Chorus cross-submission on "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"

23 June 2020

OVERVIEW

1. This cross-submission responds to submissions on the Commerce Commission's draft guidance on the equivalence and non-discrimination obligations (**Draft Guidance**).

2. We appreciate the constructive engagement from both local fibre companies (**LFCs**) and retail service providers (**RSPs**).

3. We agree with the Commission and the other LFCs that the equivalence obligation doesn't mandate a particular pricing methodology. Our view remains that equivalence is always satisfied by an ECPR-based rule relying on an EEO cost standard.

4. We agree with the other LFCs and WIK that the Commission's interpretation of non-discrimination is too broad and can't be supported from a legal and practical standpoint. If the subjective characteristics of individual RSPs are relevant to an assessment of "difference in treatment" then the first limb of the non-discrimination test is meaningless because every offer would be caught. We would be required to tailor every offer to individual RSPs which is impossible in practice and would itself violate non-discrimination.

5. Some RSPs have raised concerns about our PONFAS offering. We are confident that our PONFAS offer complies with our regulatory obligations and we will continue to engage with our customers to resolve their commercial concerns. Given that the purpose of this exercise is to provide guidance on what the equivalence and non-discrimination obligations require, we don't address PONFAS-specific issues in this cross-submission except to the extent it helps illustrate a point of more general application for the guidelines.

6. RSPs are asking for the Draft Guidance to go further and to do more. However, Commission guidance should focus on interpreting LFCs' compliance obligations. Commission guidance should not and cannot specify price or non-price terms as that is not permitted under the Deeds. The guidance needs to be grounded in the words of the Deeds, and a lot of what RSPs are asking for is outside the scope of this exercise. This is not an opportunity to make new rules.

SCOPE OF THE OBLIGATIONS

- The Commission's task is to provide guidance on what the equivalence and non-discrimination obligations require.
- The task here is not an investigation into whether our PONFAS offer is compliant. Nor is it a regulatory exercise of setting the price and non-price terms of our services.

7. Some RSPs have raised concerns about our PONFAS offering.[1] And, some RSPs are asking for the Draft Guidance to go further and to do more, for example requiring LFCs to proactively demonstrate compliance with our obligations or codifying the rules about when there will be a breach.[2]

8. The Commission's task here is to provide guidance on how it interprets the equivalence and non-discrimination obligations. In doing that, our focus should remain on the words of the obligations. Every part of the Draft Guidance must have a clear basis in the words chosen by the parties to the Deeds.

9. The equivalence and non-discrimination obligations are intended to ensure we do not favour our own downstream business over the interest of RSPs or favour some RSPs over others. The Deeds don't set our price and non-price terms of supply and can't be interpreted in a way that amounts to a de facto specification of terms. We have not breached our obligations simply because our customers don't like the terms we have set.

10. We are confident our PONFAS offer is compliant with our equivalence and non-discrimination obligations. We acknowledge RSPs have some concerns but note these concerns are largely commercial rather than regulatory issues. We have engaged and will continue to engage with our customers to resolve their concerns.

11. We understand Vector is frustrated with the time it has taken to onboard to PONFAS. While we had a compliant PONFAS offer available on 1 January 2020, Vector has experienced a disrupted unbundling experience in the first few months of 2020 for a few reasons. As the Commission and RSPs are aware, as a result of the COVID-19 pandemic RSPs were issued with force majeure notices in early April, with PONFAS

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[1] See Spark (2 June 2020) *EOI and non-discrimination guidance*, at [13], Vector (2 June 2020) *Vector Fibre: submission to the Commerce Commission on the draft guidance for non-discrimination and equivalence*, from [9]; Vocus and Vodafone (May 2020) *Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"*.

[2] See Spark (2 June 2020) *EOI and non-discrimination guidance*, at [11] and [41]; Vocus and Vodafone (May 2020) *Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"*.

specifically called out as an affected service during alert Level 4. We also note we have been in commercial discussions with Vector about its approach to unbundling.

12. Some RSPs are trying to use this process to push for additional rule-making by the Commission and in some cases, seeking to duplicate obligations that are already covered by other parts of the Telecommunications Act and the Commerce Act.

13. For example, Vodafone and Vocus ask for the introduction of additional information disclosure and certification requirements.[3] Chorus already has information disclosure and certification obligations, as agreed between Chorus and the Minister and as set out in the Deeds. The Commission doesn't have the power to introduce further disclosure and certification requirements into the Deeds. There is no basis to interpret the equivalence and non-discrimination obligations as requiring the sort of disclosure being sought here.

14. Also, as explained in our previous submission,[4] to the extent our existing information disclosure obligations involve giving RSPs commercially sensitive information, they should be interpreted consistently with Commerce Act obligations governing the exchange of commercially sensitive information between network competitors. Further, access to relevant data and governance information is only required to the extent that it is made available to those making decisions on a network operator's Layer 2 services.

15. Spark asks the Commission to think about how network operators may use product design and non-price terms to undertake exclusionary conduct to raise rivals' costs. It also suggests the Draft Guidance states, as a general principle, that conduct by access providers that weakens access seekers' ability to compete would not be consistent with equivalence and non-discrimination.[5]

16. Again, the Deeds articulate specific tests for equivalence and non-discrimination that require LFCs to treat RSPs the same as their own downstream business. The Deeds do not give the Commission a general power to proscribe exclusionary conduct; that is the role of the Commerce Act. It's not clear how Spark reconciles this argument with the words of the Deeds.

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[3] Vocus and Vodafone (May 2020) *Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"*, at p 7.

[4] Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, at [52].

[5] Spark (2 June 2020) *EOI and non-discrimination guidance*, at p 3.

EQUIVALENCE

- The Act and Deeds do not mandate a particular pricing methodology.
- Equivalence is always satisfied by an ECPR-based rule relying on an EEO cost standard. Once ECPR is satisfied, no further inquiry is necessary.

Equivalence is satisfied by ECPR

17. We note, and support, Enable and UFF's submission that the network operator has flexibility to select an appropriate pricing methodology.[6]

18. As we stated in our submission on the Draft Guidance,[7] we agree with the Commission that:

    18.1. Equivalence of price requires network operators to treat access seekers the same way as the network operators' own operations in relation to pricing.[8]

    18.2. This means network operators must provide access seekers with a service at the same (imputed) price they charge internally to their own downstream operations. This (imputed) internal price can be calculated using a number of different approaches and assumptions.[9]

    18.3. The equivalence of price obligation allows a network operator to determine the methodology and the structure of its prices, provided it treats access seekers the same way as the network operator's own downstream operations.[10]

19. An ECPR-based rule relying on an EEO cost standard can always be used as a compliance reference point. ECPR reveals the internal price that an LFC is charging itself. ECPR therefore directly addresses the relevant question under the equivalence test. The use of ECPR as a compliance reference point is also consistent with the line of cases developed under section 36 of the Commerce Act - most recently in *Telecom*

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6 Enable and Ultrafast Fibre (2 June 2020) *Submission on New Zealand Commerce Commission Draft Guidance on Equivalence and Non-discrimination in New Zealand telecommunications dated 4 March 2020, and response to submissions on the Ingo Vogelsang report dated 2 April 2020,* at [2.2].

7 Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, at [23].

8 Commerce Commission (4 March 2020) *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.23].

9 Commerce Commission (4 March 2020), *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.23].

10 Commerce Commission (4 March 2020) *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.27].

Corporation of New Zealand Ltd v Commerce Commission in relation to price squeeze, which is conceptually related to equivalence.[11]

20. We note the submission from Enable and UFF, and the accompanying report from WIK, that discusses the suitability of the economic replicability test as a measure of price equivalence during periods of penetration pricing.[12]

21. WIK considers that LFCs will not have pricing flexibility regarding Layer 2 prices until 1 January 2022 and notes that it may then be another one to two years before the prevailing Layer 2 prices can be interpreted as resulting from the unconstrained pricing behaviour of LFCs.[13]

22. WIK's assessment of pricing behaviour post-2022 does not apply to Chorus. As we stated in our submission,[14] from 1 January 2022, Chorus' FFLAS will be subject to a revenue cap under price-quality regulation, derived using a cost-based building block methodology that seeks to replicate outcomes in a workably competitive market. So, our combined Layer 1 and Layer 2 prices in aggregate cannot exceed the total cost of providing fibre services and will be consistent with prices set under conditions of competition. This means that Chorus' Layer 2 prices can't be interpreted as market prices resulting from an unconstrained pricing behaviour, contrary to WIK's assessment of LFCs' pricing behaviour.

23. We also note, and agree with, Vodafone's submission[15] that the Draft Guidance should reflect the Commission's statement from its Response to Vogelsang submissions "*In the event that penetration pricing was occurring, the consistent use of ECPR throughout the period of penetration pricing and in subsequent periods (as discussed in the draft guidance at paragraph 3.60) will ensure that there is sufficient economic space for competition at the layer 2 level*."[16]

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[11] See *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC); *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111, [2011] NZLR 577 (SC); *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278.

[12] Enable and Ultrafast Fibre (2 June 2020) *Submission on New Zealand Commerce Commission Draft Guidance on Equivalence and Non-discrimination in New Zealand telecommunications dated 4 March 2020, and response to submissions on the Ingo Vogelsang report dated 2 April 2020,* from [2.29]; WIK Consult (26 May 2020) *Equivalence and non-discrimination – A review and critique of the Commission's intended approach for fibre regulation,* from [40].

[13] WIK Consult (26 May 2020) *Equivalence and non-discrimination – A review and critique of the Commission's intended approach for fibre regulation,* at [42]-[43].

[14] Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, at [36].

[15] Vocus and Vodafone (May 2020) *Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"*, at p 6.

[16] Commerce Commission (2 April 2020) *Response to submissions: Equivalence and non-discrimination in New Zealand telecommunications – Ingo Vogelsang report*, at [31].

24. As we explained in our submission,[17] adopting an alternative cost standard for the ERT (e.g., Layer 1 cost-based pricing, or ECPR based on an REO cost standard) would require applying an appropriate allowance for asset stranding risk in order to satisfy the overall cost recovery (NPV=0) under Part 6 of the Act. 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.

Measure of downstream costs – EEO vs REO

25. We note the discussion from Spark about the appropriate measure of downstream costs. Spark argues that "*the EEO cost standard, which is more commonly applied to ex-post competition assessment rather than the ex-ante promotion of competition as required by the Act – is unlikely in practice to achieve the desired regulatory purposes that underpin the Act. Therefore, the alternative standards anticipated by the draft will inevitably be applied*."[18]

26. We agree with Spark that the EEO cost standard is more commonly applied in an ex-post compliance context as opposed to an ex-ante regulatory exercise. However, the Deeds don't involve an ex-ante regulatory exercise: they set out compliance obligations that are assessed ex-post. This is why, as the Commission recognised in the Draft Guidance, the EEO standard is appropriate. We therefore disagree that alternative cost standards will inevitably be applied here. To the contrary, our position is that alternative cost standards are very unlikely to be appropriate. As we stated in our submission,[19] an ECPR based on EEO cost standard will always satisfy equivalence.

27. The Commission's Draft Guidance recognises the importance of adopting a standard that can be applied in a compliance context. The Commission has acknowledged that setting a downstream cost standard by reference to the economic costs of a different operator is not appropriate in a setting where prices are set commercially and are subject to enforcement action under the equivalence requirement, because the LFC will not know the downstream costs of its competitors.[20] The Commission has also noted that EEO is a practical approach that network operators can implement.[21] We note that the certainty of this guidance will be undermined if Chorus and LFCs are then held to a different standard in an investigation.

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[17] Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, at [38].

[18] Spark (2 June 2020) *EOI and non-discrimination guidance*, at p 4.

[19] Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, at [43].

[20] Commerce Commission (4 March 2020) *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [3.47].

[21] Commerce Commission (4 March 2020) Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation, at [3.62].

NON-DISCRIMINATION

- The Commission's broad approach to non-discrimination is unsupportable from a legal and practical standpoint. There's no difference in treatment if RSPs are generally offered the same terms and conditions; we cannot be required to tailor offers to individual RSPs.
- Component pricing is not inherently discriminatory. There is no difference in treatment with regard 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.
- The non-discrimination obligation for self-supply is identical in effect to the service provider's equivalence obligation.

The Commission's approach to non-discrimination is too broad

28. We disagree with RSP submissions that the Commission's broad approach to non-discrimination is correct.

29. The Commission's formulation of indirect discrimination at para 4.22 of the Draft Guidance is so broad it results in the difference in treatment limb of the non-discrimination test having little meaningful effect.

30. If a difference in treatment arises simply because an offer has a "different effect" on certain RSPs, then every offer will constitute a difference in treatment. RSPs have a different business model to us and to each other – no offer in practice is equally attractive to all RSPs, as what is commercially, operationally and technically fit for one RSP isn't necessarily the same for another.

31. The parties to the Deeds can't have intended an interpretation of "difference in treatment" that would mean all offers amount to a difference in treatment. This would reduce the non-discrimination obligation to an assessment of objective justification and competitive harm, making the first limb of the test redundant.

32. While we reserve our position on whether indirect discrimination is a legitimate interpretation of the Deeds, consistent with Enable/UFF and WIK we remain of the view that indirect discrimination could only 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.

33. We agree with WIK that the inherent characteristics of individual access seekers are subjective and cannot be the reference point for determining whether offer terms constitute a difference in treatment. WIK concludes:[22]

[22] WIK Consult (26 May 2020) *Equivalence and non-discrimination – A review and critique of the Commission's intended approach for fibre regulation,* at [8].

In addition to straight forward requirements for non-discrimination, the Commission also includes in its definition a behaviour which offers the same terms to different access seekers but the offer has a different effect depending on the position of the access seeker purchasing the service. Individual and or subjective characteristics in the latter case thus become a criterion for an objective classification of the conduct of a network operator. This also implies that the characteristics of an access seeker and not objective criteria of the price structure or terms may determine whether or not the access seeker would face discriminatory treatment. This unusual approach makes the concept of discrimination highly arbitrary and subject to adverse selection and moral hazard.

34. In response to the suggestion that our offers "*have different effects on access seekers or influence adjacent and downstream markets*,"[23] we ensure our offers are designed in a way that they can reasonably be taken up by all our customers. As we already noted, non-discrimination applies in respect of RSPs in their role as customers.[24] It can't be used as a mechanism to shelter individual RSPs from network competition.

35. We also reject any characterisation of our approach as "shaping" competition in downstream markets. We develop offers that respond to RSP needs in order to maximise utilisation of the fibre network. How RSPs use our services to compete in retail markets is up to them.

Component pricing does not constitute a difference in treatment

36. 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.

37. Component pricing is consistent with our equivalence obligation because we are supplying the service using the same systems and processes as we use ourselves to meet the service levels agreed in the NIPA for our Layer 2 services. A blended price would require substantial changes to those systems and processes which would significantly impact our ability to meet our equivalence obligation.

38. We agree with WIK that component pricing is non-discriminatory. We endorse the analysis in section 4.5 of the WIK report which concludes that:

    38.1. Component pricing of the Layer 1 service does not necessarily favour larger access seekers – the rationale of using the Layer 1 service depends on its local concentration (or market share) of demand. This can but does not necessarily correlate to a buyer's size or national market share in the end-user market.

    38.2. A single price for the Layer 1 service would not satisfy non-discrimination and would be highly inefficient.

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[23] Spark (2 June 2020) *EOI and non-discrimination guidance*, at [38].

[24] Chorus (2 June 2020) *Submission on equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation,* at [64].

38.3. Component pricing creates incentives to use Layer 1 PONFAS services only if the relevant network elements are equally or similarly efficiently used as the network operator is using them. Access seekers will use PONFAS if and when they can concentrate a relevant number of customers in an FFP area so there is no inefficient duplication and underutilization of resources.

38.4. Component pricing is calculated based on cost averaging between low cost and high cost areas and is therefore consistent with geographic uniform pricing.

38.5. Component pricing is not customer-specific pricing. The price is neutral between RSPs and does not vary upon individual characteristics so component pricing is not discriminatory with regard to individual customer characteristics.

38.6. The key economic characteristic of price discrimination is that prices vary according to willingness to pay of the customer. This is not the case with component pricing – all RSPs pay the same. The intention of pricing components separately is not to differentiate according to willingness to pay, it has the rationale to incentivise an efficient purchase behaviour.

38.7. Component prices don't involve large up-front payments to adversely select large unbundlers against small unbundlers. They aren't volume discounts or a two-part tariff, and don't represent second or third degree price discrimination.

Interrelationship between equivalence and non-discrimination

39. We agree with Enable/UFF and WIK that, "*the non-discrimination obligation for self-supply is identical in effect to the service provider's equivalence obligation*"[25], and as a consequence, "*when the equivalence test is satisfied, the non-discrimination test for self-supply is automatically satisfied*."[26]

40. Vodafone/Vocus claim Enable/UFF don't understand the relationship between equivalence and non-discrimination.[27] However, Enable/UFF's submission was mischaracterised as arguing that the non-discrimination obligation is subsumed into the equivalence obligation. In fact, their position (acknowledging there are two distinct obligations) is the equivalence obligation (to treat access seekers the same as its own business units) is in effect identical to the non-discrimination obligation for self-supply (not to treat itself differently from other access seekers), and it follows that if equivalence is satisfied, non-discrimination is automatically satisfied.[28]

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[25] WIK Consult (26 May 2020) *Equivalence and non-discrimination – A review and critique of the Commission's intended approach for fibre regulation,* at [2].

[26] WIK Consult (26 May 2020) *Equivalence and non-discrimination – A review and critique of the Commission's intended approach for fibre regulation,* at [2].

[27] Vocus and Vodafone (May 2020) *Submission on the draft version of the "Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation"*, at p 4.

[28] Enable and Ultrafast Fibre (2 June 2020) *Submission on New Zealand Commerce Commission Draft Guidance on Equivalence and Non-discrimination in New Zealand telecommunications dated 4 March 2020, and response to submissions on the Ingo Vogelsang report dated 2 April 2020,* at [3.3]-[3.4].