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TRUSTPOWER'S SUBMISSION ON FIBRE INPUT METHODOLOGIES

OVERVIEW

Introduction

The Commerce Commission (**the Commission**) has started the process of implementing the new regulatory regime for fibre fixed line access services (**FFLAS**) as per Part 6 of the Telecommunications Act 2001 (**the Act**), with an invitation to comment on its proposed approach to the new regulatory framework.

The Commission's proposed approach is set out in the 9 November 2016 *New regulatory framework for fibre* consultation paper (**Consultation paper**).

This submission provides Trustpower's feedback on the matters in the Consultation paper most relevant to Trustpower's participation in the telecommunications sector.

Trustpower's perspective

Trustpower is a multiproduct retailer that offers a bundle of electricity, gas and telecommunications services to its customers. We currently retail to around 271,000 electricity connections, 93,000 telecommunication customers and 37,000 gas customers. As a market challenger in the telecommunications sector, Trustpower has established a reputation for developing disruptive service propositions and has made a significant contribution to the adoption of fibre services.

Genuine, credible market challengers operating sustainable business models provide benefits to customers by delivering innovative solutions and competitive pricing. A level playing field is essential for market challengers to continue innovating and growing their presence in the telecommunication sector. Access to wholesale inputs must be available on terms that enable genuine credible market challengers to compete effectively against larger participants, particularly those who benefit from vertically integrated mobile businesses.

Trustpower encourages the Commission to consider the implications of participant scale, particularly with regards to unbundling. Likewise, the benefits available to participants who have the ability to use mobile networks to offer alternative services to fibre need careful consideration.

Summary of our views

The Government's long-term vision is for:

"a vibrant communications environment that provides high quality and affordable services for all New Zealanders, and enables our economy to grow, innovate and compete in dynamic global environment".¹

We think the regulatory settings which apply to both the monopoly and competitive sector are critical to achieving this vision.

The regulation of the fibre networks needs to ensure the supply of competitive and efficiently priced wholesale services that enable retailers to identify and meet the changing requirements of end-users. We think the building blocks model (**BBM**) is the best way to replicate competitive outcomes for those who face little or no competition and suggest that the Commission consider a simplified form of BBM for Chorus, to reduce regulatory costs.

However, we note that, looking forward, competition prospects may differ amongst different groups of end-users.

- For some groups of end-users, the monopoly status of fibre (on which Part 6 is predicated) may dissipate more quickly than envisaged when the new telecommunications regulatory framework was first designed.
- For other groups of end-users, who are seeking more than one communications service (broadband and mobile, content etc.) from the same supplier, the options may become more restricted.

This suggests that in addition to the focus of ensuring:

- that monopoly behaviours from fibre networks (such as excess pricing or poor quality) are averted;
- investment incentives are maintained to ensure end-users quality expectations are met; and
- end-users have the opportunity to share in efficiency gains over time,

the Commission will also need to ensure that its decisions do not lead to a loss of the benefits of competition over time (either through distortions in the form of competition or the exit of players responding to an un-level playing field).

To address these matters the Commission:

- needs to make decisions in a manner that leads to an overall increase (and not decrease) in competition in the wider communications sector; and
- be pro-active in both monitoring market conditions for access seekers and in exercising its review powers² in a timely way if issues arise.

In relation to Part 6, we have suggested the Commission:

- recognises and increases focus on competition at the retail level, as opposed to being at the network level; and
- develops input methodologies (**IMs**) which foster competition at the retail level by:
 - setting out the principles fibre providers need to apply in developing the pricing of wholesale services; and

¹ Ministry of Innovation, Business & Employment *Telecommunications Act Review: Options Paper 2016* pg.8

² Including its powers under s 9A, part 6 subpart 7 of the Act (s208-10) and s 182.

- o including a process for fibre providers to amend price structures and the quality dimensions in various fibre offerings in response to changes in relevant markets and technologies.

Care may also need to be taken to ensure 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).

Structure of the balance of this submission

Our detailed answers to the questions in the Consultation paper are set out in the appendices to this letter.

These appendices follow the order in which topics are addressed in the Consultation paper:

- Appendix A provides important context to the new regulatory framework;
- Appendix B makes a few suggestions on how the Commission's process in developing the fibre IMs could be improved to facilitate participation by a variety of stakeholders;
- Appendix C provides our views on the interpretation of the new legislative framework;
- Appendix D shares our thoughts on the economic concepts and principles that are relevant to the new regime; and
- Appendix E provides selected comments on some of the issues which the Commission has identified for early discussion.

Contact information

If you have any questions regarding the matters raised in this submission, please do not hesitate to contact me at this email address: paul.bacon@trustpower.co.nz

Regards,

**PAUL BACON
HEAD OF MARKETS**

APPENDIX A: CONTEXT

Background to current regulatory framework

The evolution of the telecommunications sector regulatory environment includes:

- a light-handed era from 1989 to 2000 following the privatisation of Telecom, where the expected competition did not eventuate due to lengthy litigation on access issues;
- an era of limited regulation from 2001-2006, after the Act was first introduced. In this era, competition increased but was still relatively limited;
- the execution of operational separation and the adoption of a ladder of investment model from 2006 to 2010, which did not result in either the investment or competition outcomes which were anticipated by the Government;
- the era from 2010 to 2018 where the Government:
 - increasingly intervened in the market to secure investment in infrastructure through initiatives such as the fibre to node upgrade and the UFB and RBI programmes; and
 - developed arrangements to update its regulatory models to ensure that the desired network investment occurred and there is a platform for competition amongst retail service providers;
- the UFB era which the Government *expects* will involve extensive reliance on the fibre networks to meet end-users' growing data needs (creating a monopoly status for fibre networks) and vigorous competition amongst retail service providers.

Relevantly, the Government decided to provide support for the roll-out of UFB on the basis of a new market model as structural separation was a condition of participation in its UFB tender process.

An integral part of the structural separation model is the expectation that open access will be available for all access-seekers. This is provided by the Deeds of Open Access Undertaking which set out the obligations on fibre providers to supply service on non-discriminatory and equivalence of inputs basis.

The focus of competition under this model shifts to the retail level.

Current regulatory framework

The new regulatory framework for the UFB era provides for an information disclosure regulation for all fibre providers, supplemented by price-quality path regulation for Chorus only. Price-quality path regulation can be imposed on the local fibre companies (**LFCs**) after the implementation date if necessary.

The Commission is required to apply the IMs to determine information disclosure and price-quality regulation by 1 January 2022, as extended by the Minister.

Core assumptions about need for regulation

The assumptions behind the new regulatory framework are set out in MBIE's 2015 discussion document³.

They include the twin assumptions that:

- **fibre networks provide monopoly services**

This is illustrated by the following quotes:

"While the use of mobile connectivity is increasing relative to fixed services we do not expect mobile networks to compete effectively with fixed networks in their core business of broadband access by 2020. Despite the increase capability of 4G technology, mobile data services are still likely to provide a less consistent service, and remain more expensive than equivalent fixed line services..."⁴ (emphasis added)

"We acknowledge that there is significant upside risk if mobile networks prove to be more competitive with fixed broadband than we set out here. If that were the case, then competition would be much more intense and the case for continued regulation weaker"⁵.

"Fixed line infrastructure competition through total bypass or overbuild of the UFB network by another fixed network appears unlikely, given:

- *the significant costs involved due to New Zealand's low population density and geography (this is one of the reasons for the Government's investment in the UFB initiative);*
- *the UFB network was designed to provide open access, so provides a platform for RSPs to enter the market without having to make significant sunk investments up front; and*
- *the first-mover advantage the UFB suppliers have in building their networks."⁶ (emphasis added)*

"As we noted above, fixed networks have natural monopoly characteristics and are unlikely to be overbuilt. In markets like these where competition is expected to remain limited, the role of regulation needs to go beyond promoting competition, to directly promoting end-user interests. The purpose of Part 4 of the Commerce Act, for example, includes promoting outcomes consistent with outcomes produced in competitive markets. This is because competition is unlikely in the industries regulated under Part 4 – like in fixed line communications networks"⁷ (emphasis added)

- **retailers have a level playing field and compete vigorously**

This is illustrated by the following quotes:

"The creation of Chorus as a stand-alone wholesale network operator of both copper and UFB networks mean that New Zealand now has a level playing field amongst retail fixed line operators. Strong open access and non-discrimination obligations also apply to the other UFB and RBI providers."⁸ (emphasis added)

"This consolidation trend does not appear to have had a major impact on competition to date. Competition is strong at the retail level, as indicated by price competition, innovation and the introduction of new services."⁹ (emphasis added)

"...competition law is likely to remain sufficient as a backstop to manage any competition issues arising at the content and application layers"¹⁰ (emphasis added)

³ Ministry of Business, Innovation and Employment *Regulating communications for the future: review of the Telecommunications Act 2001 (September 2015) (MBIE Discussion Document)*.

⁴ MBIE 2015 Discussion Document, page 14

⁵ ibid page 48

⁶ Ibid page 54

⁷ ibid page 56

⁸ ibid page 54

⁹ ibid page 40

¹⁰ ibid page 14

As a consequence, the Government determined that the risk of monopoly pricing should be the main focus of the new regulatory framework:

*"While structural separation in fixed networks has reduced incentives to inhibit or delay competition, it has not removed the incentives or ability for Chorus and LFCs to charge monopoly access prices."*¹¹

These assumptions continued to prevail in the Government's *Telecommunications Act: Options* paper and Cabinet decisions paper¹². For example:

- **fibre networks provide a monopoly services**

*"...the current focus is solely on fixed line services supplied by UFB providers (**which we have identified as having natural monopoly characteristics**)."*¹³ (emphasis added)

*"I have decided that the fibre pricing framework should focus only on fibre, and not copper, because **fibre is the technology of the future and is most likely to be the monopoly asset**."*¹⁴ (emphasis added)

- **retailers have a level playing field and compete vigorously**

*"Following the separation of the former fixed line incumbent Telecom New Zealand into Chorus and Spark and the creation of 'local fibre companies' (LFCs) for the UFB rollout, **open access wholesale-only fixed line networks now allow retailers to compete on a level playing field**."*¹⁵ (emphasis added)

Although there is some recognition of the possibility that competition may develop with an impact on other market participants:

*"Although BBM is generally applied in markets where there is little or no competition, it is possible that UFB providers will face a degree of competition from other services (for example from 4G fixed wireless services). We intend to ensure the new framework recognises and responds appropriately to any competition that emerges."*¹⁶ (emphasis added)

The principal mechanism to address competition from other technologies in the new framework is the ability to deregulate FFLAS in s 208. The process involves the Commission making a recommendation to the Minister, who then has the ability to recommend to the Governor-General that services are excluded from regulation. FFLAS can be deregulated with reference to geographic region, end-users, access-seekers, technical specifications, or other circumstances in which the services are provided.

In addition, late in the select committee process a new mandatory consideration was introduced (s 166(2)(b)) to enable the Commission to consider the interests of all end-users when making decisions under Part 6 about how fibre companies are regulated.

Current market conditions

The Cambridge Economics Policy Associated (CEPA) report, published by the Commission as part of this current consultation, describes the current market in the following terms¹⁷:

"The fibre services supplied by Chorus and the LFCs are purchased by retail service providers as inputs to their provision of fixed line voice and broadband services to end users. The largest RSPs are Spark (44% market share in 2017), Vodafone (27%) and Vocus (13%)."

¹¹ ibid page 43

¹² Ministry of Business, Innovation and Employment *Telecommunications Act Review: Options Paper* (July 2016) (**MBIE Options Paper**), Cabinet Economic Growth and Infrastructure Committee *Review of the Telecommunications Act 2001: Final Decisions on Fixed Line Services, Mobile Regulation and Consumer Protection* (May 2017) (**Cabinet Paper**).

¹³ MBIE Options Paper, page 73

¹⁴ Cabinet Paper, para 63

¹⁵ MBIE Options Paper, page 5

¹⁶ MBIE Options Paper, page 9

¹⁷CEPA Quality Dimensions of Wholesale Fibre Telecommunications Services, 2018, p. 18 available from https://comcom.govt.nz/_data/assets/pdf_file/0007/105010/CEPA-report-Quality-dimensions-of-wholesale-fibre-telecommunication-services-1-November-2018.pdf

The Commission's 2018 Annual Telecommunications Monitoring Report notes:

*"...the smaller retailers have continued to grow their share of market connections with the combined share of Trustpower, 2degrees and 'Other' providers increasing from 16% in 2017 to 18% this year."*¹⁸

While the market share of challenger brands is continuing to grow slowly, the continued level of market concentration suggests there is room for new entrants/increased competition provided they provide sustainable offers that end-users value.

The CEPA report also addresses the issue of substitutes:¹⁹

"Substitutes for fibre services exist where the coverage of alternative access technologies overlaps with the fibre network. Alternative technologies include: the existing copper network owned by Chorus; a hybrid coaxial fibre network operated by Vodafone in Christchurch, Wellington and Kapiti; and - increasingly - mobile networks. Mobile networks are operated by several RSPs, namely Spark, Vodafone and 2degrees. The Commission has observed that "[d]espite the ever increasing use of mobile devices, fibre gives consistent delivery of high-speed data which cannot currently be matched by mobile." In relation to voice services however, consumers have been increasingly adopting mobile rather than fixed-line calls; the Commission notes that mobile calls are often more convenient and that many mobile plans include large (or unlimited) volumes of call minutes."

The Commission notes in its Consultation paper that:²⁰

*"Our decisions under Part 6 relating to the regulation of FFLAS may enhance or impede or have a mixed impact in the wholesale markets where FFLAS are supplied **and in one or more of the downstream retail markets involving telecommunications services that may or may not use FFLAS as an input.**" (emphasis added)*

The implications of end customers transferring to substitute technologies (fixed wireless or mobile) will be an important consideration for the Commission when developing the new fibre regulatory arrangements:

- There is a risk of costs being disproportionately allocated to some end-users who cannot afford or access new substitute technologies. An important element of the new regulatory arrangements will be the development of appropriate safeguards for end-users, along with consideration of how to mitigate any price shocks that may arise.
- There is also a risk that Chorus will under-recover its investment in the fibre network. We are not privy to details of any broader agreements between Chorus and Government around the investment Chorus has made in the fibre network, but to the extent a regulatory compact exists this is a separate matter to the development of the new fibre regulatory regime. We consider that any regulatory compact is a matter between Chorus and the Government, consequently taxpayers, not end-users, should be responsible for resolving issues associated with under recovery.

On an ongoing basis, flexibility within the new regulatory arrangements for fibre network to adjust for changes in the competitive environment due to the impacts of substitutes will be important.

¹⁸ Commerce Commission *Annual Telecommunications Monitoring Report 2018*, p. 17.

¹⁹ CEPA, p. 18.

²⁰ See section 5.32 and 5.34.

APPENDIX B: DEVELOPING THE FIBRE INPUT METHODOLOGIES

1 What changes to our process (if any) would you suggest to enhance the opportunity for you and others, to provide input and views to us as we develop the fibre input methodologies

- 1.1.1 Trustpower employs a small in-house regulatory team which needs to keep up to date with regulation across the telecommunications, electricity and gas sectors, as well as provide advice on areas in which we may seek to supply new services. We do not have a dedicated resource focussed on economic regulation of network entities.
- 1.1.2 For this reason the regulatory team is grateful that the Commission's consultation papers are well written, able to be understood on a stand-alone basis (without the history of the previous decades of reform) and provide footnotes and further information in appendices to support the analysis. We strongly support the Commission continuing to supply this material as it is of considerable assistance to our regulatory team.
- 1.1.3 We would find it very helpful if the Commission could include in its process a "launch" of each paper (recorded on video/available as a podcast) where the paper's author's step through what is in the paper and give a flavour of the questions on which feedback is sought. This would be in addition to workshops exploring the issues more fully with regulatory experts once everyone has had an opportunity to think about the matters raised.
- 1.1.4 Likewise, we support the Commission considering the suggestion put forward by Chorus at the 10 December workshop to stagger consultation on the IM's.
- 1.1.5 We acknowledge there is no perfect solution to consulting on the IM's. In the event a staggered consultation approach is adopted, it may be necessary for the Commission to make final decisions on each IM at the same time as a package. We acknowledge that may require some flexibility for the Commission to make final "tweaks" to IM's that have already undergone consultation where necessary.

2 What input methodologies (if any) could be progressed to draft or final decisions earlier to provide more certainty to stakeholders on the new fibre regulatory regime?

- 2.1.1 We will be relying on the Commission to ensure that the prices charged for our fibre services are as efficient as possible. We acknowledge the new regime will have a bedding down period and that it might take more than one regulatory period to establish the efficient price levels.
- 2.1.2 This will not harm competition if all retailers are accessing the same services on the same prices. However if as a result of technology changes or other developments, a level playing field is not available, there could be adverse impacts on downstream competition, contrary to the long-term interests of end-users.
- 2.1.3 Therefore we would like to understand how the price and non-price terms for fibre access might change over time, particularly in response to changes in market structure or technology.
- 2.1.4 Similarly we suggest it would be valuable to understand what the expectations around quality will be, given the inherent trade-off between price and quality that will be required at times.
- 2.1.5 We suggest that as a priority the Commission include in its rules and processes IM (or in another bespoke IM):
 - a) the principles fibre providers need to apply when developing the pricing of wholesale services;

- b) the circumstances in which a price-quality path can be reconsidered within a regulatory period; and
- c) the process fibre providers can follow to amend price structures and quality dimension in response to changes in relevant markets and technologies.

APPENDIX C: INTERPRETING THE NEW REGULATORY FRAMEWORK

3 What are your views on our proposed interpretation of 'end-users of telecommunications services' in s 162 and s 166(2)(b)?

- 3.1.1 We agree with the Commission's proposed interpretation of end-users of telecommunications services.
- 3.1.2 We note the Commission's view that its focus should be on end-users not those seeking to provide services to end-users such as retail service providers.
- 3.1.3 Our view is that it is in the long-term interests of end-users to have vibrant competition in the retail sector including competition from genuine, credible market challengers.
- 3.1.4 This requires decision-making to safeguard the competitive process and maintain the level playing field on which Part 6 is based.

4 What are your views on our preliminary views on how s 162 and s 166(2) (b) interact?

- 4.1.1 Section 162 provides that the purpose of Part 6 is to promote the long-term interests of "*end-users in markets for fibre fixed line access services*".
- 4.1.2 However in s 166 (2)(b) there is also a mandatory requirement on the Commission to make decisions that not only apply s 162 purposes (for the benefit of *end-users in markets for fibre fixed line services*) but also give effect to the promotion of workable competition in telecommunications markets more generally (for the benefit of the *end-users of other technologies offering similar services*).
- 4.1.3 We think these sections are most likely to interact when the interests of different groups of end-users are considered. This includes both end-users:
 - a) taking different fibre services; and
 - b) who have a choice between fibre and other technologies for their needs.
- 4.1.4 The Consultation paper notes that where end-users have a choice of technology this is likely to lead to a removal of regulation for those end-users.
- 4.1.5 However we note this is likely to occur over longer time frames given the statutory process and need to amend existing price paths. In the meantime the Commission needs to apply price-quality path regulation in a manner which accommodates the transition process (from fibre to substitute services) and meets the requirements of s 166(2)(b).
- 4.1.6 It is also important to bear in mind that a range of outcomes are possible as competition emerges. In each market segment there could be:
 - a) vigorous competition and no need for regulation;
 - b) market foreclosure by unregulated companies competing with a "sitting duck" (particularly if regulatory change is tardy or insufficient); and/or
 - c) a risk that those unable to afford or access new technologies are left carrying a disproportionate burden of costs.
- 4.1.7 The Commission will need to consider each possibility as it makes its decisions. Care will need to be taken that in solving one regulatory problem, another is not inadvertently created.
- 4.1.8 We note the Commission considers that there is generally a complementary relationship between s 162 and s 166(2)(b) as they are both concerned with workable competition.

- 4.1.9 We agree that they support each other: s 162 is seeking to replicate outcomes of competition where there is none, and s 166(2)(b) is about promoting competition.
- 4.1.10 However, if there is a conflict between s 162 and s 166(2)(b) our view is that the overall purposes of the Act will be best served if the promotion of retail competition is preferred. This appears to be Parliament's intent.
- 4.1.11 In the *Telecommunications (New Regulatory Framework) Amendment Bill: Departmental Report*, officials recognised that the telecommunications industry is dynamic, and that new technology was already developing that could challenge fibre services:²¹
- "We expect fibre to be the dominant technology for the foreseeable future, and consider that consumers should be protected from the risk of monopolistic behaviour. Part 6 is designed to do this. Nonetheless, it would be prudent to allow some flexibility as competing technology develops. The Commission already has the power to deregulate where competition has developed. However, where competition is still developing, and is vulnerable, the flexibility to consider a wider group of consumers when making decisions may be valuable. Amending s166 to permit the Commission to consider promoting the long-term benefit of all telecommunication end-users when applying the purpose statement will provide the Commission with the flexibility necessary to respond to technological change". (emphasis added)*
- 4.1.12 The Select Committee adopted this recommendation, reporting back to the House with a new s 166(2)(b) inserted.

5 What are your views on our preliminary view on how s 173²² applies when we set the input methodologies?

- 5.1.1 We agree that:
- a) the s 174 purpose statement is conceptually subordinate to the mandatory considerations set out in s 162 and s 166(2)(b); and
 - b) the IMs enhance predictability but are not intended to remove all uncertainty as the Commission can review IMs in the manner prescribed in the Act.

6 What are your views on our preliminary view that a BBM approach similar to that adopted under Part 4 would best give or be likely to best give effect to the objectives in s 166?

- 6.1.1 The Consultation paper acknowledges that providing a stable and predictable regulatory framework is an important objective for both access seekers and access providers.
- 6.1.2 A strength of the BBM approach is its ability to generate more predictable long-term outcomes. We therefore support the use of this approach for all monopoly service providers.
- 6.1.3 There may be some opportunities to simplify price-quality path regulation. For example by the regulator providing a spread sheet model and some key assumptions (such as WACC, CPI, the efficiency "x" factor etc.). The regulated supplier would then populate the model with its operating and capital expenditure forecasts, regulated asset base (RAB) roll forward and other regulated revenue, the results of which would be reviewed and modified as the regulators saw fit²³.

²¹ Telecommunications (New Regulatory Framework) Amendment Bill: Report to the Economic Development, Science and Innovation Committee, 20 April 2018,

²² Our copy of the Act has this as section 174.

²³ For more details of our views around potential simplifications to price-quality path regulation refer to our submission to the Electricity Price Review Panel's First Report.

APPENDIX D: ECONOMIC CONCEPTS AND PRINCIPLES RELEVANT TO OUR NEW REGIME

7 How relevant to the fibre input methodologies are the three key economic principles used under Part 4?

Meaning and relevance of workable competition

- 7.1.1 We agree with:
- a) the Commission's interpretation of the various components of workable competition; and
 - b) Professor Yarrow's opinion that the greatest benefits of competition are in terms of dynamic efficiency including the discovery of, and use of, new information that leads to new products and services.
- 7.1.2 We also note that in the case of competitive markets, if market conditions result in an absence or loss of competition, it can take some time to remedy that absence or loss. Thus early intervention is warranted.
- 7.1.3 However, where the objective is not *actual competition* but *replicating competitive outcomes*, the regulator has a bit more flexibility to oversee a shift towards the desired outcomes *over time*.
- 7.1.4 This means that if there are any generosity (or conversely a lack of generosity) in the way the price-quality paths are set, then this can be addressed (for future regulatory control periods) at future reviews and reset processes.

Application and purpose of economic principles

- 7.1.5 The Commission has identified certain economic principles which it plans to apply to assist it to derive an ex-ante price path for Chorus which approximates workably competitive outcomes.
- 7.1.6 These include the principles of real financial capital maintenance, allocating risk to those best able to bear it, and consideration of the consequences of the risk of over and under investment when determining the WACC.
- 7.1.7 However the Commission has been very careful to include the caveat that these principles are not intended as a regulatory compact between it and the regulated supplier as to the outcome which will ultimately prevail.
- 7.1.8 The principles are to be used merely a framework for its ex-ante decision-making. Trustpower supports this approach.

Regulatory compacts

- 7.1.9 More generally we note that regulatory compacts can be economic, social or legal.
- 7.1.10 They are often with the Government (who removed the right for the regulated entity to contract for its services) rather than with the regulatory agency, even if that regulatory agency is ultimately tasked with implementing the consequences of a regulatory compact.
- 7.1.11 In the present circumstances we are not aware of the promises (if any) which have been made to fibre investors in relation to the ability to recover the costs of the original investments in the event of significant technological change.

7.1.12 However we would observe that if any such promises are subsequently found to constitute a regulatory compact then any consequential compensation should be from tax payers not end-users.

FCM, risk allocation and asymmetric consequences of over and under investment (investment consequences principle) principles

7.1.13 We agree that;

- a) the financial capital maintenance principle is a useful concept in the context of the task of estimating what a “normal return” is for the relevant control period;
- b) in workably competitive markets risks are allocated to the parties which are best placed to manage them; and
- c) as part of its decision-making on the most appropriate price path, the Commission should consider the consequences of under and over investment.

7.1.14 We are aware that the asymmetric risk of under vs over investment has been an important factor in past regulatory decisions in the electricity sector.

7.1.15 This reflects the significant consequences of under investment (the lights will go out) and the nature of investments required (as there are often considerable efficiencies in oversizing network upgrades).

7.1.16 We do not see these factors present to the same degree in the telecommunications sector, so absent other factors, do not expect that applying the investment consequences principle would result in the use of WACC percentile above the mid-point.

8 How does the prospect of infrastructure-based and access-based competition affect the application of the three economic principles in the fibre input methodologies?

8.1.1 We think it is very difficult, if not impossible, to simultaneously:

- a) regulate Chorus as a monopoly service provider whose returns should progress towards normal efficient levels over time, and
- b) rely on:
 - o infrastructure competition from other technologies; or
 - o access-based competition

to establish efficient pricing for certain varying subgroups of end-users.

8.1.2 We note that prior regulatory models reliant on network competition did not deliver all of the outcomes the Government sought for the sector at that time.

8.1.3 Competition through duplicated fibre networks is likely to reduce innovation and downwards pressure on prices. At the same time it could increase the risk that fibre networks owners do not recover their costs of the network build leading to messy conversations about regulatory compacts and compensation.

9 What other economic principles should we have regard to when developing the fibre input methodologies? For example, should we include pricing efficiency as an economic principle for fibre?

- 9.1.1 We think that it is in the long-term interests of end-users if price structures and quality requirements of the FFLAS providers are regulated in a manner which fosters retail competition.
- 9.1.2 We expect this will require the Commission to develop IMs which:
- a) set out the principles fibre providers need to apply in developing the pricing of wholesale services; and
 - b) include a process for fibre providers to amend price structures and the quality dimension of particular product offerings in response to changes in relevant markets and technologies.

APPENDIX E: ISSUES IDENTIFIED FOR EARLY DISCUSSION

- 10 What are your views on our approach to determining the activities and/or services that fall within the scope of FFLAS (including the treatment of copper-based services, POIs, and services provided above layer 2)?**
- 10.1.1 The Consultation paper proposes that the definition of regulated services *includes* all services which enable access to and interconnection with the fibre network but *excludes* services which use copper in the last segment of connection (such as VDSL) and other services (such as value added network services and field services).
- 10.1.2 We agree that this is appropriate and note it creates a heavy reliance on cost allocation IMs to ensure the demarcation lines are fit-for-purpose.
- 10.1.3 We note the Commission's observations about the scale of the deregulation task as it includes removal of assets from the RAB which are no longer used to provide regulated services and changes to the cost allocations.
- 10.1.4 This suggests deregulation may be particularly problematic within a regulatory control period as it will presumably involve a re-opening of the current price paths. However not deregulating could also give a significant advantage to the providers of substitute services.
- 11 Are there any further key implications of the scope of regulated services for the setting of input methodologies for price-quality or information disclosure regulation?**
- 11.1.1 No further comment at this stage.
- 12 Do you agree with our application of s 166(2)(b) in practice as illustrated in the example? Where else may s 166(2)(b) be relevant in setting input methodologies?**
- 12.1.1 We think the application of s 166(2)(b) could result in outcomes which either promote or discourage network competition depending on how the Commission thinks network competition will facilitate the delivery of desired services to all end-users of telecommunications services.
- 13 What are your views on our proposal to determine only those input methodologies listed in s 175(1) by the implementation date? What additional matters should be determined as input methodologies by the implementation date?**
- 13.1.1 Please see our response to Question 2.
- 14 Which of the fibre input methodologies (if any) do you consider most appropriate for us to consider the use of a more 'principle-based' specification?**
- 14.1.1 Principles-based regulation gives flexibility to address changing circumstances. We think it is most appropriate to matters of price and service quality and cost allocation, albeit noting that certain dimensions of quality that will have implications for the retail competition would be more appropriately prescribed in detail (refer to our response to Question 25).
- 14.1.2 On the other hand we think that the IMs which apply to cost of capital, valuation of assets, treatment of taxation and capital expenditure projects could be more prescriptive.

- 15** **What are your views on our proposal to use a high-level approach consistent with Part 4 for the asset valuation IM? Please note that we have not yet set out our views on the treatment of depreciation or asset revaluations.**
- 15.1.1 We agree a high level approach to the inclusion of assets in the RAB is appropriate.
- 16** **What are your views on our proposed approach to adopt cost as the measure of asset value for assets constructed or acquired after implementation date?**
- 16.1.1 We agree.
- 17** **What specific rules or approaches (if any) are needed for the treatment of particular types of assets, or to deal with practical aspects of asset valuation?**
- 17.1.1 No particular comment at this stage.
- 18** **What are your views on our interpretation and proposed application of ss 176(2) and (2AA) for the calculation of financial losses? In particular:**
- (a) **What is your view on any simplifying assumptions for the allocation of common capital and operating expenditure costs that should be applied? and**
- (b) **What are your views on how the rate of return on investment and discount rate for the loss period should be calculated?**
- 18.1.1 No comment.
- 19** **What preference do you have regarding the two methods outlined above for reflecting the actual costs of Crown financing, and why? What other methods could be used?**
- 19.1.1 No comment.
- 20** **How should we consider the involvement of related parties to the funding arrangements (eg, LFC parent companies)?**
- 20.1.1 No comment.
- 21** **How should costs be allocated between regulated FFLAS services and other services? Are there features of suppliers or services that require particular consideration (eg, business structure, presence of other forms of economic regulation, accounting systems etc)?**
- 21.1.1 We agree that the cost allocation IM could have important ramifications for competition in the sector and consider that it will be important that the regulatory regime clearly delineates what costs can be allocated between regulated (FFLAS) and other activities.

21.1.2 A Senior Director²⁴ at the Australian Energy Market Commission in 2016 discussed some of the measures the AEMC is taking with the “*broader aim of facilitating the development of a competitive energy services market*”.

21.1.3 As part of his presentation he noted:

“In addition to ring-fencing, the regulatory framework also needs to support this objective through a range of other measures including:

- *providing clarity around which services are regulated and which are not;*
- *creating incentives for the efficient investment in, and use of, assets such as storage that can provide both regulated and non-regulated services, so that the full value is obtained from those assets;*
- ***having robust cost-allocation and shared asset regimes for circumstances where a network asset is used partly to deliver a regulated service and partly to deliver a non-regulated service; and***
- *having strong efficiency and investment tests that require and incentivise networks to procure services from the competitive market where it is more efficient to do so rather than investing in the assets to provide those services using regulated revenues and rolling them into the RAB.” (emphasis added)*

21.1.4 The allocation of shared costs will be a potentially challenging element of establishing the new fibre regulatory regime and we support the Commission in considering this important matter.

21.1.5 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.

21.1.6 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.

22 What views do you have on whether an input methodology for allocating costs between different FFLAS services should be set for information disclosure and/or price-quality regulation?

22.1.1 Refer Question 21 with respect to the importance of ensuring double counting of common costs doesn’t arise for LFCs who also have parts of their business regulated under Part 4.

22.1.2 We have no further, additional views at this time.

23 What is your view on our proposal to use the Part 4 and UCLL/UBA FPP approach as the starting point when determining the cost of capital input methodologies for FFLAS?

23.1.1 We agree.

24 What matters do you think will differ from the Part 4 approach, are novel for the regulated fibre sector, or will require re-estimation/a different approach? Should we re-estimate parameters that apply across sectors, such as the TAMRP?

24.1.1 No views at this stage.

²⁴ Richard Owens on 3 August 2016 as part of the Australian ENA Regulation Seminar: <https://www.aemc.gov.au/sites/default/files/content//Speech-Richard-Owens-ENA-Regulation-Seminar-3-Aug-2016.pdf>

25 What are your views on CEPA's advice on the approach to setting the quality dimensions input methodology?

- 25.1.1 We agree with CEPA that it would be appropriate for the quality dimensions IM to adopt a blend of prescriptive and principled quality dimensions.
- 25.1.2 There will be certain quality dimensions, such as switching and provisioning, where a prescribed quality standard should be adopted in order to ensure vibrant competition occurs in the retail sector as this will promote the long-term interests of end-users.
- 25.1.3 For example, delayed switching timeframes negatively affect the overall customer experience, this reduces customers propensity to switch retailers, thereby precluding access to the value of more competitive offers in the market. Mandated switching timeframes and protocols would address this issue.
- 25.1.4 Likewise CEPA highlights "*connection timeframes will be important for ensuring rapid take-up of fibre services by end users, and may therefore be a metric that the Commission would definitely wish to monitor over the duration of the IM*"²⁵. A prescriptive quality standard that mandates a maximum time for new connections, would provide ongoing certainty to fibre providers and end-users of the timeframes that must be adhered to for provisioning and would be more cost-effective to just be set once.
- 25.1.5 We support prescriptive quality standards (level 3 based on CEPA's hierarchy) for switching and provisioning being specified in the quality dimensions IM and note that these standards should be enduring for the entire life of the IM²⁶.
- 25.1.6 In applying the quality dimensions IM to determine the quality metrics and standards for regulated providers, we suggest that given the importance of ensuring quality of fibre services for end-users it would be most appropriate for the Commission to develop the quality metrics and standards in consultation with industry.

26 What specific factors of the telecommunications environment do you think are relevant to setting input methodologies for quality dimensions?

- 26.1.1 In addition to the above mentioned quality dimensions that can have direct implications for retail competition, we suggest that the interplay between wholesale quality (as will be captured in the quality dimensions IM) and retail quality (being considered in the Commission's separate retail service quality work stream) will be important. We support the Commission in aligning the work streams where possible.
- 26.1.2 More broadly, we suggest that a consumer panel may be able to provide additional insight to assist in the Commission in considering what quality end-users expect for their fibre services.
- 26.1.3 We however acknowledge that the timing of the development of the new regulatory arrangements for fibre may not enable a panel to be established, and so suggest that the views of end-user representatives (such as ConsumerNZ) around what customers want with respect to quality would be valuable, particularly given there will be a trade-off between cost and quality required.

²⁵ CEPA pg 40

²⁶ We note that in the case where a metric may be enduring, CEPA suggested that it would be more cost-effective to set the metric out in the IM rather than re-determining and consulting on the metric at the start of each regulatory period

- 27** **What views do you have on the approach or processes that should be adopted for setting price-quality paths? For example:**
- (a) Should a supplier be required to present a price-quality path proposal? What role would the Commission have in evaluating the proposal?**
 - (b) What historical or forecast information should be required and where should this information be sourced from? Should the information be subject to customer consultation and/or independent scrutiny or other verification?**
 - (c) Is there a role for a forecast total expenditure (totex) approach instead of requiring building blocks to be set with reference to capital and operating expenditure?**
- 27.1.2 Please see our response to Question 6. We think that the regulated supplier should present the Commission with a price-quality path that meets the requirements of the IMs for the Commission's approval. A Commission supplied or pre-agreed template would facilitate this.
- 27.1.3 The Commission should have the option of requesting certain information be verified but should be able to exercise judgment about where this is most relevant.
- 27.1.4 It may be practicable to offer a faster track approval process if certain conditions are met e.g. improved efficiency etc.
- 27.1.5 Consumer and retailer consultation may also be used as a "carrot" to facilitate a faster approval process.
- 27.1.6 More broadly, we are supportive of the Commission exploring whether a totex methodology would encourage more efficient decision making (by removing any CAPEX bias) and better promote optimal outcomes for end-users.
- 28** **Do you have any views on additional incentive mechanisms (such as IRIS) that would be beneficial to consider including? (Note that the scope to include any additional mechanisms may be limited, given the time constraints we are under.)?**
- 28.1.1 We support forward looking efficiency incentives on regulated suppliers.
- 28.1.2 We however have some concerns that the incentives under Part 4 for electricity distribution businesses to seek efficiency, while achieving appropriate quality standards, have not been effective in the most recent regulatory period. This may be because there is a limited understanding of the incentives within distribution businesses.
- 28.1.3 We support the Commission in considering whether the incentive structures that have been previously adopted for regulated businesses under Part 4 drive optimal outcomes for end-users and should be adjusted within the fibre regulatory regime (to the extent possible).
- 28.1.4 We acknowledge that the development of a quality dimensions IM may mean that the incentive mechanisms are less relevant within the fibre regulatory regime to the extent that minimum quality standards are achieved. That is, provided the driver for meeting the minimum requirements is sufficient (by way of penalties or some other "stick"), there may be a lesser reliance on the need for an incentive regime (or "carrot"). This will ultimately be a design consideration for the Commission.

29 For any additional input methodology-related issues you wish to raise, please explain:

- (a) the nature of the issue;**
- (b) the likely significance of the issue, when it will be likely to arise in practice, and whom would it affect;**
- (c) what further information or analysis would be required to understand the issue; and**
- (d) what potential solutions can be identified to resolve the issue?**

29.1.2 No further issues at this stage.