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Public

Cross-submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle
– Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014)

EXECUTIVE SUMMARY

- 1 This submission responds to industry submissions that the Commerce Commission (Commission) has received on its Further Consultation Paper released on 14 March 2014 and Supplementary Consultation Paper released on 25 March 2014 (together, the Consultation Papers).
- 2 In this submission we say:
 - 2.1 **Mapping each service to the network:** we agree with the general industry view that the Commission should map the relevant network components used by each service, and we provide a map;
 - 2.2 **MEA:** the international precedent referred to by parties in their submissions, once put in context, does not support a fibre and wireless MEA. There are also practical reasons why deploying multiple technologies for delivering one service make it highly complex and costly;
 - 2.3 **Asset valuation:** the reasons for different asset valuation methodologies in other jurisdictions do not apply here;
 - 2.4 **Section 18:** the submissions highlight the range of views on both forward-looking and backward looking policy and the impact on a company's business model when trying to work around an unpredictable framework and unclear outcomes if an efficient transition to fibre policy is not recognised; and
 - 2.5 **Process:** the Commission has consulted on a number of issues in advance of its draft decision, and parties have had an opportunity to comment on those issues. However, there are a number of practical steps that the Commission could take to enable further consultation in advance of its draft decision that would not delay the Commission's timetable.
- 3 We expand on each of these points below.
- 4 There continues to be some alignment on the issues raised in the Consultation Papers. For example, the Commission needs to identify the specific services that are subject to the price review processes (including SLU), the Commission must set a price that is equal to the TSLRIC of each service, the UBA price should be averaged and the Commission's role in these processes is to review the price with a different methodology, not to re-define the access service portfolio.
- 5 Where parties disagree with Chorus' position, it is difficult to respond in a meaningful way in the absence of evidential support for a position. However, on the key issues we refer the Commission to our previous submissions, and note:
 - 5.1 *The service:* other parties agree that the Commission must set prices for the UCLL STD service, the SLU STD service and the UBA STD service – including

both monthly charges and connection charges. When doing so, the Act requires that the Commission model the costs of replicating the full functionality of each service. We have shown that this is consistent with legal advice and regulatory precedent;

- 5.2 *MEA for the UCLL and SLU STD services*: the technology that meets the criteria for the MEA for the UCLL and SLU STD services is the current copper technology in Chorus' network. This is because the current copper technology is the only technology that delivers the full facilities and functions of the UCLL and SLU STD services. We have provided our technical assessments and expert economic evidence as to why this is the case. The alternative proposals put forward by other parties do not appear to be supported by their external expert advice;
- 5.3 *Modelling MEA candidates*: if, in addition to modelling a copper MEA the Commission chooses to model a P2P fibre MEA, the model must include the cost of the fixes needed to address the functionality shortfalls of P2P fibre. This can be done without creating resourcing contentions or complexities that affect quality decision making to the detriment of the publicly announced timetable;
- 5.4 *MEA for the UBA STD Service*: we have explained why we agree with the Commission's preliminary views that the current copper network should be assumed when modelling the additional costs of the UBA STD service. This is the approach that is consistent with the Final Pricing Principle and the mandatory relativity consideration. Other parties have provided no evidence to support the Commission changing its proposed approach;
- 5.5 *Asset valuation*: we disagree that historic cost is an available option to the Commission. The Act prescribes that the Commission is required to calculate TSLRIC on a forward-looking basis. This directs the Commission to model assets using replacement costs.¹ Use of a replacement cost valuation is also consistent with the objective of TSLRIC to set an accurate and efficient build / buy signal. It is also consistent with the Commission's views in its 2002 and 2004 TSLRIC principles papers.² Expert advice from Incenta Economic Consulting recommends valuing assets based on optimised replacement cost (ORC);³
- 5.6 *Section 18 and relativity*: there are a number of competing views on how section 18 and relativity should be applied. Where the Commission is required to exercise discretion, it must be guided by the section 18 purpose statement and the mandatory relativity consideration. Importantly, in response to once in a generation fibre investments, section 18(2A) requires that the Commission "consider the incentives to innovate that exist for, and the risks

¹ See Chorus "Submission on UCLL FPP process and issues paper" (14 February 2014) at [65 – 68] and Chorus "Cross-submission on UCLL FPP process and issues paper" (28 February 2014) at [30 – 32].

² See Chorus "Cross-submission on UCLL FPP process and issues paper" (28 February 2014) at [31].

³ Incenta Economic Consulting "TSLRIC for UCLL service – asset valuation issues" (28 February 2014).

faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services." There are tensions in the way that the Commission's decisions will impact all industry investment and choices, business models, transition to fibre and end-users in the short, medium and long term. As a wholesale only provider, our services and prices are open access and present a level playing field for RSP competition. Wholesale pricing has real impacts on an infrastructure company with a significant capital programme and on RSP choices in a period of transition. There is no certainty that changes and reductions in prices will be passed to end users or if so by how much and when;

- 5.7 *Backdating*: the Commission's intention to complete both the UCLL/SLU and UBA processes in parallel by 1 December means the practical impact of backdating is reduced. There is no backdating for UBA if the final pricing reviews are completed by 1 December 2014. We understand the commercial concern of our customers if TSLRIC prices are more akin to today's pricing levels in aggregate (with likely rebalancing in our view). We are happy to work up a proposal (essentially a repayment formula) to be discussed at a working group, with the objective being to identify a commercially workable implementation that the Commission could include in its price review determinations. We recommend the Commission enables the industry to discuss such a proposal at the next workshop so that options are available for the Commission to consider.
- 6 This is an appropriate time in the process to stand back and take stock of the various proposals being made and where they may lead.
- 7 The significance of these processes has already been demonstrated by the consequences resulting from the inherent inadequacy of benchmarking that the Commission faced difficulties in applying. With TSLRIC, the Commission isn't constrained by a limited set of international benchmarks, and this means that the Commission can determine a more appropriate price that reflects the New Zealand circumstances. This is not the time for novel approaches that are untested and lead to complexity (such as modelling a full fibre network to estimate the cost of delivering the UCLL STD service and the SLU STD service, making adjustments to a fibre model, re-defining the access service portfolio).
- 8 There are two high level reference points that should guide the Commission in this process:
- 8.1 the Act and the STDs created under it; and
 - 8.2 the regulatory and economic precedent for building a copper network cost-model to price copper services.
- 9 The Commission should, as it has rightly emphasised previously, implement the Act that is currently before it. Having regard to this first reference point includes:

- 9.1 identifying forward-looking TSLRIC costs;
 - 9.2 identifying all of the TSLRIC costs of providing the service that is the subject of the price review application (and not the costs of a hypothetical service);
 - 9.3 working with the current set of access services that the Commission has determined in STDs, and mapping each service onto the network components used by the service under consideration; and
 - 9.4 backdating the price review determinations.
- 10 The second reference point is the fact that building a cost model of a copper network is a well-trodden path. It is more certain, less contentious, less time consuming and less costly. It is also consistent with the Commission's own articulated orthodox application of TSLRIC in papers it published in 2002 and 2004. Analysys Mason is an experienced expert and has flagged that there are a myriad of modelling decisions that are settled in a copper context but are not in a fibre context. Each decision has to be framed, information gathered and tested, views sought and a decision made.

SUBMISSION

Mapping each service to the network

- 11 When setting the TSLRIC price for each service the Commission must take care to include all of the network components that are relevant to that service. This flows from the requirement to set a price that reflects the TSLRIC cost of the service that is the subject of the price review.⁴
- 12 CallPlus emphasises this principle,⁵ and we agree that it is important to be clear how each network component maps to the services that are the subject of price review (and, where appropriate, to other services).
- 13 The diagram below shows how the network components map to each service:

⁴ See Chapman Tripp "Memorandum: Unbundled copper local loop (*UCLL*) and unbundled bitstream (*UBA*) access services – pricing review determination (*PRDs*) – legal framework" (11 April 2014) at [5.3 – 5.4] and Chorus "Submission on UCLL FPP process and issues paper" (14 February 2014) at [71 – 74].

⁵ CallPlus "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [47].

Which STD price recovers which network cost elements		Network Cost Elements										
		Copper EU- LX	Copper EU-Cab	Transmission EU-Cab/LX	Cab	Copper Cab-LX	Fibre Cab-LX	Transmission Cab-LX	LX	Fibre LX-FDS	Transmission LX-FDS	FDS
<i>Network Layer</i>		0+1	0+1	2	0	0+1	0+1	2	0	0+1	2	0+1+2
STD Price	UCLL	X										
	SLU		X									
	SLES					X						
	UCLFS	X	X			X						
	SLU Co-location				X							
	SLU Backhaul						X	X				
	UCLL Co-location								X			
	UBA			X	X		X	X	X	X	X	X

EU – End-user
 Cab – Active cabinets
 LX – Local Exchange
 FDS – First Data Switch

14 Note, regarding the above table, that:

14.1 copper line costs of any sort include passive cabinets, distribution frames, and various other costs - all of which have been omitted in the interests of simplicity; and

14.2 "Transmission" means electronics costs associated with transmission, including DSLAMs, where applicable.

15 This table differs from the one discussed at the 28 March 2014 Workshop in the following ways:

15.1 the addition of another service (SLES);

15.2 UCLL does not use 'Fibre Cab – LX';

15.3 UCLL does not use 'Copper EU – Cab', 'Copper Cab – LX',

15.4 SLU does not use 'copper EU-LX', 'Copper Cab – LX', 'Fibre Cab-LX';

15.5 UCLFS does not use 'fibre Cab –LX';

15.6 SLU backhaul does use 'Fibre Cab – LX'; and

15.7 UBA does use 'Fibre Cab-LX'.

16 It is helpful to highlight some specific points from this mapping, as they have been the subject of submissions or discussions in this price review process:

16.1 the cost of the fibre feeder from the cabinet to the exchange is a cost that is relevant to the TSLRIC of the additional costs of the UBA STD service. In this regard we agree with the position of CallPlus;⁶ and

16.2 the cost of the copper feeder from the active cabinet to the exchange:

(a) is a cost that is not relevant to the TSLRIC of the UCLL STD service, the SLU STD service or the TSLRIC of the additional costs of the UBA STD service; but

(b) is a cost which is relevant to the UCLFS service.

MEA for UCLL and SLU STD services

17 As mentioned in our previous submission on 11 April 2014, fixed wireless access is not capable of providing an unbundled layer 1 service with dedicated connectivity equivalent to UCLL or SLU.⁷ Nor is it a suitable MEA for UBA.⁸

18 Vodafone refers to Sweden as an example of a potential approach for identifying customers that could be better served by wired or wireless technologies.⁹ Putting this into perspective, only 50,000 households out of several millions are priced using fixed wireless access, as these are end-users in remote and sparsely populated areas of the country. Analysys Mason observes this approach is consistent with the existing operator's network as fibre is widely deployed, plus Telia Sonera have plans to uninstall the copper network to approximately 50,000 households and replace it with fixed wireless access, in areas where services currently offered do not include broadband.¹⁰

19 In addition, it is interesting to note Frontier's paper on 14 February 2014 does not appear to support fixed wireless access, as their recommended MEA options are either the existing copper-fibre technology mix, or all fibre.¹¹ Frontier also went on to say "we note that fixed wireless technologies may in some instances offer lower performance than a copper network".¹² Frontier's concern about the quality of fixed wireless has been borne out by recent experience in rural New Zealand, where concerns have been

⁶ CallPlus "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [40 - 47].

⁷ Chorus "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [19].

⁸ Chorus "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [131].

⁹ Vodafone "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at page 4.

¹⁰ Analysys Mason "Response to Commission" (12 February 2014) at page 13.

¹¹ Frontier Economics "Submission on UCLL process and issues paper on behalf of Vodafone, Telecom and CallPlus" (14 February 2014) at page vi.

¹² Frontier Economics "Submission on UCLL process and issues paper on behalf of Vodafone, Telecom and CallPlus" (14 February 2014) at page 25.

raised about download speeds, latency, dropouts and vulnerability to service interruptions.¹³

20 It has also been suggested that the Commission should cap costs for one MEA in areas where a second modelled MEA is shown to be cheaper.¹⁴ However actually deploying multiple technologies for one service will be highly complex and costly.¹⁵ The Commission should cost only its one cheapest MEA, as a new entrant would.

21 When doing this modelling fixed nodes should be defined as existing exchanges and FTTN cabinets, as the Commission is modelling the UCLL STD and SLU STD services. Changing the location of cabinet nodes will impact on the allocation of costs when modelling UCLL and SLU.

Asset valuation

22 The Commission is required to calculate the forward-looking TSLRIC cost of providing the service. This rules out an historic cost approach and instead directs the Commission to model assets using replacement costs.¹⁶

23 Some parties have drawn on other contexts to argue that the Commission should take a different approach to asset valuation. However, the changes being made or distinctions being drawn in other regulatory contexts are not relevant to this price review process. As submissions have indicated, for example, the ACCC has moved away from using TSLRIC (after the ACCC's own TSLRIC cost modelling indicated a significant increase in key local loop prices).¹⁷ However the ACCC has the power to change the pricing principle and did so. The Commission has no such power, and is required to apply the existing statutory framework that requires prices to be set equal to forward-looking TSLRIC.

24 The same is true of the changes to different asset valuation methodologies in the European context.¹⁸ These alternatives are a move away from TSLRIC, and illustrate options that are not available under the New Zealand legislation.

25 We do not agree that use of replacement cost valuation methodologies will result in a windfall gain to Chorus. As explained in the expert evidence from Incenta there is no

¹³ Franklyn County News, Auckland "Rollout ahead of schedule but rural users reluctant" (24 April 2014), John Allen.

¹⁴ Telecom "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [26].

¹⁵ Analysys Mason "Response to Commission" (14 February 2014) at page 25 and Chorus "Submission on UCLL process and issues paper" (14 February 2014) at [241].

¹⁶ See Chorus "Submission on UCLL FPP process and issues paper" (14 February 2014) at [65 – 68] and Chorus "Cross-submission on UCLL FPP process and issues paper" (28 February 2014) at [30 – 32].

¹⁷ Chorus "Submission on the Review of the Telecommunications Act 2001 Discussion Document" (13 September 2013) at [301 - 304].

¹⁸ Chorus "Cross-submission on UCLL FPP process and issues paper" (28 February 2014) at [62].

evidence that this will occur, or to expect that this will occur.¹⁹ Further, use of a replacement cost methodology is consistent with past regulatory practice in applying forward-looking TSLRIC.²⁰

Section 18, relativity and the Ladder of Investment

- 26 There are tensions in the way that the Commission's decisions will impact all industry investment and choices, business models, transition to fibre and end-users in the short, medium and long term. Submissions highlight that there are range of views on the ladder of investment, the impact of the section 18 considerations and the application of relativity on different business models and the impact on transition to fibre. As a wholesale only provider, our services and prices are open access and present a level playing field for RSP competition. Wholesale pricing has real impacts on an infrastructure company with a significant capital programme and on RSP choices in a period of transition. There is no certainty that changes and reductions in prices will be passed to end users or if so by how much and when.
- 27 Telecom encourages the Commission to take a new approach incorporating concepts of replicating workable competition that do not come from the Telecommunications Act or TSLRIC. While Telecom has said no one anticipates a further network being built, it does not address the ladder of investment points and relativity as between the layer 1 services and UBA under discussion that sit with the Commission's build/buy focus.

The process going forward

- 28 The Commission has engaged substantially on key aspects of the FPP process, including the appropriate MEAs. The FPP process is now entering the modelling phase. We propose that, in advance of the draft determinations, the Commission:
- 28.1 release the reference and scoping papers TERA is contractually required to produce and consult the parties on that information at the industry workshop currently scheduled for 13 May;
 - 28.2 confirm its initial views on key parameters that it will need to give to TERA to the parties; and
 - 28.3 release a "dummy model" for the parties to familiarise themselves with prior to the draft determinations (which could be a limited release to external modelling experts only under the Commission's confidentiality regime).
- 29 Now that the modelling process is underway, it would be useful to use the opportunity to consult further on a number of additional points. As discussed by Orcon and CallPlus,

¹⁹ Incenta Economic Consulting "TSLRIC for UCLL service – asset valuation issues" (28 February 2014 at [1.2.4].

²⁰ Chorus "Submission on UCLL FPP process and issues paper" (14 February 2014) at [65 - 66].

greater clarity from the Commission on its approach to setting the SLU STD prices and sundry charges for the UCLL, SLU and UBA services would be beneficial.²¹

Confidentiality

- 30 Chorus has been asked to provide a significant amount of confidential information. This includes information that we are contractually required to keep confidential (including information on our customers and from our suppliers), information that is sensitive for network security purposes, is commercially valuable, or could be used to Chorus' detriment by competing network operators (for example, mobile network operators and RSPs that compete with us at layer 2) and field service company sensitive information.
- 31 There are a number of economic experts in the market with experience in cost modelling. While there are likely to be cost implications involved in engaging external people with the appropriate expertise, the Commission's pricing review decisions will have significant impacts on the market. Internal expertise can still be harnessed through the Commission sharing public information on key parameters in the model and the reasoning for them and appropriate engagement between internal and external economic advisers, as has generally been past practice.
- 32 In past processes it has only been on a very exceptional basis that internal people (other than internal legal advisers) have been able to access confidential information. In these rare cases, it was important that such people were in roles where the information could not be used to inform any commercial decision making. In the MTAS process even external advisers were required to give additional undertakings not to participate in certain commercial decisions for a specified period where confidential information could potentially be of commercial benefit. This reflected the very real difficulties of not using information disclosed in regulatory proceedings for other commercial purposes directly or indirectly.

²¹ Orcon and CallPlus "Submission on further consultation paper for UCLL and UBA FPPs" (11 April 2014) at [11.1].