Chorus submission on Fibre fixed line access service deregulation review: Reasonable grounds assessment draft decision

24 September 2024

CHORUS

Contents

Executive summary

1. This submission sets out Chorus' response to the Commerce Commission's (Commission) reasonable grounds assessment draft decision (draft decision) for a deregulation review of fibre fixed line access services (FFLAS). This submission is supported by an expert report from Frontier Economics, entitled *Reasonable grounds analysis*.

2. Some parts of this submission are confidential, marked **CCI [ ]** and we have provided public and confidential versions.

3. We strongly disagree with the Commission's draft decision that no reasonable grounds exist to start a deregulation review for FFLAS services. The available evidence – including evidence of competition that is constraining Chorus' ability to price up to its maximum allowable revenue (MAR), overlapping and inappropriate regulation, and rapidly changing market dynamics - clearly demonstrates that reasonable grounds exist. The Commission should carry out a review to consider whether those services should remain:

    a. regulated under Part 6 of the Telecommunications Act (Act); or

    b. subject to price-quality (PQ) regulation under Part 6 of the Act.

4. We therefore recommend the Commission commits to carrying out a fibre deregulation review during Price-Quality Period 2 (PQP2). By undertaking such a review, the Commission has an opportunity to address significant weakness and obsolescence in the regulatory regime applying to FFLAS.

5. The medium to long-term impacts of rapidly evolving market dynamics – including the wind-down of Chorus' copper network and evolving 5G technologies – will likely become clearer over the next two years. The aim should be to conclude a full deregulation review before 2027, so there is sufficient time to implement any deregulation decision before the start of PQP3.

6. We agree with some elements of the draft decision, including:

    a. the finding providers of voice services have no ability to extract excessive profits due to the level of competition that likely exists;

    b. the Commission's definition of substantial market power (SMP) – if not the assessment of SMP itself;

    c. the level of granularity when considering geographic market definitions; and

    d. the economic framework the Commission has developed – however we believe the Commission has misapplied the framework to the extent that it cannot be properly used to assess market power.

Assessment framework

7. We are concerned that the Commission's assessment framework in reaching its draft decision is flawed. In practice, the threshold the Commission is applying means it is difficult to conceive of any situation in which a review would occur, short of

overwhelming evidence that regulation is no longer warranted. This is clearly not what Parliament intended when it established the two-step inquiry.

8. In adopting that very high threshold to establish reasonable grounds, the Commission has misconstrued the statutory test and foreclosed the opportunity to properly assess the evidence – including that set out in our submission - as part of a full review.

9. The Commission's draft decision is:

    a. **Incorrect -** because the Commission has conflated the screening exercise it is required to undertake, by incorrectly interpreting the purpose of the two-step inquiry under s 210, and applying an excessively high threshold to the question of reasonable grounds. On any reasonable interpretation of the test, the initial reasonable grounds assessment is a screening exercise, focused on considering whether there is a case to undertake a fuller inquiry.

        The Commission's approach means it has not been sufficiently open to evidence of material competitive constraints that warrant a proper inquiry. The result is that:

        i. the Commission has prematurely ruled out a deregulation review, having hastily dismissed (and in some cases failed to consider) the available evidence; and

        ii. it creates a structural bias towards the status quo, without having made a proper inquiry into the evidence.

    b. **Static** – insofar as it describes the various services in one dimension (market participants and services), at a particular point in time, with only very limited discussion of rapidly evolving market dynamics. The Commission relies too heavily on historical data, which does not accurately reflect today's telecommunications markets.

    c. **Superficial** – rather than an examination of how the various FFLAS services are operating in practice – including drivers of market participants' behaviour and outcomes that are market-driven (and not prescribed by regulation) – the draft decision assesses each service in a limited way with reliance on anecdotal or assumption-based analysis. Many of the conclusions drawn are not accurate.

10. The draft decision leaves the impression that the Commission has not properly assessed evidence of competitive constraints, rather than considering whether that evidence warrants further examination in a full deregulation review. It is particularly surprising that the Commission's analysis excludes an assessment of Chorus' and other LFCs' pricing, which is a critical element of a SMP assessment.

Evidence and analysis of reasonable grounds

11. The Commission's analysis attaches insufficient weight to many of the regulatory and market characteristics that make the exercise of any market power by Chorus difficult or impossible. A better approach would be to apply the framework used by the Commission when carrying out inquiries into whether a sector or supplier should be regulated under Part 4 of the Commerce Act 1986. Applying this framework would enable the Commission to consider future prospects of competition, the effect of other regulation on the constraint of market power, the scope for FFLAS providers to exercise SMP, and the costs and benefits of deregulation.

12. The fact that competition constrains Chorus' ability to set prices at a level that would enable it to recover its MAR is the single most relevant piece of information for the Commission's decision.

13. Given that the primary role of PQ regulation is to constrain prices or revenues, the fact that the revenue cap does not 'bind' raises a serious question about the benefits of PQ regulation when weighed against the significant costs of implementation. If competition – and not regulation – determines the level of Chorus' prices (and hence revenue), this, in and of itself, should meet the threshold to necessitate a review as to whether Chorus' FFLAS services should remain subject to PQ regulation.

14. In this submission, supported by Frontier's analysis, we present evidence showing that pricing of FFLAS Bitstream PON products are constrained by fixed wireless competition by way of a chain-of-substitution effect, and that only a relatively small portion of our customer base needs to be able to move to fixed wireless access (FWA) services to provide a competitive constraint.

15. Other key evidence overlooked or mis-stated in the draft decision includes:

    a. The impact of regulation of transport services on Chorus' ability to compete on competitive transport links.

    b. The existence of FFLAS commercial backhaul and Chorus Exchange Connect (CXC) transport products, which face competition but are not mentioned in the draft decision paper.

    c. The reliance on a backhaul study from 2019 to determine there is limited competition in Intra Candidate Area Backhaul (ICABS), without using more up to date information that the Commission already has.

    d. The extent of competition for new property developments (NPD) or greenfield connections, for which the draft decision only mentions anecdotal evidence. In fact, there is strong competition for NPD services, including between LFCs (in each other's areas) and with third parties, and this influences Chorus' NPD pricing.

    e. The extent of competition in point-to-point services, where the draft decision lists four competitors nationally when in fact we are aware of more than three times that number.

Review outcomes

16. The available evidence clearly demonstrates there are reasonable grounds to start a deregulation review.

17. The reasonable grounds assessment and associated deregulation review process should ensure the regulatory framework is proportionate for the level of competition that exists in the markets for FFLAS. When a review is undertaken, we believe an appropriate outcome, supported by the evidence, would be:

    a. Removal of PQ regulation from Chorus, so that we are subject to information disclosure (ID) only in Chorus' UFB and non-LFC areas for PQP3 (potentially with ancillary regulatory mechanisms where appropriate); and

    b. Removal of ID requirements from Chorus in other LFC areas.

18. ID regulation for Chorus FFLAS is proportionate, appropriate and would adequately mitigate any potential risk. It provides clear information that can be scrutinised to give assurance to our retail service provider (RSP) partners and broadband customers that pricing is not producing excessive returns and service quality remains acceptable. The threat of 're-regulation' would exist if excess returns were to be earned, and Chorus would be very conscious of this fact when making pricing decisions.

19. Finally, in the absence of a review, the draft decision would perpetuate an inconsistent New Zealand regulatory landscape and retain outcomes that appear incoherent across sectors. Chorus clearly faces more competition than the energy firms regulated under Part 4, and yet is more heavily regulated (i.e. they do not have anchor product regulation in addition to PQ and ID). Similarly, given the steep decline in demand for copper, there is no material difference in the competitive position of Chorus relative to the other LFCs. However, the draft decision does not address whether ID-only or PQ regulation is a more appropriate form of regulation for FFLAS providers – it simply endorses the status quo.

Assessment framework

Legal framework

20. The Commission has incorrectly applied an overly high threshold to the question of reasonable grounds, thereby conflating the screening exercise with a substantive deregulation review.

21. Balancing the risk of unnecessary reviews against the risk of unnecessary regulation does not require the Commission to adopt such a strict a threshold as in the draft decision.

22. Through a combination of sections 201(1), 210(3) and 201(4), the Act contemplates a two-stage inquiry:

    a. first, a 'screening' inquiry to determine whether there are reasonable grounds to undertake a review; and

    b. second, the review itself.

23. The Commission has interpreted the reasonable grounds test as meaning that the Commission may start a review "*where the information before us is objectively sufficient to leave us with a view that it is likely that the services should no longer be regulated*". The Commission observes that the statutory words appear to set a "high threshold" and that, while the threshold was not intended to be so high as to risk unnecessary regulation, nor was the threshold intended to be so low as to risk unnecessary reviews.

The statutory words do not set such a high threshold

24. To the contrary, the statutory words point towards a relatively low threshold for initiating a review.

25. There are two relevant aspects to the statutory test: (i) "reasonable grounds", and (ii) "consider".

26. We agree that the requirement for "reasonable grounds" requires the Commission to have an objective basis to conclude that a review is warranted. In other words, the Commission cannot conduct a review based purely on a subjective assessment of the merits of a deregulation review. It must refer to grounds that a reasonable person would agree provide a sufficient basis to proceed. But "reasonable grounds" is principally about the requirement for an objective basis, rather than setting any particular evidentiary threshold.

27. The Commission has implicitly interpreted "consider" as equivalent to "determine" or "be satisfied", whereas the scheme of s 210 indicates that Parliament used the term "consider" deliberately to invoke the alternative meaning of "to think about".

28. Rather than the narrow interpretation the Commission has adopted, we interpret the requirement in s 210(1) as meaning the Commission may conduct a review if there is an objectively reasonable basis for making an inquiry into whether one or more FFLAS should be regulated under Part 6 of the Act.

29. That interpretation is also supported by s 210(3), which summarises the requirement in s 210(1) by saying the Commission must "consider whether there are reasonable grounds to start a review". That subsection supports the interpretation that the question is not whether the review would be "likely" to conclude that FFLAS should no longer be regulated, but rather whether there is an objectively reasonable basis to proceed with that inquiry.

Guarding against unnecessary reviews

30. We broadly agree with the Commission's characterisation of the two-step inquiry as trying to balance the risk of unnecessary reviews with the risk of unnecessary regulation. But achieving that balance does not require the Commission to adopt as strict a threshold as it has.

31. First, the scheme of s 210 indicates that Parliament intended that the Commission turn its mind to this question with reasonable regularity. Implicit in s 210 is Parliament's judgement that regularly reconsidering the need for, and scope of, regulation is an important and valuable element of the regime.

32. Second, the two-step inquiry means that the initial reasonable grounds assessment is intended as a screen only, to determine whether proceeding with a full review is warranted. It is not inconsistent with the statutory scheme that the Commission should conclude there are reasonable grounds to conduct a review, but then ultimately determine that the status quo should remain. Indeed, the purpose of s 210 is also achieved where the Commission undertakes a full review and confirms to its satisfaction that FFLAS regulation is still warranted. Parliament intended for the review process to achieve both those objectives: to remove regulation where it is no longer warranted and to periodically confirm that regulation is still warranted. Through that lens, the screening exercise is intended to avoid the need for a review where there is no reasonable basis for proceeding with a review, rather than to proceed with a review only where the likely outcome is deregulation.

33. Undertaking a review only where the Commission determines that deregulation is a "likely" outcome means that:

    a. There is a real risk the Commission will decline to undertake reviews in circumstances where, on a fuller analysis, it would conclude that regulation is

no longer warranted. The approach therefore creates a structural bias towards regulation that is likely to result in costs imposed unnecessarily on New Zealanders.

b. There is no realistic prospect of the Commission confirming, via a full review, that there is a still a case for regulation, which is inconsistent with the scheme of the Act.

c. The Commission is effectively erring on the side of the status quo without having made a proper inquiry into the evidence, in circumstances where s 210 does not imply a bias towards the status quo.

d. The review itself is relegated to merely confirming the Commission's prima facie view that FFLAS should be deregulated, rather than properly considering with an open mind whether FFLAS should be regulated or deregulated.

34. The Commission prefers its interpretation on the basis that it strikes an appropriate balance between the costs of unnecessary regulation and the costs of unnecessary reviews. That implies those costs are symmetrical (and that Parliament viewed those costs as symmetrical). They are not, and we think Parliament correctly understood that that the costs of unnecessary regulation vastly outweigh the costs of undertaking regulatory reviews, which is why it required the case for continuing regulation to be periodically re-examined.

35. The Commission's analysis in chapter 3:

a. has conflated the screening exercise with the review, by purporting to undertake a detailed analysis of the available evidence to conclude that FFLAS should still be regulated. The approach the Commission has taken in its screening exercise leaves no room for the review itself; and

b. implicitly means the Commission would only conduct a review if it was satisfied that deregulation was the outcome it was very likely or certain to recommend to the Minister.

36. The Commission's approach also creates a process bias against deregulation, as the decision (as to whether to carry out a review) is made solely based on information available to the Commission at the time of the reasonable grounds review. It is clear this set of information is of limited value, evidenced by the fact the Commission requests further information by way of submissions in response to its draft decision.[1]

Economic framework

37. The Commission uses an 'economic framework' consisting of four analytical steps in order to reach its draft decision. The four steps are:

a. describe the regulated services and the purpose they serve;

b. identify alternative services comparable to the defined regulated services;

c. consider the effectiveness of competition; and

[1] See, for example, paragraph 3.102 of the draft decision.

d. test alignment with the purpose of the regulation.

38. While these steps represent valid points to consider, the effect of its approach is that the Commission makes a (cursory) assessment of current competition and then that is deemed to equal SMP, with no further assessment.

39. As identified in the Frontier report, the Commission's analysis attaches insufficient weight to many of the regulatory and market characteristics that make the exercise of any market power by Chorus (if such market power existed) difficult or impossible. Some of these key characteristics include:

    a. Regulatory and commercial constraints that prevent Chorus from price discriminating between customers or geographic areas where Chorus might face more or less competition.

    b. The 'long tail' of relatively low use customers for bitstream PON services, who can be readily targeted by FWA competitors that are vertically-integrated and also provide fibre services.

    c. Low switching costs and barriers to expansion for key FWA competitors, particularly once regard is had to 5G deployments and the ability of FWA competitors to scale services using a combination of more infrastructure, more spectrum and greater spectral efficiency.

    d. The presence of a chain of substitution between areas of greater competition, such as relatively lower usage/speed services, and higher usage/speed services offered by Chorus.

40. Frontier concludes:

    The combination of these factors means that, in our view, there must be serious doubt that attempts by Chorus to selectively or generally raise prices above present levels would be successful – indicative of a strong degree of competitive constraint... We therefore believe that the Commission's decision that no reasonable grounds exist is not well founded.

41. We note the contrast with – now clearly disproven – assumptions made during the inception of the current regulatory framework. The Ministry of Business, Innovation and Employment assumed, for example:

    We do not expect mobile networks to be complete substitutes for fixed networks in their core business of broadband access by 2020. Despite expected advancements in technology, mobile data services are still likely to provide a less consistent service, and remain more expensive than equivalent fixed line services.[2]

42. We further note the Commission itself has identified the evolving nature of broadband markets from at least 2018:

    …it is foreseeable today that the provision of wireless services may constitute a near substitute for the provision of fibre services for certain market segments of end-users (for example, those with lower bandwidth demand requirements). Similarly, we believe it is reasonably foreseeable that other access technologies which may also be

[2] Ministry of Business, Innovation and Employment, *Regulatory Impact Statement: Initial decisions on post-2020 fixed line communications regulatory framework*, 23 March 2016 (p. 5).

substitutes for fibre services for certain market segments of end users will become available in the future.[3]

43. More recently, the Commission noted (as at June 2023) New Zealand ranked fourth in the OECD for the number of FWA connections per 100 inhabitants.[4] New Zealand now (December 2023) has the third highest penetration of FWA services – at 7.1 connections per 100 people - in the OECD, despite also having relatively high fibre penetration (26.1 connections per 100 people, ninth-ranked in the OECD).[5] The Commission goes on to note '*(t)here is competitive tension between wireless and fixed broadband services that is reflected in the prices of these services*'.[6]

44. We suggest a better approach would be to apply the framework used by the Commission when carrying out inquiries into whether a sector or supplier should be regulated under Part 4 of the Commerce Act. A Part 4 inquiry considers whether:

    a. the goods or services are supplied in a market where there is little or no competition and little or no likelihood of a substantial increase in competition;

    b. there is scope for the exercise of SMP in relation to the goods or services, taking into account the effectiveness of existing regulation or arrangements (including ownership arrangements); and

    c. the benefits of regulating the goods or services in meeting the purpose of Part 4 materially exceed the costs of regulation.

45. Applying this framework would enable the Commission to consider future prospects of competition (which are dealt with only superficially within the draft decision), the effect of other regulation on constraining any market power, the scope for FFLAS providers to exercise SMP, and the costs and benefits of deregulation. We provide an initial assessment against these points below.

46. Overall, we would expect the Commission to seek to identify and address flaws or weaknesses in the regulatory framework and ensure existing regulation:

    a. is consistent with regulatory best practice; and

    b. is proportionate given the level of competition Chorus faces.

Current and prospective competition

47. The Part 6 framework was designed explicitly to address what was considered at the time to be the enduring natural monopoly characteristics of fibre networks. Irrespective of whether that was true at the time the decision to impose regulation was made in 2016, those natural monopoly characteristics do not exist today. Reasonable grounds exist to justify the initiation of a review. We believe the outcome of the review would demonstrate some or all FFLAS should either be deregulated, or no longer be subject to PQ regulation.

48. Chorus' prices (and hence revenue) are constrained by:

[3] Commerce Commission, *Submission on the Telecommunications (New Regulatory Framework) Amendment Bill*, 2 February 2018 (paragraph 29).
[4] Commerce Commission, *2023 Telecommunications Monitoring Report*, p.51.
[5] https://www.oecd.org/en/topics/sub-issues/broadband-statistics.html
[6] Commerce Commission, *2023 Telecommunications Monitoring Report*, p. 65.

a. like-for-like services;[7]

b. the 'chain of substitution' that arises from the pricing of higher speed services being constrained by the pricing of lower speed services (discussed below); and

c. the threat that higher prices will lead to further entry and expansion by competing network providers – particularly FWA providers (predominantly mobile network owners (MNOs)).

49. We discuss the level of competition applying to different FFLAS services in the next section of this submission.

Scope for exercise of substantial market power

50. In the draft decision paper, the Commission says it 'deem[s] that a business has SMP when its actions are not effectively constrained by competition. For example, a business with SMP can profitably hold prices above competitive levels for a sustained period of time'[8].

51. Given this, it is surprising the Commission's analysis excludes any assessment of actual pricing behaviour by Chorus and the local fibre companies (LFCs),[9] which is an essential part of any SMP assessment.[10]

52. As the Commission is aware, Chorus' revenues over the first regulatory period (PQP1) have been below the level necessary to earn a normal return on FFLAS investments, and below the maximum level of revenue we were permitted by the Commission to recover. Similarly, we expect our revenues over the second regulatory period (PQP2) to also be below the level necessary to recover our MAR. We have also not priced up to the anchor service price cap during PQP1.

53. For PQP2, Chorus proposed (and the Commission accepted) a plan to apply an alternative depreciation profile to core fibre assets to avoid building up an excessive wash-up balance. This is not the behaviour that would be expected of a firm with SMP, which would normally price up to the maximum level allowed by the regulator immediately. We believe this pricing approach clearly demonstrates Chorus' pricing is constrained by competition. That of itself provides reasonable grounds to carry out a deregulation review.[11]

54. The draft decision is focused on the Part 6 framework, while failing to acknowledge that Chorus is also subject to additional regulatory constraints which limit its ability to exercise SMP. The methodology the Commission adopts is ad hoc, static, and not commonly understood as a test for SMP.

55. The draft decision also fails to consider the effect of other regulatory controls that apply to Chorus and which would mitigate any potential SMP. The business line

[7] The Commission itself accepts (for example) that, in urban areas, FWA services are a credible alternative for households with lower data speeds. Commerce Commission, *2023 Telecommunications Monitoring Report*, p. 6.
[8] Paragraph 2.48, draft decision.
[9] Northpower, Tuatahi First Fibre and Enable Networks.
[10] The list of evidence considered in paragraph 2.56 excludes any assessment of Chorus or LFC profitability or pricing decisions.
[11] In some circumstances it could be argued the prevailing price is only influenced by market fundamentals, and not determined by them. In such cases the prevailing price could be at a level higher than where it would otherwise be if determined by regulation. This is not the case for Chorus as the market price of FFLAS services is demonstrably below the price that would meet the regulatory revenue cap and thus the price set by regulation is higher than the market price.

restrictions and non-discrimination rules would continue to apply even were Part 6 regulation to be reduced.

56. Meanwhile, Chorus is subject to both PQ regulation and price caps on anchor products. There is no apparent reason why both these forms of regulation should apply, when only one of these remedies should be sufficient to constrain Chorus in the event the Commission concludes that Chorus has SMP.

Figure 1: Regulations applied to Chorus within the Telecommunications Act 2001

Telecommunications Act 2001	Part 2	Part 2A	Part 4AA	Part 6
Part heading	Designated and specified services (2006)	Structural separation of Telecom (2011)	Networks developed with Crown funding (2011)	Fibre fixed line access services (2018)
Regulated network	Copper	Copper + Fibre	FTTP	Fibre
Key obligations	• Price regulation (designated) • Non-price (specified) • Non-discrimination and equivalence.	• No retail supply • No end to end services (terminate at PoI) • No services above layer 2 (UFB FTTP only)	• Non-discrimination and equivalence (if own-supply)	• PQ and ID in UFB areas (ID only in other areas) • Revenue control • Anchor service price regulation (Voice and bitstream) • Geographically uniform pricing

Cost-benefit analysis

57. The draft decision does not attempt to carry out a cost (of regulation) benefit (to end users) evaluation. The draft decision makes no assessment of, for example, increased incentives for fixed wireless access (FWA) providers to innovate and invest if deregulation were to occur. Nor does it consider that FFLAS providers would be empowered to compete more effectively – in terms of both price and quality (i.e. innovation) – in the absence of PQ regulation. For example, it is challenging to secure regulatory approval for innovation investments,[12] and the opportunity cost of regulation is that it distracts board and management time towards compliance rather than growth and customer-focused initiatives.

58. Ultimately, however, the Commission has not carried out a proper cost-benefit analysis because it does not have good information on the costs or benefits of the current regulations. A deregulation review is needed to gather this data and support an informed decision.

No utilisation of information provided under Part 6

59. The Commission's selection of evidence for the reasonable grounds review also implies there is limited value from the existing regime. The evidence it considered does not include information provided under Part 6 – for example there is no analysis of the profitability information disclosed under ID, nor analysis of pricing activity disclosed in schedule 24 of ID and in price compliance and wash-up statements under PQ

[12] The PQP2 expenditure decision did not even respond to Chorus' recommendation as part of our PQP2 proposal for an innovation allowance fund, to support suitably-justified innovation investments by Chorus.

regulation. If such information is not informative for the purpose of this (reasonable grounds) exercise, that in itself calls into question the value of the existing regulations.

Draft decisions on the assessment of reasonable grounds

60. The Commission's economic framework does not properly account for the complexity and changing nature of markets for FFLAS.

61. In this section, we provide evidence and analysis of the level of competition for FFLAS services. These factors should be considered in more detail as part of a FFLAS deregulation review.

Voice services

62. The Commission finds there is competition in the market for voice services. However, the draft decision is that there are no grounds to carry out a deregulation review due to the Commission's expectations about the cost of implementing deregulation of voice services.

63. We agree with the Commission there is competition in the market for voice services and welcome this conclusion. However, we disagree with the draft decision that, even in this case, there are not reasonable grounds for a deregulation review. The methodology applied to the assessment of retail voice services differs significantly from that applied to other FFLAS services, using a qualitative cost-benefit discussion that is not applied to the other services.

64. The draft decision implies that if the cost of deregulation were high enough, the Commission would never deem it reasonable to deregulate (or even carry out a deregulation review), which creates an unreasonable bias towards the status quo. It would mean regulation that is clearly no longer fit for purpose may be 'off limits' to any such review by virtue of its removal coming at too high a cost. As the purpose of Part 6 is to regulate services where there is little or no competition – and little or no prospect of competition - to continue to regulate a clearly competitive service under Part 6 seems contrary to the Act.

65. The complexity of Chorus' cost allocation methodology is driven by the input methodologies, which apply a method that was intended to allocate costs between two large business units – copper and fibre. As the Commission is aware, Chorus' copper business is now much smaller. A lower-cost and more simple cost allocation methodology may be more appropriate and would, if in place, mean there were lower cost barriers to deregulating parts of FFLAS. We encourage the Commission to consider opportunities to amend the regulatory settings to support deregulation, rather than retain without question such a complex and costly set of regulations that they make deregulation undesirable even where it is clearly justified.

Bitstream PON services

66. We agree that the relevant market for Bitstream PON comprises point to multi-point wholesale services which can be used to offer retail broadband services to customers. As described in the Frontier report there is a chain of substitution effect between lower

and higher speed broadband services, which means these services act as a constraint on each other, irrespective of how the market is defined.

67. We strongly disagree with the draft decision that there are no reasonable grounds to start a deregulation review of Bitstream PON services. The chain of substitution effect means that FWA pricing provides a competitive constraint on fibre pricing (and we agree with the Commission that this constraint will strengthen as the 5G roll out continues).

Competitive constraints on Bitstream PON services

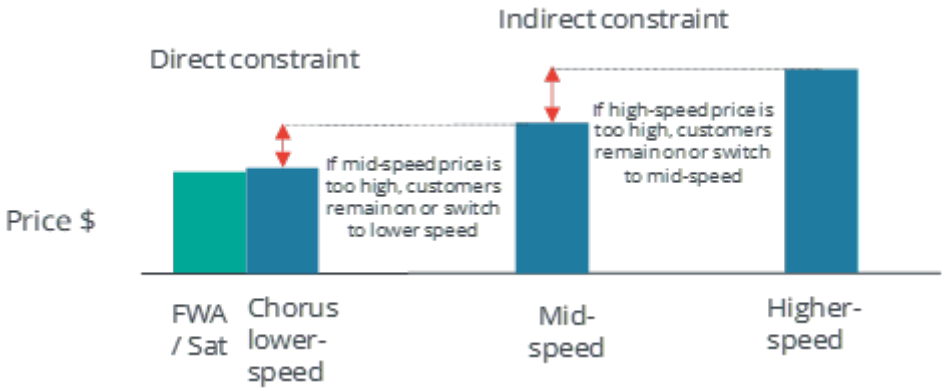
68. In competition analysis, a commonly accepted test of the level of SMP is the small but significant and non-transitory increase in price (SSNIP) test. The SSNIP test is used to define the market in question in a consistent and well-understood way. The test is designed to identify the smallest relevant market, within which a market participant could implement a profitable (small but significant) increase in price.

69. The SSNIP test can be used to determine the nature of competitive constraints in a market with overlapping, substitutable goods. The test captures the idea that if a market participant is able to profitably raise prices for a group of products (or geographic area), then that group (or area) constitutes a relevant market since there is insufficient competitive pressure from outside products (or areas).

70. In market definition exercises, a common assumption is that where the products of several adjacent firms are substitutable – forming what is known as a 'chain of substitution' – the products are able to form a single market. A chain of substitution effect may therefore enable two products – that do not constrain each other directly – to be included in the same market. The concept of a chain of substitution in the context of market definition is well understood and widely employed in international precedent and guidelines, including European market definition guidelines.

71. The chain of substitution effect in the context of the market for Bitstream PON services can be illustrated as follows:

Figure 2: The chain of substitution[13]



72. For example, if an increase in the price of Chorus' 300Mbps product resulted in lower profits due to customers switching to alternative products then the relevant SSNIP test would determine this product is competitively constrained. Table 1 at Appendix A

[13] Frontier Economics, *Reasonable grounds analysis*, 23 September 2024.

illustrates the required cross-price elasticities in order for Chorus' products to be constrained - i.e. how many customers need to be willing to switch in response to a small but significant and non-transitory price increase in order for it not to be profitable. A cross-price elasticity of 5 means that for a 1% increase in price of good A, the quantity demanded of good B will increase by 5%.

73. Table 2 at Appendix A illustrates our estimated cross-price elasticities based on analysis of our customer and pricing data. Further, more detailed, analysis is required in order to accurately determine the level and nature of competition in FFLAS. Such analysis should include the collection of data from retail service providers (RSPs) regarding the level and nature of pricing and switching behaviour.

74. The tables at Appendix A show that Chorus' estimated cross-price elasticities are within or close to the minimum range required to constrain prices. We strongly suggest the Commission should replicate this analysis with regard to FWA – with a complete data set – in order to determine the extent to which such services adequately constrain fibre services. We provide further supporting evidence at Appendix B.

Response to draft decision assessment of Bitstream PON services

75. The Commission notes that the market share of fibre broadband within each of the regulated providers' network boundaries is 75% or higher. High market shares - in and of themselves - do not necessarily indicate a firm has market power.[14]

76. The Commission also states: '*… fibre and FWA connections are both rising, seemingly at the expense of copper and HFC connections'*. This would imply fibre and FWA are competing with each other for copper and HFC connections, which is correct. However, the Commission does not acknowledge that FWA may be seeking to win customers from fibre, and vice versa – the evidence we provided on churn from FFLAS to competing services in our cross-submission on the assessment framework consultation[15] is not reflected in the draft decision. The Commission should carry out more detailed analysis to determine the level of competition between FWA and fibre services. This should include, but not be limited to, requesting connection and pricing information from RSPs, given the provision of retail broadband services to customers is the interaction where supply and demand behaviour is most accurately assessed.

77. The Commission asserts:

> *…while prices of alternatives may appear comparable, often non-price performance characteristics do not compare well to the fibre plans. For example, 4G FWA plans are similarly priced to Fibre 50 plans, but offer slower speeds and worse latency, and while HFC compares favourably to Fibre Max on price and download speed, it suffers a much lower upload speed.*[16]

78. This statement assumes consumers are using the retail broadband service to the extent of its speed and latency limits, and that these consumers do not readily compare their chosen service with others, at different price points. It also assumes customers do not trade off price versus quality when considering which product serves their purposes best. This is not how the retail broadband market functions in practice.

[14] Commerce Commission, *Market study into the retail grocery sector: final report*, 8 March 2022, footnote 437.
[15] Chorus, *Draft assessment framework for fibre deregulation review: Cross-submission*, 22 March 2024, Appendix.
[16] Paragraph 3.91, draft decision.

79. The Commission's analysis also overlooks the reality of New Zealand's broadband market structure. The three largest retailers of fibre are also vertically integrated FWA providers and have strong commercial incentives to promote FWA over fibre. As the retailers are the parties with direct relationships with customers and have the best understanding of customers' usage profiles, they are well placed to market FWA effectively to customers. This means the customers will not be making decisions based solely on the technical characteristics of the different products.

80. Chorus' pricing strategy is based on the effect of wholesale prices at the margin, not on the broader subset of customers for whom 4G, 5G, satellite or alternative fixed line services may not be a close substitute.

81. While retail broadband plans can be described as discrete, from a product perspective, they form part of a matrix of speed, performance and price considerations at an individual customer level. The suggestion '*For example, 4G FWA plans are similarly priced to Fibre 50 plans, but offer slower speeds and worse latency, and while HFC compares favourably to Fibre Max on price and download speed, it suffers a much lower upload speed'* is only relevant if the services are considered in isolation, at a single point in time, and not in comparison with other products, across time.

82. The Commission makes multiple statements regarding the ability of mobile networks to compete with fibre services by way of 4G and 5G FWA services.[17] While this acknowledges the competitive nature of FWA services, it does not consider what a sufficient level of switching is (or would be in the future) in order to trigger reconsideration of the scope of the current regulatory framework, nor does it take into account potential changes in market behaviour that could result in increased demand for FWA services.

83. The Commission seems to assume that FWA providers would need to be able to accommodate all or most customers currently on fibre before FWA could become a competitive constraint on fibre pricing. As we show in the chain of substitution analysis above, this is incorrect.

84. The Commission notes, based on its own data, a FWA urban market share of 14.3% as at June 2023. This seems low. Market data we have indicates a national FWA market share of **CCI [ ]** as at June 2024, with **CCI [ ]** FWA connections across New Zealand at that date.

Other services

85. The Commission's draft decision is that there are no reasonable grounds to start a deregulation review of Point-to-point, unbundled PON, transport, connection or colocation and interconnected services. We disagree with the draft decision. There are clear grounds to consider deregulation of these services.

86. These services are small by comparison to the primary FFLAS bitstream service. They represent around **CCI [ ]** of Chorus' FFLAS revenue and would likely not justify the cost of PQ regulation were they to be regulated absent PQ regulation of Bitstream PON.

[17] For example, paragraphs 3.100 – 3.101 of the draft decision.

87. The Commission's analysis of the level of competition and grounds for deregulation review of these services is flawed and overlooks critical facts. We outline key points for each service below.

Point-to-point services

88. The Commission identifies that alternative point-to-point fibre services are offered commercially in New Zealand. The Commission presupposes – apparently without supporting evidence – that '*regulated providers still hold significant market shares (via the regulated wholesale services), limiting the effectiveness of any alternatives to provide a genuine competitive constraint*'.[18]

89. The fact that alternative services are active in the point-to-point fibre market should be sufficient to warrant further analysis by way of a deregulation review to determine whether the level of competition in the market is sufficient to justify deregulation. The draft decision identifies only four non-LFC participants in this market. However, this is incorrect and there is an increasing level of competition in the point-to-point market, including the participants denoted in Appendix C (many more than were noted in the draft decision).

Connection services

90. The Commission notes it is possible that competition could exist in the market for connection services and that third parties could compete with LFCs. It reports having '*heard anecdotally that there have been some attempts by third parties to do this for new developments*'.[19] Despite this, the Commission sees '*no evidence that competition exists or provides any competitive constraints on the providers of Connection services*'.[20]

91. The Commission's information is out of date and inaccurate. There is strong competition for fibre connection services in new property developments (as distinct from connection services more generally), where players include LFCs and third-party fibre providers. Contrary to the assertions in the draft decision paper, there is also competition between LFCs for greenfield connections, where we have seen examples of another LFC competing for greenfield contracts within Chorus UFB areas and we have competed for NPD contracts in other LFC areas. We set our NPD pricing to reflect competitive market conditions.

92. Our records (previously provided to the Commission) indicate that, for ~200 greenfield projects between July 2022 and November 2023, we were aware of a competing provider in 64 cases. We expect there would have been competing providers in other projects as well, even if we were not directly aware of the competing bid.

93. The fact that alternative providers are active in the market for connection services should be sufficient to warrant further analysis by way of a deregulation review to determine whether the level of competition in the market is sufficient to justify deregulation. We note an increasing level of competition in connection services, including the participants listed at Appendix C.

[18] Paragraph 3.126, draft decision.
[19] Paragraph 3.200, draft decision.
[20] Paragraph 3.202, draft decision.

Transport services: Commission's draft decision

94. The draft decision that there are no reasonable grounds to deregulate transport services is based on an incorrect assessment of the market.

95. The Commission discusses only ICABS and mobile access services. It does not consider commercial backhaul or CXC services, some of which are defined as FFLAS and which face strong competition from competing networks in the main geographic centres. Many of the P2P service providers listed above also provide transport services in competition with Chorus. A deregulation review would be able to consider the extent of competition properly across each transport service.

96. The Commission's reliance on the 2019 backhaul study to determine there is limited competition for ICABS is unjustified, especially as the Commission gathers such data on an annual basis. The study is clearly out of date and a deregulation review would determine whether the prior conclusion remains valid. The conclusion that 90% of ICABS links are not competitive is also unlikely to be representative. The links which are competitive will generally be those serving the largest number of connections; hence on a per-connection basis the proportion of competitive ICABS links is likely to be much higher. A deregulation review could assess this information.

97. For mobile access, the Commission itself notes the extensive fibre network operated by One NZ.[21] MNOs already deploy fibre to their own mobile tower sites in many instances and would be able to supply more such sites were Chorus' prices deemed to be too high.

Transport services: complexity of overlapping regulations

98. The Commission's draft decision for transport services also does not engage with the complexity and commercial implications of the current regulatory settings, including the interplay of Part 6 regulation with non-discrimination requirements and Business Line Restrictions. The complexity and difficulty of these overlapping regimes is in fact impeding competition in the market for transport products. This in itself should be grounds for a fibre deregulation review of transport services. We provide further information in support of this point at Appendix D.

99. The cost and complexity of these regulatory settings are disproportionate to the risk the regulations were intended to address and cannot have been intended by the creators of the regulations. We encourage the Commission to carry out a Part 6 deregulation review so it can consider the case for reducing at least the Part 6 elements of this regulatory burden, and promote competition for transport services.

Unbundled PON services

100. For unbundled PON, the fundamental issue is that there is very little demand for the product and we are not aware of any likely material future uptake. The draft decision paper reports that no RSP has ever taken up unbundled PON services from Tuatahi First Fibre or Enable. Chorus has only one customer of our unbundled PON service and the uptake is extremely low. This is unsurprising given current market

[21] Draft decision, paragraph 3.171.

dynamics. We refer the Commission to the findings of an expert report from Skeens McDonell we have previously provided to the Commission:[22]

> *"The intent of the PONFAS service offering was to allow third parties, via their Layer 1 control of the actual fiber strands, to provide differentiated services beyond the typical PON broadband tiers that are available via the Bitstream offering…*
>
> *There was a day when control of the PHY layer of the network (Layer 1) would have been necessary for such service differentiation…*
>
> *Since such feature rich services can now be performed largely via software platforms and cloud-based services, the need for specialized hardware (i.e., more custom PON solutions) has been greatly diminished, and we believe that is why you do not see service providers around the world offering a Layer 1 type model, as exemplified by PONFAS. Our observation is that the lack of unbundler participation at Layer 1 does not reflect any flaw in the Layer 1 PONFAS design or any unfair advantage held by the incumbent, but rather reflects that it is easier and less risky for Access Seekers to participate at Layer 2, especially as recent developments (which may post-date original consideration of PONFAS) have increased service differentiation at Layer 2."*

101. Given the service is not being taken up at any significant scale, there does not seem to be any benefit derived from ongoing regulation of unbundled PON. When regulation was put in place there was an assumption that competition would emerge at the input level, however this has not eventuated – our understanding is that this is largely because it is easier for RSPs to compete at Layer 2, where they can avoid the risk and cost of investing in Layer 1 inputs.

Co-location and interconnected services

102. The Commission's draft decision concludes there is no competition for co-location services on the grounds that competitors are not able to build space in LFC exchanges. However, LFCs are not the only parties that own exchange space. MNOs also own exchanges and offer co-location products. We suggest the competitive picture for co-location is not as straightforward as is stated in the draft decision and should be considered further through a deregulation review.

Timing of the deregulation review

103. The clear intention of the Act is for the Commission to consider the appropriate scope of FFLAS regulation ahead of each regulatory period so that any revised scope can take effect for the upcoming regulatory period. The legislation requires the Commission to consider deregulation "before the start of each regulatory period".

104. Our interpretation is also supported by the Cabinet papers through which the government set out the regulatory framework that was subsequently codified in the new Part 6 of the Act. The Cabinet paper on Final Policy Decisions for Fixed Line Communications Services sets out that the Cabinet:

[22] SkeensMcDonell, *Engineering and Industry Based Evaluation and Opinion for Chorus Limited*, 16 February 2023, page 16.

Agree that the Commission regularly review whether competition has emerged for a service, market, asset or geographic location and deregulate regulated suppliers accordingly. This review is to be done prior to each regulatory period (except the first).

105. The scope of FFLAS regulation for an upcoming regulatory period is fundamental to the PQ path setting exercise. It would be highly inefficient for Chorus to develop - and the Commission to review - an expenditure proposal relating to services that are then deregulated before the PQ period starts.

106. Regrettably, the current reasonable grounds assessment has come too late to inform the decisions for PQP2. However, it is imperative that the Commission carries out a deregulation review well in advance of PQP3, in order to give time for the outcomes of this review to inform PQP3 decision-making processes.

107. In terms of the timing of a deregulation review, we note the impacts of rapidly evolving factors – including the wind-down of Chorus' copper network and evolving 5G technologies – will likely become clearer over the next 2 – 3 years. A deregulation review that was concluded before 2027 would likely benefit from this information while still being concluded sufficiently far in advance of PQP3.

Current settings create inconsistent regulatory landscape

108. While the extent to which Chorus has SMP is yet to be determined, Chorus inarguably faces more competition than the energy infrastructure businesses subject to regulation under Part 4 of the Commerce Act. The current regulatory settings do not reflect this.

109. Chorus is the only regulated business (aside from Transpower) required to submit detailed expenditure proposals each regulatory period. In addition to standard PQ regulation, Chorus is also subject to anchor service regulation, geographically consistent pricing regulation and other requirements that were set at the time of demerger from Telecom. These restrictions do not apply to the natural monopoly energy network owners.

110. Auckland Airport, which is under ID-only regulation has a market share of international passenger air travel to and from New Zealand of 77%,[23] as well as a monopoly on domestic passenger air travel to and from Auckland.

111. There is no valid policy or economic rationale to regulate Chorus more heavily than these Part 4-regulated entities. Transpower, Auckland Airport, the EDBs and the GPBs also provide essential services and face less competition than Chorus, but have fewer regulatory constraints.

112. Similarly, there is no valid policy or economic rationale to regulate Chorus more heavily than the other LFCs. The other LFCs were subject to ID-only regulation on the grounds that Chorus' copper network would provide a degree of competition. This is no longer a credible position – 5% of connections in LFC areas are copper. This number is

[23] Based on international passengers in 2023 across Auckland, Christchurch, Wellington and Queenstown Airports. Source: airport information disclosures.

declining rapidly, and we intend to move all customers in LFC areas off copper by 2026. It is surprising this point was not addressed in the draft decision paper.

113. There is especially no reason to continue to apply ID regulation to Chorus in LFC areas where we are not the incumbent provider of FFLAS services and have a small market share. We recommended the removal of ID-regulation for Chorus in LFC areas in our previous submission, but this has not been acknowledged nor responded to in the draft decision.

114. The Commission's draft decision demonstrates a 'status quo' bias where the aim seems to be to justify retention of the current settings without considering whether they are credible or consistent. We encourage the Commission to support coherent and proportionate levels of regulation across all the sectors that it regulates.

115. These points are not intended to provide an evidentiary foundation for our proposed regulatory framework. Rather they support the argument that reasonable grounds exist to justify the initiation of a review, because there are obvious inconsistencies in the way various regulated sectors are treated.

Regulatory regime should be reassessed

116. Based on the information currently available Chorus believes the most appropriate outcome from a deregulation review would be to:[24]

a. remove PQ regulation from Chorus, such that it is subject to ID regulation only in Chorus' UFB and non-LFC areas (potentially with ancillary regulatory mechanisms where appropriate);

b. remove ID from Chorus in other LFC areas.

117. Given the analysis presented above, it is clear that PQ regulation can no longer be justified, given the competitive environment Chorus operates in and the fact that:

a. competition – via chain of substitution – between lower and higher speed products constrains Chorus' pricing effectively;

b. the revenue cap does not determine Chorus' pricing decisions for Bitstream PON services, which are instead driven by market competition;

c. voice services are competitive; and

d. other services are smaller scale, would not bear the costs of PQ regulation on their own, and are increasingly competitive themselves.

118. It is no longer appropriate for Chorus to bear the costs of PQ regulation, impeding our ability to compete with vertically-integrated competitors. Chorus faces effective competition for wholesale broadband services from FWA. The application of revenue caps through PQ regulation – and price caps on anchor products – are unnecessary and impose an undue regulatory burden on Chorus. Removing PQ regulation would

[24] We believe it is helpful to specify this view now given verbal feedback from the Commission that it wants to understand what stakeholders consider to be the appropriate outcome of a deregulation review. However, the first step should be to confirm there are reasonable grounds to carry out a deregulation review – that decision should be based on the available information.

also remove many of the barriers currently faced by Chorus in seeking to provide transport services to our customers.

119. ID regulation for Chorus FFLAS is proportionate, appropriate and would adequately mitigate any potential risk. It provides clear information that can be publicly scrutinised to give assurance to customers that pricing is not producing excessive returns and service quality remains acceptable. The threat of 're-regulation' would exist if excess returns were to be earned, and Chorus would be very conscious of this fact when making pricing decisions.

Appendix A

Table 1

Price increase	Scenario	Implied cross-price elasticity to be constrained by FWA	Implied cross-price elasticity to be constrained by other Chorus product
Increase 1Gb price 5%	Lost customers move to 300mbps	**CCI [ ]**	**CCI [ ]**
Increase 300Mbps price 5%	Lost customers move to FWA	**CCI [ ]**	**CCI [ ]**
Increase 300Mbps price 5%	Half of lost customers go to FWA, half go to HFS	**CCI [ ]**	**CCI [ ]**
Increase 300Mbps price 5%	80% of lost customers go to FWA, 20% go to HFS	**CCI [ ]**	**CCI [ ]**
Increase 300Mbps price 5%	Lost customers go to HFS	**CCI [ ]**	**CCI [ ]**
Increase HFS price 5%	Lost customers move to FWA	**CCI [ ]**	**CCI [ ]**

Table 2

Product substitution	Required cross-price elasticity to constrain price	Estimated cross-price elasticity
HFS to FWA	**CCI [ ]**	**CCI [ ]**
300Mbps to HFS	**CCI [ ]**	**CCI [ ]**
300Mbps to FWA	**CCI [ ]**	**CCI [ ]**
1Gb to 300Mbps	**CCI]**	**CCI [ ]**

Appendix B

CCI [

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Appendix C

List of point-to-point providers

a. Vector (Auckland and now Waikato)
b. Kordia
c. Network Tasman
d. Vital (Auckland (Citylink Network) and Wellington (Citylink Network))
e. 2degrees (FX network)
f. Electricity Ashburton
g. One NZ
h. Tai Tokerau Cable
i. Spark
j. InspireNet
k. VelocityNet
l. Transpower
m. PowerCo

List of connection service providers

a. Tuatahi First Fibre / Unison Fibre
b. Enable
c. Northpower
d. Network Tasman
e. Electricity Ashburton
f. Infrastructure Solutions (ISNZ)
g. Liverton
h. Freedom Internet
i. VelocityNet / YRLESS / FastComm

Appendix D

Supporting evidence with regard to transport products

1. The complexity is created because transport products may be caught by any or just one of the regulatory regimes that apply to Chorus. Some but not all transport (backhaul) products are FFLAS, and one product is sometimes FFLAS and sometimes not FFLAS (depending on whether a copper exemption applies).

2. It can be resource intensive just to identify the different regulation that applies to a particular scenario. **CCI [**

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4. While it is usually possible to structure a deal to accommodate these restrictions, it is difficult to do so in a way that is commercially attractive and fast. Competitors can be more flexible with their bids – for example they can more quickly adjust pricing on links that are competitive. This means we are unable to compete properly in many instances, making the market for transport services less competitive than it could and should be, and likely driving up prices for customers of transport services.

5. Geographically consistent pricing also means that we cannot necessarily offer a transport product in a way that reflects its true cost, especially where the cost to serve a particular location is above the current average cost-to-serve. This either:

    a. limits our ability to roll out products throughout the country, especially if products are developed for urban demand that is relatively low-cost to serve; or

    b. makes our product uncompetitive in urban areas (where the strongest competition is) because we are required to average the cost over the country.

6. **CCI**

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