

Determining Chorus' first fibre price-quality path: Process update

30 April 2021

Purpose

1. To provide interested persons with an update on the process and timing of determining Chorus' Limited (**Chorus**) initial price-quality regulatory asset base (**Chorus' initial PQ RAB**), and how that fits within the process for determining the first price-quality path (**PQP1**) for Chorus.

Summary

2. In particular, this paper sets out our:
 - 2.1 adjusted timelines for key milestones for determining Chorus' initial PQ RAB;
 - 2.2 process for potential amendments to the input methodologies relating to the supply of fibre fixed line access services (**fibre IMs**) for implementing price-quality (**PQ**) paths and information disclosure (**ID**); and
 - 2.3 confirmed consultation timing and process for determining PQP1 and ID requirements to apply from 1 January 2022.

Adjusted timing for key milestones for determining Chorus' initial PQ RAB

3. We are providing this update now because we recognise that we have not detailed the process for determining Chorus' initial PQ RAB since the proposed process and approach paper we published in September 2020 (**process and approach paper**).¹ In that paper we highlighted that we may need to adjust key milestones or deliverables as the process progressed.² This paper sets out those adjustments.
4. This paper includes an explanation of how we intend to consider Chorus' proposed initial PQ RAB that we received on 26 March 2021 (**Chorus' initial PQ RAB proposal**) in our process.

¹ Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (15 September 2020).

² At para 5.123

Our updated process

5. We will follow the steps below when determining Chorus' initial PQ RAB. The descriptions below set out how the process links with our PQP1 process.
 - 5.1 **We will use Chorus' initial PQ RAB proposal as an input into our draft PQP1 maximum revenues decisions in May 2021.**³ This allows us to have a meaningful consultation on PQP1, using the best available input for the initial PQ RAB at the time.
 - 5.2 **We are consulting on what areas should be the focus of our scrutiny of Chorus' initial PQ RAB proposal.** This document has been published alongside this paper.⁴
 - 5.3 **We will determine a draft initial PQ RAB in August 2021, that will be the transitional initial PQ RAB input value for our final PQP1 decisions in November 2021.** This draft initial PQ RAB/Transitional initial PQ RAB will be based on estimates of asset values and an application of provisional cost allocators.
 - 5.4 **We will launch a consultation on the draft initial PQ RAB in August 2021.** This consultation will feed into the determination of the final initial PQ RAB in 2022.⁵
 - 5.5 **We will true-up for differences between the transitional initial PQ RAB and the final initial PQ RAB.** This will be applied in our decisions for the second price-quality path (**PQP2**) which will apply from 1 January 2025.

How our updated initial PQ RAB process fits with our PQ determination process

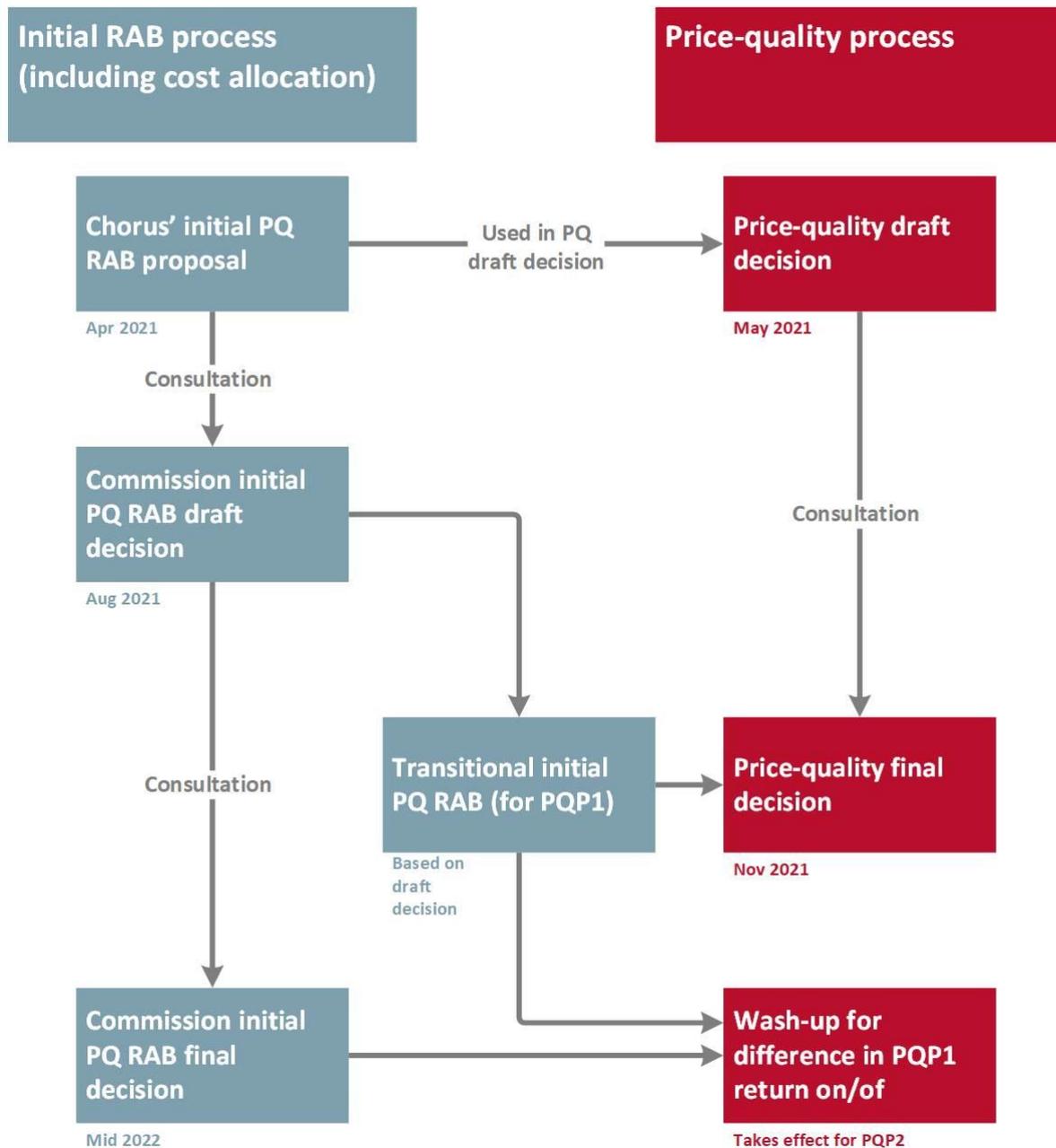
6. The way these processes link together is illustrated in **Figure 1** below. Note that the cost allocators Chorus have proposed for the initial PQ RAB will also be used to allocate forecast expenditure for PQP1 draft decisions. We will be consulting on these in August 2021. We intend to finalise the allocators we will use to determine forecast expenditure by November 2021 in time for our PQP1 final decisions.

³ Under Telecommunications Act 2001, s 194(2)(b)(ii) and s 195, our PQP1 must specify in relation to prices, the maximum revenues that may be recovered by a regulated provider.

⁴ Commerce Commission "Chorus' initial price-quality regulatory asset base as at 1 January 2022 – Consultation on Chorus' initial price-quality RAB proposal" (30 April 2021).

⁵ We intend to confirm the process for how we will determine Chorus' initial PQ RAB and the ID RABs for all LFCs, in 2022, after we have determined PQP1. The initial PQ RAB will include our determination of the financial losses under Telecommunications Act 2001, s 177(2).

Figure 1 – Links between initial PQ RAB and PQ processes



7. Note we are proposing that the determination of the initial ID RABs for all the other local fibre companies (**LFCs**) and the initial ID RAB and initial ID-only RAB for Chorus will be dealt with as part of a separate process.⁶ This will be done in 2022.

⁶ As per the regulations made under s226 of the Act, the LFCs subject to ID regulation are Chorus Limited, Enable Networks Limited, Northpower Fibre Limited, Northpower LFC2 Limited and Ultrafast Fibre Limited.

Our aims for setting the initial PQ RAB remain unchanged

8. The aims of our approach to set the initial PQ RAB remain the same as we set out in our process and approach paper:⁷
 - 8.1 ensure stakeholders have confidence that an appropriate level of scrutiny is applied and assurance processes are in place before we determine the value of the RAB that best promotes s 162 and 166(2)(b) of the Telecommunications Act 2001 (**the Act**);
 - 8.2 provide certainty to Chorus and other stakeholders on the initial PQ RAB value as soon as practical; and
 - 8.3 ensure the necessary work to establish the initial RAB is deliverable by Chorus and us in a timeframe required to set the allowable revenue for the first regulatory period, and allowing for a wash-up later once the initial RAB is finally determined.

Why we are adjusting timing of key milestones

9. We are currently in the process of determining PQP1 for Chorus under s 170 of the Act, and have commenced evaluation of Chorus' initial PQ RAB proposal as part of that process. That initial evaluation has led us to refine our intended process and time frame for determining Chorus' actual initial PQ RAB.
10. We received stakeholder submissions in response to our process and approach paper that outlined that we should include an extra step in our process – to consult on Chorus' initial PQ RAB proposal. Submitters that expressed this view were 2Degrees,⁸ Vocus,⁹ and Vodafone.¹⁰
 - 10.1 Having considered these submissions, our updated process to determine the initial PQ RAB now includes an additional step to consult on Chorus' initial PQ RAB proposal (published alongside this paper).

⁷ Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (15 September 2020), para 5.121.

⁸ 2Degrees "Commerce Commission Fibre information disclosure and price quality regulation – Proposed process and approach for the first regulatory period – 2Degrees submission" (14 October 2020), p 1.

⁹ Vocus "Fibre information disclosure and price quality regulation: proposed process and approach for the first regulatory period - Submission to the Commerce Commission" (14 October 2020), para (ix).

¹⁰ Vodafone "Vodafone New Zealand submission on fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (14 October 2020), p 6.

11. Since receiving Chorus' initial PQ RAB proposal on 26 March 2021, it has become clear that our original proposed process for a draft transitional initial PQ RAB in time for the draft PQP1 determination in May 2021 is not achievable,¹¹ because:
- 11.1 We do not expect to have obtained the required level of assurance (either via independent audit provided by Chorus or from our own assessment) of Chorus' initial PQ RAB proposal when we set out our draft decisions for PQP1.
- 11.2 The time available for scrutiny of Chorus' initial PQ RAB proposal prior to issuing our draft decisions for PQP1 has been too short to allow us to form a considered view of the calculation provided by Chorus in order to fulfil our mandatory decision-making considerations under s 166(2).
12. In our process and approach paper, we signalled that when determining the value of the final initial PQ RAB, we would need to decide on the scope of work required to update the final initial PQ RAB (determined in 2022) from the transitional initial PQ RAB that we will use as an input to our PQP1 determination.¹² We proposed two options at the time:¹³
- 12.1 update the component of the initial PQ RAB that is based on forecast values only. This would include applying scrutiny and assurance on these update years; or
- 12.2 update the forecasts and also undertake updates for actual values (including cost allocators), updates and/or error corrections (eg, asset data errors) relating to other years, with scrutiny and assurance activities wider than just update years.¹⁴
13. For the reasons outlined in para 10 above, we propose to use a transitional initial PQ RAB for PQP1 determined in November 2021, based on estimates of asset values and an application of provisional cost allocators. The actual initial PQ RAB for Chorus would be determined in 2022, once further review and scrutiny has been applied to those asset values and cost allocators. We would then 'true-up' for differences between the transitional and actual PQ RAB values through a wash-up mechanism, which would adjust revenue values in PQP2.

¹¹ Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (15 September 2020), Table 2.1.

¹² Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (15 September 2020), para 5.127 and 5.137.

¹³ At para 5.137.

14. Undertaking further scrutiny will enable us to consult on and determine a transitional initial PQ RAB before the determination of the final initial PQ RAB that will have gone undergone some review of material cost allocations and direct attribution of assets and operating costs.
15. Before the determination of the final initial PQ RAB in 2022, we consider that it is necessary to carry out further scrutiny of the transitional initial PQ RAB after having regard to submissions received on our transitional initial PQ RAB decision in August 2021.
16. This will allow the final initial PQ RAB determined in 2022 to have undergone sufficient review and assurance of material cost allocations and direct attribution of assets and operating costs.

Scope of the wash-up

17. In our process and approach paper, we noted that the need for an accelerated timeframe might reduce the time available to apply appropriate scrutiny and provide assurance to the initial PQ RAB. We noted that insufficient time to scrutinise and assure the initial PQ RAB before the final determination could be addressed by using an “initial PQ RAB estimate” that is scrutinised and assured after the final determination, with any differences between revenue consistent with the “initial PQ RAB estimate” and revenue consistent with the *[final]* initial PQ RAB washed-up.¹⁵

Why adjusting timing of key milestones best promotes the purpose of Part 6 of the Act

18. We consider this adjusted timeline and process to allow for further scrutiny will improve the quality and accuracy of the final initial PQ RAB determination in 2022. The further scrutiny will reduce the risk of material under or overstatement of these values, which would not be likely to best give effect to the s 166(2) purposes (in particular, the outcome in s 162(a) of regulated fibre service providers (**regulated providers**) having incentives to innovate and to invest and the outcome in s 162(d) of regulated providers being limited in their ability to extract excessive profits)).

Process for potential amendments to fibre input methodologies

19. As part of our process for determining PQP1 and ID, we have identified potential amendments to the fibre IMs as outlined in para 21 below. We have published notices of intention (**NOI**) alongside this paper to give formal notice of our intention that we are beginning work on these.

¹⁵ Commerce Commission “Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period” (15 September 2020), para 5.124.

Fibre input methodologies

20. On 13 October 2020 we determined the fibre IMs. On 3 November 2020, we amended the fibre IMs to include an input methodology (**IM**) for determining the initial value of the financial loss asset.¹⁶
21. As part of our process for making the determinations for PQP1 and ID regulation under s 170, we have identified:
 - 20.1 that amendments to the fibre IMs would be required to implement our proposed approach for determining Chorus' initial PQ RAB;
 - 20.2 certain circumstances where amendments to the fibre IMs are necessary to implement draft decisions that we are planning to make for our first PQ path and our ID requirements;
 - 20.3 certain circumstances where amendments to the fibre IMs would enhance certainty about the rules, requirements and processes that apply to PQ paths and ID regulation; and
 - 20.4 technical errors in the fibre IMs.
22. Having identified the matters outlined in paragraph 21, we are beginning work to consider potential amendments to the fibre IMs that would address these matters.
23. In our process and approach paper, we invited submissions on our proposed approach for amending the fibre IMs.¹⁷
24. We received a submission from Chorus on our proposed approach for amending the fibre IMs. Chorus supported our proposed approach and suggested that "it is important to adopt a flexible and pragmatic approach to addressing errors or gaps in the IMs that may only become apparent as we work through the detail of PQ and ID processes".¹⁸ We agree and consider that it is appropriate to propose amendments to the fibre IMs as long as those amendments are consistent with our proposed approach for amending the fibre IMs.
25. We have applied the proposed approach for amending the fibre IMs and consider that beginning work on a potential IM amendment process in respect of the matters identified in paragraph 21 would:

¹⁶ Commerce Commission "Fibre Input Methodologies (initial value of financial loss asset) Amendment Determination 2020" [2020] NZCC 24.

¹⁷ Commerce Commission "Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period" (15 September 2020), Attachment A.

¹⁸ Chorus "Submission on Fibre Regulation – Process and Approach" (14 October 2020), para 27-28.

- 25.1 fulfil our mandatory decision-making considerations under s 166(2); and
 - 25.2 be consistent with the purpose of IMs under s 174 by promoting certainty for regulated providers, access seekers, and end-users in relation to the rules, requirements, and processes applying to the regulation of FFLAS under Part 6.¹⁹
26. Alongside this paper, as required under s 179(1), we have published two NOI to begin work on these potential fibre IM amendments that:²⁰
- 26.1 outline the scope of the potential amendments under consideration by reference to the applicable IM and clause in the fibre IMs;²¹
 - 26.2 outline the proposed process that will be followed; and
 - 26.3 sets out our proposed indicative time frames.
27. As outlined in our NOI to begin work on these potential IM amendments, we intend to consult on draft fibre IM amendments in May 2021. In our consultation, we will explain:
- 27.1 why these draft fibre IM amendments best give or are likely to best give, effect to:
 - 26.1.1 the purpose in s 162, consistent with s 166(2)(a); and
 - 26.1.2 the extent that we consider it relevant, to the promotion of workable competition in telecommunications markets for the long-term benefit of end-users of telecommunications services
(promotion of workable competition);
 - 27.2 why these draft fibre IM amendments are consistent with the purpose of IMs under s 174; and
 - 27.3 why these proposed IM amendments are consistent with our proposed approach for amending the fibre IMs from our process and approach paper.

¹⁹ Telecommunications Act 2001, s 174.

²⁰ Telecommunications Act 2001, s 179(1).

²¹ Commerce Commission “Notice of Intention 29 April 2021 Proposal to Make Potential Amendments to the Input Methodologies for Fibre – potential August 2021 amendments” (29 April 2021), para 5-6 and Commerce Commission “Notice of Intention 30 April 2021 Proposal to Make Potential Amendments to the Input Methodologies for Fibre – potential November 2021 amendments” (30 April 2021), para 5-7.

Timeline for determining Chorus' initial PQ RAB, PQP1 and potential fibre IM amendments

28. Our revised process is set out in **Table 1** below, and illustrated in **Figure 2** at the end of this paper.

How our updated process promotes certainty

29. Chorus' expenditure proposal and initial PQ RAB proposal have already increased certainty through giving Chorus' view of their future investment and expenditure needs and past fibre investments.
30. Our draft PQP1 decisions in May will give our initial assessment of Chorus' expenditure proposal, as well as draft decisions on other inputs to Chorus' allowable revenue for PQP1. Our draft initial PQ RAB decision in August 2021 will give our initial assessment of Chorus' initial PQ RAB proposal.
31. Our final decisions on the major building-block parameters of Chorus' PQP1 allowable revenue (WACC, transitional initial PQ RAB, expenditure, and depreciation) from June to November 2021 will progressively narrow the range of possible allowable revenue.
32. Finally, long-term certainty about the value of regulated provider's initial RABs will come in 2022, when:
- 32.1 we make our final decision on the financial loss assets for Chorus and the other LFCs; and
 - 32.2 the initial RABs for Chorus (including the value of its PQ RAB and ID-only RAB) and the other LFCs are determined.
33. A summary of the remaining processes and indicative timings for determining Chorus' initial PQ RAB, Chorus' PQP1, and potential fibre IM amendments is set out in **Figure 2** below.

Table 1 – Key phases and milestones for fibre decisions

Phase	Timing	Scope
Initiation <i>Complete</i>	Q4 2020 to Q1 2021	Process and approach paper Submissions on process and approach paper Chorus PQP1 information request and proposal Consultation on Chorus PQP1 expenditure proposal Submissions on PQP1 expenditure proposal Stakeholder workshop on quality of service
Process update and initial PQ RAB proposal <i>Now</i>	29 April 2021 30 April 2021	Process update paper (this paper) Potential IM amendment NOI Publication of Chorus' initial PQ RAB proposal Consultation on Chorus' initial PQ RAB proposal Submissions on Chorus' initial PQ RAB proposal (four weeks)
Draft PQ and ID decisions	27 May 2021	ID draft decisions PQP1 draft decisions Potential August 2021 and November 2021 IM amendment draft decisions Submissions on potential August 2021 IM amendment draft decisions (four weeks) Submissions on ID, PQP1 and potential November 2021 IM amendment draft decisions (six weeks) Cross-submissions on draft decisions (two weeks)
PQP1 weighted average cost of capital (WACC) determination	By 31 July 2021	Publication of final PQP1 WACC determination
Draft initial PQ RAB decision	By 31 August 2021	Initial PQ RAB draft decision Final decisions on potential August 2021 IM amendments Transitional PQ RAB final decision Submissions on draft initial PQ RAB (four weeks) Cross-submissions on draft initial PQ RAB (two weeks)
Final PQP1 expenditure decisions	By 30 September 2021	Final decisions on base capex, connection capex, and opex allowances (excluding cost allocation)
Final PQ and ID decisions	November and December 2021	Final decisions on potential November 2021 IM amendments Final decisions on Chorus expenditure Final PQP1 decisions (including cost allocation) Final ID decisions
Final Initial RAB decisions	2022	Draft decisions on other LFC initial ID RABs and the ID RAB and ID-only RAB for Chorus Final decisions on all financial loss assets and determination of all initial RABs Disclosure on all initial RABs

Figure 2 - Updated timeline for Chorus PQP1 and related processes

