

One NZ cross submission on fibre fixed line access service deregulation review – reasonable grounds assessment draft decision

15 October 2024

Introduction

1. We welcome the opportunity to respond to the submissions on the Commerce Commission's (the Commission) draft decision on whether there are reasonable grounds to start a deregulation review of one or more fibre fixed line access services (FFLAS) under section 210 of the Telecommunications Act (the Act). In this cross-submission, we have provided a limited response in the time available that primarily addresses Chorus' submission on the Commission's draft decision.

Reasonable grounds test

2. Chorus argues that the assessment framework used by the Commission in reaching its draft decision 'is flawed' and that 'in adopting that very high threshold to establish reasonable

grounds, the Commission has misconstrued the statutory test.¹ We don't agree with this view. The issue that s210(3) of the Act instructs the Commission to determine is whether reasonable grounds exist to commence a review into FFLAS deregulation. The statute does not propose any precise calculation or formula for determining this issue. Section 210(4) of the Act provides a non-exhaustive list of factors that the Commission 'may consider' in making this determination. The Commission may also have regard for other relevant factors not listed in s210(4) in making its determination, consistent with its obligations to have regard to all relevant factors and to disregard irrelevant ones. In cases such as this one, where statutory language is imprecise as to exactly how a determination must be made, a decision maker '...may have to exercise judgment among options available on the statutory words. The only question, then, is whether the judgment made was a permissible one, or one open to the decision-maker.'² This sensible position reflects the reality that '...statutory language is not necessarily wholly prescriptive. There will be a correct interpretation, of course. But that interpretation will often leave open options to a decision-maker... Economic regulation...is notoriously difficult to prescribe, given the extraordinary variety of business practices, markets and circumstances that fall to be addressed. The reality of economic regulation is that statutes present a chart of medium scale at best. The exact route to be taken is left to the judgment of the navigator, the decision-maker.'³

3. One NZ agrees with this orthodox position, which accepts that the Commission has a broad area of discretion when reaching a determination pursuant to s210. The reasonableness test draws a range of considerations that include those listed at s 210(4) but could also include factors such as the relative youth of the regime that Chorus now argues is obsolete, Chorus' position as a monopolist (and inevitable trading partner for retailers), potential adverse impact on consumers, and loss of regulatory certainty arising from deregulation and how this

¹ https://comcom.govt.nz/_data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 4

² Chorus v Commerce Commission and others [2014] NZHC 690, [18]

³ Ibid, [15]

might alter fundamental market structure and dynamics. The Commission has discretion on how it weights these factors and any other relevant considerations.

4. In contrast, Chorus' submission suggests that the only factor that the Commission is entitled to consider is 'competition that is constraining Chorus' ability to price up to its maximum allowable revenue (MAR).'⁴ This fundamentally mischaracterises the function of the MAR, which operates as a *limit* that Chorus is not entitled to exceed (not a *target* that it must achieve in all instances).
5. Chorus goes on to suggest that Part 6 regulation is so unsatisfactory that 'a better approach would be to apply the framework used by the Commission when carrying out inquiries into whether a sector or supplier should be regulated under Part 4 of the Commerce Act 1986'. First, we note that adopting an alternative regulatory framework under different legislation is beyond the scope of the Commission's powers. Secondly, it is worth remembering that Chorus itself asked for Price-Quality (PQ) regulations under Part 6 of the Act. Indeed, in its submission to the Select Committee considering the regime, Chorus said: '[w]e generally support Part 6 of the Bill, in particular the introduction of price-quality and information disclosure regulation adapted from utility regulation in Part 4 of the Commerce Act 1986. Our submissions focus on specific issues within that framework where we think the Bill can be improved to better give effect to its objectives.'⁵
6. Chorus' argument that the regime it is subject to is not fit for purpose is consistent with its history of seeking regulatory change whenever it feels this would better achieve its commercial objectives, going back as far as its unsuccessful challenges to IPP benchmarking regulation. Chorus' criticisms of Part 6 continue its practice of blaming the rules and referee for flaws in its own performance.

⁴ Chorus submission on Fibre fixed line access service deregulation review: Reasonable grounds assessment draft determination, [3]

⁵ Chorus Submission on the Telecommunications (New Regulatory Framework) Amendment Bill 2017 (2 February 2018), [36] and [37] (available at https://www.parliament.nz/resource/en-NZ/52SCED_EVI_74818_416/9b8bf930d83b9c6962145d94c24e14f68453d921).

7. Finally, focussing on pricing and its ability to realise its MAR (as Chorus has done in its submission) ignores the broader function of the regulatory settings, which is to guard against misuse of market power, including monopoly pricing, holding back investment and reducing service quality. We discuss this point in further detail below.

Function of the MAR

8. In its submission, Chorus argues that the Commission's draft decision is wrong because 'the available evidence – including evidence of competition that is constraining Chorus' ability to price up to its maximum allowable revenue (MAR), overlapping and inappropriate regulation, and rapidly changing market dynamics – clearly demonstrates that reasonable grounds exist.'⁶
9. Chorus' key argument in support of a review into FFLAS deregulation is that 'competition constrains Chorus' ability to set prices at a level that would enable it to recover its MAR' and 'the fact that the revenue cap does not 'bind' raises a serious question about the benefits of PQ regulation when weighed against the significant costs of implementation'.⁷ Chorus goes on to argue that its scope for exercising substantial market power is limited as 'evidenced' by the fact that Chorus has not met the MAR in the first regulatory period and their expectation that their revenues for the second regulatory period will 'also be below the level necessary' to recover the MAR.⁸
10. As noted above, this view ignores the underlying function of the MAR, which is to provide an upper limit rather than a target. In setting the MAR, the Commission's role is to estimate a revenue beyond which Chorus must not exceed as a protection absent competition. It is not

⁶ https://comcom.govt.nz/___data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 3

⁷ https://comcom.govt.nz/___data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 5

⁸ https://comcom.govt.nz/___data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 11

a requirement of the statutory scheme that Chorus must achieve the MAR in every regulatory period. This is consistent with Parliament's intention when introducing the new fibre regulatory regime: 'the system will ensure that [Chorus] cannot make excess profits at the expense of consumers. Under this new regulatory framework, Chorus will be subject to a revenue cap. The revenue cap gives Chorus flexibility in how it sets prices for most of its product, but it also ensures that Chorus does not earn excessive returns on its fibre assets.'⁹ Parliament did not intend for the MAR to operate as a guarantee of earnings for Chorus.

11. Lastly, it is important not to focus on the first or second regulatory period in isolation. What is relevant is the whole asset life over future regulatory periods. Over this duration, there is no reason to support that Chorus cannot price at a level to meet the MAR. Loosening FFLAS regulation only a few years after it was introduced simply to enable Chorus' immediate commercial ambitions would be inconsistent with the purpose of promoting the *long-term* benefit of end-users.¹⁰

Bitstream PON services

12. Chorus argues that competition from FWA constrains FFLAS Bitstream products pricing. One NZ disagrees with Chorus on both the nature and extent of any competition. As outlined in our previous submission on this matter, for some consumers in specific geographic areas, FWA might be considered a 'close economic substitute' to FFLAS in terms of key price and non-price features. However, for other consumers or in the context of different applications these products are not substitutable.
13. Chorus says that '...FFLAS Bitstream PON products are constrained by fixed wireless competition by way of a chain of substitution effect.'¹¹ One NZ considers that, to the extent that any chain of substitution exists, it would extend at most from FWA to Chorus entry level

⁹ https://www.parliament.nz/en/pb/hansard-debates/rhr/combined/HansDeb_20180918_20180918_24

¹⁰ Telecommunications Act 2001, s162

¹¹ Chorus submission on Fibre fixed line access service deregulation review: Reasonable grounds assessment draft determination, [14]

fibre products, e.g. Home Fibre Starter (50Mbps). There is no evidence that FWA is considered substitutable for Chorus' higher specification fibre products (and retailers cannot advertise or proactively offer these products to customers as substitutes under the Commission's broadband marketing guidelines¹²). In addition, Chorus' own business strategy is predicated on increasing uptake of higher specification plans, e.g. >25% of end users on >1GBps plans.¹³ The existence of this strategy conflicts with Chorus' argument that fibre uptake and terms are currently constrained by FWA competition. This strategy reflects Chorus' conviction that end users will continue to 'trade up' from entry level fibre products to higher specification products, and this belief is central to Chorus' ongoing direct to consumer marketing campaigns. Contrary to this strategy however, Chorus now appears to be suggesting a broad chain of substitution exists between FWA and fibre products generally, and therefore that FWA and fibre products must be considered interchangeable and part of the same market. Its own commercial strategy denies this.

14. Chorus' stated intention to increase fibre prices from 1 January 2025, which is expressed only to be '...subject to consultation' (rather than subject to conditions of competition) is equally telling.¹⁴ Chorus has said it will be increasing the Home Fibre Starter plan wholesale price from \$35 to \$40. If Chorus genuinely believed this product was subject to competition from FWA, then it would have no ability to commit in advance to this quantum of this price increase. Instead, the quantum of increase would be determined by actual market conditions, including the price of products that Chorus believes are substitutes. This would include critical loss analysis to assess whether the proportion of customers likely to switch away will exceed the profit derived from the increase.

¹² https://comcom.govt.nz/_data/assets/pdf_file/0032/269663/Marketing-alternative-telecommunications-services-during-the-transition-away-from-copper-guidelines-8-November-2021.pdf

¹³ Chorus FY24 Results Presentation, slide 33, Chorus reported last year that "1Gig share of net adds ~40% vs 24% share of connections" Chorus FY23 Results Presentation, slide 25

¹⁴ Chorus FY24 Results Presentation, slide 35.

15. In any event, the existence of any chain of substitution effect as suggested by Chorus does not determine the nature of competition between products. Frontier Economics (**Frontier**) accepts that ‘...what matters for competition is the barriers to expansion by existing networks...the actual ability to substitute a large number of customers will be function of the ability of alternative networks to service demand; that is, their capacity...The question is whether there is enough capacity.’¹⁵ Although Frontier acknowledges this constraint, it has underestimated (or, more accurately, not examined at all) the challenges involved in expanding network capacity to provide FWA to a significant number of additional customers if a deregulated Chorus takes advantage of its monopoly power.
16. Frontier’s reasons for suggesting that FWA capacity can be expanded are general and not based on any objective evidence, i.e. ‘...wireless networks can be built in a much more modular and demand responsive fashion.’¹⁶ This theoretical statement ignores the reality that FWA services are provided via a network that also delivers mobile services. Operators must carefully manage capacity on this network to ensure capacity, quality and reliability across *both* service types. Operators therefore make careful decisions about where FWA services can be offered to customers and will only do so where existing network capacity is sufficient to support provision of high-quality services.
17. As the Commission is aware, the total data carried on One NZ’s network continues to grow exponentially – see Figure 1 below. We expect that the same growth profile is present in other operators’ networks.

¹⁵ Frontier Economics Reasonable grounds analysis Prepared for Chorus (23 September 2024), [3.6].

¹⁶ Ibid, [3.6]

[C1]

18. This level of data growth challenges existing mobile network capacity. Operators must invest continuously in networks to cater for this organic level of growth and ensure the quality of services for existing customers. Substantial further investment would be required to serve any significant addition of FWA customers.
19. In areas where network capacity is already constrained there is no scope to offer services to additional FWA customers, let alone accept a significant diversion of fibre customers in response to any misuse of market power by Chorus. All operators will have areas with very high existing network utilisation including geographic areas within Chorus' fibre coverage footprint. In these areas, it is not credible to expect that operators will be readily able to expand capacity to an extent or within a timeframe that would enable them to onboard a significant number of additional customers.
20. Frontier cites an extract from an Ericsson report that refers to the various routes to network expansion, but this does not address the practical reality of expanding under any of these routes, including the cost, timeframe or complexity of any route. There is no case for opening possibility of deregulation based on speculation regarding expansion that doesn't properly account for these factors.
21. The Ericsson report extract referred to by Frontier identifies the following ways to increase mobile network capacity:
 - a. *Adding capacity to existing sites using new or additional radio equipment.* This assumes that a site has space for additional equipment, that no new engineering is required to support that equipment, and that property access and any consenting, planning or community objections do not affect placement of equipment on a site. In reality, many sites are already full, with no scope to locate more equipment in place.
 - b. *Using additional spectrum.* One NZ and other operators already use spectrum highly efficiently. This includes maximising use of spectrum in locations where demand on the mobile network is greatest. This approach is required to ensure mobile networks can meet existing organic demand growth. However, spectrum remains a scarce resource, and no operator has large holdings of spectrum sitting idle that could be used to boost capacity to cater for a significant influx of end users seeking to avoid a material fibre price increase.
 - c. *Densifying/building additional sites.* This depends on the availability of suitable sites in the required locations. Assuming these exist, build of new sites requires rights of access to those sites to be achieved on economic terms. Experience shows that planning, consenting and community opposition can influence the scale, complexity and timeframe for completion of build programmes.

22. It follows that there are genuine barriers to expansion of mobile network capacity that make it very unsafe for the Commission to conclude that FWA would be available as an alternative for end users of Chorus' entry level fibre plans if a deregulated Chorus materially increased the price of these plans. In the very best-case scenario, any expansion of mobile network capacity would be of uncertain scale and would occur within an uncertain time period. Given the complexities of each expansion 'route' discussed above, each involving many factors that mobile operators do not ultimately control, any expansion could be slow, enabling Chorus to enjoy a period within which it can exercise market power without losing customers. One NZ considers that even this temporary exercise of market power, and corresponding detriment to end users, would be inconsistent with the underlying rationale for existing Part 6 regulation.¹⁷

Transport services

21. Chorus argues that the draft decision that there are no reasonable grounds to deregulate transport services 'is based on an incorrect assessment of the market'. We disagree and consider that the Commission's decision is reasonable based on the information before it.

Unbundled PON services

22. Chorus argues that '[f]or unbundled PON, the fundamental issue is that there is very little demand for the product and we are not aware of any likely material future uptake.' It goes on to say that 'Given the service is not being taken up at any significant scale, there does not seem to be any benefit derived from ongoing regulation of unbundled PON.'¹⁸ The real reason behind little demand for unbundled PON services is that Layer 1 commercial terms provided by Chorus are not commercially viable.

¹⁷ Any argument that Chorus could not maintain pricing over a longer-term is irrelevant to the question of whether deregulation should permit short-term misuse of market power.

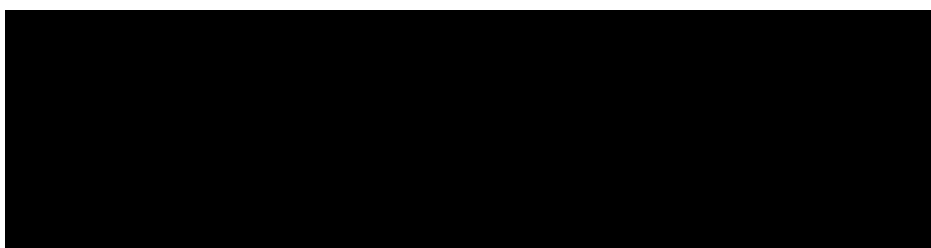
¹⁸ https://comcom.govt.nz/_data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 19

23. Chorus is required to offer passive optical network fibre access service (PONFAS) consistent with the equivalence of inputs and non-discrimination principles in the Deed of Open Access Undertakings for Fibre Services. To date, it has not done so. The PONFAS offer published by Chorus does not permit access to layer 1 services on a basis that would enable access seekers to replicate Chorus' layer 2 services on an economic basis, and this undermines scope for competition, service differentiation and the opportunity for better meeting the needs of consumers that formed the rationale for requiring layer 1 unbundling as a fundamental feature of fibre regulation under the Act.
24. One NZ has previously raised its concerns about the inconsistency of Chorus' PONFAS offer and explained why this offer is inconsistent with the objectives and scheme of the Act. The Commission has accepted that to satisfy equivalence of price, 'the margin between the network operator's upstream and downstream prices has to cover the costs of providing the downstream service including normal return on capital.'¹⁹ This means that the price of PONFAS must be sufficiently below the price of the average GPON bitstream service to allow a reasonably efficient access seeker to cover their costs of providing a layer 2 service. However, the price set by Chorus for a reasonable sized access seeker is *more than* the price offered for a bitstream service that bundles layer 1 and layer 2 capability.
25. In short, both the price and non-price PONFAS terms set by Chorus deny the possibility of access seekers replicating Chorus' layer 2 services on an economic and efficient basis, therefore to date failing to achieve the policy goal of promoting competition in telecommunications markets for the long-term benefit of telecommunications end users. Consequently, the case for strengthening the regulatory settings to make PONFAS a genuinely economic service is stronger than any case for deregulating this service.

¹⁹ Commerce Commission, *Equivalence and non-discrimination – guidance on the Commission's approach for telecommunications regulation*, 30 September 2020, para 3.32.

Timeframe for deregulation review

26. Chorus has called on the Commission to carry out and conclude a full deregulation review before 2027, arguing that ‘the medium to long-term impacts of rapidly evolving market dynamics – including the wind-down of Chorus’ copper network and evolving 5G technologies – will likely become clearer over the next two years.’²⁰ The Commission is not required to commit to completing a full review by a future date at this stage. The decision the Commission is required to reach is whether reasonable grounds exist to commence a deregulation review now. The Commission can revisit this issue again ahead of the third regulatory period to consider if reasonable grounds exist at that stage.



²⁰ https://comcom.govt.nz/_data/assets/pdf_file/0020/362621/Chorus-submission-on-draft-decision-deregulation-review-24-September-2024.pdf, p. 3