CONTENTS

Chapter 1 Introduction	4
Purpose of this consultation paper	4
<i>Structure of this paper</i>	4
<i>Background to the expenditure proposal</i>	5
<i>Our approach to evaluating Chorus' expenditure proposal</i>	7
<i>Chorus' expenditure proposal</i>	11
Process and key dates for next steps	11
<i>Key milestones (including other PQID milestones)</i>	11
<i>Workshop on quality measures and standards for PQP1</i>	12
<i>Consultation on promoting competition and the role of ID and PQ regulation</i>	12
<i>Process for providing views</i>	13
Chapter 2 Proposed topic areas to target consultation feedback	15
<i>How we have identified the consultation topics</i>	15
<i>Stakeholder input that will best assist with our evaluation of Chorus' proposal and contribute to our draft decisions in mid-2021</i>	17
<i>Issues raised by CutlerMerz</i>	19
Appendix A – list of Chorus' proposal documentation	24

Chapter 1 Introduction

Purpose of this consultation paper

1. This paper is to invite views on Chorus Limited's (Chorus) expenditure proposals for its first price-quality regulation period (PQP1)¹ before we make our draft decision in mid-2021. The paper identifies specific aspects of Chorus' expenditure proposal on which we seek stakeholder's views. We are also interested in views on any aspect of Chorus' expenditure proposal that will help inform the evaluation criteria we are required to apply.
2. On 16 December 2020, Chorus submitted its expenditure proposal to the Commerce Commission (Commission). The proposal represents Chorus' views of the expenditure it needs over PQP1 to invest in its fibre network and to deliver the services that end-users want.²
3. Chorus' proposal and supporting documentation is available on our website.³ Alongside the expenditure proposal, Chorus also submitted the report by its external expert CutlerMerz.⁴
4. Note that we are still in the process of evaluating Chorus' expenditure proposal and have not expressed particular views on Chorus' proposed expenditure in this paper.

Structure of this paper

5. This paper is structured as follows:
 - 5.1 Chapter 1 discusses relevant regulatory and background information for the expenditure proposal, briefly describes the evaluation criteria we will apply and the approach we propose to take in evaluating Chorus' proposal, and the process we propose following;
 - 5.2 Chapter 2 discusses some specific aspects of Chorus' expenditure proposal on which we seek stakeholder's views; and
 - 5.3 Appendix A lists the documentation that makes up Chorus' expenditure proposal including a description of the content of each document.

¹ 1 January 2022 to 31 December 2024.

² Throughout this paper, unless otherwise specified, where we refer to Chorus' services, network, or end-users, we mean specifically its price-quality regulated fibre fixed line access (FFLAS) services, network, or end-users.

³ The proposal documentation is available on our website at: <https://comcom.govt.nz/regulated-industries/telecommunications/projects/fibre-price-quality-path-and-information-disclosure>.

⁴ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\)](#).

Background to the expenditure proposal

Chorus is subject to a new regulatory framework

6. From 1 January 2022, Chorus' fibre business will be subject to price-quality regulation under Part 6 of the Telecommunications Act 2001 (Act).⁵ Part of our role under this new regulatory regime is to set the maximum revenue Chorus can earn, and the quality standards it must meet. A key component of this maximum revenue allowance is an allowance for the recovery of Chorus' forecast costs.
7. We will decide Chorus' expenditure allowances for the upcoming regulatory period while taking into account Chorus' expenditure proposal, and assessing it against the evaluation criteria in the Chorus capital expenditure (capex) IM.⁶ The expenditure amount we determine will help determine the maximum allowable revenue Chorus can recover from its PQ FFLAS consumers.
8. For further information on the regulatory framework applicable to Chorus refer to Chapter 3 of the PQID Approach Paper.⁷

Submissions on the PQID approach paper and implication for our approach to evaluating expenditure

9. On 15 September 2020, we published our proposed process and approach paper for PQP1, as the first step in our consultation process on ID and PQ regulation.⁸ The purpose of that paper was to set out:
 - 9.1 how we understand our task as required by Part 6 of the Act;
 - 9.2 the process we propose to achieve this task;
 - 9.3 at a high-level, how we plan to do it; and
 - 9.4 how stakeholders can get involved in the process.

⁵ Unless stated otherwise all references to statutory provisions in this paper are references to statutory provisions under the Telecommunications Act 2001.

⁶ The capex IM is contained in [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), Part 3, Subparts 7 and 8.

⁷ [Commerce Commission "Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period" \(15 September 2020\)](#), Chapter 3. Refer to paragraphs 3.14 to 3.23 for a summary of the legal framework for PQ regulation, and paragraphs 3.93 to 3.98 for a discussion of the economic principles that apply.

⁸ [Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" \(15 September 2020\)](#).

10. The paper included our proposed process and approach to determining Chorus' expenditure allowances for PQP1, including how we assess Chorus' expenditure proposal.⁹
11. In October 2020, we received submissions on that paper, including those in support of the following areas of our proposed approach to assessing Chorus' expenditure proposal. Stakeholders raised the following matters in their submissions:
 - 11.1 the degree of reliance on Chorus' external expert's report;¹⁰
 - 11.2 our proposed use of an expert opinion to support our evaluation;¹¹ and
 - 11.3 the degree of scrutiny of operational expenditure (opex) forecasts and approach to consultation.¹²
12. We note the support for our proposed process (including this current consultation on Chorus' proposal), and the importance of not placing undue reliance on the information provided by Chorus or on Chorus' behalf. Chorus also submitted proposing the use of expenditure incentive settings.¹³
13. We consider our proposed approach aligns with submission feedback to our PQID approach paper. We consider the appropriate level of scrutiny and assurance will be applied to Chorus' expenditure proposal. This includes:
 - 13.1 The assurance requirements described in the Capex IM (and the information notice for opex);
 - 13.2 The Commission's own assessment and scrutiny of Chorus' expenditure proposal; and
 - 13.3 The use of an expert opinion to support our evaluation our Chorus' expenditure proposal.

⁹ [Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" \(15 September 2020\), paragraphs 5.141 to 5.192.](#)

¹⁰ [2Degrees "Submission on 'PQID process and approach paper'" \(16 October 2020\), pages 1 and 4.](#)

¹¹ [Vocus "Submission on 'PQID process and approach paper'" \(16 October 2020\), paragraph 1\(iv\) and 6\(xiv\); and Vodafone "Submission on 'PQID process and approach paper'" \(16 October 2020\), pages 6 to 7.](#)

¹² [Vodafone "Submission on 'PQID process and approach paper'" \(16 October 2020\), pages 6 to 7.](#)

¹³ [Chorus "Submission on 'PQID process and approach paper'" \(16 October 2020\), paragraph 38.](#)

Capex IM requirements relating to expenditure proposals

14. We must apply the Capex IM when assessing Chorus' capex proposal. The Capex IM prescribes the processes and rules for how we will assess and approve Chorus' forecast capex for upcoming regulatory periods, including the requirements Chorus must meet.¹⁴
15. The IMs do not prescribe an approach to assessing operational expenditure (opex). However, as set out in the process and approach paper, for PQP1, we propose to adopt a similar approach for opex to that specified in the Capex IM for assessing capex.¹⁵ Submitters did not object to our proposed approach to use the evaluation criteria in the Capex IM when assessing opex.

Information gathering notice

16. The Capex IM requires the Commission to issue an information request to Chorus prior to Chorus submitting an expenditure proposal. On 18 November 2020, we issued an information notice under s 221 of the Act.¹⁶
17. The information notice drew on requirements in the Capex IM to specify the information Chorus was required to provide in its expenditure proposals, along with audit and other assurance requirements.
18. On 16 December 2020, we received information from Chorus covering the majority of its proposal. On 5 February 2021, we received additional information related to historic costs and Chorus' approach to cost allocation. This timing was agreed between Chorus and the Commission to ensure the information provided is aligned with Chorus' process to determine the value of its initial regulatory asset base (RAB).

Our approach to evaluating Chorus' expenditure proposal

19. We will make a determination on the base capex allowance, connection capex baseline allowance and opex allowance for Chorus' upcoming regulatory period.¹⁷

¹⁴ [Commerce Commission "Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period" \(15 September 2020\)](#), paragraphs 5.150 to 5.166.

¹⁵ [Commerce Commission "Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period" \(15 September 2020\)](#), paragraphs 5.28 to 5.29 and 5.167 to 5.172. We did not receive submissions on this aspect of the proposal in the consultation.

¹⁶ We discussed this in [Commerce Commission "Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period" \(15 September 2020\)](#), paragraph 5.30; the information request is available at [Commerce Commission Notice to supply information to the Commerce Commission under section 221 of the Telecommunications Act 2001 \(18 November 2020\)](#).

¹⁷ Chorus may also apply for additional expenditure at any time through the individual capex mechanism. For further detail on individual capex, refer to section 4 in subpart 7 of the Fibre Input Methodologies.

20. We will assess Chorus' proposed expenditure against the evaluation criteria in the Capex IM.¹⁸ This includes considering whether the proposed expenditure meets the expenditure objective and reflects good telecommunications industry practice. In this instance, we have proposed applying the same evaluation criteria in the Capex IM when assessing proposed opex, while making appropriate changes in criteria where relevant.

Expenditure objective and good telecommunications industry practice

21. The expenditure objective as set out in the Capex IM is that capital expenditure "reflects the efficient costs that a prudent fibre network operator would incur to deliver PQ FFLAS of appropriate quality, during the relevant regulatory period and over the longer term".¹⁹
22. Good telecommunications industry practice means:²⁰

the exercise of a degree of skill, diligence, prudence, foresight and economic management, that would reasonably be expected from a skilled and experienced asset owner engaged in the management of a fibre network under comparable conditions. A decision on good telecommunications industry practice should take into account the domestic and international best practice, including international standards and factors such as the relative size, age and technology of the relevant fibre network and domestic regulatory and market conditions, including applicable law.

Capex IM assessment factors

23. We will also have regard to the relevant assessment factors in the Capex IM when considering whether a capex proposal has met the expenditure objective.²¹ The assessment factors will help us identify the different aspects of prudence and efficiency that we consider relevant when evaluating capex proposals, and to assist us in setting expenditure allowances that are consistent with the statutory decision making framework.²²

¹⁸ [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), clause 3.8.5(1).

¹⁹ [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), clause 3.8.5(2).

²⁰ [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), clause 1.1.4(2).

²¹ [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), clause 3.8.6; we discuss this in [Commerce Commission "Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period" \(15 September 2020\)](#), paragraph 5.175.

²² [Telecommunication Act 2001](#), s166(2).

24. The assessment factors we must apply to capex allowances, and that we are proposing to apply (where relevant) to the opex allowance, are listed in Table 1 below. We are interested in your views about whether the expenditure proposed by Chorus meets the expenditure objective when considered in light of these factors.
25. We will also ensure that the expenditure proposal is compliant with both the IMs and the information notice we have issued to Chorus.

Table 1 – Capex assessment factors

Capex IM assessment factors
Whether the proposed capex complies with all applicable legal and regulatory obligations associated with the provision of PQ FFLAS;
Governance relating to proposed capex, including evidence that appropriate policies and processes have been applied;
Historic capital expenditure and consideration of historic rates of investment;
Quantitative or economic analysis related to the proposed capex, including sensitivity analysis and impact analysis undertaken;
Approach to forecasting capital expenditure, including models used to develop the capital expenditure forecasts;
Relevant financial information including evidence of efficiency improvements in proposed capex;
Competition effects, including specific information for sub-categories of capital expenditure that have potential impacts on competition in PQ FFLAS and other telecommunications markets;
The linkages between the proposed capex and quality, including the impact the capital expenditure would have on PQ FFLAS quality outcomes;
Consideration and analysis of alternatives to the proposed capex, including the impact of the alternatives on PQ FFLAS quality outcomes;
The extent and effectiveness of consultation and engagement with stakeholders and the extent that feedback received has been incorporated into the capex proposal;
Procurement, resourcing, and deliverability of the proposed capex;
Common costs and benefits between PQ FFLAS, ID-only FFLAS and services that are not regulated FFLAS;
Fibre asset and fibre network information;
Mechanisms for controlling actual capital expenditure with respect to the proposed capex and achieving the PQ FFLAS quality outcomes;
The extent of the uncertainty related to the: need for the proposed capex; economic case justifying the proposed capex; and timing of the proposed capex;
The extent that a risk-based approach has been applied;
The impact that the proposed capex has on a layer 1 service in respect of PQ FFLAS;
The dependency and trade-off between the proposed capex and related operating expenditure to ensure least whole-of-life cost for managing assets and cost-efficient solutions;
The accuracy and reliability of data; and
The reasonableness of the key assumptions, methodologies, planning and technical standards relied upon.

Chorus' expenditure proposal

How to navigate Chorus' expenditure proposal

26. Chorus is required to provide the Commission with quantitative and qualitative information that sets out the proposed expenditure for PQP1. To assist with our evaluation, Chorus is required to separate/explain its proposal in expenditure sub-categories. These categories were agreed previously between Chorus and the Commission as part of the Capex IM and are set out in the information notice.
27. Chorus' proposal includes both holistic information relating to how the expenditure was forecast and specific information relating to each sub-category of expenditure. The documentation supporting Chorus' proposal includes an external expert report from CutlerMerz. As discussed in more detail in Chapter 2, the findings of this report have helped inform the focus areas where we are particularly interested in stakeholder views.
28. In Appendix A, we have tabled each document in Chorus' expenditure proposal by document type and included an explanation of the type of information presented in each document.
29. We note that some of the information provided by Chorus is confidential and has not been published. In specific cases, aggregated or amended versions of the information have been included in the published expenditure documentation. This has been done so that stakeholders have access to the maximum amount of information while still retaining Chorus' right to confidentiality on certain information.²³
30. On 20 January 2021, we issued a notification email requesting interested parties to contact the Commission if they want their independent experts to assess the confidential versions of Chorus' expenditure documents. We will allow those independent experts to access the documents, subject to confidentiality orders under s 100 of the Commerce Act 1986.

Process and key dates for next steps

Key milestones (including other PQID milestones)

31. A list of major milestones for the assessment of Chorus' expenditure, as well as the broader PQ work programme, is set out in Table 2 below.

²³ The Commission received updated versions of some of Chorus' public expenditure proposal documentation on 10 February 2021. This followed a process undertaken by the Commission to assess claims of confidentiality that Chorus' made on specific information in its expenditure proposal.

Table 2 – Current dates for the expenditure assessment and PQ projects

Date	Milestone	Description
26 February 2021	Quality of service workshop	Industry workshop on quality measures under ID and quality standards under PQ
12 March 2021	Consultation on Chorus' expenditure proposal	Date for receiving submissions on Chorus' expenditure proposal
May 2021	Chorus PQP1 draft decision	Draft decision on Chorus' allowable revenue and quality standards for PQP1
September 2021	Chorus expenditure final decision	Final decision on Chorus' capex allowances (per the capex IM)
November 2021	Chorus PQP1 final decision	Final decision on Chorus' revenue path and quality standards for PQP1

Workshop on quality measures and standards for PQP1

32. Stakeholders will have an opportunity to provide views on Chorus' proposed quality measures and standards at a Commission-run quality workshop in February. Chorus has proposed quality standards for PQP1 as part of its expenditure proposal.²⁴
33. We are interested in stakeholders' views on the quality standards proposed by Chorus and whether the proposed expenditure by Chorus is sufficient and appropriate to deliver the quality standards we set for PQP1. Chorus' expenditure proposal also provides contextual information on historical fibre quality performance and forecast performance for PQP1.

Consultation on promoting competition and the role of ID and PQ regulation

34. On 28 January, we published a paper and survey on competition to consult with stakeholders on:²⁵
- 34.1 the key risks that may lead to a lessening of competition in telecommunications markets, and key opportunities to promote competition in telecommunication markets; and
- 34.2 the role that the ID requirements for all regulated fibre service providers (regulated providers) and the PQ path for Chorus can play in mitigating these risks or seizing these opportunities.

²⁴ [Chorus "Our Fibre Plans" \(16 December 2020\)](#), Section 5.0.

²⁵ [Commerce Commission "Promoting competition in telecommunications markets as part of fibre information disclosure \(ID\) and price-quality \(PQ\) regulation – companion paper" \(28 January 2021\)](#).

35. In setting ID and PQ determinations, we have an obligation (where we consider it relevant) to promote workable competition in telecommunication markets for the long-term benefit of end-users of telecommunication services.²⁶ We consider that some areas of Chorus' proposed expenditure have the potential to impact competition.
36. These include:
 - 36.1 incentive payments; and
 - 36.2 the level of investment in layer 1 assets that are an input to rivals' layer 2 services.
37. For further detail on these issues, refer to the Commission's "Promoting competition in telecommunications markets as part of fibre information disclosure (ID) and price-quality (PQ) regulation" paper.²⁷
38. We are currently gathering views on these issues, and more broadly on risks to competition, in the competition survey. We encourage you to complete the survey by **5pm on 25 February 2021**.²⁸
39. When submitting feedback on Chorus' expenditure proposal, we encourage you to consider the competition paper and survey, as it may help you identify risks or issues with Chorus' expenditure proposal. Similarly, please submit in the competition survey any risks or issues related to competition that you identify as part of considering Chorus' expenditure proposal.

Process for providing views

40. We encourage stakeholders to consider Chorus' expenditure proposal and provide views to help shape our draft decision due in mid-2021. We are particularly interested in stakeholders' views on the questions set out in Chapter 2 of this paper.
41. Submissions can be made through the submission portal available on our website at: <https://comcom.govt.nz/file-upload-form-folder/file-upload-form/>
42. The project page will direct you to a form with instructions on how to upload your submission. Your submission should be provided as an electronic file in an accessible form.

²⁶ [Telecommunications Act 2001](#), section 166(2)(b).

²⁷ [Commerce Commission "Promoting competition in telecommunications markets as part of fibre information disclosure \(ID\) and price-quality \(PQ\) regulation – companion paper" \(28 January 2021\)](#).

²⁸ [Commerce Commission "Promoting competition in telecommunications markets as part of fibre information disclosure \(ID\) and price-quality \(PQ\) regulation – Survey questions" \(28 January 2021\)](#).

43. We invite submissions on the matters discussed in this paper or on any other issues related to the evaluation of Chorus expenditure proposal by **5pm on Friday 12 March 2021**.

Confidentiality

44. The protection of confidential information is something the Commission takes seriously. To continue to protect confidential submissions, we require you to upload your submission via the form on the project page. The process requires you to provide (if necessary) both a confidential and non-confidential/public version of your submission and to clearly identify the confidential and non-confidential/public versions.
45. When including commercially sensitive or confidential information in your submission, we offer the following guidance:
 - 45.1 Please provide a clearly labelled confidential version and public version. We intend to publish all public versions on our website.
 - 45.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
 - 45.3 Please note that all submissions we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we do not publish unless good reason existed under the Official Information Act 1982 to withhold it. We would normally consult with the party that provided the information before any disclosure is made.

Chapter 2 Proposed topic areas to target consultation feedback

46. This section presents the specific areas of Chorus' expenditure proposal on which we are most interested in stakeholders' views. The areas identified in this chapter are not an exhaustive list of what we are considering in making our decision. We are interested in your views on any other aspect of Chorus' expenditure proposal or Chorus' external expert's report.

How we have identified the consultation topics

47. We have identified consultation topics by considering:
- 47.1 An initial review of Chorus' expert's report findings and conclusions; and
 - 47.2 Which stakeholder input will best assist with our evaluation of Chorus' proposal and contribute to our draft decision.

Initial review of Chorus expert report findings and conclusions

48. Chorus commissioned CutlerMerz²⁹ to produce an external expert report on its expenditure proposal prior to submitting it to the Commission.
49. Chorus sought our involvement in a process for independent verification of its expenditure proposal for PQP1. We were unable to participate because the process for setting IMs for use in the development of the PQ path was not yet complete.³⁰

²⁹ CutlerMerz is a specialist management, economic and engineering consultancy to the energy sector.

³⁰ [Commerce Commission "Chorus' arrangements for an independent expert to scrutinise its capital expenditure for its first price-quality path" \(24 October 2019\)](#).

50. In its expenditure proposal, Chorus refers to CutlerMerz as an “independent verifier”.³¹ We have not referred to CutlerMerz as an “independent verifier” as the term carries a specific meaning in the IMs³² where an “intended independent verifier” must be approved by us before becoming an “independent verifier” of base capex and connection capex baseline proposals.³³ As the IMs requiring an approval process for the intended independent verifier of base capex and connection capex baseline proposals only apply for the second regulatory period onwards, we have not carried out an approval process for CutlerMerz which could result in it being an “independent verifier” under the IMs.³⁴
51. In our PQ/ID approach paper, we outlined a proposed approach for assessing a report provided by an “independent expert”.³⁵ As we have not undertaken an approval process under the IMs which would assess CutlerMerz’ independence, in this paper we refer to CutlerMerz as an “external expert”. We do not consider it necessary for us to form a view at this time.
52. However, we still consider the CutlerMerz report has value for the expenditure assessment process for PQP1. We have not yet reached a view on the entirety of CutlerMerz’s findings nor have we determined how we will incorporate or rely on the report. Our initial view is that the report by CutlerMerz provides a useful assessment of Chorus’ expenditure proposal. We can see evidence of how the process conducted by CutlerMerz has positively impacted the quality of Chorus’ expenditure proposal.
53. We will conduct further analysis of the report to determine how much we will rely on its findings in our evaluation.³⁶ For the purpose of this consultation paper, we consider it appropriate to consult on some of the potential issues/evaluation focus areas raised by CutlerMerz in its report. We summarise these areas below.

³¹ For example, Chorus “Chorus Modelling and Cost Allocation Report” (16 December 2020), page 3.

³² Under clause 1.1.4(2) of the IMs, an “independent verifier” means “...a person who-

- (a) is independent; and
- (b) has been engaged to verify part or all of Chorus’s capex proposal;”.

³³ Under clause 3.7.10 and 3.7.16 of the IMs, for the second regulatory period onwards we must approve intended verification information before the start of the verification process and be satisfied that:

- (a) the verifier is independent and capable of undertaking the verification; and
- (b) the terms and conditions of engagement and the scope of the independent verification report will provide the appropriate assurance needed to assess the applicable base capex and connection capex baseline proposal.

³⁴ Clause 3.7.10 and 3.7.16 of the IMs.

³⁵ [Commerce Commission “Fibre information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period” \(15 September 2020\)](#), paragraph 5.163-5.166, 5.174, and 5.188.4.

³⁶ We consider that our approach on how we will use CutlerMerz’s report in our evaluation is consistent with our approach outlined in the PQID Approach Paper. We discuss this in [Commerce Commission “Fibre](#)

Stakeholder input that will best assist with our evaluation of Chorus' proposal and contribute to our draft decisions in mid-2021

54. Chorus is proposing to spend \$983.3 million in capex during PQP1 – comprising \$504.4 million for network extension and installations, and \$478.9 million on recurring capex to sustain service quality while managing lifecycle and compliance needs.³⁷ Chorus is also proposing to spend \$599.2 million in opex during PQP1 (the three calendar years from January 2022 to December 2024).³⁸
55. Chorus' proposed capex and opex is broken down into individual sub-categories. We will assess each sub-category of expenditure separately as well as Chorus' expenditure proposal as a whole.
56. When reviewing Chorus' expenditure proposal, we have identified general areas of Chorus' proposal where we are interested in stakeholder views. Input into these areas will assist our evaluation of Chorus' expenditure proposal and support our draft decision on Chorus' allowances for PQP1. The areas or considerations we seek specific views from stakeholders on are:
- 56.1 Whether, after applying proportionate scrutiny, the expenditure objective has been met for each expenditure sub-category and for the expenditure proposal as a whole;³⁹
- 56.2 Potential gaps in the information provided by Chorus in its proposal documentation including but not limited to information on the justification of Chorus' proposed expenditure, and forecast methodology used;
- 56.3 Expenditure with potential competition impacts (eg, customer incentive payments, and investment in layer 1 assets that rivals use to deliver their own layer 2 services), noting the link with the competition and PQID consultation paper;
- 56.4 Expenditure where forecast certainty is low. Areas of Chorus' proposal that appear highly uncertain may be best treated as individual capex or deferred until later regulatory periods.

[information disclosure and price-quality regulation – Proposed process and approach for the first regulatory period” \(15 September 2020\)](#), paragraph 5.162 – 5.166.

³⁷ [Chorus “Our Fibre Plans” \(16 December 2020\)](#). Values are in constant 2019/2020 price terms and reflect Chorus' proposed cost allocation.

³⁸ [Chorus “Our Fibre Plans” \(16 December 2020\)](#), page 19. Values are in constant 2019/2020 price terms and reflect Chorus' proposed cost allocation.

³⁹ [Commerce Commission Fibre Input Methodologies Determination 2020 \[2020\] NZCC 21 \(13 October 2020\)](#), clause 3.7.5.

Question 1

We welcome your views on the overall appropriateness of Chorus' expenditure proposal and on whether it will deliver outcomes to the long-term benefit of end-users with specific reference to the areas raised in paragraph 56. We are also interested in specific issues you think the Commission should focus on in its evaluation.

57. An additional key element of our evaluation will be to determine Chorus' application of the IMs and how they impact its allowances. In some cases, in the proposal documentation, Chorus has included lease costs in its opex forecasts. This has been done to help explain the trends in these forecasts. Note that we will assess that the appropriate capitalisation of costs has been applied as per the IMs. We will also assess Chorus' approach to cost allocation, and the treatment of capital contributions in its forecasts.
58. For example, Chorus estimates that PQ FFLAS opex was 55% of FY20 total opex. This includes a high allocation of labour costs to PQ FFLAS. Chorus estimates that FFLAS labour opex was 91.25% of FY20 total opex (for Labour opex this is FY20 FFLAS (indicative) \$73m of FY20 reported \$80m).⁴⁰
59. Chorus' reason for this large allocation of labour costs to FFLAS, in its investor presentation, was that Chorus was founded as a fibre business and that, therefore, corporate overheads should mostly be attributed to fibre as these were incremental costs. However, given the relative segments of Chorus' business in 2020, as Chorus reported, we query this allocation of labour costs to FFLAS.⁴¹

	<i>GPON</i> ⁴²	<i>P2P</i> ⁴³	<i>Fibre</i> ⁴⁴	<i>Total</i>	<i>Fibre share</i>
Revenues (\$M)	393	73	466	959	49%
Connections	740,000	11,000	751,000	1,415,000	53%
Labour opex (\$M)			73	80	91%

Question 2

We want to know whether you agree with this estimated allocation of labour costs to FFLAS for FY20. We welcome your views.

⁴⁰ [Chorus "Price-Quality Expenditure Proposal Overview" \(17 December 2020\)](#), slide 9.

⁴¹ [Chorus "Annual Report 2020" \(24 August 2020\)](#), pages 2 and 22-23.

⁴² Fibre broadband (GPON).

⁴³ Fibre premium (P2P or point to point).

⁴⁴ Where Fibre is the sum of GPON and P2P.

Issues raised by CutlerMerz

60. CutlerMerz’s report has raised a number of potential areas that the Commission should investigate further during its evaluation of Chorus’ proposal. We will consider these issues as part of our general evaluation of Chorus’ proposal. We seek your views on the findings and conclusions in the report and whether the issues raised by CutlerMerz are the issues we should focus on in our evaluation.

Standard installations – IFRS 15 Customer Capex (customer retention and incentive capex)

61. Chorus’ expenditure proposal includes capex to incentivise, and for provision of, customer connections to the fibre network. These incentives include cash incentives to RSPs and end users as modem credits.
62. CutlerMerz found that the proposed expenditure for customer incentives reflected the efficient costs that a prudent fibre network operator would incur to deliver regulated FFLAS at appropriate quality, during the upcoming regulatory period and over the longer term, having regard to good telecommunications industry practice.
63. However, CutlerMerz found that additional information should be provided for the assumptions in the incentives model component of customer retention.⁴⁵ We have previously raised this type of capex as an area of interest in our evaluation and consider there could be potential competition impacts on other telecommunication services.⁴⁶

Question 3

We welcome your views on customer retention and incentive capex, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice. We are also interested in views on any competition impacts of this spend on relevant telecommunication markets and whether further information is required to assess Chorus proposed expenditure in this area.

Chorus’ proposal for innovation spend

64. Chorus proposes to invest \$42.1m in corporate IT and support capex. This sub-category of expenditure funds corporate innovation, optimisation, and corporate property and building costs.

⁴⁵ [CutlerMerz “Independent Verification, Chorus Expenditure Forecast 2022 to 2024” \(December 2020\)](#).

⁴⁶ [Commerce Commission *Fibre Input Methodologies: Main final decisions – reasons paper 2020 \[2020\]* NZCC 21 \(13 October 2020\)](#), paragraphs 7.157 – 7.158.

65. CutlerMerz' view is that the "methods and input assumptions used to forecast the Corporate capital expenditure would result in a forecast that reflects the efficient costs that a prudent fibre network operator would incur to deliver regulated FFLAS at appropriate quality, during the upcoming regulatory period and over the longer term, having regard to good telecommunications industry practice."⁴⁷
66. However, CutlerMerz states that its view is dependent on innovation capex being ring-fenced and recommends that the Commission focus its assessment on this area including testing that proper controls will be put in place to prevent investment in uneconomic projects. We have raised the challenge of determining innovation allowances in previous publications.⁴⁸

Question 4

We welcome your views on corporate IT and support capex, and in particular the component relating to innovation spend. This includes whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice.

Business IT - Customer capex and related opex sub-categories

67. Chorus proposes to spend \$32.7m on business IT for customer experience and optimisation. The programme would fund the IT solutions required to improve the experience of customers and to optimise Chorus' operations to improve efficiency and productivity.
68. CutlerMerz has identified some issues in relation to its requirement for 'capex/opex dependency and trade-off and whole of lifecycle cost'.
69. Specifically, CutlerMerz finds that while "Chorus has included a capex programme for IT optimisation which is expected to produce savings for the business and improvements in delivery of FFLAS services", the forecasts for the three major opex categories do "not appear to include any step changes or other adjustments for productivity improvements from the optimisation investment".⁴⁹
70. CutlerMerz concludes that while "analysis of minimum expected benefits has been included in the Optimisation Capex POD document, Chorus has not yet clearly linked any step changes related to Optimisation Capex into the opex forecasts."⁵⁰

⁴⁷ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\)](#).

⁴⁸ Commerce Commission Fibre Input Methodologies: *Draft* decision – reasons paper 2019 [2019] NZCC (19 November 2019), refer to Table 3.15 on page 452.

⁴⁹ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\)](#)

⁵⁰ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\)](#), customer opex at page 123, network opex at page 134, and support opex at page 143.

Question 5

We welcome your views on Business IT capex as well as the related opex sub-categories, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice.

Communal fibre access component of augmentation capex sub-category

71. Chorus proposes to spend \$10.3m on augmentation capex. This sub-category of expenditure funds the extension and enhancement of Chorus' fibre network and includes:
- 71.1 UFB infill – reticulation of unserved infill addresses and associated network elements where required (this includes replacement of faulty fibre);
 - 71.2 Communal fibre access – post UFB2+ rollout to smaller communities that did not make the list for the existing UFB roll-out phases.
72. CutlerMerz raised the risk that the communal fibre access component is contingent on certain criteria being met and may not be delivered during the regulatory period.⁵¹ We agree with CutlerMerz's view that the proposed expenditure for additional communal fibre access projects is uncertain and raises potential issues with the deliverability of projects.
73. While the spend amount is relatively small compared with other sub-categories, we still consider there is potential risk to stakeholders that the amount proposed for communal fibre access projects may not reflect the efficient costs that a prudent fibre network operator would incur to deliver regulated FFLAS at appropriate quality, during the upcoming regulatory period and over the longer term, having regard to good telecommunications industry practice.

Question 6

We welcome your views on augmentation capex, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice. We also welcome views on whether this expenditure would be best treated as individual capex.

⁵¹ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

Access electronics capex sub-category and approach to forecasting XGSPON upgrades

74. Chorus proposes to spend \$73.2m on the access capex sub-category. This programme funds access equipment that enables the connection of GPON (Gigabyte Passive Optical Networks) customers to Chorus' fibre network. This includes OLT ports in the Chorus Central Office and splitters in FFPs. Chorus also has a significant individual project to enable XGSPON products which requires replacement of OLT (Optical Line Terminator) cards for customers that request the product.⁵²
75. CutlerMerz noted that "the Access Electronics XGSPON volume forecast has a high level of uncertainty as it is dependent on the uptake of a new product (Hyperfibre) by end users. The volume forecasts are not based on actual uptake data as the product is only in the early stages of being released. The Commission should verify the volume forecast for Hyperfibre against actual uptake volumes closer to the time of the determination."⁵³

Question 7

We welcome your views on access capex, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice.

Building and infrastructure compliance capex in site sustain capex sub-category

76. Chorus proposes to spend \$36.2m on site sustain capex. The programme funds the building and engineering services infrastructure required to support the physical network and network electronics.
77. CutlerMerz raised potential issues with the uncertainty related to the proposed property and infrastructure compliance component of the expenditure. CutlerMerz noted that:⁵⁴

Chorus is proposing a material increase in expenditure over recent historical levels for Site Sustain capex for property and infrastructure compliance. Chorus has claimed that expenditure in this category had been deferred to facilitate the construction of the fibre network. Based on the evidence reviewed, we believe an increase from historic levels is prudent in order to improve the health of the assets. However, as the timing of maintenance and replacement activities is discretionary, we recommend that the Commission review the timing of the proposed expenditure in more detail before approving an expenditure forecast. We suggest that the Commission review Chorus' tracking of actual expenditure against current forecasts during FY21 to determine whether Chorus is investing as planned in this area before the final determination.

⁵² [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

⁵³ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

⁵⁴ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

Question 8

We welcome your views on site sustain capex, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice.

Field sustain capex

78. Chorus proposes to spend \$60.4m on field sustain capex. This programme funds the renewal and replacement of Chorus network assets (with the exception of poles which is funded in another expenditure sub-category).
79. CutlerMerz raised a number of potential issues with the level of uncertainty linked to the forecast expenditure in this sub-category as well as how the proposed expenditure is expected to impact quality outcomes.⁵⁵ CutlerMerz noted that:⁵⁶

Uncertainty is high across a number of components of this programme. However, some of this uncertainty is offset by third-party contributions to the cost (OHUGs, roadworks) that reduces the impact on Chorus' net capex.

Question 8

We welcome your views on field sustain capex, including whether the amount proposed by Chorus meets the expenditure objective and reflects good telecommunications industry practice.

⁵⁵ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

⁵⁶ [CutlerMerz "Independent Verification, Chorus Expenditure Forecast 2022 to 2024" \(December 2020\).](#)

Appendix A – list of Chorus’ proposal documentation

Table A1 – List and description of Chorus’ proposal documentation

Document type	Document	Description
Integrated Fibre Plan	Our Fibre Plans	Forms a key part of Chorus' proposal for expenditure on fibre fixed line access services (FFLAS) during PQP1, covering the three calendar years from January 2022 to December 2024. This covers all of Chorus’ integrated fibre plan (IFP) reports (except investment) and its connection capex proposal: <ul style="list-style-type: none"> - Overview - Governance - Demand - Quality - Delivery - Engagement - Connection Capex - Investment Summary
	Our Fibre Assets	This document constitutes the Investment Report, which is a requirement of the Integrated Fibre Plan, and forms a key part of Chorus’ expenditure proposal. It describes Chorus' assets, investment planning and operations for each expenditure category in its proposal. It outlines plans for PQP1.
	Glossary	Provides a summary of key terms and abbreviations used in Chorus’ proposal and information request responses.
	Document List	This list outlines all the documents included in Chorus proposal suite and the responses to the information request dated 18 November 2020.
Regulatory Templates	RT01 - Forecast expenditure	Regulatory template for forecast expenditure.
	RT02 - Cost escalation	Regulatory template for cost escalation.
	RT03 - Cost allocation	Regulatory template for cost allocation.
	RT04 - Connections capex and adjustment	Regulatory template for connections capex and adjustment.
	Modelling and Cost Allocation Report	This report explains how Chorus has developed its regulatory expenditure forecasts for both capex and opex. It includes an explanation of modelling approach and how Chorus has applied the cost allocation methodology.

Document type	Document	Description
Assurance documentation	Directors' certification	Director certification in line with the IM requirements.
	Assurance Opinion from KPMG	KPMG assurance opinion for audit of Chorus' proposal.
	Report from the External Expert	Report from CutlerMerz, which has assessed Chorus' full expenditure proposal.
	Compliance map	Sets out how Chorus' documents comply with the IM requirements.
	Confidential information appendix	Details the information over which Chorus claims confidentiality within the proposal and information request responses.
	Confidential information appendix for CutlerMerz report	Details the information over which Chorus claims confidentiality within the external expert's report.
Attachment A series – general and short form responses for information requests	A1. Cover letter	Letter introducing Chorus' information request responses.
	A2. Index for information request	A list of the information requests cross-referenced to where Chorus' responses can be found.
	A3. Short form responses	Short form responses to information requests with interpretation notes and explanations.
Attachment B series – long form responses for information requests	B1. Business Information	Contains information on: <ul style="list-style-type: none"> • Response on company structure and organisational information questions. • Response on key legislative obligations question. • Response on dividend and debt management strategy questions. • Response on questions relating to policies.
	B2. Forecasting Information	Contains information on: <ul style="list-style-type: none"> • Response on questions relating to forecasting approaches, key assumptions and uncertainties for capex and opex. • Response on questions regarding drivers, outputs, outcomes and benefits of capex and opex. • Response on questions relating to efficiencies.
	B3. Accounting Information	Contains information on: <ul style="list-style-type: none"> • Response on demarcation of base capex, connection capex and opex question. • Response on questions relating to asset valuation and lease treatment. • Response on question relating to capitalisation.
	B4. Regulatory Information	Response on questions relating to connection capex.

Document type	Document	Description
Attachment C series - Other supporting documents - referred to in our information request responses	C1. A30 annex – Asset Capitalisation Policy January 2020	Chorus' Asset Capitalisation Policy.
	C2. Asset Management Policy	Chorus' Asset Management Policy.
	C3. Procurement Policy	Chorus' Procurement Policy.
	C4. NZIER report – March 2020	NZIER report on cost escalators, March 2020.
	C5. NZIER report – September 2020	NZIER report on cost escalators post COVID-19, September 2020.
	C6. Service Level agreement extracts from service company contracts	Extracts from service company contracts with service level agreements.
	C7. A31 - opex to capex quantitative analysis	Opex to capex quantitative demonstration analysis for question 31 of the information request.