

# Submission in response to the Commerce Commission's Fibre input methodologies – Regulatory processes and rules topic paper dated 19 August 2019

9 September 2019



## OVERVIEW

1. We welcome the Commerce Commission's consultation paper *Fibre input methodologies – Regulatory processes and rules – topic paper* published on 19 August 2019 (**P&R Paper**). This consultation process is an important step to provide clarity on the rules and processes for price-quality regulation (**PQR**).
2. Flexibility and certainty need to be balanced in setting the input methodologies (**IMs**). For Chorus, this means providing certainty for areas where:
  - 2.1. The legislation specifies requirements and the Commission needs to confirm its interpretation;
  - 2.2. Chorus is preparing the price-quality proposal well in advance of receiving formal requirements; and
  - 2.3. Rules are required for one-off exercises.
3. There is considerable uncertainty about the implications for Chorus and other stakeholders of transitioning to a price-quality path (**PQP**) for fibre fixed line access services (**FFLAS**). Delivering this certainty through the process and rules IM (**P&R IM**) should be a key priority for the Commission as it has consequences for Chorus, other local fibre companies (**LFCs**) and the wider industry. Flexibility and certainty can be balanced under a constrained timetable by utilising a principles based approach to setting IMs (where this makes sense), with the details specified in price quality determinations (**PQDs**).<sup>1</sup>

## Key comments on the Commission's views

4. Chorus agrees with topics the Commission has proposed as in scope of the P&R IMs, in particular:
  - 4.1. **Specification of price, pass-through and recoverable costs** – We largely agree with the Commission's views regarding the IM for specification of price. The Commission should also include costs associated with disputes resolution schemes and membership fees as pass-through costs, and allow for innovative practices and some insurance related costs as recoverable costs. We also seek clarity on how levies associated with the implementation of the new regulatory regime will be treated as a significant proportion of these will be paid prior to the implementation date.
  - 4.2. **Re-openers and reconsideration events** – We consider that telecommunications-specific scenarios should be added to the list of reopener matters, including for events relating to cyber security and market changes.

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<sup>1</sup> Chorus (21 December 2018), *Submission in response to the Commerce Commission's invitation to comment on its proposed approach to the new regulatory framework for fibre dated 9 November 2018*, at [151]-[153] and page 61, Q14 response.

- 4.3. **Regulatory balance dates** – We support having a balance date of 30 June for the information disclosure (**ID**) year and 31 December for the revenue control year for Chorus in the first regulatory period (**RP1**) (given the constraints with an implementation date of 1 January 2022). This approach promotes the Part 6 Telecommunications Act (**Act**) purpose through certainty and efficiency. We would also like the opportunity to consider alignment of both regulatory balance dates and our financial year as we move from RP1 to the second regulatory period (**RP2**).
5. We consider that additional topics should be dealt with in the IMs, and not deferred to PQR, these topics include:
  - 5.1. **Wash-up** – As the wash-up mechanism is specified in the Act, it is more appropriate to include the requirement in the IMs than defer to PQD.
  - 5.2. **Revenue smoothing between periods** – Revenue between regulatory periods should be in scope of the IMs. Not only does this ease price shocks and is needed for cost recovery, but it should be considered together with the depreciation options put forward by the Commission for smoothing revenues as part of the IMs process.
  - 5.3. **Expenditure evaluation criteria** – The evaluation criteria rules should be stipulated upfront so they are clear when formulating a price-quality proposal.
  - 5.4. **Price-quality proposal process** – The IMs should set the fundamental principles and information required relating to price-quality proposals on an enduring basis.
  - 5.5. **Expenditure incentives** – Incentives are a capex and opex topic and it may be more appropriate for development in the P&R IMs or in a broader expenditure IM.

## SCOPE OF REGULATORY PROCESSES AND RULES IMs

- There are a number of matters we consider appropriately fit within the scope of the P&R IMs including:
  - Wash-up;
  - Revenue smoothing between periods;
  - Expenditure evaluation criteria;
  - The key processes to be followed when developing a price-quality proposal, and the information required in a price-quality proposal; and
  - Processes for reopening the PQP.
- We agree some matters can be addressed with principles based IMs. Then the detail and practicalities involved could be developed through PQD, including the wash-up, processes for expenditure proposals and expenditure incentive mechanisms.

### Legislative framework

6. We agree with the Commission topics that fall within the scope of P&R IMs are the upfront rules that then apply to PQR, and in some limited instances to ID.
7. Section 176(1)(c) of the Act requires the regulatory P&R IMs to cover, as a minimum:
  - 7.1. The specification and definition of prices, including identifying any costs that can be passed through to prices; and
  - 7.2. Identifying the circumstances in which the PQP may be reconsidered within a regulatory period.
8. We support the Commission drawing on its experience in setting and applying similar P&R IMs in Part 4 of the Commerce Act (**Part 4**). We also agree with the Commission there are differences in the fibre legislative and market context that may require other topics to be included in scope of fibre P&R IMs.

### Within scope of IMs

#### *Wash-up*

9. As the wash-up mechanism is specified in the Act, it would be more appropriate to include the requirement in the IMs, rather than defer to PQD as currently proposed.

As we outlined in our submission in response to the Commission's Emerging Views Paper (**EV Paper**),<sup>2</sup> the legislation requires:

- 9.1. The application of a systematic wash-up account for RP1; and
  - 9.2. The wash-up account to be unconstrained (i.e. no caps and collars applied etc.) and it washes up all variations between allowed and actual revenue.
10. This interpretation broadens the purpose of the wash-up account beyond its standard application in Part 4 (i.e. managing forecasting risk within periods) to align with the policy recognition that Chorus has invested ahead of demand (i.e. allowing Chorus to wash-up the difference between our maximum allowable revenues (**MAR**) and actual revenues for recovery in future periods).
  11. There are also good reasons for a symmetric wash-up to continue to apply into future regulatory periods. In subsequent future regulatory periods the focus may revert to managing forecasting risk rather than the broader application intended for RP1.
  12. A wash-up mechanism is important in this regime given a range of additional rules carried over in contrast to other regimes. This includes that anchor and mandatory services constrain Chorus' revenue and may lead to periods of under-recovery of allowable revenues. Without an ability to carry under-recovery into future periods, real financial capital maintenance (**FCM**) will not be realised.
  13. Investors expect Chorus will be able to wash-up over regulatory periods and early clarity is sought from the Commission for all stakeholders.

### **Revenue smoothing**

14. There are two types of smoothing to be considered under a BBM regime:
  - 14.1. Revenue smoothing **between** regulatory periods; and
  - 14.2. Revenue smoothing **within** a regulatory period.
15. While revenue smoothing *within* regulatory periods is relevant to PQR, it's more important to include revenue smoothing *between* regulatory periods in scope of IMs. This is because it's important to balance:
  - 15.1. Revenue smoothing to ease price shocks; and
  - 15.2. The need for cost recovery.
16. As mentioned in the Commission's EV Paper, section 197 of the Act refers to the potential use of depreciation (and other tools) by the Commission to adjust revenues and prices (i.e. smoothing). In addition, the EV Paper puts forward a number of depreciation options for smoothing revenues. These issues all need to be considered together as part of the IMs process.

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<sup>2</sup> Chorus (16 July 2019), *Submission on the Commerce Commission's emerging views*, at [27]-[30].

17. Where revenue smoothing within regulatory periods is required, we agree with the Commission that this can be deferred to PQR consultations.

### **Price-quality evaluation criteria**

18. Evaluation criteria for the assessment of expenditure proposals should be set in the IMs rather than consulted on in PQR.
19. The evaluation criteria rules should be stipulated upfront so they are clear when formulating a price-quality proposal. The criteria for how price-quality proposals should be assessed also need to be enduring to provide a minimum amount of certainty.
20. The IMs should include:
  - 20.1. Information requirements for price-quality proposals (and any other expenditure mechanisms);
  - 20.2. Key process requirements;
  - 20.3. Specification of the types of PQP reopeners and allowance reconsideration mechanisms; and
  - 20.4. Associated evaluation criteria (for proposals and mechanisms).
21. Practicalities and operating parameters specific to a given regulatory period (such as lists of contingent projects) could sit in PQD.
22. As discussed in our submission on the EV Paper,<sup>3</sup> we agree with the Commission's view that different types of capex require different evaluation criteria to be applied, depending on materiality, timing of expenditure and nature of the investment. We also agree that different evaluation criteria can apply to different types of capex to address the characteristics of that type of expenditure.<sup>4</sup> These criteria should be set out in the relevant IM.
23. As we stated in our submission on the EV Paper, we agree with the Commission that the Transpower Individual Price Path (**IPP**) framework under Part 4 is a sensible starting point for consideration and approval of Chorus' price-quality proposals.<sup>5</sup>
24. In designing IMs under Part 6, the Commission doesn't need to replicate the exact structure of the IMs applying to Transpower's IPP under Part 4 – it should design IMs so they appropriately fit the context for Part 6 regulated suppliers.

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<sup>3</sup> Commerce Commission (21 May 2019), *Fibre regulation emerging views – Technical paper*, page 55.

<sup>4</sup> Chorus (16 July 2019), *Submission on the Commerce Commission's emerging views*, page 96.

<sup>5</sup> Chorus (16 July 2019), *Submission on the Commerce Commission's emerging views*, at [328].

25. Some of Transpower's capex rules fall across IMs and it has a capex IM, which reflects Transpower's transition to Part 4 from the Electricity Commission approval of major capex proposals. For Part 6, the key expenditure rules (including rules for operating expenditure (**opex**)) and criteria should sit together, and be set in IMs, not in a PQD. If the Commission elects not to determine a general expenditure IM, the opex rules should still be set at the IMs stage. Leaving them to the PQD would not give sufficient certainty.

### **Price-quality processes**

26. We disagree with the suggestion that the price-quality proposal and evaluation process would be more effectively dealt with outside the current IM-setting process. The IMs should set the fundamental principles relating to price-quality proposals on an enduring basis and should include IMs on:
  - 26.1. The central expenditure objective and other evaluation criteria (as noted above);
  - 26.2. The key processes to be followed when developing a price-quality proposal; and
  - 26.3. The information required in a price-quality proposal.
27. This reflects the IMs' purpose, which is to provide upfront certainty by setting out the rules that regulated suppliers must meet, but also constraining the Commission's ability to impose different rules or criteria on a regulated supplier's PQP.
28. From a business planning perspective, clear up-front specifications are important for efficient planning and delivery of high-quality price-quality proposals, which in turn support efficient and high-quality evaluation. These requirements can also be principle level process requirements, such as a requirement to have independent verification without detailed specification.
29. Currently, although we are anticipating preparing a PQP proposal, we have no legal certainty around the substantive rules, what the processes requirements are, or what information must be provided. Leaving these issues for decision in the context of the PQR consultation undermines the certainty the IMs are intended to deliver. It would also hamper our efforts to plan and prepare a high-quality proposal that will facilitate the Commission's evaluation.
30. For our first price-quality proposal we are having to anticipate information requirements, evaluation criteria and regulatory mechanisms as we test and document our forecasts. The earlier we have clarity on the actual requirements, the better we'll be able to meet them.
31. Preparing new information and applying new tests (with appropriate quality assurance, governance and compliance checking) can take considerable time. So late visibility of new or unexpected requirements could compromise our ability to deliver a complete proposal after June 2020, when we anticipate the final IMs will be set.
32. It's also appropriate that the IMs set key post-proposal dates that impact management of our business or have flow-on impacts through the supply chain. For example, locking in the latest date by which the Commission can make its final PQD

(to set the MAR), would assist us to plan our financial processes with confidence, and would enhance process clarity for our investors and other stakeholders.

33. We agree that more minor process matters could be consulted on early in the PQD process or settled as PQD outcomes. For example, the timing of the Commission's consultation and decision-making steps could be established early in the PQD process. Matters such as the operation of the annual wash-up and PQP update processes, and some details of other within-period mechanisms could be an outcome of the PQD process.

### **Expenditure incentive mechanisms**

34. The Commission notes it's consulted on expenditure incentives in the EV Paper, under the capital expenditure section, suggesting that it's a capex topic. However, in the EV Paper, the Commission only suggested an opex incentive. This indicates that incentives are also an opex topic and may be more appropriate for development in the P&R IM (as for Part 4) or in a broader expenditure IM.
35. As mentioned previously,<sup>6</sup> we are interested in exploring the development of a simplified opex incremental rolling incentive scheme (**IRIS**) similar to the mechanisms applicable under Part 4 and a low rate capex incentive that could work alongside the opex IRIS. Having early clarity will help ensure our price-quality proposal properly fits within the incentive environment.

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<sup>6</sup> Chorus (16 July 2019), *Submission on the Commerce Commission's emerging views*, at [352].



## SPECIFICATION OF PRICE, PASS-THROUGH COSTS AND RECOVERABLE COSTS

- We support the Commission adopting an approach in line with Part 4 categorising costs as pass-through and recoverable costs. The Commission should also include costs associated with disputes resolution schemes and membership fees as pass-through costs, and allow for innovative practices and some insurance related costs as recoverable costs.
- We also seek clarity on how levies associated with the implementation of the new regulatory regime will be treated as a significant proportion of these will be paid prior to the implementation date.

### Specification of price, pass-through and recoverable costs

37. We support the Commission's view that:
- 37.1. The IM for price specification will prescribe that a revenue cap will apply from the implementation date, as required by section 195 of the Act for RP1; and
  - 37.2. To include rules for identifying costs that can be passed through to revenue, consistent with Part 4 where costs are categorised as pass-through and recoverable, in the fibre P&R IMs.

### Pass-through costs

38. We agree that costs outside the control of the regulated supplier should be passed through to customers without the need for the Commission to undertake a cost assessment, as cost categories are defined upfront. The IMs should be prescribed at a level which allows for control, but also allows flexibility for costs to be included as a pass-through as they arise.
39. We agree that levies (including Telecommunications Development Levy and Telecommunications Regulatory Levy) and rates paid to local authorities should be included as pass-through costs as these are outside Chorus' control. So, in line with Part 4, the Commission should also include costs associated with:
- 39.1. **Disputes resolution schemes** – For example utilities disputes, shared property access disputes scheme and telecommunications disputes resolution, which we may need to join in the future; and
  - 39.2. **Membership fees** – Associated with being part of industry groups we are required to join to be a party to regulated codes (e.g. the Telecommunications Forum (**TCF**)).
40. The groups of costs set out above fit the definition of pass-through costs as they are wholly outside the control of Chorus, industry specific, and are difficult to forecast.

41. In addition, we welcome clarity on how levies associated with the implementation of the new regulatory regime will be treated as a significant proportion of these will be paid prior to implementation date. Our expectation is that the Commission needs to ensure there is an appropriate mechanism for recovery of these costs, options include:
  - 41.1. A pass-through cost added post implementation;
  - 41.2. Included as past losses; or
  - 41.3. Treated as a direct cost to FFLAS and included in the RAB.

### **Recoverable costs**

42. We support the Commission adopting an approach in line with Part 4 by including recoverable costs as a category that can be passed through to revenue. As with pass-through costs, the IMs for recoverable costs need to balance the need to add some control around the types of costs that are allowed, with being flexible enough to add new costs if, or when they are identified.
43. We agree with the Commission's definition including costs associated with incentive payments, audit and verifier fees should be included as recoverable costs. In addition, we also note in the latest draft decision for electricity distributors,<sup>7</sup> the Commission is seeking to promote innovation by proposing a new recoverable cost term for innovative practices.
44. The Commission should also consider whether it is appropriate to define some insurance related costs as being recoverable, for example:
  - 44.1. **Premiums** – Chorus is largely a price-taker for insurance premiums; and
  - 44.2. **Self-insurance** – Chorus does not have a captive insurer (unlike Transpower) and it is not clear how self-insurance costs (including costs below policy deductibles or above policy limits) will be treated under PQR.
45. Categorising insurance as recoverable costs could provide part of the solution and may be more efficient than incentivising the setup of a captive insurer and/or extension of insurance coverage (to limit unrecoverable self-insurance).
46. In addition, there should be criteria or a process to guide the assessment and approval of recoverable costs, as opposed to relying on Commission judgement as to how much should be passed through.

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<sup>7</sup> Commerce Commission (29 May 2019), *Default price quality paths for electricity distribution businesses from April 2020 Draft Reasons paper*, page 66.

## REOPENERS AND RECONSIDERATIONS

- ❑ Two telecommunications-specific scenarios – relating to cyber security and market changes – should be added to the list of reopener matters.
- ❑ The way in which forecast and uncertainty risk is dealt with under Part 4 should apply under Part 6.
- ❑ Beyond that, Chorus will face other classes of uncertainty that are different to those faced by Transpower and other Part 4 suppliers (who have fully built networks). So we expect that the further mechanisms needed in a Part 6 expenditure IM – including reconsideration criteria – may be new and unique to Chorus.
- ❑ It's important that reconsideration rules are not limited to capex – there is no in-principle reason to treat capex and opex differently in this respect.

### Reopening a price-quality path

48. The Commission sets out situations where it would consider reopening a price path. Reopeners should apply to a PQP – not just a price path as suggested in the P&R Paper – given that price and quality are causally linked in Part 6.
49. PQP reopeners operate like *force majeure* provisions in contracts by providing an efficient method for dealing with contingencies that are unlikely, unpredictable and too material to address through within-period substitution. We broadly agree with the items the Commission lists, and suggest adding two further items that address telecommunications sector matters:
  - 49.1. **Cyber security** – A step-change in the prudent level of cyber-security investment. This could arise due to a change in the external threat environment, new information on vulnerabilities, or a shift in expectations regarding security levels. These changes could impact capex or opex, and could be material relative to our overall digital spend. This reopener could be defined according to an objective measure; and
  - 49.2. **Market change** – As raised by the Commission, the dynamic nature of the telecommunications market means it would be appropriate to include a reopener for material changes affecting the FFLAS market. As with other reopeners, this would only be used in exceptional circumstances for changes with material impacts on expenditure levels or quality standards.
50. In addition, the change event situation the Commission notes should be broadened to include government policy (“legislation, regulatory or government policy environment”), to allow for scenarios such as further government tenders for network build.

## Reconsideration of an expenditure allowance

51. The Commission says the capex IM may set out specific situations in which the capex allowance would be reconsidered during a regulatory period. It is considering whether this situation should be covered by the capex IM or by an additional reopener under the P&R IMs. As we discuss above, we favour expenditure rules being grouped together in an expenditure IM – including rules for reconsidering an expenditure allowance.
52. The Commission is designing IMs afresh for Part 6, and should aim to group ‘like rules with like’ for clarity and coherency. It’s important that reconsideration rules are not limited to capex – there is no in-principle reason to treat capex and opex differently in this respect. The omission in Transpower’s regime of rules for opex and inclusion for capex is more to do with circumstance than principle.
53. In our EV submission,<sup>8</sup> we referred to the primary way in which forecast and uncertainty risk is dealt with under the Part 4 regime. We noted those mechanisms should apply in Part 6, and beyond that, Chorus will face other classes of uncertainty that merit the availability of further mechanisms.
54. At this point in the new regime design, we know that mechanisms that allow us to access additional capex within a regulatory period will be an important feature of the expenditure IM – including reconsideration criteria. Locking in a fixed allowance for a regulatory period is unlikely to work – leaving too much risk of windfall gain or loss. Neither outcome would be good for consumers. In fact, the latter would cause Chorus to curtail investment in initiatives that would have provided consumer benefit.
55. The uncertainties we expect to face are different to Transpower’s and other Part 4 utilities (who have fully built networks, longer-lived assets and a slower pace of market and technological change). So we expect that the mechanisms needed in a Part 6 expenditure IM may be new and unique to Chorus. These uncertainties directly reflect our business and our new (and incomplete) network, which the Part 6 framework will need to accommodate by allowing sufficient mechanisms with options for addressing uncertainties.
56. The table below demonstrates the types of uncertainties we anticipate facing within a regulatory period. The list does not provide a view at this stage as to which mechanisms will be best implemented for RP1. Instead it should be used to develop a ‘menu’ of available mechanisms. One of the goals of the RP1 PQD process is then to land on an overall price-quality design that efficiently manages risk and uncertainty – mitigating any severe windfall and curtailment dynamics without creating too much complexity or inflexibility.

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<sup>8</sup> Chorus (16 July 2019), *Submission on the Commerce Commission’s emerging views*, at [332]-[340].

Uncertainty/ Circumstance	Description	Treatment/rationale
FFLAS uptake	<p>Demand for connection to our fibre network is our biggest uncertainty.</p> <p>It impacts capex and opex directly, and through reallocation of common costs.</p> <p>Uptake is also one of the factors driving traffic growth, and is a key factor influencing the timing for, and extent of, copper to fibre migration.</p>	<p>Adjust allowances <i>ex-post</i> each year for actual connections.</p> <p>Known uncertainty with material impact on opex and capex allowances during RP1.</p> <p>A symmetric wash-up would insulate both Chorus and consumers from windfall gains or losses from forecasting challenges – both of which will continue beyond RP1.</p>
Traffic step change	<p>Traffic is influenced by multiple factors that cannot be forecast with confidence over long horizons. These include connections to the network, product speed, and the way consumers use the network.</p> <p>Traffic growth can exhibit both consistent growth (e.g. as connection numbers and average usage grow) and step changes (e.g. due to new services like Google Stadia).</p>	<p>Adjust allowances in the event of step-change events not built into proposal forecasts.</p> <p>An <i>ex-post</i> adjustment for actual connections could possibly resolve challenges around consistent growth, but would not resolve step-growth events.</p>
Copper to fibre migration	<p>The timing and scale of effort to enable copper withdrawal is unknown.</p>	<p>It may be sufficient to rely on the <i>ex-post</i> adjustment mechanism described above.</p> <p>If not, then mechanisms could be developed that release pre-defined opex and capex amounts as a function of the number of connections transitioned to fibre.</p>

Uncertainty/ Circumstance	Description	Treatment/rationale
PSTN migration	<p>The timing of the PSTN migration will be determined by Spark, so it is not within our control.</p> <p>Migration drives direct costs, may reallocate some common costs to FFLAS, and can impact the extent to which Spark contributes to shared costs at exchanges (such as for electricity usage).</p>	<p>Depending on the scale of cost uncertainty (e.g. between our estimated mid-point cost scenario and high or low cost scenarios) it could be appropriate to develop a mechanism that adjusts allowances for the actual pace and scale of the migration programme.</p>
Major new product	<p>Our first preference is to include major new products in our proposal, but there may be new products on the horizon of each period that it would be premature to lock-into an allowance.</p> <p>Application for an increase in allowance could apply to any or all stages of the product deployment cycle – from investigation and deployment of enabling technologies, through to provisioning and marketing.</p>	<p>Allow Chorus to apply for an increase in its capex and/or opex allowances at any time to support the introduction of a major new product.</p> <p>This increase could be limited to investment above a suitable cost threshold (e.g. &gt;10% of average annual allowance for the period).</p> <p>This avoids locking-out major new products that are not ready for investment commitment at the time a proposal is being prepared.</p> <p>Such a mechanism is appropriate given the pace of technology and market development relative to the length of the regulatory cycles.</p>
Major service enhancement	<p>Similar to the item above, but for non-product changes to regulated services. Examples could include enhanced resilience, restoration performance, or the provisioning approach, etc.</p>	<p>As above, allowances adjusted on application with service enhancement above a suitable cost threshold.</p>

57. The examples above illustrate three types of uncertainty mechanisms:
- 57.1. **Rate driven** – The allowance per unit is determined in advance (to preserve efficiency incentives) and adjusting allowances is a predictable and mechanical process, e.g. ex-post adjustment for actual uptake;
  - 57.2. **Event driven** – A predetermined adjustment is made to allowances if or when a predetermined event occurs, e.g. PSTN migration. Adjustment can be a fixed amount, or a function of some measurable cost-driver (e.g. an amount per exchange); and
  - 57.3. **On application** – Allowances are only adjusted if the Commission approves an investment put forward by Chorus, e.g. a major new product or service enhancement.

## ARRANGEMENTS FOR BALANCE DATES

- ❑ We support having a balance date of 30 June for ID (disclosure year) and 31 December for the revenue control year for Chorus in RP1 (given the constraints with an implementation date of 1 January 2022), as this approach promotes the Part 6 purpose through certainty and efficiency.
- ❑ We would like the opportunity to consider alignment of both regulatory balance dates and our financial year as we move from RP1 to RP2.

### Regulatory year balance dates

58. For the regulatory year balance dates, our preference for Chorus is to have the:
- 58.1. ID reporting year (disclosure year) with a balance date of 30 June; and
  - 58.2. Revenue control year set as the calendar year, i.e. starting 1 January 2022 (the implementation date), with a balance date of 31 December.
59. This is the best approach to address the issue of a fixed implementation date for the new fibre regime of 1 January 2022 and also promote the purpose of Part 6 with certainty and efficiency. Not only does this approach achieve alignment between the balance dates for ID and general financial reporting for efficiency within Chorus, but it also ensures our public reporting (financial and ID) is available to stakeholders within the same period (e.g. August – November).
60. This is the most efficient approach for Chorus as auditing processes can be aligned and fewer audit cycles means less resourcing and cost to implement the new regulatory regime. It also means the one off cost and process of having to change our financial reporting year to the calendar year could be avoided.
61. The approach supports the purpose of ID too, as most suppliers regulated for ID have 30 June as their disclosure year balance date. It will be easier for stakeholders to compare data in regulated suppliers' disclosure reporting for the same period.
62. Beyond RP1 it may be optimal for Chorus if disclosure, regulatory control and financial years all share a common 30 June balance date. This alignment could facilitate timely and efficient audit cycles and flow of MAR updates to pricing. We would like the Commission to consider the potential for achieving this change as we move from RP1 to RP2, for example by setting a 6 month control at the end of RP1, or by setting a 3.5 or 4.5 year period for RP2.

### Implementation

63. Implementing the approach above will require us to submit expenditure forecasts for financial years, which is consistent with the approach we have taken to date in preparing our expenditure proposal. We recognise that depending on whether the revenue control year leads or lags the disclosure year, we may need to add 12 months to the forecast horizon we have been using to date.



## APPENDIX A

### Responses to questions

**Q1 What are your views on what we propose to include in the regulatory processes and rules IM? Are there any other issues we should consider within the scope of regulatory processes and rules IM?**

Chorus agrees with topics the Commission has proposed are in scope of the P&R IMs, in particular:

- Specification of price, pass through and recoverable costs.
- Re-openers and reconsideration events.
- Regulatory balance dates.

And we consider that additional topics should be dealt with in the P&R IMs, and not deferred to PQR. These topics include:

- Wash-up – As the wash-up mechanism is specified in the Act, it is more appropriate to include the requirement in the IMs.
- Revenue smoothing between periods – Revenue between regulatory periods should be in scope of the IMs.
- Expenditure evaluation criteria – The evaluation criteria rules should be stipulated upfront so they are clear when formulating a price-quality proposal.
- Price-quality proposal process – The IMs should set the fundamental principles and information required relating to price-quality proposals on an enduring basis.
- Expenditure incentives – Incentives are a capex and opex topic and may be more appropriate for development in the P&R IMs or in a broader expenditure IM.

We agree some matters can be addressed with principles based IMs and then the detail and practicalities developed through PQD, including the wash-up, processes for expenditure proposals and expenditure incentive mechanisms.

We agree that the form of control is set by legislation for RP1 as a revenue cap.

**Q2 What are your views on how we have applied the legislative framework of Part 6 in considering the scope of this IM?**

**Q3 What are your views on how the regulatory processes and rules IM should apply to price-quality and information disclosure regulation?**

We agree with the Commission that the topics that fall within the scope of P&R IMs are the 'upfront rules' which then apply to PQR, and in some limited instances to ID.

We note that section 176(1)(c) does not provide an exhaustive list of what is within scope of the P&R IMs. So differences in the fibre legislative and market context may require other topics to be included within the scope of the fibre P&R IMs under Part 6.

**Q4 What are your views on how pass-through costs and recoverable costs should be defined in the IMs? Does adopting the approach set out in paragraph 26 work for fibre regulations?**

We support the Commission adopting an approach in line with Part 4 categorising costs as pass-through and recoverable costs.

In addition, we consider that it is appropriate to have criteria or a process to guide the assessment and approval of recoverable costs.

**Q5 Are there any other costs that you think should be included in either pass-through costs or recoverable costs? Are there any other categories of costs that should be included in the regulatory processes and rules IM?**

The Commission should also include:

- Pass-through costs: any costs associated with disputes resolution schemes and membership fees; and
- Recoverable costs: should allow for innovative practices and some insurance related costs.

We also seek clarity on how levies associated with the implementation of the new regulatory regime will be treated as a significant proportion of these will be paid prior to the implementation date.

**Q6 What are your views on which events should trigger the reconsideration of a price quality path?**

**Q7 What are your views on whether there are any specific factors of the fibre market, or the telecommunications industry, which could disrupt the fibre regime during the first regulatory period? Please provide examples of potentially disruptive events in your response.**

Two telecommunications-specific scenarios – relating to cyber security and market changes – should be added to the list of reopener matters.

The way in which forecast and uncertainty risk is dealt with under Part 4 should apply under Part 6. Beyond that, Chorus will face other classes of uncertainty that are different to those faced by Transpower and other Part 4 suppliers (who have fully built networks, longer-lived assets and a slower pace of market and technological change). The further mechanisms needed in a Part 6 expenditure IM – including reconsideration criteria – may be new and unique to Chorus.

We set out, under the heading 'Reconsideration of an expenditure allowance', a table containing examples of the types of uncertainties we could face within a regulatory period. A 'menu' of mechanisms should be available, with a goal of the RP1 PQD process

being to land on an overall price-quality design that efficiently manages risk and uncertainty. We also provide examples that illustrate three types of uncertainty mechanisms.

**Q8 What particular approach do you think should be taken to balance dates and why? How would that approach best promote the purpose of Part 6 of the Act?**

We support having a balance date of 30 June for ID (disclosure year) and 31 December for the revenue control year for Chorus in RP1 (given the constraints with an implementation date of 1 January 2022), as this approach promotes the Part 6 purpose through certainty and efficiency.

This approach supports the purpose of ID too, as most suppliers regulated for ID have 30 June as their disclosure year balance date. It will be easier for stakeholders to compare data in regulated suppliers' disclosure reporting when it is provided for the same period.

**Q9 What are your views on whether any of the approaches used in Part 4 could be applied to fibre regulation? Are there any other approaches we should consider?**

The approach used for Part 4 suppliers of having different regulatory balance dates for ID and revenue control can be used for fibre regulation to manage the constraint of the implementation date for RP1. In particular, we note the approach with Transpower's IPP where the ID/disclosure year balance date is 30 June and revenue control balance date is offset to 31 March. We would also like the opportunity to consider alignment of both regulatory balance dates and our financial year as we move from RP1 to RP2.