



Regulatory processes and rules: topic paper

Submission | Commerce Commission

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Executive summary

Key outcomes of the Part 6 process are that access seekers have certainty over the specification and performance of wholesale service and confidence in the process for changing these specifications over time, and that future prices are predictable. This is so access seekers can invest with confidence in new capabilities and retail services. The Commission is not a passive participant in providing that certainty.

However, while we appreciate that the Part 6 implementation is a work in progress, the pathway through the IM and PQR process to achieve this certainty remains unclear. For example, access seekers proposed that the Commission set out detailed service specification and performance through the Quality IM and price quality determinations, and that a Pricing Methodology set out how it will apply cost-based principles required by the Act.

Specification and definition of prices and revenues

The Commission's Part 4 approach suggests that revenue cap and washup design also plays a part, promoting efficient and predictable future prices for access seekers and avoiding price volatility within and between regulatory periods¹. The Commission proposes to consider revenue related design matters – i.e. implementation of the cap, washup and revenue smoothing – in the price quality determination processes consultation before the end of 2019.

We agree that the the instruments are interrelated and that a Commission “hands on” approach to setting price quality path will required. However, there is a risk that input methodologies and PQR processes become disconnected, leaving gaps and disputes when IMs are implemented in practice. Accordingly, we recommend that the planned PQR processes consultation set out where decisions are expected to be made (IM or PQR determinations), specifying the scope of expected decisions in future processes.

Reopening price quality determinations

The Commission has also asked for comments on the circumstances under which it should reopen a PQR determination. We operate in a dynamic sector with quickly changing technologies and consumer demands – it would be risky to lock in all service specification and performance aspects of regulated services for the regulatory period.

Accordingly, we recommend that the Commission reserve the ability to clarify - or amend - service specification and performance aspects of services mid-way through a regulatory period. The Commission has found it necessary to clarify and amend Part 2 determinations from time to time, albeit infrequently.

Finally, the Commission shouldn't have to show that false or misleading information was knowingly provided in order to reopen a price path. If the false or misleading information had a material impact on the Commission determination, the determination should be corrected.

¹ For example, as specification of pricing rules in Part 3 of the EDB Input Methodologies.

Introduction

1. Thank you for the opportunity to comment on submissions on the Commission's Fibre Input Methodologies Regulatory Processes and Rules topic paper for implementing Part 6 of Act (**the topic paper**).
2. The Commission's emerging view is that it will determine processes and rules relating to the specification and definition of prices, processes and rules for reconsidering a price-quality path, and arrangements for regulatory balance dates.
3. In this submission, we address:
 - a. Proposals to consider the design of the revenue cap, wash-up and price smoothing issues in the forthcoming PQR processes consultation. We recommend that the Commission consider, in the PQR processes consultation, the relationship between IMs and price quality determinations, specifying the scope of expected decisions in these future processes; and
 - b. The criteria for reconsidering a price quality path determination. The telecommunications sector is dynamic with technology change and complex interactions between parties, and the Commission may also wish to clarify or amend quality or performance aspects of services (as it has to Part 2 regulated services from time to time).

Specification and definition of prices

4. The Commission emerging view is that the IM for the specification of price will prescribe that: a revenue cap will apply from implementation day, and specific matters such as the proposal/evaluation process, washup and revenue smoothing will be addressed as part of the PQR consultation process [paragraph 25].

Service specification and predictable future prices

5. For Spark, a key Part 6 outcome is that we have certainty over the service specifications of wholesale services and confidence in how these specifications evolve over time – so that we can develop our own platforms to support great services for end users – and predictability over future prices for our own investments².
6. Predictability of service specifications and pricing has both immediate and longer-term implications for access seekers and end users, for example:
 - a. Chorus has given notice (5 September) that it would apply a new \$170 charge for cancelled fibre connection orders from 1 November 2019. Chorus notes that around 23% of submitted fibre orders are cancelled due to factors external to Chorus and intends to apply a cancellation charge where it considers that the RSP or end user is to blame.

However, we believe Chorus processes and technician's actions contribute – directly or indirectly – to many of the cancellations for which Chorus is looking to charge. The proposed approach, while ultimately increasing prices to consumers, is unlikely to improve customer satisfaction as by pushing costs on to RSPs and end users it reduces Chorus incentives to improve processes or technician compliance

² Wider concerns discussed in previous submissions relate to Chorus' ability to act on incentives to distort competition or high Part 6 prices undermining public confidence in the regulatory framework.

which contribute to cancellations (such as turning up for appointments on time and correctly categorising cancellations). RSPs have further not been able to plan for this change and, combined with the incentives within the framework, short notice and customer concerns, implementation will likely be difficult and disruptive.

- b. Over the medium term, the predictability of future prices and confidence in how service specifications will evolve are key for access seekers to invest in their capabilities and networks.
7. We believe that a key objective of Part 6 implementation must be to service specifications and performance and future prices more predictable for access seekers.

Predictability comes from IMs and implementation design

8. The Commission's approach to setting both Pricing Methodologies and the operation of the framework, through the design of key elements such as revenue cap and washup, make future prices more predictable (fostering access seeker investment) and reduce price volatility.
9. As set out in our emerging views submission, we believe that the Commission should set a Pricing Methodology that provides guidance on how it will apply the cost priced principles in the Act. The Part 6 framework provides for several ongoing regulatory pricing considerations, including the
 - a. Anchor services review (for which cost based prices are required)³;
 - b. Review after the first period relating to whether an unbundled service should be declared (for which cost based prices are required)⁴; and
 - c. Integration of the Fibre Deed required unbundled fibre service prices and revenue in to the RAB and optimisation between current and future consumer prices⁵.

The predictability of future prices is important for access seekers considering making long term investments. Accordingly, as set out in the Axiom report, the Commission should be looking to provide certainty relating to how it will determine cost-based prices.

10. The Commission's Part 4 approach suggests that specification and definition of prices within the revenue cap is an important part of the utility regulation framework. For example, when the Commission considered comparable issues in proposed 4 EDB revenue cap arrangements, it:
 - a. Considered the efficiency, incentive and certainty promoting elements of the revenue cap design;
 - b. Focused on access provider incentives to inefficiently price services⁶ and avoid connecting new customers⁷; and

³ Section 208 of the Act.

⁴ Section 209 of the Act.

⁵ For example, the Commission will likely need to consider current and future pricing, and the impact on predictability and volatility of future prices, when considering smoothing, washup and expected relative cost recovery between anchor and uncapped Fibre Network services.

⁶ The Commission set out known incentives with a revenue cap model for providers to increase prices above that of an unregulated monopolist in order to reduce demand (thereby, maximising profits as revenues remain unchanged by costs fall) and whether there were countervailing factors that mitigated this risk.

⁷ The Commission proposed increasing the information disclosure requirements to, in part, mitigate concerns that providers would not pursue new connections as vigorously under a revenue cap approach

- c. Make design decisions specifically intended to make future prices more predictable for access seekers and to reduce price volatility within and between regulatory periods.
11. The Commission reflected these considerations in proposals to net out quantity impacts, apply a washup mechanism relating to any under or over recoveries resulting from differences between actual and forecast values, apply a cap on the average price increase, and smoothing of prices within the period (this latter design element was ultimately not required).
 12. The Commission should likewise consider revenue cap and washup design principles that reflect the Part 6 context and access provider incentives.

Ensuring that we get certainty across IMs and specification and definition of prices

13. The Commission is not a passive party in reducing pricing uncertainty. The Commission can determine a Pricing Methodology and design a revenue cap and washup process that reduces uncertainty⁸.
14. However, at this stage, these aspects of the regulated services remain unsolved and there is no obvious pathway through the IMs and PQ process that will deliver this certainty:
 - a. The specification of services and change framework is being considered in the Quality process - access seeker submitters have asked for detailed service descriptions;
 - b. Access seekers have proposed that the Commission set out how it will apply cost-based principles in an IM; and
 - c. The Commission's emerging view is that it will consult of the design issues in the PQR processes consultation by the end of 2019.
15. The Commission proposes to address design matters in the PQ determination process consultation, and we support considering these issues together to promote a "joined up" approach. However, we recognise that these requirements could sit in different regulatory instruments or parts of the Part 6 process, i.e. the specification of prices should sit in a processes and rules IM, or within the PQR process or another IM⁹.
16. Therefore, with multiple processes where these issues can be addressed, there is a danger that gaps are left in the framework or disputes arise over the scope of some processes. We recommend that the Commission set out in the PQ processes consultation where the key decisions sit, and the scope and nature of decisions that will be left to future processes.

Washup

17. The Commission's emerging view is that it would consider the washup mechanism alongside other tools when setting the price path in contrast to "locking in" its approach as part of the upfront IMs. Revenue smoothing would likewise be considered in the context of the whole regime alongside other tools such as a wash-up and anchor services regulation.

⁸ For example, see 2016 Input methodologies review decisions Topic paper 1. The Commission proposed washup mechanism was expected amongst other factors to discourage EDBs from suddenly increasing price to move to a profit maximising low demand position [330-332], and considered limits on under or over recovery pass through for price stability [109], and designed an annual allowable revenue process that better matched cost and price, and considered a cap on price increases.

⁹ A price change process with caps on volatility - and frequency of "new" charges - can properly be included in the Quality IM to mitigate the Chorus cancelled connection concerns discussed above.

18. We agree that the Commission will likely need to take a “hands on” approach to the PQ determination, using several mechanisms in order to achieve the multiple objectives and requirements of the Act. However, the design of the washup has significant implications for the allocation of risk and incentives and it is unclear how the washup can be considered in isolation from WACC, for example.
19. We expect that the operation of the washup is important for determining residual risk faced by fibre access providers. For example, as set out in our submission on the emerging views, the Crown took fibre deployment risks through UFB arrangements. Further, while Chorus has submitted that an increment should be added to the fibre return for the risk associated with deploying the UFB network, this was not how Chorus was viewed at the time Chorus committed to participate in UFB. For example, the Grant Samuel Independent Expert Report for shareholders highlights that¹⁰:
- a. The key benefits of participating in UFB was Crown payments and avoiding competition with a new high-speed network (rather than to acquire fibre demand in itself). Grant Samuel advised that the Crown was committed to a long-term investment in fibre telecommunications infrastructure and that shareholders had a choice of partnering with the Crown or face competing with a Crown subsidised UFB provider; and
 - b. Chorus would further have an asset profile, stable earnings and government support which would likely be compared by the market to other infrastructure entities. Fibre uptake was not seen as a key sensitivity as connection costs to the premise are driven by demand (with an associated revenue stream) and, even if fibre uptake is low Chorus would continue to generate earnings from its copper network.

Chorus’ September 2011 investor roadshow presentation likewise highlighted Chorus’ significant fixed network build experience, stable long-term demand, and solid and stable financial outlook with strong cash flow generation¹¹.

20. Therefore, we agree with Chorus and, while not necessarily specified in an IM, the Commission will likely need to consider the washup and revenue smoothing design (albeit at a principle level) alongside other Part 6 parameters such as WACC.

Reconsidering a price-quality determination

21. The Commission emerging view is that it would consider re-opening a PQR determination where: a catastrophic event, change in legislation or regulatory environment, error or knowingly false or misleading information being provided to the Commission. The Capex IM may set out specific situations in which a capex allowance would be reconsidered during a regulatory period.
22. The Commission has asked whether there are any specific factors in our sector that would justify a price quality path being reconsidered. The Commission could also consider reopening a PQ

¹⁰ See Scheme Booklet, Grant Samuel’s independent expert report for shareholders, Part 7. The choice was described as between “cooperating versus competing” with the Crown. <https://chorus-nzx-test.demo.outside.net/api/announcements/download/2011/1f89459e-2856-4517-80c9-0c5af431da69/b098a215-84eb-478e-9ee9-1b4c89cac27a/149667.pdf>

¹¹ See Chorus September 2011 presentation. <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=10&ved=2ahUKEwjCzI7a7sLkAhWn8HMBHSlzBj8QFjAJegQIARAC&url=http%3A%2F%2Fphx.corporate-ir.net%2FExternal.File%3Fitem%3DUGFyZW50SUQ9MTA2Nzc4fENoaWxkSUQ9LTF8VHlwZT0z%26t%3D1&usg=AOvVaw2jEJ8ZwODt5a4C7C6a2Eyh>

determination where necessary to make changes to the specification of services or performance objective.

23. Telecommunications sector technologies and services are evolving quickly, and determinations are expected to be set for three to five years. Therefore, while it is not expected to be common, it is likely that changes will be required to service specifications and quality dimensions that have material benefits for the end users at the day to day level. For example, the Commission has made specific amendments and clarifications to Part 2 determinations from time to time. We recommend that the Commission provide itself similar flexibility in the processes and rules IM, or potentially through specific provision in the Quality IM as it has for capex related changes.
24. Further, the Commission might consider reopening for any false or misleading information, irrespective of whether it has been knowingly provided. If the information has a material implication for the price quality determination, there should be an adjustment without the Commission having to establish that it was knowingly provided.

[End]