# ENABLE NETWORKS LIMITED AND ULTRAFAST FIBRE LIMITED

# SUBMISSION ON NZCC FIBRE REGULATION INPUT METHODOLOGIES REGULATORY PROCESSES AND RULES

**27 MAY 2020**

## 1. Introduction

1.1 This submission is made by Enable Networks Limited (**Enable**) and Ultrafast Fibre Limited (**Ultrafast Fibre**) (collectively referred to in this submission as **LFC**s) in response to the Commerce Commission's (**Commission**) *Fibre input methodologies draft decision – reasons paper (regulatory processes and rules)* dated 2 April 2020 (**RPR**) and the *[Draft – regulatory processes and rules] Fibre input methodologies determination 2020* (**Determination**).

1.2 In this submission we respond to the draft decisions on:

(a) Regulatory balance dates

(b) Specification and definition of price including pass-through costs

(c) Circumstances in which a PQ path may be reconsidered within a regulatory period.

## 2. Regulatory balance dates

2.1 The draft decision is that the regulatory balance date for all regulated fibre service providers for both ID and PQ purposes will be 31 December. The RPR states that this date aligns with the implementation date of the fibre regime and will aid interested persons in comparing information disclosed by regulated providers over time[1]. This proposal means that the regulatory balance date will not align with the annual reporting cycles of any of the regulated providers.

2.2 We therefore do not support this decision as it is inconsistent with the proportionality principle which underpins good regulatory practice. This principle is intended to support the IM decisions, as described in the Emerging Views consultation: '*Individual decisions will consider whether the proposed regulation best serves the purposes in s 162(2) and is proportionate to the regulatory need it addresses'*[2].

2.3 In our view the additional cost and complexity of reporting on regulatory balance dates which do not align with external reporting dates are not justified. We support each FFLAS provider adopting a balance date for ID purposes which is aligned to their external financial reporting balance dates.

2.4 We note that UFF does not prepare half year accounts at 31 December, as suggested in the RPR. Enable's half yearly reporting to its shareholder at 31 December is limited in scope and does not provide the information required to support a regulatory disclosure regime.

2.5 The consequences of this draft decision for LFCs include:

(a) Disclosure audits occurring during the financial year end preparation and completion time period, with additional workload and likely duplication of activity. Total audit costs will increase as a result. Enable's disclosure audit fee is currently approximately $15k p.a. This modest fee reflects the reliance that the auditors place on their audit of the year end information, and the limited scope of the regulatory disclosures. This fee, along with the resources required to prepare disclosures can be expected to increase significantly as:

(i) Disclosures can be expected to be more extensive, consistent with the legislative mandate, and as experienced under Part 4

[1] Commerce Commission, RPR, paragraph 117

[2] Commerce Commission, Fibre Emerging Views, Technical Paper, 21 May 2019, para 143.2

(ii) The IMs will introduce more complexity and increased departures from GAAP

(iii) The auditors will not be able to rely on their year-end audit work.

(b) Complexity and risks of publicly releasing performance information prior to official release to the market via parent companies in the normal course of business

(c) Additional activities to close a December year, including tax and works under construction. This will occur during the summer holiday season and at the time where resources are under pressure preparing budgets, particularly for UFF with a March balance date

(d) Restrict the ability to automate accounting and disclosure processes in financial systems, as it is not possible to have multiple balance dates. This will require manual (spreadsheeting) of disclosures. Moving to a new system to accommodate multiple balance dates will be cost prohibitive. A manual compilation process will limit opportunities for efficiency and increase risk of calculation errors

(e) Complexity for planning, as there is no December planning cycle. Planning is on a March or June year basis, including budgets, forward work plans, annual progress and variance analysis, assurance and governance

(f) Additional reconciliation complexity between GAAP and regulatory reporting. We note that GAAP and regulatory rules are likely to diverge further once the new regime is in place

(g) Additional complexity for shareholders, customers and local communities in understanding and monitoring business performance.

2.6 The RPR suggests that the Commission will consider further how to minimise reporting and compliance costs for providers[3], however there are no examples provided, and no further explanation of how the Commission intends the complexity from misaligning reporting dates can be overcome.

2.7 There is precedent for supplier specific regulatory balance dates under Part 4 regulation where, like FFLAS services, there are a small number of regulated suppliers. The four gas pipeline businesses and three regulated airports have different ID reporting balance dates, which align with each company's financial reporting dates. As the purpose and scope of ID regulation under the Act is the same as Part 4, we do not accept that there is justification for imposing additional cost on the regulated providers of FFLAS services.

2.8 The IM matters described in paragraph 110 of the RPR (regulatory asset base roll forward, causal allocators for cost allocation and cost of capital) can be determined for multiple balance dates. Monitoring financial performance against a cost of capital benchmark range is logical for a financial/budget year end but makes a lot less sense for a calendar year end which is unrelated to pricing or planning years. Current industry convention is for prices to be reset on 1 July.

2.9 We acknowledge that an initial RAB must be established at implementation date, 1 January 2022. However, that RAB can be rolled forward for a part year to align with each supplier's financial year end. Having RAB and financial year asset reporting aligned means that asset reporting systems can be used for both purposes. Year-end asset commissioning processes are not completed at 31 December, and staff availability is reduced during the Christmas holiday period.

2.10 The purpose of ID regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose statement is being met. This objective does not

[3] Commerce Commission, RPR, paragraph 121

require synchronised disclosures across regulated providers, as the same information will be disclosed, and each provider's disclosure will cover periods of the same duration.

2.11 Section 187(2)(b) of the Act requires the Commission to publish summary and analysis of disclosure information for the purpose of promoting greater understanding of the performance of individual service providers, relative performance, changes in performance over time, and their ability to extract excessive profits.

2.12 We note that common reporting dates assist with, but are not essential for, compiling relative performance assessments. Relative performance assessments are undertaken for the regulated gas and airports sectors without common reporting dates. The remaining section 187(2)(b) requirements – individual performance, changes in performance over time and ability to extract excessive profits are focussed on the performance of each provider, and therefore the assessments can be undertaken at any reporting date.

2.13 The LFCs therefore submit that aligning regulatory balance dates with financial reporting balance dates will generate better regulatory outcomes because:

(a) Performance monitoring at the end of each supplier's normal business financial and planning period aligns with existing business and shareholder processes

(b) It has lower compliance costs and complexity

(c) The Commission's performance monitoring obligations are met

(d) It is consistent with the approach adopted in the other regulated sectors with few participants, and therefore enhances regulatory certainty.

## 3. Specification and definition of price including pass-through costs

3.1 The draft decision is that prices will be specified as maximum revenues (defined in nominal terms, exclusive of GST, and after deducting discounts and rebates) in the form of a revenue cap for Chorus. Maximum revenues will comprise building blocks revenues, pass-through costs and the revenue wash-up.

3.2 We support specifying in the Process and Rules Input Methodology (**PRIM**) the price components of the revenue cap to apply from implementation date, the pass-through cost components and the revenue cap wash-up.

3.3 We challenge the draft decision to exclude local body rates, industry levies and disputes resolution scheme levies, which are incurred in the provision of the regulated service, from pass through costs. This is inconsistent with the treatment of these costs under Part 4 regulation and therefore creates regulatory uncertainty.

3.4 We do not accept the rationale presented in the RPR that these costs can be controlled by regulated service providers. It is not consistent with our experience to date. For example, requests to consider revisions to Utilities Disputes fees were rejected by the entity.

3.5 We also note that rates typically fall outside of commercial property lease fees, and thus are incurred by the property tenant, irrespective of ownership. Local bodies can change rating policies annually, modifying the allocation of rates between rate payers and the quantum of rates. This is not something that can be readily forecast in advance for an entire regulatory period, or which a rate payer can influence.

3.6 In addition, the draft decision will reduce incentives to participate in Utilities Disputes which is inconsistent with the long-term interests of users.

3.7 As the specification of price component of the PRIM applies to PQ regulation which does not apply to LFCs, we have not commented further on the detailed drafting in the Determination. We may respond in cross submission if any specific issues emerge during the consultation process.

## 4. Circumstances in which a PQ path may be reconsidered within a regulatory period

4.1 The draft decision is that a PQ path can be reconsidered following a catastrophic event, change event, error event, provision of false or misleading information, a change in generally accepted accounting practice (GAAP), or for major transactions (including amalgamations).

4.2 We support the decision to allow for reconsideration of PQ paths under these circumstances, with appropriate materiality thresholds. We consider the 1% threshold proposed is reasonable and note that this is consistent with the reconsideration threshold adopted under Part 4 regulation. This threshold is specified as at least 1% of maximum revenues for the affected years of the regulatory period.

4.3 While this threshold is useful for events which impact costs and revenues, it is less useful for events which impact quality performance. We therefore submit that an additional threshold is included, specified as the impact on expected quality performance of at least 1% of the quality standard (ie: the performance standard which must be met under the PQ path) for the affected years of the regulatory period.

4.4 We propose that the two thresholds are independent, and that a PQ path may be reopened if either threshold is exceeded as a result of a reconsideration event. For the avoidance of doubt, we support the ability for the Commission to amend either or both of the price path and quality standards in response to a reconsideration event, as drafted in clause 3.9.7(1) of the PRIM.