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TRUSTPOWER SUBMISSION: FIBRE REGULATION EMERGING VIEWS

1 Introduction

- 1.1.1 The Commerce Commission (the **Commission**) is continuing to progress with developing the new regulatory regime for fibre fixed line access services (**FFLAS**) as required under Part 6 of the Telecommunications Act 2001 (the **Act**).
- 1.1.2 The Commission recently published its Fibre regulation emerging views summary and technical papers (**Emerging views paper**) and is currently seeking feedback.
- 1.1.3 This submission provides Trustpower's feedback on the matters in the Emerging views paper most relevant to Trustpower's participation in the communications sector.

2 Trustpower's perspective

- 2.1.1 Trustpower is a multiproduct retailer that offers bundles of electricity, gas and telecommunications services to its customers. We currently retail to 267,000 electricity connections, 96,000 fixed-line customers and 39,000 gas customers. We will also be participating in both the mobile and fixed-wireless markets in due course.
- 2.1.2 As a market challenger in the telecommunications market, we have a reputation for developing disruptive service propositions and have made a significant contribution to the uptake of fibre services.
- 2.1.3 Genuine, credible market challengers operating sustainable business models provide benefits to customers by delivering innovative solutions and competitive pricing. To enable genuine, credible market challengers to continue innovating and growing their presence in the New Zealand telecommunications sector, it is essential that:
 - a) a level playing field is maintained; and
 - b) access to wholesale inputs is provided on terms that allow competition with larger participants, particularly those who benefit from vertically integrated mobile businesses .
- 2.1.4 From Trustpower's perspective, we wish to emphasise the importance of retail competition between Retail Service Providers (**RSPs**) using FFLAS services provided by regulated suppliers, but also the importance of enabling competition using other technologies that use FFLAS as key inputs. The market should be allowed to evolve without technology preference. The views expressed in this submission generally are premised around this position.

3 Trustpower's views

- 3.1.1 We thank the Commission for the opportunity to provide a submission on its Emerging views paper for the new fibre regulatory regime, including the input methodologies (IMs).
- 3.1.2 Our submission is structured to present our general views around the new fibre regime (section 3.2), followed by our more detailed points on each of the relevant chapters within the Commission's technical Emerging views paper (sections 3.3- 3.10).
- 3.1.3 Our submission should be read in conjunction with the advice of Link Economics (provided in Appendix A), who we engaged to assist us in understanding the potential competitive and consumer outcomes of the new fibre regulatory arrangements.

3.2 General views

- 3.2.1 To support the New Zealand Government's long-term vision of a vibrant telecommunications environment, the regulatory settings that apply to both the monopoly and competitive sector are critical.
- 3.2.2 The design of the new regulatory regime for FFLAS is an important element in getting the regulatory settings right so that competition is promoted both within the fibre market, and in related telecommunications markets, including fixed-wireless and mobile. Ensuring that the regime results in a level playing field, and leads to outcomes that do not favour one technology over another, are important underpinning design considerations.
- 3.2.3 Ensuring good outcomes under the new regulatory regime will require the Commission to proactively monitor outcomes and exercise its review powers¹ and broader discretions in a timely way if issues arise. This will include needing to ensure that a disproportionate share of the fibre network build costs are not allocated to that group of end-users who have less choice (such as might occur if there is a shift to new technologies).
- 3.2.4 We are conscious that the new regulatory regime will impact on competition and consumer outcomes over time. Understanding how the competitive environment may evolve and over what timeframes is incredibly complex and there is uncertainty around a number of interrelated elements, including but not limited to:
 - a) the relationship between the fibre and copper networks, including the speed of transition and changes in the competitive pressure that the copper network exerts on the fibre network over time;
 - b) pricing of FFLAS at different levels of the supply chain, including unbundled fibre services, DFLAS and layer 2 and the resulting implications on RSPs choices around inputs; and
 - c) the relationship between fibre networks and substitute/complementary services, such as fixed wireless and mobile networks.
- 3.2.5 We engaged Link Economics to support Trustpower in better understanding these complexities and the potential implications with respect to competition and consumer outcomes. Relevantly Link Economics highlights that the implications on competition by the fibre IMs are likely to be "... substantially more so than for IM decisions relating to other sectors regulated under Part 4"².
- 3.2.6 Given these complexities and uncertainties, we consider that it is important that the new fibre regulatory regime provides the Commission with sufficient flexibility to ensure unintended consequences do not arise both with respect to competitive outcomes and end-user impacts,

¹ Including its powers under s 9A, part 6 subpart 7 of the Act (s208-10) and s 182.

² Link Economics, *Report on the Commerce Commission's Emerging Views on Fibre Regulation*, 2019, p. 2.

while balancing the need for regulatory certainty, i.e. with respect to the processes that will be applied, considerations that will be taken into account etc.

- 3.2.7 In the case of the fibre IM's, this balancing act will also need to extend to ensuring that the methodologies are robust and rigorous given they will play a key role in determining the revenues that Chorus can recover and the arrangements for information disclosure by Chorus and the Local Fibre Companies (LFCs). This is supported by the views of Link Economics³:

"The application of building block model regulation clearly has the potential to affect allocative and productivity efficiency, but in respect of telecommunications sector there is also a heightened impact on dynamic efficiency as a result of potential impacts on incentives for investment in alternative networks as well as for downstream competition. While the Commission is clearly aware of the complexities associated with application of IMs to fibre services, it seems crucial that these are kept front of mind in making Fibre IMs decisions. These complexities, uncertainties and evolving nature of the telecommunications sector also mean that it is important to incorporate flexibility in the regulatory process without trading off rigour and robustness in determining methodologies." (emphasis added)

- 3.2.8 Finally, we note that the effectiveness of the new regulatory regime also in part hinges off the effectiveness of the anchor products in providing an appropriate constraint on the price and quality of other FFLAS variants offered by Chorus. Similarly the regulated price of DFAS and, in the future, unbundled fibre services, will also impact on the effectiveness of the regime in constraining Chorus.
- 3.2.9 We suggest that prior to the commencement of the new arrangements, the Commission should review the proposed definition of the anchor products to ensure they remain in-synch with the evolution of end-user preferences and will act to appropriately constrain Chorus.

3.3 Chapter 1 - Legal framework

- 3.3.1 We agree with the Commission's views regarding the legal framework.

- 3.3.2 In particular, we agree with the Commission that:

"We do not consider that we should focus on promoting a particular form of competition, or that there is any presumed hierarchy between different types of competition that we could promote";⁴ and

".. as both s 166(2)(a) and s 166(2)(b) were concerned with outcomes produced by workable competition their objectives were complementary rather than competing, and that there was no hierarchy between the two outcomes".⁵

- 3.3.3 This is consistent with Trustpower's views as set out in previous submissions.

- 3.3.4 We also agree with the Commission's view that:

"the 'end-users' of FFLAS referred to in s 162 include any consumers of telecommunications services that use FFLAS as an input such as fixed wireless access"⁶ and

"... retail services will be "dependent" on a FFLAS whenever a FFLAS is used as an input to supply the retail services, even where a non-FFLAS alternative is available"⁷

and consider that this interpretation best aligns with ensuring a level playing field is maintained and that the regime remains technology agnostic.

3.4 Chapter 2: Key economic principles

- 3.4.1 We agree with the three economic principles of real financial capital management (FCM), allocation of risk and asymmetric consequences of over and under-investment.

³ Link Economics, *Report on the Commerce Commission's Emerging Views on Fibre Regulation*, 2019, p. 3.

⁴ Fibre regulation, Emerging Views Summary Paper. p.17. Paragraph 43.

⁵ Fibre regulation, Emerging Views Technical Paper. p.16. Paragraph 61.

⁶ Fibre regulation, Emerging Views Summary Paper. p.16. Paragraph 41

⁷ Fibre regulation, Emerging Views Technical Paper. p.11. Paragraph 40.

- 3.4.2 The discussion of these principles in the technical paper relate to the assumption of risks by regulated suppliers and how those risks may be compensated for.
- 3.4.3 A general point that we wish to make is that, when the regulated suppliers decided to participate in the UFB initiative in 2011, the risks that they assumed were managed with no expectation that a new regulatory framework would protect those suppliers.
- 3.4.4 For example, build risk in the early years of the Government's Ultra-Fast Broadband (**UFB**) was assumed by regulated suppliers and they faced the consequences if the build took longer or cost more than anticipated. There was no expectation that future regulation would, say, compensate them if these adverse consequences came to pass.
- 3.4.5 We believe this factor should be given greater prominence in the Commission's analysis. It follows that we do not necessarily believe that risks assumed by regulated suppliers prior to the new regulatory regime in 2018 should be reflected in any additional compensation for those regulated suppliers.
- 3.4.6 We accept that the legislation provides for the inclusion of accumulated financial losses in the regulated asset base (**RAB**), but we do not accept a general principle which notes that risks which were assumed in the early days of UFB should be compensated under the new regulatory regime.

Real FCM

- 3.4.7 In respect of Real FCM, while we recognise that the principle does not guarantee a normal return on a regulated supplier's investments, we request that the Commission clarifies whether the regulated supplier should have the "opportunity"⁸ (an even chance) or a stronger "expectation" of recovering their cost of capital over time.
- 3.4.8 In our view, the principle should relate to the opportunity, but not necessarily the expectation of recovery. While the regulated supplier may face future competition, additional compensation should not be warranted, provided that supplier has the opportunity of recovery.

Allocation of risk

- 3.4.9 In respect of the allocation of risk principle, we believe the Commission should recognise the distinction between the risks assumed by the regulated supplier prior to the new regulatory regime coming into force in 2018 as compared to risks assumed after that date, as discussed above.
- 3.4.10 We therefore query whether risks that were assumed by the regulated supplier prior to 2018 may be allocated to consumers under the allocation of risk principle. The Commission should take into account what actually happened when the regulated supplier assumed those risks, rather than considering this in the abstract.
- 3.4.11 We recognise that it is different for risks assumed post the new regulatory regime coming into place in 2018. However, we also recognise that the regulated suppliers committed to invest in 2011 and so whether compensation for risks has a detrimental impact on investment incentives doesn't appear a relevant consideration, given that the commitments have already been made.⁹

Asymmetric consequences

- 3.4.12 In respect of asymmetric consequences of over and under-investment, we note that the regulated suppliers are contractually obliged to roll-out their fibre networks. The concept of under-investment should be considered in this context.

⁸ We note that in the technical paper the Commission suggests that the Real FCM principle, in combination with the revenue cap, roll-over of the RAB and resets for each regulatory control period will enable suppliers to have an "opportunity" to earn a normal return on investments.

⁹ Fibre regulation, Emerging Views Technical Paper. p 28, Paragraph 116.2.2.

3.4.13 A regulated supplier's agreements with Crown Infrastructure Partners (**CIP**) may provide some latitude to under-invest, but generally it would be unlikely that a regulated supplier could invest less than it has contractually committed to in those agreements.

Pricing principle for LFCs

3.4.14 We would like the Commission to consider whether a further economic principle may be appropriate for the LFCs.¹⁰ While we note the Commission's emerging views around the need for a pricing principle for Chorus, the situation of the LFCs is different and warrants consideration. They are not subject to the various legal pricing requirements imposed on Chorus.

3.4.15 In reaching the view that a pricing principle was not required for Chorus, the Commission pointed to the fact that:

"... Chorus is subject to a number of additional legal pricing requirements imposed by the Act (eg, geographic consistency of prices and price caps for anchor services and DFAS)"¹¹

3.4.16 We recognise that the LFCs are not subject to the revenue caps, but the LFCs are also not subject to the price caps for anchor services and DFAS that Chorus is, although they are subject to geographic consistency and equivalence requirements.

3.4.17 Link Economics notes¹²:

"While broadband services supplied over copper networks place at least some competitive constraint on fibre pricing at the outset of the regime, it is unlikely that this competitive constraint will be sustained over the medium to long-term as bandwidth requirements extend beyond the limitations for the copper network. Application of pricing principles to the LFCs will help ensure the interests of consumers are protected."

3.4.18 We note that similar requirements exist in the electricity distribution context, although the relevant disclosures may need to be different for LFCs.

Competition principle

3.4.19 We would also like the Commission to consider the introduction of a further economic principle around competition to help guide the design of the new regulatory regime.

3.4.20 The competitive implications of IM decisions are complex and require clarity and prominence in decision making. Link Economics notes¹³:

"IM decisions have the potential not only to impact on incentives for infrastructure-based competition but also on the dynamics of retail competition, for example, by influencing the relative price of alternative FFLAS products that may be used by different RSPs... it is crucial that decisions on the Fibre IMs require specific consideration of competition impacts. These considerations will differ from Part 4 and are not necessarily captured by the three economic principles identified by the Commission"

3.4.21 We consider a competition principle would:

- a) provide more certainty as to how the Commission intends to take into account the impacts on competition when making decisions;
- b) assist the Commission in striking the necessary balance between flexibility and regulatory certainty, as discussed above; and
- c) be consistent with the requirement in section 166(2)(b).

¹⁰ Chorus is also considered an LFC but for the purposes of this submission LFC's are any FFLAS providers who are not Chorus.

¹¹ Fibre regulation, Emerging Views Technical Paper. p 37, Paragraph 135.2

¹² Link Economics, *Report on the Commerce Commission's Emerging Views on Fibre Regulation*, 2019, p. 4.

¹³ Link Economics, *Report on the Commerce Commission's Emerging Views on Fibre Regulation*, 2019, p. 5.

3.5 Chapter 3: Asset valuation

- 3.5.1 Under the legislation, the losses for regulated suppliers that were incurred prior to the implementation date must be included in the RAB.
- 3.5.2 As captured earlier in our submission, we consider that the incentives for regulated suppliers to ensure they are making prudent investment decisions has changed over time. While we believe that regulated suppliers were fully at risk for these losses prior to the new regime coming into force, and as a result it is reasonable to assume that they have efficiently incurred the relevant costs and assumed risks, after that date the risk shifted as there was certainty that further losses incurred would be included in the RAB.
- 3.5.3 This means that the Commission should specifically focus on scrutinising losses incurred after 2018 and before the implementation date. The regulated suppliers, at that point, were subject to a different set of incentives which may have affected how they incurred costs and took on risks.
- 3.5.4 More broadly, we support the Commission in ensuring it has appropriate regulatory tools (including depreciation and indexing) available to minimise any price shocks to end-users through smoothing revenues and prices. Application of these tools should enable smoothing to mitigate impacts for end-users: at the start of the first regulatory period; within the first regulatory period; and then in subsequent regulatory periods.

Calculation of financial losses

- 3.5.5 We note that under section 177(1)(a)(ii) the cost of Chorus' pre-2011 assets may be included in the fibre assets. However, in calculating the financial losses that may be included in the fibre assets, it is Chorus' post-2011 investments that must be considered.
- 3.5.6 Section 177(3)(a) provides that *"In determining the financial losses under subsection (2), the Commission— (a) must take into account any accumulated unrecovered returns on investments made by the provider under the UFB initiative"*.
- 3.5.7 Necessarily, these investments under the UFB initiative were made post-2011.
- 3.5.8 Therefore, if Chorus has unrecovered returns on pre-2011 investments, these should not in our opinion be included when calculating the financial losses within the fibre assets. This may include any pre-2011 assets that have subsequently been used for FFLAS by Chorus.
- 3.5.9 We consider that calculating financial losses in this way would be the correct outcome, as it is only those costs incurred *"... as a direct result of meeting specific requirements of the UFB initiative"* (s. 177(5)) that may be considered and any costs associated with pre-2011 assets would not be directly incurred as a result of UFB.

3.6 Chapter 4: Cost allocation

- 3.6.1 Our main concern in the area of cost allocation relates to the risk of an over allocation of shared costs to those FFLAS services that provide key inputs into potentially competitive services, such as DFAS with fixed wireless access.
- 3.6.2 While we accept that the cost allocation IM does not have to be overly prescriptive, we suggest that the Commission errs on the side of prescription in relation to this IM, particularly in those sensitive areas where a misallocation of costs are likely to impact competition.
- 3.6.3 Given the potentially significant impact on consumer outcomes associated with cost allocation decisions, the Commission should consider the suggestion of Link Economics that more detailed rules could be developed by Chorus in consultation with RSPs for approval and amendment by the Commission.

- 3.6.4 If in the future price-quality regulation is extended to any of the LFCs, clearly delineating which costs can be allocated to the regulated “fibre” business versus what costs accrue to other activities will be made more challenging as some LFCs are also regulated under Part 4 as an electricity distribution network. As we explained in our 2018 submission:

“We support the Commission in ensuring that the arrangements would not result in a double-counting of costs that arise between the Part 4 regime and new fibre regime, if any of the LFCs are subject to price-quality regulation in the future”.¹⁴

- 3.6.5 We also note that the Commission states that “...efficiency gains can be shared with end-users when the price-quality path is reset - or via an incentive mechanism, if one is applied - consistent with s 162(c)”¹⁵. We are uncertain how this is likely to work in practice and would appreciate further guidance from the Commission on how efficiency gains may be shared with FFLAS end-users.

3.7 Chapter 5: Cost of capital and risk

- 3.7.1 We agree with the Commission that the actual financing costs of Crown financing are likely to be zero.
- 3.7.2 We also agree with the Commission that an uplift to the weighted average cost of capital (**WACC**) is not required. Underinvestment risks and consequences are likely to be less significant in a fibre context than in the electricity sector.
- 3.7.3 This is supported by Link Economics who goes on to state that¹⁶:

“To the extent that there are underinvestment concerns, these are better dealt with via quality measures, particularly given the Commission’s view that underinvestment is likely to be more observable for fibre networks than electricity. In addition, WACC uplifts in the fibre context may lead to an over-investment in fibre, thereby distorting the potential for competition from other networks.”

- 3.7.4 As outlined earlier in this submission, we also question whether there are many opportunities for under-investment when regulated suppliers have committed contractually to deploying the fibre network. This would also suggest an uplift is not required.
- 3.7.5 Finally, we recommend caution in considering reducing asset lives, or an increase in the WACC in the face of competition. The competitive environment for high speed broadband is evolving and will continue to evolve. For example, the future environment will likely comprise of both fixed-line and wireless or other technologies. For periods of time wireless technologies may be in the ascendant, only to be overtaken by fixed line technologies. It will be difficult for the Commission to accurately determine whether and when assets may be stranded, and when a future upgrade may completely change the situation.

3.8 Chapter 6: Quality dimensions

- 3.8.1 We generally agree with the Commission that a transitional approach with respect to quality dimensions may be appropriate for the first regulatory period and that the quality IM should apply to all regulated suppliers (i.e. those subject to both PQ regulation and ID, and those subject only to ID). We also generally support the level of prescription intended by the Commission, i.e. up to level 3 as reflected in CEPA’s report.
- 3.8.2 Given where we are in the current life cycle of the fibre network, we see merit in the quality IM focussing more on the ongoing operational tasks that the regulated suppliers must perform for service providers, rather than say on deployment.

¹⁴ Trustpower submission, *New regulatory framework for fibre*, 21 December 2018. Paragraph 21.1.6

¹⁵ Fibre regulation, *Emerging Views Technical Paper*. p 28, Paragraph 116.1.3.

¹⁶ Link Economics, *Report on the Commerce Commission’s Emerging Views on Fibre Regulation*, 2019, p 9.

- 3.8.3 At a minimum, the existing service level arrangements for fibre should be captured by the quality IM measures/metrics contained with the Quality IM. It also stands to reason that the new regulatory regime should enable quality improvements where possible.
- 3.8.4 For example, service quality in the provisioning of fibre connections presents an ongoing challenge for RSPs and could be significantly improved. Likewise, bulk migrations to another handover on Chorus' fibre network creates significant challenges both in terms of the time taken for migrations to occur and the associated cost.
- 3.8.5 In our view, relying purely on the requirements for ordering, provisioning and switching within the current service level agreements would mean that an opportunity for improving the end-user experience would have been lost.
- 3.8.6 We also note that while fault and availability service level performance may be high now, we still see the need for some focus in this area as failings in faults and availability may reflect cost cutting and short cuts in terms of maintenance of the network.
- 3.8.7 The measures/metrics to be captured within the Quality IM will play an important role in ensuring the fibre network delivers to the quality required by end customers. We are therefore pleased that the Commission has agreed with our suggestion to engage directly with groups like ConsumerNZ to ensure that end-users expectations are accurately reflected.
- 3.8.8 We also suggest that during the detailed development of the Quality IM, further engagement with the relevant operational staff from RSPs and Chorus/LFCs would be valuable by way of a public workshop(s). This would help ensure that the metrics/measures are designed to drive the right quality outcomes (when applied in both ID and setting quality standards under-price quality regulation), while taking into account real world experiences.

3.9 Chapter 7: Capex IM

- 3.9.1 We note that Professor Cave referred to the risk that a regulated supplier over invests as a means of foreclosing the emergence of more efficient competitors. This would clearly be a concern and so processes such as customer and stakeholder consultation and independent verification are important.
- 3.9.2 We have no other particular comments on the CAPEX IM at this time.

3.10 Chapter 8: Treatment of taxation

- 3.10.1 We have no particular comments to make on the treatment of taxation, but wish to draw the attention of the Commission to the comments provided in Link Economics report around the importance of the methodology used for calculating regulatory tax not overstating the tax allowance required in future periods.

For any questions relating to the material in this submission, please contact me on 027 549 9330.

Regards,



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