FIBRE INFORMATION DISCLOSURE AND PRICE QUALITY REGULATION: PROPOSED PROCESS AND APPROACH FOR THE FIRST REGULATORY PERIOD

Submission to the Commerce Commission

PUBLIC VERSION

14 October 2020

EXECUTIVE SUMMARY

1. Vocus welcomes the opportunity to submit in response to the Commerce Commission (Commission) consultation paper *"Fibre information disclosure and price quality regulation: Proposed process and approach for the first regulatory period"*, 15 September 2020:

   (i) We consider that the Commission's proposed **process and approach for the first Price-Quality Path (PQP1) determination is principally sound**.

   (ii) For example, **basing first year pricing on the draft decision with wash-up is a pragmatic approach**. The Commission should consider whether any amendments to the draft will be possible for the purposes of the transitional PQP1 reset e.g. the Commission should be able to use the actual final WACC rather than the draft WACC it will need to apply in the draft determination.

   (iii) **We agree with the Commission that disclosure dates should be the same for all FFLAS providers**. This is important for ensuring comparability of Chorus' and the Local Fibre Companies' (LFCs') disclosures.

   (iv) **Expert opinion will play an important role in scrutinising Chorus' first expenditure proposal:** We agree that *"In the absence of an independent verifier report, … it [is] appropriate to seek an expert opinion to support our evaluation of Chorus' expenditure proposal"*.

   (v) **The (regulated) PQ FFLAS business should include all monopoly provision of FFLAS:** We support the Commission's emerging view that the PQ Fibre Fixed Line Access Service (FFLAS) business should include Chorus' UFB areas, and other areas supplied by Chorus where there isn't a competing LFC i.e. the PQ FFLAS business should include all monopoly fibre services.

   (vi) **The footprint of the 'UFB' business the purpose of determining the value of the Financial Loss Asset is smaller than the PQ FFLAS business.** The financial losses that section 177(2) of the Telecommunications Act requires to be included in the RAB are losses *"incurred by the provider in providing fibre fixed line access services under the UFB initiative"* [emphasis added], which excludes any (voluntary) financial losses for FFLAS services provided in other areas and is narrower than the approach the Commission is proposing to take to specification of the PQ FFLAS business.

   (vii) **There is a substantial risk overstatement of the initial PQ RAB will lock in excessive prices and returns**. This is a particularly significant issue given *"the initial PQ RAB determination has material and lasting implications for Chorus' allowable revenue"*.

   (viii) While the Commission doesn't consider it workable for it to undertake *"all modelling",* for determination of the initial RAB value, given the time frames it is working to, it could consider a middle ground option where it models the FLA value, or utilises the lattitude it has giving itself for prices to be initially reset on the

basis of the draft decision. The Commission should also undertake the type of review it undertook of the Chorus' TSLRIC and TSO modelling to identify issues that might need to be addressed.

(ix) **The Commission should seek submissions on Chorus' proposed asset valuation on the same basis as it is proposing for Chorus' expenditure proposals, including prior to the release of the draft decision on the transitional PQ RAB**. The Chorus' PQP1 expenditure proposal and proposed PQ RAB (including Financial Loss Asset) should be released to stakeholders for review and submission at the same time Chorus submits them to the Commission.

(x) **Layer 1 pricing is an unresolved problem**. We welcome that the Commission has confirmed its approach to monitoring and enforcing non-discrimination and equivalence obligations.[1]

We agree with the Commission that there *"are … risks of inefficient price structures, including price structures that may have anticompetitive effects".* This is a particularly significant issue in relation to layer 1 unbundling which we consider already warrants regulatory intervention, as reflected in joint submissions and correspondence from Vocus and Vodafone.

(xi) **We consider that the Commission should follow Part 4 Commerce Act precedent and adopt an *"Undercharging limit"* for wash-up**. This would help reduce the risk of price volatility or instability (with Chorus adopting 'catch-up' to its pricing).

[1] https://comcom.govt.nz/news-and-media/media-releases/2020/commission-confirms-its-approach-to-monitoring-and-enforcing-non-discrimination-and-equivalence-obligations

INTRODUCTION

2. Vocus welcomes the opportunity to submit in response to the Commerce Commission's (Commission) consultation paper *"Fibre information disclosure and price quality regulation: Proposed process and approach for the first regulatory period"*, 15 September 2020.

3. As a process matter, we do not consider the Commission's intention to provide 4 – 6 weeks for submissions, and 2 weeks for cross-submissions, on the first draft Price Quality Path (PQP1) will be long enough. Based on experience with Part 4 Commerce Act, the UBA and UCLL determination process, and the substantive elements of the Part 6 regime development, particularly the draft fibre Input Methodologies consultation, we consider a minimum of 8 weeks should be provided for submissions, and 3 for cross-submissions.

4. We also consider it would be desirable for the consultations on the Information Disclosure (ID), Price-Quality (PQ) and Chorus' transitional Regulatory Asset Base (RAB) draft determinations to be sequenced, rather than being published around the same time. To the extent there is overlap more time will be needed for the consultations.

5. If you would like any further information or have any queries about this submission, please contact:

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VOCUS SUPPORTS KEY ELEMENTS OF THE PROPOSED PROCESS AND APPROACH

6. We support the following key elements of the Commission's intended process and approach for PQP1:

   (i) **Running the ID and PQ processes in tandem is pragmatic**, but overlaps in consultations should be avoided or minimised. Where consultations overlap additional time should be provided for responses.

   (ii) **PQ regulation will evolve and develop over-time:** We agree there will be *"features of a PQ path that [the Commission] will not be able to implement for PQ1".* The experience with the Part 4 Commerce Act PQP regime is that it has developed and evolved, notably in relation to incentive mechanisms, over time.

   (iii) **There should be limits on wash-up:** We agree it is *"not ... appropriate for the wash-up to account for any general under- or over-forecast of opex and capex"* and *"To do so would undermine the efficiency and investment incentives PQ regulation is intended to create".*

(iv) **The Commission may not be able to finalise all aspects of the Information Disclosure requirements:** We support the Commission's position that *"While our preference is to determine all ID requirements prior to 1 January 2022, if necessary, certain aspects of ID could be deferred until after this date"*. This reflects the limited time provided in the Telecommunications Act for the Commission to implement the new Part 6 regime.

(v) **Basing first year pricing on the draft decision with wash-up is pragmatic:** We support the Commission's position that *"Given the constraints imposed by the timeline for the final decision, we intend to allow Chorus to set its prices for the first year of PQP1 based on the allowable revenues proposed in the draft decision".* The Commission should consider whether any amendments to the draft will be possible for the purposes of the transitional PQP1 reset e.g. the Commission won't have the actual final WACC when it issues the draft determination but it have the final WACC when it issues the reset determination.

(vi) **Part 4 Information Disclosure provides useful precedent:** We support the Commission's proposal *"to draw on existing disclosure requirements"* under both the Telecommunications Act and Part 4 of the Commerce Act 1986. While the Commission has telegraphed this includes *"Incorporating existing requirements into the ID requirements under Part 6, with refinements to scope, if relevant",* the same should also be possible for Part 4 Commerce Act ID requirements. The more existing Part 4 templates/precedent etc can be followed the easier the transition to the new regime will be.

(vii) **Making disclosed information easily accessible including electronically is important:** We support the Commission's intention to undertake summaries and analysis of disclosures to make information disclosed in standardised spreadsheet templates more accessible. An innovation the Commission should consider is to model provision of disclosed spreadsheet template information on the Electricity Authority's EMI website. This would make it very easy for stakeholders to use and access the information.

(viii) **Disclosure dates should be the same for all FFLAS providers:** We support the Commission's *"general"* intention *"to determine fixed dates for disclosures, (eg, disclosures are required annually by a certain date each year) on a common time frame for each regulated provider"*, and would not support allowing *"different disclosure dates for different providers"*.

(ix) We agree with the Commission that *"ensuring information is 'readily available'"* includes *"Consistent disclosure of data—disclosure of data in a standardised form that can be compared over time and across regulated providers—helps interested persons to assess performance of regulated providers, including whether they are managing their assets for the long-term benefit of end-users".*

(x) The significant impact of COVID19 on the economy provides a good illustration of the difficulties that would be created in trying to compare Chorus and the Local

Fibre Companies' (LFCs) performance if different regulatory periods/disclosure dates are used which captured different parts of the 'COVID19 period'.

(xi) **A 'roll over' approach would not be appropriate for the first reset:** We agree it would not be appropriate to adopt *"a 'roll-over' approach, where future revenues are based on current revenues, possibly adjusted for inflation and changes in demand"*.

(xii) **Chorus won't face financial hardship as a consequence of the PQP1 determination:** We agree that *"consistent with [the Commission's] approach when regulating allowable revenue under Part 4 of the Commerce Act, … Chorus would need to demonstrate that our proposal creates financial hardship risk before we would consider options for addressing it"*.

(xiii) **We support the Commission adopting a *"Limit on the increase in total FFLAS revenue recovered"***. We agree with the Commission reasoning, including that applying a mechanism like this during PQP1 would *"help insulate non-anchor product end-users from price-shocks. … if demand for anchor services is lower than forecast, this could result in an increasingly large portion of revenue being recovered from end-users receiving other services that are not subject to any form of price control"*.

(xiv) **Expert opinion will play an important role in scrutinising Chorus' first expenditure proposal:** We agree that *"In the absence of an independent verifier report, … it [is] appropriate to seek an expert opinion to support our evaluation of Chorus' expenditure proposal"*.

(xv) **The (regulated) PQ FFLAS business should include all monopoly provision of FFLAS:** The Commission has recognised the distinction between, for example, PQ applying only to areas where Chorus is the UFB provider, and applying PQ to Chorus FFLAS services *"except to the extent that a service is provided in a geographical area where a non-Chorus regulated provider has installed a fibre network as part of the ultra-fast broadband (UFB) initiative".*

(xvi) We support the Commission's emerging view that the PQ FFLAS business should include Chorus' UFB areas, and other areas supplied by Chorus where there isn't a competing LFC i.e. the PQ FFLAS business will include all monopoly fibre services. As the Commission has noted *"The rationale of reg 6 is that Chorus should not be subject to PQ regulation in areas where it faces a competitive constraint from the FFLAS provided by other LFCs in UFB areas"*.

The Commission will need to distinguish between the footprint of the PQ FFLAS business and the narrower 'UFB' business for the purpose of determining the value of the financial loss asset (FLA). The financial losses that section 177(2) of the Telecommunications Act specifies be included in the RAB are losses *"incurred by the provider in providing fibre fixed line access services under the UFB*

initiative" [emphasis added] which excludes any (voluntary) financial losses for FFLAS services provided in other areas.

(xvii) **Backhaul, transport and co-location FFLAS are clearly part of the (regulated) PQ FFLAS business, regardless of location:** We note and support the Commission's confirmation, in relation to backhaul etc, that the relevant criteria is whether it is used to supply end-users of the PQ FFLAS and does NOT need to be physically in the PQ FFLAS areas.

(xviii) We agree with the Commission that its *"approach to the interpretation of reg 6 applies equally to FFLAS where there is an end-user within the LFC's UFB area and to backhaul, transport and co-location FFLAS that fall outside the bounds of FFLAS to which an end-user can directly connect. The intended focus of reg 6 is on the location of the end-users who are the ultimate recipients of FFLAS. It follows that reg 6 is not confined to FFLAS that originate and terminate wholly within an LFC area"*. The Chorus' proposed alternative approach on this would be unworkable and would mean substantial elements of the monopoly FFLAS business would be unregulated.

THERE IS SUBSTANTIAL RISK OVERSTATEMENT OF THE INITIAL PQ RAB WILL LOCK IN EXCESSIVE PRICES AND RETURNS

7. We agree with the Commission that *"information asymmetry and potential lack of information on the approach presents risks to the PQ RAB valuation being in the long-term benefit of end-users"*. We also agree with the Commission that *"Chorus might have a greater incentive in PQP1 (relative to subsequent periods) to engage in forms of regulatory gaming".* It may be that the incentive won't necessarily change, but Chorus' ability to successfully engage in regulatory gaming may be higher for PQP1 than subsequent regulatory periods.

8. This is a particularly significant issue given *"the initial PQ RAB determination has material and lasting implications for Chorus' allowable revenue"*.

9. The experience with Chorus' grossly over-estimating its copper TSLRIC and TSO net cost has been raised a number of times in submissions. This experience makes us uneasy with the Commission's proposed approach that *"the initial PQ RAB (including the financial loss asset) … will be developed by Chorus"*.

10. While the Commission doesn't consider it would be workable for it to undertake *"all modelling",* given the time frames it is working to, the Commission could consider a middle ground option where it models the FLA value, or utilises the lattitude it has giving itself for prices to be initially reset on the basis of the draft decision.

11. To the extent the Commission relies on Chorus' modelling the *"package of assurance"* should include the type of review and analysis it undertook of the Chorus' TSLRIC and TSO modelling to identify issues that would need to be remedied. These reviews usefully identified substantial issues and (upwards) biases in the Chorus modelling.

12. Stakeholder consultation and review can also play an important role. The Commission has noted *"Stakeholder consultation on Chorus' [expenditure] proposal and our expenditure allowance determination is important to ensure the allowance we determine for PQP1 is likely to best give effect to s 166(2)(a) and (where relevant) s 166(2)(b)"*. The same is true of any Chorus submission of its initial RAB value and FLA modelling estimate.

13. The Commission should not wait until it has reached a draft determination on RAB value before consulting. The Chorus' PQP1 expenditure proposal and proposed PQ RAB (including Financial Loss Asset) should be released to stakeholders for review and submission at the same time Chorus submits them to the Commission.

LAYER 1 PRICING IS AN UNRESOLVED PROBLEM

14. We welcome that the Commission has confirmed its approach to monitoring and enforcing non-discrimination and equivalence obligations.[2]

15. We agree with the Commission that there *"are … risks of inefficient price structures, including price structures that may have anticompetitive effects"* and support the intention *"to monitor prices through targeted ID requirements and assess whether further intervention is required in the future"*. This is a particularly significant issue in relation to layer 1 unbundling which we consider already warrants regulatory intervention, as reflected in joint submissions and correspondence from Vocus and Vodafone.

THE COMMISSION SHOULD FOLLOW PART 4 PRECEDENT AND ADOPT AN "UNDERCHARGING LIMIT"

16. We consider that the Commission should adopt an *"Undercharging limit"* for wash-up. This would help ensure pricing isn't volatile (with Chorus adopting 'catch-up' to its pricing).

17. While the Commission has suggested *"there may be reasons for Chorus to undercharge its revenue cap that benefit end-users (such as to manage lower than forecast demand)"* we don't think this would be consistent with Chorus' advocacy that a revenue cap be applied rather than a price cap so that its revenue would be insulated from demand risk or uncertainty.

[2] https://comcom.govt.nz/news-and-media/media-releases/2020/commission-confirms-its-approach-to-monitoring-and-enforcing-non-discrimination-and-equivalence-obligations