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TRUSTPOWER SUBMISSION: DRAFT GUIDANCE EQUIVALENCE AND NON-DISCRIMINATION

1. Introduction and overview

- 1.1.1. Trustpower Limited (**Trustpower**) welcomes the opportunity to comment on the Commerce Commission's (**the Commission**) *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation* paper (**the draft guidance paper**).
- 1.1.2. The Commission released a suite of documents between March and April 2020 relating to their interpretation of equivalence and non-discrimination obligations under the Telecommunications Act 2001 (**the Act**).
- 1.1.3. While the Commission's draft guidance paper relates to the principles of equivalence and non-discrimination generally, we have approached these submissions mindful of the prospect of layer 1 unbundling and the application of these principles to this service.

2. Trustpower's views

- 2.1.1. Today, all retail service providers (**RSPs**) acquire the same wholesale services from Chorus and local fibre companies (**LFCs**) on the same terms. This has resulted in a level playing field among RSPs, regardless of size, encouraging new entrants into the New Zealand fixed-broadband market and increasing the overall level of retail competition. Product innovation by Chorus and the other LFCs does not appear to have been affected by the lack of access to unbundled local fibre loops.¹
- 2.1.2. On the other hand, PONFAS is likely to only be economically viable for the very largest of the RSPs. This poses risks with respect to the effectiveness of retail competition.
- 2.1.3. In our November 2019 submission, we addressed the prospect of unbundling and stated:

¹ In 2016 the Commission's Annual Telecommunications Monitoring report found that the 3-firm concentration ratio (the sum of market shares for the three largest firms) for fixed broadband in NZ was 92%. By 2019 the 3-firm concentration ratio had fallen to 78%. It is crucial that the way in which unbundling is managed, including the regulatory principles that guide it, do not result in a backward step in the extent of competition and consumer outcomes.

The Commission will need to consider the unintended consequences of any selected pricing methodology. In particular, a scenario that favours the market position of the major players, that benefit already from vertically integrated mobile businesses, is likely to be harmful for the competition that exists under the current market structure. If the level or structure of unbundled fibre were such that smaller scale players, who are likely to act as maverick firms, were no longer able to viably compete, consumers would be worse off both in terms of reduced price competition and less innovation.

- 2.1.4. In discussing our November 2019 submission, the Commission noted that “... it is unlikely that the economics of unbundling will ever be completely independent of scale. However, RSPs will continue to be able to compete downstream using L2 products”.
- 2.1.5. Our submission that follows addresses the significance of scale in the context of the Commission’s proposals in the draft guidance paper and how this may restrict competition and investment by smaller players, relative to the status quo.
- 2.1.6. We believe that the answer to our concerns is not whether smaller RSPs can continue to use layer 2 products, but whether the competitive playing field will become tilted so far in favour of larger unbundling RSPs that the ability of smaller RSPs to compete is meaningfully diminished.

3. Equivalence

- 3.1.1. The Commission explains that an Efficient Component Pricing Rule (ECPR)-based Equally Efficient Operator (EEO) cost standard would represent the “minimum” downstream cost standard for satisfying equivalence of price.
- 3.1.2. However, the Commission also recognises that this minimum standard would mean that “... only access seekers that are at least as productively efficient as the network operator in providing the downstream service can enter the downstream market”.²
- 3.1.3. From section 3.53 to 3.60 in the draft guidance paper, the Commission discusses the alternative standards from the ECPR-based minimum standard, which include:
 - a) application of an adjusted EEO standard (based on the network operator’s downstream costs, but taking into account the scale and scope that can be reasonably achieved by third party access seekers); or
 - b) a standard relying on Reasonably Efficient Operator (REO) costs.
- 3.1.4. The key points that we wish to make with regards to the Commission’s discussion of the equivalence obligation in the draft guidance paper relate to the circumstances in which these alternative standards may apply.
- 3.1.5. In section 3.55 in the draft guidance paper, the Commission sets out the instances where it may consider alternative downstream cost standards:

3.55 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. Examples of markets in which an alternative cost standard might be appropriate when applying the ERT are as follows:

3.55.1 markets in which regulation or workable competition does not constrain downstream prices;

3.55.2 markets in which there are economies of scale / scope in the downstream market which result in downstream costs for the network operator (based on an EEO standard using long-run avoidable costs) that access seekers cannot feasibly replicate because of their smaller scale, even if they are as efficient as the network operator; and/or

3.55.3 markets in which additional investment / entry by access seekers might be deemed to be to the long-term benefit of New Zealand consumers (for example, if a loss of productive efficiency is likely to be

² Section 3.46

outweighed by a gain in dynamic efficiency as a result of overall expansion of market demand or innovation arising from the additional entry in the downstream market).{emphasis added}

- 3.1.6. We encourage the Commission to take a broad perspective when considering : “... *applying an alternative standard would promote competition and investment for the long-term benefit of telecommunication end-users*”.
- 3.1.7. In particular, as we describe further below, there is a risk that alternative downstream cost standards promote competition and investment by scale players, but diminish competition and investment by smaller players, relative to the status quo.

3.2. Alternative standards may create dynamic efficiency losses in downstream FFLAS

- 3.2.1. While we foresee there may be some dynamic efficiency benefits in adopting an alternative standard (such as adjusted EEO, as we discuss below), there may also be losses in dynamic efficiency particularly in the downstream FFLAS market, which must be weighed up by the Commission.
- 3.2.2. Professor Vogelsang’s paper contemplated a REO that has a 15-20% market share³ (and presumably an adjusted EEO may be based on an access seeker’s market share at that level).
- 3.2.3. According to the Commission’s most recent Annual Telecommunications Monitoring Report⁴, only Spark (41%) and Vodafone (24%) are above the REO market share threshold. Vocus (13%), falls under, but is not far behind, and Trustpower and 2Degrees are in the next tier. We note that these market shares relate to fixed broadband, rather than fibre only, due to the lack of more granular data. If we assume this market data reflects the downstream FFLAS market, then only two RSPs have an REO’s market share.
- 3.2.4. So, an alternative standard may give rise to some dynamic efficiency benefits by enabling the largest two RSPs to acquire an input service based on a contemplated REO’s market share. However, smaller, sub-REO scale RSPs would not have that opportunity.
- 3.2.5. This is likely to have a material impact on dynamic efficiency in the downstream FFLAS market. It may lead to scale being *the* key competitive differentiator in the market and so weakening, potentially substantially, the competitive prospects of smaller scale players.
- 3.2.6. Among other things, this will likely promote consolidation among market participants, as large RSPs acquire smaller, sub-REO scale, competitors. A number of these smaller competitors may previously have operated successfully at sub-REO scale, but the adoption of the alternative standard may lead to a change in market structure benefitting REO scale RSPs that leave these viable sub-REO scale RSPs little choice but to acquire or be acquired.
- 3.2.7. Viable, smaller scale RSPs play a valuable role in the competitive market for FFLAS services. They are likely to act as maverick firms and, if they were no longer able to effectively compete, consumers would be worse off, both in terms of reduced price competition and less innovation.

3.3. Limited extent of dynamic efficiency benefits

- 3.3.1. In addition, if there are dynamic efficiency benefits in adopting an alternative standard, the Commission must take into account the *extent* of these benefits in this particular market. For

³ Professor Vogelsang noted that, to the best of his knowledge, this market share range is “not theoretically or econometrically derived but rather taken from the market shares that access seekers can actually achieve against incumbents with much larger market shares.”

⁴ https://comcom.govt.nz/_data/assets/pdf_file/0021/212763/2019-Annual-Telecommunications-Monitoring-Report-Revised-version-12-March-2020.pdf

example, we believe it will be difficult to make the case that there will be superior downstream FFLAS products as a result of layer 1 unbundling.

- 3.3.2. Layer 2 products are fairly simple, differentiated primarily based on speed, and Chorus is already introducing higher speed FFLAS products in the market (Gbps).
- 3.3.3. We do not expect that layer 1 unbundlers will look to strongly compete on service quality. If this is correct, then any dynamic efficiency benefits must come from price competition.
- 3.3.4. However, if an unbundler is able to compete with LFCs on price, it is likely to be only through subsidisation by LFCs and any such subsidisation would be recovered by LFCs in other ways under the new regulatory framework and ultimately borne by downstream consumers. If that is the case, then the extent of any dynamic efficiency benefits may be small.

3.4. Minimal dynamic efficiency benefits in upstream FFLAS markets

- 3.4.1. As well as downstream FFLAS markets, the Commission would also need to consider dynamic efficiency benefits in upstream FFLAS markets. In principle, we may see increased competition between the larger RSPs and the LFCs for the provision of layer 2 services to RSPs. However, the Commission must examine this closely.
- 3.4.2. As we have previously submitted, we are not convinced that the larger RSPs that seek to unbundle at layer 1 are likely to strongly compete with LFCs in providing layer 2 services to RSPs. These larger RSPs are at least as likely to use those inputs solely for the purpose of providing retail FFLAS services to their own customers.
- 3.4.3. The LFCs would not need to respond, as the smaller RSPs would have no choice but to continue to acquire services from the LFCs and the larger RSPs are unlikely to be tempted back, so there is no point in LFCs offering more attractive terms to smaller RSPs.
- 3.4.4. If that is the case, then there would be minimal dynamic efficiency benefits in upstream FFLAS markets.

4. Non-discrimination

- 4.1.1. We agree with the Commission that:

*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.*⁵

- 4.1.2. Yet the Commission's discussion of this point in the draft guidance paper focusses primarily on the situation where preferring the network operator could be discriminatory⁶. We believe it may also be the case that treatment is discriminatory *between* access seekers.

- 4.1.3. Earlier in the draft guidance paper, the Commission notes that:

Assessing difference in treatment requires consideration of both the terms on which the offer is made and the effect of those terms on access seekers. 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.

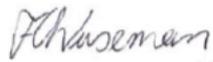
- 4.1.4. In the current context, while price or non-price terms may satisfy the equivalence requirements (if the Commission adopts an alternative cost standard), it may still be discriminatory if those terms result in a different treatment of smaller RSPs as compared to larger RSPs.

⁵ Section 5.5

⁶ Section 5.10

- 4.1.5. While the no harm to competition limb is about the competitive process and not about individual market participants, the reality is that a substantial number of smaller RSPs will be treated differently to the larger RSPs and this will affect the competitive process.
- 4.1.6. Unbundling terms offered may be “... *structured in such a way that it could never be taken up by certain categories of (or any) access seekers ...*” (smaller, sub-REO scale RSPs) and therefore “... *could ... result in a difference in treatment*”.
- 4.1.7. It must be emphasised that a new product or service (such as PONFAS) must satisfy both the equivalence and non-discrimination requirements. Satisfaction of, say, equivalence does not necessarily satisfy non-discrimination.
- 4.1.8. As we noted in our November 2019 submission, we continue to support the possibility of an industry workshop or webinar on this matter prior to the Commission preparing its final guidance.
- 4.1.9. For any questions relating to the material in this submission, please contact Fiona Wiseman, Senior Advisor, Strategy and Regulation on 027 549 9330.

Regards,



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