Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"

Thank you for the opportunity to provide a submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation", 4 March 2020 (the draft Guidelines). This is a joint submission made by Vocus Group New Zealand and Vodafone New Zealand.

A long road to a decision on unbundling

We continue to be frustrated that the Commission is taking such a long route to making any assessment of the Local Fibre Companies (LFCs) compliance with their unbundling requirements. The LFCs were required by the Act to have a compliant product in market by 1 January 2020. It is clear both from the draft Guidelines and Vogelsang's paper that this is not they have not meet their obligations. LFCs failure to comply with a clear statutory requirement is not a position that the Commission can tolerate or treat as a matter of low priority: it must take steps to address this compliance failure with urgency.

Under the Commission's current process, we will have to wait until September for final Guidelines, and then several more months for the Commission to assess the Passive Optical Network Fibre Access Service (PONFAS) service. By this time there would likely have been non-compliant services in the market for more than a year, a situation that is inconsistent with the scheme of the Act and undermines our ambitions to provide innovative unbundled fibre services to New Zealanders, and the corresponding benefit to end-users of increased competition and innovation.

While we welcome the announcement that the Commission is starting to gather evidence of non-compliance with non-price terms, this must start immediately and be extended to cover price terms. There is no need for these investigations to wait until final Guidelines are published, there is abundant evidence that we and other parties have already provided the Commission proving non-compliance and the Commission should progress an investigation based on this evidence. The assessment of this evidence can begin now on the basis that there is clearly a problem, without final Guidelines. We make the following points to inform that analysis:

- The Commission must as a matter of priority clarify what cost standard will be applied to the PONFAS product.
    - The draft Guidelines notes that where there are economies of scale / scope it may be appropriate to apply an alternative cost standard.[1] This must apply in the case of PONFAS, as the Commission itself notes "it is unlikely that the economics of unbundling will ever be completely independent of scale".[2]
    - The draft Guidelines also notes that where additional investment will provide long term benefits to consumers, then a cost approach that is more likely to facilitate competition is appropriate. Again unbundling clearly has these properties.
    - As we have previously argued, we consider that the appropriate cost standard takes into account the LFCs current scale advantage, and also allocates common costs in a

[1] Commerce Commission, Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation, draft version, 4 March 2020, paragraph 3.55.2

[2] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020 (Response to Submissions), paragraph 97

way that adjusts for the economies of scope they gained by building layer 1 and layer 2 technology concurrently. This is the only approach that will allow infrastructure level competition, as has been the intent of UFB from day one.

- The Commission must clarify its view of the competition impact of unbundling. A number of submitters, appear to hold the view that denying unbundling will enhance competition. This argument seems to be based on the idea that the LFCs will cede their layer 2 role and not vigorously compete, and that Access Seekers would not wholesale to other retailers. Neither views are supported by evidence, including the publically stated commercial ambitions of Access Seekers.

- The Commission must not accept unsubstantiated statements regarding the risk of asset 'stranding'. The LFCs must provide proof that unbundling caused some assets that were otherwise in use to be unused, and:
    - That the investment is 'irreversible'[3] and has no other economic use (such as sale to an access seeker)
    - That the investment was efficient, the LFCs have known that unbundling was coming since UFB started in 2011. This is particularly acute for assets commissioned since 2020, when unbundling was supposed to be available.

- The Commission notes that the 'unit of PONFAS' will be key in its decisions.[4] We consider that it is only justifiable to define a service as a stand-alone unit, if it can in fact be purchased and used on its own. This is not true for the two components of the PONFAS service. Chorus and the LFCs have prohibited RSPs from purchasing either the distribution or feeder fibre in isolation of the other.

Clear guidance on application of the equivalence and non-discrimination obligations is needed

While we would like to see faster action on the PONFAS service, Vocus and Vodafone fully support the Commerce Commission (Commission) developing and setting rules for the interpretation and application of the equivalence and non-discrimination obligations applying to telecommunications regulation in New Zealand.

The importance of the equivalence and non-discrimination obligations is reflected in the fact they are included in the copper deed, fibre deeds and (non-discrimination only) in the Chorus and Vodafone RBI deeds, as well as sections 69XA (Chorus undertakings) and 156AB (Undertakings relating to networks developed with Crown funding as part of UFB initiative) of the Telecommunications Act.

The publication, last year, of an expert report by Professor Ingo Vogelsang on the economic interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies (LFCs) was a positive and welcome step. We agree with Spark that "Dr Vogelsang's paper makes an important contribution to understanding the key economic and policy principles that underpin Equivalence of Inputs (EOI) and non-discrimination obligations".[5]

[3] Commerce Commission, "Fibre regulation emerging views: Technical Paper", 21 May 2019, para 594.
[4] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 134.
[5] Spark, Fibre EOI and non-discrimination, 18 November 2019, paragraph 2.

Our concerns about non-compliance with the obligations remain

As stated above, we have substantive concerns about the extent to which these obligations are being met.[6] It is clear from submissions from Spark and Vector that our concerns are shared by other stakeholders. Vector's submission sums up the situation well:[7]

> In our view, this is a critical piece of work given the potentially adverse implications for fibre unbundling should the price and non-price terms for unbundled fibre not pass the important tests of equivalence and non-discrimination. Put simply, if the current terms that Chorus has offered the industry for its unbundled fibre product stand unaltered, the uptake of fibre unbundling will be extremely limited, if there is any interest at all. This will have obvious detrimental impacts on competition, innovation and price of fibre products for years, not least given that cost-based terms will not come into effect the January 2025 (after RP1).

It is also clear from the Commission's Response to Submissions[8] that Access Providers do not fully understand what the equivalence and non-discrimination obligations actually mean and require in practice. It is reasonable to assume if the Access Providers don't understand their obligations they won't be able to comply with them.

The draft Guidelines should provide substantively more certainty and direction about what is and is not acceptable behaviour

The draft Guidelines largely do a good job of identifying the issues that need to be considered, in order to ensure the equivalence and non-discrimination obligations are met. However, the Commission has taken a tentative and unduly cautious approach to developing the draft Guidelines.

There would be substantial public benefits, as well as greater regulatory certainty for both Access Providers and Access Seekers, in providing more conclusive direction (to the extent practicable) about what would and would not be acceptable behaviour in relation to the equivalence and non-discrimination obligations. Consistent with this, Chorus has commented "Certainty about our compliance obligations … will help us continue to deliver products and services to meet our customers' needs".[9]

The Commission has noted that "Enable/UFF … are confident that their respective pricing methodologies for their PONFAS products meet Professor Vogelsang's criteria for meeting the equivalence standard".[10] We consider this to be nothing more than an unsubstantiated assertion.

Our scepticism about the unsubstantiated assertions is reinforced by Enable/UFF's view that "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".[11] This is clearly incorrect.

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[6] https://comcom.govt.nz/__data/assets/pdf_file/0027/151578/Letter-received-from-Vodafone-New-Zealand-and-Vocus-Group-New-Zealand-Layer-1-unbundling-price-11-April-2019.pdf

[7] Vector, Submission on Telco Application of Equivalence and Non-Discrimination Obligations, 18 November 2019, paragraph 2.

[8] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020.

[9] Chorus, Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies, 18 November 2019, paragraph 2.

[10] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 40.

[11] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 41.2.

Considerations such as "promote competition" and "facilitate efficient investment" are clearly highly relevant criteria when evaluating any particular pricing methodology. We instead agree with the Commission that it needs to "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".[12] The Commission has also detailed that Enable/UFF misunderstand the meaning of, and interrelationship between, equivalence and non-discrimination.[13]

A mix of clearer and more certain guidance, coupled with Information Disclosure Requirements which make transparent pricing methodologies, and the rationale for the selected methodologies, along with price squeeze testing requirements, is needed to provide reasonable surety that the equivalence and non-discrimination requirements are being met.

The draft Guidelines are overly qualified

Vocus and Vodafone consider the draft Guidelines could and should provide greater direction and certainty about what is and is not acceptable behaviour (to the extent practicable). As it stands, and they are unduly qualified on these points.

By way of example, paragraph 3.51 states:

> In markets with significant fixed and common costs, a 'margin' between the downstream price and the upstream price that is only equal to, but not greater than, the long-run average avoidable costs of the downstream product might not be sufficient to allow entry by access seekers, unless the access seekers were significantly more efficient than the network operator. Therefore, to achieve the policy goal of promoting competition in telecommunication markets for the long-term benefit of telecommunication end-users (under s 156AC(a)), it might be appropriate to adopt an alternative downstream cost category during an investigation of equivalence of price in such markets.

This provides substantial latitude for how the directions in the draft Guidelines could be interpreted. If it is only the case that "a 'margin' between the downstream price and the upstream price that is only equal to, but not greater than, the long-run average avoidable costs of the downstream product might not be sufficient to allow entry by Access Seekers", it follows that it might alternatively be sufficient to allow entry by Access Seekers. If the Commission considers it necessary to use the qualifications such as "might not" rather than "would not" then it should specify the (presumably limited) circumstances where such pricing would be sufficient to allow entry.

Likewise, by way of example, paragraph 3.55 of the draft Guidelines states: "Alternative downstream cost standards [to ECPR-based pricing] will be appropriate if applying an alternative standard would promote competition and investment for the long term benefit of telecommunication end-users" [emphasis added].

This statement leaves it open for considerable judgement and interpretation whether applying an alternative downstream cost standard would promote competition.

Paragraph 3.55 goes on to provide "Examples of markets in which an alternative cost standard might be appropriate when applying the ERT" [emphasis added] but, again, the examples are prefaced by a

[12] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 43.
[13] For example: Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 81.

qualification. As it stands, the clause effectively provides "Examples of markets in which an alternative cost standard might [or might not] be appropriate when applying the ERT". This severely limits the usefulness of the clause.

One of the examples provided in paragraph 3.55 is where an alternative access price might promote competition and investment for the long-term benefit of telecommunication end-users consists of "markets in which additional investment /entry by end-users might be deemed to be to the long-term benefit of New Zealand consumers (for example, if a loss of productive efficiency is likely to be outweighed by a gain in dynamic efficiency as a result of overall expansion of market demand or innovation arising from the additional entry in the downstream market)". In situations where this example applies, it would be to the long-term benefit of end-users to adopt an alternative pricing arrangement but it would not be to the long-term benefit of Chorus.

Examples of the limitations of the draft Guidelines

There are various areas where the draft Guidelines have taken what seems to be a backward step compared the advice Vogelsang provided.

By way of example:

- Vogelsang was clear a safe harbour for layer 1 price is the lower of the resource based cost and the ECPR cost (based on an efficient entrant). We supported this position. However, the draft Guidelines don't specify any such safe harbours.

- Vogelsang was clear a two-part tariff is inconsistent with the non-discrimination requirements. This corresponds directly with the Vocus-Vodafone submissions on this matter. The draft Guidelines, however, have been specified in a more tentative and qualified manner: "Examples of price structures that can result in difference in treatment include: ... multi-part tariff structures, such as if the price for the product fixed upfront price and a variable unit price ..."

We reiterate, that we support Dr Vogelsang position that:

- "a safe harbour of layer 1 price that is the lower of the resource based cost and the ECPR cost (based on an efficient entrant)"; and

- "a two-part tariff is inconsistent with the non-discrimination requirements".[14]

The Guidelines should specify these requirements without qualification. Discriminatory two-part tariffs must be removed.[15]

Examples where the Guidelines are vague or silent

There are various examples where the Guidelines are either unduly vague or simply silent on how to meet the equivalence and non-discrimination obligations.

[14] Vocus and Vodafone, Joint submission on expert report from Dr Ingo Vogelsang on equivalence and non-discrimination, 18 November 2019.
[15] For more detail on this point see also: https://comcom.govt.nz/__data/assets/pdf_file/0027/151578/Letter-received-from-Vodafone-New-Zealand-and-Vocus-Group-New-Zealand-Layer-1-unbundling-price-11-April-2019.pdf

By way of example, the content in relation to non-price terms is very vague. We reiterate our submission that this is something that the Commission should develop its thinking on in the final Guidelines.

An example where the Commission is simply silent, or the Commission's views are at best implicit, is in relation to 'penetration pricing'.[16] We consider the Commission's Response to Submissions[17] provides additional and greater clarity in relation to penetration than the draft Guidelines and material from the Response to Submissions should be uplifted into the Guidelines e.g.: "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 Guidelines at paragraph 3.60) will ensure that there is sufficient economic space for competition at the layer 2 level."[18]

Access Providers needs to be able to provide "objective justification" for their pricing

We agree with the Commission that "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".[19]

We also agree with the Commission that Access Providers need to provide "objective justification", "which requires adequate supporting evidence" and "depends on individual circumstances and available evidence in support".[20]

This is a widely accepted approach. For example the European Commission allows for an objective justification defence in relation to the behaviour of dominant firms which are likely to have a foreclosure effect on the market. However, this is only accepted for cases where there are other external factors, such as health and safety considerations, or where it is a 'loss minimising' reaction to competition from others.

Critically they conclude that "The burden of proof for such an objective justification or efficiency defence will be on the dominant company".[21]

This concept has also been adopted in New Zealand, for example in the Human Rights Act.

The Human Rights Act, allows "different terms or conditions for each sex or for persons with a disability or for persons of different ages if the different treatment" but these need to reflect their underlying economic costs i.e. the differences need to be "based on … actuarial or statistical data, upon which it is reasonable to rely, relating to life-expectancy, accidents, or sickness; or … where no

[16] We recognise that paragraphs 3.62-3.64 of the draft Guidelines are relevant. This is made clear in the Commission's Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020.
[17] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020.
[18] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 31.
[19] Subject to the unnecessary use of the term "may".
[20] Commerce Commission, Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation, draft version, 4 March 2020, paragraphs 4.24 and 4.25.
[21] European Commission, DG Competition discussion paper on the application of article 82 of the Treaty to Exclusionary Abuses, Brussels, December 2005, paragraph 77.

such data is available in respect of persons with a disability, reputable medical or actuarial advice or opinion, upon which it is reasonable to rely, whether or not contained in an underwriting manual".

The Human Rights Act places the obligation on the insurance supplier to be able to provide "justification … for reliance on the data or advice or opinion and for the different treatment" and "views of an actuary on the justification for the reliance and for the different treatment".

It therefore follows that the burden of proof of any objective justification must sit with Chorus and the other LFCs.

The Guidelines should be extended to include details of what Chorus (and the other LFCs) need to do to demonstrate they have met their equivalence and non-discrimination obligations

Vocus and Vodafone consider that the Guidelines should be complemented by supporting Information Disclosure Requirements to help provide transparency about whether the equivalence and non-discrimination requirements have been, and are being, met. This should include, for example,

- Requirements for Directors to report that Chorus (and the LFCs) have meet requirements such as that Chorus has provided its own business operations and Access Seekers with the same confidential information about the service provided by means of the same systems and processes. This should include specific reporting, for example, that Access Seekers have equal access to information about the network provider's risk management and high level access management approach, including information about plans for network expansion and product development and approval milestones for investment plans;

- Disclosure of service delivery times for itself and Access Seekers. This should include reporting on specific elements of service delivery including the time taken to fix faults;

- Disclosure of transfer prices and imputed internal prices (the price the Access Provider charges internally to their own downstream operations), including the methodology used to determine the transfer/imputed prices and rationale for the methodology (where this isn't prescribed in the Guidelines); and

- Application of economic replicability tests, including financial reporting of information required to demonstrate that their pricing does not result in price squeezes e.g. the profit or loss of the Access Provider's own downstream operations if it incurred the same explicit external price payable by Access Seekers. We note and agree with the Commission's observation (paragraph 3.42) 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 the access seekers".

Adoption of compliance reporting requirements would provide greater regulatory certainty for Access Providers and Access Seekers and to help ensure a greater level of compliance with the equivalence and non-discrimination obligations. They Commission may want to consider how such requirements would best fit into the overall regulatory framework.

Chorus' submission muddies the water, rather than shedding any light

We have limited our commentary on the Chorus' submission in response to Vogelsang[22] as the Commission has largely addressed the submission in its Response to Submissions.

Overall, we did not consider the Chorus submission aided the determination of how the equivalence and non-discrimination obligations should be interpreted. The main thrust of the Chorus submission seemed to be to attempt to minimise the Commission's reliance on Vogelsang's advice.

A clear example where the Chorus submission could be viewed as unhelpful was on its commentary on how to interpret equivalent and non-discrimination. By way of summary, Chorus asserted:

> The interpretation of the equivalence and non-discrimination obligations is principally a question of law – not one of discretionary decision-making in which economic analysis or regulatory policy is directly implemented.

The Part 4 Commerce Act Input Methodologies Merit Appeal decision provides relevant precedent for statutory interpretation.[23]

The Merit Appeal decision makes it clear that even when words used in legislation "are plain English words" it can be the case that "dictionary definitions are not sufficient to give flesh to the term as it is used in economic regulation".[24] The High Court decision drew on "the large body of theoretical literature" to determine how terms such as "workable competition" and "efficiency" should be interpreted.[25]

It is notable also the High Court commented that the Commission's explanation of "the relationship between the s 52A(1) purpose and outcomes, and economic principles stemming from the three dimensions of economic efficiency – allocative, productive and dynamic – which the s 52A(1) outcomes both reflect and are designed to promote" is "non-controversial". The Chorus position would limit the interpretation of "efficiency" narrowly to "the quality of doing something well with no waste of time or money" which is, at best, a productive efficiency concept.

We support holding a workshop on the draft Guidelines

We are open to the suggestion (Trustpower) that the Commission consider holding an industry workshop, but only if this does not unduly delay the final Guidance, or any investigation into the price or non-price terms of the PONFAS service.[26] A workshop could be a useful way of testing the Commission and stakeholder views on the draft Guidelines and should be held prior to the Commission making decisions on the Guidelines.

We would also support an industry workshop "either as we prepare the final Guidelines, or shortly after the final Guidelines is published" if the Commission considers this is needed to assist stakeholders understanding of the new regime and compliance obligations.[27]

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[22] Chorus, Chorus submission on Professor Ingo Vogelsang's interpretation of the equivalence and non-discrimination obligations imposed on local fibre companies, 18 November 2019.
[23] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013].
[24] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [11].
[25] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].
[26] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 110.
[27] Commerce Commission, Response to submissions, Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report, 2 April 2020, paragraph 111.

Concluding remarks

The draft Guidelines provide a useful outline of the issues that need to be addressed to ensure compliance with the equivalence and non-discrimination obligations. However, they are entirely silent in relation a number of critical issues, including penetration pricing.

Vocus and Vodafone reiterate that "The Commission must draw stronger conclusions [than Vogelsang] on what pricing approaches are non-compliant with the Act".[28] The Commission has instead reached weaker draft conclusions, and effectively stepped back, from Vogelsang's report.

We reiterate, that we support Dr Vogelsang position that:

- "a safe harbour of layer 1 price that is the lower of the resource based cost and the ECPR cost (based on an efficient entrant)"; and

- "a two-part tariff is inconsistent with the non-discrimination requirements".[29]

The Guidelines should specify these requirements without qualification.

Vocus and Vodafone consider substantive further work is warranted to develop a set of Guidelines that provide clear direction about what is required to meet the equivalence and non-discrimination obligations and not leave it to the Access Providers on self-interest to judge what is and is not acceptable behaviour, including in relation to pricing and terms and conditions for access services.

[28] Vocus and Vodafone, Joint submission on expert report from Dr Ingo Vogelsang on equivalence and non-discrimination, 18 November 2019.
[29] Vocus and Vodafone, Joint submission on expert report from Dr Ingo Vogelsang on equivalence and non-discrimination, 18 November 2019.