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Memo

To: [redacted]

Date: 24 September 2024

From: [redacted]

Subject: **Comments on the NZCCs reasonable grounds assessment**

1. Introduction

1. On 27 August 2024 the New Zealand Commerce Commission (NZCC) concluded in a draft decision that are no reasonable grounds to commence a deregulation review for fibre fixed line access services (FFLAS).
2. You have asked me to review this decision. I note that I have only had ~1 week to conduct this review, and therefore my review has necessarily been relatively high level and conceptual. In this short note I comment briefly on:
   a. The NZCC's view that setting a low threshold for the reasonable grounds assessment would result in regulatory uncertainty due to the number of reviews that would occur;
   b. The circularity that results from conducting a shadow review for the reasonable grounds assessment;
   c. The NZCC's interpretation of the introduction of a lower priced, lower speed wholesale fibre product in response to the growth of FWA as evidence that LFCs have the ability to exercise substantial market power; and
   d. Generalizations about FWA which are likely to lead to an underestimation of the constraint FWA exerts on fibre.

2. Regulatory uncertainty related to multiple reviews

3. At various points in in the draft reasonable grounds paper (2.15.3, 2.15.4, A14, A30) the NZCC justifies setting a high threshold for the reasonable grounds assessment on the basis that setting a lower threshold would create regulatory uncertainty due to having multiple unnecessary reviews.
4. The occurrence of multiple reviews does not, in and of itself, create regulatory uncertainty. Regulatory uncertainty, in the harmful sense is a situation where firms have uncertainty about the timing, process and approach that will be adopted, and/or there is inconsistency in these

factors over time. It is this type of "shifting of the goal" posts that leads to policy concerns about the effect of regulatory uncertainty on investment.

5. Viewed this way, conducting multiple reviews should not create concerns about regulatory uncertainty unless the NZCC cannot commit to conducting review in a consistent manner over time. As Willis (2012) notes, regulatory discretion is a key driver of regulatory uncertainty:[1]

> *the exercise of the regulator's discretion may generate regulatory uncertainty, even where that exercise is clearly within the formal limits of the regulator's jurisdiction. If the regulator exercises its discretion in unpredictable or unjustifiable ways—for example, acting inconsistently with accepted principles or established precedent and without articulating credible reasons for that inconsistency — then uncertainty results.*

6. In the present context where we have a new regulatory regime, conducting a review would in some sense help reduce regulatory uncertainty, as it would give parties knowledge of how the NZCC will conduct deregulation reviews in the future. This could also be partly achieved by providing more guidance on how a full review conducted and how it would differ from the shadow review the NZCC is conducting as part of its reasonable grounds assessment. The NZCC has done this in partial sense by noting it would obtain switching data[2] and examine "pockets of competition" in more detail,[3] but has not done this in the systematic way that would be required to reduce regulatory uncertainty. In this regard, I note that Spark submitted the NZCC could promote certainty by providing guidance on the wider considerations it would apply to a full review, to which the NZCC has responded in Table B1 that *"as this is only the reasonable grounds assessment, we have not commented on what a deregulation review may consider*".

3. Issues created by conducting a shadow review for the "reasonable grounds" assessment

7. The NZCC considers that there are reasonable grounds to conduct a deregulation review where "*the information before us is objectively sufficient to leave us with a view that it is likely that the services should no longer be regulated*." The result of this threshold is that the NZCC is essentially conducting a shadow review, which means it needs to tackle some complicated and substantive questions such as market definition and the constraint of FWA. However, because it is not a full review, it is unable to engage with some questions in a sufficient level of detail.

8. This risks leading circularity in the NZCC decision making, as the NZCC may lack the data during the reasonable grounds assessment to properly analyse issues such as market definition and the extent of the constraint from FWA. Indeed, as already noted, at multiple places the NZCC notes that in a full review it might obtain switching data. Yet by committing to doing a market definition and competition analysis during a reasonable grounds assessment, the NZCC is only able to make relatively high-level generalisations on these issues. The risk is that these generalisations leads the NZCC to make a conclusion that would be contradicted by more detailed analysis and information (which would be gathered in detailed review).

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1 Willis, Edward, "On regulatory uncertainty", *New Zealand Law Journal,* August 2012, p. 233.

2 3.45, 3.95, 3.138, 3.157 and 3.184.

3 A31.

9. This is illustrated by the NZCC's approach to market definition and whether there are separate markets for different speed products. At 3.63 - 3.65 the NZCC defines a single retail broadband market, and states that defining a separate market for lower speed broadband services would not change their conclusions (3.63) and that they "*note the implications of if we had used a narrower market below*" (3.65). This appears to be a reference to 3.83 (given 3.83 refers back to 3.65). At 3.83, the NZCC notes that defining a narrower product market by speed would result in even higher fibre shares.

10. However, the fibre share increasing is a finding specific to a high-speed market. The opposite would occur in a separately defined low-speed market. The NZCC notes this in the appendix at A36, where they state "*only a relatively small number of retail fibre connections would be included in the market*". If a separate low-speed bitstream market was defined it therefore seems likely that the NZCC would find a lack of SMP by the fibre providers given their very small share in the market. It is therefore unclear why the NZCC states at 3.63 that their findings are invariant whether a separate low speed market is defined. As discussed further in para 19 below the NZCC does not appear to have analysed whether there is chain of substitution between low and high speed broadband products, such that FWA might constrain high-speed plans even if many users of high-speed plan would not themselves switch to low-speed plans.

11. This issue is further illustrated by the NZCC's concern at A31 regarding false positives related to defining narrow markets when there are "pockets of competition". I interpret the concern to be that if the NZCC erroneously defined narrow markets during a reasonable grounds assessment, this would lead to an incorrect finding that there is no SMP in this narrow market, as the market is actually broader and the "pocket of competition" does not influence the (correctly defined) broader market. The NZCC's solution to this is to define broad markets and then leave any analysis of the impact of pockets of competition to a full deregulation review. In doing so, the NZCC has therefore ruled out the possibility of deregulating more narrowly defined markets.

4. Interpretation of introduction fibre starter

12. At 3.107 regarding whether the LFCs have the ability to exercise SMP in the provision of Bitstream PON, the NZCC concludes *"it is probable that there is little competitive constraint on the ability of regulated providers to exercise SMP*."

13. In support of this conclusion, the NZCC cites (3.109 – 3.110) the introduction by the LFCs of the 50/10 fibre starter plans to compete with FWA. The NZCC notes at 3.111 that these examples "*highlight how the regulated providers are able to adjust service offerings in order to compete with other technologies which already operate at full-speed.*"

14. On its face, this is a competitive response to LFCs by the growth of FWA, and the NZCC itself notes in the quote above it was done to compete with other technologies. The examples given are also an effective wholesale price reduction for fibre broadband, since prior to this the cheapest fibre broadband was for a more expensive and higher speed product. It is therefore unclear how this is evidence of an ability to exercise SMP.

15. At 3.108, the NZCC states that there is little cost for an LFC to adjust the speed of fibre plans to compete with services offered by other technologies and cross refers to paragraph 3.74. Paragraph 3.74 notes that the ability to change plan speeds without incurring costs is a form of

price discrimination. Evidence of price discrimination is not evidence of an ability to exercise SMP – price discrimination occurs in many markets that are considered to be competitive (e.g. airlines, movie theaters etc…).

5. Generalizations about constraint from FWA

16. When assessing the competitive constraint of FWA and 4G FWA in particular, the NZCC downplays its competitive significance, largely based on technical characteristics. Given that the NZCC's concerns are with the technical characteristics in particular, the key limitations of FWA relative to fibre, in the NZCC's view, appear to be:

    a. *Lower technical performance* means 4G FWA is not a close substitute to fibre;[4] and

    b. *Capacity constraints* may limit the competitive constraint FWA places on fibre.[5]

5.1. Technical performance characteristics

17. Regarding the first point, it is not necessary for FWA to have near identical technical performance to fibre for it to be close substitute. What matters for whether a given technology is a substitute is whether the technical characteristics meet the needs/use case of customers. Which is to say, if fibre is materially 'overspec'd' for a given customer's needs/use case (for example a customer that primarily browses the internet and sends emails), then fibre and FWA may be functionally equivalent from that customer's perspective.

18. Thus, for customers at the lower end of the market, 4G FWA and fibre are likely to be close substitutes, despite fibre having better technical performance. Which is to say, economic, rather than technical substitutability is what matters for market definition and competition analysis.

19. If FWA is a material constraint at the bottom end of the market, then that may justify defining a separate low speed market. It may also be the case that there is a single market in which FWA constrains higher speed plans via a "chain of substitution". In effect if there are enough customers at the margin who would switch between a high and low speed product depending on relative retail prices, the price for the high speed product will be constrained by the lower speed products. The NZCC has given some consideration to whether there is separate low speed market, but by nature of ruling out FWA as a material constraint does not appear to have assessed the latter.

[4] E.g. at 3.91 the NZCC notes that 4G FWA plans are similarly priced to Fibre 50 plans, but offer slower speeds and worse latency.

[5] See, e.g. 3.100, 3.105, 3.106 and A39. where the NZCC states "Capacity constraints of FWA may limit their ability to provide strong competitive constraints on Bitstream PON services, but capacity can be managed through investment by providers."

5.2. Capacity constraints

20. While the NZCC is correct that capacity constraints can limit competition, the NZCC has made several generalisations regarding capacity constraints, which are likely to result in the competitive significance of FWA being understated.

21. Firstly, the NZCC has acknowledged the constraints are not hard, but it considers that FWA's capacity constraints are expensive to relieve.[6] However:

    a. Simply noting a constraint exists and it is "relatively expensive to relieve" does not mean it is not economic to relieve. the NZCC has noted there are a number of "stop-sells" in place for FWA, the NZCC has not stated it has evidence from the MNOs regarding the conditions under which they would relieve those constraints and indeed whether or not they have plans to invest to relieve the constraints.

    b. Which is to say, the constraints currently being witnessed may be transitory and could equally be interpreted as evidence of the competitive success of FWA, rather than evidence of permanent handicap. Indeed, if constraints are appearing in areas where FWA has been successful in capturing a high share, that would be consistent with this interpretation.

22. Secondly, the NZCC states that where capacity constraints exist, FWA-based competitors will face a reduced incentive to compete to acquire new end-users.[7] This argument ignores that if other firms have spare capacity (such as other MNOs or the relevant LFC), those firms will still be incentivized to acquire customers from the constrained FWA operator (and not all FWA operators will be constrained in a given areas). In this scenario, a constrained FWA operator will still need to compete to retain its customers and will likely experience some churn, meaning it will still need to acquire customers.

23. Thirdly, the NZCC's concerns are framed around concerns about what would occur if a "material number of customers" were to shift from fibre to FWA.

    > *Critically, if a material number of consumers were to shift off of retail fibre services to alternatives such as FWA, capacity issues would likely result. Service quality would degrade for both new and existing users, providing them with a quality of service below (or in the case of high-speed fibre plans significantly below), what they previously experienced. Users may not even be able to switch if capacity issues were significant. As noted in paragraph 3.101, this is a possibility for 5G FWA as it expands further.*

24. In this regard we note:

    a. A "material number of customers" shifting would improve the business case for expanding FWA capacity, given the lumpiness of the capital investment required; and

    b. Relatedly, capacity constraints are very localized, so a "material number of customers" may not cause constraints if they are dispersed across an MNO's network; and

    c. A "material number of customers" is not the relevant test whether a competitor could constrain SMP – it is whether sufficient customers would switch to render a price increase unprofitable.

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6 At 3.8 and A39.

7 A39.