



**Submission to the Ministry of Business, Innovation &
Employment on Review of Telecommunications Service
Obligations (TSO) for Local Residential Telephone
Service**

20 August 2013

TABLE OF CONTENTS

INTRODUCTION **3**

OPENING COMMENTS **4**

 Vector supports the TSO review’s focus on investment incentives 4

 TSO Deeds should be phased out/replaced 4

 TSO Deeds should NOT be expanded or morphed into new roles 5

INCONSISTENCIES IN THE REGULATORY APPROACH ACROSS SECTORS **7**

PRICE CONTROL SHOULD BE ADOPTED UNDER THE COMMERCE ACT OR TELECOMMUNICATIONS ACT **11**

‘FREE’ LOCAL CALLING REQUIREMENT UNNECESSARY **13**

CONCLUDING REMARKS **14**

 Price control should be adopted under the Commerce or Telecommunications Acts 14

 Phase out of TSO Deeds 14

 TSO should not be expanded or morphed into new roles 14

 Cost of supplying CNVCs appears to be minor 15

 Regulation of tariff structures is unnecessary 15

APPENDIX 1: MATTERS THAT MUST BE CONSIDERED IN THE TSO REVIEW **16**

INTRODUCTION

1. Vector welcomes the opportunity to submit on the Ministry of Business, Innovation & Employment's (MBIE) Discussion Document "Review of the Telecommunications Service Obligations (TSO) for Local Residential Telephone Service" (TSO Discussion Document), dated July 2013.
2. Appendix 1 to this submission contains a summary of Vector's views on each of the matters the Minister of Communications and Information Technology is required to consider, as part of the review of local service TSO arrangements, under s 101A of the Telecommunications Act 2001.
3. This submission should also be treated as a submission, in respect of section 157AA(2)(b) of the Telecommunications Act, on whether generic price control under Part 4 of the Commerce Act 1986 would be preferable and more effective than under arrangements such as the TSO Deeds.
4. No part of this submission is confidential and Vector is happy for it to be publicly released.
5. Vector's contact person for this submission is:

Robert Allen
Senior Regulatory Advisor
robert.allen@vector.co.nz
+64 9 978 8288

OPENING COMMENTS

6. Vector supports the review of the Chorus and Telecom Telecommunications Service Obligation (TSO) Deeds.
7. There have been substantial regulatory and technological change since the Kiwi Share Obligation (KSO) was initially put in place in 1990, and then amended into the TSO Deed when the Telecommunications Act was introduced in 2001.
8. The current TSO Deeds are a legacy of the absence, beyond light-handed regulation, of network utility regulation at the time Telecom was privatised. As MBIE has noted "At the same time as privatization ... New Zealand was unique in the world ... in its almost exclusive reliance on generic competition regulation (under the Commerce Act 1896) to constrain any anticompetitive behavior."¹

Vector supports the TSO review's focus on investment incentives

9. Vector supports the focus in the statutory terms of reference for the review contained in s 101A(3) of the Telecommunications Act. Section 101A(3) requires ((a) and (b)) consideration of the long-term interests of end-users as well as: "(c) the legitimate business interests of TSO providers: (d) the ability for providers of TSO services to receive a reasonable return on the incremental capital employed in providing the services required under deemed TSO instruments: (e) the impact on the incentives and capabilities of TSO providers and other telecommunications service providers to invest in new and improved telecommunications facilities and services" (emphasis added).
10. Similarly s 157AA(2) of the Telecommunications Act requires consideration of whether the Act is the most effective means to: "(i) promote competition for the long-term benefit of end-users; (ii) promote the legitimate commercial interests of access providers and access seekers; and (iii) encourage efficient investment for the long-term benefit of end-users, by (A) providing investors with an expectation of a reasonable return on their investment; and (B) providing sufficient regulatory stability, transparency, and certainty to enable businesses to make long-term investments" (emphasis added).
11. These are matters that should be considered as part of the review and operation of any economic regulation for network utilities, be it under the Telecommunications Act, Commerce Act 1986 or other relevant legislation.
12. It is Vector's view that the long-term interests of consumers will not be met unless suppliers of regulated goods or services "have incentives to innovate and to invest, including in replacement, upgraded, and new assets" (as per the objective in s 52A(1)(a) of Part 4 of the Commerce Act 1986) which, as reflected in ss 101A and 157AA of the Telecommunications Act, requires that the legitimate commercial interests of regulated suppliers are taken into account, including ensuring they expect to receive a reasonable return on their investment.

TSO Deeds should be phased out/replaced

13. Vector does not support any of the TSO options² included in the TSO Discussion Document.
14. Vector has the following views on the future of the TSO Deeds:
 - a. While Vector has concerns about the way the Commerce Commission operates Part 4 of the Commerce Act, and believes the Part 4 legislation could be improved, existing legislative mechanisms for price control should be adopted, preferably on a generic basis, for services where there is little or no

¹ Paragraph 65, MBIE, Discussion Document, Review of the Telecommunications Act 2001, August 2013.

² Status quo, minimal change, medium change and significant change.

competition (including Chorus' copper network), rather than relying on commercial arrangements to control price. This could be through either Part 4 of the Commerce Act, or designation under Part 2 of the Telecommunications Act (for access services);

- b. The retail price caps in Telecom's TSO Deed should be phased out as and when competition develops at the retail level for residential telephony services;
 - c. The Crown should remove aspects of the TSO Deeds that have become obsolete or redundant, such as free local calling and the minimum dial-up speed requirements; and
 - d. The Crown should not expand the TSO Deeds or find new objectives to justify their continued existence.
15. Vector does not believe it is appropriate to continue to regulate prices through commercial arrangements with the Crown.
16. Price regulation should be undertaken by an independent regulatory body. MBIE should consider the potential effectiveness of transferring price control regulation of Chorus' TSO service into the Telecommunications Act or (as part of fixed line price control under) the Commerce Act from 2020 onwards, after the Government's UCLL/UBA copper price intervention expires.
17. If it is determined that there is competition for residential telephony services and/or the prospect of a substantial increase in competition, it may be best to adopt a sunset clause and phase out the Telecom TSO price cap requirements as competition develops. The TSO Discussion Document does not provide sufficient information, prima facie evidence only, to draw firm conclusions on the question of whether residential competition can be relied on rather than the retail price cap that Telecom currently operates under.
18. **Aspects of the TSO are no longer required:** The Discussion Document suggests there will be an ongoing need to impose price control on Chorus' TSO services. Should this be the case, Vector believes this should be implemented through Part 2 of the Telecommunications Act or Part 4 of the Commerce Act, and that the price cap on Telecom's residential telephony service should be phased out as competition develops.
19. It is also clear many other aspects of the TSO Deeds are now redundant or are becoming redundant. For example, 98% of the population have Internet access in excess of 5 mbs, whether there is a TSO or not, making the existing TSO Service Quality Measures in relation to Internet calls³ largely irrelevant from a consumer perspective.
20. Likewise, whether local calling is bundled into the fixed price of residential telephony services should be driven by consumer demand and not by regulation. (Vodafone, for example, offers mobile phone tariffs that include "free" local, national and mobile-to-mobile calling.) Vector sees no need for regulation of the tariff structure of residential telephony services (or residential electricity services, for that matter).
21. Components of the TSO Deeds that are deemed to no longer serve a useful consumer protection role could be removed now or phased out through sunset clauses.

TSO Deeds should NOT be expanded or morphed into new roles

22. Vector does not believe there are valid consumer protection grounds for expansion of the TSO Deeds.

³ In clause 11.1 of Part II of the Telecom TSO Deed,

23. **No need to update to reflect broadband service expectations:** Vector does not see any reason or need to revise the TSO Deeds to reflect current consumer expectations for Internet service quality. The Government's desire for improved/ubiquitous broadband is being addressed through other mechanisms such as the UFB and RBI initiatives.
24. **No need to expand TSO coverage:** It is unclear what the purpose would be of expanding the TSO Deeds' customer coverage from the 2001 Telecom residential footprint to the 2013 Telecom residential footprint. Residential customers supplied with new service after 2001 are subject to the price control protections of the Telecom TSO Deed. Revising the date from 2001 to 2013 would only mean that Chorus and Telecom would be required to continue to serve those customers. But given Chorus/Telecom voluntarily connected them after 2001, it is not obvious why they would subsequently decide to disconnect them.⁴ Vector is not aware of any evidence of this being a problem.
25. **No need to expand TSO requirements to competitive entrants:** MBIE has also suggested the TSO requirements could be extended to apply to all telecommunications service operators that provide residential telephony services. Vector does not see any merit in this proposal. In areas where other telecommunications service operators are providing residential telephony there is, by definition, some degree of competition. This puts into question the need to maintain the TSO requirements in those areas. Where workable and effective competition develops it will provide consumer protection. The proposal loses sight of the fact that the TSO was put in place to protect consumers against Telecom's 1990 monopoly provision of residential telephony services.
26. **Any expansion should not be funded by liable persons:** There are no circumstances in which Vector believes liable persons in respect of the new Telecommunications Development Levy (TDL) should be required to contribute to the TSO. Section 94 of the Telecommunications Act should be treated as redundant (and overridden in the TSO Deeds for both Chorus and Telecom).⁵ Chorus and Telecom are able to use the unreasonable impairment of profitability provisions in their respective Deeds if their TSO prices are too low.
27. If the Crown and Chorus/Telecom agree to widen the current TSO requirements it should be on the basis that this is an additional commercial arrangement Chorus/Telecom have voluntarily entered into. Any such arrangements should explicitly exclude Chorus/Telecom from seeking future regulatory relief for the financial impacts of the new provisions.⁶ It would be objectionable for the Crown and Chorus/Telecom to reach a commercial agreement, where part of the financial cost of the agreement could subsequently be imposed on their competitors (other liable parties).

⁴ Given that customers connected after 2001 were connected on a voluntary basis (and subject to capital contributions/connection charges) it is reasonable to assume – in terms of calculating the cost of providing TSO services – that those customers are profitable to supply.

⁵ Clause 41 of the Telecom TSO Deed excludes Telecom from seeking relief under s 94 of the Telecommunications Act.

⁶ *ibid.*

INCONSISTENCIES IN THE REGULATORY APPROACH ACROSS SECTORS

- 28. A comparison of the TSO provisions in the Telecommunications Act and TSO Deeds, specifically the price control provisions, against the approach to price control under Part 4 of the Commerce Act highlights a number of unwarranted and undesirable inconsistencies.
- 29. The price control component of the TSO is inconsistent with and less robust than that which would be imposed under Part 2 of the Telecommunications Act or Part 4 of the Commerce Act.
- 30. MBIE should identify and review the inconsistencies between the way telecommunications and energy network infrastructure regulation (including in relation to the TSO Deeds) to determine the extent of reforms required to ensure a more consistent, robust and coherent approach to economic regulation. The Productivity Commission inquiry into regulatory design and operation may also help inform this issue.
- 31. Some specific examples of the inconsistencies, specifically relating to the provision of TSO services, are detailed below:

Telecommunications Act	Commerce Act/ Electricity Industry Act/ Gas Act	Comment
The Telecommunications Act contains regulatory review provisions (including in relation to the TSO) which require consideration of, amongst other matters, the ability of regulated suppliers to receive a reasonable return, and incentives and ability to invest	The Commerce Act, Electricity Industry Act and Gas Act contain no equivalent review provisions.	Review of regulatory arrangements is an important element of regulatory design and is a significant gap in the current regimes under the Commerce Act and Telecommunications Act.
If Chorus considers that its TSO prices are inadequate, it can seek redress through the Commerce Commission or the Crown. Chorus has the option of: (i) increasing their respective TSO prices if they suffer an unreasonable impairment of overall profitability, as a result of providing TSO services (determined by	Electricity and gas networks can only seek redress under Part 4 of the Commerce Act for inadequate prices by applying to the Commerce Commission for a Customised Price-Quality Path (CPP).	It is unclear to Vector why Chorus should need two separate options for addressing the cost impact of provision of TSO network services. Section 94 of the Telecommunications Act should be revoked or the Chorus TSO Deed should be amended to exclude Chorus using s 94 of the Telecommunications Act. ⁹

⁹ Consistent with clause 41 of Telecom’s TSO Deed.

Telecommunications Act	Commerce Act/ Electricity Act/ Gas Act	Act/ Industry Comment
<p>the Crown);⁷ or (ii) requiring a calculation by the Commerce Commission of the net loss of providing TSO services (with consequent funding from liable persons).⁸</p> <p>[Clause 41 of Telecom’s TSO Deed presently excludes Telecom from adopting option (ii), notwithstanding that it is permitted under s 94 of the Telecommunications Act.]</p>		
<p>Price control of residential telephony services is operated through commercial agreement between the Government and the “regulated” party(ies).</p>	<p>Price control is operated under Part 4 of the Commerce Act.</p>	<p>TSO Deeds should not be used to operate price control.</p> <p>Consideration should be given to whether Chorus’ copper network should be subject to price control under Part 4 of the Commerce Act, otherwise the TSO network service should be designated under Part 2 of the Telecommunications Act [at least from 2020 after the expiry of the Government’s UBA/UCLL pricing intervention].</p>
<p>TSO prices are set at CPI-0% in perpetuity (which also applies to service quality requirements).</p>	<p>Prices (service quality) are reset under Part 4 of the Commerce Act every five years, including starting price adjustments, x factor and claw-back.</p>	<p>Vector is of the view that there are a number of anomalies and inconsistencies between the energy and telecommunications regulatory regimes that</p>

⁷ Clauses 8 – 13 of the Telecom TSO Deed and 7 – 12 of the Chorus TSO Deed.

⁸ Section 94 of the Telecommunications Act 2001.

Telecommunications Act	Commerce Act/ Electricity Industry Act/ Gas Act	Comment
<p>If the Crown or Commerce Commission determined that the TSO Deed price cap is more than sufficient to cover the cost of providing TSO services, and was actually in excess of what was required, the prices would not be adjusted downward.</p>	<p>Under Part 4 the Commerce Commission could determine that the DPP was more generous than the regulated supplier actually needed, and set a CPP that is worse for the regulated supplier than the DPP. In relation to the TSO Deed, no such mechanism exists under either of the two price relief options (listed above).</p>	<p>do not have sound justification and should be reviewed.</p>
<p>No rules exist in relation to how the Crown or the Commerce Commission would determine Chorus/Telecom's cost of providing TSO services, if Chorus or Telecom sought regulatory relief (see above) from the TSO price caps.</p>	<p>Part 4 of the Commerce Act requires the establishment of Input Methodologies for determining such matters as WACC, asset valuation, projections of forward-looking costs etc.</p>	
<p>Telecom is not required to pass-through reductions in access prices or efficiency gains/Telecom is able to retain 100% of any efficiency gain/cost saving.</p>	<p>EDBs/GDBs are required to pass-through reductions in transmission costs.</p> <p>Operation of Part 4 is also subject to the requirements that regulated suppliers (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and (d) are limited in their ability to extract excessive profits.</p>	

Telecommunications Act	Commerce Act/ Electricity Industry Act/ Gas Act	Comment
Subject to 100% fixed charge ("free" local calling) requirement. ¹⁰	Subject to low fixed charge requirement.	Vector considers it contradictory to require high fixed charges for residential telephony but low fixed charges for residential electricity services. Vector considers that both sets of requirements should be revoked.

¹⁰ Refer to the section "'Free' local calling requirement unnecessary".

PRICE CONTROL SHOULD BE ADOPTED UNDER THE COMMERCE ACT OR TELECOMMUNICATIONS ACT

32. The TSO Deeds include two interrelated components; universal service obligation (USO), including coverage, and price regulation. The price regulation consists of a retail price cap set by the Crown and Telecom, and a price for access by Telecom to Chorus' TSO network that is pegged to the price the Commerce Commission sets for Chorus' unbundled copper low frequency services.
33. USO and comparable regulation can be prone to assessment within the vacuum of USO regulatory models only. However, there is a wide body of broader regulatory experience, especially in the context of price and quality regulation, which can be drawn to assess the effectiveness of the TSO Deeds.
34. That is, while the assessment of comparator jurisdictions with USO obligations is helpful, MBIE is well positioned to rely on deeper regulatory expertise developed under Part 4 of the Commerce Act, Part 2 of the Telecommunications Act, and more broadly in relation to the regulation of monopoly or near-monopoly services (including where obligations relating to supply and minimum standards are imposed) from a number of comparator jurisdictions.
35. An assessment on this basis would suggest that the current TSO Deeds are sub-optimal from a regulatory outcomes perspective, and New Zealand may be better served through leveraging the more robust framework available under the Telecommunications Act or Commerce Act.
36. It should be noted Vector has concerns about the way the Commerce Commission operates Part 4 of the Commerce Act, and believes the Part 4 legislation could be improved. We are also of the view, however, that legislative mechanisms that have been introduced to enable price control are more appropriate to rely on, preferably on a generic basis, rather than relying on commercial arrangements.
37. Part 4 of the Commerce Act and Part 2 of the Telecommunications Act (for access services) are the existing legislative mechanisms for price control of services in markets where there is little or no competition, and not commercial agreements between the Crown and the "regulated" party such as under the TSO Deeds.¹¹ Consideration should be given to whether the Commerce Act or the Telecommunications Act would be most suitable:
 - a. **Telecommunications Act provides a simpler fit in the short-term.** The Telecommunications Act provides a simpler fit, especially prior to 2020, given that UCLL and UBA copper services are already designated under the Telecommunications Act. It would be a simple matter to include Chorus' TSO service as an additional designated service.
 - b. **Commerce Act provides a more business-wide model.** Telecommunications Act access regulation can be contrasted to regulation under Part 4 where, broadly, the regulation is more naturally applied to the regulated entity or particular assets. In this case, the Commission broadly calculates a "reasonable return" for the regulated supplier, but is not necessarily specific about how individual services should be priced.
 - c. **2020 and beyond.** Assuming UFB services are regulated following the expiry of the UFB contracts, it would make sense to consider fully regulating Chorus (both its copper and fibre networks) under Part 4. Any policy need for the TSO obligations to be met at a network level could be met by requiring Chorus to

¹¹ The tests for regulation under Part 4 of the Commerce Act and the Telecommunications Act are very similar. The Commerce Act includes the tests of whether there is limited competition and price control would be to the long-term benefit of consumers. The Commerce Commission has adopted similar tests under the Telecommunications Act with the additional test that regulation would promote competition (not relevant under the Commerce Act).

provide those services, and permitting the regulator to take this into account. The effect of this would be comparable to the electricity industry, where distributors have obligations to supply under s 105 of the Electricity Industry Act (implicitly requiring cross-subsidies to less viable customers).

38. Regulation of Chorus' fixed line network under Part 4 of the Commerce Act, if administered appropriately by the Commerce Commission, could provide greater surety overall prices are at a level that provides Chorus an appropriate return, than regulation of individual copper access services under the Telecommunications Act.
39. MBIE should consider s 157AA(2)(b) of the Telecommunications Act, in its review of the residential TSO, and "assess whether alternative regulatory frameworks, including (without limitation) generic price control, would be ... preferable and more effective" than the TSO Deeds. As MBIE has noted, "Regulation under Part 4 is currently applied to electricity lines, gas pipelines and airports, but it can be applied in any market where competition is not possible ... it could apply to some telecommunications services."¹²
40. While s 101A does not specify the same consideration in relation to the TSO review, Vector considers that a broader inquiry is warranted. Specifically, s 101A(1)(a)(vi) requires the Crown to consider alternative arrangements for achieving the purposes of the TSO instruments, as specified in s 70(1) of the Telecommunications Act. In Vector's view, a consideration of generic price regulation under Part 4 of the Commerce Act, or designation under Part 2 of the Telecommunications Act, satisfies this requirement.
41. Given the Government has made a decision to allow Chorus to price copper well above cost until 2019 (setting copper prices equal to the new fibre network prices), a pragmatic approach may be to: (i) retain the current Chorus' TSO pricing arrangements pegging the price equal to UCLL – either in the TSO Deed (for the sake of convenience) or through the legislation; but (ii) prescribe in the amendment legislation that price regulation of Chorus' fixed network be transferred to Part 2 of the Telecommunications Act or Part 4 of the Commerce Act in 2020.
42. The appropriate treatment of price cap regulation for Telecom's residential telephony service depends on the extent to which competition has developed at the retail level for those services. Consistent with s 52G(1)(a) of the Commerce Act, price control should only be applied where there is (i) "little or no competition"; and (ii) "little or no likelihood of a substantial increase in competition". Vector suggests that where both of these tests are not satisfied (e.g. there is competition) then Telecom's TSO obligations should be removed. If the first test is satisfied but the second test is not, and there is the prospect of competition developing, the pragmatic approach may be to retain the TSO price cap on Telecom, but phase it out as competition develops for residential telephony services.
43. MBIE could consider introducing sunset clauses that would result in the expiry of the TSO Deed requirements/or amendments when certain trigger(s) have been met. The triggers could include, for example: (i) the Commission has determined that the TSO results in a net loss; and/or (ii) the Crown has determined that the TSO results in unreasonable impairment or overall impairment; and/or (iii) x% of households are supplied by fibre/alternative providers.

¹² Paragraph 92, MBIE, Discussion Document, Review of the Telecommunications Act 2001, August 2013.

'FREE' LOCAL CALLING REQUIREMENT UNNECESSARY

44. The TSO Deeds include a "free" residential telephony calling requirement. This requires a 100% fixed charge for residential telephony services.
45. The requirement for Telecom to provide residential telephony services on a 100% fixed charge basis may disadvantage low-use consumers and is the opposite of the approach the Government has taken in electricity with a low user fixed charge tariff requirement.
46. It is not clear what consumer protection a 100% fixed charge requirement adds in addition to the TSO price cap.
47. Vector agrees with Mighty River Power:¹³

... it is rather curious that, under the Kiwi Share Obligation, Telecom is required to offer basic residential telephony services using a 100% fixed charge. It is not clear to Mighty River Power why residential electricity services should have a requirement for low fixed charges, but residential telephony services should have the opposite obligation?
48. The comments from Ministry of Consumer Affairs on fixed charge regulation, albeit in the context of electricity fixed charges, are worth noting:¹⁴

... it is sometimes argued that high fixed charges are inequitable in that they favour rich consumers who use relatively large amounts of electricity. However, there are other large consumers of electricity who are not rich, such as large families on low incomes, people with homes that are difficult (and costly) to heat, and low income earners (e.g. beneficiaries who may spend more time at home, Maori and Pacific Island people).

Under a variable charging regime (with low or no fixed charges), large consumers would pay a larger proportion of the fixed costs of the electricity network, in effect subsidising small consumers of electricity. Conversely, it is sometimes argued that low fixed charges favour pensioners and other disadvantaged groups. But, there is only weak evidence that these are low-rate users of energy and, in any event, not all consumers of small amounts are in this category. Examples of small consumers who may be favored if a high proportion of the electricity charge is variable include batch/holiday homeowners (who are likely to be on high incomes).
49. Given MBIE's suggestion that the supply of residential telephony in some parts of New Zealand is becoming competitive, we would also question the desirability of interfering with retail prices in competitive or potentially competitive markets. The 100% fixed charge cap could serve to interfere with the emergence of competition e.g. fixed-to-mobile substitution.
50. MBIE should consider whether it is to the long-term benefit of consumers (in telecommunications and electricity) for there to be regulation on the level of fixed charges for residential (telephony and electricity) services, and whether these requirements should be removed. This may be a matter that MBIE could usefully discuss with the Commerce Commission and the Electricity Authority.

¹³ Paragraph 118, Mighty River Power, Submission to the Electricity Commission on: distribution pricing methodology, 10 July 2009.

¹⁴ Ministry of Consumer Affairs, Submission to the Ministerial Inquiry into the Electricity Industry, March 2000.

CONCLUDING REMARKS

51. Vector is of the view that:

- a. None of the TSO options in the TSO Discussion Document should be adopted;
- b. The TSO Deeds should be phased out and/or replaced with price control under Part 4 of the Commerce Act or Part 2 of the Telecommunications Act;

Price control should be adopted under the Commerce or Telecommunications Acts

- c. Section 101A(1)(a)(vi) requires the Crown to consider alternative arrangements for achieving the purposes of the TSO instruments, as specified in s 70(1) of the Telecommunications Act. In Vector's view, a consideration of generic price regulation under Part 4 of the Commerce Act, or designation under Part 2 of the Telecommunications Act, would satisfy this requirement;
- d. While Vector has concerns about the way the Commerce Commission operates Part 4 of the Commerce Act, and believes the Part 4 legislation could be improved, we are of the view that existing legislative mechanisms for price control should be adopted, preferably on a generic basis, for services where there is little or no competition (including Chorus' copper network), rather than relying on commercial arrangements to control price. This could be through either under Part 4 of the Commerce Act, or through designation under Part 2 of the Telecommunications Act (for access services);
- e. Generic price control under Part 4 of the Commerce Act, or designation under Part 2 of the Telecommunications Act (for access services), should be applied where there is little or no competition (including Chorus' copper network);
- f. The Government's decision to set Chorus' copper/TSO prices above cost until 2019 means that application of price control under Part 4 of the Commerce Act or Part 2 of the Telecommunications Act should operate from 2020 onwards;
- g. Price control should not be operated through commercial agreements such as the TSO Deeds;

Phase out of TSO Deeds

- h. Sunset clauses should be adopted that phase out the TSO Deeds/TSO retail price cap as and when competition develops at the retail level for residential telephony services;
- i. In relation to Telecom, if nationwide competition is expected to develop overtime, then phased removal of the TSO requirements/price cap as substantial competition develops may be more appropriate than price control under Part 4;
- j. The Crown should remove aspects of the TSO Deeds that have become obsolete or redundant, such as free local calling and the minimum dial-up speed requirements;
- k. The roll-out of broadband/fibre and the development of competition, in parts of the telecommunications market, mean that aspects of the TSO Deeds are now becoming redundant;

TSO should not be expanded or morphed into new roles

- l. The Crown should not be looking to expand the TSO Deeds or find new objectives that would justify their continued existence;

- m. There is no need to update the TSO Deeds to reflect consumer broadband service expectations. This has been dealt with through alternative Government intervention – UFB and RBI;
- n. There is no need to expand TSO coverage to post-2001 customers. It should also be noted that post-2001 residential customers are protected by the TSO price cap anyway;
- o. While these customers are not subject to the TSO coverage requirements they have been supplied on a commercial basis without Government intervention. Vector is not aware of any evidence of a problem of Chorus/Telecom connecting (non-TSO) residential customers then deciding to disconnect them;
- p. There is no need to expand TSO requirements to competitive entrants. The TSO is only needed to protect consumers where there is little or no competition;
- q. If the TSO Deeds are to be retained they should be technologically neutral i.e. Chorus/Telecom should not be required to provide TSO services through copper, if delivery through other technologies (including fibre) would be cheaper and would not unreasonably impact on service quality;

Cost of supplying CNVCs appears to be minor

- r. If TSO prices resulted in unreasonable impairment of profitability for Chorus/Telecom, this should be resolved by raising their prices for residential telephony services/removing the TSO, and should not be funded by TDL liable persons;
- s. All the available evidence suggests the uneconomic components of the TSO Deeds are minor, and readily covered by profitable TSO customers – reinforced by the Government’s decision to allow Chorus to retain copper access services at (substantially) above cost; and

Regulation of tariff structures is unnecessary

- t. It seems anomalous that residential telephony services are required to be provided on a 100% fixed charge basis, yet there are restrictions on fixed charges for residential electricity services.
52. Vector would not support any option which would reverse the previous TSO funding reforms and require TDL liable persons to contribute to the cost of supplying CNVCs under the TSO Deed(s).

APPENDIX 1: MATTERS THAT MUST BE CONSIDERED IN THE TSO REVIEW

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
<p>Section 101A(a) at the start of 2013, commence a review of the deemed TSO instruments and the provisions of this Act that implement those deeds (including the provisions that relate to funding) (collectively, the deemed TSO arrangements), including consideration of the following:</p>	
<p>(i) the operation of the deemed TSO arrangements:</p>	<p>The TSO Deeds include two interrelated components; universal service obligation (including coverage) and price cap regulation.</p> <p>Vector does not believe the TSO Deeds are an appropriate mechanism for regulating either Chorus' TSO network service access pricing or Telecom's retail residential telephony prices in today's environment.</p> <p>Price regulation should not be through commercial arrangements with the Crown. Part 4 of the Commerce Act or Part 2 of the Telecommunications (for access services) are the existing legislative mechanisms for regulating prices (including service quality) for services where there is little or no competition.</p>
<p>(ii) changes in the telecommunications sector that have arisen from investments in, and the roll-out of, new and enhanced telecommunications infrastructure and facilities and the impact of those changes on the deemed TSO arrangements:</p>	<p>Vector does not see any reason or need to revise the TSO Deeds to reflect current consumer expectations for Internet service quality from the TSO Deeds minimum dial-up requirements to broadband speeds. The Government's desire for improved/ubiquitous broadband is and has been addressed through other mechanisms such as the UFB and RBI initiatives.</p>
<p>(iii) the continued need for, and relevance of, the deemed TSO arrangements:</p>	<p>Vector is of the view that the Crown should be moving to phase out the Chorus and Telecom TSO Deeds.</p> <p>Price regulation should not be through commercial arrangements with the Crown. Part 4 of the Commerce Act or Part 2 of the Telecommunications Act (for access services) are the existing legislative mechanisms for regulating prices (including service quality) for services where there is little or no competition.</p>

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
	<p>It is also clear many aspects of the TSO Deeds are now redundant or becoming redundant. For example, 98% of the population have Internet access in excess of 5 mbps, whether there is a TSO or not, making the existing TSO Service Quality Measures in relation to Internet calls largely irrelevant from a consumer perspective.</p> <p>Components of the TSO Deeds that are deemed to no longer serve a useful consumer protection role could be phased out, including through sunset clauses.</p>
<p>(iv) the practicality of adopting universal, rather than provider-specific, arrangements for provision of the services and achievement of the outcomes covered by the deemed TSO arrangements:</p>	<p>The KSO (now TSO Deed) was put in place to protect residential telephony customers from Telecom's market dominance/monopoly.</p> <p>In areas where other telecommunications service operators are providing residential telephony there is, by definition, some degree of competition. This puts into question the need to maintain the TSO retail requirements in those areas, as competition may be able to be relied on to provide consumer protection, let alone to expand those obligations. The proposal loses sight of the fact that the TSO was put in place to protect consumers against Telecom's 1990 monopoly provision of residential telephony services.</p>
<p>(v) the impact of the funding arrangements for deemed TSO instruments and the calculation of costs in relation to deemed TSO instruments on TSO providers, market competition, and the development generally of the telecommunications industry:</p>	<p>Vector does not believe there is any need for funding provisions beyond Chorus and Telecom's ability to cross-subsidise CNVCs from profitable TSO customers.</p> <p>It is common for supply of network utility services to include an element of price averaging and cross-subsidisation between low and higher cost customers, making specific funding mechanisms to supply the latter unnecessary. The Government's announcement that it would set Chorus' copper access prices at the same level as fibre, and substantially above cost, means that the provision of TSO services will remain extremely profitable for Chorus for the foreseeable future; particularly if Chorus can incentivise access seekers to remain on copper.</p> <p>MBIE considered whether a specific funding mechanism was needed to cover the cost to electricity distribution businesses (EDBs) continuance of supply obligations under s 105 of the Electricity Industry Act. MBIE determined that no specific funding mechanism was needed for EDBs to meet these obligations. The same conclusion should be drawn in relation to the TSO Deeds.</p> <p>There is sufficient evidence available that uneconomic components of the TSO Deeds are minor, and readily covered by profitable TSO customers.</p>

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
	<p>The Commerce Commission's last TSO calculation was \$72 million for 2007/08, equating to 59,240 CNVCs. This is extremely low relative to Chorus and Telecom's liable qualifying revenues of approximately \$2.8 billion.</p> <p>The Courts (including the Supreme Court) determined that the way the Commission calculated this cost was incorrect and overstated the cost.¹⁵ A corrected value was never provided as compensation for overpayment was settled out of court.¹⁶</p> <p>Telecom's disclosures under the Telecommunications Disclosure Regulations 1990 demonstrated that the cross-subsidisation from the profitable KSO customers alone was substantially in excess of what was required to fund the uneconomic customers,¹⁷ even though Telecom's calculation of the net cost of supplying CNVCs was substantially higher than the Commerce Commission's calculation.</p>

¹⁵ Paragraphs 3 and 4, Vodafone New Zealand Limited v Telecom New Zealand Limited SC 4/2010 [17 November 2011].

¹⁶ <http://www.chorus.co.nz/telstraclear-and-chorus-announce-tso-settlement>

¹⁷ Telecom, Assessing the cost of the KSO, September 2001.

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
	<p>Source: Telecom "Assessing the cost of the KSO", September 2001.</p>
(vi) alternative arrangements for achieving the purpose set out in section 70(1) , including—	<p>The only issue Vector is aware of that could create problems with the “supply of [residential telephony services]” or ensuring the services are provided “at a price that is considered by the Minister to be affordable to those groups of end-users” are the monopoly components of the provision of TSO services. These should be addressed through Part 4 of the Commerce Act and/or designated as access services under Part 2 of the Telecommunications Act, not through Part 3 of the Telecommunications Act.</p>
(A) the potential for adopting a contestable TSO model for deemed TSO arrangements and the costs and benefits of those alternatives in comparison with the deemed TSO arrangements; and	<p>We do not see merit in making the TSO services contestable:</p> <ul style="list-style-type: none"> • The Crown should phase out the TSO Deeds; • The cost of supplying CNVCs under the TSO is funded by Chorus/Telecom through cross-subsidisation from profitable customers. If Chorus/Telecom were relieved of the need to provide service to CNVCs, the TSO Deeds would not be adjusted to remove the source of the subsidies.

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
	<ul style="list-style-type: none"> Complexities would arise because: (i) Chorus' CNVCs (if any) will not necessarily be the same as Telecom's CNVCs (and vice versa); and (ii) profits Telecom makes from supplying Chorus' CNVCs may exceed the losses Chorus incurs (if any) (and vice versa).
<p>(B) alternative approaches for the funding of deemed TSO instruments and the calculation of costs in relation to deemed TSO instruments, including the costs and benefits of those alternative approaches in comparison with the deemed TSO funding arrangements:</p>	<p>See comments under (v) above.</p> <p>Chorus and Telecom have the option of increasing their respective TSO prices if they suffer an unreasonable impairment of overall profitability, as a result of providing TSO services (determined by the Crown). Chorus also has the option of requiring the Commerce Commission to determine the net cost of providing TSO services (with consequent funding from TDL liable persons).</p> <p>It is also notable that the funding review mechanisms are asymmetric. There is no mechanism for review where the TSO prices are excessive and/or where Chorus or Telecom sought relief from the TSO price caps but the Commerce Commission or Crown (depending on what option Chorus/Telecom choose) determined that the price caps were in excess of that required to fund the TSO services.</p> <p>Principle 1 of the Chorus TSO Deed pegs the price Chorus can charge Telecom to an amount equivalent to the regulated price of Chorus' unbundled copper local loop network (UCLL) service.</p> <p>The pricing principles for UCLL are cost-based with international benchmarking used as the initial pricing principle and TSLRIC as the final pricing principle.</p> <p>If the Commerce Commission was left to make a final price determination for the UCLL service, Vector would expect the price Chorus would receive to be adequate to cover the costs of CNVCs unless:</p> <ul style="list-style-type: none"> the Commission sets the UCLL price below cost/does not provide a reasonable allocation of forward-looking common costs in the TSLRIC price, contrary to the (cost-based) final pricing principle or TSLRIC; and/or the cost of providing TSO services is (materially) higher than the cost of providing UCLL services (it is not obvious why this would be the case).

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
	<p>If setting the TSO service price equal to the TSLRIC based price for UCLL was inadequate, this would suggest deficiencies in reliance on the use of a combination of the Telecommunications Act and TSO Deed to regulate Chorus' copper network prices. This reinforces Vector's view that consideration should be given to price controlling Chorus' copper network under Part 4 of the Commerce Act.</p> <p>The Government has announced that it will override the Commerce Commission's decision and set copper access prices at substantially above cost-based prices – including to enable funding (cross-subsidisation) of fibre roll-out.¹⁸ This makes it implausible that copper access prices would not be sufficient to enable continued cross-subsidisation of TSO services to CNVCs, or that the TSO could unreasonably impair Chorus' profitability.</p> <p>Telecom, in turn, continues to receive a CPI-0% retail TSO price for residential telephony services. Assuming MBIE's assessment is correct, and CPI-0% "is likely to overestimate the actual costs faced by Telecom in providing the TSO services"¹⁹ then Telecom's TSO Business is growing in profitability and prices are well in excess of that needed to cross-subsidise CNVCs.</p> <p>To the extent that the prices set for UCLL (be it by the Commerce Commission or by the Government) results in a reduction in UCLL prices,²⁰ this will in turn translate to a reduction in the price Telecom pays Chorus for TSO services (as per Principle 1 of the Chorus TSO Deed) and a further uplift in Telecom's TSO retail price margins.</p> <p>Telecom would only be price squeezed in the unlikely event that the Commerce Commission determine of the TSLRIC UCLL price (or Government intervention on the UCLL price) resulted in a substantial uplift in UCLL prices. As there is no automatic "pass-through" mechanism for changes in Chorus' prices (up or down) this would result in a reduction to Telecom of the profits from providing TSO services. This is not a situation that would arise under Part 4 of the Commerce Act as Chorus' access price changes (upwards or down) would be treated as a pass-through cost.</p>

¹⁸ MBIE, Discussion Document, Review of the Telecommunications Act 2001, August 2013.

¹⁹ Paragraph 155, MBIE, Discussion Document "Review of the Telecommunications Service Obligations (TSO) for Local Residential Telephone Service", July 2013.

²⁰ A Commerce Commission (Government) determined price would result in a substantial (slight) reduction.

Section 101A(a) of the Telecommunications Act:	Summary of Vector's views
(vii) related regulatory issues	<p>MBIE should consider s 157AA(2)(b) of the Telecommunications Act, in its review of the residential TSO and "assess whether alternative regulatory frameworks, including (without limitation) generic price control, would be [a] preferable and more effective" than the TSO Deeds. As MBIE have noted "Regulation under Part 4 is currently applied to electricity lines, gas pipelines and airports, but it can be applied in any market where competition is not possible ... it could apply to some telecommunications services."²¹</p> <p>While s 101A does not specify the same consideration in relation to the TSO review, Vector considers that a broader inquiry is warranted. Specifically, s 101A(1)(a)(vi) requires the Crown to consider alternative arrangements for achieving the purposes of the TSO instruments, as specified in s 70(1) of the Telecommunications Act. In Vector's view, a consideration of generic price regulation under Part 4 of the Commerce Act, or designation under Part 2 of the Telecommunications Act, satisfies this requirement.</p>

²¹ Paragraph 92, MBIE, Discussion Document, Review of the Telecommunications Act 2001, August 2013.