



Cross-submission to Commerce Commission on the Fibre Regulation Emerging Views Paper

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Public Version

Introduction

Vector Communications appreciates the opportunity to continue our engagement in the Commission's important work on establishing a new regulatory framework for fibre providers.

We consider it important to add our views at this point of the process, not least as we have serious concerns about the positions that Chorus is advocating. Our cross-submission will focus on those issues which we view as critically important for the future competitive environment for fibre services in New Zealand, and therefore the impact on investment, competition and innovation in this area.

The points we would like to touch upon include:

1. A recap of the legislative and historical context of UFB
2. Deed of Open Access Undertakings for Fibre Services
3. Chorus' behaviour and incentives
4. Sections 162 and 166 of the Telecommunications Act
5. Treatment of losses and pricing principles
6. Risks
7. Risks to and benefits of wholesale competition
8. FFLAS definition
9. Transitional arrangements and quality metrics
10. Conclusion

The brevity of our paper is not a reflection on the significance to Vector Communications of the issues under consideration by the Commission and interested parties. Rather, we would like to reiterate the views outlined in our previous submission and acknowledge many of the other parties' submissions, which have traversed the issues thoroughly, and with which we share similar views.

By default, our points tend to touch on the positions set out by Chorus. We would add that the recent experiences of the New Zealand telecommunications industry are salient, with regulation resulting in increased competition, investment and huge benefits to consumers. Simply, Chorus is trotting out well-worn arguments that don't stand up to scrutiny.

As noted earlier, Vector Communications has plans to invest in the fibre market to bring healthy competition at the wholesale level, the benefits of which are well understood by the Commission. Those plans depend critically on the work the Commission is undertaking to establish a durable and equitable regulatory regime.

1. A recap of the legislative and historical context of UFB

Many of the submissions refer to the key policy statements and legislative initiatives relating to UFB, including our own. Chorus, in particular, draws heavily on such documents to illustrate the Government's original objectives, including from the review of the Telecommunications Act¹ and from a briefing for the incoming minister².

A brief section from the latter follows:

The digital economy is not new, but it is becoming an increasingly important driver of New Zealand's economic growth and the wellbeing of all New Zealanders. Technology underpins more of how our businesses operate and how New Zealanders participate in economic and social activities. Investment in connectivity infrastructure is putting in place a strong foundation for the country's digital future.

We concur with those statements, as evidenced by the similarity in the content of the quotes outlined in our earlier submission. Vector is of course a major investor in critical infrastructure, including a fibre network, so understands very well the importance, dynamics and incentives associated with this type of large-scale complex investment.

Chorus also refers repeatedly to the UFB Government Policy Statement (UFB GPS) from 2011, and to section 19A of the Telecommunications Act: *Commission to have regard to economic policies of Government.*

To quote from that GPS,

"The UFB Objective will be supported by a Government investment of up to \$1.35 billion, which will be at least matched by private sector investment and will be **directed to open-access infrastructure (UFB Initiative)**."³ (Note: bolded text from the original.)

The reference to open-access infrastructure is very deliberate and important, and consistent with other key UFB documents, including the NIPA, the Deed of Open Access, and the original *Invitation to Participate in Partner Selection Process* as we discussed in our submission.

The statement in the NIPA is particularly clear on the issue of layer 1 unbundling, and bears repeating, "... to generate widespread uptake of services (including Layer 1 Services and Layer 2 Services)..."⁴. (Note: underlining added by Vector Communications.)

¹ Economic Growth and Infrastructure Committee (10 May 2017), *Review of the Telecommunications Act 2001: Final Decisions on Fixed Line Services, Mobile Regulation and Consumer Protection*, p 26.

² Ministry of Business, Innovation & Employment (26 October 2017), *Briefing for the Incoming Minister of Broadcasting, Communications and Digital Media*, at [13-14]

³ *Incentives for businesses to invest in ultra-fast broadband infrastructure*, 2011, available at:

[https://www.dia.govt.nz//Pubforms.nsf/NZGZT/NZGazette155Oct11.pdf/\\$file/NZGazette155Oct11.pdf#page=96](https://www.dia.govt.nz//Pubforms.nsf/NZGZT/NZGazette155Oct11.pdf/$file/NZGazette155Oct11.pdf#page=96)

⁴ Network Infrastructure Project Agreement, Telecom Corporation of New Zealand Limited and Crown Fibre Holdings Limited, dated 24 May 2011

Chorus makes a series of strong statements about the impacts on the incentives to invest in New Zealand infrastructure. Again, we are aligned with the sentiment but add that incentives need also to apply to other parties, not just to Chorus. A sound regime will enhance investment incentives in the industry as a whole.

2. Deed of Open Access Undertakings for Fibre Services

Of the foundation documents, the Deed is of particular importance, as acknowledged by the Commission's decision to clarify issues within it. We discussed this point in our last submission, so do not need to repeat the detail here. However, it is important at this juncture to emphasise its place in an effective regulatory regime, both in the medium and long term.

The Deed sets out clearly and unambiguously the obligations that Chorus signed up to, notably in the areas of non-discrimination and equivalence, and it is incumbent on the Commission to ensure that Chorus complies with them.

3. Chorus' behaviour and incentives

The above statement is not merely a hypothetical: the evidence to date is equally clear. As has been widely canvassed, Chorus (and the other LFCs) have recently released their terms (price and non-price) for unbundled fibre (PONFAS in Chorus' terminology). The terms make the product effectively uneconomic to consume. Chorus' actions are consistent with its incentives in this area – to make unbundled fibre unattractive to RSPs and therefore favour its layer 2 services, in the process, foreclosing competition from layer 1 services.

The outcome would be serious: this will result in a lack of investment, competition and consequential benefits to consumers. **Vector Communications is currently making plans for considerable investments in new services which are dependent on layer 1 unbundling / PONFAS on reasonable terms.** Our plans are not only to substitute layer 1 and layer 2 inputs that we consume from Chorus, but to develop a range of new layer 2 access services to offer to the wholesale market – and compete directly with Chorus – including attracting small RSPs as customers (we would be happy to discuss our plans further with Commission). Such competition will deliver price, service and other benefits.

Therefore the PONFAS terms have the potential to have a profound impact on the competitive landscape for fibre services for years to come, at both the retail and the wholesale level.

4. Sections 162 and 166 of the Telecommunications Act

Again, this issue has been covered in previous submissions and other documents, with most submitters pointing out views consistent with ours. That is; that where workable competition may be promoted by a decision to be made by the Commission or the Minister, then section 166(2)(b) is activated; if workable competition may not be promoted, then outcomes consistent with outcomes produced in workably competitive markets are to be achieved.

In our view, it is necessary to highlight that Chorus' motivations in pushing for the primacy of section 162 are clear in that it downplays the promotion of workable competition. This will have the potential for adverse implications for competition, at the wholesale layer in particular.

5. Treatment of losses and pricing principles

It is important to reiterate our concern about the potential impact of allowing Chorus to claim losses which were never originally intended to be claimable (as we pointed out in our earlier submission), and over a period that Chorus has been enjoying very healthy returns (see for example Spark's cross submission⁵).

Similarly, the lack of specificity on pricing principles leaves Chorus with both the incentive and the opportunity to price to foreclose competition and maximise profits. Pricing principles and guidance are therefore critical, as we proposed in our submissions.

6. Risks

Chorus devotes a lot of energy to discussing risk in its submission, including references such as the following:

7 ... There has been a 49% compound annual growth rate in fixed line data usage over the last 6 years, the industry is heavily engaged in supporting the Rugby World Cup online later this year and Olympic broadcasters are already promoting the next high definition 8K television broadcasts for next year.

8 Changes in consumer demand and use cases (such as e-sports and virtual reality), as well as technology upgrades like 10GPON and potential 5G mobile technology, continue to demonstrate how dynamically this industry evolves.⁶

Vector Communications addressed this briefly in its submission, and other submitters have covered these issues in some detail. What is apparent from Chorus' submission is the over-statement of the risks it faces, including references to elements that have little relevance to a fibre access provider facing limited or no competition (risks that are more relevant to RSPs and network operators). The quote above amply demonstrates this – the first sentence is not as applicable to Chorus as it is to Vector Communications and other RSPs that are planning and managing product innovations to meet customer demands in highly competitive markets. The second sentence refers to trends that are hardly new, with next generation mobile and data networks driven by data growth having been a concern for technology strategists and network planners for the last few decades.

Added to this, the risk profile of the network build phase against that of the built environment is significantly different. The UFB 1 roll-out is almost complete, and in Vector Communications' case at least, our interest is primarily in accessing existing access fibres (in many cases we would like to consume **only** the distribution fibre at the FFP which, by definition, is a dedicated P2P fibre (akin to SLU). However, Chorus' terms do not allow this, for reasons that we regard as spurious.)

⁵ Spark: New regulatory framework for fibre: proposed approach: Cross-submission 1 February 2019

⁶ Chorus: Submission in response to the Commerce Commission's fibre regulation emerging views dated 21 May 2019
Commerce Commission – Submission

The investment requirements and risk to Chorus associated with this are extremely low. And, as noted, the success of the uptake of UFB to date and returns to Chorus are strong evidence of the low risk environment in which it operates (putting aside the losses argument, as covered elsewhere).

As noted, Vector Communications' primary interest is consuming unbundled layer 1 fibre to use as an input to a range of services we can develop and offer to the wholesale market. That involves consuming existing fibre deployed during the UFB 1 deployment, for which the costs to maintain and associated risks are exaggerated by Chorus.

Further, s. 177 (4) is clear on the point that it is not the intention that Chorus be protected from "all risk of not fully recovering those financial losses through prices over time"⁷.

7. Risks to and benefits of wholesale competition

In the analysis of risks, we believe the Commission should consider the very real risk that competition will be curtailed by Chorus' (and other LFCs') terms for unbundled fibre, with the consequent loss in benefits to consumers. In our view Chorus has strong incentives not to encourage PONFAS uptake due to the higher value of its layer 2 services, and potential competition that could result from economic layer 1 access.

Our plans include extending our range of layer 2 access services – for both business and consumer markets – to offer our wholesale customers (which span the range from large to very small RSPs) which would compete directly with Chorus' layer 2 products. This will not be possible without reasonable terms for unbundled fibre.

If Chorus is suggesting that it may refrain from layer 2 investment under certain circumstances, Vector Communications would be happy to consider filling that gap.

8. FFLAS definition

Chorus devotes a section to setting out its views on the appropriate definition for FFLAS in the absence of a proposed scope and definition from the Commission. We are very concerned that Chorus is attempting to persuade the Commission to improperly narrow the scope of the definition and would urge the Commission to exercise caution in accepting Chorus' advice without broader consultation. Its proposed definition poses immediate challenges and further questions, the experience to date of Chorus dictating terms for PONFAS is illustrative and not in the interests of the broader industry.

9. Transitional arrangements and quality metrics

While there may be sound reasons to consider transitional arrangements for quality during RP1, we again urge caution unless it translates into a de facto regulatory holiday and loosens incentives on Chorus to meet standards set under the new regime. The impact of such arrangements on access seekers should also be taken into account.

⁷ S 177(4) Telecommunications Act 2001
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Of particular concern is the uncertainty surrounding PONFAS, especially given it is due to be available from 1 January 2020 – we have plans to start consuming it in early 2020 – and Chorus’ incentives to favour its layer 2 services. Only five months until unbundling is due to start, Chorus still has not released the PONFAS operations manual and service level terms, saying only that it is due “later this year”, despite the obligations around unbundling being clearly set out in the original agreement (the NIPA) signed by Chorus in 2011.

This seems very indicative of Chorus’ lack of appetite to offer PONFAS on reasonable price and non-price terms. We fully anticipate there will be major issues to work through in respect of the operations manual and service levels, just as we are confident that Chorus’ terms are likely to cause us difficulties in consuming PONFAS on a reasonable basis.

Given the two-year gap before RP1, there needs to be transitional arrangements put in place for the purposes of consuming PONFAS. The Commission’s work in providing guidance on non-discrimination and EOI this year should inform this issue, however we fear it will be insufficient and lack measures to ensure Chorus meets its obligations. We are concerned that an abstract consultation on non-discrimination and EOI risks failing to address the key issues raised by Vodafone and Vocus of the legality of Chorus’ PONFAS terms.

With respect to quality metrics, we are concerned about the uncertainty surrounding arrangements over the next few years, and note that under the banner of quality are areas where significant obstacles to PONFAS could manifest. There are currently no industry quality terms for the PONFAS service. It will not simply be a case of mirroring the layer 2 quality terms and a more stringent set of quality measures is likely to be required for the PONFAS service.

We would like to reiterate our comments from our last submission on the importance of an industry wide approach to this (for instance facilitated by the TCF) and the role of non-discrimination and equivalence as outlined in the Deed.

Notwithstanding our comments above, an interim measure may be to adopt Vodafone’s suggestion to apply the current WSAs while new agreements are being worked on. This would be preferable to no agreed quality terms at all, of course there needs to be something in place from 1 January 2020 to ensure there is a framework in place for PONFAS.

10. Conclusion

Vector Communications is keen to participate in the Commission’s process to establish a new regulatory regime for fibre and to ensure the maximum benefits to the country are underpinned for many years. The Government’s original – and more recent – statements and objectives are still valid and serve as important signposts for the new model.

Like other interested parties, we worry that the largest party with the most resources will have undue influence on the shape of that regime. Which will inevitably have an adverse impact on the competitive landscape for fibre services, with severe implications for innovation and consumer welfare. This is too important a part of New Zealand's infrastructure to allow that to happen.

We are currently making plans to invest in fibre infrastructure in New Zealand, so the outcomes of this exercise – and other Commission work – are very topical for us, and very likely will have a direct influence on those plans.