

17 February 2019

*Ms Vanessa Howell*  
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Regulation Branch  
Commerce Commission  
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Dear Vanessa,

### **Fibre Input Methodologies Draft Decision Cross-Submission**

1. In this cross-submission we address only matters raised by parties which warrant further comment to ensure the Commission has thorough stakeholder feedback on the matter.

#### *Service definitions*

2. The Chorus submission notes the Commission has responsibility for regulating access services – which have the characteristics of an enduring bottleneck in the context of current technical and economic circumstances.
  3. Having appropriate service specification is an important part of the regulatory framework. We agree with Chorus that targeting bottleneck services should be the primary focus of FFLAS. This has been a consistent feature of telecommunications regulation of ensuring equitable, consistent and efficient access to regulated network inputs. In this regard, the enduring bottleneck telecommunications services are the layer 1 customer access network service inputs.
  4. The current terms for Chorus' new layer 1 PONFAS service violate its own construct for economic regulation. The Chorus/LFC PONFAS service description bundles and charges for two service elements into a single service offering. This appears to breach the requirements of the UFB Network Infrastructure Participation Agreements (NIPA) which list the subsequent services required to be provided from 1 January 2020. The PONFAS service description forces access seekers to acquire both a feeder fibre service and distribution fibre service.
  5. The service terms for PONFAS derogate from the telecommunications construct of having each service element severable and acquired separately for an access seeker to complete their offering.
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6. Forcing access seekers to acquire the feeder fibre service limits the opportunity for efficient access where this additional service element is not necessary to complete their telecommunications offering.
7. Further, the requirement for access seekers to have an in-tact feeder fibre before being able to order a distribution fibre service to provision a customer significantly undermines the usability of the service. These service terms are in effect uncommercial and result in an unmanageable customer experience. This is contrary to the expectations of unbundled access which is intended to allow more control of service elements and greater management of the customer experience.
8. We consider FFLAS service descriptions should result in a suite of regulated access services that provide certainty to Chorus and LFCs about their obligations for delivering fair and reasonable service definitions. We do not believe Chorus and LFCs should be unfettered in their obligation to define regulated FFLAS.

*Points of interconnect decision/handover points*

9. Vector recommends the Commission have an active role in defining terms for access at handover/aggregation points. Defining network handover/aggregation points is part of the Commission's role in administering Part 6 of the Telecommunications Act. Without a clear Commission role in defining network handover Chorus/LFCs will frustrate access with technical specification inconsistent with the expectations of the Act.
10. Chorus expressed its dissatisfaction with the Commission's Points of Interconnect (POI) decision not to specify layer 1 points of interconnection. We also believe the Commission erred in its POI decision by noting that it will not specify layer 1 handover points for the PONFAS FFLAS service. Instead, the Commission has suggested it will allow aggregation/handover points to be defined by LFCs themselves in their Reference Offers for PONFAS.
11. Vector consider the requirements under section 231 should not be narrowly defined to define the outer limit of the regulated network. They should also define how service handover should be provided for different FFLAS services including those that can be connected at points closer to the end-user. This reflects the technical nature of handovers. We believe that this was what the Economic Development, Science and Innovation Select Committee had in mind for the Commission when it included the power under subpart 10

of Part 6. Accordingly, we believe there is a requirement for the Commission to specify handover connection points for layer 1 access services to ensure they are provided on terms consistent with the purpose of Part 6.

12. We agree with the Commission that a network handover point captures aggregation points closer to the end-user premises such as an active cabinet or building where layer 1 services could be offered. However, we disagree with the Commission that layer 1 handover points should be excluded from the POI process. The Commission's responsibility is to ensure handovers enable the efficient use of infrastructure in a way that enhances the competitive process and limit technical foreclosure.
13. Accordingly, the Commission's decision to allow Chorus/LFCs to specify the locations and terms for layer 1 handover for PONFAS appears to derogate from the requirements of Part 6 of the Act.
14. The Commission's approach for PONFAS layer 1 handover term is a marked contrast to how unbundled access was enabled for Telecom's customer access network where locations and technical features of the handover were described in detail in standard terms determination documents. It is also a marked departure from the approach being adopted by the Commission and Electricity Authority in their open access project for electricity networks where extensive consultation is being undertaken to amend the Electricity Industry Participation Code for standardised access.
15. We consider layer 1 handover points of PONFAS should be defined to allow connection at all aggregation points. However, we have little confidence Chorus/LFCs will offer services at aggregation points on reasonable terms or at all. We encourage the Commission to adopt a consistent approach for open access across regulated sectors as the current fragmentation to decisions provides very little confidence for stakeholders.

#### *Quality IM*

16. Several submissions highlighted the importance of a clearly defined quality framework for FFLAS services. Given the high interest and concern around the quality framework we see even more merit with the Commission convening a workshop for the Quality IM. The technical nature of FFLAS will create opportunities for Chorus/LFCs to limit service quality to the detriment of access seekers and end-users.

17. The technical nature of telecommunications services means the critical dimensions of the service may require iteration which should be supported by the regulatory framework. Submissions pointed to the TCF Product Forum as a vehicle for implementing orderly change to service quality metrics. We support the TCF Product Forum or similar vehicle where industry input can be exchanged for adapting regulated service terms.
18. The layer 2 WSA took a significant period for service providers to negotiate and iterate with Crown Fibre Holdings and LFCs. Indeed, the commencement of UFB was marked by a period where RSPs refused to sign onto the network given the original non-price terms of the agreement were unacceptable. This was despite the assurance provided by rate-card pricing.
19. Accordingly, we support a more rigorous process for new layer 1 FFLAS services where both non-price and price terms are being offered for the first time and the opportunity for negotiation is much more limited than with the layer 2 bitstream services.
20. We support the Quality IM being supported by meaningful information collected as part of the Information Disclosure regime as suggested by Vodafone. We also agree with the Vodafone suggestion that IMs for Price Quality and ID need to apply to all FFLAS services including layer 1 unbundling. Therefore, information which suggests that layer 1 services are not reaching their full potential needs to be systematically collected by the Commission and reported on regularly.
21. A well-informed quality regime is especially important for new FFLAS services such as layer 1 PONFAS. Consistent information reporting will ensure concerns around layer 1 access can be managed. This includes information on co-location space (or exchanges declared full), provisioning times for layer 1 services, availability of facilities and layer 1 service take up relative to layer 2 services in operation. There is industry need for this information being collected and published on a more frequent basis than annually.

#### *WACC – TAMRP*

22. We note two lobby groups the Major Energy Users Group (MEUG) and Board of Airlines of New Zealand (BARNZ) have both suggested the tax adjusted equity market premium (TAMRP) for the cost of equity portion of WACC should be set on the estimated value and not using the rounding recommended by the Commission's expert. Their recommendation focuses on using the median of the five different estimates.

23. Both submissions acknowledge there is difficulty with estimating the TAMRP to precision. Neither submission considers the very different methods in the sample used to determine the TAMRP. Given the cost of equity is assumed to be over half of funding in the benchmark WACC then it is especially important for the Commission not to underestimate the expected commercial equity return.
24. Rather, as discussed in our original submission, the models used by the Commission to estimate the TAMRP suffer from being inextricably linked to the prevailing risk-free-rate. For example, the Commission itself acknowledges the key underpinning of Siegel 1 (one of the five TAMRP methods used by the Commission) is the assumed long-term real risk-free rate. The Competition Economics Group (CEG), in a report for Vector, in 2019 highlighted Siegel 1 presumes NZGB investors have a long-run 3.5% real return expectation. This assumption failed to hold in 2019 when real returns for NZGB were negative for a significant portion of the year. This included the period used by the Commission to observe the risk-free rate for the five-year WACC for the EDB 2020-2025 regulatory control period.
25. The Commission may get fixated on making more regular changes to its TAMRP for changes to its median estimate as suggested by BARNZ and MEUG, but this masks the real issue with the TAMRP. The real concern with the TAMRP is there are situations where the assumptions in the estimates for the TAMRP are invalidated. This is particularly relevant for a hardcoded TAMRP in the IMs. When this is the case it will involve a WACC being set that is misaligned with the return on equity expected by commercial investors.
26. CEG highlighted the overwhelming response of economic regulators in Europe and the United States when faced with low risk-free rates (delivering negative real returns) is not to pass through such rates in the return-on-equity estimate.
27. Therefore, Vector considers the more important issue for the TAMRP is to ensure it continues to provide a reasonable expectation for equity returns. This should involve the Commission articulating when it is necessary to review the hardcoded parameter. Having the parameter hardcoded does risk having a market environment misaligned with the expected return on equity.

#### *WACC – Cost of debt*

28. Our submission to the Draft Decision noted the cost of debt WACC methodology requires an artificial debt hedging strategy specifically linked to the Commission's regulatory construct. This is in marked contrast to efficient treasury management practices. Firms

typically manage a debt portfolio using a range of instruments of different maturities. Several regulators have recognised this and set their cost of debt using a portfolio approach for the cost of debt.

29. In this regard, Atlas Infrastructure noted in their submission the Fibre IMs Draft Decision would derive a benchmark cost of debt for Chorus of 2.92% which compares to Chorus' actual debt costs of 5.75%. Atlas Infrastructure noted that even with the two years until the first regulatory control period in 2022 – it is unlikely Chorus would be able to move its cost of debt down to the levels assumed by the Fibre IMs Draft Decision. The significant delta between the Commission's assumed cost of debt and Chorus' actual debt costs highlights the perverseness of the Commission's cost of debt assumptions and the inconsistency of the approach with typically efficient treasury management practice.

#### *Conclusion*

30. We welcome the opportunity to discuss the matters raised in this cross-submission with the Commission. We also encourage the Commission to consider the use of industry workshop/discussions on matters it wishes to seek further input on. Given the complex nature of the task of developing the new telecommunications regulatory framework – it is important that contentious issues are resolved with the fullest use of available information.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Shirley', written in a cursive style.

**Michael Shirley**  
GM Vector Communications