10 September 2020

Submission on:
Fibre Input Methodologies
Further consultation draft [initial value of financial loss asset]

Northpower Fibre Limited and Northpower LFC2 Limited

Public version

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Thank you for the opportunity to provide feedback on the Fibre Input Methodologies, *Further consultation draft [initial value of financial loss asset]*, published 13 August 2020 (**Consultation**).

Northpower Fibre Limited and Northpower LFC2 Limited (together, **Northpower Fibre**) make this submission on points that are relevant and most important to Northpower Fibre.

1. Approach to establishing the financial loss asset (FLA)

1.1 In general, Northpower Fibre supports adopting a simple approach to determining the FLA so long as the approach is fit for purpose and consistent with the requirements of section 177 of Part 6 of the Telecommunications Act 2001. The Discounted Cash Flow (DCF) approach now proposed appears to be more intuitive and straight forward than the previous building block proposal.

1.2 However, even with the simpler DCF approach there are some implementation complexities for Northpower Fibre which need to be addressed:

- Northpower Fibre Limited and Northpower LFC2 Limited are different legal entities and have different balance dates; 30 June and 31 March respectively. While we understand that the new regulatory framework applies to the regulated service, and therefore regulation will look through the legal structures, the balance dates create an issue for implementing the proposed FLA component of the input methodologies (**IMs**) for Northpower Fibre.

- Our preferred approach is to determine a FLA for each entity, using financial data which is consistent with the financial years for each entity. This approach will ensure we are able to use audited year end information for the revenue, cost and financing cash flows. In order to do this, the definition of financial loss year, and the corresponding WACCs in the draft IM determination will need to be amended to accommodate the 31 March reporting period for LFC2.

- Estimating separate FLAs for each entity also ensures that the FLA components of the regulated asset bases (RABs) are assigned appropriately to the underlying core fibre assets of each entity.

2. Benefit of Crown financing

2.1 The proposed move to a DCF approach for the FLA also involves a change to the method for estimating the benefit of Crown financing. Paragraph 3.38.2 of the Consultation states that the benefit of Crown financing will be determined as the net present value of the net drawdowns minus the sum of the net drawdowns. This is explained further in Attachment A of the Consultation as follows:

The benefit of Crown financing is calculated as:

- *The sum of Crown financing in nominal terms as at 31 December 2021;*
- *Less the sum of Crown financing in dollars of 31 December 2021 (i.e. annual drawdowns present valued to 31 December 2021 using the mid-year compounding rate), using the appropriate method to calculate the present value of Crown financing.*

2.2 We understand that in this context the annual drawdowns referred to may be positive (i.e. funding drawn down), or negative (i.e. funding repaid). This is consistent with the spreadsheet model provided with the Consultation.

2.3 We also understand that it is proposed that the DCF approach to the FLA will adopt variable financing rates (either debt or equity rates as appropriate) for each financial loss year and that these variable rates will apply to the annual drawdowns (including repayments) which occur in each year.

2.4 The proposed approach will overstate the benefit of Crown financing for Northpower Fibre, because with a variable WACC which declines over the pre-implementation period, repayments will be valued at lower financing rates than the drawdowns which they relate to. As a result, Northpower Fibre does not support this proposed method of quantifying the benefits of Crown financing.

2.5 In our view, the proposed approach cannot be adopted for the purpose of estimating the benefit of Crown financing because it is inconsistent with section 177(3)(b) of Part 6 of the Telecommunications Act which requires the FLA to take into account the actual financing costs of Crown financing.

2.6 We submit that the Commission's previous proposal for estimating the benefit of Crown financing, where the variable financing rate (either debt or equity as appropriate) is applied to the net funding in each loss year, more correctly estimates the actual costs of Crown financing during the pre-implementation period.

We thank you again for the opportunity to provide this submission.

Please contact Darren Mason (darren.mason@northpowerfibre.co.nz) if you would like to discuss any aspect of this submission further.

Darren Mason

Chief Executive

Northpower Fibre Limited