Vodafone New Zealand submission on fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period

14 October 2020

Thank you for the opportunity to provide our views on the information disclosure and price quality proposed process paper. This marks a critical milestone in the process as we move from the input methodologies to the determinations that will enact the regulations themselves. We appreciate the transparency the Commission has given on the next steps in the process.

This submission focusses on:

- the scope of quality standards;
- how to apply controls to minimise price-shocks;
- monitoring of inefficient price structures;
- the process for setting the initial regulatory asset base (RAB) and opex forecasts; and
- unbundling.

The scope of quality standards

We consider quality to be the most important aspect of the first regulatory period to ensure delivery and performance of fibre services improves in line with consumer expectations. We are pleased to see the Commission will be holding an industry workshop on quality standards.

We will make more substantive submissions on this topic in future consultations, however we make the following initial points:

- A specified process for setting or changing key terms is essential. We strongly disagree with the statements in the recent input methodologies final decision that a change process would not give effect to the implementation of a new regulatory model as intended by Government.[1] Changes to service quality terms have a significant impact on RSPs and end-users, and it is vital that these changes are subject to a proper process. A specified change process will simply ensure that appropriate consultation is taken and assurances given to the fairness of changes. This is no different than what would be expected in a workably competitive market.

- Information disclosure requirements should include metrics to demonstrate that the local fibre companies (LFCs) are being responsive to retail service provider (RSP) and end-user needs, including monthly performance reporting to RSPs, weekly reports on performance against installation time targets, and a process to work with RSPs if any specified quality thresholds are breached.

- There must be robust customer surveys, including surveys of RSPs themselves as the customers of the LFCs. These surveys could play a similar role as the Asset Management Plans used in Part 4, by showing that investments and practice by the LFCs is aligned with consumer interests. This will provide the Commission a robust dataset to consider further interventions in the future.

- A comprehensive set of pricing principles is an essential quality metric. This is necessary to ensure that the LFCs price efficiently and do not aim to harm competition. This is discussed further in the section below on inefficient pricing structures.

[1] Commerce Commission, *Fibre input methodologies: Main final decisions – reasons paper*, 13 October 2020, para 5.53.

- Finally, there must also be measures of innovation and an obligation to improve over time. This will help keep track of whether the LFCs are stagnating on technological progress, and if more intervention is required.

Minimising price-shocks

We support the proposal to put in place controls to minimise price shocks for end-users. Under the new regime the LFCs are likely to have significantly higher revenue allowance than possible under the current price caps, providing ample opportunity for price shocks to occur.

This will be particularly important in a post-Covid-19 world. Many New Zealanders will be recovering from severe financial distress, alongside a growing digital divide that is shutting many Kiwi's out of the digital society we are rapidly moving towards.[2] Adding a price shock to wholesale fibre services used to deliver connectivity to so many end users could light the powder keg bringing on a range of social and economic consequences.

The Commission has experience in managing price-shocks in the electricity sector. However there are some critical differences in the telecommunications sector that will require further consideration. We make the following observations:

- The Commission typically considers a price rise of greater than 10% in a single year as a price shock. This is far too high for wholesale fibre services. For example 3 years of 10% price increases on Chorus' fibre max service would increase the price by $18.50, or almost 18% of the current retail price. There are two factors worth highlighting
    1. Wholesale fibre prices make up a far larger proportion of end-user bills than electricity lines charges. For our most popular plans the wholesale component is approximately 60% of the retail charge (and much higher when retail discounts are taken into account). This is almost double the contribution of electricity lines (roughly 36%).[3]

[2] https://www.stuff.co.nz/auckland/300093059/coronavirus-covid19-exposes-digital-divide-internet-havenots-further-cut-off
[3] https://www.ena.org.nz/news-and-events/news/

2. There is no financial assistance from government for vulnerable users of telecommunications services. In the electricity sector there are winter energy payments, and assistance through Work and Income for power, gas, and water bills.[4] These programmes help shelter the most vulnerable from price rises, but no similar safety net is available for a broadband bill, except to the extent that support is fully funded by RSPs. While we will always try to support customers in cases of genuine hardship we cannot fund the inevitable hardship that would result from fibre price shocks.

- Price shocks may occur due to the removal of a service rather than an increase in monthly charges. For example about 10% of Chorus' customers are using the entry level 50Mbps service.[5] If Chorus chose to no longer offer this service, those customers would shift on to a higher cost plan, and face a sharp increase in price.
- Unlike the electricity sector, there are many different telecommunications services. If price shock is only considered at a revenue level, there is a real prospect of one service increasingly substantially above a price shock threshold, but still remain below the revenue cap threshold by keeping price changes on other services low. We support the Commission's proposal to consider price shocks for non-anchor services,[6] but this cannot be done at an aggregated revenue level, it requires a careful analysis of the impact of changes to individual service prices.

Inefficient price structures

The hands off approach to individual prices and service standards proposed by the Commission will likely lead to inefficient pricing structures and practices. This will diminish competition and lessen choice for New Zealanders contrary to the purpose of the Act. We note the intention to monitor inefficient pricing structures, but the Commission must go further.[7]

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[4] https://www.workandincome.govt.nz/eligibility/living-expenses/heating-and-power-bills.html
[5] https://company.chorus.co.nz/investor-news
[6] Commerce Commission, *Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period*, 15 September 2020, para 5.82.
[7] Commerce Commission, *Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period*, 15 September 2020, 3.92.

For example, right now both Chorus and Enable have targeted discounts that appear to be focussed on influencing and distorting competition in the retail market. Chorus are offering RSPs a $300 credit if they are able to sell fibre to a customer not currently using any of Chorus services (ie they are currently on HFC, fixed wireless, or not connected at all). Similarly Enable are offering $250 to RSPs who bring over customers currently connected to HFC. We expect that both of these offers well exceed the average profit for fibre services, and are therefore specifically targeted at inducing customers to switch to fibre and ultimately reducing competition from alternative access methods.

To ensure a healthy market we recommend the commission implements pricing principles as a quality measure. The pricing principle should include:

- The frequency of price changes. Prices must only change once a year to avoid unnecessary costs, and confusion for end-users.
- That a range of services are available and there are meaningful differences in price to meet the needs of all New Zealanders.
- That scrutiny is applied to any discounts to ensure that they do not harm competition
- A justification for any price changes, and evidence that they have considered the impact on end-users.

Oversight of the initial RAB and opex forecasts

We are concerned that the Commission will be basing the value of the initial RAB on Chorus' own modelling.[8] This will provide Chorus with too much influence likely resulting in an over-estimation of the RAB that end-users will continue to pay for for decades.

[8] Commerce Commission, *Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period*, 15 September 2020, para 5.135.

However, we appreciate the time constraints the Commission is under to deliver the first price-quality determination. We therefore propose two additional steps to tighten up the scrutiny:

1. Allow for stakeholders to provide their views on Chorus' proposed initial RAB. As it currently stands there will be less scrutiny placed on the initial RAB than there will be for the capex and opex proposals for the first period, yet the initial RAB will be many times more material. Allowing for stakeholders to provide their views puts many eyes to the most material decision of the entire regime, and utilises the knowledge of the sector to highlight concerns that the Commission may not otherwise identify.

2. Once the price quality determination is set the Commission should do a bottom up re-estimation of the initial RAB. This is the most critical decision that will be made in the lifetime of this regime, it cannot be done in a hurry, and left that way for decades. Any differences between the RAB used for the first price-quality path and the RAB re-estimated by the Commission can be washed up through a reopener, or as part of the second regulatory price-quality path.

The opex forecasts will also require significant scrutiny as they are often the most material decision on a revenue cap. We are pleased to see stakeholders will be given an opportunity to provide their views on these forecasts.[9] However, we expect a key area of dispute will likely be the uptake forecasts for costs dependent on connection numbers. As an operator of competing HFC and fixed wireless networks we will likely have a different view of fibre uptake than Chorus will itself. It may be necessary for the Commission to procure an independent expert opinion to assess a reasonable estimate of uptake.

[9] Commerce Commission, *Fibre information disclosure and price-quality regulation: Proposed process and approach for the first regulatory period*, 15 September 2020, para 5.168.2.

Unbundling

We continue to be frustrated by the inconsistency in the Commission's approach to assessing, and measuring compliance with the fibre unbundling requirements. The legislation requires a compliant product and price from the start of 2020, but we seem to still be a long way away from anything resembling a reasonable price or terms.

In the Commission's guidance on equivalence and non-discrimination one of the tests of compliance is whether the layer 1 price is equal to or lower than the upstream cost of providing layer 1 services.[10] However, because the Commission has failed to establish an input methodology on how to allocate shared costs between layer 1 and layer 2 there is no practical way this test can be implemented. We recommend that an input methodology amendment process is started immediately to resolve this hole in the Commission's logic.

Until such an input methodology is developed we should at least be able to see the LFCs interpretation of its layer 1 and layer 2 costs, including allocating shared costs between the layers. We note that there are other ways that the Commission can request this data from the LFCs,[11] however none of those approaches require public disclosure. Since the equivalence requirements can be enforced by both the Commission and access seekers, it is insufficient to rely on information powers only available to the Commission. Interested persons must also have the means of gathering data to determine if a breach has occurred.

[10] Commerce Commission *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, 30 September 2020, para 3.70.
[11] Commerce Commission, *Fibre input methodologies: Main final decisions – reasons paper*, 13 October 2020, para 2.380.