CHORUS

PO BOX 632

Wellington 6140

Tristan Gilbertson
Telecommunications Commissioner
Telecommunications, Regulation
PO Box 2351
Wellington 6140

By email: regulation.branch@comcom.govt.nz

26 March 2021

Dear Tristan

Response to Attachment B of the Commerce Commission's 26 February 2021 section 221 notice

1. This letter and the accompanying documentation forms Chorus' response (**Response**) to Attachment B of the Commerce Commission's (**Commission**) notice issued under section 221 of the Telecommunications Act 2001 (**Act**) dated 26 February 2021 (**Notice**) seeking certain information from Chorus in relation to the first initial price-quality regulatory asset base (**initial PQ RAB**).

2. We are providing the **final IAV Model**[1] and the **final AM Opex Model**[2] (together the **Models**) built by Analysys Mason. Drafts of these were provided to the Commission on 5 March 2021. We will continue to make Analysys Mason available to Commission staff to support their understanding of the model.

3. The Models are the critical input for establishing Chorus' starting RAB and the sustainability of price-quality regulation for our fibre access services. As the Commission will appreciate the modelling task is highly complex and significant work has gone into sourcing current and historical financial and operational data, building and testing the Models, and ensuring compliance against the relevant obligations.

4. The work required to implement price quality regulation by 1 January 2022 places both the Commission and Chorus under significant pressure. Given these timing pressures we are concerned that we still do not have clarity on the Commission's intended approach for establishing a starting RAB in order to propose a price path in its draft decisions scheduled for release on 31 May.

5. This process uncertainty, and compressed timeframe has required us to take a conservative approach, supported by a robust assurance process the Commission is able to rely upon. Analysys Mason has built a model (which has been assured by Deloitte) based on the best available data. That data can be reconciled to our published accounts and PwC has been able to verify that the model complies with its understanding of the Input Methodologies (**IMs**).

6. If the Commission intends to engage on the detail of the model with a view to seeking amendments, our expectation is that it would establish a process for a principles-based

---

[1] Pursuant to the Notice dated 26 February 2021, means a version of the IAV Model populated with data as of 26 March 2021 (A3.3.26).

[2] Pursuant to the Notice dated 26 February 2021, means a version of the AM Opex Model populated with data as of 26 March 2021 (A3.3.26).

discussion on key elements of the model. In particular, alternative approaches to cost allocation might better reflect the full costs of structural separation incurred by Chorus to participate in the government's UFB programme.

7. While the Models produce a conservative initial asset valuation of $5.5 billion, this result is likely to be below our shareholders' expectations. This will sharpen market focus on the maximum allowable revenue as the defining measure of a fair return for Chorus' participation in the UFB project. Recent decisions by Ofcom have been highlighted by our investors as significantly more favourable than those provided for by the IM decisions. Applying a cost of capital for the pre-implementation period that more accurately reflected the costs Chorus incurred to build the UFB network would have produced a starting RAB more aligned with investor expectations. As a result, the Models also support discussion of an asset valuation outcome of approximately $6bn, which is more in line with our investors' expectations. We would see this upper case as the starting point for any discussion of alternative cost allocation approaches.

8. Our expectation is for the Commission to review the information accompanying this Response and determine the initial PQ RAB before the end of the year. Our investors are seeking this certainty. We look forward to working with the Commission to support a robust draft Price Quality determination in the coming months. We will also ensure that our external experts continue to be available to respond to questions.

Response to Notice

9. Because much of the modelling work predates the IMs and the Notice, inevitably there are some instances in which the Response is incomplete, or is not in full technical compliance with the IMs or the requirements of the Notice, or where there are competing interpretations available. However, we are confident that the Response is consistent with the spirit and intention of the Act and IMs. In the interests of full transparency, we have identified in Appendix A to this letter instances (of which we are aware) in which the Response is either incomplete or there is room for reasonable disagreement regarding compliance. You will note that the executive certification provided alongside the response expressly refers to these qualifications. We expect to discuss these issues with the Commission further in the course of your evaluation of the Models. A number of the issues identified in the Appendix are the subject of RFIs issued by the Commission since we submitted our draft models on 5 March and therefore are already known to the Commission.

10. We respond to Attachment B of the Notice by way of the Models and information requested, as detailed in the document list and responses (named Appendix B), in the formats requested and uploaded to the Commission's box.com data room.

11. To the extent additional allocators are applied, our intention is that the information provided in this Response provides notice to the Commission for its approval process.

12. Additional explanation on our approach is included at **Appendix A** of this letter.

Asset valuation and pricing outcomes

13. We are required to prepare an initial asset valuation that complies with the IMs. We made a principled decision not to appeal those aspects of the IMs that we disagreed with and instead have focused on working constructively with the Commission to develop the price-quality determination. In practice, an IMs appeal would have made the process of reaching a robust price-quality determination before 1 January 2022 unworkable. The Commission still has discretion to make targeted amendments to address unintended consequences that we identify in the course of the current process. That would be consistent with the Commission's approach in other contexts – for example the recent EDB DPP reset, in which the Commission considered IM amendments in parallel with the determination. Accordingly, in the course of evaluating the initial asset valuation, we would hope to have a sensible discussion with

the Commission about any amendments that are required to give proper effect to the purposes of the Act.

Chorus' asset valuation model and certified approach

14. We have submitted a model that supports a stable, sustainable outcome: a solid conservative starting RAB of $5.5 billion. The model also supports consideration of alternative cost allocation approaches ranging up to $6 billion.

15. In preparing the Models, we have been mindful of the very challenging timeframes facing the Commission as it develops the draft and final Price-Quality path decisions for Chorus' RP1. We believe our conservative asset valuation model will support the Commission's need for a quick review process, as we expect the Commission can accept our certified asset valuation outcome once satisfied with our approach to assuring legal and input methodology compliance, and subject to resolving your remaining questions regarding our approach.

16. It is worth emphasising the magnitude of the task of preparing the IAV Model – a complex technical exercise, drawing on the best available data relating to the entirety of Chorus' UFB business operations and assets, and subject to rigorous quality assurance processes. In the circumstances we believe the model represents a robust approach to calculate the starting asset valuation and expect there would be little further gain to be made from revisiting the process for compiling the calculations.

Cost allocation choices

17. Our allocation methodology is conservative, has been independently verified and, subject to the matters identified in the Appendix, is demonstrably compliant with the IMs, using an Accounting Based Allocation Approach (**ABAA**). However, there are strong arguments to support allocations closer to standalone cost which better reflect the cost drivers of standing up a fibre business.

18. If the Commission considers alternative cost allocators for setting the financial loss asset, the Commission should consider a stand-alone cost allocation approach. To facilitate a discussion about alternative allocations that better reflect the true cost drivers of the fibre business, the model supports consideration of an alternative approach where costs are allocated based on the underlying drivers for standing up a fibre business.

19. We consider that the Telecommunications Act and the IMs could support higher valuations. The Commission should remain open to this possibility as it evaluates the Models. A standalone cost approach to cost allocation may better achieve the intent of the Act because:

    19.1. It reflects the reality that Chorus was established with a core purpose – to build and operate a fibre-to-the-home network. This was a precondition for participating in the UFB programme, where LFCs were required to establish a new commercial entity and fully divest themselves of any non-permitted telecommunications services. Absent this goal, Chorus would not have been established, and none of the establishment costs associated with demerger would have been incurred. A traditional ABAA approach is not well-suited to capturing the drivers of those expenditures.

    19.2. In a workably competitive market, Chorus' investment in standing up the fibre business would be recovered from consumers of the fibre service, not from consumers of copper services. Chorus was also obliged to "generate widespread uptake" of fibre services and this has been the clear focus of our business since inception.[3] It is reasonable that the costs of establishing the new fibre network, which was built ahead of demand and took some time to reach scale, are borne by consumers of fibre services.

19.3. Fibre was and is expected to replace copper in UFB areas, meaning the focus of Chorus has been on fibre investment and uptake, with investment in, and business planning attention to, copper being relatively limited.

20. We do not believe there is any scope for a reduction in our asset valuation and cost allocation approach. Our position is that a materially lower starting RAB would be inconsistent with the Part 6 purpose statement as it would place the financeability of the business at risk and undermine incentives to invest and innovate.

21. In particular, we consider that using a proxy allocator would not be consistent with the IMs where a causal allocator is available – the IMs make it clear that proxy cost allocators can only be used where a causal allocator is not available.[4] We therefore consider that reliance on proxy allocators, such as connections, would not be compliant with the IMs where Chorus has identified and used causal allocators within the model.

22. We have provided to the Commission an expert paper by Incenta[5] which considered whether a per connection allocator would be a reasonable default allocator. Incenta concluded:

22.1. The principal guidance in the IMs for allocating shared costs and assets is that the allocation should reflect causation.

22.2. Connections cannot be relied on as an allocator on the basis of double recovery. As the Commission is already aware, there are significant difficulties comparing building block concepts (FFLAS) and the final pricing principle (copper). On top of this, it can be shown that where causal allocators provide a higher allocation than connections, this does not imply over recovery.

22.3. To the extent that the fibre rollout did cause an increase in a shared cost or asset category, then a per connection allocation would be expected to result in an under-recovery overall.

23. Chorus has applied connections as an allocator only in limited circumstances where it is clearly appropriate, but it would not be a reasonable allocator to apply generically across Chorus' shared costs.

Potential pricing outcomes for RP1

24. Chorus has previously raised with the Commission our concern about an outcome where the $5.5bn initial asset value drives our revenue cap for RP1 below our business revenue forecasts. A revenue cap below our natural expected rate of growth risks poor outcomes for end-users.

25. The 2022-2024 regulatory period is the first time that price-quality regulation will be applied to fibre services in New Zealand and the first time that price-quality regulation will be applied to a service that is still growing, with a network not yet at maturity. RP1 will necessarily have some features that are transitional. The pricing decision is also being made at a time where Covid-19 is creating unusual economic conditions and heightened uncertainty.

[3] Network Infrastructure Project Agreement between Chorus and Crown Infrastructure Partners.

[4] Fibre Input Methodologies Determination 2020, Clause 1.1.4, definitions of 'proxy cost allocator' and 'proxy asset allocator'. Also clause 2.1.3(2)(a).

[5] Incenta, Certain cost allocation issues relevant to the IAV, March 2021.

26. Given the unusual circumstances in place at the start of RP1, the Commission should lean towards being cautious about driving Chorus' FFLAS revenues below the levels that would be delivered through natural growth in fibre services. There is a risk of decisions being made that create perverse incentives and outcomes that are not in the long-term interest of end-users. When the Commission considers Chorus' price-quality path for RP2, the regime will be more settled and the Commission will have a more informed basis for decisions.

27. We consider that there are strong reasons to ensure RP1 MAR is set at or above the level of expected natural revenue growth:

    27.1. Government policy and Chorus' intent has always been to avoid price shocks for both end-users and investors.

    27.2. Current prices have been set to optimise uptake and have been highly successful to date. They have supported strong network investment, a high rate of migration from copper to fibre and ongoing development of new products and promotion of higher-speed fibre plans. These are all consistent with workably competitive market outcomes. At the same time, consumers are benefitting from ever-growing speeds with no increase in prices in real terms. These are good outcomes that we do not want to jeopardise.

    27.3. Chorus' fibre business is still growing and we need to retain positive incentives to continue to sign up customers to fibre and to promote new products, so end-users can continue to be able to access the ever-widening benefits of future fibre services. As Chorus' copper business is subject to a price cap and the FFLAS business will be subject to a revenue cap, Chorus would have limited incentives to grow our fibre business if the revenue cap is met.

    27.4. Chorus could have less incentive to move customers to higher-speed fibre plans, which over time is likely to mean New Zealanders are less able to access advanced fibre services that rely on higher speed services.

    27.5. Key regulatory settings are not yet in place which constrain the Commission's ability to make changes and gather data on their impact:

        27.5.1. There are no IM-compliant information disclosures for Chorus available to the Commission, so the Commission does not have as much information available about Chorus' performance as it usually would when setting prices for Part 4 firms.

        27.5.2. The Commission does not yet have the ability to materially amend the anchor service requirements, meaning that revenue reductions could result in distorted pricing decisions.

    27.6. Chorus is facing a growing competitive threat from vertically integrated fixed wireless providers and this, combined, with COVID-19 has increased our risk of medium-term asset stranding.

Relationship between asset valuation and RP1 proposal

28. Our approach has been to use consistent allocators for calculating the initial PQ RAB and our RP1 expenditure proposal. We applied provisional allocations (available in November 2020, and before full model assurance was completed) to the RP1 expenditure submitted in December 2021 on the basis they would be updated once the

initial PQ RAB was submitted. This was understood by the Commission and transparent in our proposal.[6]

29. We have informed the Commission of plans to provide updated RP1 expenditure forecasts, reflecting final RAB allocations.

30. With one exception, we have used consistent expenditure forecasts in the RP1 proposal and the initial PQ RAB for:

    30.1. The RP1 period, from 1 January 2021 to 31 December 2024; and

    30.2. The forecast period prior to the commencement of RP1, 1 July 2020-31 December 2021.

31. The exception is to update the capex forecast for the latest outturn and forecast information. Specifically, to reflect higher than planned fibre capex due to:

    31.1. Higher New Property Development capex. The FY21 5YP assumed a reduction of new property development activity by around a third. This assumption has been proved incorrect and we observe an increase rather than reduction in new property development activity.

    31.2. Higher installation capex. After approval of the FY21 5YP approval, the Chorus Board approved a fibre acceleration programme involving significantly higher managed migration activity and therefore installation activity than was assumed in the FY21 5YP.

    31.3. UFB2/2+ and the West Coast fibre project being ahead of schedule, resulting in higher capex spend to 31 December 2021.

Assumptions, limitations and additional notes

32. Key assumptions are recorded in the information submitted as part of this Response. In the interests of full transparency, we have also identified in **Appendix A** instances (of which we are aware) in which the Response is either incomplete or there is room for reasonable disagreement regarding compliance. To assist the Commission with its review additional notes, limitations and assumptions are also noted in Appendix B and Appendix D of the Response.

33. Some limitations on the information apply generally to the information submitted in this response.

34. First, we have sought where possible to respond to the Notice by extracting operational information directly from the relevant systems and to provide that information to the Commission. Because of this the information supplied may contain errors due to the fact that our systems are necessarily deployed in a complex operational environment, with data entered in some cases directly from field activities. In the event that errors are identified, we will work with the Commission to promptly resolve these where possible.

35. Second, while we have sought to record relevant assumptions and limitations to the information provided, information is generated and held by us in our systems for particular purposes. It is also often intended to be used by staff and third-party contractors familiar with the information, the systems and their limitations.

---

[6] Refer to Chorus expenditure proposal documents: Our Fibre Plans, Investment Summary, page 107; Modelling and Cost Allocation Report page 8; and A3. Short form responses in response to request A47.1, page 28.

Accordingly, caution is necessary before utilising information for other purposes or in selecting particular elements of information for use outside of its business context.

36. Third, forecast information may have assumptions applied and in some cases may have some uncertainty regarding future scenarios. These assumptions and uncertainties are recorded where relevant in the model documentation.

37. If additional context would be useful in relation to any of the information provided in this response, we would be happy to respond to further questions.

Confidentiality

38. As discussed with Commission staff on 19 February, the Models and accompanying information provided in this Response are confidential and commercially sensitive to Chorus. Accordingly, we ask that you treat the Models and information that make up our Response with the utmost confidentiality; keep the Response as secure as possible; share it only as widely as reasonably necessary within the Commission; and not share it with any third parties without Chorus' express written permission. We request that the Commission provide us with advance notice of any documents it proposes to publicly release which include, or draw on, the information in this Response so that we can consider our disclosure obligations prior to publication.

39. We appreciate the Commission allowing a longer timeframe to respond to the requirements set out in clause 17 in respect of confidentiality and commercially sensitive information.

40. For completeness, we consider that the information and documents supplied under cover of this letter and identified in Appendix A would be protected from disclosure under the Official Information Act 1982. If the Commission intends to disclose this information or these documents to any third party under that Act, we ask that you notify us so that we can consider our response and take any action as appropriate.

41. Please note that Deloitte has consented to Chorus providing the Deloitte FFLAS Report, dated 24 March 2021, to the Commission strictly on a commercial-in-confidence and non-reliance basis.

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

Yours sincerely,

JB Rousselot

CEO

Chorus

APPENDIX A

Allocations and allocators

1. The asset valuation process includes determining allocators and allocations which are expected to apply for assets and expenditure up to the implementation date (within the IAV Model) and future expenditure as set out in our December 2020 RP1 proposal.

2. To explain the allocators, it is necessary to understand how the allocators have been calculated and applied in the IAV Model. The Analysys Mason report provided in our response dated 5 February 2021 seeks to provide an explanation of the methodology underpinning these allocators.

3. This topic was also the subject of Analysys Mason's presentation to the Commission on 29 January 2021, which highlighted that each asset class in each geography and asset purchase timeframe has an asset allocator. In practice, this means for each year there will be a change in the allocator used due to the expansion of the UFB footprint and a further change to reflect changes in uptake, traffic or customers. Notably:

    3.1. Certain assets are attributed to non-FFLAS or to FFLAS (on a 100% or 0% basis).

    3.2. Some assets are attributed to FFLAS but split between contracted and voluntary FFLAS (so not all attributed to UFB FFLAS pre-implementation).

    3.3. There are specific causal allocators for specific shared assets including, for example: ducts, poles and manholes.

    3.4. Where causal allocators are not available, proxy allocators are considered for use.

4. In each financial year, the value of the relevant allocators is calculated and applied. Noting that post-implementation the allocators change slightly due to the change in services that are considered in scope. In particular, post-implementation voluntary FFLAS and Lost and Non areas are in scope. The FFLAS services in the Lost/LFC area are considered to be ID-only FFLAS and excluded from PQ FFLAS. The initial value of the RAB uses these post-implementation allocators.

5. The allocation approach relies on data from the Fixed Asset Register (**FAR**). Where there is insufficient data available in the FAR to enable an asset to be identified as FFLAS, non-FFLAS, or shared then Decision Packet[7] data has been used to gather more information about the asset to enable a more accurate attribution.

6. A similar allocation approach is applied to operating costs. Our General Ledger (**GL**) accounts and forecasts are used as the basis for grouping together costs into categories. These are then allocated:

    6.1. Some cost categories are attributed to non-FFLAS or to FFLAS (on a 100% or 0% basis).

    6.2. Where costs are not directly attributable, they are allocated between FFLAS and non-FFLAS. This is mainly performed in the final AM Opex Model.

---

[7] Meaning a grouping of capital expenditure with a similar outcome. These sit behind a category level of Chorus expenditure.

6.3. In many cases, once costs are allocated between FFLAS and non-FFLAS, they are subsequently allocated between PQ FFLAS and ID-only FFLAS. This allocation is performed in final IAV Model.

7. For both assets and operating costs we have used causal allocators where possible to allocate cost. Where causal allocators are not available, proxy allocators are considered for use. We are seeking approval for a number of allocators we have used in the Models, for example Totex and Net Book Value. The allocators we are proposing more directly reflect the underlying causation, effort and timing of costs incurred for the fibre network when compared to alternatives. These are discussed further in Analysys Mason's response to the information request with further justification provided in Incenta's report "Certain cost allocation issues relevant to the IAV".

8. As noted in Chorus' 12 March submission[8] allocations are dynamic over time. This means it can be expected that more of our costs will be allocated to FFLAS during RP1 as fibre connections grow and we migrate customers off copper.

Shared cost cap

9. We have sought expert advice from Incenta to develop an approach for testing compliance with the shared cost cap, this is discussed in the report "Certain cost allocation issues relevant to the IAV". We note Incenta's advice that the shared cost cap cannot be objectively tested for within the IAV Model as it requires consideration of complex hypothetical scenarios that are inherently judgement based. We don't believe the shared cost cap is binding for any cost or asset categories because:

9.1. We have applied ABAA for opex and assets. This means we have used causal and proxy allocators to distribute shared costs across multiple services. Due to economies of scope, the shared costs allocated to FFLAS are no more than costs of a standalone FFLAS provider.

9.2. Applying a materiality threshold implies that the cap should only be considered for a small number of costs.

9.3. Most assets are economically sunk in that they cannot practically be used for anything else or, where they can, the costs of repurposing them exceeds the benefit.

9.4. The IM reasons paper made it clear that this exercise was not intended to optimise the network in a hypothetical, TSLRIC, sense.[9]

FFLAS

10. As discussed with Commission staff in late 2020 regarding the RP1 Proposal, we have generally applied the categories of FFLAS described in the Commission's "Fibre Input Methodologies – Main final decisions reasons paper".[10] However, we don't break down forecasts by FFLAS categories. For example, there is no separate forecast for DFAS or backhaul. The cost allocation approach ensures assets are mapped to FFLAS.

11. In terms of voice services, the Commission specifically includes as an example baseband. However, we note that "baseband" is a set of voice access services provided

[8] Chorus submission – consultation on RP1 expenditure proposal dated 12 March 2021.

[9] Commission's "Fibre Input Methodologies – Main final decisions reasons paper", dated 13 October 2020, para 4.102 – 4.106.

[10] Described in the Commission's "Fibre Input Methodologies – Main final decisions reasons paper", dated 13 October 2020, para 2.108.

by Chorus over a range of different technologies. The only fibre voice service we provide is ATA voice.

12. We believe our approach to backhaul services (referred to as transport services by the Commission) is consistent with the IMs. However, we set out below how we have approached backhaul services for transparency:

    12.1. Layer 1 and layer 2 backhaul services are included as FFLAS where the backhaul service supports fibre access FFLAS (e.g. backhaul that carries only copper PSTN is not considered to be FFLAS).

    12.2. Backhaul services within the scope of FFLAS are limited to those within the boundaries of the fibre network (i.e. between the specified POI, determined by the Commission, and the end-user's premises or access point). This means it excludes national and inter-candidate area backhaul services like Chorus Regional Transport (**CRT**).[11]

13. However, the approach to backhaul services was resolved late in the IMs process and in some scenarios requires a granular link-based approach. There are some edge cases with backhaul that are difficult to implement:

    13.1. Some CRT links fall within the definition of FFLAS in uncommon scenarios, for example, where the layer 1 handover point is outside the UFB footprint and the Commission has indicated a backhaul link to a specified POI is included.[12]

    13.2. The Tail Extension Service (**TES**) starts at the layer 2 handover point (as we don't have layer 1 TES). There is a scenario where TES could potentially fall within the definition of FFLAS if there were multiple layer 2 handover points in an UFB candidate area. However, this is an unlikely scenario as TES is handed over to the layer 2 handover point the RSP requests within the same UFB candidate area.

PQ FFLAS vs ID-only FFLAS

14. The Commission has sought information with respect to the valuation of assets and operating costs. The IMs require asset valuation for pre- and post- implementation. With respect to PQ FFLAS and ID-only FFLAS allocation, Chorus has considered the Commission's emerging view as to how PQ FFLAS/ID-only FFLAS is to be allocated. Namely:

    14.1. The presence of the LFC UFB network is to be determined by drawing upon data collated for the purposes of the specified fibre area determination; and

    14.2. The location of the provision of FFLAS is to be determined by the location of the end-user(s) of the FFLAS.

15. As discussed with the Commission on 29 January 2021, when the IAV Model was designed it was unclear how ID-only FFLAS would be approached. The Commission subsequently confirmed that the ID-only deregulation was only to be applied to a subset of the end-users in areas with optionality to purchase services from other LFCs. Additionally, as submitted during the IM consultation process and outlined in our

---

[11] Described in the Commission's "Fibre Input Methodologies – Main final decisions reasons paper", dated 13 October 2020, para 2.108.5.

[12] Commission's "Specified points of interconnection – reasons paper", dated 19 December 2019, para 61. The Commission said: "Our view is that an end-user premises outside a UFB geographic area should be related to the nearest UFB initiative POI (whether on a geographic or network topology basis) such that RSPs can access all end-user premises from a UFB initiative POI."

submission on the Commission's Paper on PQID,[13] Chorus cannot determine the location of end-users for co-location and backhaul services. We would need the Commission or RSPs to provide the location of end-users when RSPs purchase co-location and backhaul services as we have no visibility.

16. As presented to the Commission by Analysys Mason, the approach taken with respect to PQ FFLAS and ID-only FFLAS is as follows:

    16.1. The assets within the FAR are tagged with their ESA. The FAR underpins historic geographic information, noting that Chorus is unable to retrospectively create tags. Accordingly, the Commission has indicated that it does not anticipate reviewing information prior to the implementation date, nor does it require a more granular approach than the one taken; and

    16.2. It is assumed that assets in the lost areas generally support customers in the lost areas as we do not have a means of distinguishing whether any of our assets overlap. Rather than excluding these assets from the RAB, they are pro-rated based on the demand evidenced in the area of Lost/UFB overlap and the Lost/RONZ overlap. This is immaterial. In practical terms this means a consistent set of PQ-FFLAS and ID-only FFLAS allocation factors are applied.

Matters relevant to certification

17. Because much of the modelling work predates the IMs and the Notice, which have been finalised at a comparatively late stage in the process of developing the Models, inevitably there are some instances in which the Response is incomplete, or is not in full technical compliance with the IMs or the requirements of the Notice, or where there are competing interpretations available. However, we are confident that the Response is consistent with the spirit and intention of the Act and IMs.

18. In the interests of full transparency, we set out below instances (of which we are aware) in which the Response is either incomplete or there is room for reasonable disagreement regarding compliance. You will note that the certificate accompanying the Response expressly refers to these matters. A number of these matters are the subject of existing RFIs issued by the Commission. We expect to resolve these matters with the Commission post-submission of this Response.

19. If the Commission considers that any of these issues reflect technical non-compliance with the IMs, then it would be appropriate to consider an amendment to the IMs to ensure the purpose of Part 6 of the Act is met.

Notice / IM requirement	Comment
Notice B14.2	*Capital contributions:* Chorus doesn't record asset values net of capital contributions received. To produce the effect equivalent to netting off capital contributions, the IAV Model incorporates capital contribution 'negative' asset classes over which contributions received are spread.
Notice B26, B27	*Permanent and temporary taxation differences:* while Chorus has breakdowns on these at a company level, the model then aggregates and allocates data meaning we are unable to identify permanent and temporary differences.
Notice B21 and B36	*Related party transactions:* As per our previous response to the Information Request of 25 July 2019, Chorus does not have any subsidiaries that provide to Chorus. Therefore, there were no related party transactions entered into.

[13] Chorus' submission, dated 14 October 2020, on the Commission's PQID process and approach paper (dated 15 September 2020).

Notice B35.1, IMs B1.1.3(2) and 2.2.13(3)(a)	*Value assigned to Easements:* Easements in Chorus' FAR were, at the relevant time, recorded at transaction cost rather than at a market valuation determined by a valuer. We therefore do not have the information necessary to apply this requirement.
IMs B1.1.6	*Allocation of certain Chorus establishment IT assets:* The Commission's RFI No.004 dated 12 March 2021 queried the allocation of certain IT assets to FFLAS where those assets have subsequently been partly used by non-FFLAS services. The assets in question are currently categorised in the IAV Model as directly attributable to FFLAS. We acknowledge that these should properly be treated as shared assets, subject to cost allocation. However, our view is that a proper allocation approach would treat these assets as 100% allocated to FFLAS notwithstanding their shared use because: • the driver for the investment was the need to establish Chorus as a standalone business to undertake the UFB initiative; • the asset lives for the relevant assets, for the purposes of the RAB, are short (four to five years) but the assets will remain in use for a substantially longer period for the benefit principally of FFLAS and FFLAS consumers. Accordingly, using – for example – connections as a proxy allocator would result in these assets being over-allocated to non-FFLAS services despite the fact the investment was incurred for the sole and express purpose of supplying FFLAS. The relevant shared assets are included in an asset category in the model that includes other directly attributable assets. We have been unable at this late stage to adjust the model to identify and separately categorise these assets. We propose discussing with you an approach to allocating these assets post-submission of the Response.
Definition	*Identifiable non-monetary asset:* Chorus' IFRS15 spend doesn't fit tidily into the definition of identifiable non-monetary asset. This is because the main focus of IFRS15 is revenue received in advance and how this is amortised over the period of a revenue contract. Chorus has taken this principle and applied to customer incentives incurred in advance. So we believe the Commission has unlikely considered how these items should be treated in drafting the IMs.
IMs 2.2.2.13(6)(b)	*Additional capex incurred:* requires expenditure incurred on a fibre asset after it is commissioned, to be treated as separate asset. There are occasions in the FAR where additional capex is settled to an existing asset number. However, our approach is economically consistent with the IM.
IMs B1.1.7(3)	*Tax depreciation:* The treatment of tax depreciation is consistent with the Commission's intended approach for the Financial Loss Asset as specified in the Reasons Paper, but inconsistent with this clause of the IMs, which uses the term 'GAAP depreciation'. We assume the IMs reference is intended to be to 'tax depreciation'. The use of tax depreciation would be consistent with wording elsewhere in the IMs that requires Chorus to follow the tax rules, and with the Reasons Paper.
IMs B1.1.2(4)(d)(i)	*NBV Corrections:* represent adjustments in the Chorus FAR rather than individually identifiable (e.g. Transfers, Disposals, Write-ups to either book value or tax book value).
IMs B1.1.2(7)(b)	*Approach to revenue date compounding factor:* Analysys Mason has used a different approach to determine a 'revenue date compounding factor'. The IMs ask for revenue timing to be the 20th of the month after the month in which the mid-period date falls. Our approach (revenue date being 34 days after mid-period-date) is based on that used by the Commission in similar Part 4 calculations, which models the effective revenue date of a series of 12 equal payments falling on the 20th of the month after the revenue was earned.
Economically equivalent methods	As we have described to the Commission, in a number of instances the model uses methodologies that diverge from those specified in the IMs but

	produce economically equivalent outcomes. These are discussed in Annex E to Analysys Mason's report.