



9 November 2020

Vanessa Turner
Head of Telecommunications, Regulation Branch
Vanessa.Turner@comcom.govt.nz

BY EMAIL ONLY

Dear Vanessa,

As you know, Vodafone has expressed its concerns to the Commission about conduct by Chorus in retail broadband markets which we believe to be in breach of the line-of-business restrictions in the Telecommunications Act 2001 (the Act) and harmful to competition and to consumers. When we last met with you on this issue, we undertook to set out these concerns in writing.

In addition to our concerns regarding line-of-business restrictions, we note that the PQ and ID determinations under Part 6 of the Act are designed so that discounts that Chorus offers to retail customers are not “costless”. That is, a level playing field between providers of broadband infrastructure requires that a discount comes off Chorus’ bottom line and does not create headroom that Chorus can recoup from captive customers.

The Commission needs to be alert to the potential for Chorus to distort competition and must appropriately scrutinise its future retail offers and activities. The Commission should consider enforcement action and remain alert to any potential gaps in the legislative regime.

Chorus fibre: Wholesale-only model

The Act was amended in 2011 to allow for the structural separation of Telecom into wholesale and retail companies (now Chorus and Spark). This was necessary for Chorus to participate in the Ultra-Fast Broadband initiative.¹

Under the Act, Chorus is prevented from re-entering retail product markets as this would recreate the same incentive problems that structural separation was designed to remove.² Chorus is subject to three line-of-business prohibitions:³

¹ See *New Zealand Government Ultra-Fast Broadband Initiative: Invitation to Participate in Partner Selection Process* (October 2009) at [13.4(a)]: “In the event that a prospective Partner, or a related or associated entity of the Partner, currently (or at any time while a Partner) owns or controls a business which provides any Telecommunications Service other than the Permitted Services, the Partner must fully divest, or must ensure that the Partner’s related or associated entity fully divests, itself of that business.”

² Ministry of Economic Development *Regulatory Impact Statement: Regulatory Issues Resulting if Telecom becomes a Partner in the Ultra-Fast Broadband Initiative* (16 February 2011) at [120]-[130].

³ Since 2018, s 69SA has allowed the Commission to grant exemptions from ss 69R and 69S. The Select Committee, however, rejected the repeal of ss 69R and 69S on the basis that this “would leave Chorus with both the ability and incentive to expand into competitive markets, which risks distorting competition and innovation”.

Vodafone New Zealand Limited

Vodafone New Zealand Limited: 74 Taharoto Rd, Takapuna, Auckland 0622, New Zealand.
Private Bag 92161, Auckland 1142, New Zealand.



1. Chorus must not participate in the supply of a telecommunications service at retail (that is, to end-users) (s 69O);
2. Chorus must not participate in the supply of fibre services above layer 2 (s 69R); and
3. Chorus must not provide end-to-end services (that is, it can only provide services between an end-user and an aggregation point. Any regional transport must be sold as a separate product) (s 69S).

Parliament's intention was for Chorus to operate a wholesale-only business and for competition between RSPs to provide innovation and diversity in retail offerings.⁴

Chorus is also in the process of transitioning into the price-quality and information disclosure regime contained in Part 6 of the Act, which was introduced in 2018. Part 6 is based on Part 4 of the Commerce Act. While Part 4 has been applied in relation to natural monopolies such as gas and electricity distributors, it is recognised that Chorus fibre faces competition from other broadband technologies such as FWA and HFC (and that other LFCs face competition from ADSL/VDSL over Chorus copper). In its commentary on s 166(2), the Commission recognised the importance of implementing Part 6 in a way that provides **a level playing field for competition on the merits** between alternative broadband technologies.⁵

Participation by Chorus in retail and in supply of services above layer 2

Vodafone is concerned about a pattern of behaviour by Chorus that is apparently directed at it becoming an active participant in retail broadband markets and in the supply of services above layer 2.

There are two types of conduct at issue:

1. Installation of Optical Network Terminals (ONTs) with capability to offer services at layer 3 and above: Chorus is presently installing ONTs at the end-user's premises which contain a residential gateway (RGW). The RGW has the potential to provide the functionality of a modem/router which has, until now, been provided by the RSP. We understand that Chorus intends to enable this functionality on 23 November. For a particular end-user, the enhanced functionality would be activated at the RSP's request and implemented through the operation of a TR-069 protocol (a layer 7 service). Once activated, the RGW will provide a broadband connection and wifi capability (that is, a layer 3 or above service).
2. Attempts to distort the retail telecommunications market towards fibre services; examples include:
 - a. A bonus credit offered between 1 September and 31 December 2020 where RSPs received a \$350 credit for moving customers on to fibre that are currently not on any of Chorus' networks (ie those on competitors HFC or FWA networks). Chorus is now proposing to extend this offer until 30 June 2021.
 - b. A direct consumer marketing offer where Chorus sends pre-paid Mastercard payment cards (loaded with sums ranging from \$50 to up to \$500 in some cases) to households not connected to Chorus' network where fibre or VDSL is available. The cards are

⁴ This is also supported by the non-discrimination and equivalence of supply obligations in Part 4AA of the Act.

⁵ Commerce Commission, *Fibre input methodologies: Main final decisions – reasons paper*, 13 October 2020, at [2.260]-[2.261].

Vodafone New Zealand Limited



activated once the address connects to Chorus fibre or VDSL broadband.⁶ (Although our concerns are focussed on Chorus, we note that LFCs have on occasion made similar offers, e.g. an offer by Enable incentivise RSPs to migrate a customer off Vodafone's HFC network on to Enable's fibre services. Between November 2020 and the end of June 2021 Enable will provide a \$250 rebate to RSPs who migrate customers).

- c. A proposed retail offer where Chorus would directly contact customers not on any Chorus network and offer six months free fibre broadband for the 100/20 or fibre max services. The customer would elect to take the offer from a participating RSP through the Broadband Compare website. Chorus would then rebate the selected RSP for part of the cost, with the RSP making up the difference for the six months free fibre broadband. The RSP would also pay a success fee to Broadband Compare. This offer was not ultimately implemented but indicates a pattern of behaviour.

Harm to competition and harm to consumers

The purpose of the relevant parts of the Act is to promote competition in telecommunications markets for the long-term benefit of end-users.⁷ We consider that Chorus' behaviour risks being harmful to competition and to consumers.

Our main concerns are that Chorus is attempting to tilt the playing field in favour of Chorus fibre and that its conduct is likely to reduce diversity of retail offerings.

In terms of bundling RGW functionality with the ONT, customer choices between higher and lower specification RGWs would be distorted by Chorus providing the functionality **at less than its true cost**. This may prevent competition in the provision of RGW services, ultimately to the detriment of consumers. For example there is a wave of new wifi technologies such as wifi mesh and wifi 6 that Chorus' equipment cannot offer, but may be difficult to introduce these products in circumstances where Chorus ONT pricing would not allow retailers to earn an economic margin on these alternatives. Chorus appears to have the ability to engage in margin squeeze by providing the RGW functionality at less than its true cost as the assets will become part of the regulated asset base and contribute to the maximum allowable revenue.

In terms of the attempts by Chorus to directly influence and distort the retail market, Vodafone is concerned that this would tilt the retail playing field in favour of fibre services, ahead of other networks. For Vodafone as an owner of competing infrastructure (HFC and FWA), it may be forced by competition between RSPs to participate in the cannibalisation of its own customer base. Further, offers like these could also steer consumers towards particular fibre services allowing Chorus to avoid price caps on anchor services. Such an offer may also reduce diversity in retail offerings as it will direct potential RSP marketing spend into this particular offering.

Vodafone is also concerned to ensure that the PQ and ID determinations do not operate to allow any rebates to be a "costless" discount to Chorus. In a normal market, a rebate or other discount would come off the provider's bottom line. Chorus **should not be able** to use such a discount to create headroom beneath its maximum allowable revenue that can be recouped from captive customers. Such a benefit would be an artefact of Part 6 and inconsistent with competition on the merits under s 166.

⁶ <https://sp.chorus.co.nz/product-update/customers-connect-chorus-cards>

⁷ See ss 18, 69A and 166 of the Act.

Vodafone New Zealand Limited



Application of the Telecommunications Act

Vodafone believes that the Commission should consider taking enforcement action against Chorus for breach of the line-of-business restrictions in the Act in respect of the ONT with layer 3 and above functionality and the continued attempts to distort the retail market.

Section 69R: No services above layer 2

Section 69R requires the Chorus Limited Deed of Open Access Undertakings for Fibre Services to include “a prohibition on participation by Chorus, or any related party of Chorus, in services above layer 2 services”. Clause 7.5 of the Chorus Deed in turn provides that “Chorus will not supply any Access Seeker with a Downstream Service”.⁸ A breach of clause 7.5 is a breach of an “enforceable matter” and can be enforced by the Commission.⁹

We consider that once the RGW is enabled and activated at the RSP’s request, Chorus would be providing a layer 3 or above service. This is what is experienced by the end-user, and the RSP is not providing any additional equipment or functionality.

This is precisely the type of practice that the exemption clause (s69SA) was intended to resolve. During the Select Committee process for the 2018 Amendment Act we raised this exact issue. In response parliament included the exemptions clause to ensure that any easing of s69R, was well considered and conditions were put in place to minimise risks. This process must be completed before any service above layer 3 can begin.

Section 69O: No participation in supply of retail services

Section 69O prohibits Chorus from participating in the supply of a telecommunications service at retail.¹⁰ Enforcement is by the Commission only.¹¹ The Commission also has jurisdiction to provide guidance on this restriction. Clause 7.4 of the Deed notes that Chorus will comply with s69O. In turn the Commission has responsibility for enforcing and clarifying the interpretation of the Deeds.

In our view, Chorus “participates” in retail supply where it makes retail offers direct to end-users such as the offer of six months broadband for free.

We do not consider that s 69O is limited to the scenario where Chorus has a direct contractual relationship with an end-user. The Regulatory Impact Statement noted that one of the objectives of the line-of-business restrictions was to prevent Chorus from either direct or indirect participation in the supply of services to end-users.¹² If a contractual relationship was a requirement for retail participation, then Chorus could develop customer-focussed functions and offer a white-label fibre service to RSPs who would simply add a brand and manage the contractual relationship. Section 69O cannot have been intended to permit that sort of vertical reintegration.

⁸ A “Downstream Service” is defined: “any Service that is a layer 3 or above service by reference to the OSI Model. For the avoidance of doubt, a Service is not a ‘layer 3 or above service’ where it has layer 3 or above capabilities for the purpose of supporting or interfacing with Access Seeker networks or services.”

⁹ See ss 156AQ-156AS, 156L, 156M and 156O-156R of the Act.

¹⁰ Supply is considered to be at retail (that is, to an end-user) if “25% or more of the services supplied, or to be supplied, by Chorus to [the recipient] in any year are or will be supplied for [their] own use or consumption”.

¹¹ See ss 69T, 69V, 156B and 156L of the Act.

¹² Ministry of Economic Development *Regulatory Impact Statement: Regulatory Issues Resulting if Telecom becomes a Partner in the Ultra-Fast Broadband Initiative* (16 February 2011) at [127].



Next steps

In light of the concerns we have set out above, Vodafone asks that the Commission:

1. commence enforcement action against Chorus in relation to the RGW-enabled ONT. If Chorus still wishes to proceed with this offer a formal exemptions process **must** be initiated.
2. properly supervise any further initiatives by Chorus in the retail space or for services above layer 2;
3. provide guidance on how to interpret s690, where Chorus is seeking to directly influence the retail market and end-user choices.
4. ensure that the “free discount” risk is addressed in the PQ and ID determinations; and
5. continue to apply Part 6 in a way that creates a level playing field and promotes competition on the merits, but also consider whether there are any gaps in the legislative regime that need to be addressed given the unusual hybrid where Chorus is subject to a model which assumes strong natural monopoly characteristics but where competition exists

We look forward to your confirmation as to next steps.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'T. Thursby', is located below the 'Yours faithfully,' text.

Tom Thursby
Lead Counsel & Head of Public Policy
Vodafone New Zealand Limited

Vodafone New Zealand Limited

Vodafone New Zealand Limited: 74 Taharoto Rd, Takapuna, Auckland 0622, New Zealand.
Private Bag 92161, Auckland 1142, New Zealand.