

**Submission on
proposed
amendments to fibre
input methodologies**

27 April 2023

C H ● R U S

Executive summary

1. This is Chorus' submission on the Commerce Commission's (**Commission's**) draft decisions reasons paper dated 29 March 2023¹ which proposes to amend the fibre input methodologies (**IMs**) to:
 - a. Implement a wash-up of Chorus' opening regulatory asset base (**RAB**) values for price-quality (**PQ**) regulation from the second PQ path period (**PQP2**) onwards; and
 - b. Allow additional time for the Commission to determine the annual weighted average cost of capital (**WACC**) for Chorus for information disclosure (**ID**) purposes.
2. We support the wash-up for the opening RAB for PQP2 and beyond, and have proposed IM drafting to correctly implement the Commission's stated policy intent. We also recommend that associated wash-ups be included for opening tax asset values and opening carried forward tax losses from PQP2 onwards. Suggested drafting is contained in the **Appendix** to this submission.
3. We do not object to the proposal to allow additional time for the Commission to determine Chorus' annual ID WACC, and trust that IM timeframes and other regulatory requirements affecting regulated suppliers could also be re-considered in the future on the grounds of workability if required.
4. We have no comment on the IM amendments proposed in relation to the determination of the initial RABs affecting only the Local Fibre Companies.

Wash-up of Chorus' opening PQ RAB

5. In its draft decisions reasons paper, the Commission proposes to extend the existing wash-up to maximum allowable revenues (**MAR**) for initial RAB values contained in cl. 3.1.1(11)(a) of the IMs for PQP1 to future PQ periods, such as PQP2, to address the "gap year" forecasting problem when setting ex ante PQ paths.
6. Specifically, when calculating Chorus' MAR wash-up for PQP2 and beyond, we understand that the proposal would involve the following:
 - a. Actual opening RAB values determined under the ID IMs for all fibre assets in the PQ RAB will be substituted for the forecasts of opening PQ RAB values at the start of the regulatory period adopted when the PQ path was set
 - b. The MAR model for the PQ period will be re-run, and the actual opening RAB values will affect the various building block components (and the roll-forward of the PQ RAB) calculated for each year in the PQ period

¹ Commerce Commission, Proposed amendments to Fibre Input Methodologies: Draft decision – Reasons paper, 29 March 2023.

- c. The difference in the MARs for each of the years in the PQ period will determine the value of the MAR wash-up in respect of the opening PQ RAB to carry forward to future PQ periods.
- 7. A wash-up for the “gap year” problem was suggested by Chorus previously, and we thank the Commission for proposing the amendment in advance of the commencement of PQP2 in order to promote certainty.
- 8. We agree with the Commission that implementing a wash-up for the effect on PQ MARs of actual opening RAB values will provide better regulatory incentives. It removes a potentially material source of forecasting error in setting PQ paths and allows Chorus to maintain expectations of ex ante FCM, strengthening incentives to innovate and invest for the long-term benefit of fibre end-users. It also minimises excessive profits by ensuring that prices reflect actual opening RAB values.
- 9. In our view, the wash-up appropriately addresses the effects of all sources of “gap year” forecast error for the PQ RAB values adopted at the start of a regulatory period, including forecasts of commissioned assets, depreciation, revaluations, disposals and cost allocation. We note this differs to the wash-up provisions for electricity distribution businesses under the Part 4 IMs,² but has the advantage of being more comprehensive so should be preferred.

Drafting of wash-up mechanism

- 10. After reviewing the drafting proposed we have identified some changes required to correctly give effect to the Commission’s stated policy intent. Our suggested IM drafting is contained in the **Appendix** to this submission, and:
 - a. Amends clause 3.1.1(11)(a) to wash-up for the difference in the value of the opening RAB values for PQ applying at the start of the PQ regulatory period (rather than at the start of disclosure years prior to the regulatory period as the Commission has proposed)
 - b. Makes other drafting improvements, e.g., by re-instating “the difference between” in the introductory words to clause 3.1.1(11)(a) to give effect to the wash-up, and removing the references to “equivalent” and “disclosed under ID” (unnecessary and not an approach used in other wash-up IMs).

Wash-up of opening tax asset values and tax losses

- 11. A related, and potentially material, source of “gap year” forecast error when setting a PQ path are the forecast values of opening tax asset values and opening tax losses for the start of a regulatory period.
- 12. We recommend including a wash-up for these items to apply from PQP2 because:
 - a. Chorus expects that its carry forward tax losses will be fully utilised at some point during PQP2, and will give rise to a positive tax building block in the PQ modelling in the latter years of PQP2, thereby affecting the determination of PQP2 MARs

² The EDB provisions wash-up for the forecast value of commissioned assets only – see “capex wash-up adjustment” specified in cl. 3.1.3(8) of the EDB IMs.

- b. A wash-up for opening tax asset values and opening tax losses at the start of PQP2 would remove the effect of “gap year” forecasting error on the tax building block in PQP2 MARS, and, similar to the opening RAB wash-up, provide better incentives for regulated suppliers to innovative and invest for the long-term benefit of fibre end-users
 - c. The wash-up falls within scope of amendments set out in the Commission’s Notice of Intention dated 3 March 2023, and satisfies the Commission’s criteria for making such an amendment set out in the Commission’s draft reasons paper (i.e., an incremental improvement to the IMs ensuring consistency in the treatment of the RAB and tax values of fibre assets).
13. We have set out suggested IM drafting for a tax asset value and tax losses wash-up in the **Appendix** to this submission. While Chorus currently expects that a wash-up would be needed for PQP2, the drafting allows a wash-up for tax asset values (and carry forward tax losses if required) to apply for regulatory periods beyond that.

ID WACC determination date

14. The Commission proposes to alter the IM timeframes to determine Chorus’ annual ID WACC by one month. We understand this is to cater for possible Commissioner absences over the January holiday period, and make the requirements more likely to be workable in practice and therefore more administratively effective.
15. We do not object in principle to re-considering various IM requirements (including timeframes) applying either to the Commission or regulated suppliers if there is a risk they would be impractical. However, we would expect the Commission to extend the same willingness to consider changes to IM requirements or timeframes suggested by regulated suppliers on the basis of workability if identified in the future.
16. It also highlights the need to carefully consider requirements and timeframes set under IMs, and for other regulatory processes, to avoid imposing unrealistic obligations on affected parties in the first place.

Appendix

Suggested drafting for amendments to clause 3.1.1(11) of the Fibre IMs

Wash-up for opening RAB values

- (a) ~~subject to subclause (12),~~ the difference between:
- (i) the sum of ~~all forecast~~ **“opening RAB values”** of all **fibre assets** for the **PQ RAB for the first regulatory year of the regulatory period** ~~as of the implementation date,~~ as determined under ~~clause 3.3.1(8)–(9);~~ and
 - (ii) the sum of ~~all initial RAB values~~ **actual opening RAB values** in respect of all **fibre assets** in the **PQ RAB for the disclosure year that corresponds with that regulatory year** ~~as at the implementation date,~~ as determined in accordance with clauses ~~2.2.5(3) and 2.2.6(1)2.2.3(2) and 2.2.4(1);~~ and

Wash-up for opening regulatory tax asset values

- (h) the difference between:
- (i) the sum of forecast **regulatory tax asset values** in respect of **PQ FFLAS** at the start of the first **regulatory year** of the **regulatory period**; and
 - (ii) the sum of **regulatory tax asset values** in respect of **PQ FFLAS** at the start of the **disclosure year** that corresponds with that **regulatory year** as determined under clause 2.3.2(1); and

Wash-up for opening tax losses

- (i) the difference between:
- (i) forecast **opening tax losses** in respect of **PQ FFLAS** for the first **regulatory year** of the **regulatory period**; and
 - (ii) **opening tax losses** in respect of **PQ FFLAS** for the **disclosure year** that corresponds with that **regulatory year** as determined under clause 2.3.3(3).