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Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report

Response to submissions

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Associated documents

Publication date	Title
18 October 2019	Equivalence and non-discrimination in New Zealand telecommunications markets – Ingo Vogelsang report – 16 October 2019
18 October 2019	Commerce Commission seeking views on Telco application of equivalence and non-discrimination obligations
4 March 2020	Equivalence and non-discrimination - guidance on the Commission's approach for telecommunications regulation
4 March 2020	Consultation on the draft equivalence and non-discrimination guidance

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Purpose and structure of this paper

1. On 4 March 2020, we published draft equivalence and non-discrimination guidance (**draft guidance**).[1] Publishing the draft guidance and seeking submissions on it assists us to develop, in a transparent way, our views on the application of equivalence and non-discrimination obligations in telecommunications regulation in New Zealand.

2. As part of our process in creating the draft guidance, we engaged Professor Ingo Vogelsang to provide expert economic advice (**the expert report**)[2] on the economic interpretation of the equivalence and non-discrimination obligations imposed on the local fibre companies (**LFCs**)[3]. The expert report had particular reference to the unbundled point-to-multipoint layer 1 fibre access service (**PONFAS**). We invited stakeholder views on the expert report on 18 October 2019, and published the submissions received on our website.[4]

3. This current paper (**this paper**) sets out our responses to points raised in submissions on the expert report and the three questions posed by the Commission in its consultation paper on the expert report (**consultation paper**).

4. This paper is intended to be read as an accompaniment to the draft guidance. Unlike the draft guidance, we are not seeking submissions on this paper. However, we expect that the responses provided here to points raised in submissions on the expert report will assist stakeholders in preparing their draft guidance submissions, by understanding the Commission's preliminary position on certain topics.

Purpose of this paper

5. The primary purpose of this paper is to provide the Commission's responses to stakeholder submissions on the expert report and consultation paper, in order to:

    5.1 show how points raised by stakeholders have been taken into account in preparing the draft guidance;

    5.2 explain why we agree or disagree with certain points; and

    5.3 explain why some points cannot be addressed through the draft guidance.

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1 Available on the Commission's website at: https://comcom.govt.nz/__data/assets/pdf_file/0014/212252/Draft-equivalence-and-non-discrimination-guidance-4-March-2020.pdf

2 The expert report is available on the project page on the Commission's website: https://comcom.govt.nz/regulated-industries/telecommunications/projects/unbundled-layer-1-fibre-service

3 The LFCs comprise Chorus, Enable Networks Limited, Northpower Fibre Limited, Northpower LFC2 Limited and Ultrafast Fibre Limited.

4 The request for views and the stakeholder submissions are available on the project page on the Commission's website: https://comcom.govt.nz/regulated-industries/telecommunications/projects/unbundled-layer-1-fibre-service .

6. The secondary aim of this paper is to provide discussion of the application of equivalence and non-discrimination to PONFAS specifically. The draft guidance is intended to cover a broad range of telecommunications services. This recognises that equivalence and non-discrimination obligations exist in the undertakings provided by Chorus Limited (**Chorus**) in respect of its copper network under Part 2A of the Telecommunications Act 2001 (**Act**)[5], as well as the undertakings given by Chorus and the other LFCs in respect of their fibre networks under Part 4AA. Non-discrimination obligations also exist in the undertakings given by network operators under the Rural Broadband Initiative (**RBI**), also under Part 4AA. In this paper, these undertakings, whether given under Part 2A or Part 4AA, are referred to as '**the deeds**'.

7. Given that equivalence and non-discrimination obligations apply to a broad range of telecommunication services, the draft guidance does not focus on PONFAS, but is more general in its application. However, we are aware that much of the current industry interest in equivalence and non-discrimination obligations stems from the LFCs' obligation to offer PONFAS from 1 January 2020 (although only for now on their networks constructed as part of the first stage of the Government's Ultrafast Broadband Initiative (**UFB1**)). The PONFAS must be supplied by the LFCs on an equivalent and non-discriminatory basis, pursuant to the fibre deeds.

8. This paper includes more discussion of the equivalence and non-discrimination obligations as they relate to PONFAS. However, any decision by the Commission on whether it considers the specific LFC PONFAS offers comply with the equivalence and non-discrimination obligations under the deeds will require an application of the principles in the guidance to the particular facts of those offers. We would expect any assessment of the PONFAS offers to require consideration of further evidence gathered from the LFCs and access seekers. The earliest that this would take place is once our final guidance on equivalence and non-discrimination has been published, noting that LFCs may decide to amend their PONFAS offers once the final guidance is in place.

9. This paper is structured as follows:

   9.1 **chapter 1** sets out responses to some points on equivalence and non-discrimination made by stakeholders in their submissions on the expert report; and

   9.2 **chapter 2** discusses certain PONFAS-specific issues.

10. Alongside this paper, we are also publishing a high-level explanation of the regulatory regime for telecommunications in New Zealand and how regulatory tools interact and apply.[6] This overview addresses submissions on the expert report and should assist stakeholders in understanding the powers the Commission has and

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5 All statutory references are references to the Act, unless otherwise stated.

6 This is available on the project page on the Commission's website: https://comcom.govt.nz/regulated-industries/telecommunications/projects/unbundled-layer-1-fibre-service

does not have in regulating telecommunication markets; specifically, our role as it relates to the LFCs' obligations to provide PONFAS.

11. It is important to recognise that regulation of telecommunications services under the deeds is quite different from the forms of regulation typically undertaken by the Commission under other Parts of the Act. These other forms of regulation involve, for example, setting price and non-price terms of access through standard terms determinations (**STDs**) for services listed in Schedule 1, or imposing price-quality or information disclosure requirements under Part 6. By contrast, the Commission has no role under the deeds to set prices or non-price terms for services (including PONFAS). We consider that it will be of assistance to stakeholders to explain the limits of regulation under the deeds, and the enforcement options available to the Commission and access seekers.

Our consultation on the expert report

12. On 18 October 2019, we published the expert report on the economic interpretation of the equivalence and non-discrimination obligations imposed on LFCs. Alongside the expert report, we published the consultation paper outlining key insights from the expert report and asked stakeholders three questions related to those key insights. We sought stakeholder views on the three questions and the expert report.

13. The consultation questions we asked are as follows.

Question 1: What is your view on the implications of potential penetration pricing (downstream pricing below cost) for the equivalence of price (EOP) obligation on the PONFAS?

Question 2: What are your views on each of the following conclusions in the expert report (relating to equivalence)?

a) The EOP obligation does not require a particular pricing methodology or structure, but it does entail certain restrictions on the pricing freedom of the service provider.

b) The EOP obligation requires that the LFCs' own downstream operations can profitably supply the downstream product if faced with the upstream access price (i.e., a form of 'no price squeeze' test has to be satisfied based, at least, on an 'equally efficient competitor' standard).

c) There is an optional approach to establish a 'safe harbour' price level for the upstream price, based on the formula provided in paragraph 15 which, if demonstrated to hold, would be presumed to satisfy the EOP obligation.

Question 3: What are your views on each of the following conclusions in the expert report (relating to non-discrimination)?

a) Any price structure that deviates from a single price per unit (aside from de minimis deviations) or that impacts different access seekers differently (from each other or an LFC's own downstream operations) can be considered to fail the non-discrimination obligation unless it qualifies for the exemption in the relevant provision of the Fibre Deeds.

b) Pricing practices that are likely to favour large access seekers can be presumed to fail the non-discrimination obligation, since they are likely to harm competition.

14. We received submissions from Chorus (with a report from NERA), Enable Networks and Ultrafast Fibre Limited (with a report from WIK Consult), Nova Energy, Spark, Trustpower, Vector Communications, and Vocus and Vodafone (which included references to a public report from Network Strategies previously provided to the Commission in April 2019).[7] We thank stakeholders for their submissions.

15. Our responses to stakeholder views on the three questions and the expert report are outlined below. Readers should bear in mind the following factors.

15.1 We have not attempted to respond to every point made in submissions. Instead, this outline intends to provide our views on the main substantive points raised by stakeholders.

15.2 We have endeavoured to treat the responses to each of the three questions separately, recognising that some submissions did not engage directly with the consultation questions as posed.

15.3 In providing responses, we have grouped submissions on broadly the same issue (even where the views expressed by stakeholders have been very different).

15.4 Points raised in submissions are discussed below in no particular order.

15.5 To the extent relevant, we have provided cross-references to paragraphs of the draft guidance where our views on particular points have been expressed.

[7] The submissions are available on the project page (see footnote 4).

1. Our responses to stakeholder submissions on the expert report

Penetration pricing – question 1

16. Question 1 of the consultation paper asked about 'penetration pricing'. The expert report had noted that the current context of fibre networks in New Zealand, where the network build-out is ongoing and LFCs have an incentive to increase fibre take-up, may allow for some special circumstances which involve penetration pricing (in other words, below-cost downstream pricing).

17. In the consultation paper, we noted that the implications of downstream penetration pricing[8] for the price of the upstream product might depend on the pricing methodology chosen, and that the optimal choice between these could depend on the policy intent.

    17.1 If a (resource) cost methodology is selected for the price of the upstream product, penetration pricing downstream would imply that there is no economic room for access seekers to compete in the downstream market (unless they choose penetration pricing themselves). In this scenario, there is likely to be no, or very little, take-up of PONFAS.

    17.2 If a 'retail-minus' methodology is selected for the price of the upstream product, penetration pricing downstream is likely to imply prices below costs also for the upstream product. This scenario may impact negatively on the LFCs' incentives to invest.

18. In the draft guidance (at paragraphs 3.62-3.64), we stated that to be consistent with equivalence, upstream prices should always meet the efficient component pricing rule (**ECPR**) based, at a minimum, on the long-run avoidable downstream costs of an equally efficient operator (**EEO**). We further propose that equivalence of price is likely to be met if the upstream price is set at the *lower* of:

    18.1 an ECPR-based upstream price estimated using the long-run avoidable downstream costs of an equally efficient operator; or

[8] Penetration prices are often offered by companies introducing a new product in order to encourage customers to switch to this product or service. Penetration prices might cover the average variable costs of supplying the product (and thus would not be considered anti-competitive in most cases), but might not allow for a contribution towards the fixed costs of supply (or a return on capital). Thus, they would not be sustainable in the long term. In the context of the UFB fibre networks in New Zealand where the network operators are vertically-integrated, 'downstream penetration pricing' refers to prices for the Layer 2 (**L2**) service that are below the full costs of supplying the L2 service, including the cost of any upstream inputs required (e.g. Layer 1 (**L1**) services). We note that where the network operator is vertically-integrated and the internal prices are not transparent, the 'penetration price' could be theoretically associated with any of the services in the vertical stack.

18.2 an upstream price which reflects the costs of the upstream service (estimated using long-run incremental cost (**LRIC**) or a building block methodology (**BBM**)).

19. The approach outlined in our draft guidance recognises that, for equivalence to be a meaningful concept, the margin between the upstream and the downstream prices has to cover the costs of providing the downstream service, including a normal return on capital, ie, the available margin has to satisfy an economic replicability test (**ERT**). Where the LFCs engage in penetration pricing in the downstream market, maintaining a sufficient margin to satisfy an ERT may imply an upstream price below the upstream costs. This is illustrated in Scenario 2 of Figure 3.2 of our draft guidance. That is, for equivalence to be satisfied, ERT implies the penetration pricing would apply in the upstream market.

20. The draft guidance (at paragraph 3.60) acknowledged that "if the ECPR minimum standard is applied during periods when downstream prices are below costs, it would not be appropriate to move to a cost-based standard for the upstream price in subsequent periods without considering the costs to end-users from the risk of asset stranding".

21. Vodafone/Vocus and Chorus submitted on Question 1 in their responses. Our responses to some of their points are outlined below.

Vodafone/Vocus

22. Vodafone/Vocus[9] (page 6) contended that equivalence requirements do not change during periods of 'penetration pricing', and that the suggestion has no legal or economic merit. They added that there is no evidence that the LFCs' current UFB prices are below cost. Vodafone/Vocus also submitted that when evaluating the relevant costs for the UFB services it would not be appropriate to include the costs of any investments that would have occurred irrespective of the UFB network, such as those built before December 2011, or the 'losses asset' constructed as part of the Part 6 regime.[10]

23. Vodafone/Vocus (page 7) also said that in their view, there is no legal basis for ignoring the statutory purpose of the Act at sections 156AC(a) and 156AC(b) under penetration pricing. In their view, the requirements to promote competition (s 156AC(a)) and to apply EOI and non-discrimination (s 156AC(b)) cannot be ignored or traded off and must be equally met. Vodafone/Vocus considered that the requirement to promote efficient investment (s 156AC(c)) is complementary and not at odds with the promotion of competition and the application of equivalence.

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9 Vocus Group New Zealand and Vodafone New Zealand "Joint submission on expert report from Dr Ingo Vogelsang on equivalence and non-discrimination" (18 November 2019) (**Vodafone/Vocus**).

10 In establishing the initial value of fibre assets for the purposes of implementing the new regulatory regime for fibre fixed line access services (**FFLAS**), the Commission must determine the financial losses incurred by FFLAS providers for the period from 1 December 2011 to the implementation date. This requirement is set out in s 177(2). The value of the financial losses is referred to as the 'losses asset'.

Chorus

24. Chorus,[11] and their consultants, NERA,[12] submitted that:

    24.1 (Chorus at page 25 and paragraph 46) penetration pricing does not matter for equivalence because an ECPR price always satisfies equivalence;

    24.2 (Chorus at paragraph 49 and NERA at paragraphs 7.f and 39-41) if prices were capped at the minimum of LRIC and ECPR and LRIC is below ECPR, this would undermine the LFCs' ability to recover economic losses from penetration pricing;

    24.3 (Chorus at paragraphs 56-57) Professor Vogelsang's approach implies an absolute limit on the PONFAS price (regardless of L2 price). Chorus contended that this is beyond the scope of the deeds, and inconsistent with the principles of the Act. In Chorus' view, a resource-based approach is one way of demonstrating compliance with equivalence, but a resource-based approach is not mandatory in any circumstances; and

    24.4 (NERA at paragraph 32) the LFCs' incentives to invest will not be undermined by the use of (properly applied) ECPR even if L2 prices are below cost. With ECPR, the network operator is indifferent from a profit perspective between L1 and L2 sales and thus, any inefficient investment by LFCs will be due to the below-cost L2 price, and not due to the L1 price based on ECPR.

Our view

25. We agree with Vodafone/Vocus and Chorus that the interpretation of the equivalence obligation does not alter with the level of the downstream price. This is reflected in the approach to satisfying equivalence through meeting ERT outlined in our draft guidance (at paragraphs 3.30 and 3.35).

26. In our view, Chorus (and NERA) misinterpreted the expert report, which did not propose a cap for the upstream price using the lower of the two standards discussed above, but instead suggested a rule to establish a 'safe harbour' in which the upstream price would be presumed to meet equivalence of price without further investigation if it was set at the minimum of those two standards. As outlined in paragraph 18 above, the draft guidance proposed that equivalence of price is likely to be met if the upstream price is the lower of the ECPR price (using the EEO cost standard discussed in the draft guidance) and upstream costs.

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11 Chorus "Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies" (18 November 2019) (**Chorus**).

12 NERA "Equivalence and non-discrimination: a review of Ingo Vogelsang's report" (18 November 2019) (**NERA**).

27. An upstream price that is above the 'ceiling' at which equivalence can be presumed (ie, lies between the cost-based and the ECPR-based price) may still satisfy equivalence, but further investigation will be required. As also acknowledged at paragraph 20 above, and in the draft guidance at paragraph 3.60, should an alternative standard be considered appropriate for meeting ERT (such as a cost-based standard for the upstream price), it would be appropriate for the application of this standard to consider the costs to end-users from the risk of asset stranding if an ECPR standard had previously been applied for calculating the upstream price during a period of penetration pricing.

28. If penetration pricing is in effect in the downstream market – and we are not saying this is or is not currently the case for the LFCs' reference layer 2 prices – an ECPR-based price for the upstream service would likely form the 'ceiling' for a price consistent with equivalence, as a cost-based layer 1 price would provide insufficient margin for downstream competition.

29. Although the ECPR-based price for the upstream service would likely be below the cost of supplying the upstream service when penetration pricing is in effect in the downstream market, we acknowledge NERA's point that this – and any resulting impact on incentives to invest in the upstream service – would not be due to the application of the ECPR methodology. It would be as a result of the decision to engage in penetration pricing in the first place.

30. In response to Vodafone/Vocus' submissions on the interpretation of s 156AC in a penetration pricing scenario, our view is that the purpose statement for Part 4AA should be used to interpret the provisions of the deeds. However, as we explained in paragraph 2.36 of the draft guidance, the limbs of the purpose statement do not create a separate or independent test for compliance with the deeds and the Act. We also disagree that the correct approach to interpretation is to require that the limbs are always equally met in any application of the purpose statement. In our view, none of the limbs should be treated as paramount and, further, they should not be regarded as separate and distinct from each other. Rather, we must balance them and exercise judgement in doing so.[13]

[13] For an application of this approach in the context of another purpose statement with multiple objectives, see our discussion of the interpretation of s 162 at paragraphs 2.112-2.115 of our draft decision reasons paper for the fibre input methodologies: https://comcom.govt.nz/__data/assets/pdf_file/0038/189893/Fibre-input-methodologies-Draft-decision-paper-19-November-2019.pdf

31. In the event that penetration pricing was occurring, the consistent use of ECPR throughout the period of penetration pricing and in subsequent periods (as discussed in the draft guidance at paragraph 3.60) will ensure that there is sufficient economic space for competition at the layer 2 level. We also noted in the draft guidance that in applying ECPR, the EEO downstream cost standard is a minimum, and that other standards providing greater economic room to compete may be appropriate in some circumstances.

32. We also note that under the building block model of regulation being implemented under Part 6, there is a wash-up mechanism which could allow LFCs subject to price-quality regulation (at present, only Chorus) to recover any losses arising from penetration pricing or from a change from ECPR to cost-based pricing at layer 1 in subsequent periods. The wash-up feature of Part 6 regulation is discussed by Spark at paragraph 28 of its submission.[14]

Equivalence – question 2

Question 2(a) – cost methodology

33. Question 2(a) asked whether stakeholders agreed with the argument in the expert report that the equivalence of pricing obligation in the deeds does not require a particular pricing methodology or structure, but that it does entail certain restrictions on the pricing freedom of the service provider.

34. The position that we have taken on this issue in the draft guidance is to support the finding in the expert report; namely, that a range of prices and pricing structures can potentially satisfy equivalence of price obligations (see paragraph 3.26-3.27) provided they meet the ERT. We propose that the margin between the downstream and upstream prices cover at a minimum the downstream long-run avoidable costs of an EEO. This will include any downstream fixed costs that are avoidable in the long run (see paragraph 3.43 of the draft guidance).

35. A number of stakeholders made submissions on this question, and the related question of what cost standard/s should be applied when assessing equivalence of price.

Vector

36. In relation to the cost standard to be applied, Vector submitted that: [15]

    36.1 (at paragraph 4) Professor Vogelsang's four approaches to ECPR can lead to very different outcomes for equivalence of pricing;

    36.2 (at paragraph 33) the clean margin rule ('costs saved') is inconsistent with the purpose of Part 4AA, while the Armstrong-Doyle Vickers approach is highly theoretical and inaccurate, and therefore should not be adopted;

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[14] Spark "Fibre EOI and Non-discrimination Submission" (18 November 2019) (**Spark**).

[15] Vector Communications "Submission on Telco Application of Equivalence and Non-Discrimination Obligations" (18 November 2019) (**Vector**).

36.3 (at paragraph 35) the incumbent's 'cost of expansion approach' is not appropriate, as it limits the avoidable costs to those of the incumbent which are less likely to be replicable by a new entrant; and

36.4 (at paragraph 39) using the efficient entrant's costs, via a reasonably efficient operator (**REO**) or adjusted EEO approach, is the most appropriate method in terms of consistency with the purpose of Part 4AA.

Our view

37. We understand from Vector's submission that they do not disagree with the proposition that multiple methodologies (including different cost standards) can be used to determine an upstream price that is consistent with equivalence. However, Vector believes that a cost standard relying on a REO or an adjusted EEO standard would best give effect to the purpose of Part 4AA. In our draft guidance, we outlined that a range of prices and price methodologies can potentially satisfy equivalence (see paragraphs 3.26-3.27), provided their application ensured that ERT is met (see paragraphs 3.30 and 3.35).

38. In our draft guidance, we proposed that to satisfy ERT the available margin between the downstream and upstream prices should cover *at a minimum* the downstream long-run avoidable costs of an EEO (see paragraphs 3.42-3.45 and 3.62). The draft guidance suggested the use of the EEO cost standard, rather than the REO standard, as a practical 'minimum standard' that network operators can implement (see paragraph 3.62). Our reasons for adopting this approach are explained in the draft guidance (at paragraph 3.47), noting that in a setting where prices are determined commercially, it would not be practical to set a minimum standard with reference to the downstream costs of an access seeker, since the network operators only have visibility over their own downstream costs.

39. As signalled in the draft guidance at paragraphs 3.54-3.55, depending on the specific market characteristics and circumstances, an alternative cost standard might be more appropriate to demonstrate compliance with equivalence. The question of whether a different standard for satisfying equivalence[16] – such as an adjusted EEO standard which takes into account the scale of an access seeker, or the REO standard – may be appropriate given the specific market circumstances and service(s) in question can only be addressed through an in-depth investigation (and considered by the High Court in any enforcement action concerning the deeds).

[16] See discussion at paragraphs 3.53 to 3.60 of the draft guidance.

*Enable/U*ltrafast Fibre (UFF)

40. Enable/UFF[17] (at paragraph 7) agreed with the proposition in the expert report that equivalence of pricing does not require a particular pricing methodology. Those parties are confident that their respective pricing methodologies for their PONFAS products meet Professor Vogelsang's criteria for meeting the equivalence standard.

41. In addition, they argued that:

    41.1 (at paragraph 2.8) a 'top-down' methodology will meet the equivalence of pricing obligations; and

    41.2 (at paragraph 4.5) the purpose statement in s 156AC does not place any additional constraint on LFCs, and s 156AC has no role to play in how service providers identify the price of internal supply.

Our view

42. As explained above, in the draft guidance we took the view that the concept of equivalence does not prescribe a particular price methodology and a range of prices or price structures can satisfy equivalence provided they meet the ERT (paragraphs 3.26-3.28 and 3.35). While we agree that the deeds and the Act do not prescribe a specific way for the LFCs to determine the upstream price that would satisfy equivalence, as explained in the draft guidance this does not render the equivalence obligation meaningless and for equivalence to be satisfied sufficient margin must exist between the downstream and upstream prices for ERT to be met.

43. Enable/UFF expressed a view that the s 156AC purpose statements do not place any additional constraint upon LFCs. As explained in our draft guidance (at paragraphs 2.35-2.36) and in this paper (see paragraph 30 and paragraph 50), we will take into account the purposes when assessing whether conduct is in breach of equivalence or is discriminatory in the exercise of our monitoring and enforcement powers. However, we agree that the s 156AC purposes do not create a separate or independent test for compliance with the deeds and the Act.

Chorus

44. Chorus (and NERA, on Chorus' behalf) expressed a range of views concerning cost standards and pricing methodologies. They agreed with the expert report that no particular methodology is mandated by the Act or the equivalence obligation in the deeds (see paragraph 89).

[17] Enable Networks Limited and Ultrafast Fibre Limited "Submission on application of equivalence and non-discrimination obligations under Part 4AA of the Telecommunications Act 2001" (31 October 2019) (**Enable/UFF**).

45. Chorus also submitted that:

45.1 (at paragraph 58) a vertically integrated business will always charge its downstream business an ECPR-based price, and ECPR is always available to demonstrate compliance regardless of market conditions (at paragraph 28);

45.2 (at paragraph 58) in the specific context of PONFAS, if the PONFAS price is derived from the LFC's L2 price, and the PONFAS price reflects the costs avoided by the LFC in providing access, then the LFCs and any equally efficient access seekers would be on a level playing field;

45.3 (at paragraphs 51 and 59) equivalence relates to the relativity between L1 and L2 prices, not the absolute level of either L1 or L2 prices, and focussing on the relativity between L1 and L2 prices provides for efficient downstream competition;

45.4 (at paragraphs 27-28 and 50) consideration of a LRIC-based approach to layer 1 pricing is inappropriate and seems at odds with the rejection by Parliament of TSLRIC for fibre services; and

45.5 (at paragraph 41) while the interpretation of the Act and the deeds must be cross-checked against the purpose statement, neither the Act nor the deeds directly incorporates the purpose statement as the standard for assessing equivalence or non-discrimination compliance.

46. In their submission on behalf of Chorus, NERA argue that a cost-based approach, such as LRIC, will not satisfy the equivalence of price obligation because:

46.1 (at paragraphs 7.e and 25) either the network operator would be favouring itself (if LRIC is above ECPR) or they would be favouring access seekers (if LRIC is below ECPR); and

46.2 (at paragraphs 7.f and 39-41) requiring that equivalence of price is met by the minimum of ECPR and LRIC may lead to economic stranding, if ECPR is applied when the downstream prices are below costs, while LRIC is applied in subsequent periods when the downstream prices are above costs.

Our view

47. On the question of the role of ECPR, the draft guidance set out that satisfying equivalence requires meeting the ERT. Paragraph 3.62 of the draft guidance expressed our view that the use of ECPR based on the EEO standard is a practical approach that the network operators can implement, and that, to be consistent with equivalence, upstream prices should always meet this test at *a minimum*. However, the draft guidance also noted that alternative downstream cost standards might be appropriate in some market conditions (see paragraphs 3.53-3.55). The draft guidance did not propose an absolute cap for the upstream price linked to the lower of the ECPR-based price or the LRIC-based price.[18] Rather, the draft guidance(at paragraph 3.60) acknowledged that if ECPR-based prices are applied during periods of penetration pricing, then it would be appropriate to consider the costs to end-users from the risk of asset stranding if a move to cost-based upstream prices is proposed in a subsequent period.

48. The draft guidance also accepted the idea that equivalence fundamentally relates to the relativity between L1 and L2 prices, rather than their absolute levels. This is why (at paragraphs 3.29-3.32) we propose the ERT, which is designed to ensure that there is sufficient economic space between the downstream price and upstream price for access seekers to compete with the network operator. We note that under an EEO minimum cost standard only access seekers that are at least as efficient as the network operator in providing the downstream service will be able to enter the downstream market. This view is supported by NERA in its submission on behalf of Chorus (at paragraph 29).

49. The approach in the draft guidance to establishing whether an upstream price is consistent with equivalence is summarised at paragraph 18 of this paper. Our proposed approach does not imply that, if a cost-based price is considered appropriate in some market conditions, TSLRIC (as per the final pricing principle for some designated access services) would be the only cost standard that could be used. Further, as explained in the draft guidance at paragraphs 3.58-3.59, we accept NERA's point that equivalence will not be satisfied if a cost-based upstream price is above the ECPR price. However, we disagree that equivalence will be breached if a cost-based upstream price is below the ECPR price, since in that situation ERT would still be met.

50. In the draft guidance (at paragraphs 2.35-2.36), we agreed that the purpose statements do not create a separate or independent test for compliance with the deeds and the Act. However, in our view, we are required to interpret the requirements of the Act and the deeds in accordance with the purpose statements. We will therefore take the purposes into consideration when exercising our monitoring and enforcement powers.

[18] As explained at paragraph 26 above, it is our view that the expert report did not suggest an absolute cap on the upstream price either.

Vodafone/Vocus

51. In their submission, Vodafone/Vocus (at page 8) contended that the Commission is required in its enforcement of the deeds to identify which pricing approaches are inconsistent with the LFCs' obligations.

52. Vodafone/Vocus also had some specific comments regarding cost standards.

    52.1 (at page 11) The parties contend that, as there are clear economies of scale in unbundling, a 'cost of expansion' model would only be appropriate if an efficient competitor could gain sufficient scale. However, they maintain that with the non-price terms for PONFAS as proposed, this is impossible.

    52.2 (at page 12) Vodafone/Vocus submit that it is inappropriate to use market share as a factor in calculating cost benchmarks, as these are subject to change. However, they agree that a nominal market share of 15-20% is appropriate as a guide, and reiterate that a key requirement for equivalence is sufficient economic space for a competitor.

    52.3 (at page 10) The parties state that although a 'clean margin' approach might satisfy equivalence, it clearly fails the requirement to promote competition. For example, in the context of PONFAS, they note that L2 equipment can be installed on an as required basis, and can easily be re-deployed or re-sold and so is unlikely to be stranded.

Our view

53. As expressed in the draft guidance, we consider that a range of prices and pricing structures could potentially satisfy equivalence of price obligations. In particular, our view (at paragraph 3.27 of the draft guidance) is that:

    53.1 the equivalence obligation does not prescribe a specific price level for the upstream inputs, provided that the price(s) applied to access seekers are equivalent to the (imputed) price applied to the network operator's own operations; and

    53.2 the equivalence of price obligation allows a network operator to determine the methodology and the structure of its prices, provided it treats access seekers the same way as the network operator's own downstream operations.

54. We agree that equivalence requires sufficient economic space for competition to occur, ie, ERT must be met. The minimum downstream cost standard used in the draft guidance (at paragraph 3.43) is intended to serve as a minimum tractable benchmark for judging whether there is sufficient economic space for an efficient access seeker to enter and compete at the downstream level, using the upstream service supplied by the network operator. Paragraph 3.55.2 of the draft guidance also noted that an alternative downstream cost standard might be appropriate in markets in which there are economies of scale/scope in the downstream market. These scale or scope economies result in downstream costs for the network operator (based on an EEO standard using long-run avoidable costs) that access seekers cannot feasibly replicate because of their smaller scale, even if they are as efficient as the network operator.

55. The draft guidance did not adopt the 'clean margin' rule or the 'cost of expansion' model for setting the minimum downstream cost standard, and the specific point regarding stranded costs would be considered as part of an investigation, so we have not sought to comment on this further.

Question 2(b) – EEO

56. Question 2(b) asked whether the equivalence of pricing obligation requires that the LFCs' own downstream operations can profitably supply the downstream product if faced with the upstream access price (ie, whether a form of 'no price squeeze' test has to be satisfied based, at least, on an 'equally efficient competitor' standard).

57. The draft guidance did adopt this principle (e.g., at paragraph 3.42); namely, that to satisfy equivalence of price, a network operator must be able to demonstrate at a minimum that its own downstream operations can profitably supply the downstream service when faced with the upstream input price(s) offered to access seekers. The minimum downstream cost standard adopted is EEO, because this standard is based on information which LFCs can more readily access. However, an adjusted EEO cost standard that takes into account the scale and scope that can reasonably be achieved by third party access seekers, or a standard relying on REO costs, might be appropriate in some markets (see paragraph 3.54 of the draft guidance).

Vector

58. At paragraphs 38-39 of its submission, Vector contends that access seekers do not enjoy the same scale as Chorus, and that an access seeker would not be able to economically replicate Chorus' L2 services if they had to be in the same position as Chorus. For this reason, Vector supports an adjusted EEO or an REO downstream cost standard. At paragraphs 3.54-3.55, the draft guidance pointed out that in markets where there are economies of scale or scope, an alternative downstream cost standard might be required to satisfy ERT. Such alternative cost standards include the adjusted EEO or REO standard. Without conducting an in-depth investigation, we are not in a position to comment on whether the fibre L2 market is subject to economies of scale.

59. At paragraph 53, Vector submits that use of a weighted average L2 price to calculate a L1 price when applying an ECPR-based approach must consider the different service combinations offered at L2 (eg, bundles of L2 services with different levels of 'assure' will have different prices). At paragraph 3.38.2, the draft guidance stated that in the case of differentiated downstream services, the (notional) downstream price should be calculated as a volume-weighted average across all downstream services supplied using the same upstream service. The draft guidance recognised that additional complexities might arise in calculating a weighted-average downstream price when the downstream services are sold in bundles with other services (see footnote 64 of the draft guidance).

60. At paragraph 50, Vector lists a series of costs it considers to be avoidable costs in the context of PONFAS: these include the cost of installing an optical network terminal (**ONT**) in end-user premises, the cost of replacing or changing the fibre flexibility point (**FFP**), the cost of adding electronics at the exchange, operation and maintenance costs of electronics, hardware vendor support, licencing, port costs on the optical line terminal (**OLT**), product development and management costs, marketing costs, service and assure costs for layer 2 support services. While the costs listed by Vector would appear to be avoidable in the long-run, this would need to be tested further within the context of a specific investigation. Given our stated aim in the guidance process of not drawing conclusions regarding the particular PONFAS offers of LFCs, we have therefore not responded directly to these aspects of Vector's submission.

Vodafone/Vocus

61. Vodafone/Vocus (at page 13) submitted that the unbundled price must not depend on the downstream service, contending that this would breach the competition and efficient investment obligations, and would provide LFCs the means to control the L2 market. We agree that the purpose of unbundling is to promote downstream competition and innovation, and that this may be stifled if the terms of the unbundled service are constrained or restrictive (for example, if there are limits placed on the use of the unbundled service). However, the ERT proposed in our draft guidance is designed to ensure there is sufficient economic space between the downstream price and the upstream price (e.g., see paragraph 3.30). This relativity inherently involves the downstream price, and means that, in our view, the assessment of whether ERT is met will need to have reference to downstream costs.

Question 2(c) – 'safe harbour'

62. Question 2(c) asked whether the draft guidance should establish a 'safe harbour' price level for the upstream price, which, if demonstrated to hold, would be presumed to satisfy the equivalence of pricing obligation.

63. The position that we have taken on this issue in the draft guidance is that it would be inappropriate for the Commission to create 'safe harbours', given that our role under the deeds is limited to monitoring and enforcement, and not to setting prices. Instead, our view is that it would be the role of the courts, in applying the equivalence provisions in the deeds, to decide whether to set standards for prices.

64. However, we recognise that there is benefit in providing an indication to stakeholders, through the guidance, regarding the approaches that we may apply in deciding whether particular prices warrant further scrutiny or investigation, and which might give rise to a higher likelihood of the Commission instigating enforcement action. To that end, the draft guidance included (at paragraph 3.64) a statement that, in our view, equivalence of price is likely to be satisfied if an upstream price is shown to be at the lower of:

    64.1 the imputed upstream price calculated using the ECPR-based rule with EEO as a minimum downstream cost standard; or

    64.2 the upstream costs including a normal return on capital, calculated using either LRIC or BBM methodology.

Enable/UFF

65. Enable/UFF (at paragraph 7) submitted that a L2 retail-minus price methodology will only derive an efficient L1 price when the L2 price is cost-based or competitively set. They argued that since this is not the case in NZ, the current L2 price cannot be used as a reference point for determining the L1 price. Enable/UFF submitted that the expert report "comes to a similar conclusion, recommending that the layer 2 methodology be considered for safe harbour purposes only when penetration pricing has ceased".

66. It is our view that Enable/UFF mischaracterise the conclusions of the expert report. The expert report states (at page 4):

> If one can characterize the below-cost L2 pricing as "penetration pricing" the question is if this deserves special treatment from the L1 pricing perspective. Unbundling can in this case only be certain to survive under retail-minus rules […], but not at a resource cost based unbundled price.

67. Thus, the expert report points out that ECPR is the only approach that would satisfy equivalence during periods of penetration pricing. The expert report recommends an optional safe harbour rule that considers the minimum of a resource-based upstream price or the ECPR-based upstream price only in periods when penetration pricing is not in effect (page 4).

68. As explained at paragraphs 18 and 28-29 above, with penetration pricing ECPR (using the downstream price as a reference point) can be used to ensure that efficient entry can occur in the downstream market. The fact that the resulting upstream price will be below the cost of the upstream service is not due to ECPR – it is due to the pricing of the downstream service.

Chorus

69. In its submission, Chorus (at paragraph 48) disagreed with what it characterised as the 'two-way safe harbour' (ie, the lesser of ECPR and LRIC). In its view, that proposed approach would imply an absolute limit for the upstream price (regardless of L2 prices), and a limit that is determined with reference to L1 costs. Chorus contended (at paragraph 56) that this was beyond the scope of the deeds and inconsistent with the principles of the Act.

70. As explained earlier at paragraph 26, we consider that Chorus (and NERA) misinterpreted the expert report, which did not propose a cap nor imply an absolute limit for the upstream price using the lower of these two standards, but instead suggested a rule to establish a safe harbour. The function of a 'safe harbour' would be to create a ceiling as guidance for when upstream prices may be presumed to meet equivalence of price without further investigation.

71. Even relying on the approach outlined at paragraph 3.64 of the draft guidance, the fact that an upstream price lies above the minimum given by the two criteria suggested does not automatically imply that the Commission would find that such pricing failed equivalence. As explained in paragraph 3.66 of the draft guidance, upstream prices that do not meet these criteria, but still satisfy ERT using the minimum standard for the downstream costs set out in the draft guidance, may also satisfy equivalence of price, but "further investigation will be required to determine whether equivalence of price is satisfied, depending on the specific market circumstances".

Non-discrimination – question 3

Non-discrimination generally

72. Stakeholders submitted a range of views on the particular questions posed in the consultation paper, and on the topic of non-discrimination more generally.

Chorus

73. Chorus' submission (at paragraph 89.1) contended that a broad interpretation of the 'difference in treatment' test leads to a collapse of the non-discrimination test to the subsequent limbs, since any offer will have different effects. In its view, this deprives the 'difference in treatment' requirement of meaning, and is therefore unsupportable. Chorus added its view (at paragraph 12.7) that no difference in treatment should be found if LFCs offer the same service and terms to access seekers, and all access seekers are capable of accepting those terms.

74. At paragraph 77 of its submission, Chorus also contended that there is no difference in treatment if the varying prices reflect varying costs. In its view, the concept of price discrimination can only be engaged if the price difference cannot be justified (eg, by costs).

75. As explained in the draft guidance (at paragraph 4.17), our view is that assessing difference in treatment under the deeds is a two-part test where both parts must be satisfied. We must consider both the terms on which the offer is made and the effect of those terms on access seekers. While we accept Chorus' point that a service provider cannot be expected to tailor their offers to individual access seekers, an offer that is structured in such a way that it could never be taken up by certain categories (or any) access seekers could still result in a difference in treatment (what Chorus describes as "indirect discrimination" in paragraph 86.2 of their submission).

76. On the question of whether prices related to underlying costs can be discriminatory, we have taken in the draft guidance a slightly different view from Chorus. At paragraph 4.42, we have concluded that there may be a difference in treatment under the deeds even if differential prices are linked to differences in the underlying costs of the service for access seekers. However, while underlying costs in themselves are not relevant in establishing a difference in treatment, underlying costs may be relevant to whether the difference in treatment is objectively justifiable and does not harm competition. If prices appear discriminatory, the network operator may need to show how the difference in price, or the difference in the effect the same price has on access seekers, is justifiable by differences in the underlying costs.

77. In their submission (at paragraphs 56-64) NERA, on behalf of Chorus, points to several definitions from the academic literature and international agencies that link price discrimination directly to customers' willingness to pay, rather than differences in the underlying costs of supplying the product.

78. While we agree with these definitions as a matter of economics, as stated above, the non-discrimination obligation in the Act and the deeds does not require that services be priced on a particular basis (cost-based or otherwise). Instead, the obligation requires that there is no difference in treatment, either between different access seekers or between the network operator and other access seekers, including where the offer has a different effect depending on the position of the access seeker purchasing the service.

79. Chorus (at paragraph 74) submitted that offers that satisfy equivalence are unlikely to violate non-discrimination obligations. As outlined in Chapter 5 of the draft guidance, we consider that there are clearly situations in which a network operator may supply a service in a way that meets the equivalence obligations but is still discriminatory.

Enable/UFF

80. Enable/UFF (at paragraph 3.5) consider the use of the word "or" in the definition of non-discrimination means that, where the service provider supplies itself with a relevant service, the non-discrimination obligation is different to where it does not self-supply. In their view, (paragraph 36) the non-discrimination obligation for self-supply is therefore identical in effect to the service provider's equivalence obligation to treat third party access seekers the same way as its own business operations. Consequently, in their view when the equivalence test is satisfied, the non-discrimination test for self-supply is automatically satisfied.

81. We do not consider Enable/UFF's interpretation of non-discrimination - namely that the use of the word "or" implies that non-discrimination is satisfied by EOI in the case of self supply – is correct. In our view, there is no evidence, in the words of the statute, the deed or applicable precedent, that Parliament intended to subsume the non-discrimination obligation into the equivalence obligation. The history of the concepts of equivalence and non-discrimination in New Zealand (including the Loyalty Offers case),[19] shows that there may be circumstances where the equivalence obligation is satisfied but a network operator has nevertheless breached the non-discrimination obligation. In our view, and consistent with Chorus' observation (paragraph 70) "non-discrimination and equivalence are distinct forms of regulation" and may both apply to the same conduct. Accordingly, where both equivalence and non-discrimination obligations apply to a relevant service, we must assess compliance with both requirements.

Question 3(a) – price structure

82. Question 3(a) asked whether any price structure that deviates from a single price per unit (aside from *de minimis* deviations) or that impacts different access seekers differently (from each other or an LFC's own downstream operations) can be considered to fail the non-discrimination obligation unless it qualifies for the exemption in the relevant provision of the Fibre Deeds. An obvious example in the context of the current PONFAS offers is the component-based pricing adopted by the LFCs.

83. The position that we have taken on this issue in the draft guidance (at paragraph 4.44) is that price structure can in itself result in a difference of treatment; for example, multi-part tariff structures, such as where the price for the product is a combination of a fixed upfront price and a variable-per-unit price. However, depending on the given market, the draft guidance provided (at paragraphs 4.37 to 4.39) that a difference in treatment can be both objectively justified and not harmful to competition. On that view, a network operator would need to provide sufficient evidence that the practice is compatible with the non-discrimination obligation by showing that there is both an objective justification for the difference in treatment with regards to price, and the difference in treatment does not, and is unlikely to, harm competition.

[19] See Appendix B of the draft guidance.

Vodafone/Vocus

84. Vodafone/Vocus submitted (at page 5) that the component pricing as proposed by LFCs would result in geographic discrimination and discrimination between access seekers with different market shares.

Enable/UFF

85. Enable/UFF submitted that:

    85.1 (at paragraph 3.7) Building their networks requires them to incur separate costs for feeder and distribution fibres, and the equivalence obligation requires them to treat access seekers the same as they treat themselves, so in their view L1 prices must reflect the cost structure incurred internally.

    85.2 (at paragraph 5.2) Component pricing is not a two-part tariff, but reflects the efficient cost of providing the service. A single per connection pricing model would lead to inefficient entry and underutilised splitters, the cost of which would be borne by LFCs. In their view, it would not lead to an efficient choice between L1 and L2 services.

    85.3 (at paragraph 3.10) Where non-discrimination between access seekers is concerned, the individual circumstances of access seekers are not relevant, provided that services are supplied on the same terms. In Enable/UFF's view, the fact that some access seekers are better able to take up a service because of their size, resources or other factors does not relate to the supply of the service by the network operator but relates instead to the characteristics and attributes of the access seeker.

Chorus

86. Chorus outlined in its submission a range of reasons why it considered that component pricing was not discriminatory. In summary, it argued that this pricing structure:

    86.1 had been used for copper services subject to the copper deed and also for fibre services agreed with Crown Infrastructure Partners;

    86.2 could not be discriminatory, as the price did not vary depending on the volume purchased by the retail service provider (**RSP**); and

    86.3 would be neutral between RSPs both on its face and in effect, provided each separately priced component reflected a genuine service, and actual network architecture and costs.

87. It also noted (at paragraph 95) that criticising component pricing as resulting in a different price per unit paid by RSPs begged the question of what the appropriate unit is against which to assess discrimination.

88. Chorus also submitted (at paragraphs 98-99 and 109) that, by contrast, a single blended price for PONFAS:

88.1 would create incentives for unbundlers to target higher-value end-users since a blended price would create arbitrage opportunities; and

88.2 would result in RSPs with high utilisation per feeder fibre/splitter being disadvantaged relative to RSPs with low utilisation, because RSPs that achieve very low utilisation would pay the same price per connection as RSPs that achieved high utilisation. As a result, RSPs with high utilisation would be deprived of the opportunity to enjoy the scale efficiencies they generate and would, in effect, cross-subsidise RSPs with low utilisation, since the blended price would reflect the sum of all L1 costs.

Our view

89. Given our stated aim in the guidance process of not drawing conclusions regarding the specific PONFAS offers by the LFCs, we have not responded to the arguments in the Vodafone/Vocus submission regarding the current structure of the LFCs' PONFAS offers. However, we note that, based on the position in the draft guidance(paragraphs 4.41-4.43), difference in treatment with regards to price will exist if there is any (non-trivial) difference in the unit price of a given service as sold to access seekers, unless the network operator can demonstrate that the difference in treatment is objectively justifiable and does not and would not harm competition.

90. While we agree with Enable/UFF's argument that a single per connection pricing model for PONFAS may lead to inefficient entry and underutilised splitters (a view also expressed in the expert report at page 17), we note that we have not reached a view on whether a 'connection' constitutes a 'unit' of PONFAS (see also discussion in Chapter 2 of this paper). As noted in footnote 85 of the draft guidance, the definition of what constitutes a unit of service will vary from market to market and will depend on the characteristics of the particular service and how it is sold. This is consistent with Chorus' observation at paragraph 95 of their submission.

91. With respect to Enable/UFF's argument that component pricing is not a two-part tariff, but reflects the efficient cost of providing the service and the cost structure incurred internally, as well as similar arguments brought forward by Chorus, we note that neither the equivalence nor the non-discrimination obligation require the L1 prices to be cost-based. As explained at paragraphs 4.42-4.43 of the draft guidance, differences in treatment may arise even if prices are linked to differences in the underlying costs of the service. While underlying costs in themselves are not relevant in establishing a difference in treatment, they may be relevant to whether the difference in treatment is objectively justifiable and does not harm competition.

92. We also do not agree with Enable/UFF's view on the relevance of the circumstances of access seekers (paragraph 3.10). In our view, the words of the statute and the deed are clear in that the network operator's obligation is not to *treat* access seekers differently, which necessarily requires the consideration of the effect of a particular offer on access seekers. Enable/UFF's interpretation would change the statutory meaning to require network operators not to *supply on different terms*, which could be satisfied even if the effect of the offer were discriminatory or formulated in a way that is uneconomic for any access seekers to accept. This is not consistent with the meaning of non-discrimination as it has developed since 2006 nor is it consistent with the plain reading of the definition in the Act and the deeds.

Question 3(b) – pricing practices that favour large access seekers

93. Question 3(b) asked whether pricing practices that are likely to favour large access seekers can be presumed to fail the non-discrimination obligation, since they are likely to harm competition.

94. The position that we have taken in the draft guidance is that:

94.1 (at paragraph 4.17) assessing difference in treatment requires consideration of both the terms on which the offer is made and the effect of those terms on access seekers;

94.2 (at paragraph 4.41) differences in treatment with regards to price will exist if there is any (non-trivial) difference in the unit price of a given service as sold to access seekers—provided that the services provided to access seekers (or the network operator's own downstream operations) are the same (i.e., have the same quality characteristics);

94.3 (at paragraph 4.43) if prices appear discriminatory, the network operator may need to show how the difference in price, or the difference in the effect the same price has on access seekers, is justifiable by differences in the underlying costs (or some other objective justification);

94.4 (at paragraph 4.31) harm to competition requires a wider consideration of the market context to determine whether there has been a more than minimal impact on competition. However, the draft guidance also recognised (at paragraph 4.33) that while the legislation focuses on harm to the competitive process rather than the effect on individual competitors, in markets with few actual (or potential) competitors, harm to an individual competitor can have a significant impact on the competitive process as well; and

94.5 (at paragraph 4.46) in assessing harm to competition, we will consider whether the price terms offered are functionally available to access seekers (in that access seekers can feasibly meet the conditions for a particular price or discount), and whether the pricing practice is designed to favour the network operator's own downstream or upstream operation. For example, large volume discounts not directly linked to fixed-cost savings realised from larger volume sales may be so large that they are only available to the network operator's own downstream business.

Smaller access seekers

95. Nova (at paragraph 4) strongly encouraged the Commission to consider how any PONFAS pricing methodology ultimately applied by Chorus (and endorsed by the Commission via guidance and enforcement action) would impact on smaller RSPs and their ability to continue to compete with larger RSPs. [20] Nova observed that using a L2 "price-based" approach that factors the avoidable costs of an REO with 15-20% market share to determine PONFAS prices, as opposed to a linear unit-based or resource cost based approach, creates a lot of uncertainties (especially in terms of the range of different impacts on different access seekers). It also contended that this approach poses a higher risk for smaller players' ability to compete (given smaller players do not come close to having a 15-20% market share).

96. On the same topic, Trustpower stated (at paragraphs 2.3.2-2.3.4) that, in the current market structure, smaller RSPs could compete effectively against much larger RSPs and that scale was not a key competitive advantage. [21] It was concerned with the possibility that a L2 price-based approach using a particular REO definition might lead to scale being the key competitive differentiator in the market and so weakening, potentially substantially, the competitive prospects of smaller scale players. It asserted that if the level or structure of unbundled fibre were such that smaller scale players, who are likely to act as maverick firms, were no longer able to viably compete, consumers would be worse off both in terms of reduced price competition and less innovation.

97. We note that, whilst such effects could be minimised where appropriate, it is unlikely that the economics of unbundling will ever be completely independent of scale. However, RSPs will continue to be able to compete downstream using L2 products.

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20 Nova Energy "Submission to the Commerce Commission: Unbundled Layer 1 Fibre Service" (18 November 2019) (**Nova**).

21 Trustpower "Trustpower views on advice from Professor Ingo Vogelsang on the interpretation of equivalence and non-discrimination obligations imposed on Chorus and the Local Fibre Companies" (15 November 2019) (**Trustpower**).

Enable/UFF

98. In the context of PONFAS, Enable/UFF (at paragraph 5.5) contended that the fact that unbundling is only attractive to larger access seekers is neither discriminatory nor harmful to competition. In their view, the 'ladder of investment' concept places unbundling on a higher rung than resale and wholesale services, available to an access seeker who has developed sufficient scale to justify the necessary unbundling infrastructure investment. Enable/UFF argue that this was also the case with copper unbundling in New Zealand.

99. In response, we note that unbundling allows access seekers to gain access to the physical (L1) layer of the network. The access seeker will then have to incur downstream costs in order to deliver downstream services. These downstream costs will incur fixed costs, such as the costs of the active electronic equipment to support downstream services. An access seeker wanting to unbundle L1 services will need to achieve sufficient scale in order to justify unbundling and incurring the downstream fixed costs (ie, to get sufficiently high utilisation of the downstream equipment). This is what happened with copper unbundling – unbundlers installed their own DSLAM (L2) equipment in the local exchanges, and had to achieve sufficient scale to cover the cost of that L2 equipment. However, a potential issue may arise if the structure of the L1 price itself precludes entry by making L1 access only feasible for a supplier with the same scale as the network provider (who would already have had the benefit over access seekers of having supplied a L2 service for many years).

Chorus

100. Chorus (at paragraph 92) submitted that the concept of indirect discrimination must be confined in its interpretation. In its view, there are key differences between its PONFAS pricing and the Loyalty Offers case, since the differences in PONFAS pricing are driven by the underlying costs rather than a pure pricing methodology. The economics of the point-to-multipoint service are better when utilisation is high, and Chorus argues that it would be unreasonable to expect that Chorus' pricing structure would not reflect this reality.

101. At paragraph 116, Chorus submitted that most FFPs serve 48 connections, so to be economic, an RSP would need to achieve 16 connections (with 1:16 splitters) or 33% market share. By contrast, it noted that the biggest FFPs serve ~1000 connections, requiring 1.6% market share. It contended that RSPs can target specific areas to achieve the required penetration.

102. Given our stated aim in the guidance process of not drawing conclusions regarding the particular PONFAS offers of LFCs, we have not responded to these aspects of Chorus' submission.

Other issues raised in submissions

103. There were a range of other issues raised in submissions on the expert report. Some of those issues, and the Commission's response to the points raised, are detailed below.

Process

104. Enable/UFF (at paragraph 6.1) contended that the Commission's guidance was being provided too late. In their view, there would have been benefit in the Commission developing its views on the obligations in the deeds before the obligation to publish prices had crystallised. Those parties went further in their criticism and asserted that "consultation on the legality of past conduct with parties with opposed interests is inconsistent with the Commission's enforcement role".

105. Vodafone/Vocus also stated (page 3) that the Commission's guidance will not be provided in a timely manner, and that this would be to the significant detriment of end-users and competition. Those parties urged the Commission to start a compliance investigation of the LFCs' PONFAS offer, covering both price and non-price terms.

106. Chorus (at paragraph 5) was keen to argue that the guidance should not be about PONFAS pricing.

107. Our responses to these criticisms are set out as follows.

    107.1 Section 156AP prohibited the Commission from commencing an investigation into "the unbundling of any point-to-multipoint layer 1 service provided by an LFC that is subject to a binding undertaking" before the close of 31 December 2018. This prohibition, and the fact that the issues surrounding the application of equivalence and non-discrimination obligations to PONFAS are complex, have limited the ability of the Commission to provide guidance on these issues as quickly as stakeholders would have liked. In addition, we note that non-discrimination in particular applies to a broad range of services, and we have therefore had to consider principles that have broader application. However, we consider that the draft guidance (and final guidance, once published) will still be of real benefit to all interested parties.

    107.2 Under the deeds regime, the Commission is only able to provide guidance on these issues. Definitive findings regarding the interpretation of equivalence and non-discrimination can only be provided by the courts.

    107.3 The expert report was intended to provide independent advice on principles relating to equivalence and non-discrimination. It was not intended to engage in discussion of specific observations made by stakeholders about the current PONFAS offers by LFCs.

    107.4 The Commission intends to conclude this guidance process, establishing the principles that it would apply in enforcement, before it considers any specific application of those principles in an assessment of compliance. We firmly

reject any assertion that providing guidance on principles is inappropriate and note that the Commission has often provided guidance or guidelines in connection with topics that relate to potential future enforcement activities.

Smaller stakeholders

108. We welcome the fact that a number of smaller stakeholders provided submissions on the expert report.

109. Nova (at paragraph 5) encouraged the Commission to actively seek targeted input from less well-resourced parties and smaller players throughout the remainder of the consultation process. The Commission seeks input from as many parties as possible, and we are open to receiving oral or 'in-person' submissions from smaller parties on the draft guidance if they would prefer to submit in this way.

Workshop

110. Trustpower (at paragraph 2.6.3) encouraged the Commission to consider holding an industry workshop to ensure industry had a good understanding of the Commission's preliminary views around the equivalence and non-discrimination obligations, and in particular what they may mean for fibre unbundling and the broader telecommunications sector going forward.

111. We are keen to increase our understanding of the views of stakeholders, and to assist them to understand the overall framework of the new regime and our role within that framework. Most specific comments from stakeholders concerned the LFCs' PONFAS offers. Circumstances permitting, we will investigate the possibility of holding an industry workshop or webinar with these objectives in mind either as we prepare the final guidance, or shortly after the final guidance is published.

Fibre Deeds have wider transparency and open access objectives

112. Spark (at paragraphs 6 to 12) outlined that the Fibre Deeds include broad obligations intended to ensure open access and transparent access to Crown funded UFB networks. Spark suggested the Commission consider providing guidance on the wider open access and transparency obligations in our consultation on the guidance.

113. We agree with Spark that the Fibre Deeds are intended to ensure a greater level of access and transparency to Crown funded UFB networks. As noted in paragraph 10 of this paper, we are publishing at the same time as this paper a document that provides an overview of the overall regime for regulation of telecommunications in New Zealand, which should assist in explaining the Commission's view on these obligations.

114. Since 1 January 2020, the LFCs are required to make available and provide all Input Services on an equivalent and non-discriminatory basis. We expect the LFCs to comply with their obligations and we are open to access seekers raising specific issues with us if they believe the provisions of in the Fibre Deeds have been contravened.

The interaction between equivalence and non-discrimination

115. Trustpower (at paragraph 2.4.2) criticised the expert report for not adequately exploring the interrelationship of equivalence and non-discrimination to reconcile the two requirements. The topic of the interaction between equivalence and non-discrimination is dealt with extensively in chapter 5 of the draft guidance.

The regulatory frameworks for copper and fibre

116. A number of submissions on the expert report (Nova, Trustpower, Vector, Spark) asked us to provide greater clarity on the interaction between the undertakings regime and the regulatory frameworks for Part 6, and encouraged us to explore the analysis in the expert report in the context of other regulatory tools.

117. As noted above at paragraph 10, we are publishing at the same time as this paper a document that provides an overview of the overall regime for regulation of telecommunications in New Zealand, which should assist in explaining the Commission's view as to the interaction of these regulatory instruments. However, while the Commission acknowledges the need for coherence in the operation of different forms of regulation, the draft guidance is not intended to determine the operation of Part 6. Any points that stakeholders wish to make in the context of Part 6 (including the current process of determining the input methodologies for FFLAS) must be submitted as part of those decision-making processes.

118. In its submission, Chorus (at paragraph 12.1) said that the purposes of the deeds in sections 69W/69XA and 156AB/156AC are a necessary cross-check to the interpretation of the relevant provisions, and that the different limbs of the purpose statement are not additional conditions. It added that those provisions are subject to the generally accepted rules of statutory interpretation.

119. Our view of the purpose statements is discussed in paragraphs 2.33-2.40 of the draft guidance. In paragraph 2.40 of the draft guidance, we noted our position that the equivalence and non-discrimination concepts have the same meaning in the deeds and in the Act, and should be implemented in the same way, subject to their statutory and factual context.

Other

120. There were a range of other points made in submissions, which did not directly relate to the interpretation of equivalence or non-discrimination.

121. For example, Chorus (at paragraph 10) stated that Professor Vogelsang had not acknowledged the move to a new, more holistic form of regulation. It expressed the view that Parliament deferred the decision regarding price-control of fibre services until 2025, and this process should not over-ride that. We agree that the deeds regime does not allow price control (beyond the limitations of pricing implied by the equivalence and non-discrimination obligations), but do not consider that the expert report (or the draft guidance) could be read as reaching any conclusion to the contrary.

2. PONFAS

122. From 1 January 2020, the LFCs were required to make PONFAS available to access seekers on an equivalent and non-discriminatory basis under the Act and the deeds in respect of UFB1. Each of the LFCs consulted on, and have now published, offers for a PONFAS.

123. The UFB contracts require the LFCs to work with CIP to develop service descriptions and pricing for PONFAS. CIP published a letter sent to Chorus on 10 August 2018 recommending it engage directly with its retail customers to develop the service descriptions and pricing for PONFAS, rather than engaging with CIP as contemplated by the UFB contracts. Our understanding is that Chorus developed its service descriptions and pricing for PONFAS on this basis.

124. Many of the comments made by submitters on the expert report focussed on the application of equivalence and non-discrimination provisions in the particular context of PONFAS. We have received a number of requests from stakeholders to provide clarity on how we would approach a compliance assessment in relation to PONFAS.

125. The draft guidance is of general application to all products subject to the deeds, and not merely PONFAS. While the guidance is intended to provide the Commission's views on the interpretation of these provisions in principle, the scope of the guidance does not extend to outlining a compliance assessment of the LFCs' PONFAS offers. Any compliance assessment would require a separate process on the part of the Commission, and the analysis of evidence provided by the LFCs and potential PONFAS customers.

126. However, in the interest of providing stakeholders with an insight into how the guidance might be used in a future compliance assessment of the LFCs' PONFAS offers, we have set out below, by way of example only, the price and non-price terms or characteristics of PONFAS that we might regard as relevant in such a compliance assessment.

Equivalence of inputs

127. In assessing equivalence of inputs for PONFAS, we might consider some or all of the following characteristics of the service:

    127.1 the reservation of the second fibre into each premises for the LFC (an issue which Spark notes in its submission, at paragraph 15);

127.2 how service requirements are replicated for self-supply, including any cost, for example, of:

a) ordering;

b) lead times;

c) truck rolls; and

d) installation;

127.3 whether the technical provision of the distribution fibre to access seekers is technically equivalent based on the LFC's use of distribution fibre in its supply of downstream services;

127.4 the ONT, including whether it is provided to access seekers to use, or whether it is removed to allow an access seeker to provide its own;

127.5 the splitter, including how it is provided to access seekers and self-supplied; and

127.6 the permitted use of the service, for example for wholesale supply or fixed wireless access.

128. Vector (at paragraph 54) indicated its view that many of the difficult issues that arise with Chorus' proposed PONFAS terms relate to non-price matters. It contended that there were potential problems in terms of the ordering and provisioning process (which result in significantly longer lead times for a L1 service than the downstream L2 service offered by Chorus), feeder service requirements, service disruption for end-users and the transparency of the separation of the L1 and L2 services.

129. Vodafone/Vocus (page 14) contended that non-price terms set by the LFCs make unbundling unviable, including access to distribution fibres, access to FFPs and cabinets, access to existing ONTs and provisioning terms. In their view, the LFCs claiming exclusive access to one distribution fibre is a clear breach of the EOI terms, and will damage the customer experience. They claimed that Chorus' L1 service can take up to 95 days for a simple install, whereas Chorus can provision a L2 service in 30 days.

130. Spark (at paragraphs 13-16) indicated its view that non-price terms were as important as pricing for promoting competition. It contended that Chorus and LFCs' approach to PONFAS "results in a complex and high cost to support service which, together with an expected inferior customer experience relative to that available from Chorus and LFCs, results in an unworkable service for access seekers and their customers".

Equivalence of price

131. In assessing equivalence of price for PONFAS, i.e. in establishing whether ERT is met, we would be likely to rely on BBM either:

    131.1 to determine the costs of supplying the Layer 2 services for an application of an ECPR-based approach; and/or

    131.2 to determine the costs of supplying the PONFAS if a cost-based price obligation is introduced in future.

132. This is because the regulatory framework for fibre is based on a BBM model.

Difference in treatment with respect to price

133. In assessing whether a price for PONFAS complied with the non-discrimination obligation, we might consider some or all of the following characteristics of the PONFAS service:

    133.1 whether the components can be purchased separately or they must be purchased together; and

    133.2 the price structure offered for the service and whether it deviates from a uniform per-unit price.

134. If the pricing for PONFAS appeared or was alleged to be discriminatory, we might also consider whether there were justifications for component pricing (for example, increased efficiencies) and whether or not such pricing harmed competition in terms of the deeds.

135. In conducting a compliance assessment, we also expect that we would need to analyse what constitutes a unit of the PONFAS product based on the requirements in the deeds.[22]

[22] Chorus acknowledge this point at paragraph 95 of its submission on the expert report.