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## TRUSTPOWER CROSS SUBMISSION: FURTHER DRAFT PRICING REVIEW DETERMINATIONS

### 1 Introduction

1.1.1 Trustpower Limited welcomes the opportunity to provide a cross-submission to the Commerce Commission on its further draft pricing review determinations, dated 2 July 2015.

### 1.2 Trustpower's history

1.2.1 Trustpower is a vertically-integrated renewable generator-retailer in the New Zealand and Australian electricity markets. Trustpower's unique utility retail offering bundles electricity, gas and telecommunications services (including ultra-fast broadband). Trustpower also provides water storage for irrigation users in the South Island.

1.2.2 Head-quartered in Tauranga, Trustpower owns and operates a total of 23 hydroelectric power schemes (comprising 41 stations), five wind farms, and one diesel peaking scheme, across New Zealand and Australia. As the fifth largest generator-retailer in New Zealand, the company's electricity customer base consists of around 252,000 electricity connections, including some of the largest electricity consumers in New Zealand. Around 27,000 of Trustpower's customers are dual fuel, and almost 50,000 purchase energy and telecommunication bundles.

1.2.3 Trustpower is one of the most experienced wind farm developers and operators in Australasia, and has also been active in Australia for the past 12 years. The company now has an installed asset base in Australia with a value of around a billion dollars, including Snowtown, which at 370 MW is the largest wind farm in South Australia.

### 1.3 Trustpower as a participant in the telecommunications market

1.3.1 Trustpower actively pursues innovation as a means to deliver value to consumers. Our success in adding telecommunications and gas services to the company's retail electricity offering demonstrates that 'bundles' are attractive to consumers. Trustpower is currently the only major company that bundles electricity, gas and telecommunications services in New Zealand.

- 1.3.2 Trustpower has grown from small reseller of under 1,000 telecommunications services in 2004 to its current position providing over 90,000 services to 49,000 customers.
- 1.3.3 Trustpower provides over 10,000 fibre broadband connections on the Chorus and Ultrafast fibre networks, and over 30,000 xDSL services nationwide. All internet services are delivered on Trustpower's own internet infrastructure, which is duplicated with full redundancy across two third-party data centres. Trustpower provides full technical support internally from its Tauranga and Oamaru centres. No customer services are outsourced.
- 1.3.4 Trustpower also provides PSTN and calling services to 35,000 customers via wholesale agreements with Spark Wholesale for PSTN and switchless Non Coded Access calling.
- 1.3.5 Trustpower's growth has been largely organic, achieved through its unique ability to bundle telecommunications and energy services, creating unique propositions and a superior service model. We are New Zealand's fourth-largest telco, and potentially the fastest growing. Our expectation is a further four-fold increase in the size of our telco customer base over coming years.
- 1.3.6 We bring to the New Zealand telecommunications market a unique perspective as a deeply experienced and successful participant in a highly-competitive, regulated market setting – being electricity. We constantly compare and contrast the market rules, structure and competitive behaviour not just between the two markets but also between New Zealand and Australia.

#### **1.4 Impact of the draft pricing review determinations**

- 1.4.1 As the retail telecommunications component of our multiproduct offering becomes increasingly important to our customers, we are strengthening our engagement on key regulatory matters within the telecommunications environment.
- 1.4.2 The draft decision will have a significant impact on our customers, and our business. It is important that the Commission considers the impact on smaller participants in the telecommunications market when making decisions such as this one.
- 1.4.3 Unlike some of the larger participants in the market, Trustpower does not have the resources to build its own model, or to review the Commission's model in depth. As a result, we are unable to substantially submit on all modelling decisions, and have restricted our comments in this cross-submission to those listed in the following section.

## **2 Overview of cross submission**

- 2.1.1 Our comments in this cross submission are principally that:
  - a) A conventional and predictable approach is one that puts the long-term interests of end-users at the forefront of decisions, adopts best current international practice in determining the cost of an efficient operator, and applies cross-sector precedent where applicable;
  - b) Certainty will be achieved by the Commission establishing a robust approach to TSLRIC determination – which enables efficient cost recovery and is LTBEU – and sets a precedent for future determinations;
  - c) The pricing decisions are important for ensuring affordable telecommunications services, and for uptake of broadband;
  - d) We are concerned about evidence from other submissions, and expert reports, that the draft TSLRIC modelling is producing substantially excessive costs;
  - e) We consider that FWA should be used more extensively in the modelling, by adopting the approach recommended by Network Strategies;

- f) We agree with submitters that the valuation of re-usable assets should reflect that they will not be replaced;
- g) Our concern that non-recurring charges are excessive is heightened by evidence in submissions of inefficient Chorus' practice and cross-subsidisation – we agree with Vodafone that *“Chorus’ aging copper network and systems mean that the total non-recurring costs simply do not match an efficient operator”*<sup>1</sup>;
- h) We cannot see how increasing copper access prices by 12% harms Chorus' incentives to invest;
- i) Backdating would be detrimental to end-users, and could only be justified where there was evidence the IPP prices were below cost (this is supported by the Part 4 IMs Merit Appeal decision); and
- j) Levelisation of prices is not justified by *“simplicity”*, and making end-users pay more initially would not be to their long-term benefit.

2.1.2 Each of these issues is addressed in the remaining sections of this cross-submission.

### **3 Adoption of a conventional and predictable approach**

- 3.1.1 Chorus and Sapere support the Commission's adoption of a *“conventional”* or *“orthodox”* approach to TSLRIC.
- 3.1.2 We consider the appropriate interpretation of *“conventional”* or *“orthodox”* to be an approach that is accepted practice and commonly used by regulators, and also accounts for more recent and/or the latest developments that reflect the evolution in regulatory experience with TSLRIC (New Zealand is behind other countries in undertaking a TSLRIC determination for the first time).
- 3.1.3 We would not define *“conventional”* or *“orthodox”* to exclude the last international practice – to do otherwise could delay New Zealand benefitting from overseas developments in how to best/most accurately calculate the TSLRIC cost of an efficient operator.
- 3.1.4 The Commission has emphasised predictability and certainty, again with support from Chorus (but less so from other submitters). We have support for ensuring certainty by regulated suppliers in the Part 4 setting, including in the recent consultation as part of the IMs statutory review.
- 3.1.5 From our perspective, certainty will be achieved when the regulator takes a cautious approach to rule changes that impact on investment, and follows best-practice regulatory change-management principles. We also consider that it is important that investors expect to be able to recover the cost of long-lived investments (though this is not applicable in relation to the UCLL and UBA price-setting as it would appear that the draft prices include generosities that will ensure more than full cost recovery). These views are not dissimilar to the regulated supplier views referred to above.
- 3.1.6 While we consider regulatory certainty to be important, we would also note that the Commission is undertaking a TSLRIC determination (other than for TSO) for the first time. Concerns about the impact of rule changes on certainty are of limited relevance. Certainty will be achieved by the Commission establishing a robust approach to determination of the TSLRIC prices which is LTBEU and sets a precedent for future determinations.

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<sup>1</sup> Vodafone, SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION on FURTHER DRAFT PRICING REVIEW DETERMINATION FOR CHORUS' UNBUNDLED COPPER LOCAL LOOP SERVICE and FURTHER DRAFT PRICING REVIEW DETERMINATION FOR CHORUS' UNBUNDLED BITSTREAM ACCESS SERVICE, 13 August 2015, para [xii].

- 3.1.7 Certainty and predictability will also be enhanced where the Commission adopts a consistent approach to generic issues. For example, there should be a common methodology for WACC, with differences in approach based on industry specific or legislative differences.
- 3.1.8 The WACC percentile draft decision is a good example of the latter. The Commission and submitters have pointed out various substantive differences between the energy and telecommunications sectors (including application of TSLRIC, and limited need for investment in copper) which count against an above mid-point WACC for UCLL and UBA (and any other modelling “generosities”). The electricity sector WACC uplift, however, is set to the 67<sup>th</sup> percentile due to different circumstances.

#### **4 Importance to our customers and end-users of getting prices right**

- 4.1.1 Trustpower wants to ensure it can offer affordable and value for money services to our customers, and prospective customers, in both the energy and telecommunications markets. Our propositions are based on customers saving money by taking up combinations of power, gas, internet (broadband) and phone services. This is making broadband more affordable.
- 4.1.2 The decisions the Commission makes on the UCLL and UBA access prices is a critical component of ensuring we can offer retail prices that are reasonable and affordable. As Vodafone notes, *“To continue to deliver great retail broadband services to Kiwi families and businesses, retail service providers ... are dependent on a wholesale access regime that delivers fair prices”*.<sup>2</sup>
- 4.1.3 While a lot of the discussion from Chorus and its advisors has been on incentives to migrate to fibre, from a customer-centric perspective there needs to be more focus on the impact on whether customers choose to take up phone and broadband services at all (or remain connected) and what higher prices mean for their disposable income. As Spark has noted, *“Higher broadband prices will result in fewer New Zealanders having access to broadband, and it will result in lower utilisation of broadband”*.<sup>3</sup> We would like to see consideration of the expected impact of the draft prices on uptake and affordability, and note Spark has previously done some work on this.<sup>4</sup>
- 4.1.4 Given the importance of the Commission’s decisions to the market for broadband services and for end-users, we are concerned about the large number of modelling issues that are being raised by Network Strategies and WIK at this stage of the process.

#### **5 Ensuring prices reflect the costs of an efficient operator**

- 5.1.1 While we are keen to see reasonable and affordable pricing, this does not mean access prices should be the lowest they can possibly be. They should, however, reflect the costs of an efficient operator using efficient modern technology.
- 5.1.2 We interpret an efficient operator as being one that does not have excessive costs, including excessive return on capital.
- 5.1.3 As various submitters have pointed out, an efficient operator using efficient modern technology may use a mix of copper, fibre and FWA (depending on what is lowest cost), and is likely to include greater use of FWA than the draft decisions provide for.
- 5.1.4 We agree with Vodafone that, *“The Commission must follow its own statement, namely ‘FWA should be used for lines where costs are particularly high and unbundling is unlikely’ - rather than*

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<sup>2</sup> Vodafone, at para [ii].

<sup>3</sup> Spark, Further draft pricing review determination for Chorus’ UBA and UCLL services, 13 August 2015, at para [6].

<sup>4</sup> Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, Appendix D.

*applying an irrelevant distance criterion based on copper capacity degradation*".<sup>5</sup> We note and support the submissions of Network Strategies on FWA, and the approach they advocate for determination of FWA.

- 5.1.5 We are particularly concerned about whether the draft prices are as low as they should be, consistent with long-term benefit of end-users, when we observe comment from various submitters and experts about "*generosities*" in the draft prices e.g.:
- a) Network Strategies described the draft prices as being "*beyond an upper bound estimate*".<sup>6</sup>
  - b) Vodafone holds the view that, "*The modelling approach continues to result in draft TSLRIC prices that are well above the true TSLRIC level*".<sup>7</sup>
  - c) We would like to understand how WIK could have found the Commission's drafts to be 65% higher than the cost estimate based on the Swedish model – even adjusting for NZ-specific factors.<sup>8</sup>
  - d) Wigley and Company noted that the Commission had valued Chorus' copper network at double its entire market value.<sup>9</sup> In the energy WACC percentile review, the Commission provided evidence that some market values were in excess of the RAB, which suppliers explained was due to factors such as outperforming (being comparatively efficient) the CPI-X settings. Is the corollary explanation that Chorus' is grossly inefficient or does this suggest the TSLRIC valuation is too high?

## 6 Forward-looking costs should reflect that some assets won't be replaced

- 6.1.1 The forward-looking cost of an asset that is re-usable, and won't be replaced, is not replacement cost – the forward-looking cost of re-usable assets is either nil, or the depreciation and recovery of the cost of capital (which depends on actual historic cost, not replacement cost).
- 6.1.2 As Spark notes, "*Allowing Chorus the benefit of revaluing these assets as if they were new is unsupported where it can be shown that Chorus will not in fact replace them*".<sup>10</sup>
- 6.1.3 We also note WIK's observations that the Commission's modelling is closer to Chorus' actual network. However, WIK observes that in conducting this approach, "*the Commission made a major conceptual breach: the network deployment approach building the basis for the Commission's cost model only makes sense, has its justification and its costing logic, if the reuse of existing assets of the legacy network is part of the deployment of the modelled (fibre) network. This holds in particular for (certain) legacy civil engineering assets. Chorus and any other incumbent operator build their new fibre network on such a brownfield deployment approach. It is not logical nor efficient to build the network of the HEO on the (inefficient) structure of the incumbent operator and at the same time not to integrate the corollary of this assumption at the asset valuation or costing side of the determination.*"<sup>11</sup>

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<sup>5</sup> Vodafone, at para [xv].

<sup>6</sup> Network Strategies, Revised draft determination for the UCLL and UBA price review, 13 August 2015, at page i.

<sup>7</sup> Vodafone, at para [xviii].

<sup>8</sup> WIK, Submission In response to the Commerce Commission's "Further draft pricing review determination for Chorus' unbundled bitstream access service" and "Further draft pricing review determination for Chorus' unbundled copper local loop service" including the revised cost model and its reference documents, 12 August 2015, para [20].

<sup>9</sup> Wigley and Company, Submission on Further Draft Pricing Review UCLL and UBA Determinations, 13 August 2015, para 5.12(h)(i)].

<sup>10</sup> Spark, at para [14a].

<sup>11</sup> WIK, at para [176].

6.1.4 We are familiar with the references made by Wigley and Company to the ODV methodology that the Commission uses historic cost to value sunk energy network assets (including in the RAB IMs).<sup>12</sup> We agree this approach is appropriate for UCLL and UBA services.

## 7 Non-recurring charges are a concern

7.1.1 Our submission raised concern about the substantial increases in non-recurring charges, which we consider reflects “*monopoly opportunism*” and (mis)use of substantial market power.

7.1.2 We found the evidence from Callplus, Spark, and Vodafone – of charges for services that were not needed – to be particularly concerning.

7.1.3 We consider it likely, based on the submissions of Spark and others, that Chorus’ provision of non-recurring services has a high degree of inefficiency (particularly if they are able to get away with charging for services that aren’t needed). We agree with Callplus, for example, that “*The Commission should not assume Chorus processes and systems are efficient, the copper network is old and the associated systems are complex, piecemeal and the accuracy of records is impacted as a result. CallPlus sees many signs of inefficiencies in Chorus processes and systems however it is often difficult to pinpoint these due to the asymmetry of information*”.<sup>13</sup>

7.1.4 If the top-down approach (based on Chorus’ actual costs and activity) is retained, then we agree with Spark<sup>14</sup> that a more aggressive approach to efficiency adjustments is necessary. This would provide Chorus’ with strong incentives to cut costs and innovate to develop better ways of providing non-recurring services.

## 8 There is no evidence investment incentives are a problem

8.1.1 We question how Chorus could argue the prospect of a 12% price increase would harm its incentives to invest. We have never seen a regulated supplier complain that a price increase amounts to “*regulatory opportunism*” before, as Sapere does on Chorus’ behalf.<sup>15</sup>

8.1.2 In the energy WACC percentile review last year, the Commission noted investment levels were sufficient at 75th percentile, so it may be the case that a lower WACC percentile (and price) would still deliver sufficient investment. Applying the same logic to UCLL and UBA, we are not aware of any evidence that investment in Chorus’ copper network is insufficient. This suggests the IPP prices are sufficient (or more than sufficient) to ensure any necessary investment in copper assets, and that a 12% (or more) increase is not needed.

8.1.3 As various submissions have noted, with Chorus’ copper investment tracking at about \$60m, it is difficult to see that much, if any, price increase is warranted to ensure incentives to invest. We understand that for each \$1 increase in price Chorus’ receives an NPV of about \$100m. The draft \$4 increase would cover all of Chorus’ copper investment for the entire regulatory period.

8.1.4 We note the IMs Merit Appeal decision which various parties have referred to, and agree incentives to invest are only undermined where price is below cost.

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<sup>12</sup> Wigley and Company, Submission on draft pricing review determination for UBA and UCLL services, 20 February 2015, paras 12.9] to [12.14].

<sup>13</sup> CallPlus, Submission on the Commerce Commission's Further Draft Pricing Review determinations for UBA and UCLL services, 13 August 2015, at para [5].

<sup>14</sup> Spark, at paras [18] – [24].

<sup>15</sup> Sapere, Economic Comment on UCLL and UBA Pricing Issues, 11 August 2015, at para [93].

## 9 Backdating should not be adopted

- 9.1.1 As we noted in our submission, we welcome the Commission changing its position on backdating, as do all submitters other than Chorus.
- 9.1.2 As with submitters other than Chorus, we struggle to see how our customers would benefit from Trustpower and other access seekers providing Chorus' with a retrospective windfall gain.
- 9.1.3 We agree with CallPlus that this would “*effectively [be] a wealth transfer from RSPs and end-users to Chorus, a network operator who is investing in fibre regardless as part of a commercial contract with the Government*”.<sup>16</sup>
- 9.1.4 In this regard, we note that Chorus assumes in its submissions that all RSPs have increased their prices since December 2014 (when the paper announcing possible backdating was released), to get 100% pass through to consumers. That is incorrect as to us: in the market conditions, we were unable to increase our prices, and therefore did not do so.
- 9.1.5 We also agree with Vodafone, for example, that “*Backdating in this case would harm the long-term interests of New Zealand telecommunications end-users. It would significantly harm competition, and introduce new distortions into a market that is already operating under uncertainty*”.<sup>17</sup>
- 9.1.6 From our perspective, consistent with other access seeker and consumer submissions, the possibility of backdating increases business risk and makes it more difficult, particularly as a small operator, to compete vigorously on price (again to the detriment of our customers). A clear decision not to backdate would provide better certainty for future pricing decisions
- 9.1.7 We question how Chorus considers backdating to be mandatory, when the Telecommunications Act contains no specific provision for backdating.
- 9.1.8 Part 4 of the Commerce Act provides for claw-back (which parallels backdating), but the decision to apply claw-back is entirely at the Commission's discretion. The Commission's application of claw-back under Part 4 has been to ensure regulated suppliers did not recover excess profits/and were not precluded from recovering their costs. This is an appropriate approach to adopt – and consistent with the Wigley and Company submission that investment incentives are only harmed if price (including potential backdating) is inadequate to recover cost.<sup>18</sup>
- 9.1.9 If, however, backdating is applied, we would support adoption of the claw-back approach taken in the energy sector. Based on submissions we don't think any of the parties would object to this approach, if backdating were to occur.

## 10 Levelisation is not justified by simplicity

- 10.1.1 We were surprised Chorus has done a u-turn and now advocates levelisation of prices on the basis “*that a single price for the regulatory period has the advantage of simplicity*”.<sup>19</sup> Chorus was asked at the FPP Conference for its view on levelisation:<sup>20</sup>

*CHAIR: In our draft determination we traced through the way in which capital costs were turned into annual payments and annual payments turned into monthly charges*

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<sup>16</sup> CallPlus, at para [39].

<sup>17</sup> Vodafone, at para [ix].

<sup>18</sup> Wigley and Company, at para [5.12(g)].

<sup>19</sup> Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, at paras [29] and [281].

<sup>20</sup> UCLL and UBA Services Final Pricing Principle Conference held on 15-17 April 2015, Transcript, pages 283-4.

*per line, and then in a flash of creativity we decided to levelise those over the course of the five years so it was a constant nominal number thinking that that would be simpler for all parties and a great relief to everybody. As far as I can make from submissions, nobody likes that option; am I right?*

*ANNA MOODIE [Chorus]: I think we're okay with that option.*

- 10.1.2 The nature of copper access pricing is already very simple compared to the charges for network services, transmission and distribution, in the energy sector. Or any other good or service we can think of.
- 10.1.3 Making an annual adjustment to prices (known up to five years in advance) is hardly onerous. Regulated suppliers in the energy sector make annual adjustments (to reflect CPI), as well as once five-yearly starting price adjustments.
- 10.1.4 We doubt end-users would prefer to pay more now for copper broadband services with the promise they will pay less than they otherwise would later on in the five-year regulatory cycle.
- 10.1.5 We would also note that that we struggle to see how Chorus could advocate levelisation on the basis of “simplicity” yet also support backdating, which would be far from simple for RSPs to deal with in their pricing.

## **11 Closing remarks**

- 11.1.1 For any questions relating to the material in this submission, please contact Peter Gregory, Trustpower’s Business Manager Telecommunications, on [peter.gregory@trustpower.co.nz](mailto:peter.gregory@trustpower.co.nz).

Regards,



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