ENABLE NETWORKS LIMITED

SUBMISSION ON COMMERCE COMMISSION DRAFT DECISION OF LOCAL FIBRE COMPANIES' INITIAL INFORMATION DISCLOSURE REGULATORY ASSET BASES AS AT 1 JANUARY 2022

27 APRIL 2023

Our city of possibilities

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1. Introduction

1.1 We appreciate the opportunity to submit on the Commerce Commission's (**Commission**) Draft Decision of the Local Fibre Companies' Initial Information Disclosure Regulatory Asset Bases as at 1 January 2022 (**Draft Decision**).

1.2 We agree with the majority of the Draft Decision and our submission is solely in relation to Chapter 5– Benefit of Crown financing.

2. Summary of Commission's Draft Determination

2.1 In paragraph 5.10 of the Draft Decision, the Commission considered whether consistency can be achieved across the three LFCs and developed three options on how to calculate the benefit of Crown financing for the LFCs:

(a) Accept that the methods can differ between suppliers and use the methods proposed;

(b) Assume that 50% of Crown financing was in substance debt and 50% was in substance equity (**50/50 Method**); or

(c) Assume Crown financing will be repaid at a set time in the future, with the present value of this repayment used as the value of Crown financing that is in substance debt.

2.2 As stated in paragraph 5.21 of the Draft Decision, the Commission decided to apply the 50/50 Method as it is a *"robust way of calculating the debt-equity split and there is no alternative method that we know of that is more precise than assuming the Crown financing comprised equal shares of debt and equity funding*".

2.3 In this paper, we submit:

(a) the Commission's decision to apply the 50/50 Method to determine the benefit of Crown financing for Enable is inconsistent with the Fibre Input Methodologies Determination 2020 (Consolidated 21 December 2021) (**IMs**); and

(b) the actual proportion of debt and equity as recorded in Enable's audited published financial statements should be used to determine Enable's benefit of Crown financing as this is compliant with the IMs and the most robust method for Enable.

3. Decision is inconsistent with final IMs

3.1 We submit the Commission's decision to use the 50/50 Method in relation to the treatment of Enable's Crown financing is inconsistent with IMs.

3.2 For regulated providers that are subject only to information disclosure regulation, the IMs prescribe that the benefit of Crown financing is to be derived using the formula set out in clause B1.1.2(6). Inputs to the formula are the proportion of net drawdowns in each year which are in substance debt, and the proportion which are in substance equity.

3.3 The IMs do not specify a proportion of debt or equity for Enable or the other LFCs that are only subject to ID regulation. The explanations in the IM reasons paper[1] indicate that it is the actual proportions of debt and equity in each financial loss year which are to be used to derive the actual costs of Crown financing received by each entity, for example at paragraphs X13.3, X29 and 3.422.

[1] Fibre Input Methodologies, Financial Loss Asset Final Decision – Reasons Paper, 3 November 2020

The Draft Decision to assume a 50:50 apportionment of debt and equity where there is robust evidence to the contrary is therefore inconsistent with the IMs.

3.4 The proportions of debt and equity for Chorus are specified in the IMs, with reference to the contract between Chorus and Crown. They are not specified for the other LFCs, including Enable. While we cannot comment on the funding arrangements of the other LFCs, we note that each party negotiated its own contracts with the Crown, including in respect of financing. The IMs contemplate these arrangements by requiring the actual proportions of debt and equity to be used by each LFC entity in applying the formula in clause B1.1.2(6).

3.5 In this formula, Enable is required to calculate the annual benefit of Crown financing one of three ways, depending on whether for a given year, there was in substance (1) a combination of debt and equity (2) all debt, or (3) all equity financing[2]. The IMs therefore contemplate that the benefit of Crown financing is to be calculated in accordance with the actual debt and equity position of Enable during the financial loss period.

3.6 We submit that the Commission's decision to apply the 50/50 Method to Enable is therefore the least robust of the options proposed because it ignores the actual Crown financing arrangements reported by Enable and therefore is inconsistent with the IMs.

3.7 We further note that the IMs do not require the LFCs to adopt consistent proportions of debt and equity when calculating the benefit of Crown financing, or that these proportions would be fixed across the financial loss period.

4. Enable present value and form of Crown Financing

4.1 Below we clarify what appears to be a misunderstanding in the Draft Decision about our calculation of the present value benefit of Crown financing.

4.2 As set out in our Summary of Information dated 9 December 2022 (**ENL Summary of Information**), in June 2016 Enable underwent a reorganisation whereby all of CIP's shares in Enable Networks Limited (**ENL**) transferred to Enable Services Limited (**ESL**), and ESL's parent company, Christchurch City Holdings Limited (**CCHL**), entered into a Loan Agreement with CIP as consideration for the share transfer. Accordingly, from June 2016 onwards, Crown financing was recorded as 100% debt with no equity. Prior to the reorganisation in June 2016, as correctly stated in the Draft Decision, 65% to 85% was recorded as debt, with the remainder equity. This record of Enable's Crown financing was reported in all of Enable's audited published financial statements since June 2012, which were signed off by CIP each year until June 2016. At no point did Enable record less than 65% of Crown financing as debt and no debt was repaid until CCHL repaid the CIP loan in full in May 2021. The consequence of this is that the proportion of Crown financing that was debt grew over the financial loss period as the network was built.

4.3 When considering Enable's present value approach, in paragraph 5.18 the Draft Decision states:

> *Regarding Enable's assumption that the Crown Financing would be repaid in three years (or the two years suggested by Tuatahi), we do not consider this to be a reasonable assumption as it is arbitrary and not consistent with actual repayments*.

4.4 We believe that Enable's treatment of Crown financing may have been misunderstood in the Draft Decision as our calculation did not assume that the Crown financing would be repaid in three years. There may be some confusion with the three-year discount rate we applied to the financing as opposed to a three-year repayment term. As documented in paragraph 2.4 of the ENL Summary of

[2] Fibre Input Methodologies Determination 2020 Consolidated as of 21 December 2021, para 2.4.11(1)

Information we calculated the PV based on the theoretical repayment date of 31 December 2019, not three years. This was the contracted date for completion of our network build.

4.5 The PV calculation did not make assumptions about a three-year debt repayment as no repayments occurred until May 2021. The three-year term assumed that all conditions to convert the compounding financial instruments (see Appendix 1) to an equity instrument would be completed in three years for our first three Network Deployment Plans (**NDP**). For NDP4 to NDP7, this date was extended to 31 December 2019.

4.6 The Draft Decision concludes at paragraph 5.21 that the 50/50 Method has been elected because there is no alternative method that is more precise, and the present value calculation is not robust.

4.7 We have provided the Commission with the actual proportions of debt and equity which are consistent with our audited published financial statements, and the relevant contracts with the Crown over the financial loss period. We submit that this is more precise than the 50/50 Method which is proposed, and more consistent with the intent of the IMs.

4.8 We submit that our PV calculations are consistent with the IMs, are robust, and are not arbitrary. The following example illustrates how the debt and equity values were determined for financial reporting purposes.

4.9 In the first quarter (September 2014) of the 2015 financial year Enable passed [redacted] premises for which we received a cash payment of $4,736,950 (i.e., [redacted] premises @ $[redacted]) as specified in our contract with the Crown.

(a) This $4,736,950 needed to be paid back in full in December 2019 as per the NDP, as CFH A Shares.

(b) The $4,736,950 was initially recorded as debt (our financial statements use the term compounding financial instrument) because it represents an unavoidable obligation of the Company to repurchase the A shares for cash.

(c) The $4,736,950 was discounted to $3,391,688 at a rate of 6.50% per annum (which was pegged to the rate that ESL was paying CCHL) between December 2019 to September 2014.

(d) The amount of $3,391,688 was recorded as debt in September 2014 with the balance of $1,345,262 recorded as equity.

4.10 As each NDP Stage was completed each tranche of Crown funding received was treated in a similar manner, consistent with our contract with the Crown.

4.11 These transactions were recorded in our audited financial statements consistent with the contractual method explained above. In Appendix 2 we show extracts from the notes to the financial statements which explain the financial reporting treatment.

4.12 The financial statements were signed by the directors, two of which were appointed by CIP, who therefore endorsed the categorisation of the funding for each annual reporting period.

5. Conclusion

5.1 Enable supports the Draft Decision apart from the benefit of Crown financing for Enable. The incorrect application of the IMs to Enable is material, resulting in a $9.281m reduction in the initial RAB.

5.2 We submit that, to be consistent with the IMs, the Commission must use the actual proportion of debt and equity as recorded in Enable's audited published financial statements.

5.3 We would be happy to meet with the Commission to provide further explanation of our historical Crown financing arrangements.

Appendix 1

Crown Fibre Holding (CFH) A Shares:

The A shares held by CFH may be required to be repurchased by the Company (at a fixed price of $1 per share) at any time during the concession period when notified to do so by ESL, provided that:

- *Enable Services Limited funds the buy-back;*
- *certain solvency and debt covenant requirements are met; and*
- *if the build of the network is incomplete the buy-back would not result in CFH holding less than 51% of the total A shares on issue (in which case the buy-back is deferred until the build is complete).*

This represents an unavoidable obligation of the Company to repurchase the A shares for cash, and accordingly the A shares held by CFH represent a compound financial instrument. In determining the liability component, the Company has estimated the earliest possible date at which the Company would be required to buy-back the A shares, and discounted the repayment at that date to arrive at the amount to be recognised as a liability. The remainder is recognised as equity.

The A shares held by CFH are also required to be repurchased in the event of certain cost-savings as described below, however this is considered remote and has not impacted the measurement of the liability component of A shares held by CFH as described above.[3]

[3] 2012 Enable Networks Limited Annual Report – 1. Statement of accounting policies

Appendix 2

Liability component of A shares and Issued capital
A shares held by CFH contain a liability component.

As each stage of the deployment plan is completed by Enable Services Limited, Enable Networks Limited purchases the UFB network from the Enable Services Limited based on an agreed cost per premises passed (CPPP) for the number of premises passed by fibre optic cable upon successful user acceptance testing (UAT).

A Shares

CFH funds approximately 67% of the Company's purchase of each stage by way of subscribing to A shares (these shares carry full voting rights, with no dividend rights until 10 years from establishment (the end of the concession period), the price for which is the agreed CPPP. The remaining 33% of each stage is funded by ESL in return for A shares with the same rights as those issued to CFH.

The A shares issued to CFH are compound financial instruments as the partner has the option, at any time during the concession period, to purchase from CFH its A shares at $1 per share, or alternatively the partner may instruct the Enable Networks Limited to repurchase the A shares from CFH, subject to certain conditions which are set out above.

The A shares held by CFH and ESL are also required to be repurchased in the event of certain cost-savings, however this is considered remote and has not impacted the amount attributed to equity.

At the end of the concession period, any remaining A shares convert to ordinary shares.[4]

[4] 2012 Enable Networks Limited Annual Report – 14. Liability of A shares and issued capital