Vodafone Aotearoa' submission on incentive payments as part of fibre price-quality decisions on expenditure allowances

13 October 2021

Introduction and summary

1. Nei rā te mihi ki ngā kaimahi o Te Komihana Tauhokohoko, mō te kōwhiringa, a ka taea, kia uruparetia ki te uiuinga e pā ana ki tēnei kaupapa hirahira. Thank you for the opportunity to respond to the consultation on incentive payments as part of fibre price-quality decisions on expenditure allowances.
2. In this submission we continue to make the following points:
    a. Allowing incentive payments as part of capex for the purposes of determining the RAB would enable Chorus to earn monopoly profit by resulting in increased revenue allowance which is in excess of the normal rate of profit.
    b. Accepting Chorus' proposals regarding the treatment of incentives would harm competition and is not in the best interests of consumers.
    c. Chorus' incentives marketing requirements are contrary to non-discrimination obligations.
3. These are points that Vodafone has previously made. We repeat them in this submission because the Commission does not appear to have engaged with them in any meaningful way. Ignoring the significant concerns raised by Vodafone and other retailers regarding the inclusion of Chorus incentive payments within the maximum allowable revenue (MAR) does nothing to support confidence in the Commission's decision making process. We request that the Commission now gives specific consideration to these points and demonstrates how it has done so.

Confidentiality

4. This submission contains no confidential information.

Incentive payments must not increase allowable revenue

5. As covered at length in our last submission[1], Chorus' proposal to include incentive payments in expenditure allowance fundamentally misunderstands the role of forecast allowances. Incentives do not increase the cost of delivering the network services, and therefore must not result in an increase in the revenue allowance.

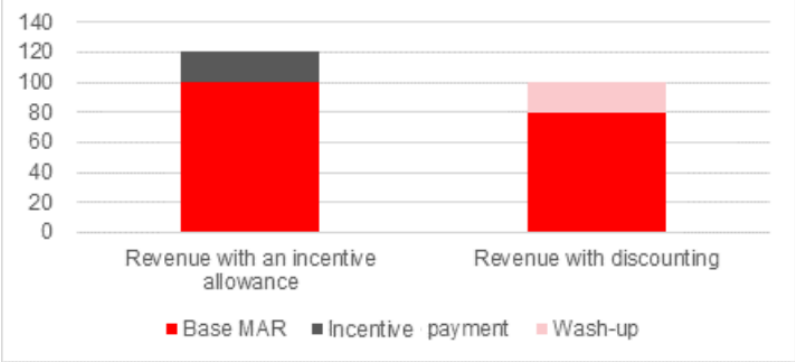
6. As Vodafone has previously argued, the PQ and ID determinations should not allow incentives to operate as 'costless' fibre discounting for Chorus. In a normal market, a rebate or other discount would come off the provider's bottom line. Chorus should not be able to use an incentive structure to create headroom beneath its maximum allowable revenue that can be recouped from captive customers. This would be inconsistent with competition on the merits under s 166 of the Telecommunications Act.

7. The expert report from Frontier Economics[2] (**the Frontier report**), which we provided alongside our last submission, clearly shows that this 'costless' discounting would result in substantial over-recovery of costs by Chorus. Incentive payments are functionally equivalent to a discount, (e.g. Vodafone pays $45 and Chorus gives $3 back as an incentive payment. This is equivalent to Vodafone paying Chorus $42). But incentive payments are obviously discretionary. Chorus alone decides whether to give incentives at all and, if it does, controls both the amount that is paid and the eligibility conditions that apply. The Commission has no ability to control Chorus' future application of incentive payments and cannot reach a decision based simply on assurances about how its incentive payment scheme might operate.

8. It should be expected that we see both an incentive payment and a discount resulting in the same revenue allowance. However, because of the way it has been constructed, that is not the case. The below diagram (Figure 1) demonstrates this. In this scenario, the base MAR is 100, and the incentives and discount are both 20. If the incentives are added to the MAR, then total revenue becomes 120. However, in the case where there is discounting, the MAR remains at 100, but actual revenue is 80. The remaining 20 is captured in the wash-up and can be earned in future years.

[1] https://comcom.govt.nz/__data/assets/pdf_file/0016/262240/Vodafone-Cross-submission-on-Fibre-PQ-draft-decisions-5-August-2021.pdf
[2] https://comcom.govt.nz/__data/assets/pdf_file/0023/262238/Vodafone-Cross-submission-on-Fibre-PQ-draft-decisions-Incentive-payments-5-August-2021.pdf

Figure 1



9. As the Frontier report states, 'If there is a revenue cap, the effects of a simple reduction in price and an incentive payment are different because an incentive payment increases the RAB whereas a reduction on price for the first year of a contract does not. If there is a revenue cap, offering incentive payments enable the provider to earn some monopoly profit.[3]'

10. The diagram in Figure 1 also clearly demonstrates how allowing Chorus to include incentive payments within the MAR would be contrary to the purpose of Part 6 of the Telecommunications Act as it would allow Chorus to thwart the very purpose of the revenue cap, which is to limit its ability to extract excessive profits. We are surprised and concerned that the Commission has not engaged with this point in any serious way.

11. Removing the incentive allowance altogether is key for avoiding an increase in allowable revenue as a result of incentives. Otherwise, a further adjustment to the annual revenue allowance would be required to avoid over-recovery costs.

Potential harms from unconstrained incentives

12. Enabling incentives risks harming competition. Again, while Chorus claims that incentive payments are 'efficient', we have not seen any evidence to support that assertion. In particular, to meet the claim that the payments are efficient, the regulations should not result in the discounts being costless. A level playing field between providers of broadband infrastructure requires that any incentive offered by Chorus to drive fibre demand comes off its bottom line and does not create headroom that Chorus can recoup from captive customers.

13. In their submission to the Commission, Chorus claims that increasing the uptake of fibre through incentives has broader social benefits 'due to the superior performance [of fibre] ...relative to alternatives.' Chorus goes on to state that 'incentives grow these benefits by helping overcome consumer inertia, while pricing restrictions limit monetisation.'[4] We challenge this claim for several reasons, including:

[3] https://comcom.govt.nz/__data/assets/pdf_file/0023/262238/Vodafone-Cross-submission-on-Fibre-PQ-draft-decisions-Incentive-payments-5-August-2021.pdf, p. 7

[4] https://comcom.govt.nz/__data/assets/pdf_file/0026/259352/Chorus-Submission-on-Chorus-price-quality-path-from-1-January-2022-draft-decision-8-July-2021.pdf p. 29

a. There are greater benefits of having diverse set of modern access technologies competing fairly with each other. The Commission appears to support this by emphasising the importance of not favouring a specific technology type when offering consumers alternative telecommunications services and focusing on what is 'best suited to their needs', as emphasised in the Commission's open letter to industry on 4 August 2021[5].

b. To the extent that incentive payments enable an outcome where consumers are offered products for which there is no demand, we believe Chorus' claim that incentives 'help overcome consumer inertia' is not correct. The Frontier report argues that incentive payments are, in fact, 'a form of price discrimination contingent on the length of time a customer has been loyal to a supplier. They arise when markets are characterised by customer inertia – when customer inertia means that customers are more responsive to the prices they have to pay up-front than the prices they may be required to pay in subsequent periods. This form of customer inertia has been observed among the customers for many of the old public utilities, such as electricity, gas and telecoms.'[6]

c. Incentives can also lead to consumers being encouraged to purchase more expensive products than they require, resulting in overpayment for services they don't necessarily need. We note that the Commission has repeatedly expressed concerns about consumers paying for more than they use.[7] In addition, the substantial risk of overselling makes Chorus' proposal inconsistent with the s162 purpose to promote the long-term benefit of end-users in markets for fibre fixed line access services by promoting outcomes that are consistent with outcomes produced in workably competitive markets.

14. The distortionary effects above are exacerbated where an incentive payment scheme results in consumers in different geographic areas being offered fibre services on different terms. We agree with the Commission's Guidance on our intended approach to s 201 of the Telecommunications Act 2001 that incentive payments by Chorus to access seekers form part of the price of a FFLAS service.

15. The Commission states '[w]e would examine closely any evidence of Chorus formulating different services for different parts of the country, particularly where this had the effect of depriving end-users in some parts of the country from an equivalent service at an equivalent price to end-users in other parts of the country.' This ignores the reality that incentives are

[5] https://comcom.govt.nz/__data/assets/pdf_file/0026/260792/Marketing-of-alternative-services-to-consumers-during-copper-and-PSTN-withdrawal-Open-letter-4-August-2021.pdf

[6] https://comcom.govt.nz/__data/assets/pdf_file/0023/262238/Vodafone-Cross-submission-on-Fibre-PQ-draft-decisions-Incentive-payments-5-August-2021.pdf, p. 6

[7] The Commerce Commission open letter on marketing of alternative services to consumers during copper and PSTN withdrawal, 4 August 2021; The Commerce Commission open letter on improving retail service quality for consumers, 29 October 2020

by design likely to prioritise converting customers from other networks to Chorus fibre. This is the whole rationale of the incentive scheme.

16. Furthermore, Chorus' letter to the Commission states that the requirement for RSPs to undertake fibre-focused marketing in order to qualify for incentives 'helps to reduce end-customer confusion about technology choices that can occur when a technology agnostic marketing approach is adopted.[8]' While it may indeed help with consumer awareness of a product they are purchasing, this approach discriminates against RSPs that offer alternative technologies by requiring them to promote fibre products exclusively over and above other alternative access technologies that are available to consumers. It also compels RSPs to avoid any discussion in advertising of the relative merits of different access types. As such, this requirement impacts competition in the telecommunications market, as it harms competition between different access types.

17. This approach is also contrary to the Commission's argument that consumers should be provided with information on *all* access technology options available to them to help them make informed decisions. It is difficult to understand why the Commission would propose reaching a decision in respect of incentive payments that so directly contradicts outcomes it is right now seeking to promote under Part 7 of the Telecommunications Act. The fact that the present fibre regulation and retail service quality regulation are different activities does not relief the Commission of the obligation to apply a consistent and predictable approach across the statutory scheme.

18. Lastly, as noted by Chorus, the effect of the incentive payments is to influence the retail markets, and provide an advantage to RSPs without mobile networks[9]. This is contrary to Parliament's intention for Chorus to operate a wholesale-only business and for competition between RSPs to provide innovation and diversity in retail offerings[10]. It is also inconsistent with the Commission's objective of promoting outcomes that are consistent with outcomes produced in workably competitive markets. We request that the Commission engages with this specific submission and demonstrates that it has done so.

Tools the Commission has to manage these risks

19. The Commission must immediately establish a pricing methodology IM. We have repeatedly asked for this as there is a gaping hole in the regime. The Commission appears to be trying to fill this gap by using the price path, but as highlighted by Chorus, it is simply not suited to this purpose[11]. As outlined by Chorus, they are under no obligation to seek approval before

[8] https://comcom.govt.nz/__data/assets/pdf_file/0031/266935/Chorus-Context-note-on-Chorus-Customer-Incentive-Expenditure-10-September-2021.pdf, paragraph 21.
[9] Chorus, 8 July 2021, Submission on price-quality path draft decision, pp4-5
[10] This is also supported by the non-discrimination and equivalence of supply obligations in Part 4AA of the Act
[11] https://comcom.govt.nz/__data/assets/pdf_file/0031/266935/Chorus-Context-note-on-Chorus-Customer-Incentive-Expenditure-10-September-2021.pdf, paragraph 10.

making any incentive payments, and we therefore remain confused why the Commission is even considering an allowance.

20. Enforcement of non-discrimination obligations. Chorus has attempted to confuse this matter by highlighting the caveat in the Commission's guidance that they are not required to tailor offers to each individual access seeker[12]. However, in this case, Chorus has actively developed plans with the intent of making them unattractive to some RSPs. These are entirely different matters.

21. As outlined above in paragraph 16, Chorus' fibre-focused marketing requirement means that the incentives system discriminates based on RSPs' advertising activities, which is not objectively justifiable. An offer can be discriminatory without technically excluding RSPs from access. If an offer is structured in a way that, because of some feature of it, it is effectively unavailable or undesirable (as is the case with this offer for RSPs who wish to adopt marketing that focuses on alternative access technologies as well as fibre), then that could be just as discriminatory as an offer that excludes those RSPs. As currently designed, Chorus' incentives by their very nature provide unequal benefits to different RSPs.

Contact

22. Please contact the following regarding any aspect of this submission:

Tom Thursby
Head of Legal & Regulatory
t: [redacted]
e: tom.thursby@vodafone.com

Kamile Stankute
Senior Public Policy Advisor
t: [redacted]
e: kamile.stankute@vodafone.com

[12] https://comcom.govt.nz/__data/assets/pdf_file/0030/266934/Chorus-response-Fibre-PQ-Expenditure-RFI-24-Additional-information-on-incentive-payments-22-September-2021.pdf, pp. 7-8