23 June 2020

Cross-Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"

Thank you for the opportunity to provide a cross-submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation", 4 March 2020 (the draft Guidance). This is a joint cross-submission made by Vocus Group New Zealand and Vodafone New Zealand.

The Commission could adopt a two stage process to guidance development

We support and agree with Spark's recommendation that the Commission:

> "a. Consider how network operators may use product design and non-price terms to undertake exclusionary conduct to raise rivals' costs.
>
> "b. Be open to revisiting aspects of the guidelines (providing more guidance) when the investigation in to RSP layer 1 complaints has been completed. As noted in the draft, the appropriate cost standard for a margin squeeze test is context specific, and detailed investigation may enable the Commission to provide additional useful guidance.
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> "c. Provide greater clarity on the type of conduct that would likely breach the non-discrimination obligation, including an analytical method for doing so. Given the purpose of the legislation it is important that non-discrimination guidelines recognise the potential distortions in downstream and adjacent markets, not just on downstream fibre markets."

Trustpower's competition concerns are not well founded

We fully support Trustpower's stance that "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".[1] The concerns Trustpower has raised about layer 1 versus layer 2, however, lack foundation.

Trustpower considers that "it will be difficult to make the case that there will be superior downstream FFLAS products as a result of layer 1 unbundling" and "[does] not expect that layer 1 unbundlers will look to strongly compete on service quality". Despite Trustpower's views about the lack of advantage from Layer 1 services, Trustpower is concerned "a substantial number of smaller RSPs will be treated differently [in provision of Layer 2] to the larger RSPs [in provision of Layer 1] and this will affect the competitive process".

Trustpower should provide evidence that a competitive disadvantage and/or discrimination would arise from the differences it expresses concern about if it wants the Commission to be able to consider the points they are trying to make.

[1] Trustpower, TRUSTPOWER SUBMISSION: FIBRE REGULATION EMERGING VIEWS, 16 July 2019.

Chorus appears to be attempting to minimise the scope of the equivalence and non-discrimination obligations

We consider the legal points Chorus is trying to make about whether equivalence and non-discrimination are compliance obligations or principles are strained at best and a matter of semantics.

Despite Chorus' purported view that "Equivalence and non-discrimination are compliance obligations, not principles", Chorus also argues the Commission should develop "guidance for compliance obligations … based on high-level principles" (emphasis added).

Chorus also contradicted itself with the stance that "Guidance [should be] based on high-level principles, rather than detail", but "Chorus and other LFCs must be able to assess in advance of any enforcement action whether their conduct complies with the requirements of equivalence and non-discrimination". The extent to which Chorus will be able to rely on the Guidance to assess in advance whether their conduct is compliant is directly related to how detailed and prescriptive the Commission's Guidance is.

While Chorus considers that "Compliance can't turn on the exercise of judgement in relation to matters on which there could reasonably be disagreement" it should be clear compliance is not simply a binary pass/fail construct, and can depend on the particular circumstances. This is evident from Commission's paper and the expert advice it has received. Spark have noted "The draft rightly recognises that the appropriate standard depends on the regulatory purposes and context within which the test is being applied and, in practice, a range of cost standards have been applied to establish a margin squeeze depending on the context".

Chorus has raised a strawman objection that "An interpretation of the obligations that means compliance can only ever be assessed ex-post undermines the rule of law" or "based on the Commission's subjective judgement". Compliance with legislative requirements is rarely (if ever) contingent on the existence of a set of ex-ante binary pass/fail guidance, and will inevitably involve ex post evaluation of whether a regulated firm's behaviour is consistent with its obligations. Nothing in the Telecommunications Act requires a mechanistic set of rules (which would have to be highly prescriptive) for determining compliance.

However, we do agree with the overall sentiment of Chorus' argument that for the guidance to have any practical value it needs to be less tentative, and more precise in the standards that would be applied. This would be better achieved by immediately starting an investigation into the price terms of the PONFAS service.

Chorus appears to be trying to establish an artificial separation of its undertakings (the Deeds) from the legislative provisions they were established under

We note Chorus' statement that:

> The equivalence and non-discrimination obligations are set out in both the Fibre Deed and Copper Deed and are required by the Act. While the Deeds need to be read consistently with the purpose statements in sections 69W and 156AC of the Act, the words of the Deeds are paramount and every part of the Draft Guidance must have a clear basis in the words of the Deeds.

> The obligations are unique in the regulatory framework because they are set out in deeds of undertaking given by LFCs in favour of the Crown, rather than directly in legislation. The Act sets out certain minimum requirements for the Deeds, including that they must provide for equivalence and non-discrimination. However, the obligation to comply with equivalence and non-discrimination arises from the Deeds rather than from the Act.
>
> This was a deliberate decision by Parliament. Parliament could have prescribed equivalence and non-discrimination obligations directly in the Act, as it did for example in relation to the first and third business line restrictions in subpart 3 of part 2A of the Act. Instead, it left it to LFCs and the Minister to define the precise scope of the obligations through agreed undertakings. [footnotes removed]

The purpose in section 156AC of the Telecommunications Act includes promotion of competition and requirements for non-discrimination and equivalence of supply. Section 156AD requires undertakings that, amongst other things, "achieve non-discrimination in relation to the supply of relevant services", "design and build the LFC fibre network in a way that enables equivalence in relation to the supply of unbundled layer 1 services …" and "achieve equivalence in relation to the supply of unbundled layer 1 services …" The requirements of the Act would not be meet if the Deeds are specified or interpreted in a way that narrows the extent to which non-discrimination and equivalence is achieved. Further, if there is any lack of clarity in the Deeds then it is available for them to be interpreted in light of the requirements and purposes of the Telecommunications Act under which they were established.

We also note that despite Chorus' claims to the contrary, any Court would look to the standard interpretation of technical phrases within the industry it is used. In this case, equivalence of inputs and non-discrimination are specific technical terms used in telecommunications regulation around the world. Both the Crown and the LFCs would (should) have had mind to their meaning when entering into the Deeds. This makes the wide international body of literature on these topics of paramount importance, not to be dismissed as suggested by Chours.

Chorus should not use its access pricing to protect against asset stranding

We note Chorus' statement "Adopting an alternative cost standard, for example ECPR using REO, would require applying an appropriate allowance for asset stranding risk in order to satisfy the overall cost recovery (NPV=0) under Part 6. We note the Commission's current proposal for an ex-ante allowance for asset stranding risk may not include the specific economic stranding that would result from adopting an alternative cost standard to ECPR using EEO".

It follows that if ECPR using REO would result in asset stranding then, ECPR using an EEO cost standard would insulate Chorus and Chorus' assets from competition. Chorus is basically admitting their current price and non-price terms are intended to stop unbundling. Either way, Chorus has not provided any evidence that unbundling will cause stranding at any scale that cannot otherwise be managed.

Differential vs discriminatory treatment

Chorus queried the draft Guidance's statement that, "a difference in treatment could include…offering the same terms if the offer has a different effect depending on the position of the access seeker purchasing the service". According to Chorus "This suggests that the same terms will amount to different treatment simply because the offer is more or less attractive to certain RSPs". Chorus' statement about differential treatment is surprising as it suggests it doesn't understand the

distinction between differential and discriminatory treatment. For example, if an insurance company offered males and females the same rates for car insurance, the margin made from women would be higher than for men because women are lower risk to insure (are less likely to cause a car crash).

The same comments about differential and discriminatory treatment apply, for example, to Chorus' claims that "The Draft Guidance also says that the price structure of a service can in itself result in a difference in treatment. As we have previously explained, there is no difference in treatment with regards to price simply because a pricing structure is more or less attractive to some RSPs. Nor is there a difference in treatment where RSPs choose to consume different components of a service in different proportions" [footnote removed].

The one element of Chorus' comments we agree with is that "Indirect discrimination could arise … where a significant cross-section of RSPs would not be eligible for an offer as a result of factors entirely outside of those RSPs' control. For example, volume discounts set at thresholds for which only the largest RSPs would be eligible plausibly constitute indirect discrimination". We consider that this is the exact situation the industry is faced with regarding the PONFAS service.

We consider that Chorus' claims about how the draft Guidance should be interpreted support the Commission erring towards more detailed and prescriptive Guidance.

It is unclear why Chorus asserts "Adopting a position that doesn't allow component pricing would require substantial changes to those systems and processes"

Chorus asserts "Adopting a position that doesn't allow component pricing would require substantial changes to those systems and processes". This statement is not explained. Why would non-component pricing require substantial changes to systems and processes? Chorus currently does non-component pricing for bitstream products. Why is PONFAS fundamentally different? In any case, practical considerations cannot justify a pricing approach insistent with their clear regulatory obligations.

Chorus' comments about blended prices is misleading but raises questions about the efficacy of bitstream price scale discounts to reflect the differences in costs for Chorus

We consider the following Chorus' statement to be misleading:

> … no offer is equally attractive to all RSPs, including a blended price. Generating a blended price for PONFAS is arbitrary (Chorus would have to make assumptions about the expected utilisation of feeder fibres and splitters) and would not neutralise scale. A blended price would be based on an assumed level of utilisation which may cause RSPs with a higher than assumed unbundled connection per FFP to be disadvantaged relative to RSPs with low utilisation. Critically, the difference in outcomes would be the direct result of Chorus' pricing methodology, as opposed to reflecting differences in the underlying costs that arise from varying levels of utilisation. [footnote removed]

While Chorus claims a blended price would favour RSPs whose connections per FFP were less than used for the blended price, other economies of scale for unbundling (such as OLT ports) would largely neutralise this. Also based on this line of argument, Chorus' current bitsteam prices assume a certain scale level, which favours smaller RSPs. For example there will be certain fixed costs for Chorus to establish a new access seeker at layer 2, so the per unit cost should be higher for smaller player than larger ones. If this is discriminatory, then we would like to open a discussion about bitstream price scale discounts to reflect the differences in costs for Chorus.