

VODAFONE NEW ZEALAND LIMITED
SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION



**CROSS-SUBMISSION ON PROCESS AND ISSUES PAPER FOR THE
UNBUNDLED COPPER LOCAL LOOP (UCLL) FINAL PRICING
PRINCIPLE**

Public version

28 February 2014

A Introduction

A1 Vodafone New Zealand Limited (**Vodafone**) welcomes the opportunity to comment on the submissions received in relation to the Commerce Commission's (**Commission**) *Process and issues paper for determining a TSLRIC price for Chorus' unbundled copper local loop service in accordance with the Final Pricing Principle* (**Issues Paper**).

A2 This submission should be read in conjunction with our original submission on the Issues Paper (the **Vodafone Submission**) as well as the expert reports prepared by Frontier attached to that submission (the **Frontier Report**) and this cross-submission (the **Frontier Cross-Submission Report**). We also refer the Commission to our submission on the *Process and issues paper for determining a TSLRIC price for Chorus' unbundled bitstream access service in accordance with the Final Pricing Principle* (**UBA Issues Paper**).

B Executive Summary

B1 The Commission is charged with establishing a price for the UCLL (and UBA) services using a TRSLIC methodology. The Telecommunications Act 2001 (the **Act**) provides only very limited guidance as to how this should be applied. As such, the Commission has a wide discretion as to how a TSLRIC methodology should be applied to Chorus' network.

B2 This scenario places a spectrum of theoretical options before the Commission:

- (a) at one end, a narrow and conservative reading of TSLRIC could suggest a fully greenfield network is required; and
- (b) at the other end, the Commission could attempt to model a network which directly reflects Chorus' existing network (including any inefficiencies which are built into the network).

B3 The Commission's preliminary views, the views of access seekers recorded in submissions on the Issues Paper, and the survey of international approaches presented in the Issues Paper all broadly support the an approach that sits at the "middle" of this range of potential options. While between these different approaches there is still significant work to be done in identifying the proper approach to individual elements of analysis, it is clear that the majority of views expressed—and the weight of available evidence—support an approach which is some distance from the two extremes of a purely greenfield network or Chorus' existing network.

B4 This reflects a recognition that, in discharging the statutory function at issue, the over-arching requirement for the Commission is to:

- (a) determine the price for the UCLL services within the bounds of the (broadly defined) parameters of TSLRIC; and
- (b) ensure the outcomes of its FPP determination are consistent with the purpose set out in s 18 of the Act (i.e., promoting competition in telecommunications markets for the long term benefit of end-users of telecommunications services).

B5 Chorus, on the other hand, takes a relatively extreme position in suggesting that the Commission should put aside its preliminary views—and the weight of available evidence regarding

international practice which they reflect—and instead adopt the novel model proposed by Analysys Mason.¹ For the reasons set out below (as well as in the Frontier Cross-Submission Report) we submit that the Chorus / Analysys Mason approach:

- (a) is outside the bounds of any reasonable interpretation of how TSLRIC modelling should be applied for Chorus' regulated copper services; and
- (b) would result in outcomes which are fundamentally inconsistent with the long-term benefits of end users of telecommunications services in New Zealand.

B6 Accordingly, the Commission should rule out the approach proposed by Chorus, and continue down the path generally described in its Issues Paper. Subject to the comments made in our initial submission on that Issues Paper, we consider this approach will lead the Commission towards the outcomes required under the Act.

C Specific responses to Chorus' proposed approach

C1.1 We strongly disagree with the approach proposed by Chorus, including the framework for the TSLRIC model suggested by Analysys Mason. This section responds to specific comments made in Chorus' submission on the Issues Paper, and the supporting material prepared by Analysys Mason for Chorus.

C1.2 This section, in particular, should be read in conjunction with the Frontier Cross-Submission Report, which provides a fuller critique of the approach adopted by Analysys Mason.

C2 The Commission should develop the model

C2.1 We strongly recommend that the Commission develop the TSLRIC model.² For the reasons set out in our initial submission (as well as in the Frontier Report), we strongly oppose Chorus' proposal that the Commission, through a s 45 notice, require Chorus to prepare the model.³

C2.2 The development of the model by the Commission:

- (a) reflects international best practice;
- (b) ensures the regulator has appropriate control over the key inputs;
- (c) better enables transparency and reduces information asymmetry (especially in this case, where there is relatively little in the way of reliable regulatory accounts with which to cross-check Chorus' assumptions); and
- (d) mitigates the risk of the delays experienced when the Commission has previously required regulated service providers to develop the model.

¹ Frontier Cross-Submission Report at p 8.

² Vodafone Submission at [D.23].

³ *ibid.*, and Frontier Report at section 3.1.

C3 The timeline proposed by Chorus is not realistic

- C3.1 The Commission must adopt an approach to determining the UCLL TSLRIC price in a comprehensive and robust manner that prioritises quality over speed. The outcomes of this process will be long-lived and, as the Commission has acknowledged, will have a significant impact on New Zealand's fixed telecommunications market. In our view:
- (a) Chorus' proposed approach will not enable the Commission to deliver an FPP for either UCLL or UBA by 1 December 2014. Even if Chorus were to develop the model (and we strongly submit that it should not), the timeline proposed in their submission is not realistic.
 - (b) Setting out a realistic timeline will provide certainty for all parties. Conversely, extending or changing timelines during the process will increase uncertainty for all parties, particularly if the Commission has set a timeline and expectations that cannot realistically be achieved.
 - (c) Working to a truncated timeline that, in reality, is unlikely to be achieved will reduce the ability of all parties to fully and properly engage in the decision-making process.
 - (d) Ultimately, 'going fast' runs the real risk of reducing the quality of input and evidence made available to the Commission through this administrative process, even where doing so may not ultimately yield a determination by a 1 December target date.
- C3.2 Put simply, a timeline that contemplates the Commission completing the FPP process in less time than the (relatively) simpler IPP process is not realistic.⁴ As such, we recommend that the Commission provides an indicative timeline with a more realistic work programme.

C4 Total alignment of function between the MEA and Chorus' copper network is not required

- C4.1 The Act provides the Commission with a wide discretion as to how to apply TSLRIC modelling as part of the FPP determination in this case.⁵ This extends to the MEA choice (and indeed the decision to include the concept of an MEA in the TSLRIC model). In exercising this discretion, the Commission has identified possible characteristics that the MEA should reflect in order to be an appropriate replacement (for the purpose of modelling) of Chorus' copper network. In our view:
- (a) The introduction of a functionality assessment is an appropriate exercise of the Commission's discretion, but it is not required by the Act.
 - (b) As indicated in our initial submission, we agree with the Commission's preliminary assessment that functionality is a relevant factor that should be considered when identifying the MEA. We also agree with the Commission's preliminary views as to the possible service characteristics that it should have regard to when considering functionality, subject to the caveat, which the Commission acknowledges⁶, that it is entirely possible that the MEA ultimately selected may not support all of these service

⁴ See discussion in Vodafone's submission on the UBA Issues Paper at section C.

⁵ See discussion in *Vodafone Submission* at section C2.

⁶ Commerce Commission *Issues Paper* at [103].

characteristics. The Commission's final conclusion, which we support, that a fibre and fixed wireless access (**FWA**) network would be an appropriate MEA is wholly consistent with these principles.⁷

C4.2 We strongly disagree with Analysys Mason's assessment of the functionality required by the UCLL STD for two reasons:

- (a) First, the functionality identified by Analysys Mason merely reflects the particular attributes of the copper network that happens to be regulated, as opposed to actual requirements in the UCLL STD (and, in some cases, seeks to import entirely separate requirements, such as under the TSO, which have nothing to do with the UCLL STD).
- (b) Second, many of the "requirements" are not relevant in the context of a hypothetical TSLRIC modelling exercise: for example, if we are to imagine a hypothetical replacement network (as is the standard practice required by TSLRIC), it is absurd to suggest that a particular option should be excluded because there is need to replace CPE.⁸ Functionality should be informative but not determinative when developing a forward-looking hypothetical cost modelling exercise. Taken to its logical conclusion, Chorus' argument that the MEA ultimately selected by the Commission must enable delivery "*all of the service attributes currently delivered by [the UCLL STD service]*" would require the Commission to enable an MEA service that supports all current and ancillary functions enabled by the UCLL STD service – including support of peripheral products and services (e.g., modems, alarms etc.). In our view, there is nothing that requires the Commission to ensure this absurd outcome, and it should not feel constrained in this way.

C4.3 We note that Chorus refers to the comments of Network Strategies in its report for Vodafone on the Government's Review of the Telecommunications Act 2001.⁹ In that report (as Chorus notes), Network Strategies concluded that "it is evident at this point in time [that] fibre cannot be seamlessly swapped for copper at the MEA in New Zealand".¹⁰ The implication that this is evidence against adopting a fibre MEA in the Commission's TSLRIC process is unfounded.

C4.4 The crux of the Network Strategies argument is that the assumption at the root of the proposed prices in the discussion document was flawed. This central argument is described in that report as follows:¹¹

The Review discussion document claims that the proposed pricing approach is consistent with the 2001 Act's pricing principles – an efficient forward-looking long-run cost (LRIC) standard. This claim relies on acceptance of the assertions that:

- *fibre is the Modern Equivalent Asset (MEA) of copper*
- *contracted UFB prices are an accurate reflection of copper replacement / MEA cost.*

⁷ Vodafone Submission at [E1.1] – [E.1.2].

⁸ In addition, we note that even in the case of Chorus' copper network there has been numerous requirements to CPE to be replaced by access seekers (i.e., in the shift from ADSL to ADSL2, and in respect of VDSL services).

⁹ Chorus Submission at [101].

¹⁰ Network Strategies *Review of the Telecommunications Act 2001: Key Issues* (13 September 2013) at pp 42 – 43.

¹¹ Network Strategies *Review of the Telecommunications Act 2001: Key Issues* (13 September 2013) at p i.

*However these assertions cannot be correct as the proposed prices will be **higher** than a true LRIC model would estimate. They will be higher than the proxy LRIC benchmarks estimated by the Commerce Commission. An appropriate MEA methodology requires technological neutrality and assumes the most efficient forward-looking technology will deliver the service in question at lower cost than actual cost of service provision (which may well include the inefficiencies of the access provider).*

C5 The MEA should reflect the most efficient network

- C5.1 Chorus submits that its approach is “not a case of the law constraining the Commission to a second best outcome”, and that modelling its full copper network (with all of its presumed inefficiencies) would be less costly and give rise to TSLRIC prices that are lower than those if a ‘fibre-only’ or a ‘fibre and FWA’ network is modelled.¹² We have two responses to this:
- (a) we strongly reject the implication that the Commission is constrained by the Act to model Chorus’ actual network. To the contrary, we submit (as just one example) that a TSLRIC model which does not adjust out a reasonable level of inefficiency in the network (i.e., through optimising under a scorched node or scorched earth approach) sits outside the bounds of a reasonable interpretation of TSLRIC; and
 - (b) we agree with Chorus that TSLRIC prices using a copper network (or indeed Chorus’ actual network) sets a theoretical ceiling for TSLRIC prices, but we highly doubt that Chorus’ approach will result in prices higher than those which would be achieved using an optimised network reflecting today’s technology (with the appropriate adjustments made to abate the lesser service quality possible using Chorus’ copper technology, as well as to reflect the age and state of Chorus’ existing network).
- C5.2 We remain of the view that a fibre and FWA MEA is likely to be the most useful starting point for the Commission’s in undertaking this TSLRIC exercise.

C6 A performance adjustment from a fibre MEA to a copper service is feasible and common practice

- C6.1 The Issues Paper identifies a number of approaches to the treatment of MEA performance adjustments. In our initial submission, we referred to the approach adopted in Denmark, which we consider a useful starting point for considering the appropriate adjustment from a fibre-based MEA to the provision of copper services.¹³
- C6.2 We acknowledge that there are challenges with making this adjustment, but there are challenges in all aspects of TSLRIC modelling. There is nothing in the Analysys Mason report to suggest that the requirement to make a performance adjustment is fatal to application, for example, of a fibre and FWA MEA. The Commission has identified workable solutions to this in the Issues Paper, and we are confident that these challenges can be resolved through the modelling process.

¹² Chorus Submission at [12]. We note that Chorus also argues that this approach would be more “complicated and time consuming”. We acknowledge that it may be quicker and less complicated for Chorus to provide the topology for the network, using its existing assets, for the reasons set out above this is unlikely to achieve an outcome which is consistent with s 18 of the Act.

¹³ Vodafone Submission at section E4.

C7 The network must reflect an element of optimisation

- C7.1 It is difficult to see how Chorus' recommendation that the Commission adopt a hybrid cost-modelling approach based on Chorus' actual network configuration and asset count would result in prices that are consistent with TSLRIC pricing.¹⁴
- C7.2 As observed by the Commission in the Issues Paper, regulators in other countries tend to include a form of optimisation (either scorched node or modified scorched node) in TSLRIC models.¹⁵ This reflects the efficiency standard embedded in TSLRIC. In our view, a failure to optimise the network used in the TSLRIC model will embed inefficiencies into the price, in a manner which would be inconsistent with s 18 of the Act.

C8 Depreciation

- C8.1 The Chorus approach does not provide a clear indication of the proposed approach to depreciation.
- C8.2 In our view the model should take into account Chorus' past recovery of costs (i.e., accumulated depreciation should be included in the forward-looking costs). The alternative is to, artificially, provide Chorus with a windfall gain in the form of the recovery of the full cost of a network (potentially at a much higher current replacement cost) over the twilight of the asset's life.¹⁶ The alternative of applying depreciation on a retrospective basis is not credible.¹⁷

C9 The regulatory control period should take into account changes to the market

- C9.1 In our initial submission, we recommended that 2020 provides an appropriate inflection point at which the Commission should reconsider the UCLL FPP prices.¹⁸
- C9.2 Chorus recommends a 10 year regulatory control period (or through to 2025). While we consider this to be a lengthy period, we believe it is appropriate for the Commission to consider a longer period.

¹⁴ Frontier Economics Cross-Submission Report at p 9.

¹⁵ Commerce Commission *Issues Paper* at [94].

¹⁶ Frontier Economics Cross-Submission Report at section 4.

¹⁷ *ibid.*

¹⁸ Vodafone Submission at section C5.