Submission on Section 201 Draft Guidance

24 June 2021

CHORUS

Executive summary

- We welcome the Commerce Commission's (**Commission**) consultation on its draft guidance on s 201 – GCP, dated 27 May 2021. We appreciate that developing guidance for compliance obligations is difficult and ultimately compliance is a question for the courts to decide. This submission represents our observations on the Commission's guidance and does not represent our final position on the proper interpretation of s 201.
- Parliament enacted s 201, Geographically Consistent Pricing (**GCP**), to ensure comparable pricing for end-users regardless of their geographic location, and to help mitigate risk of further widening the digital divide. We share the Commission's interpretation of s 201 as being primarily aimed at ensuring that rural residential users pay the same for access services as their urban counterparts.
- We generally support the Commission's approach. However, GCP is only one element of many within the broader telecommunications framework. It is important to consider GCP within this broader context and help ensure the appropriate incentives are set to promote the purpose of Part 6 of the Telecommunications Act 2001 (**Act**). In particular:
    - We disagree with the Commission's position that incentive payments form part of the "price" of fibre fixed-line access services (**FFLAS**). The relevant legal definition of price, the substance of the transactions between Chorus and retail service providers (**RSPs**) and the accounting treatment of the incentive payments confirm that these payments are not part of the "price" that RSPs pay to Chorus for the provision of FFLAS.
    - GCP must be read so as to permit different prices where appropriate and location agnostic. While the vast majority of Chorus' FFLAS are priced consistently irrespective of geographic location (including all access services directly used by residential end-users, i.e. consumer bitstream), some FFLAS prices may vary according to cost of the underlying physical or technological inputs. In these limited instances, prices may be cost-reflective or distance-based, but do not differ based on the location they service.
    - An overly restrictive approach to GCP, which does not permit variable prices, even for a limited range of input products, could disincentivise network investment and expansion or the provision of FFLAS in certain locations.
    - We agree that Chorus is best placed to ensure that its product portfolio is GCP-compliant, and we are taking steps to ensure this.

Context

1. GCP prohibits price differences solely attributable to the location of the access seeker or end user. While we support the objective to close the 'digital divide', GCP is one regulatory tool of many and the digital divide is a much broader policy issue that requires attention from multiple sectors, continued support from Crown funding, and the appropriate regulatory settings. We understand that government is looking at these issues and we welcome engagement with government on ways to support and improve digital equity for New Zealanders.

2. When Parliament enacted s 201, it also tasked the Commission and the Ministry of Business, Innovation and Employment (**MBIE**) with designing and implementing other regulatory tools that constrain the way in which we can price FFLAS and operate our fibre business. It is important to recognise that GCP cannot fix the digital divide alone, and it operates within a broader telecommunications framework of regulatory tools that constrain the way in which we can price FFLAS and operate our fibre business. For instance, Chorus' suite of fibre services will be constrained by a revenue cap and any MBIE declared services (i.e. anchor voice and broadband services, and direct fibre access services) will be price capped.

3. The Commission has indicated that one of the purposes of s 201 is to prevent pocket pricing to deter competition.[1] Chorus disagrees with the idea that price drops are used to deter competition. Rather, price drops are usually made in response to market dynamics. It would be a perverse outcome if s 201 was used to constrain otherwise workable competition.

4. All parts of this framework must work together to achieve the purpose of the Act. With the right regulatory settings Chorus could be incentivised to expand its network.

Application of GCP

5. The definition and scope of FFLAS is an important part of the application of s 201. While this is largely dealt with outside the draft Guidance (initially in the Fibre Input Methodologies – main final decisions reasons paper, and recently in the draft price-quality determination (**PQD**) decisions), it is important to acknowledge that the decisions taken in the context of the PQD have a significant impact on the scope of the application of s 201.

6. Chorus agrees with the Commission's position that the GCP requirement only applies to services that are subject to price-quality (**PQ**) regulation (i.e. PQ-only FFLAS). This approach is consistent with the general principle that the regulatory framework provides for "less intrusive regulation where competition is present".[2]

7. Accordingly, GCP does not apply to services offered by Chorus in other LFC areas. This reflects the wording of the legislation, and recognises that in other LFC areas, the

[1] Commerce Commission, *Section 201 – Geographically consistent pricing (draft guidance)*, dated 27 May 2021, at paragraph 33.
[2] Commerce Commission, *Section 201 – Geographically consistent pricing (draft guidance)*, dated 27 May 2021, at paragraph 6.

presence of those other providers of FFLAS means there is sufficient competitive constraint on Chorus, such that PQ regulation (and GCP) is not required.

8. Below we outline our view on GCP and how it deals with the location of FFLAS, the "same service" and the "same price".

Location of service provided

9. We agree that there are practical difficulties where the end-user is not the ultimate recipient of the FFLAS service, such as aggregation and transport services, and hence a different approach is needed. We also agree that the approach should be based on proportionate regulation and be fit for purpose.

10. We appreciate that the Commission has signalled a more nuanced approach to services where the location of the end-user is not known. However what this appears to translate to is determining that all transport services, other than those provided solely within other LFC areas, are captured; and colocation and other similar services are provided at the location of the facility regardless of the actual location of the end-users. We consider that as a matter of principle if we can establish that FFLAS is provided substantially for the benefit of end-users in an LFC area, it should be ID-only FFLAS. This may occur if we expand our services in other LFC areas which could include the use of our existing UFB exchanges.

Determining "same service"

11. We agree with the Commission's position that what constitutes the "same service" should be based on substance over form. This means that, regardless of name, any differences in technology, contractual terms and / or performance or quality aspects of the service can be relevant factors in assessing whether services are the same or not. The focus should be on the characteristics of the service and not the name by which it is known or marketed. A corollary of this principle is that different versions / implementations of a service with the same product name may constitute different services for the purposes of s 201. It would potentially be confusing for end-users if in order to be GCP-compliant we were required to call every service that has different technical characteristics by a different name.

12. We acknowledge the Commission's view that trivial difference in service delivery cannot be used to justify a different price. However, care needs to be taken in categorising what is or is not "trivial", as seemingly trivial things from an outside perspective may have a material impact on a service or the terms on which it is supplied (such as, service levels). A determination of the "same service" should support continued product differentiation and innovation, which Part 6 aims to promote (outside of any declared anchor or DFAS services).

Determining "same price"

What constitutes "price"

13. Before turning to the issue of what constitutes the "same price" we first need to address what "price" means.

14. We disagree with the Commission's position that "price" includes incentive payments made by Chorus. The Commission appears to have conflated the concepts of

"incentives" and "discounts", and this interpretation is incorrect in our view due to the following factors:

- The relevant legal definition of price;
- The accounting treatment of the incentives; and
- The substance of incentive transactions differs from, and is separate to, the transaction for acquiring FFLAS.

15. The Commission has interpreted incentives as constituting a "related term of payment" (which is part of "price" for the purposes of Part 6) under s 164. However, the phrase "related terms of payment" must be read in conjunction with the s 5 definition of "price", which in this context makes it clear that "price" means consideration provided by RSPs for the provision of FFLAS. This excludes incentive payments from the definition of "price", as incentives are not part of the consideration provided by RSPs for FFLAS, but are a separate payment to RSPs under separate arrangements made to secure certain behaviours or activities and are treated as capex in accordance with GAAP, specifically the IFRS15 accounting standard.

16. Unlike credit terms, interest, and discounts, incentives cannot be classified as "related terms of payment".[3] If incentives were to be a term of payment that operates as a discount off the price, there would need to be a known and certain amount that can be subtracted from the price list price to reach a net price. This is not the case, and it is unclear how the Commission envisages this being calculated for an incentive (a one-off payment) against the monthly rental for FFLAS, especially when it is not known how long the service will be purchased for.

17. "Price" for the purposes of GCP must also be consistent with the definition used in the PQD. Both drive off the same statutory definition, so there is no basis to adopt different interpretations. For the purposes of PQD, "price" is defined in the draft determination as "an individual fee or charge…for the provision of PQ FFLAS". Incentives are a payment made by Chorus to RSPs and therefore does not meet this definition.

18. The Commission has suggested that Chorus should submit an individual capex proposal for incentives. While the substance of that suggestion is outside the scope of this submission and will be addressed in our PQ Draft Decision submission, the Commission's proposal is relevant for the interpretation of "price". This is because if incentives are part of a capex proposal (as the Commission acknowledges), they cannot also be part of the price for FFLAS.

19. As discussed above, the treatment of incentives as capex and not part of "price" is consistent with GAAP. We caution the Commission's potential departure from GAAP – a divergence in audited and regulatory accounts will create confusion and complexity, particularly if we end up counting "price" as capex for one purpose and have a separate treatment of "price" for a difference purpose.

20. Lastly, the substance of incentive transactions between Chorus and RSPs indicate they are not a "related term of payment". Incentive offers are made separately from the provision of the underlying service. In some cases, incentives are calculated across a bundle of services, not a single service (so cannot be attributed to the purchase of

[3] We assume that the Commission will adopt the same approach to "discounts" as in Part 4, where discounts are treated as part of the price if they meet specified conditions (so not all discounts are part of the price).

any one service). In addition, incentives change from year to year (so cannot be calculated across the duration of the service or the amount paid for that service at the time it is purchased) and are paid pursuant to a separate offer and acceptance process with the RSP. There is often further activity required from the RSP to qualify for an incentive (such as specific fibre-focused marketing activity) which indicates the incentive is not part of the "price" of the FFLAS service but payment in return for additional obligations. Some RSPs choose not to accept the incentive offers, which again indicate they are not part of the price (as it seems unlikely an RSP would refuse a straight discount off the price).

What constitutes the "same price"

21. Almost all our FFLAS access products are offered at a flat price, which means end-users pay the same across all locations. A limited range of products, generally inputs such as transport, are not flat-priced but are priced based on a consistent formula to reflect distance or some other inherent feature. We agree with the Commission that GCP prohibits price differences that are "wholly" attributable to end-user location. However, it does not necessarily follow that distance-based pricing, or all forms of cost-reflective pricing, are not permitted. Price cannot be limited to mean the same unit price for every instance of FFLAS.

22. In particular, "distance" is not the same as "location". For example, transport services are by definition distance-based (in simple terms, they are charged on a per km basis). Provided that they are location-agnostic, we consider them to be GCP compliant.

23. By analogy, consumers would expect to pay for a taxi ride based on distance, and it would be considered the "same price" if the per km distance-based price were the same in Gisborne as in Auckland. It would not make sense if a taxi was forced to charge the same actual dollar amount from Auckland Airport to Auckland CBD as from Gisborne Airport to the centre of Gisborne. The different costs for this service, and therefore the different price paid, are due to the inherent nature of the service (taking a passenger X distance) and are (or can be) agnostic with respect to the location of that service.

24. Accordingly, we consider that adopting a pricing approach that is applied consistently and does not refer to or rely on the location of the end-user, is consistent with the requirement to charge the "same price".

25. The Commission has acknowledged that geographically consistent pricing has been a feature of the copper regulatory framework prior to the promulgation of s 201.[4] However, the Act contemplated copper prices that vary with distance (such as backhaul[5]), and pricing methodologies that recognise component costs. Distance-based or variable pricing can be consistent with geographically consistent pricing.

26. Section 201 should be interpreted consistently with these established positions and recognise the intention for standardised end-user prices (as was the case with copper) without completely negating the need for some variable pricing (especially for necessary inputs, such as transport).

[4] Commerce Commission, *Section 201 – Geographically consistent pricing (draft guidance)*, dated 27 May 2021, at paragraph 9.
[5] For example, regulated UBA Backhaul Service Recurring Charges was based on "Distance Groups" for charging.

27. We note that this issue largely arises due to the Commission's expansive view of FFLAS, which includes services that are not access services to end-users but inputs that support those access services and have never been subject to regulation or control to date (most notably transport and ancillary services). To reiterate, this is not an issue for our consumer bitstream services and may affect only a small subset of services. Our consumer bitstream services are priced flat.

Obligations and enforcement

28. We agree with the Commission's position that Chorus is best placed to ensure that its product portfolio is GCP-compliant.

29. Chorus wants to be able to expand its network, including offering FFLAS in rural areas wherever it is commercially viable to do so and with the appropriate regulatory settings. An overly restrictive application of GCP will risk curtailing, and not promoting, this expansion. The Commission's approach to GCP and enforcement should support, not hamper, the policy goals of encouraging the expansion of FFLAS into rural areas.

30. As the Commission has previously recognised,[6] a restrictive application of GCP will result in inefficiency, including distortionary pricing for potentially competitive technologies. In particular, averaging prices across our whole FFLAS portfolio could result in artificially high urban prices. This would encourage uptake of alternative technologies in an economically inefficient manner and could result in inefficient under-utilisation of fibre assets.

31. In addition, as the Commission has noted, Chorus has no obligation under s 201[7] to provide FFLAS in every location. Therefore, even with the right regulatory settings, an overly broad interpretation of s 201 could discourage the provision of FFLAS.

[6] Commerce Commission, *New regulatory framework for fibre - Invitation to comment on our proposed approach,* dated 9 November 2018, at paragraph 6.53.3 and footnote 143.
[7] Noting that we may have separate regulatory obligations to provide services in some locations, such as Anchor Services.