Wigley+Company solicitors

Cross-submission in response to Commission's consultation on setting service transaction charges on UBA and UCLL FPPs

16 October 2014

Table of Contents

1. Summary

All transaction charges to be priced

1.1 Chorus originally asked for all STD charges to be priced on the FPP. With the effect of avoiding regulation of the $115 charge, for example, it now backs away from that approach, saying that only a few prices should be established on the FPP.

1.2 The Act is clear that all transaction charges are to be priced on the FPP. We have brought together the key points in the various submissions on this.

Chorus shows in the real world why all charges must be regulated

1.3 Overnight, Chorus intends to:

(a) move from $145 to $284 as the one-off price for providing the same services (connection and wiring including end user side wiring and splitter). Remarkably, that has a retail minus price (pre 1 December 2014) at around one half of what is supposed to be the cost based price. Yet it is well established that retail minus produces pricing that is generally much higher than cost-based pricing. That implies strongly implies that Chorus' charges are not cost based;

(b) move from \$5 to \$10 per month, on an amortised basis, for providing the same services for regulated VDSL. That doubling from \$5 to \$10 also represents nearly the same as the underlying recurring charge of \$10.92, which is a clear sign that transaction charges are highly material. Amortised commercial charges are closely related to underlying one off regulated charges, further implying the one off charges markedly exceed cost.

1.4 The \$115 charge under the IPP only complies with the STD if it strictly implements the cost formula for the service in Sch 2. There are multiple signs – including the facts above - that it does not including Chorus using a UFB “benchmark” to justify the \$115 when only direct cost can be used. Of itself, use of a benchmark is in breach of the STD as only actual cost can be used. That Chorus resorts to using benchmarks is also a strong indication that the data it is required to rely upon (actual cost) produces lower prices.

1.5 While that raises IPP and breach issues prior to the FPP, to be dealt with separately, including misuse of substantial market power and gaming issues, this is a clear sign that the FPP must regulate all transaction service charges to reduce misuse of market power and gaming. Otherwise, such activity will continue to the detriment of consumers.

1.6 It appears possible if not likely there is an error in the new Schedule 2 and that the \$169.73 includes both connection and wiring. This is an issue to address on a s 30R review or a reconsideration.

10 GigE handover pricing

1.7 We pick up on the Spark submission on this, which is really a matter to address primarily in relation to recurring charges including the interplay of UBA recurring charges and handover charges.

1.8 We conclude that the Commission must, on the FPP, price handover variants other than the current 1 GigE handover service and price. That includes the 10 GigE handover, which Chorus will unilaterally increase the price of, in apparent misuse of substantial market power and gaming. The increase to \$1,444 per month is 53% higher, relative to what is charged in the current environment, and the comparable cost for UFB is \$300 per month.[1]

Chorus should be required to provide RSPs with details of which end user sites are VDSL capable

1.9 We outline why Chorus only having details of what end user sites have been upgraded to VDSL is inefficient. It is appropriate to have a supplementary requirement in the determination (or a s 30R decision) requiring Chorus to provide that information on request to RSPs.

Bottom up v top down modelling

1.10 Building on earlier submissions throughout the FPP process, only bottom up modelling is available. In any event, there are strong reasons why top down modelling is unsuitable.

1.11 We endorse all of the WIK report, save as to its seemingly reluctant view, based on limited time to complete the FPP, that top down with benchmarked

[1] CallPlus 9 October 2014 submission at Para 7(a)

international comparators might be an option. WIK assume that top down pricing can be fixed later, when there is more time, by a bottom up model. But that is not an option, as the final determination is just that. Ruling that out is one reason why top down is not suitable. But in any event the Commission cannot use top down methodologies.

Merging of charges

1.12 This is possible and often preferable, so long as it is handled carefully.

UCLFS

1.13 The UCLL PRD (price review determination) does not decide the UCLFS prices, contrary to the Chorus submission. Instead, UCLFS prices separately derive from the UCLL FPP. But UCLFS shares network elements with UBA and UCLL and thus there are common cost and contribution issues.

1.14 We turn now to the body of the submission.

2. Which charges are being priced?

Chorus cannot resile from its stated requirement that all prices for all service transactions are to be set

2.1 Chorus now says that only the services for which prices were decided – the core transaction charges – are to be priced on this FPP, as the IPP only applied to those services.

2.2 As inconvenient as it would be for Chorus – for example, it would have its new $115 charge reviewed - Chorus cannot resile from its request to review the transaction charges for **all** services, by which it has acknowledged that all charges in Schedule 2 are reviewable.

2.3 As we explained in our submission,[2] the Chorus UCLL and UBA FPP applications both explicitly sought pricing as to all services in the new Schedule 2's.

Drawing together the key submissions – including ours - for review of all Schedule 2 prices

2.4 Under s 42 applications are "*for a review of that part of the determination that relates to the price to be paid for the service".*

2.5 Via the draft determination (s 47), the Commission issues the final determination under s 52, which *"**must** include ...the price payable for the **designated access service** which…is determined in accordance with…the applicable final pricing principle"* (highlighting added*).*[3]

2.6 The "designated access service" for which the price is being determined is defined as the UCLL service in Sch 1 of the Act and the UBA service is Sch 1 of the Act.[4]

[2] At Para x. See also the UCLL application in which Chorus states that it wants the service pricing in Attachment E to be reviewed. That attachment is the updated Schedule 2.
[3] As the Commission "must" set the prices, this is not discretionary, as Vodafone submit (Vodafone 9 October letter; last para page 2
[4] That is the definition of designated access service in s 5

2.7 Therefore the prices for all service components (recurring and one-offs) in UCLL and UBA services must be stated in the determination. That would be so even if no party had asked for a review of all prices, but in fact Chorus has asked for that review.

2.8 That deals conclusively with the scope of the required review but in any event:

(a) The Commission has made an IPP decision on all prices for service transactions. Just because it has not benchmarked all prices does not mean that no decision has been made. For example:

(i) Not changing the status quo is still a decision as to price;

(ii) Not specifically dealing with certain prices is still an IPP decision;

(iii) Introducing POA pricing, or retaining POA pricing is a decision as to price;

(iv) In any event, POA pricing is in fact defined pricing as the Schedule 2's set out formulae for determining price, based on cost. See cl 2.4 in Schedule 2 and the specific references to POA in the list of charges. Pricing by formula is just as much a decided price as a price stated in final $ terms.

(b) The PRD is a new process that does not mirror the IPP process;

(c) Annual reviews of sundry charges are no answer.[5]

(d) While the Act is clear and does not require interpretation in context, the interpretation by Chorus would mean:

(i) there could never be an FPP review of some prices where, for example, IPP benchmarked prices were not set.[6] This cannot have been intended and would undermine the core objective of the PRD: to achieve TSLRIC pricing;

(ii) such an outcome would leave an unsatisfactory patchwork of inconsistent pricing for services and that is inefficient and distortionary;

(iii) Chorus could game the regulatory regime, as illustrated by the example in the next section of this submission.

(e) In any event, the discretion to include in the determination *"matters that relate to the price payable for the designated access service"* can accommodate any gaps in pricing.(s 52(b)).

3. Chorus shows why all service transactions must be priced: to stop Chorus from using substantial market power and gaming

3.1 The behaviour of Chorus as to connection and wiring charges illustrates well why all transaction charges need pricing on the review. It also illustrates that transactions are highly material.

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[5] Contrary to Para 3 Chorus 25 September 2014 submission
[6] See, additionally, Para 11 of the Spark 9 October 2014 submission

3.2 Chorus now say that the $115 for cabling, splitter, etc, at the home derives from a UFB benchmark for work at the end users' site. The $115 is in addition to the $169.73 home site visit charge (ie the technician is already on site and the truck roll is paid for out of the $169.73).

3.3 Our understanding is that the combined fee of $284.73 for services for connection and wiring including cables and splitter ($169.73 plus $115) as from 1 December, is for the same services charged at $145.05 prior to 1 December.

3.4 This is made clear in Chorus' 2013 document, "Information about Chorus VDSL" which at page 2 describes what is in the "connection and wiring service" costing $145.05. This comprises the connection service plus the splitter.

3.5 Chorus has signalled that its charge for the cabling and splitter component from 1 December will be $115, the connection component from that date costing, under the new Sch 2, $169.73.

Error in Schedule 2 to be remedied?

3.6 It may well be that there is an error in Sch 2, at 1.1 in the Table of Charges, and that a price of $169.73 for both connection and wiring was intended. It is now well known and accepted that retail minus (the applicable regime up to 30 November) generally produces prices higher than cost based prices). That connection and wiring under retail minus at $145.05 would produce, under a cost based regime, a price for connection and wiring of $169.73 would be unusual. But that the higher price would be for a lesser service is most unusual and implies an error: that it was intended that $169.73 was to cover both connection and wiring. As a matter separate from this consultation, as it is an IPP matter, this implies a need for clarification or reconsideration under s 58 or 59 (or, in practice, as a s 30R review may happen anyway, as part of that process). There is likely to be an extended period before the problem is fixed on the FPP determination and there are major inefficiencies from leaving this unremedied, reflected in the unilateral doubling of amortised charges overnight.

Increase most unlikely to reflect cost

3.7 What can be said however is that an increase in price under a retail minus regime ($145.05) to a price under a cost regime – albeit an IPP but still cost based to nearly double (at $284.73) is remarkable and the increase is most unlikely to reflect anything like cost. Therefore in addition to the question marks around the $169.73, there are strong implications the $115 addition does not reflect cost.

Implications for commercial variants

3.8 Those one off charges to 30 November underpin the $5 per month amortised commercial offer. The commercial service pricing for amortised installation will always mainly be driven by underlying regulated service pricing given that is the alternative available to RSPs. An increase in regulated pricing correspondingly drives up commercial amortised pricing.

3.9 From 1 December, Chorus intends to double its amortised charge for installation cost for regulated VDSL from $5 to $10 per month.[7] That reflects the

[7] As we have submitted in the Boost investigation, VDSL must in any event be supplied as a regulated service: as such transaction services must be charged as one offs. On that basis, the $5 and $10 monthly charges would

underpinning one off “regulated” charges. This is explicitly confirmed in the October 2014 Chorus Dialogue as the increase from $5 to $10 is explicitly based on underlying regulated one-off charges including the new $115 charge for cabling, splitters etc.[8]

High materiality of transaction charges

3.10 That is a highly material increase, not only because it is a doubling but it is also a large figure relative to the $10.92 IPP UBA price. This in turn implies that, in terms of impact on the markets and LTBEU, transaction charges are highly material. Yet transaction charges are receiving little attention relative to recurring charges. Transaction changes should be treated as carefully and as fulsomely as recurring charges. This is a key point that emerges from the submissions.

3.11 Until 30 November, the services which would the next day cost $10 per month, are included in the $5 per month. This implies that both the $115 and the doubling from $5 to $10 are far removed from TSLRIC cost, leaving aside for the present that the technician is on site anyway (and that visit is paid for in the home site visit one-off regulated price (and its $5 per month commercial equivalent). Proportionately to the $169.73, which includes the truck roll, the $115 appears high for the relatively limited work of installing in premises cabling and splitter. In the IPP review for example, Telecom submitted that charge should be $35 not $115.

The cost formula for connection services

3.12 Under the new IPP Schedule 2,[9] the price for cabling, splitter etc must be *“based on recovery of costs incurred (including contribution towards common costs unless already recovered)”.* That is a legally enforceable definition. If Chorus purports to charge more, it is in breach of the STD (and may also be in breach of the good faith obligations too, by purporting to provide a service in accordance with the cost formula when it in fact is not). We note that cl 2.4 requires Chorus to use reasonable endeavours, if requested, to provide two or more competitive quotes. We expect that one or more RSPs would ask for that, but this does not erode the base requirement that the pricing for cabling and splitters, where Chorus contractors are already on site, must comply with the costs formula from the outset.

3.13 The price under the formula cannot be derived from other service costs, namely UFB charges. For this IPP pricing, actual cost data must be used, not so called benchmarks.

3.14 For this reason alone, the $115 is in breach of the STD as it is not calculated based on the formula in Schedule 2. Chorus must withdraw and correctly calculate the price according to the formula.

3.15 In any event, negotiated UFB pricing is not “cost” pricing. For the reasons so well explained by WIK in its 25 September 2014 report, prices decided on competitive tendering do not produce cost pricing, and there are the multiple

be commercial not regulated offerings. Chorus have since confirmed that for regulated VDSL the one-off pricing will be available as an option for RSPs

[8] The page in the Dialogue update outlining new regulated VDSL charges specifically relies on the pricing summary at page 1 of the update

[9] At cl 1.50

other reasons why such pricing is not relevant, as noted by WIK, us and RSPs on this point.

3.16 Chorus will certainly have available to them the cost of incremental services for its providers when they additionally do cabling and splitters etc during the regulated "site visit". It may require some work for them to unravel that, although that would be surprising, as this should be readily available. In any event, the reliance on UFB "benchmarking" instead of actual cost data implies the $115 exceeds cost. And then there is the background of (a) the overnight doubling in price of the commercial variant for this cabling and splitter work, previously included in the $5 (b) the increase from $145.05 to $284.73 for the same service and (c) the increase in price from retail minus to cost when generally the reverse happens.

3.17 There is a further important point that implies that the actual cost to Chorus (which is the key part of the formula) is far less than is stated by Chorus:

(a) Chorus stated this week that it does not, when doing VDSL truck rolls under the commercial amortised arrangements, first identify if the truck roll is required (that is, whether in fact the end user site has been upgraded already to VDSL).

(b) The majority of the $115, if correctly calculated, represents cost actually incurred with third party contractors.

(c) Chorus has ready access to information as to whether a site has been upgraded already for VDSL.it can readily set up a process by which sites it need not visit can be avoided.

(d) If the visit truly costs the thick end of $115, as to only the wiring component, Chorus is unlikely to take the course it is, given the unnecessary and irrecoverable spend that involves. It would want to avoid paying cash to its contractors.

(e) The addition of the cost payable to contractors as a component of the $169.73 adds even more to that irrecoverable wastage, implying that this figure also is substantially higher than cost.

(f) The implication is that both figures are substantially higher than cost, given Chorus is not incentivised to establish systems to avoid unnecessary truck rolls, which saves out of pocket cost..

3.18 All this points to, at least as to the $115:

(a) misuse of substantial market power to unilaterally impose increased pricing;

(b) gaming by Chorus, in the well-known context of it endeavouring to increase its prices one way or another (see for example our latest cross-submission in the Boost investigation);

(c) the need for regulation of prices.

Implications for the IPP

3.19 There is an immediate issue, pre-release of the final FPP determination, as to the correct IPP pricing and, as a consequence, the amortised commercial pricing as to the $115 component. There are firm indications the $115 does not comply with the IPP. This is something that the Commission may be able to be clearer on by exercising its statutory evidence gathering powers. This of course ultimately is handled separately from the FPP.

Implications for the FPP

3.20 That is also an issue to be considered in parallel in the PRD. For the purposes of the FPP, and as noted above, determining the FPP price for cabling, the splitter etc (when the tech is already on site) will reduce use of substantial market power and gaming opportunities. This demonstrates the significance and scale of transaction charges.

4. 10 GigE and other handover pricing

4.1 In the Chorus Dialogue update earlier this month, Chorus purported to unilaterally increase the price of 10 GigE handovers. This also implies use of market power and gaming, based on the observations above.

4.2 Spark, in its 9 October 2014 submission on service transaction charges, has raised this. While there are service transaction issues, the main concern is one of recurring fees. Thus, this part of our submission, and also Spark's submission, is relevant to the Commission's review of recurring charges too and it is submitted should be treated as such by the Commission.

4.3 This may raise IPP issues which would be handled separately from this submission.

4.4 The implications for the UBA PRD – as to recurring charges - are as follows:

(a) There is only, relevantly,[10] a Schedule 2 price for 1 GigE handovers. A question arises as to how the Commission must handle higher GigE handovers. We will use 10GbE handovers to illustrate as that is commercially realistic.

(b) As we explained in our latest cross submission on Boost, Schedule 1 is FS/FS end to end, including at the handover switch, and the throughput metric does not change this. Nor does the pricing being limited to 1 GigE handovers change this. Schedule 1 speaks for itself, as we outlined in the Boost cross submission, and in any event the handover size requirements have increased.

(c) As outlined above, s 52 makes clear that it is the designated access service that is being priced. In any event, it is at least the service in Schedule 1 of the STD that is being priced. Therefore, what is in Sch 2 does not limit the way in which services are to be priced.

(d) Thus as an RSP may want to take the unrestrained service at the handover, that option needs to be priced on the PRD. If it wants to take a 10 GigE handover instead that needs to be priced. And so on. (This incidentally might be a mechanism for managing and resolving the question of how to manage future investment requirements upon Chorus).

(e) The Commission must price each relevant handover size at TSLRIC, taking care of course to avoid double recovery as between in particular

[10] As the STM1 and 4 handovers are not used

the UBA recurring charge and the handover charge. As the handover is a switch that is part of the UBA service, it is hard to see why there is any incremental cost at handover beyond minimal (if there is anything), over and above cost incorporated in the recurring UBA monthly charge. That assumes the in situ network in place. Having handover points at different sizes may be a mechanism to deal with future investment requirements over a network shared by multiple services including UFB.

5. Ancillary terms requiring VDSL site suitability disclosure by Chorus

5.1 Emerging from the submissions, and from Chorus-provided information is the significance of RSP lack of knowledge as to the end user sites that have already been made VDSL capable.

5.2 Unlike Chorus, RSPs do not have data as to which end user sites have already been upgraded for VDSL suitability (unless by chance the new customer is churning from one of its prior VDSL customer sites). Chorus will have that data and it can be made available for RSP use. In order to efficiently offer its amortised VDSL service, Chorus would or should avoid unnecessary VDSL truck rolls. (Note above however that, for Chorus, the apparent low cost does not make this necessary, but the high upfront charges (whether one off or amortised) make this correspondingly highly material for RSPs).

5.3 Without that data, and assuming, as we understand to be the case, all end user sites need to be upgraded at some point if VDSL is to be installed, an RSP decision by which VDSL truck rolls are ordered only for non-VDSL ready end user sites is problematic. The RSP would be reliant on negative customer feedback about performance, and then order truck rolls (to avoid having 100% truck rolls ordered). See the CallPlus submission in this regard.

5.4 Already, around 40% of new UBA connections are to VDSL. For that and other reasons, such as migration of existing RSP customers to VDSL, and churn of VDSL capable customers, the number of VDSL-capable end user sites will escalate. That correspondingly reduces the need for VDSL truck rolls.

5.5 The efficient approach is for VDSL truck rolls to be ordered only for sites that have not already had VDSL truck rolls. Currently, only Chorus knows that. As noted above, regulated prices drive commercial amortised offerings. Where that offering, as is the case with the $10 uplift, has Chorus ensuring all sites are VDSL capable, the asymmetric knowledge, as between Chorus and RSPs, in relation to which sites are VDSL-capable, means Chorus can charge inefficiently high commercial prices.

5.6 It is therefore efficient for Chorus to inform RSPs, on request, whether a site is VDSL capable.

5.7 We are informed that RSPs have little choice but to seriously consider taking the $10 per month amortised service for regulated VDSL, instead of paying one-off service charges for both home site visits and cabling and splitter upgrades. That is because:

(a) Chorus can, as part of its amortised services, identify where it needs to do a site visit and where that is not necessary.

(b) If they pay one-off regulated service charges, RSPs face customer complaints and management/operational cost in handling problems at non-VDSL-compliant end user sites.

5.8 The information asymmetry enables Chorus to charge inefficiently higher prices than would be the case if the readily available information was provided.

5.9 Section 52 enables ancillary determinations to be made and it is efficient for Chorus to be required to provide, on request, confirmation of whether the particular end user site has had VDSL upgrades. Alternatively, that can and should be achieved under s 30R.

6. Modelling the transaction charges

Using Chorus cost does not work

6.1 WIK explains why there should be bottom up modelling but, seemingly reluctantly, notes the option of bottom down pricing with adjustment, checked via benchmarks.

6.2 WIK assume that the shortness of time drives this and that the Commission can move to bottom up pricing when there is more time in a subsequent phase.

6.3 In all other respects, the WIK report is excellent and fully supported. The problem with this top down approach, before addressing legal issues, is that there is no subsequent phase, contrary to what WIK assume. The final determination is just that and there is no room to fix this later by a bottom up approach. That would leave the WIK report supporting bottom up.

6.4 Also, Chorus itself shows why top down modelling won't work. Crucial in both the WIK analysis and the Commission's consultation document is that, if there is to be a top down approach, there must be cross checking against international benchmarks. But Chorus explains why that will not work:[11]

> "Cross-checks [against international comparators] are also potentially misleading, due to the difficulties of finding appropriate comparators and making allowance for different circumstances in the relevant comparator jurisdictions."

6.5 Unchecked, Chorus costs are not a suitable basis to be used to derive the TSLRIC price and therefore bottom up is the only option.

The legal requirements on the Commission

6.6 We have submitted in detail over a series of submissions that the Commission is legally required to:

(a) Undertake a bottom up analysis, and that applies to transaction charges too;

(b) Follow the methodology in the Act, and that differs from approaches in other countries (in particular, use of a methodology in one country, such as top down modelling, does not mean it is available in this country); and

[11] Chorus October 2014 submission at Para 48

(c) Where available and relevant, to quantitatively assess the suitability of different modelling options. This also extends to transaction charges.

6.7 Transaction charges are substantial for the reasons outlined above and call for careful and fulsome TSLRIC treatment. These are far from minor issues.

Timing

6.8 Consultation in this transaction charge design phase ends in mid-October, with a draft decision, assumed to include transaction charges, to be released around one and a half months later. Given the Commission will not have chosen and started implementing its model already, as that would be a decision prior to consultation and raise public law issues, and assuming a fortnight to decide, the Commission has a month to produce its draft. It is difficult to see how the Commission can do a top down draft decision in that time, cross checked against other benchmarks, without considerable compromise. A bottom up model cannot be completed in that time, implying that the Commission has no choice but to opt for top down, with the public law issues that entails, as outlined in several earlier submissions.

6.9 The reality is that the service transaction charge consultation kicked off in September, 19 months after the UCLL review applications and 8 months after the UBA review applications, implying problems in delivering a draft in only a month from design decision. That is only one of the warning signals in these PRDs, on which we have submitted in the past. All those concerns and submissions also apply to transaction charges. It is now known clearly that transaction charges have considerable implications for the market, illustrated by unilateral doubling of charges and connection and wiring charges amortised at rates that nearly equal the underlying UBA monthly charge.

7. Merging of charges etc

7.1 As noted above, the Commission is not limited to the IPP list of charges and can merge, add and change the basis of the charges. That is efficient and in the LTBEU. We draw attention however to the risks and issues identified in the CallPlus submission on this point.

8. UCLFS

8.1 Chorus incorrectly submits[12] that UCLFS transaction charges are to be established in the current process. UCLFS charges (whether recurring or for transactions) are derived from UCLL prices: they are not part of them and are not being determined on this PRD. A separate process is required, although that can be done in parallel with this PRD, if that is seen to be pragmatic.

8.2 However, as Chorus identifies,[13] UCLFS cost and charges are an integral component of this PRD, as UCLFS is a service that shares components with UCLL and UBA. That is to be taken into account, as we have submitted in previous submissions.

[12] Para 19.1 Chorus 25 September 2014 submission
[13] At Para 20-27 Chorus October 2014 submission