



Cross-submission: fibre de-regulation review draft
assessment framework paper [updated]

Cross-submission | Commerce Commission
22 March 2024

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Executive Summary

Thank you for the opportunity to provide feedback on submissions to the Commission's proposed assessment framework for considering whether there are reasonable grounds for undertaking a deregulation review (**the draft**).

Submissions highlight the importance of potential deregulation and predictability in the regulatory framework. Chorus notes that the possibility of deregulation is an important part of the regulatory framework, and that it is important that the Commission establishes a clear and predictable framework. Vector is looking for certainty relating to access to a viable unbundled service to facilitate its investment in fibre infrastructure.

We agree with both submissions. The Commission can promote certainty by implementing a predictable regulatory framework that promotes competition, deregulation, and investment.

Conversely, submitters have differing views on the purpose and outcomes of a reasonable grounds review, and the nature of any future deregulation review. Therefore, we recommend that the Commission consider resolving submitters' differing views by confirming its approach to the reasonable grounds review and wider competition/deregulation framework:

- The reasonable grounds review. Chorus submits that the Commission should complete a deregulation review before each regulatory period. Chorus and Enable/Tuatahi (**LFCs**) further submit that the reasonable grounds review should be based on segments within the FFLAS service (i.e. low- and high-speed broadband) and that a change in fibre provider constraints should be sufficient to trigger a full deregulation review.

We disagree. The Commission is only required to consider whether there are reasonable grounds to start a review. In our view, the reasonable grounds review is simply a reminder to check whether a deregulation review is likely to have merit (the Commission can start a deregulation review at any time). Further, Chorus and LFCs' proposed approach would fail to properly account for their position as providers of the shared fibre network, and would remove any materiality threshold to justify the significant effort for a deregulation review. In our view, the Commission would need to see competitive constraints across multiple FFLAS services to consider that a deregulation review might be warranted.

- The Commission competition framework. We agree that the possibility of deregulation is an important part of the regulatory framework. The promotion of competition and potential deregulation is an objective of the framework and should not be considered incidental to the setting of regulated returns and transparency requirements.

Vogelsang and Cave recommended that the promotion of competition and deregulation be considered as part of a consistent framework. As set out in our submission, we believe the Commission should consider providing guidance as a means of promoting certainty.

We also cross-checked Enable's and Tuatahi's claims that there is ample evidence of the competitive constraint currently imposed on fibre services by alternative technologies using ROI and cost data available under information disclosure requirements. On the face of it, benchmarking suggests that LFCs have ROIs that are significantly above both Chorus and mid-point WACC estimates. These observations do not, on their own, suggest meaningful competitive constraint, or support reasonable ground for deregulation.

We acknowledge that this rough benchmarking is illustrative and has limitations. However, it does reinforce the importance of taking a wider fibre network perspective.

Introduction

1. Thank you for the opportunity to provide feedback on submissions to the Commission's proposed assessment framework for considering whether there are reasonable grounds for undertaking a deregulation review (**the draft**).
2. The submissions highlight that while the parties agree the deregulation review process is an important feature of the fibre regulatory framework, there were also differing views on the purpose and framework for establishing reasonable grounds and any subsequent deregulation review.
3. Chorus¹ further submits it is important that the Commission establishes a clear and predictable framework. We agree. The promotion of competition and deregulation are key elements of the regulatory framework, and the Commission should seek to establish a clear and predictable framework that promotes certainty.
4. We believe that the Commission can best do this by providing further guidance on key issues raised by submissions, i.e.:
 - a. The purpose of the reasonable grounds review and the criteria it will apply in establishing reasonable grounds, and
 - b. The criteria it will apply to any deregulation review, and broader competition and deregulatory framework within which any review sits.
5. Enable's and Tuatahi's submission that there is clear support for a deregulation review highlights the danger of a taking a narrow approach to the reasonable grounds review. When we sanity-checked this submission using ROI and cost data available under the information disclosure requirements, we found that LFCs had comparable operating costs but ROIs above both Chorus and mid-point WACC estimates. We would not typically expect to see this sort of disconnect in a competitive market or in a regulatory framework that seeks to simulate competitive market outcomes.
6. While the benchmarking is high-level and has gaps, it suggests that a cross check using other indicators should be a key part of the review.

The reasonable grounds framework

The purpose of the reasonable grounds review

7. There were differing views in submissions relating to the timing and how exhaustive the analysis should be to establish reasonable grounds.
8. Chorus² submits that the clear intention of Act is for the Commission to consider the appropriate scope of FFLAS regulation ahead of each regulatory period so that any revised scope can take effect for the upcoming regulatory period. Therefore, the legislation requires the Commission to consider deregulation before the start of each regulatory period.
9. We disagree. The Commission is only required to consider whether there are reasonable grounds to start a deregulation review prior to each regulatory period. We believe the reasonable grounds review is a useful reminder to check whether regulation remains in end user interests, rather than an instruction to start a deregulation review (which the Commission can initiate at any time).

¹ Para 3

² Para 7, 11 and 12

The reasonable grounds test

10. There are also differing views on what the reasonable grounds assessment entails:

- a. 2Degrees and One.nz³ recommend that the Commission consider whether the regulated provider continues to exercise substantial market power (**SMP**) as specified by the Act. As a practical question, the Commission should consider whether there are any credible trading partners for retailers in areas where Chorus and LFCs operate.
- b. BTG recommends that the question the Commission should ask itself, when deciding whether a close economic substitute is truly comparable to FFLAS, is *if the FFLAS was withdrawn from an entire area would the 'close economic substitutes' be able to provide the same level of service (speed, data cap, latency, price) to all users that FFLAS had.*
- c. Mercury notes that it relies heavily on Chorus' and other LFC networks as key inputs for the services it offers its customers, and there are often no wholesale alternatives it can switch to if the price of FFLAS is increased, or if the quality diminishes. Mercury also notes that until such time as there are meaningful competitive options for these key inputs it is hard to see how FFLAs services can be deregulated.

11. Alternatively, Chorus^{4,5} and LFCs propose that:

- a. The Commission^{6,7} should consider reasonable grounds in the context of FFLAS speed variants such as low and high-speed fibre services, and whether there are competitive constraints at a granular level. For example, Enable/Tuatahi⁸ propose that the Commission FFLAS categories be further divided into fast (up to and including 300Mbps download), faster (301Mbps to 1 Gbps), and fastest (more than 1Gbps) PON bitstream services, which will better identify the competitive constraints which differ between each tier.
- b. Reasonable grounds would be satisfied if:
 - i. It can be shown that there has been an increase in competition that may constrain FFLAS or where alternative networks have expanded or emerged that have increased the competition fibre wholesalers face, or
 - ii. Competition has increased or decreased in a relevant market that may constrain regulated services that Tuatahi and Enable provide.
- c. The Commission should take into account that broadband services delivered over a fixed wireless network are unregulated, while equivalent services delivered over a fixed fibre network are subject to Part 6 regulation.

12. We agree that 2Degrees, One.nz, BTG and Mercury propose useful questions that would help in understanding whether Chorus and LFCs are likely constrained by alternatives, and bring in a practical consideration that for retailers, in many cases, there are no practical alternatives to wholesale fibre. The framework for determining reasonable grounds should also recognise that

³ Para 5

⁴ Chorus para 17 and Enable/Tuatahi para 3.5. Submissions have the same themes but vary in their articulation.

⁵ Para 3.2

⁶ Para 35

⁷ Para 2.9

⁸ Para 5.3

the ability to exercise substantial market power would be a consideration in any subsequent deregulation review.

13. However, we don't support Chorus and LFCs' proposals that rely solely on a granular segmentation of FFLAS services and an increase in constraints (without bringing the analysis up a level to understand wider effects and materiality). For example, irrespective of any pockets of competitive offerings, submissions highlight that it is not possible to acquire fibre services off alternative wholesale providers. In our view a narrow focus of this nature – on its own - likely has little informative value and is unlikely to expose the competitive constraints faced by LFCs in practice. We believe that the Commission would need to see competitive constraints across a range of FFLAS services – to better capture the shared nature of the fibre network and dominant place regulated providers have in the market - before it should consider taking the next step of a deregulation review. Chorus and LFCs' proposed approach is prone to mistake and would set a low bar for starting a full deregulation review.
14. The Commission has the discretion to determine whether reasonable grounds exist for launching a review to deregulate under section 210. But it is important not to conflate the grounds for deregulation (which are determined following evidence obtained in a review) with the grounds required to conduct the review (which must exist before a review is conducted).
15. The cost of conducting a deregulation review will not be insubstantial and so before the Commission launches into any such review it should have a reasonable degree of confidence that market conditions warrant the investment and that at the very least there is a reasonable prospect that deregulation is warranted.
16. In our view this does not require the Commission to form a view on one or more narrow market definitions as proposed by some submitters, nor does it require evidence of the competitive strength of one or more alternative services in sub-markets or a competition law analysis of the performance of those markets. Those are subsequent questions to be considered during an actual deregulation review. The key question for the Commission now is whether the regulatory settings are doing a reasonable job in promoting the purpose set out in Part 6, or if there's clear evidence that the regulatory settings are constraining the performance of the markets and outcomes for end users. Only if it's reasonable to conclude that the regulation is not promoting the purpose and that a deregulatory review will at least materially benefit end users should the Commission find that it has reasonable grounds to conduct a review.
17. It is open to the Commission to conclude for example, in assessing the costs and benefits of a potential review, that it is too early in the regulatory period/framework to consider that a service or a provider should no longer be regulated. If it formed that view, that would militate against a finding that there are reasonable grounds to conduct a deregulation review.

A framework within which competition and deregulation matters can be considered

A framework across the promotion of competition and deregulation

18. Chorus and LFCs note that potential deregulation is an important part of the regulatory framework.
19. Several submissions further highlight the importance of the deregulation review in the Part 6 framework and importance that the framework evolves in a predictable way. For example:

- a. Chorus⁹ noted the importance of the deregulation review mechanism in the Part 6 framework and that, as this is the first time the Commission is undertaking a reasonable grounds assessment, the importance of establishing a clear and predictable framework.
- b. Vector set out its concerns relating to access to a workable PONFAS services that would facilitate further Vector investment in fibre infrastructure. Enable and Tuatahi propose that, due to there being no take-up of the unbundled PON service, the service should no longer be regulated.

We note that access to a viable unbundled service has been an ongoing concern which could be mitigated by the predictability provided by a competition framework.

20. We agree that the Commission can promote certainty and predictability through a competition framework that would inform both regulatory and deregulation decisions. In our submission, we recommended that the Commission consider developing a framework along the lines Vogelsang and Cave recommended earlier. This would inform market identification and form of deregulation that best promotes the purposes of the Act¹⁰ and, by making implementation of the framework more predictable, promote certainty and investment.

A s226 review as an outcome of reasonable grounds

21. The reasonable grounds review rightly focuses on whether the Commission should start a deregulation review.
22. However, evidence submitted by the parties suggests that future reviews may identify providers or services that should be subject to PQ regulation. For example, several submissions refer to matters that suggest a lessening of competitive constraints:
 - a. 2Degrees notes that the phasing out of copper has reduced consumer options in fibre areas. LFCs were subject to the lesser ID regulation due to, in part, potential competition from Chorus copper-based services. Chorus is currently in the process of retiring the copper network, reducing this constraint.
 - b. BTG experience is that there is almost no overlap/overbuild between FFLAS providers, and therefore no competition between FFLAS providers.
 - c. Mercury notes that there are often no wholesale alternatives it can switch to if the price of FFLAS is increased, or if the quality diminishes.
 - d. Northpower notes that community ownership was a factor in applying ID only to LFCs. However, Tuatahi is no longer in community ownership and residual LFCs may adopt purely commercial objectives or change ownership over time.
23. While we do not propose that the Commission consider further regulation at this stage, this may be appropriate in a future deregulation review to promote end user interests. LFC price quality regulation may be in end-users' interests. The IMs¹¹ already anticipate both regulation and deregulation and submissions highlight potential regulatory concerns.

⁹ Para 3

¹⁰ Vogelsang and Cave identify that defining the markets (for both promotion of competition and deregulation) is a first step in its unified framework. In other words, the same market definition informs both the promotion and deregulation functions.

¹¹ Around 2.182

24. We recommend that any Commission framework set out how it Commission might act on information that has come to it in the context of reasonable grounds or deregulation review to consider a s226 recommendation to the Minister.

Enable and Tuatahi submission

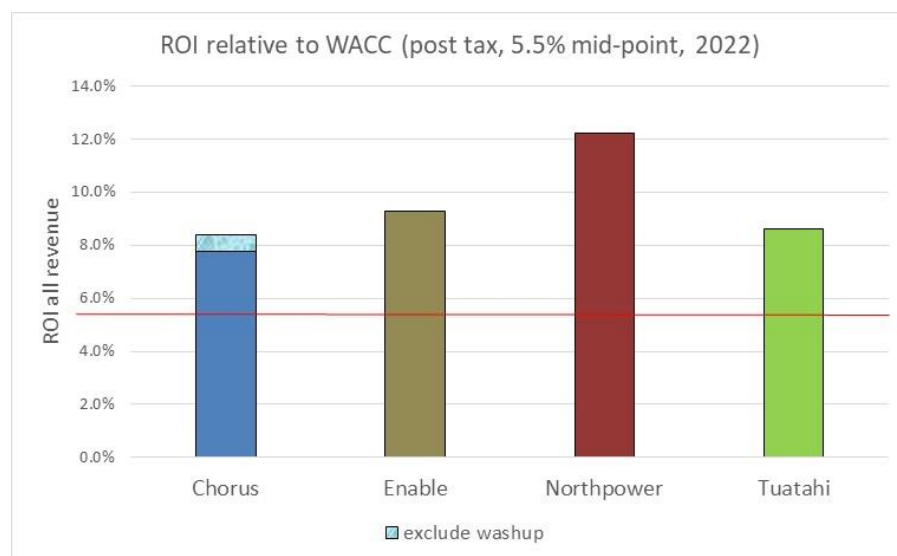
25. Enable and Tuatahi have also submitted information they believe is relevant for the assessment and conclude that there is ample evidence of the competitive constraint currently imposed on fibre services by alternative technologies.

26. As discussed above we disagree with the Enable/Tuatahi framework, and with their characterisation of the broadband market. For example, we recommend to our customers the broadband technology that best meets their needs and follow TCF codes in the marketing of our services. Submitters also advise the Commission that there is no material crossover in the wholesaling of fibre broadband services and that it is only practical to acquire wholesale fibre services from LFCs. Chorus and LFCs all price services and service variants within narrow price bands. The reason that Chorus and LFCs are regulated is because they have the ability and incentive to exercise market power.

27. The Enable/Tuatahi approach highlights the importance of financial and behavioural cross checks to inform the review. For example, a high-level review of ID data released to date suggests that Enable and Tuatahi's ROI is higher than Chorus' and the Commission estimated mid-point WACC. Figure 1 suggests that LFCs are reporting ROIs of between 8.6% and 12.2% compared to a mid-point WACC of 5.5%. Figures 2 and 3 suggest that LFCs have comparable ID reported operating expenditure and lower asset costs than Chorus.

28. We would not expect any firm in a competitive market could sustain differentials of this nature over their competitors as, for example, a high-cost provider would face competitive pressure to reduce costs to those of its competitors, while excess returns would be shared with consumers through lower prices or deferred price increases.

Figure 1: LFCs enjoy higher ROI than Chorus and Commission estimated mid-point WACC¹²



¹² 1(i) and 1a(i) ROI-comparable to a post tax WACC of 2022 ID reporting.

Figure 2: LFC RAB value (allocated and unallocated) per connection is around 30% less than Chorus

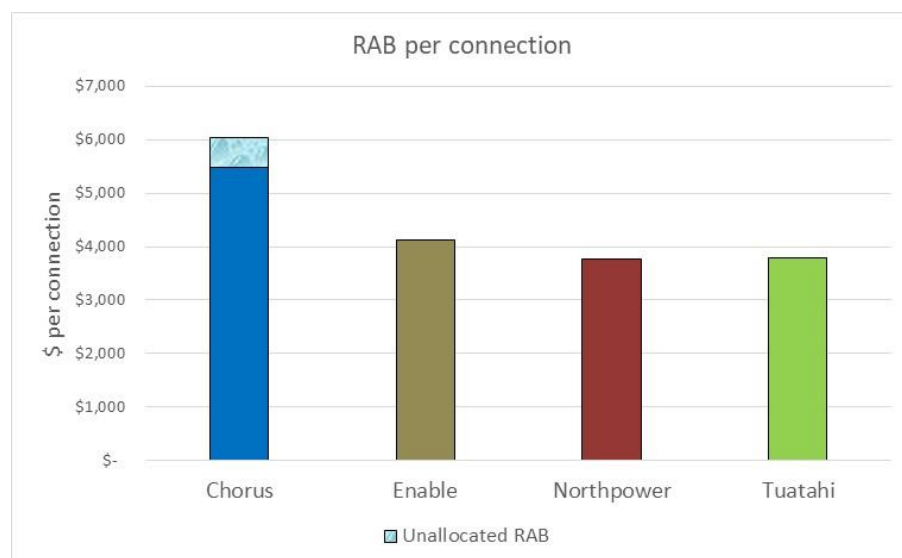
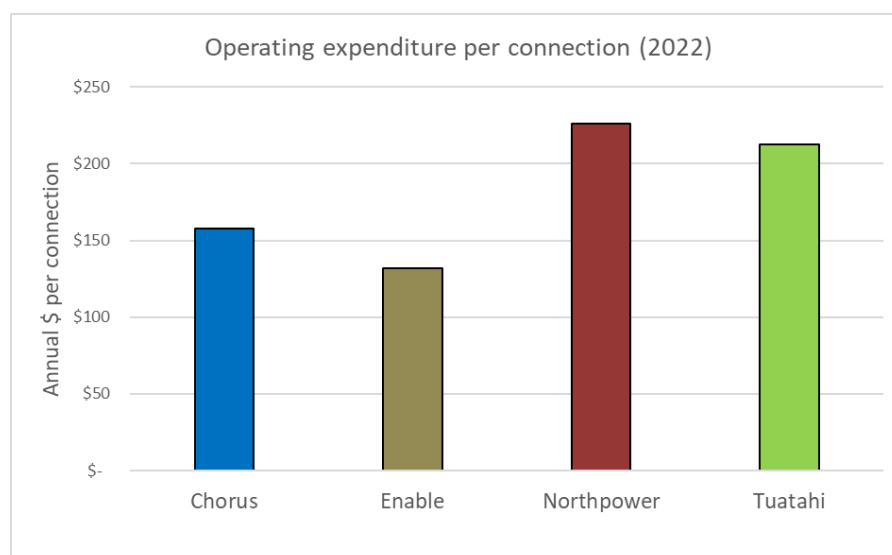


Figure 3: LFC operating expenditure per connection varies¹³



29. LFCs further price within a tight band but not identically.

	Bitstream Starter 2 50/10	Bitstream 2 50/10	Bitstream 2 300/100	Bitstream 2 1,000/10	Hyperfibre 2000/2000
Tuatahi	\$38.00	\$48.98 ^{14*}	\$53.02	\$63.40	\$88.61
Enable	\$38.00		\$53.59	\$62.41	\$81.81
Chorus	\$35.00	\$50.47	\$53.54	\$61.86	\$70.00
Northpower	-	\$50.50	\$50.50	\$58.00	\$75.00

¹³ 4(ii) and 4b(ii) RAB and Unallocated RAB from 2022 ID reporting. Simple annualization of 6 month and 3 month reporting period. Volumes from FY22 and H12023 financial reports, and CIP annual report.

¹⁴ Plus 5% price increase announced for all variants except Starter

30. The financial analysis is high-level and likely incomplete: the information disclosure requirements have only been applied for a short period and – at this stage – only provide a snapshot of regulated outcomes. It's unclear whether reporting will evolve over time.
31. Nonetheless, the analysis highlights the importance of considering financial and behavioural evidence for understanding the nature of competition in the market, and the value of ID in the context of the wider regulatory framework. The Commission should consider further benchmarking and behavioural cross checks as part of determining reasonable grounds.

[end]