Promoting competition in telecommunications markets as part of fibre information disclosure (ID) and price quality (PQ) regulation

Survey response | Commerce Commission

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Contents

Executive summary

Thank you for the opportunity to provide feedback on how the Commission might best promote competition through its information disclosure (**ID**) and price quality (**PQ**) regulatory decisions.

We support the Commission further considering how it might best promote competition in its Part 6 approach. The promotion of competition is a key element of the framework – the Commission must make decisions that best give effect to s162 and promote competition – and service providers highlighted competition concerns through earlier IM submissions.

The Commission's initial views set out in the companion paper are welcome first step to resolving key questions: what are the competition settings for the sector? What are the PQ and ID levers that could directly or indirectly impact competition? And what should the Commission do to promote outcomes to give best effect to the purpose? These are questions which warrant meaningful consideration – and the Commission's approach will provide clarity on how it will give effect to the purpose and prioritise competition as an objective.

For traditional utilities ID and PQR provide reasonable tools to create transparency of and limitations on the scale to returns achieved by regulated entities. In competition law terms this provides safeguards against traditional price gouging that could be expected from operators of monopolies. In our view however, the ID and PQR tools available to the Commission could also be used with greater sophistication to proactively prevent, limit the likelihood or reduce the incentives on regulated entities to engage in a broader range of anti-competitive behaviours.

The companion paper usefully highlights potential risks and opportunities to the promotion of competition. However, the analysis focuses on specific market segments and provider behaviours. The Commission may wish to consider its framework further to ensure it captures the full range of competition concerns. For example:

- To impacted markets beyond the four market segments - across layer 1 and layer 2, and PQ and ID only areas – identified in the paper. For example, Chorus' interests extend nationally to copper access, tail extension, regional transport, retail functions and future network services, and incentives to distort competition in these markets. PQ and ID decisions concern the promotion of competition in telecommunications markets.

- To concerns that decisions relating to the scope of FFLAS funded capability and cost allocation less competition. PQ decisions that enable Chorus to fund competitive activities from guaranteed BBM returns can only lead to a lessening of competition in related markets. While the survey mainly focuses on regulated provider actions, Commission PQ decisions have the potential, in themselves, to lessen competition - or provide incentives for behaviour that lessens competition - relative to the alternatives available to it.

Further, we have not attempted in our response to:

- Provide an exhaustive summary of how PQ and ID might work to promote competition – this can only be developed as the ID and PQ determination process evolves.

- Rank the regulatory tools. PQ and ID regulation complements other elements of the regulatory framework, and all act to promote the purposes of the Act. Therefore, we agree that the focus should be on how PQ and ID decisions can act to mitigate competition impacts – outcomes - rather than particular ranking; or

- Prioritise specific competitions risks as specific behaviour can impact competition in several ways. For example, a recent area of concern for Spark has been the market distorting effect of incentive payments made to RSPs to win over specific customers from alternative access providers. These payments have a direct and indirect effect on the performance of retail markets. Chorus can readily embark on a strategy of pricing below cost in a distortionary manner, with targeted incentive payments acting as a form of market discipline against competing infrastructure players, as the regulatory framework ensures these costs are recovered over regulatory periods. As set out in the paper, ID and PQ tools have a role to play in setting the rules and processes for preventing and unwinding such conduct. The Commission could, for example, refuse to allow incentive payments to be included in Chorus' expenditure proposal.

Introduction

1. Thank you for the opportunity to provide input on how the Commission might best promote competition through its information disclosure (**ID**) and price quality (**PQ**) regulatory decisions.

2. The Commission is seeking to identify to identify key risks to, and opportunities to promote competition in telecommunication markets through ID and PQ decisions over the remainder of the year.

3. We support the Commission considering further how it might promote competition in applying Part 6 of the Act. The Commission is required by the Act to, amongst other things, to make decisions that best give, or are likely to best give, effect to the promotion of:

    a. Workable competition in telecommunication markets[1]; and

    b. Outcomes that are consistent with outcomes produced in workably competitive markets. The Commission noted in the IM reasons paper that, while its approach is based on s52A of the Commerce Act, its approach to s162 in the context of FFLAS would recognise the unique competitive landscape of telecommunications and differences between Part 4 and Part 6[2].

       We agree. We wouldn't expect to see wholesale providers in a workably competitive markets, for example, inefficiently expanding into related markets or acting to distort competition. Given our competitive landscape and Chorus incentives, the Commission will face additional considerations for achieving the s162 outcomes.

4. Accordingly, the Commission is right to consider how it might reflect the risks and opportunities for promoting competition in PQ and ID decisions as required by the Act.

5. Our survey response is attached. In our covering submission we discuss the complementary competition concerns raised by Chorus' expenditure proposal (on which the Commission is consulting on separately) and suggest that the Commission broaden the analytical model set out in the companion paper.

6. We stress that our responses are tentative and seek to highlight where the focus might go, the development of the PQ and ID decisions is at an early stage and the PQ and ID approach that best promote competition will come out of the detailed analysis.

How the survey might relate to issues raised by Chorus' expenditure proposal

7. As it stands, the survey largely focuses the risk and opportunities to mitigate anti-competitive behaviours by regulated providers, i.e. margin squeeze, withholding key inputs and market distorting incentives. We agree these behaviours would be concerning and reflect the concerns of service providers through submissions and complaints to the Commission. Vector, Vodafone and Vocus have all set out their unbundled fibre concerns.

8. However, it is unclear whether the survey is intended to capture risks and opportunities relating to PQ and ID decisions themselves. For example, PQ decisions have the potential to lessen competition - or provide incentives for behaviour that lessens competition - relative to the

[1] Para 2.220 of IM Reasons paper and 1.10 of companion paper
[2] IMs reasons paper 2.217 at footnote 94

alternatives available to it. Access seekers expressed concerns in earlier submissions that PQ and ID decisions can work to undermine competition by[3], for example:

a. Drawing the BBM boundary in a way that, in practice, captures competitive parts of the market. No firm can compete against a provider with guaranteed BBM returns;

b. The Commission accepting an allocation of shared costs to the monopoly regulated business that works to undermine competition in competitive markets;

c. Allowing regulated providers to facilitate or subsidise expansion (or an option to expand into competitive markets; and

d. Permitting Chorus to undertake pricing practices that inefficiently distort competition in retail markets. This issue is addressed in the survey.

9. Chorus operates in (or plans to expand into) a number of related markets – i.e. providing copper access, tail extension, regional transport and future network services - and has strong incentives to use FFLAS and guaranteed regulatory funding to distort competition in those markets. No firm can compete over time against a regulated firm whose activities are is funded through guaranteed BBM returns.

10. Further, Chorus' expenditure proposal, on the face of it, highlights the risk that guaranteed regulatory funding will be applied to a complex and costly business model that goes far that required for FFLAS services and a significant proportion of overall costs will be allocated to the regulated business. The Commission has asked for feedback on Chorus' proposal, highlighting that Chorus proposed incentive payments and investment to support an unbundled layer 1 service potentially impact competition[4], and questioning the proposed high allocation of labour costs to FFLAS[5].

11. The Commission has posed important competition questions which go wider than the framework set out in the companion paper and survey. The Commission may wish to come back to the framework following expenditure proposal submissions.

Assessment framework

12. Further, it is unclear whether proposed framework captures the breadth of potential competition impacts.

Market definition

13. The Commission identifies four market segments for the competition analysis based on whether the services are layer 1 or 2, and in PQ or ID only areas[6]. It proposes to consider the state of competition, and the risks to existing competition or opportunities to promote competition, in these market segments[7].

14. However, this approach may be too narrow to capture the breadth of competition the Commission is tasked with promoting. PQ and ID decisions may have implications for the wider telecommunications markets. For example, Chorus interests extend to copper access, tail extension, regional transport, retail functions and future network services.

[3] These concerns are detailed in Axiom report submitted to the Commission in July 2019 https://comcom.govt.nz/__data/assets/pdf_file/0023/161915/Axiom-for-Spark-submission-Fibre-emerging-views-Report-July-2019.pdf
[4] Para 36 of PQ consultation
[5] Question 2 of consultation. Chorus proposes to allocate 91% of labour costs to regulated fibre services that contribute to around 50% of Chorus revenue and connections.
[6] Para 2.8
[7] Para 2.12

15. The Commission has rightly identified a number of competition risks in the survey relating to bundling, margin squeeze and connection incentives. While the source of exploited market power may sit within FFLAS described by the segment in the survey, the lessening of competition can occur in markets outside regulated geographic areas or connectivity services. For example, the identified bundling and incentive payment structure risks can act to assuage Chorus existing and/or potential competitive threats in transport and access markets outside regulated areas.

16. Accordingly, when the Commission assesses specific risks a wider market perspective will likely be required.

Ranking of regulatory tools

17. We also haven't sought to rank the regulatory tools for addressing competition risks. PQ and ID decisions are required to promote competition and the outcomes of workably competitive markets. PQ and ID regulation complements other elements of the regulatory framework, and all act to promote competition. Therefore, we have focused on how PQ and ID decisions can act to mitigate competition impacts – outcomes - rather than particular ranking.

Priorities

18. The survey also asks for feedback on priorities reflecting the likelihood of conduct occurring and the impact in terms of lessening of competition.

19. It is difficult to prioritise specific risks as the we are still in the early stages of applying utility regulation – Chorus' expenditure proposal has only recently been made available and an initial quality workshop is tomorrow – and providers behaviour may be seen across several risks (as described in the companion paper).

20. Therefore, we've groups the risks in to related behaviours and suggested general areas, i.e:

    a. Chorus incentive payment practices – these practices are ongoing and risks distorting retail markets;

    b. The scope of capability funded, and allocation of costs to, the regulatory funded services – the Commission is required to consider these issues in any case in determining permitted expenditure; and

    c. Providing transparency of costs and performance, particularly as this relates to consumer outcomes and planned layer 1 unbundling.

[End]

Response to survey questions

1 Risk analysis

We have grouped the risks by themes as there as regulatory tools are relevant for cross overs between a number of

	Risk	a. Usefulness of ID relative to other tools	b. Role of ID to mitigate, and suggestions how to apply to promote LTIEU	c. Usefulness of PQ relative to other tools	d. Role of PQ to mitigate, and suggestions how to apply to promote LTIEU
	Risk identified in the companion	a. How useful do you think information disclosure (ID) regulation is to mitigate this risk, relative to other tools, such as price-quality (PQ) regulation, equivalence of inputs (EOI) or non-discrimination (ND) obligations?	b. What role do you see for ID regulation in mitigating this risk? What are your specific ID-related suggestions? How does this promote the long-term benefit of end-users of telecommunication services?	c. How useful do you think PQ regulation in the first regulatory period is to mitigate this risk, relative to other tools such as ID regulation, EOI or ND obligations?	d. What role do you see for PQ regulation in mitigating this risk? What are your specific ID-related suggestions? How does this promote the long-term benefit of end-users of telecommunication services?
A	Chorus lessens competition by charging anti-competitive prices for layer 1 services that are an input to rival competitors downstream at layer 2. This raises the costs of downstream rivals, making them less competitive	We agree with the companion paper, ID can contribute to transparency, but it cannot be assumed that it will be sufficiently granular to provide a meaningful assessment of the regulated entity's conduct. By making transparent the cost allocation methodologies and allocations to assess compliance against provides more certainty for unbundler investment and innovation		PQ can perform the same role as ID. The important outcome is that provide transparency. Specific obligations on the regulated entity's pricing of key services, pricing relativity and the way it prices across the range of services (including incentives it pays out) will be key.	
C	Chorus lessens competition through non-price terms (including quality) for layer 1 services that are an input to rival competitors downstream at layer 2. This negatively impacts downstream rivals, making them less competitive			PQ can also make a significant contribution as quality requirements and reporting are set (service and responsiveness to access seekers). PQ decisions should set quality, including measures showing quality and responsiveness.	
D	Chorus lessens competition through insufficient investment in layer 1 services that are an input to rival competitors downstream at layer 2. This negatively impacts downstream rivals, making them less competitive			Very important as quality reporting can highlight service level concerns as lack of investment implications roll through. Monitor through capex reporting	Through making quality transparent (both for end users and responsiveness to access seekers) and scrutiny and reporting of capex proposal

	Risk	a. Usefulness of ID relative to other tools	b. Role of ID to mitigate, and suggestions how to apply to promote LTIEU	c. Usefulness of PQ relative to other tools	d. Role of PQ to mitigate, and suggestions how to apply to promote LTIEU
G	Chorus lessens competition by charging anti-competitive prices for specific layer 2 services where it faces competition (eg, lower speed broadband)	FFLAS prices and services should be transparent.	Making transparent services and pricing. We have proposed previously that Chorus be required to make transparent offered FFLAS services and prices. The intention being to highlight where these practices have occurred.	The promotion of competition is a key PQ cost allocation consideration.	If Chorus can rely on recovering costs (within in the current or future regulatory period), it may execute a targeted predatory pricing strategy (within in the current or future regulatory period) then PQR will not meet the purpose.
I	Chorus lessens competition by charging anti-competitive prices at layer 2 in areas only subject to information disclosure (ID) regulation, enabled by inappropriate allocation of costs between ID and price-quality (PQ) areas			These are examples of our key concern that cost allocation can lessen competition in competitive markets, distorting competitive.	Commission should ensure cost allocation decisions best promote competition in telecommunications markets, including ID only areas. Cost allocation should prevent below cost targeted or differential pricing to respond to competition.
J	Chorus lessens competition by charging anti-competitive prices at layer 1 in areas only subject to information disclosure (ID) regulation, enabled by inappropriate allocation of costs between ID and price-quality (PQ) areas				
K	Chorus bundles layer 2 products with layer 1 backhaul products, such as Intra Candidate Area Backhaul Service (ICABS), in a way that makes entry into the backhaul market uneconomic (eg, not enough contestable volumes). Backhaul is the intermediary link in a telecommunications network between the edge of the network (eg, copper or fibre connecting homes or mobile sites) and the core network (eg, internet gateways and content provision)	Very important that FFLAS prices and services are transparent.	Making transparent services and pricing. We agree with the companion paper analysis – provides should be required to disclose reference contract terms. The intention being to highlight where these practices have occurred.		

	Risk	a. Usefulness of ID relative to other tools	b. Role of ID to mitigate, and suggestions how to apply to promote LTIEU	c. Usefulness of PQ relative to other tools	d. Role of PQ to mitigate, and suggestions how to apply to promote LTIEU
L	Chorus bundles layer 2 products between price-quality (PQ) and information disclosure (ID)-only areas that have exclusionary effect on local fibre companies in ID-only areas (eg, prices in PQ areas are lower if you also purchase ID-only area requirements from Chorus)	FFLAS prices and performance should be separated out between PQ areas and ID areas in a sufficiently transparent way.	We have proposed previously that Chorus be required to make transparent offered FFLAS services and prices. The intention being to highlight where these practices have occurred. The Commission should have the ability to require that Chorus take action to correct any pricing issues that lessen competition.		
M	Chorus lessens competition at layer 2 in price-quality (PQ) and/or information disclosure (ID)-only areas by making anti-competitive incentive payments (also referred to as 'retention capex') to attract/retain end-users (price terms)			Very important as BBM approach, without mitigation, provides further incentives for distortionary practices.	Retention capex should only be permitted where it best promotes competition in telecommunications markets.
N	Chorus lessens competition at layer 2 in price-quality (PQ) and/or information disclosure (ID)-only areas by imposing anti-competitive conditions attached to the incentive payments (also referred to as 'retention capex') (non-price terms)			This is current Chorus practice with significant implications and resolving M, N risks should be a high priority.	Recoverable capex should be defined so that it excludes capex initiatives with conditions or outcomes that do not best promote competition.
O	Chorus prevents other local fibre companies (LFCs) from expanding their network (limiting growth opportunities for LFCs within their own areas and preventing entry into Chorus' price-quality regulated areas) by undercharging for laying new network/connections (for example, cross-subsidising the network expansion and recovering the costs elsewhere)			PQ important tool to mitigate.	Chorus capex expenditure proposal should come with sufficient supporting evidence showing to mitigate and outcome reporting. Commission capex approval conditions set that discourage this behaviour.

	Risk	a. Usefulness of ID relative to other tools	b. Role of ID to mitigate, and suggestions how to apply to promote LTIEU	c. Usefulness of PQ relative to other tools	d. Role of PQ to mitigate, and suggestions how to apply to promote LTIEU
B	Local fibre companies (other than Chorus) lessen competition by charging anticompetitive prices for layer 1 services that are an input to rival competitors downstream at layer 2. This raises the costs of downstream rivals, making them less competitive	As applies to Chorus, LFCs should be required to disclose pricing methodologies, cost allocations and quality reporting.	A similar level of scrutiny to that applied to Chorus.		
E	Local fibre companies (other than Chorus) lessen competition through non-price terms (including quality) for layer 1 services that are an input to rival competitors downstream at layer 2. This negatively impacts downstream rivals, making them less competitive				
F	Local fibre companies (other than Chorus) lessen competition through insufficient investment in layer 1 services that are an input to rival competitors downstream at layer 2. This negatively impacts downstream rivals, making them less competitive				
H	Local fibre companies (other than Chorus) lessen competition by charging anticompetitive prices for specific layer 2 services where they face competition (eg, lower speed broadband)				

2 Ranking of risks

Please rank your top five risks in order of most to least material in the next three years (materiality combines the likelihood of conduct occurring and the impact in terms of lessening of competition). Please do not give the same ranking to more than one risk.

As set out above, we're only attempted to prioritise groups of activity due to the related nature of the behaviours, risks and mitigations.

- Chorus incentive payments – these practices are ongoing and market distorting.
- Scope of capability funded and cost allocation to the through the BBM and cost allocation.

- Address pricing concerns by making prices and pricing methodologies transparent.
- Ensuring comprehensive disclosure of price and non-price terms, service performance.

3 Impact of geographic consistent pricing obligation

Help us improve our collective understanding of how the requirement in section 201 of the Telecommunications Act 2001 on geographically consistent pricing impacts on competition in telecommunication markets

a. Is there a role for information disclosure regulation (supplemented by summary and analysis) to help interested stakeholders understand these impacts?

Include yes/no answer

b. If yes, what information and forms of summary and analysis would help you to understand potential competition impacts of geographically consistent pricing?

Please specify

- It is unclear whether geographically consistent FFLAS pricing is likely to be a material competition issue.

4 Any other key risks or opportunities

Are there any other key risks or opportunities to promote competition? If so, which ones? Please only include those that can be mitigated or realised with information disclosure or price-quality regulation, and rank them relative to the other risks

Please specify

- Resolving cost scope and allocation risks for the promotion of competition and workable competition outcomes in PQ decisions. As discussed above, these risks come to bear in the analysis of Chorus' expenditure proposal.