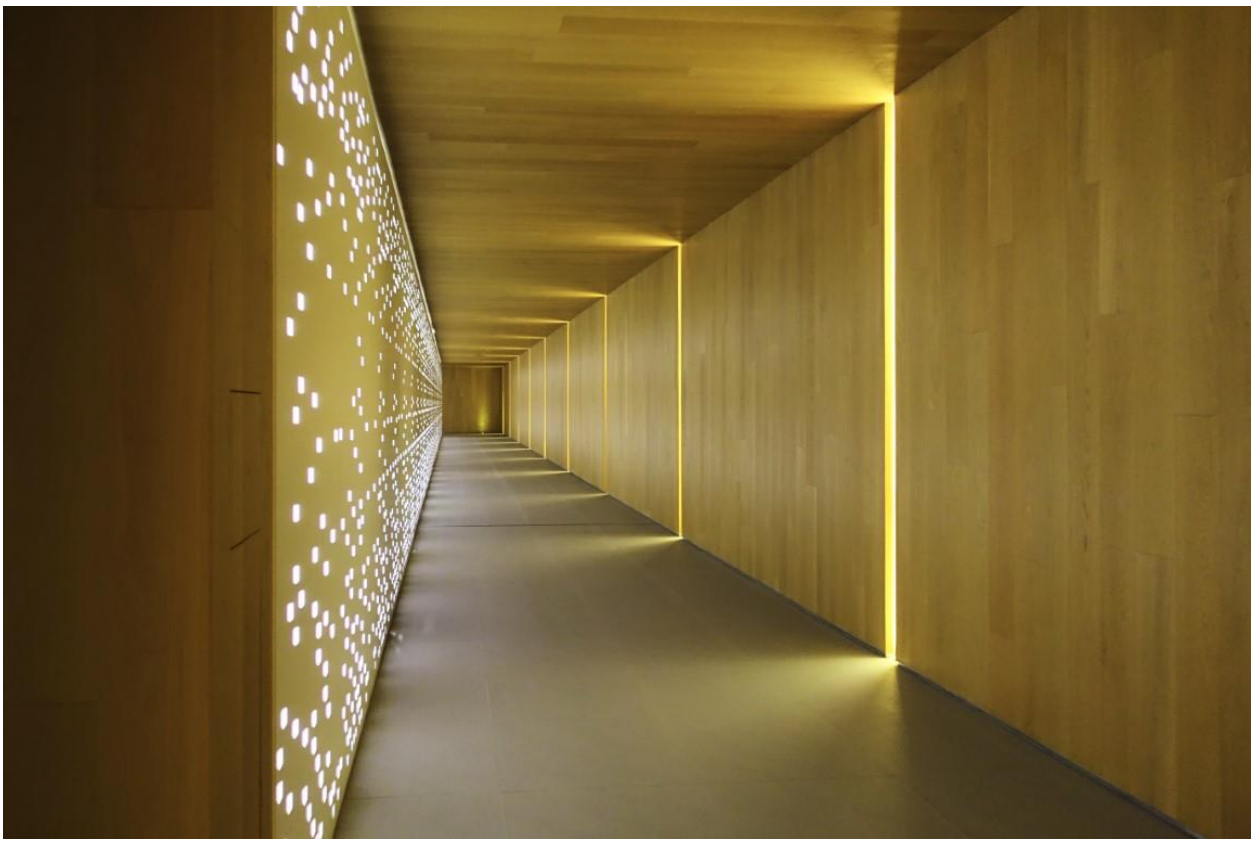
Chorus submission on "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"

2 June 2020



OVERVIEW

1. We welcome the Commerce Commission's consultation on its draft guidance on the equivalence and non-discrimination obligations (**Draft Guidance**), published on 4 March 2020.

2. We appreciate that developing guidance for compliance obligations is difficult. Guidance, by its very nature, must strike the right balance between providing certainty and flexibility. Guidance based on high-level principles, rather than detail, is more likely to strike that right balance and be enduring.

3. We agree with many of the high-level principles in the Draft Guidance. As the Commission pointed out in its *Fixed line telecommunications regulation overview,* the Deeds don't set price or non-price terms. Every part of the Draft Guidance must have a clear basis in the words chosen by the parties to the Deeds, and Local Fibre Companies (**LFCs**) should be able to reasonably ascertain in advance whether their conduct complies with the Deeds. Where we tend to diverge from the Commission's view, is where we think the Draft Guidance moves from interpreting the words of the Deeds to rule-making.

4. This is not the first time the equivalence and non-discrimination obligations have been interpreted and applied, although the Commission's previous interpretations took place prior to the wholesale-only model being implemented in New Zealand. Chorus' fibre network has also been built to comply with our equivalence obligations, including through extensive engagement with the Commission.

5. It is also important to remember the equivalence and non-discrimination obligations are intended to operate within the broader telecommunications regulatory framework, which as a whole achieves the objectives of the Telecommunications Act (**Act**). Chorus is operating as a wholesale-only business in an environment where the fixed market is structurally separate; we are not a vertically integrated service provider and most of our services are regulated.

6. We have not commented on the Commission's *Fixed line telecommunications regulation overview* in this submission. There are areas where our views may diverge from the Commission's. For example, we have previously indicated we interpret the definition of FFLAS and copper deregulation differently from the Commission.

7. We look forward to engaging further with the Commission on the development of the Draft Guidance.

CONTEXT

- Equivalence and non-discrimination are part of an integrated suite of regulatory mechanisms, which collectively achieve the relevant purposes of the Telecommunications Act. When interpreting the equivalence and non-discrimination obligations, it is important to bear in mind the overall regulatory framework in which they operate.

8. Chorus operates under layers of regulation that have evolved since it operationally, then structurally, separated from Telecom. The equivalence and non-discrimination obligations are intended to operate within this overall regulatory framework, which collectively achieve the relevant purposes of the Act. When interpreting the equivalence and non-discrimination obligations, it is important to bear in mind they do not operate in a vacuum. The obligations also can't be directly compared to the equivalence and non-discrimination obligations in the Telecom Operational Separation Undertakings.

9. Our copper services are regulated under Part 2 of the Act (which subjects the majority of our copper services to regulated price and non-price terms), and our fibre services are regulated under Part 6 of the Act (where they will be subject to price-quality (**PQ**) regulation, mandatory services, geographically consistent pricing and a revenue cap). In addition, the Act requires Chorus to operate in accordance with business line restrictions.

10. The overall aim of these regulatory constraints is to make Chorus behave as if it were in a market with competition (Part 2), and to promote outcomes consistent with workable competition (Part 6), limiting the risk of excessive profits for either copper or fibre services.

APPROACH TO INTERPRETING EQUIVALENCE AND NON-DISCRIMINATION OBLIGATIONS IN THE DEED

- The words of the non-discrimination and equivalence obligations are paramount. Every part of the Draft Guidance must have a clear basis in the words chosen by the parties to the Deeds.
- The Commission should have regard to New Zealand competition case-law.
- European policy has no immediate relevance to the interpretation of the Deeds.
- Equivalence and non-discrimination are compliance obligations, not principles that empower the Commission to make determinations of regulatory policy. Chorus and other LFCs must be able to assess in advance of any enforcement action whether their conduct complies with the requirements of equivalence and non-discrimination. Compliance can't turn on the exercise of judgement in relation to matters on which there could reasonably be disagreement.

Words of the Deeds are paramount

11. The equivalence and non-discrimination obligations are set out in both the Fibre Deed[1] and Copper Deed[2] and are required by the Act.[3] While the Deeds need to be read consistently with the purpose statements in sections 69W and 156AC of the Act, the words of the Deeds are paramount and every part of the Draft Guidance must have a clear basis in the words of the Deeds.

12. The obligations are unique in the regulatory framework because they are set out in deeds of undertaking given by LFCs in favour of the Crown, rather than directly in legislation. The Act sets out certain minimum requirements for the Deeds, including that they must provide for equivalence and non-discrimination. However, the obligation to comply with equivalence and non-discrimination arises from the Deeds rather than from the Act.

13. This was a deliberate decision by Parliament. Parliament could have prescribed equivalence and non-discrimination obligations directly in the Act, as it did for example in relation to the first and third business line restrictions in subpart 3 of part 2A of the Act. Instead, it left it to LFCs and the Minister to define the precise scope of the obligations through agreed undertakings.

14. The task here, in determining the scope of the equivalence and non-discrimination obligations, is to interpret the words of the Deeds as bilateral instruments between LFCs and the Crown. The Deeds do not empower the Commission to make determinations of regulatory policy based on the underlying purposes in sections 69W and 156AC of the Act. The Commission's role is to enforce the Deeds, which it may do so only through the Court. Ultimately, it is for the Court to determine whether the Deeds have been breached.

European policy has no immediate relevance to the interpretation of the Deeds

15. It is likely that the High Court, in considering any enforcement action, would have regard to New Zealand jurisprudence, particularly appellate jurisprudence under section 36 of the Commerce Act, where that's relevant to the economic concepts in the Deeds.

16. We caution the Commission against placing any weight on international regulatory policy. UK and EU practice is informative only to the limited extent that it shows how similar, although not identical, obligations have been interpreted and applied

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[1] Chorus (October 2011), *Chorus Limited Deed of Open Access Undertakings for Fibre Services*; (May 2017), *Chorus Limited Deed of Open Access Undertakings for Fibre Services for UFB2*, each at [5]-[6].

[2] Chorus (October 2011), *Chorus Limited Deed of Open Access Undertakings for Copper Services*, at [5]-[6].

[3] Telecommunications Act 2001, sections 69X and 156AD.

elsewhere. The Commission has noted our non-discrimination obligations are different to those in the UK and EU.[4]

17. While Parliament likely had regard to overseas precedents, it ultimately left it to LFCs and the Minister to define the precise scope of the obligations that apply in New Zealand. Regulatory policy in other jurisdictions doesn't override the words chosen by the parties to the Deeds and developments in European policy have no immediate relevance to the interpretation of the Deeds.

18. We note that this is consistent with the views expressed by the Commission in the *Loyalty* case:[5]

> *As a preliminary point, it is noted that, where the language in the Undertakings is different from that used in other jurisdictions, decisions from those overseas jurisdictions are unlikely to be a sound source of guidance. If the Undertakings were intended to adopt the same standard, they would have used the same language.*

Equivalence and non-discrimination are compliance obligations

19. It's important the Draft Guidance acknowledges that equivalence and non-discrimination are compliance obligations, rather than principles that empower the Commission to make determinations of regulatory policy.

20. This means:

    20.1. LFCs must be able to reasonably know in advance whether their proposed conduct complies with the requirements of equivalence and non-discrimination. An interpretation of the obligations that means compliance can only ever be assessed *ex-post* undermines the rule of law; and

    20.2. The test for compliance (i.e. what the obligations require of Chorus and other LFCs) cannot be subject to the Commission's exercise of discretion, or subjective judgement of the appropriate standard of compliance under the circumstances.

21. Elements of the Draft Guidance imply that different market conditions would prompt the Commission to adopt different tests for equivalence or non-discrimination. For example, the Commission's view appears to be that, depending on the market conditions, equivalence might require the selection of a "reasonably efficient operator" versus an "equally efficient operator" when determining avoidable downstream costs, or differing methodologies depending on whether the market is characterised by penetration pricing. The Commission also suggests in several places in the Draft

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[4] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.6]-[4.12].

[5] Commerce Commission (16 October 2009), *Consultation on the non-discrimination and EOI obligations under the Telecom Separation Undertaking requirements with respect to the complaints concerning the Telecom Wholesale Loyalty offers* (***Loyalty***), at [72].

Guidance that the relevant legal test for compliance would depend on what conduct was most likely to maximise competitive outcomes in the market.

22. These are factors that would only be relevant if the Commission were tasked with making a regulatory determination setting the margin between upstream and downstream prices (it is in that context these considerations are typically applied in European regulatory policy). They are unworkable as compliance standards because they rely on the exercise of judgement in relation to matters on which there could reasonably be disagreement. They also have no apparent basis in the words of the Deeds.

EQUIVALENCE

- Equivalence is always satisfied by an ECPR-based rule relying on an EEO cost standard. Once ECPR is satisfied, no further inquiry is necessary.
- An interpretation of the obligations that means compliance can only be assessed *ex-post*, and which turns on the Commission's subjective judgement of what is appropriate under the specific market circumstances, does not work as a compliance obligation.
- New Zealand case law developed under section 36 of the Commerce Act is relevant here and the Commission should take a consistent approach.
- There is limited risk of excessive profits for either fibre or copper. Under Part 6 of the Act, Layer 1 and Layer 2 prices, in aggregate, can't be above cost because they are subject to a revenue cap. Under Part 2 of the Act, the Commission has set the price and non-price terms for copper services under STDs.
- Adopting an alternative cost standard, for example ECPR using REO, would require applying an appropriate allowance for asset stranding risk in order to satisfy the overall cost recovery (NPV=0) under Part 6. We note the Commission's current proposal for an ex-ante allowance for asset stranding risk may not include the specific economic stranding that would result from adopting an alternative cost standard to ECPR using EEO.
- The equivalence of inputs obligation must be interpreted consistently with the Deeds' other provisions and with the Commerce Act, particularly as they relate to information access.

Equivalence of price

23. We agree with the Commission that:

    23.1. Equivalence of price requires network operators to treat access seekers the same way as the network operators' own operations in relation to pricing.[6]

[6] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.23].

23.2. This means network operators must provide access seekers with a service at the same (imputed) price they charge internally to their own downstream operations. This (imputed) internal price can be calculated using a number of different approaches and assumptions.[7]

23.3. The equivalence of price obligation allows a network operator to determine the methodology and the structure of its prices, provided it treats access seekers the same way as the network operator's own downstream operations.[8]

24. We also agree with the Commission that the use of an ECPR-based rule relying on an EEO cost standard (**ECPR upstream price**) is a practical approach that network operators can implement.[9] ECPR reveals the internal price that an LFC is charging itself. ECPR therefore directly addresses the relevant question under the equivalence test.

25. However, we are concerned about a number of statements in the Draft Guidance that suggest an ECPR upstream price may not meet equivalence under specific market circumstances,[10] and that alternative approaches (for example a cost-based approach or an ECPR-based approach using an REO standard) may instead be more appropriate.[11]

26. We disagree. Compliance with the equivalence obligation can always be demonstrated using an ECPR upstream price – we expand on this in more detail below. And, as we have explained above, this is a compliance obligation, which means Chorus and other LFCs need to be able to assess in advance of any enforcement action whether their conduct complies. An interpretation of the obligations that means compliance can only be assessed *ex-post*, and which turns on the Commission's subjective judgement of what is appropriate under the specific market circumstances, does not work as a compliance obligation.

Equivalence is satisfied by ECPR

27. The fundamental question posed by the equivalence obligation is whether the LFC is charging RSPs no more than the (imputed) internal price it is charging itself. The

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[7] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.23].

[8] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.27].

[9] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.62].

[10] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.45]-[3.47], [3.54]-[3.55], and [3.66].

[11] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.45]-[3.47], [3.54]-[3.55], and [3.66].

ECPR upstream price represents the (imputed) internal price that a vertically integrated supplier charges itself.[12]

28. The use of ECPR upstream price as a compliance reference point is also consistent with the line of cases developed under section 36 of the Commerce Act - most recently in *Telecom Corporation of New Zealand Ltd v Commerce Commission* (***Data***) in relation to price squeeze, which is conceptually related to equivalence.[13] The New Zealand case law that has developed in that context provides insight to the proper approach to equivalence.

29. As mentioned above, the Commission should primarily have regard to New Zealand case law that has developed under section 36 of the Commerce Act, where that is relevant to the economic concepts in the Deeds, rather than the development of competition law in the EU. It is likely that the High Court, in considering any enforcement action, would do so.

The Commission's two-step assessment

30. In the Draft Guidance, illustrated in Figure 3.2, the Commission proposes to use a two-step assessment, where:[14]

    30.1. Equivalence of price is likely to be satisfied if an upstream price is shown to be at the lower of the ECPR upstream price and the cost-based upstream price; and

    30.2. Upstream prices that lie above this minimum may also satisfy equivalence of price (except where downstream prices are below combined downstream and upstream costs) but further investigation will be required to determine whether equivalence of price is satisfied, depending on the specific market circumstances.

31. It is not clear to us, but the Commission appears to be trying to address two separate objectives – dealing with 'exclusionary prices' (or margin squeezes) and dealing with prices that may result in 'excessive returns' (or profit above normal return on capital).

32. Figure 3.2 in the Draft Guidance shows that in Scenario 2 (where downstream prices are below the combined downstream and upstream costs), the objective is to ensure there is sufficient economic space for competition at Layer 2. However, in Scenario 1 (where downstream prices are above the combined downstream and upstream costs), the objective isn't clear. In Scenario 1, if the ECPR upstream price is used, the economic space for competition at Layer 2 is the same as it is in Scenario 2, but there

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[12] See NERA (November 2019), *Equivalence and non-discrimination: a review of Ingo Vogelsang's* report, at [23], and Chorus (November 2019), *Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies*, at [58].

[13] See *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC); *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111, [2011] NZLR 577 (SC); *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278.

[14] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at page 49.

appears to be an assumption the upstream provider will earn profits above the normal return on capital.

33. If we have understood Figure 3.2 correctly, then we note that the economic replicability test (**ERT**) only needs to solve for 'exclusionary prices'. Potential 'excessive returns', as portrayed in Scenario 1 in Figure 3.2 of the Draft Guidance, is not something the ERT test is concerned with. Other regulatory tools are available to deal with potential excessive returns - as explained below, the Part 6 regulatory framework, specifically the revenue cap, prevents Chorus from earning profits above the normal return on capital.

34. Again, it is not clear to us, but the Commission's two-step assessment appears to be based on Professor Vogelsang's response to the following questions the Commission asked him to answer:[15]

> *1.1.4 Under Part 6 of the Act, there is no requirement for the L2 prices to be cost-based, except the Commission has the power to recommend a cost-based price for the anchor product sold by Chorus from 2025. In this context:*
>
> *1.1.4.1 What are the pros and cons of different methodologies for evaluating whether the prices of the unbundled product comply with equivalence?*
>
> *1.1.4.2 Which approach (if there is a "winner") would best give effect to the purpose at s 156AC, if we can assume that the L2 prices will be, in aggregate, above costs after 1 January 2022?*

35. If we have understood that correctly, then we note that the task at hand is to interpret the equivalence obligation in the Deeds, rather than developing a pricing rule that optimises the purpose statement. As we have explained above, while the purpose statements in sections 69W and 156AC of the Act provide relevant context, the words of the Deeds are paramount, and every part of the Draft Guidance must have a clear basis in the words of the Deeds.

36. In any event under Part 6, Chorus is limited in its ability to extract excessive profits: we cannot set downstream prices that are, in aggregate, above the combined downstream and upstream costs. From 1 January 2022, Chorus' FFLAS will be subject to a revenue cap under PQ regulation, derived using BBM cost methodology. So, our combined Layer 1 and Layer 2 prices in aggregate, cannot exceed cost-based prices, and we cannot earn profits above the normal return on capital.[16]

37. This means, under Part 6, Scenario 1 of Figure 3.2 of the Draft Guidance does not apply. Instead, only the following two scenarios are relevant:

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[15] Ingo Vogelsang (October 2019), *Equivalence and non-discrimination in New Zealand telecommunications markets: The case of Layer 1 unbundled access to fibre networks*, at pages 7 and 24-25.

[16] Other LFCs are also limited in their ability to earn profits above normal return on capital. Although other LFCs will only be subject to information disclosure regulation, there is potential for PQ regulation to be applied in the future.

37.1. Market conditions in which downstream prices (in aggregate) are set below combined downstream and upstream costs (so-called 'penetration pricing');[17] and

37.2. Market conditions in which downstream prices (in aggregate) are set equal to combined downstream and upstream costs.

38. Under both scenarios, equivalence is satisfied using the ECPR upstream price. Adopting an alternative cost standard would require applying an appropriate allowance for asset stranding risk in order to satisfy the overall cost recovery (NPV=0) under Part 6. This is consistent with the Commission's view that "*if the ECPR minimum standard is applied during periods of penetration pricing, it would not be appropriate to move to a cost-based standard for upstream price in subsequent periods without considering the costs to end-users from the risk of asset stranding*."[18]

39. We note the Commission's view that:[19]

> *"In the event that penetration pricing was occurring, the consistent use of ECPR throughout the period of penetration pricing and in subsequent periods (as discussed in the draft guidance at paragraph 3.60) will ensure that there is sufficient economic space for competition at the layer 2 level. We also noted in the draft guidance that in applying ECPR, the EEO downstream cost standard is a minimum, and that other standards providing greater economic room to compete may be appropriate in some circumstances.*
>
> *We also note that under the building block model of regulation being implemented under Part 6, there is a wash-up mechanism which could allow LFCs subject to price-quality regulation (at present, only Chorus) to recover any losses arising from penetration pricing or from a change from ECPR to cost-based pricing at layer 1 in subsequent periods."*

40. We agree with the Commission that a wash-up mechanism provides LFCs subject to PQ regulation with the opportunity to recover any losses arising from penetration pricing or from a change from the ECPR upstream price to Layer 1 cost-based pricing (or ECPR based on REO cost standard) in subsequent periods.[20] However, as we noted above, adopting an alternative standard to the ECPR upstream price would need to satisfy the overall cost recovery (NPV=0) under Part 6, which includes considering the costs to end-users from the risk of asset stranding. We note the Commission's current proposal for an ex-ante allowance for asset stranding risk may not include the specific

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[17] Under Part 6, the 'penetration pricing' market conditions can be observed if the amount of financial losses, as determined in accordance with section 177, is higher than zero, and for as long as it remains above zero.

[18] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.60].

[19] Commerce Commission (April 2020), *Equivalence and non-discrimination in New Zealand telecommunications: Response to submissions*, at [31]-[32].

[20] For Chorus' position regarding the wash-up mechanism, see Chorus (July 2019), *Submission in response to the Commerce Commission's fibre regulation emerging views dated 21 May 2019,* at [27]-[30] of Appendix A.

economic stranding that would result from adopting an alternative cost standard to ECPR using EEO.[21]

41. It is also unclear how the Commission derives its two-step approach from the words of the Deeds. As we have discussed above, the ECPR upstream price reflects the (imputed) price that an LFC charges itself. It therefore directly addresses the factual inquiry required by the equivalence obligation. In contrast, the Commission has not provided any reasoning in support of the proposition that, under certain conditions, an upstream cost standard is instead required.

42. Related to that point, it is also unclear what additional inquiry would be required in circumstances where prices were set above the lower of the ECPR upstream price or cost-based upstream price. The Commission has not explained what additional test might apply under these circumstances, or what factors would be relevant to the Court's assessment. In our view, the underlying error here is in focusing on what pricing methodology would best achieve the Act's purpose statement, rather than asking what factual inquiry is required to apply the equivalence obligation as set out in the Deeds.

Measure of downstream costs – EEO versus REO

43. An ECPR based on EEO cost standard will always satisfy equivalence. We disagree that ECPR based on an EEO cost standard should be treated as the 'minimum downstream cost standard' and that a stricter cost standard, for example REO, may apply in certain circumstances.

44. The question the equivalence obligation asks is whether the LFC is charging others the same price it is charging itself. That question is about the LFC's conduct; it does not depend on the circumstances of the RSPs, nor their relative efficiencies of scale and scope compared to the LFC.

45. The question the Commission appears to be asking is whether there is sufficient economic space for an efficient RSP to enter and compete at the downstream level, using the upstream service supplied by the network operator.[22] That's a different question, and not relevant to the equivalence obligation.

46. The Commission explains that its approach "*is consistent with the purpose under section 156AC(a) and the requirement in the Deeds that LFC fibre networks be designed and built to facilitate unbundling*",[23] and that the "*minimum standard might be insufficient to promote competition to the long-term benefit of telecommunications*

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[21] Commerce Commission (November 2019), *Fibre Input Methodologies, Draft Decision, Reasons Paper,* at [3.1372-3.1402].

[22] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.45].

[23] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.45].

end-users in New Zealand."[24] The Commission effectively elevates the purpose statement to the status of a rule, saying "*alternative downstream cost standards will be appropriate if applying an alternative standard would promote competition and investment for the long-term benefit of telecommunication end-users*."[25]

47. However, the purpose statement can't be used to read into the equivalence obligation requirements that have no basis in the words of the Deeds. That is not an appropriate approach to interpretation of the obligations. It would override the intention of the parties to the Deeds and Parliament's intent to permit the LFCs and the Minister to define the precise scope of the equivalence obligation. It appears inconsistent with the Commission's own view that the purpose statements do not create a separate or independent test for compliance with the Deeds and the Act[26] and its statement in its *Fixed line telecommunications regulation overview* that the Deeds don't set price or non-price terms.[27]

48. The practical consequence of the Commission's approach is that LFCs can't know *ex-ante*, whether they are complying with their Deeds obligations, because – in the Commission's view – the relevant downstream cost standard that is used to inform the equivalence test depends on:

    48.1. Whether regulation or workable competition adequately constrains downstream prices;[28]

    48.2. Whether RSPs are able to feasibly replicate the LFC's economies of scale and scope;[29] and

    48.3. Whether additional investment/entry by RSPs "might be deemed to be to the long-term benefit of New Zealand consumers".[30]

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[24] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.46].

[25] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.55].

[26] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [2.36].

[27] Commerce Commission (April 2020), *Fixed line telecommunications regulation overview – context of the regulatory framework,* Figure 2.1, at page 7.

[28] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.55.1].

[29] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.55.2].

[30] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.55.3].

49. Each of these requires an exercise of judgement on which people could reasonably disagree.[31] And, the judgement is a complex one, based on information which may or may not be available to LFCs and which cannot be readily made *ex-ante*. The Commission acknowledged this when it observed that setting a downstream cost standard by reference to the economic costs of a different operator is not appropriate in a setting where prices are set commercially and are subject to enforcement action under the equivalence requirement, because the LFC will not know the downstream costs of its competitors.[32]

50. Even assuming it was reasonable to expect LFCs to make these assessments of market conditions in advance of setting prices, LFCs would then have to determine what adjustments should be made to the EEO cost standard in order to meet the Commission's requirements. It is unclear how an LFC could determine – at the point of setting prices – what adjustments to its own downstream costs are required to meet these standards. The exercise is necessarily a discretionary one with no single right answer. This is not appropriate as a compliance measure.

Equivalence of inputs

51. We agree with the Commission that:

    51.1. Equivalence of inputs requires a network operator to use the same systems, inputs and processes to supply itself and access seekers.

    51.2. To satisfy equivalence of inputs, a network operator must provide all inputs to access seekers on the same terms (including timeliness and quality of provision) as those the network operator offers its own downstream business operations.

    51.3. There are exemptions from having to supply on the 'same' terms. In the Deeds, that means exactly the same terms, subject to certain specified differences.

52. We note two points. First, some processes within the scope of equivalence of inputs (specifically, data access and governance) relate to the extent of access to the network operator's information. When interpreting equivalence of inputs in that context, it is important to be consistent with the other provisions of the Deeds on information disclosure, and with the Commerce Act. In particular:

    52.1. These requirements potentially oblige Chorus to disclose commercially sensitive information to network competitors. Interpretation of the Deeds must be consistent with network operators' Commerce Act obligations and should not require a network operator to disadvantage itself relative to customers' competing networks.

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[31] We note that the first example is not relevant under Part 6 of the Act, because the LFCs are limited in their ability to extract excessive profits.

[32] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.47].

52.2. Access to relevant data and governance information is only required to the extent that it is made available to those making decisions on a network operator's Layer 2 services. The Deeds specify that Chorus is not required to implement separate management and reporting lines, and therefore that Chorus' executive and board will on occasion have access to information pertaining to both Layer 1 and Layer 2 services in circumstances where that information would not necessarily be made available to other market participants.

52.3. There are already specific obligations around information disclosure in the Deeds (in relation to "Commercial Information", as the Commission notes). The general equivalence obligations should be interpreted consistently with these.

53. Second, the equivalence of inputs standard is closely linked in our case to a component pricing structure. We discuss that structure later in relation to the non-discrimination obligation. It is also relevant here though because that pricing structure reflects that we are supplying the service using the same systems and processes as we use ourselves to meet the service levels agreed in the NIPA for our Layer 2 services.

54. Adopting a position that doesn't allow component pricing would require substantial changes to those systems and processes. That would significantly negatively impact the service levels and service experience of our customers, for both Layer 1 and Layer 2 services, or significantly impact our ability to meet our equivalence obligation.

NON-DISCRIMINATION

- The Commission's interpretation of "difference in treatment" is so broad that this limb of the non-discrimination test is given little meaningful effect. While we reserve our position on whether indirect discrimination is a legitimate interpretation of the Deeds, it could only arise where a significant cross section of RSPs would not be eligible for an offer as a result of factors entirely outside of those RSPs' control.
- Non-discrimination is about RSPs in their role as customers. It cannot be used as a mechanism to shelter individual RSPs from network competition.
- On the interrelationship between equivalence and non-discrimination, satisfying equivalence indicates that non-discrimination will also be satisfied. ECPR is always available to demonstrate compliance with equivalence and non-discrimination obligations.

Difference in treatment is defined too broadly

55. The Commission's interpretation of "*difference in treatment*" is so broad that this limb of the obligation is given little meaningful effect. That can't have been the intention when it was included in the Deeds.

56. The Draft Guidance suggests there are broadly two types of differential treatment:

56.1. Direct – where a service provider offers different terms (price or non-price) to different RSPs; and

56.2. Indirect – where a service provider offers the same terms to all RSPs, but those offer terms disadvantage some RSPs relative to others.

57. The Draft Guidance is unclear regarding the limits of the Commission's concept of indirect discrimination. The Commission says that "*While a network operator cannot be expected to tailor their offers to each individual access seeker, an offer that is structured in such a way that it could never be taken up by certain categories of (or any) access seekers could still result in a difference in treatment*".[33]

58. We reserve our position on whether indirect discrimination is a legitimate interpretation of the Deeds. However, if it is, we agree that it would be narrowly confined to offers that, as the Commission says, could "never be taken up" by a significant proportion of RSPs. That approach is consistent with the *Loyalty*[34] case, in which the volume discounts adopted by Telecom were found to amount to a difference in treatment because smaller RSPs could never meet the criteria for the offer.

59. However, the Draft Guidance goes on to say that, "*a difference in treatment could include…offering the same terms if the offer has a different effect depending on the position of the access seeker purchasing the service*".[35] This suggests that the same terms will amount to different treatment simply because the offer is more or less attractive to certain RSPs.

60. This formulation is so broad that it results in the difference in treatment limb having little meaningful effect. If a difference in treatment arises simply because an offer has a "different effect" on certain RSPs, then every offer will constitute a difference in treatment. No offer is equally attractive to all RSPs, given their inherent differences in commercial strategy, product range, scale, operational capability, marketing spend and strategy.

61. A basic principle of interpretation is that words cannot be interpreted in such a way that they are deprived of any effect. The parties to the Deeds cannot be taken to have intended an interpretation of "difference in treatment" that would mean all offers amount to a difference in treatment. Such an interpretation would reduce the non-discrimination obligation to an assessment of objective justification and competitive harm, making the first limb of the test redundant.

62. As we have stated previously,[36] the difference in treatment limb of the non-discrimination test must, as a matter of contractual and statutory interpretation, have

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[33] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.17].

[34] Commerce Commission (16 October 2009), *Consultation on the non-discrimination and EOI obligations under the Telecom Separation Undertaking requirements with respect to the complaints concerning the Telecom Wholesale Loyalty offers*.

[35] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.22.1].

[36] Chorus (November 2019), *Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies,* at [89.1].

some meaning in the context of the non-discrimination obligation. It must be doing some work in distinguishing between compliant and non-compliant offers.

63. Indirect discrimination could arise only in circumstances where a significant cross-section of RSPs would not be eligible for an offer as a result of factors entirely outside of those RSPs' control. For example, volume discounts set at thresholds for which only the largest RSPs would be eligible plausibly constitute indirect discrimination. In contrast, indirect discrimination would not arise simply because an offer is less attractive to one RSP or group of RSPs, including where that is due to their inherent characteristics (e.g. the geographic spread of an RSP's customer base).

Other telecommunications markets

64. The Draft Guidance states that non-discrimination, "*may also extend to differences in treatment affecting the activity of access seekers in their capacity as participants in any other telecommunications market*."[37] We disagree. Non-discrimination only applies to RSPs when taking relevant services from us.

65. The reference to "effects on competition in any telecommunications market" does not relate to the difference in treatment limb of the non-discrimination provision. Those words relate to the exception to the non-discrimination obligation. While we accept that the Commission may look at competitive effects in any telecommunications market when assessing whether an objectively justifiable difference in treatment nonetheless harms competition, this analysis does not apply to the "difference in treatment" limb of the non-discrimination test. Other telecommunications markets are not relevant to the threshold question of whether an offer constitutes a difference in treatment; they only come into play when relying on the exception.

66. The only differences in treatment that are relevant are those that affect RSPs in their capacity as LFCs' customers. This is apparent from the words of the non-discrimination obligation in the Deeds, which provide that discrimination arises from a difference in treatment "*in respect of a Service*". "Service" is defined as a wholesale telecommunications service provided by the LFC via its fibre network. Similarly, the definition of non-discrimination in the Act provides that the service provider must not treat access seekers differently "*in respect of a service*". The non-discrimination obligation protects access seekers solely in their capacity as access seekers.

67. This interpretation is also supported by practical considerations. LFCs don't have knowledge of an RSP's activities other than in its capacity as an access seeker. It would be unreasonable to expect LFCs to consider differential effects on RSPs in relation to activities or services which LFCs may have limited or no information about. In addition, an interpretation that applied non-discrimination to RSPs' activities other than as LFCs' customers would risk proscribing competition between LFCs and RSPs' competing network technologies. For example, LFCs' fibre services compete with fixed wireless and mobile services. It is normal competitive conduct for LFCs to offer fibre services on terms that compete effectively with fixed wireless and mobile.

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[37] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.18].

Difference in treatment with regards to price

68. The Draft Guidance states that a difference in treatment with regards to price will exist if there is any (non-trivial) difference in the unit price of a given service as sold to access seekers – if the services provided to access seekers (or the network operator's own downstream operations) are the same (i.e. have the same quality characteristics).[38]

69. While we reserve our position on this interpretation, we agree that identifying the relevant unit of service is a key question. What constitutes the unit of service depends on the functional level of the market where the service is supplied (i.e., Layer 0, 1 or 2), and the characteristics of the service provided at that functional level. For example:

    69.1. A unit of service supplied at downstream level (Layer 2 market) is generally expressed as a unit of specific bandwidth (and other service characteristics) supplied per access line;

    69.2. A unit of service supplied at upstream level (Layer 0 or Layer 1 markets) may be expressed as a unit of footprint allocated in the colocation space, or a unit of distribution component supplied to connect an additional access line to an existing point-to-multipoint connectivity.[39]

70. The Draft Guidance also says that the price structure of a service can in itself result in a difference in treatment.[40] As we have previously explained, there is no difference in treatment with regards to price simply because a pricing structure is more or less attractive to some RSPs. Nor is there a difference in treatment where RSPs choose to consume different components of a service in different proportions.

71. Component pricing is an efficient and commonly used pricing structure at upstream level, including in pricing set by the Commission previously for copper services subject to non-discrimination under the Copper Deed and for fibre services subject to CIP agreements and the Fibre Deed.

72. As we have stated previously, no offer is equally attractive to all RSPs, including a blended price.[41] Generating a blended price for PONFAS is arbitrary (Chorus would have to make assumptions about the expected utilisation of feeder fibres and splitters) and would not neutralise scale. A blended price would be based on an assumed level of utilisation which may cause RSPs with a higher than assumed unbundled connection per FFP to be disadvantaged relative to RSPs with low utilisation. Critically, the difference in outcomes would be the direct result of Chorus' pricing methodology, as

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[38] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.41].

[39] Where a service comprises multiple components, which may be utilised in different proportions depending on the customer's requirements, it will be appropriate to recognise that when defining the relevant unit or units of supply.

[40] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.44].

[41] Chorus (November 2019), *Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies,* at [97].

opposed to reflecting differences in the underlying costs that arise from varying levels of utilisation.

73. Also, as explained above in the "Equivalence of inputs" section, component pricing is consistent with our equivalence obligation. A blended price would not be consistent with the way we supply the service to ourselves.

No harm to competition

74. Economic regulation and competition law are concerned with harm to the competitive process, not the protection of individual competitors.

75. The Draft Guidance notes that in markets with few actual (or potential) competitors, harm to an individual competitor can have a significant impact on the competitive process.[42]

76. This isn't a concern for retail fixed telecommunications markets, where there are many actual (or potential) competitors. If the Commission is concerned about the harm to competition in the Layer 2 market, where there are likely to be few actual (or potential) competitors, the equivalence obligation is specifically designed to prevent any harm to efficient competition. This means, if a service satisfies the equivalence obligation, it can be assumed there will be no harm to efficient competition.

Interrelationship between non-discrimination and equivalence

77. Satisfying equivalence indicates that non-discrimination should also be satisfied.[43]

78. The Draft Guidance states:[44]

> "*A network operator may supply or price services on an equivalent basis, but the nature or effect of the terms of supply may have a different effect on access seekers, which may be discriminatory. For example, a network operator could discriminate against access seekers compared to its own business by packaging a service in a way that is only efficient to purchase if an access seeker shares the network operator's unique characteristics*".

79. We disagree. The Commission's statements on the interrelationship between non-discrimination and equivalence reflect that it has taken an incorrect, overly expansive approach to interpretation of the "difference in treatment" limb of the non-discrimination test.

80. It is important to acknowledge that there are two distinct non-discrimination obligations in the Act (and reflected in the Deeds):

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[42] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [4.33].

[43] Chorus (November 2019), *Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies,* at [12.5].

[44] Commerce Commission (March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [5.5].

80.1. *No self-supply* - the service provider must not treat access seekers differently. This is concerned with potential harm to competition between RSPs in markets where an LFC is not in direct competition with RSPs.

80.2. *Self-supply* - where the service provider supplies itself with a relevant service, the service provider must not treat itself differently from other access seekers. This is concerned with potential harm to competition between LFCs and RSPs in the Layer 2 market where an LFC operates as a vertically integrated provider of Layer 1 and Layer 2 services.

81. This distinction was explained in the Amended Invitation to Participate for the UFB initiative (**ITP**):[45]

> ***Where the LFC Provides Layer 1 Services Only***
>
> *7. Where the LFC provides Layer 1 services only, the LFC must provide the Layer 1 services on non-discriminatory terms.*
>
> *8. Non-discrimination ensures that like Access Seekers are treated in a like manner, and that any differences are objectively justifiable by differences in costs, the Access Seeker's needs or the Access Seeker's characteristics. It is also essential that any differences in treatment do not harm competition;*
>
> ***Where the LFC Provides Both Layer 1 Services and Layer 2 Services***
>
> *9. Where the LFC will provide both Layer 1 Services and Layer 2 services, the LFC must:*
>
> *(a) provide Layer 1 services to itself and to all other Access Seekers on equivalent terms, where the standard of equivalence will be "equivalence of inputs", meaning the LFC must offer the same service at the same price and using the same operational processes to all Access Seekers, including itself (**EOI**); and*
>
> *(b) the Layer 2 services must be supplied on non-discriminatory terms.*
>
> *10. EOI provides an assurance that all Access Seekers receive the same products and services on the same terms. It is a measure to ensure that the LFC does not give itself an unfair advantage (whether explicit or implicit, direct or indirect) when both the LFC and its Access Seeker customers compete in the marketplace for the provision of Layer 2 services.*

82. It is clear from the ITP that the Government envisaged two separate scenarios where non-discrimination applies, and that the test for non-discrimination in the self-supply scenario is in effect identical to the equivalence obligation.

83. Where an LFC provides Layer 1 services to itself and to RSPs on identical terms in accordance with its equivalence obligation, it will have also satisfied its non-discrimination obligation for self-supply. Given that equivalence is a more stringent

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[45] Ministry of Economic Development (October 2009), *NZ Government Ultra-Fast Broadband Initiative, Invitation to Participate in Partner Selection Process*, as amended by letter dated 5 July 2010.

test, it logically follows that offers which satisfy equivalence will not breach non-discrimination.

84. The Commission's statement in *Loyalty* supports our view that if a service is supplied consistent with the equivalence obligation, it is also consistent with the non-discrimination obligation:[46]

> *It is the Commission's preliminary view that* ***the non-discrimination obligation prohibits Telecom Wholesale from designing, offering, or supplying a Relevant Wholesale Service on terms and conditions (including price) that are different between any two service providers, unless****:*
>
> *•The difference is required by, and necessary for, addressing the specific needs of the service provider; or*
>
> *•* ***The difference is consistent with Telecom's EOI obligations*** *set out in clauses 47 through 49 [emphasis added]*

[46] Commerce Commission (16 October 2009), Consultation on the non-discrimination and EOI obligations under the Telecom Separation Undertaking requirements with respect to the complaints concerning the Telecom Wholesale Loyalty offers, at [82].