ENABLE NETWORKS LIMITED AND ULTRAFAST FIBRE LIMITED

SUBMISSION ON NZCC FIBRE REGULATION INPUT METHODOLOGIES REGULATORY PROCESSES AND RULES

9 SEPTEMBER 2019

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, regulatory processes and rules, Topic Paper* dated 19 August 2019 (**RPRP**).

1.2 In Part I of this submission we focus on seven key issues. In Part II we respond to questions asked by the Commission in the RPRP.

1.3 Part I of this submission addresses the following issues:

(a) specification of prices, pass through costs and recoverable costs;

(b) form of control;

(c) revenue smoothing and wash-ups;

(d) reconsidering a price-quality path;

(e) regulatory balance dates;

(f) price-quality evaluation processes; and

(g) application to information disclosure regulation.

1.4 We note that the primary purpose of the input methodologies (**IMs**) under Part 6 of the Telecommunications Act 2001 (**Act**) is to promote regulatory certainty.[1] The IMs must also include sufficient detail to ensure regulated providers are able to estimate the material impacts on them.[2] Our submission is focussed on assessing whether the proposals in the RPRP achieve the s 174 purpose and meet the 'sufficient detail' standard.

[1] Section 174

[2] Section 176(2)(a)

PART I

2. Specification of prices, pass-through costs and recoverable costs

2.1 We support specifying in the Process and Rules Input Methodology (**PRIM**) the price components of the revenue cap to apply from implementation date, as proposed in the RPRP.

2.2 We also support specifying the pass-through cost components in the PRIM, and agree that the proposed industry levies and local body rates meet the criteria of being largely outside the control of FFLAS providers, and not requiring Commission approval.

2.3 We submit that Utilities Disputes Limited (**UDL**) levies should also be included as a pass-through cost, as they are for the energy companies subject to Part 4 regulation. These levies meet the pass-through cost criteria. Enable is a member of UDL, and UFF is expected to join in the near future.

2.4 The PRP proposes that audit and verification fees for price-quality regulation (**PQR**) are included as recoverable costs. We submit that any audit and verification fees for information disclosure (**ID**) regulation are also included in this category of cost. These are costs incurred as a result of the regulatory framework which are largely outside the control of the FFLAS providers.

2.5 It is expected that abnormal audit fees, and possibly independent verification fees will be incurred at the start of the regime, as the initial IMs are applied (for example in estimating financial losses and RAB values). These costs will be incurred by all fibre providers (Chorus and the three LFCs), as will ongoing audit fees for ID and PQR reporting purposes.

2.6 Ring fencing these costs for pricing and cost recovery purposes is just as valid for ID purposes as for PQR purposes, in the same way that pass-through costs are ring fenced.

2.7 In this respect we note that approval of recoverable costs by the Commission does not necessarily need to occur in advance, and can be achieved through disclosure of information about the costs incurred. This approach has been adopted for Part 4 regulation.

3. Form of control

3.1 We do not support the proposal to exclude the form of the control from the PRIM because this does not provide sufficient regulatory certainty.[3] The IMs are intended to apply across regulatory periods, which is critical for promoting regulatory certainty for long life infrastructure.

3.2 The Act specifies the form of control[4] and the length of the regulatory period for the first regulatory period.[5] However it is silent on subsequent regulatory periods, other than specifying that they must be between three and five years duration.[6]

3.3 Accordingly, as the IMs are intended to endure for up to seven years,[7] there will be a gap in the regulatory framework if the form of control to apply for PQR is not fully addressed in the PRIM.

3.4 Therefore we suggest that the initial PRIM includes:

(a) the form of control for the first PQR period;

---

[3] We note that the PRP appears to put forward two different views on whether the form of control will be addressed in the processes and rules IM (at paras 25 and 59)

[4] Section 195

[5] Section 207(1)

[6] Section 207(3)

[7] Section 182

(b) the process and timing for determining whether the form of control and duration of regulatory period should change for subsequent regulatory periods; and

(c) the criteria to be adopted for this purpose.

3.5 This will provide more certainty than the option proposed in the RPRP, but it does not require commitment to a specific form of control for the next regulatory period at this time. However we submit that it will be reasonable to adopt a process which assumes that the status quo will be maintained in the future, unless there are good reasons to depart from it, i.e. to better promote the s 162 purpose. This expectation will further contribute to promoting regulatory certainty.

3.6 The RPRP addresses revenue smoothing and wash-up mechanisms for PQR. It is proposed that revenue smoothing and wash-ups will not be addressed in the PRIM, but instead will be considered when each PQR determination is made. The RPRP suggests that Part 6 provides sufficient guidance on how these mechanisms should be applied.

3.7 We acknowledge that s 196 addresses wash-ups. We agree that there is sufficient guidance in the legislation to demonstrate the policy intent for a wash-up mechanism between regulatory periods. However the legislation is silent on mechanisms for wash-ups within regulatory periods which are expected to form part of a PQR revenue cap. We encourage the Commission to consider this issue more fully and provide more information about the process for wash-ups under PQR, and whether it intends to address these in the PRIM or the PQR determination. We note that in Part 4 the revenue cap wash-ups are addressed both in the PRIM and the PQR determination.

3.8 We also acknowledge that s 197 addresses revenue smoothing and provides some guidance on the policy intent in this respect. However there is little direction on how or when the smoothing mechanisms are to be applied. There is also no guidance on how the "undue financial hardship" and "price shocks to end-users" criteria are to be assessed for the purpose of revenue smoothing.

3.9 In other regulatory jurisdictions, financeability of the regulated provider is assessed:

(a) at the time that regulatory decisions are made; and

(b) monitored during regulatory periods.[8]

3.10 The process and metrics for assessing financeability would be useful additions to the PRIM to improve regulatory certainty about how s 197 will apply in practice.

3.11 In addition, thresholds for determining price shock could be included in the PRIM. The Commission has some experience with making price shock assessments under Part 4 and has developed and implemented revenue smoothing criteria when making its price-quality determinations for gas and electricity distributors.

3.12 Regulatory certainty would be promoted if these criteria were established in advance. They would also assist LFCs, subject to ID regulation, when making pricing decisions.

4. Reconsidering the price-quality path

4.1 Enable and UFF support the proposals to specify in advance when price-quality paths may be reconsidered within a regulatory period, because this promotes regulatory certainty.

4.2 The proposals to include catastrophic events, change events (incorporating legislative or regulatory changes) and error/false information events appear reasonable, and are consistent with regulatory experience under Part 4 of the Commerce Act.

[8] Refer, Ofgem, RIIO 2 Financeability assessment, 26 March 2019 and IPART, Review of our financeability test, November 2018

4.3 If there are other design features of PQR which allow for the revenue path to be reopened, such as unforeseen capex, then we submit these should also be included in the PRIM to reduce regulatory complexity. Accordingly we do not support the option of including additional reopeners in the capex IM.

4.4 We note that any reopener should provide for changes to both the price/revenue caps and the quality standard components of PQR. This needs to be taken into consideration when designing the materiality thresholds for reopeners, because they must be suitable to accommodate quality impacts as well as financial impacts.

4.5 We do not support the proposal to allow for additional reopeners in the event of an amalgamation of an FFLAS provider subject to PQR. We do not consider that this option provides sufficient certainty and it will not be possible to estimate the material effect of the IM. Instead we submit that the consequences of amalgamations for FFLAS providers should be addressed in the PRIM, as they are under Part 4.

4.6 In this respect we submit that any FFLAS services provided by an LFC subject only to ID regulation remain exempt from PQR for the remainder of the regulatory period in which an amalgamation occurs. This is consistent with the Part 4 provisions for amalgamations between exempt and non-exempt electricity distributors.

4.7 This will provide any FFLAS providers considering amalgamation within a regulatory period an understanding of the regulatory consequences for them. This will be essential information for FFLAS providers prior to any potential amalgamations.

4.8 Finally, we do not support the proposal by Trustpower to include an IM process for amending price structures and quality dimensions in response to changes in relevant markets and technologies. This goes beyond the s 174 purpose of the IMs and the s 162 purpose statement. FFLAS providers are able to price their services and manage their quality performance within the bounds of any PQR determination. A revenue cap form of price control limits the total amount of revenue able to be recovered within a regulatory period, but does not regulate individual product prices within that revenue allowance.

4.9 In response to Trustpower's suggestion, we note that under ID regulation, FFLAS providers will be required to disclose information about their performance. Section 188 specifies that information about financial and quality performance, assets, plans, prices and pricing methodologies may be required to be disclosed.

5. Regulatory balance dates

5.1 We support specifying annual regulatory balance dates for information disclosure purposes in the PRIM because it promotes regulatory certainty objectives. We consider that annual disclosures will be meaningful, and assist in promoting the s 186 purpose of ID. More frequent disclosures are not justified, as the additional compliance costs are likely to outweigh any incremental benefit.

5.2 We support each FFLAS provider adopting a balance date for ID purposes which is aligned to their external financial reporting balance dates. For Enable this will be 30 June, and for UFF, 31 March.

5.3 As regulatory financial information will be extracted from each FFLAS provider's financial reporting systems, regulatory cost and complexity will be minimised if the financial and regulatory reporting dates are aligned. This will also minimise audit costs, as auditors will be able to rely on audited data for the reporting period when assessing regulatory disclosures. They will also be able to co-ordinate their audit activities, such as on site visits, to reduce costs.

5.4 There is precedent for this practice under Part 4 where there are a small number of regulated businesses. The four gas pipeline businesses and three airports regulated under Part 4 have different ID reporting balance dates, which align with each company's financial reporting dates.

5.5 With few regulated FFLAS providers this approach is manageable. Monitoring is able to be undertaken effectively by the Commission because each regulated entity reports similar information, covering periods of similar length (e.g. twelve month historical periods or ten year forecast periods). It also helps to ensure that time series data is robust for each FFLAS provider, as the data aligns with audited financial year end information which is subject to robust cut off processes.

5.6 We acknowledge that the PQR dates are guided by the legislation, at least for the initial regulatory period. If PQR was applied to the LFCs at a future date, Enable and UFF would support an approach which aligns the PQR regulatory periods and annual reset dates with annual pricing cycles. This would assist the LFCs to set prices to meet the annual revenue constraints imposed by PQR. It is anticipated that in the future, price resets will generally occur at 1 January.

6. PQR evaluation processes

6.1 The RPRP proposes that PQR evaluation processes are excluded from the PRIM and addressed through consultation on PQR decisions. We disagree with this proposal because it creates unnecessary regulatory uncertainty.

6.2 PQR evaluations must occur prior to a PQR determination being made. They cannot be addressed in the PQR determinations themselves; the only determinations which are available for these processes are the IMs.

6.3 As PQR may apply to LFCs in the future, and the IMs are intended to span multiple regulatory periods, it is appropriate to provide more certainty about these processes for future resets, particularly as these processes must be applied well before any PQR determination is made. In addition, it will be more difficult to assess whether PQR should apply to the LFCs at the time of the first review, if there is significant uncertainty about how PQR will apply in practice.

6.4 We note that under Part 4 regulation, evaluation processes are set out in the IMs for those suppliers subject to PQR that relies on business specific proposals.[9] These include the CPP IMs for gas and electricity distributors and the capex IM for Transpower.

6.5 The RPRP suggests that the Commission intends to set out the evaluation processes as part of consultation on PQR resets. However, this proposal is suboptimal because the Commission's expectations for information and its evaluation processes and criteria need to be available much earlier, and with much more certainty. By definition, consultation papers cannot provide certainty until final decisions are made.

6.6 Accordingly, under this proposal FFLAS providers will have insufficient direction for:

(a) preparing information to support a PQR decision in a way which meets the Commission's expectations; and

(b) preparing for and completing any pre-submission review processes – such as independent verification and assurance, in advance of submitting the information to the Commission.

6.7 The PRIM is intended to provide a mechanism for specifying the operational matters of the regulatory framework. We submit that the PRIM should specify processes relevant for making price-quality decisions, including:

(a) information to be provided by the FFLAS provider;

(b) pre submission verification, certification and assurance requirements; and

[9] This excludes EDBs and GPBs subject to Default Price-Quality Paths

(c) criteria to be applied by the Commission when assessing the provider's information.

6.8 There are precedents for all of these items in Part 4 regulation. We note that while there is some cross over with the proposed capex IM, there is substantial non-capex related information that is relevant to making PQR decisions, such as forecast opex, demand and quality. This information will also need to be specified in advance, audited and potentially independently verified before the Commission undertakes its assessment prior to making a PQR determination.

6.9 We acknowledge the submission by Chorus that these processes may be more limited in scope for the first regulatory period. However, we do not believe that this is sufficient reason to exclude these items from the IMs entirely.

7. Application to information disclosure regulation

7.1 We agree with the RPRP that elements of the PRIM (as it is proposed) will apply to FFLAS providers subject to ID regulation, including the specification of pass-through costs and balance dates.

7.2 However other components of the PRIM are indirectly relevant to LFCs subject only to ID regulation because they may provide guidance when:

(a) setting prices, for example price smoothing, recoverable costs and wash-ups;

(b) considering the regulatory consequences of potential amalgamations; and

(c) assessing the potential impact of future PQR on them.

PART II Response to PRP (Questions)

Question	
1	*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 the regulatory processes and rules IM?* We support the proposal to include in the PRIM information about: • specification of prices; • pass-through and recoverable costs; • reopeners; and • regulatory balance dates. However we submit that additional information should also be included in the PRIM, including: • form of control and the process for reviewing the form of control and duration of regulatory period beyond the first regulatory period; • revenue cap wash-ups; • criteria for assessing financeability and price shock for revenue smoothing; • regulatory consequences of amalgamations of FFLAS providers; and • evaluation and information requirements for PQR proposals.
2	*What are your views on how we have applied the legislative framework of Part 6 in considering the scope of this IM?* Our comments on the application of the legislative framework to the determination of the IMs was provided in our submission dated 16 July 2019, on the Emerging Views Paper. We note that the primary purpose of the IMs is to promote regulatory certainty.[10] The proposals set out in the RPRP do not fully meet this objective, particularly because they do not adequately consider how regulation will apply beyond the first regulatory period. In addition it is proposed to exclude information which is necessary to meet the requirements of s 176(2)(a) which requires IMs to include sufficient detail to estimate the material effects of the methodologies. As the IMs are intended to apply across regulatory periods, for up to seven years, the proposed approach to the PRIM is not sufficient. We note that the inter-period application of regulatory methods is essential for regulatory certainty, as investments in FFLAS are expected to provide services over the long term.
3	*What are your views on how the regulatory processes and rules IM should apply to price-quality and information disclosure regulation?* The application of the PRIM to ID regulation is addressed in section 7 of Part I of this submission. The application of the PRIM to PQR regulation is addressed in response to Q1 and Q2 above.

[10] Section 174

Question	
4	*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?* We agree with the approach set out in paragraph 26 of the RPRP for pass-through and recoverable costs. We note that recoverable costs do not necessarily need to be approved in advance, and they have not always been so under Part 4. Disclosure of audited information about recoverable costs has been sufficient for this purpose.
5	*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?* We submit that the following additional costs should be included as discussed in section 2 of Part I of this submission: • UDL levies as pass-through costs – consistent with Part 4 regulation; and • regulatory audit and verification fees for ID and PQR as recoverable costs – consistent with the similar proposals for PQR. This is expected to include one-off audit and verification costs associated with the implementation of the IMs at implementation date, and ongoing costs associated with ID and PQR.
6	*What are your views on which events should trigger the reconsideration of a price-quality path?* As stated in section 4 of Part I of this submission, we agree with the events specified in the RPRP and consider any capex reopeners should be included in the process and rules IM. In addition, as discussed in section 4 of Part I of this submission, we do not support additional regulated processes for changing prices or quality standards in the event of market or technological change within a regulatory period. This would be inconsistent with a revenue cap form of control, which limits the total amount of revenue able to be recovered within a regulatory period, but does not regulate individual prices within that revenue allowance. We do not support amalgamations as re-openers because this approach does not provide sufficient certainty prior to the decision to amalgamate and it is not possible to estimate the material effect of the IM. Amalgamations should be addressed in the PRIM. We submit that any FFLAS services provided by an LFC subject only to ID regulation remain exempt from PQR for the remainder of the regulatory period in which an amalgamation occurs.

Question	
7	*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.* As we have submitted consistently throughout the consultation process,[11] the introduction of fixed wireless access services using 5G technology has the potential to disrupt the fibre market during the first regulatory period.
8	*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?* We have addressed this question in detail in section 5 of Part I of this submission. We support balance dates which match financial reporting balance dates for ID regulation because this will minimise cost and complexity for FFLAS providers and help to ensure disclosure data is robust and consistent over time. We note the Commission has effectively undertaken its monitoring activities for the gas and airports sectors (the other sectors with small numbers of regulated entities) using this approach. If PQR were to apply to LFCs in the future we would support balance dates which align with annual pricing periods, because this will assist with regulatory compliance.
9	*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?* Refer to section 5 of Part I of this submission and Q8 above.

[11] For instance, LFC Submission on Emerging Views Paper, 16 July 2019, [5.2]; LFC submission on New Regulatory Framework for Fibre, 21 December 2018, Q8; Enable submission to the Economic Development, Science and Innovation Committee on the Telecommunications (New Regulatory Framework) Bill, 2 February 2018, Schedule 1 [9.3] – [9.11]