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Fibre input methodologies

Regulatory processes and rules

Topic paper

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Background

1. We are currently in the process of developing input methodologies (**IMs**) that underpin the regulation of fibre fixed line access services under Part 6 of the Telecommunications Act 2001 (**the Act**). The purpose of IMs is to promote certainty for regulated suppliers, access seekers, and end-users in relation to the rules, requirements, and processes that will apply to fibre regulation. The IMs will be applied to the price-quality regulation (**PQR**) and information disclosure (**ID**) in respect of fibre network providers.

2. As part of our IM consultation process, on 21 May 2019 we released a technical paper on our fibre regulation emerging views (**emerging views paper**), along with a summary paper and submission template form,[1] which discussed the following IMs:

    2.1 cost of capital;

    2.2 asset valuation;

    2.3 cost allocation;

    2.4 treatment of taxation;

    2.5 quality dimensions; and

    2.6 capital expenditure (**capex**).

3. In order to give ourselves additional time to develop our views, we did not discuss regulatory processes and rules in the emerging views paper, despite it being a matter we must cover in IMs under the Act.[2]

We are seeking stakeholder views on the regulatory processes and rules IM

4. The purpose of this paper is to:

    4.1 explain our current thinking on the issues relevant to the regulatory processes and rules IM; and

    4.2 seek stakeholder views on the proposed scope and content of this IM.

5. This topic paper is not intended to be a stand-alone document and should be read in conjunction with the emerging views paper. That paper will provide guidance to stakeholders about how this IM fits within the wider regulatory framework for fibre.

6. Please send your views to **telcofibre@comcom.govt.nz** by **5pm on 9 September 2019**. You also have the opportunity to make a cross-submissions until **16 September 2019** on points you agree or disagree with, as raised by other submitters.

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1 Links to all three of these documents can be found here: https://comcom.govt.nz/regulated-industries/telecommunications/projects/fibre-input-methodologies#projecttab

2 Telecommunications Act 2001, s 176(1)(c).

Emerging views on scope of the regulatory processes and rules IM

7. This section is a brief overview of our emerging views on what will be covered in the regulatory processes and rules IM and what will not be included at this time. The sections following this summary section provide more detail on the topic areas considered for this IM. We are seeking stakeholder views on the issues discussed in this paper as we develop our draft decisions on the fibre IMs, which we are due to publish in November.[3]

8. We are required under the Act to make the IM determination that we consider best gives, or is likely to best give, effect to the purposes set out in s 162 of the Act (the outcomes of workable competition), and, where we consider it relevant, to the promotion of workable competition in telecommunications markets. You will find the legal framework for the IM determination discussed more fully in Chapter 1 of the emerging views paper.

9. There are also specific requirements related to IMs. We must consider both the purpose of IMs (s 174) and the required content of the IMs (s 176) when determining the regulatory processes and rules IM under the Act. This is in addition to our consideration of the s 162 purposes and the overall decision-making framework in s 166 of the Act.

10. Section 176(1)(c) of the Act states that we must set IMs relating to regulatory processes and rules, such as:

    (i) the specification and definition of prices, including identifying any costs that can be passed through to prices (which may not include the legal costs of any appeals against input methodology determinations under this Part); and

    (ii) identifying circumstances in which a price-quality path may be reconsidered within a regulatory period…

11. In developing our emerging views on the regulatory processes and rules IM, we have also drawn upon our experience setting and applying similar processes and rules under Part 4 of the Commerce Act 1986 (**Part 4**). In considering the lessons from Part 4, we acknowledge the differences in the fibre legislative and market context.

12. We have provisionally identified three topic areas to include in this IM that we consider will support the purposes of Part 6, meet the requirements of the decision framework in s 166, and promote certainty in the market when we determine price-quality paths. Our emerging view is that the regulatory processes and rules IM will cover:

    12.1 the **specification and definition of prices** (including the treatment of pass-through costs and recoverable costs);

[3] For an overview of our timeframe for developing the fibre regulatory framework see "Commerce Commission – Fibre regulation emerging views: Summary Paper" (21 May 2019), paragraph 14.

12.2 **processes and rules for reconsidering a price-quality path**; and

12.3 **arrangements for regulatory balance dates.**

13. The following sections of this paper discuss these processes and rules in more detail, but we note here that s 176(1)(c) requires the first two proposed IMs (paragraphs 12.1 and 12.2) to be included in the IM determination, to the extent they are applicable to PQR and ID regulation.

14. We also consider it beneficial to include methodologies relating to regulatory balance dates in order to centralise our decision on this matter. We think this is a fundamental aspect of the IMs that will underpin how we set regulatory control periods and disclosure years in the future and centralising our decisions will make the potential impacts more transparent to stakeholders.[4]

15. In their submission on the "New regulatory framework for fibre – Invitation to comment on our proposed approach" (**proposed approach paper**), Enable, Ultrafast Fibre and Northpower Fibre requested confirmation on whether the regulatory processes and rules IM would apply to ID.[5]

16. Our view is that the topics we are proposing for this IM are primarily concerned with setting the upfront rules which will apply to PQR. There are, however, instances where the IM may be applied in our ID determinations. For example, processes and rules for balance dates may be relevant for ID reporting purposes. The IM may also relate to ID to the extent we might need to cross-reference the definitions set out in the IM. For example, we anticipate the definition of pass-through costs may be cross-referenced in ID determinations.

17. We have considered other regulatory topic areas in the context of the legislative framework. Our emerging view is that these issues would be more effectively dealt with outside of the current IM-setting process:

17.1 **form of control,** as for the first regulatory period, s 195 already prescribes that the price-quality path must specify the maximum revenues that may be recovered by a regulated fibre service provider, and must not specify the maximum prices that may be charged; and

17.2 **PQR proposal/evaluation process, wash-up mechanisms** and **revenue smoothing,** as we think it is more appropriate to cover these issues as part of our PQR consultation process.

18. Further discussion on these topic areas is provided below at paragraph 55 onwards.

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4 Note that s 186 sets out that the purpose of ID is "to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met." Our view is that setting rules on balance dates helps us achieve this.

5 Enable, Ultrafast Fibre and Northpower Fibre "Submission on new regulatory framework for fibre" (21 December 2018), page 13.

19. We note that there are other topics included in the regulatory processes and rules IMs determined under Part 4, such as additional expenditure incentive mechanisms. Since we have consulted on this topic as part of our emerging views paper published in May 2019, in relation to the capex IM, incentives are not discussed in this paper.

20. As we explain in paragraph 63, we intend to begin consulting on our approach to the PQR-setting processes at the end of 2019. Stakeholders will have a chance then to submit views on the issues mentioned in paragraph 17 as part of that process.

21. In the sections below, we explain why we consider each of the topics identified in this section to be in or out of scope of the regulatory processes and rules IM at implementation date. We invite stakeholder views on these matters.

Questions for stakeholders

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?
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?

Proposed regulatory processes and rules to be included in this IM

22. This section discusses the three topic areas identified for inclusion in the regulatory processes and rule IM.

Specification of price, pass-through costs and recoverable costs

23. Section 176 of the Act requires an IM related to the specification and definition of prices to be included in the regulatory processes and rules IM to the extent that it is relevant to the proposed regulation. It may be useful to note here that s 164 defines "price" to mean one or more of individual prices, aggregate prices, or revenues (whether in the form of specific numbers, or in the form of formulas by which specific numbers are derived).

24. The Act also sets out in s 195, that the basis of regulatory control will initially be based on maximum revenue for the first regulatory period rather than prices. The choice of whether to base regulatory control on prices or revenues in the future is covered as part of our "form of control" discussion from paragraph 56.

25. Consistent with s 195, we propose that the IM for specification of price will prescribe that a revenue cap will apply from implementation date. We propose that the IM will also specify certain basic matters; for instance, whether items such as GST, customer discounts, and "other regulated income" are included in the measure of revenue. We will also need to ensure that the IM is consistent with the requirement to apply a wash-up mechanism pursuant to s 196 (see paragraph 64 onwards).

26. Section 176(1)(c)(i) of the Act also provides that our IM on the specification of prices (revenue) should include rules for identifying any costs that can be passed through to revenue. These costs are outside of the building blocks calculation.[6] In our input methodologies for Part 4, we categorise these costs as pass-through and recoverable costs, as follows.

    26.1 **Pass-through costs** include the costs we allow to be passed directly onto customers outside the elements of the building blocks calculation and are typically costs which we consider to be wholly out of control of the regulated supplier. These costs tend to be difficult to forecast in terms of when they will be incurred, and the monetary amount.

    26.2 **Recoverable costs** provide for allowances outside of the building blocks calculation and include allowances for "post scheme adjustments" administered by us, such as incentive payments. Recoverable costs are used to provide for both positive and negative incentive amounts to be passed through to prices. A recoverable "cost" can also be a "benefit". While regulated suppliers typically have no control over pass-through costs, they have some control over recoverable costs. A key difference with recoverable costs (compared to pass-through costs) is that they are subject to approval by us.

27. Our emerging view is that it is necessary to include pass-through costs in the fibre regulatory processes and rules IM, as this will help promote outcomes set out in the purpose statement in s 162 of the Act. This rule will help ensure the only costs which can be passed through to end-users are costs which the regulated supplier is unable to control and can be passed through to consumers without the Commission needing to undertake any assessment of these costs.

28. In workably competitive markets, we would generally only expect a supplier to pass cost increases through to prices if costs had increased for all its competitors.

29. Defining pass-through costs also places a control on what costs suppliers can pass through to end-users. If regulated suppliers had the ability to pass through all costs, it would mean they had little incentive to minimise costs and improve efficiency, which would be contrary to elements (b) and (c) of s 162.

30. We propose to include levies (such as the Telecommunications Development Levy and Telecommunications Regulatory Levy) and rates (such as those paid to local authorities) as pass-through costs, since in our view, they will be outside the control of regulated suppliers.

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[6] Under the building blocks method, we calculate the value of the network that is used to supply the regulated services; this forms the regulated supplier's regulatory asset base. We then use the regulated asset base, along with the supplier's other costs—together, the building blocks—as a basis for calculating the regulated supplier's maximum allowed revenue or prices. See Commerce Commission "New regulatory framework for fibre – Invitation to comment on our proposed approach" (9 November 2018), pages 31-32.

31. Our emerging view is that we should also adopt a similar approach to Part 4 by including recoverable costs as a category that can be passed through to prices. The key difference with recoverable costs is that we would have a role in approving the costs included in the recoverable costs category, as there may be judgement involved as to how much should be passed through. We propose to include as recoverable costs such items as incentive payments and reasonable audit/verifier fees.

Questions for stakeholders

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?
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?

Reconsidering a price-quality path

32. Section 176 of the Act includes "identifying circumstances in which a price-quality path may be reconsidered within a regulatory period" as a requirement for the regulatory processes and rules IM, to the extent applicable. These are also known as "reopeners".

33. The Commission sets price-quality paths on an ex-ante basis for the regulatory period. To maximise incentives for suppliers to behave efficiently, the rules on when a price-quality path may be reconsidered should, where possible, be clearly specified.

34. For instance, where the rules are not clear, suppliers may be concerned that significant efficiency gains might be viewed as excessive profits and result in pressure for the Commission to reduce prices within the period. In addition, a supplier may not take appropriate action to mitigate risks that it is best placed to manage, as it may assume that consumers will be required to compensate it through increased prices or by accepting lower quality should the risk eventuate.

35. However, there are other circumstances, such as where the price-quality path was set on incorrect information, where the basis for the price-quality path is clearly inappropriate and should be reconsidered.

36. We consider reopeners necessary to ensure that both regulated suppliers and end-users are not adversely impacted by certain events that may occur during a regulatory period. In our view, a balance needs to be struck between:

    36.1 the need to ensure that a supplier can seek a reconsideration of the price-quality path if an event is so material in terms of financial effects on the business, that the existing path is no longer appropriate; and

36.2 the need to appropriately restrict the circumstances or events under which a path may be reconsidered. Reconsidering a price-quality path could be a costly and time-consuming task, and leaving the criteria too broad could detract from the certainty that the IMs are intended to provide.

37. As a result, price-quality paths should only be reconsidered in circumstances where the benefit of reconsidering the path is expected to outweigh the likely cost (including both immediate and longer term costs), with other risks left as the responsibility of the supplier.

38. In the process of reconsidering a price-quality path, we would apply section 166(2), and assess the likely impact of the event on the considerations in s 162, as they affect the long-term benefits of fibre end-users, as well as the promotion of workable competition in telecommunications markets (to the extent relevant).

39. Our emerging view is that we would consider reopening a price path in the following situations:[7]

39.1 **catastrophic event,** meaning an event beyond a regulated supplier's control that could not have been reasonably foreseen;

39.2 **change event,** meaning a change in a regulated supplier's legislative or regulatory environment that will require costs to be incurred in response to that change;

39.3 **error,** meaning incorrect data, clearly unintended by the Commission to be included, that impacts the price path; or

39.4 **false or misleading information** has been knowingly provided by a regulated supplier to the Commission.

40. Note that the capex IM may also set out specific situations in which the capex allowance would be reconsidered during a regulatory period. We are considering whether this situation should be covered by the capex IM or whether this should be an additional reopener under the processes and rules IM.

41. We are also considering whether any additional events, other than those listed above, should be included as circumstances when we could consider reopening a price path.

42. We are particularly interested in stakeholder views as to whether there are any specific factors of the fibre market, or the telecommunications industry, which could disrupt the fibre regime during a regulatory period. This could include events that would materially impact regulated suppliers, access seekers or end-users, and would therefore justify a price-quality path being reconsidered.

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[7] These events are largely based on those set out in Commerce Commission *Transpower Input Methodologies Determination 2010* (Consolidated June 2019) pages 95-98.

43. We are also interested in stakeholder views about whether we need to define a specific re-opener provision to allow us the discretion to reconsider a price-quality path in the event that Chorus amalgamates with another supplier.

44. Trustpower submitted on our proposed approach paper that the regulatory process and rules IMs should cover the circumstances in which a price-quality path can be reconsidered within a regulatory period. They also suggested we include the process fibre providers can follow to amend price structures and quality dimensions in response to changes in relevant markets and technologies.[8] We are interested in hearing stakeholder views about whether we should have a re-opener for market changes, and how that could be incorporated in the IMs.

45. Our view is that reconsidering a price path gives us an opportunity to consider accounting for unforeseen events that are likely to have a material impact, or events which may jeopardise the long-term benefit of end-users. The benefits of re-openers need to be balanced with the risk that reconsidering a price-quality path too often could undermine the certainty IMs aim to provide. We would also need to consider how to use other tools such as wash-ups and revenue smoothing.

Questions for stakeholders

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.

Arrangements for balance dates

46. In implementing the new regulatory framework for fibre, it is necessary to agree on the relevant regulatory periods, typically defined by annual regulatory balance dates. Economic regulation tends to rely on regulatory calculations being performed for discrete periods because:

    46.1 legislation is often drafted in relation to fixed dates and periods (eg, implementation date for new regulatory framework, length of the regulatory period of a price-quality path);

    46.2 reporting periods are a familiar concept to regulated suppliers and other stakeholders, and are used under financial reporting, tax law and internal management accounting;

    46.3 data-gathering is easier over defined periods, and this reduces regulatory burden and compliance costs; and

[8] Trustpower "Submission on new regulatory framework for fibre" (21 December 2018), page 3.

46.4 it is potentially easier for interested persons to compare data amongst regulated suppliers if the data covers the same time period.

47. The implementation date for the new fibre regime is 1 January 2022,[9] and s 207 sets out that "the first regulatory period starts on the implementation date and lasts for a period of 3 years". However, none of the four regulated suppliers have a 1 January balance date for general financial reporting purposes.[10] Chorus, Enable and Northpower Fibre all have 30 June balance dates, whereas Northpower LFC2 and Ultrafast have 31 March balance dates. This could pose potential difficulties in implementation for:

47.1 initiating ID regulation from a fixed date (ie, 1 Jan 2022) as annual ID disclosures will span part-years of all suppliers' financial results;

47.2 setting price and quality limits for Chorus as financial data needed will span part-years of Chorus' financial results;

47.3 comparing financial and other information across all suppliers; and

47.4 calculating the initial loss asset from 1 December 2011 to implementation date, as the loss period will span all regulated suppliers' financial results.

48. For fibre, we see an opportunity to give visibility to, and centralise, the decision on regulatory balance dates for all regulated suppliers in the IMs. For instance, we are interested in whether the regulatory processes and rules IM should include arrangements for balance dates so that:

48.1 each regulated supplier's disclosure year lines up with their financial years for ease of reporting and compliance; or

48.2 all regulated suppliers have the same disclosure year so interested parties (including the Commission) can assess performance more easily.

49. We are also interested in views as to whether we should include specific arrangements for Chorus' balance date and how it might relate to the regulatory control period of their price-quality path.

50. Our view is that including arrangements for balance dates will help promote certainty, as set out in s 174 of the Act. In particular, it will promote certainty for regulated suppliers and help them prepare for fibre regulation (eg, by making any required adjustments to their financial reporting processes).

51. The option set out in paragraph 48.2 above may help promote the purpose of ID set out in s 186 of the Act, which is "…to ensure that sufficient information is readily

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9 See Minister for Broadcasting, Communications and Digital Media *Notice of Deferral of Implementation Date Under the Telecommunications Act 2001* (12 December 2018).

10 In this paper we have assumed the regulated suppliers will be Chorus Limited (Chorus); Enable Networks Limited (Enable); Northpower Fibre Limited and Northpower LFC2 Limited (Northpower); and Ultrafast Fibre Limited (Ultrafast).

available to interested persons to assess whether the purpose of this Part is being met." For instance, if each regulated supplier has the same disclosure year for ID, this might facilitate interested persons (including the Commission) to compare financial and other information about the performance of regulated suppliers.

52. We are aware that any arrangements we make for balance dates will need to consider potential changes to regulated suppliers' financial reporting dates. We are interested in hearing stakeholders' views on how our approach might anticipate any future changes.

53. For the reasons mentioned in paragraph 46, Part 4 regulation has adopted annual regulatory periods. Part 4 regulation building blocks revenue and profitability calculations draw on past ID disclosure periods as base data, and pass-throughs, wash-ups and incentives are calculated annually. The IMs for Part 4 regulation therefore have particular balance dates, eg:

    53.1 asset values are calculated at the end of a regulatory year, and "rolled forward" to the next balance date (ie, end of the next year);

    53.2 depreciation and revaluations are calculated for a financial year; and

    53.3 PQR requires forecasts of annual operational expenditure (opex) and capex to determine allowable revenues.

54. The rule for balance dates is incorporated into the various IMs through a common defined term of "disclosure year". However, the actual definition (ie, the period constituting a disclosure year) differs across the regulated Part 4 sectors (electricity, gas and airports), for example:

    54.1 for electricity transmission, Transpower's IPP defines the regulatory control period as the year ending in 31 March but the disclosure year as the year ending 30 June;[11]

    54.2 electricity distribution companies must disclose information and are price-quality regulated on an annual basis with 31 March as the year end, irrespective of their financial reporting balance dates;[12]

    54.3 gas distribution companies have varying disclosure years for ID (eg, Vector and GasNet use the year ending 30 June; whereas FirstGas and Powerco use the year ending 30 September);[13]

[11] Commerce Commission *Transpower Individual Price-Quality Path Determination 2015* (consolidated 26 November 2018), page 11.

[12] Commerce Commission *Electricity Distribution Information Disclosure Determination 2012* (consolidated April 2018), page 15

[13] Commerce Commission *Gas Distribution Information Disclosure Determination 2012* (consolidated April 2018), page 13.

54.4 for airports, the disclosure year for Wellington International Airport is defined as 31 March, whereas the other two regulated airports report on the year ending 30 June.[14]

Questions for stakeholders

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?
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?

Topic areas not proposed for this IM

55. This section identifies topic areas considered but not proposed to be included in regulatory processes and rules for the first IM determination.

Form of control

56. Related to the rules for the specification of price are rules on the form of control. As noted in paragraph 17.1, we do not have the choice of which control we use for the first period.

57. Section 195 of the Act sets out that we must set maximum revenues, rather than maximum prices, in the first regulatory period (and every period before the "reset date"):

> *(1) Despite section 194(2)(b), the Commission must, in the price-quality paths for each regulatory period that starts before the reset date,—*
>
> *(a) specify the maximum revenues that may be recovered by a regulated fibre service provider; and*
>
> *(b) not specify the maximum price or prices that may be charged by a regulated fibre service provider.*

58. We have also undertaken work in the Part 4 area, including in response to the seven-year IM review, to amend or include rules and process matters such as changes to forms of control (price cap versus revenue cap).[15]

59. Given we do not have the choice of the form of control we use for the first period, we do not consider it necessary to cover the issue of the form of control in the initial regulatory processes and rules IM.

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[14] Commerce Commission *Airport Services Information Disclosure Determination 2010* (consolidated June 2019), page 28.

[15] For more information on the 2015/16 IM review see our website: https://comcom.govt.nz/regulated-industries/input-methodologies/projects/201516-im-review

PQR proposal/evaluation processes

60. In our proposed approach paper, we outlined the potential for the regulatory processes and rules IM to specify the requirements to be met by suppliers when proposing, and us when evaluating, a price-quality path for a regulatory period.[16] Some submitters (such as Trustpower, Transpower, Chorus and 2Degrees)[17] noted that the processes used for setting IPPs (ie, those used by the Commission in its current regulation of Transpower) are likely to be the most relevant approach to regulation under Part 6.

61. Stakeholders also raised potential issues to be managed if we adopted an approach where Chorus were to submit a price-quality path proposal for our assessment. 2Degrees noted that any such proposal may have to be more limited in scope for the first period given both the time pressure, and industry concerns about suppliers engaging in the process in "good-faith".[18]

62. When considering the requirements for setting rules related to price-quality path proposals in IMs, it is worth noting that the statutory requirements of Part 4 are different to those pertaining to fibre IMs. In particular, s 52T (the Part 4 equivalent of s 176) requires IMs to be set for:[19]

> *(d) matters relating to proposals by a regulated supplier for a customised price-quality path, including—*
>
> *(i) requirements that must be met by the regulated supplier, including the scope and specificity of information required, the extent of independent verification and audit, and the extent of consultation and agreement with consumers; and*
>
> *(ii) the criteria that the Commission will use to evaluate any proposal.*

63. Section 176 of the Act does not require the fibre IMs to cover matters relating to price-quality path proposals, and we do not think it is necessary for these to be included in the regulatory processes and rules IM. Instead, we intend to set out any matters relating to PQR proposal/evaluation processes as part of our consultation process for our PQR determination. One reason we consider this more appropriate is that it would be difficult to consult on the draft IMs for proposal/evaluations when we have not yet begun the consultation process for PQR. Currently, we plan to begin consulting on PQR towards the end of 2019. It is also worth noting that:

    63.1 the other fibre IMs we determine (relating to the calculation of individual building block costs) will already have to cater for PQR at a detailed level (for

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16 Commerce Commission "New regulatory framework for fibre – Invitation to comment on our proposed approach" (9 November 2018), paragraph 7.121.3.2.

17 Trustpower; Transpower; Chorus; 2 Degrees "Submission on new regulatory framework for fibre" (21 December 2018).

18 See 2Degrees "Submission on new regulatory framework for fibre" (21 December 2018), page 19.

19 We consulted on the topics set out s 52T(d)(i) of the Commerce Act as part of our capex IM section of our emerging views paper. This is consistent with the requirement for a capex IM set out in s 176 of the Act.

example, forecasting asset values and capital expenditure values, cost allocation and tax); and

63.2 determining PQR process issues in detail in the IMs, rather than the PQR determinations, risks unnecessarily restricting the way in which we can set PQR later (for instance, before we fully understand how certain requirements may need to change between the first two regulatory periods).

Wash-up mechanism and revenue-smoothing

64. This section deals with how we propose to approach determining revenue-smoothing and a wash-up mechanism through our PQR determination.

65. Section 196(2) of the Act sets out the following:

The Commission must, in calculating the maximum revenues, apply a wash-up mechanism that provides for any over-recovery or under-recovery of revenue by the regulated fibre service provider during the previous regulatory period to be applied in a manner that is equivalent in present value terms (as calculated in the manner that the Commission thinks fit) over 1 or more future regulatory periods.

66. In addition, s 197 of the Act stipulates that when we specify maximum revenues, we must consider whether it is appropriate to smooth revenues between periods. We can do this in a manner that we consider appropriate to minimise undue financial hardship to a regulated supplier or to minimise price shocks to end-users.

67. In response to our proposed approach paper, Chorus submitted that the processes and rules IM should cover pass-through costs, recoverable costs, reconsideration of a price-quality path, and wash-ups.[20] While we agree that the first three issues should be covered by this IM, we do not consider it necessary to include wash-up mechanisms in the IM at this stage. This is because we would consider the application of a wash-up mechanism alongside other tools when setting the price path. This is in contrast to "locking in" our approach to applying the wash-up as part of the upfront IMs.

68. We would generally expect to assess the need for revenue smoothing as part of the price-quality determination process and to ensure we account for the impacts of smoothing within the ID requirements. In making a decision on revenue smoothing, we would consider the context of the whole regime, alongside other tools, such as the use of a wash-up mechanism, and the anchor services set out in the regulations. In doing this, we would apply what is set out in s 197 (ie, minimise undue financial hardship to a regulated supplier or to minimise price shocks to end-users).

69. We do not consider it necessary to cover wash-up mechanisms or revenue-smoothing in the regulatory processes and rules IM because the PQR requirements of the Act (subpart 5 of Part 6) provide sufficient certainty as to how these rules must be applied by the Commission or regulated suppliers.

[20] Chorus "Submission on new regulatory framework for fibre" (21 December 2018), paragraph 148.