



Cross-Submission to the Commerce Commission on the
UBA Price Review

1 March 2013

***Public Version
(there is no confidential version)***

Contents

1.	Introduction	3
2.	Executive Summary	4
3.	Promoting competition is the purpose of the Act	10
4.	Section 18 has no effect on price	16
5.	Price increase on s18 grounds not justified	21
6.	The Section 18 Relativity requirement	33

1. Introduction

- 1.1 Thank you for the opportunity to cross-submit in this review.
- 1.2 Chorus's submission is largely addressed to Government and policy makers and not the Commission. It is as though the Commission is a secondary audience. The Commission has an obligation to continue this price review unaffected in any way by the wider debate on telecommunications policy. It must do so independently.
- 1.3 A key role of the independent regulator is to keep the regulatory function separate and independent from the direct economic interests of Government. That is why independent telecommunications regulators are ubiquitous internationally, in contrast to other functions regulated from within Government (e.g. spectrum is regulated from within MBIE). Independent telecommunication regulators have evolved out of the days when Governments controlled PSTNs. The same problem arises now by way of the UFB PPP, as Government has a strong economic interest. The regulator is there to ensure an independent approach is taken in balancing the interests of stakeholders, whether Chorus, RSPs, Government, CFH, or consumers.
- 1.4 InternetNZ is strongly supportive of the initiatives Government is taking in rural and urban areas to roll out faster broadband services. We are also firmly of the view that generally, competitive markets will deliver the best possible outcomes. That is why, fundamentally, we support the purpose of the Telecommunications Act and believe the competition it is founded on is the best way to secure the interests of telecommunications and Internet users in the long run.
- 1.5 Our support for effective regulation is based on clear principles, such as the promotion of competition and the importance of technology neutrality. It does not diminish our passion for the transition from copper to fibre. We do not believe the two views pose any conflict. Rather, the opposite is the case. A pro-competition framework with copper access prices set at cost will help secure a predictable, stable and orderly transition from copper to fibre, based on what consumers need as shown by the choices they make in purchasing services – rather than the second-guessing of consumer choices by the state or the regulator.
- 1.6 We believe it is important to present clear, sharp views and options in this submission to assist the regulator and stakeholders to develop the approach optimally in this developing area. As the issues evolve, we are open to changing our views including following feedback on the points we have made.
- 1.7 The position established in this cross-submission is designed to advance InternetNZ's broader Policy Principles, as noted in the initial submission.

Our only interest is in the continued evolution of the telecommunications regulatory framework in a direction that serves the interests of end-users.

- 1.8 We are perplexed by some of the arguments Chorus has made in its initial submissions and publicly.
- 1.9 We appeal to Chorus to be forthcoming with information that could support the arguments it advanced in its initial submission. Only by exposing the full body of information it has available to testing and public scrutiny can the public, the Government, the Commission and other stakeholders be assured that the challenge Chorus is making to the draft determination is something other than a simple case of corporate and shareholder self-interest.
- 1.10 Nothing that the Commission does, in our view, should deviate from the Act. In particular, nothing should encourage Chorus away from the new direction it set out to take, when separating from Telecom, to be a reliable, customer-focused network owner, operating the copper and new UFB networks in a manner that builds public and market trust and confidence. We admired that vision when established. We admire it now and we urge Chorus to continue down that path in future.

2. Executive Summary

- 2.1 The main points in this submission are summarised in this section.

Promoting competition is the purpose of the Act

- 2.2 Under s18 (and, expressly, under s18(2A)) the **sole** purpose of the relevant parts of the Act is “*to promote competition in telecommunications markets for the long-term interests of end-users of telecommunications services.*”. That is the framework that must govern the Commission’s review.
- 2.3 It is not enough – of itself - to say (for example, as Chorus says), that UFB is great for New Zealanders and produces dynamic efficiencies. The Commission must address dynamic efficiencies strictly in the context of whether they promote competition.
- 2.4 As Chorus largely does not address the position within the framework of promotion of competition – indeed it mainly argues against promoting competition as envisaged by the Act - much of its submission on s18 must be disregarded.
- 2.5 The competition between fibre and copper platforms (and other platforms such as mobile) is a central part of the framework implemented by Parliament. It is basic regulatory economics that increases in prices beyond cost are inefficient, and constitute moves away from the competition model. Juggling the numbers artificially takes away copper’s competitive constraint.

It makes no sense to talk of competition when it is based on artificial numbers.

Chorus acknowledges correctly that copper supports UFB Growth

- 2.6 Chorus agrees that growing copper services encourages uptake of services, when the UBA price is set at cost. We strongly agree with the following submission by Chorus:¹

“Chorus believes that encouraging growth over copper will itself lead to uptake of fibre services. But a UBA price below cost will choke off competition on the fibre platform by deferring the migration to the UFB network...”

Chorus submission that there is strong competition in retail broadband

- 2.7 Chorus says there is no competition problem in the retail broadband market, given competition using copper inputs. That submission is misconceived. It is focussed on a market it defines by technology (copper) when the retail broadband market includes mobile broadband (including LTE), HFC, non-UFB fibre, other wireless solutions, and UFB. Artificially increasing the copper input price distorts that wider retail market. Seeking to solve for one perceived problem (migration to fibre) creates other problems.
- 2.8 It also reduces migration of the 700,000 Dial-up and basic POTS customers to broadband, given higher input prices payable by copper-based RSPs. That is an inefficient consequence.

History shows why infrastructure competition is effective

- 2.9 Competition drives innovation. Competition drives investment. Regulation supports both. History shows this. For example, despite the years of Telecom arguing unbundling was not needed (and therefore, there was lack of investment and innovation by Telecom and other), unbundling has led to innovative services, better pricing, and increased investment. Dynamic efficiencies and consumer welfare are maximised when there is the greatest possible space for innovation and investment.
- 2.10 The new situation with a fibre access network does not change this insight.

History is repeating itself

- 2.11 Chorus is heading down the same path as Telecom did in this regard. Chorus submits that “*the key mechanism for ensuring the success of UFB is the current relativity between the copper and fibre prices*”.
- 2.12 Only a monopolist, without competitive pressure, would say such a thing. Left to its devices in this way, Chorus will fail to innovate in multiple areas (a deja vu problem from the days of copper monopolies).

¹ At Para 207 of its submissions

2.13 A fibre provider under competitive pressure will rapidly come up with other “key mechanisms” better than the simple price mechanism. In this way, competition will promote innovation, investment and consumer welfare. Chorus’s options include:

- (a) Leveraging the superior service of fibre over copper, even at entry level;
- (b) Offer better services at the same price;
- (c) Drop the UFB pricing;
- (d) Provide packages that encourage RSPs to migrate, especially Telecom with its ability to unbundle when the moratorium ends;
- (e) Create growth via demand side initiatives: that’s the classic focus of any supplier in a competitive market. Supply what the customers (RSPs and their customers) want, and market accordingly.

Little or no discretion to adjust price under s18

2.14 We maintain our view outlined in our initial submission that the Act does not permit movement of the price above a price based solely on cost. The Act can only be interpreted that way, as a matter of law, as we explain in this submission.

2.15 There are over 16 categories of decisions on which the Commissioner and the Minister must consider and apply the purposes in s18, as required by s19. They range across a spectrum from decisions that have high s18 input to decisions that have low s18 input. By focussing on only one of those categories of decisions –price determination - the overall approach to s18 is lost.

2.16 At one end of the spectrum (high s18 input) is the Sch 3 investigation. At the other is the price decision, which is heavily constrained to the cost formula in the Act.

2.17 Viewing s18 and s19 from the perspective of a spectrum of decisions shows that Even though s18 including s18(2A) has little application to price decisions, it is still valuable for Chorus (e.g. if an RSP seeks regulation of commercial non-regulated UBA variants: the Commission for example rejected regulation of VDSL based on dynamic efficiency consideration).

Section 18 consideration is a single step not a multi-step process

2.18 Section 18 can only be considered once, at the end of the process, and not at each step in the cost analysis (such as benchmark data set selection, and so on).

Increase in price beyond cost is not justified

- 2.19 Above, we have submitted that, as a matter of interpreting the regulatory framework, there is little or no room to increase the price beyond cost. If we are wrong in that, however, we consider that the grounds are not made out to increase the price based on s18. We start by adopting Chorus's net benefit approach. We then give the reasons why the price should not increase beyond cost.

Net benefits and efficiencies

- 2.20 Chorus correctly confirms that the s18 considerations must be assessed based on the s18 efficiency criteria (as added to by s18(2A)) with a proper application of the following net benefit test stated by Chorus:

“whether or not the result of its decision will achieve (in the long run) a *net benefit* to New Zealand.”²

- 2.21 That requires consideration of all efficiencies and consideration of the net benefit to New Zealand end users (which is a consumer welfare test). Dynamic efficiencies will generally be the most significant although, as noted above, the efficiencies in question are those that arise **solely** out of promotion of competition.
- 2.22 The Chorus submission asserts that having a regulated UBA price point that is too low relative to entry level UFB contract price caps is inefficient and does not meet the net benefits test. Few reasons are given for this assertion.
- 2.23 That price differential is only a small sliver of the overall facts underlying an adequate efficiency/net benefits analysis. Taken in isolation it is misleading and incomplete.

A more comprehensive net benefit analysis

- 2.24 If an appropriately comprehensive net benefit analysis is done, we expect that the case to increase the price based on s18 would collapse. We expand on a number of reasons for this, including as follows:
- (a) DSL QoS is lower and less consistent than UFB QoS. Consistent service specifications cannot be marketed for DSL across the UFB footprint, a major reason for RSPs to migrate to UFB. This difference in QoS will become much more significant in the key period when Chorus rolls out more heavily in residential areas in 3 to 7 years' time. By then consumers will require fibre speeds and reliability.
 - (b) Regulated UBA is artificially constrained to 32kbps. It is a relatively poor service and weak relative to entry level UFB. Chorus offers better commercial variants including VDSL. Chorus can manage the pricing and QoS of those better unregulated commercial services,

² Para 163 Chorus submission

implying no need to adjust the entry level regulated price for s18 purposes.

- (c) To consider overall efficiencies and net benefits, not to mention the economic growth considerations which led to the UFB in the first place, consideration must be given to whether the Chorus UFB prices should drop instead of the copper prices increase.
- (d) Chorus can offer improved QoS for the same price, making UFB more attractive to RSPs and their customers. Chorus has ample head room to retain the ability to price-differentiate higher QoS services.
- (e) Chorus can offer solutions to RSPs to encourage them to migrate. In particular there is the major RSP, Telecom, which will face a choice when the moratorium expires to unbundle, or be enticed to move directly to UFB via UBA offerings.
- (f) An important s18 consideration is that increasing price beyond cost is inefficient. Solving one efficiency driver (migration to fibre) by increasing the price beyond cost creates a different efficiency problem. All this is a matter of balance overall (i.e. net benefits) but what is clear is that there should not be a departure from cost-based pricing. The efficiency challenge as to UFB –if any - must be solved in another way.
- (g) UBA is already well above true cost anyway. WIK-Consult indicates that TSLRIC leads to regulated copper pricing around 300% higher than a more appropriate cost calculation. In setting price, however, the Commission is constrained to TSLRIC but it is not so constrained when considering cost in an efficiency analysis context; for the latter analysis, the more appropriate cost should be used.
- (h) During the key period (3 to 7 years away), LTE will have considerable impact on the market. LTE service will generally have better and more reliable QoS than copper-based services. Increasing the copper prices beyond cost still leaves LTE as a strong alternative to fibre.
- (i) Therefore, lifting the copper price above cost does not solve the problem perceived by Chorus as LTE (and other services) constrain migration to fibre. If there is a problem as to migration to fibre, it is not solved by increasing the copper prices, but those increased copper prices would distort the broadband retail markets.
- (j) As noted above, copper is designed, under the regulatory and contractual model, as a competitive constraint on fibre. Unlike the Australian model – which assumes mandated migration to fibre – there is deliberate retention of the copper network as a competitive constraint.

- (k) There isn't a sufficiently demonstrated problem set out by Chorus. Chorus would need to provide a carefully verified and sufficiently detailed explanation for what the problem is and what has been its fundamental cause.
- (l) In any event, the decisions are better made later when the information is more reliable, such as on an UBA price review in 3+ years: a review at that stage would be usual, and this coincides with the period when the major UFB roll-out occurs (i.e. the time when price relativity becomes important). This also opens up the option for a glide-path.
- (m) Before there could be a price uplift beyond cost, Chorus would need to demonstrate why it shouldn't have to honour its existing commitment. If circumstances had changed since it made its UFB commitment, why shouldn't Chorus carry the risk on that, rather than effectively offloading the risk onto RSPs and end users, and obtaining increased monopoly rents at the same time by above cost pricing?
- (n) However, circumstances have not changed. There can be nothing of surprise to Chorus in a \$8.75 price point as that must have been within the range of prices they would have modelled when doing their business cases for UFB, the demerger, etc. We are particularly concerned about the Chorus approach in this regard. We are also particularly concerned that Chorus would claim that there is regulatory uncertainty when in fact there is certainty and Chorus is pushing for change - away from that certainty.
- (o) This week, Chorus has announced a \$300M blow-out on UFB roll-out. This highlights the concern that Chorus' problems are due to internal error or issues, rather than policy uncertainty. Should Chorus be allowed to recover monopoly rents by above cost pricing in these circumstances?
- (p) If there are problems under the contracts between CFH/Government and Chorus, the answer is not to increase prices paid for copper services. That is distortionary, unfair, and in the end, opens a Pandora's box of on-going regulatory uncertainty (including inviting endless lobbying for future, consequential regulatory change) which is not in the interests of Chorus, the Government, RSPs or end-users. Government and Chorus should look to other solutions if there are problems.
- (q) Increasing the UBA price beyond cost will see Chorus getting monopoly rents from RSPs and end-users outside the UFB footprint. Those rural RSPs and end-users will pay more, with nothing in return. It is difficult to see how those outcomes can be justified, particularly as Chorus has other options available to it.

Relativity between UBA and UCLL prices

2.25 As we said in our submission, setting prices for UCLL and for UBA based on costs automatically sets appropriate relativity. Chorus agrees. It states:

“To clarify, appropriately determined cost-based prices should result in the right relativity.”

Submission

Our submission is in the following order:

- (a) The Commission must approach the review solely on the basis of promotion of competition;
- (b) Section 18 has no effect on price;
- (c) Price increases on s18 grounds cannot be justified;
- (d) Relativity of UBA and UCLL prices.

3. Promoting competition is the purpose of the Act

3.1 We start with the significance of the competition purpose as Chorus do not appear to adequately recognise it, and it must drive all decisions by the Commission. At all stages of this review, the approach must fulfil the s18 competition purpose.

3.2 Under s18 the purpose (that is, the **sole** purpose) of the relevant parts of the Act “*is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services...*”

3.3 Section 18(2A) in no way changes that sole purpose. It expressly states that consideration of incentives to innovate, etc in new services is only to be given for the objective of determining whether the purpose of promoting competition is met. Section 18(2A) provides:

“(2A) To avoid doubt, **in determining whether or not, or the extent to which, competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand is promoted, consideration must be given to the incentives to innovate** that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services. Parliament explicitly did **not** choose to identify the UFB project, or fibre generally, as a special case. They retained in the legislation the principle of technological neutrality, for good reason. “

- 3.4 It is not enough – of itself - to say (for example, as Chorus says) that UFB is great for New Zealanders and produces dynamic efficiencies. The Commission must address dynamic efficiencies strictly in the context of whether they promote “*competition in telecommunications markets for the long-term interests of end-users*”.

Chorus’s submission that the retail broadband market is sufficiently competitive

- 3.5 Chorus submits³ that there is no competition problem to solve in the retail broadband market given strong competition between existing providers. In effect, the cost of inputs is common to all (all boats rise or fall together on the same tide) and users of those inputs are competitive on an even playing field.
- 3.6 This is not correct but, more fundamentally, Chorus, as it is doing when it focuses only on the price difference between copper and fibre, is focussing only on one sliver of the relevant market: competition for supply of DSL-based retail broadband services. As we submit at Section 5 below, we agree with Chorus that there must be a comprehensive net benefits analysis basis on the s18 efficiencies, from a consumer welfare perspective.
- 3.7 The retail market is not defined by the technology – copper-as Chorus appears to say. It is defined by the overall broadband retail market (and/or variations of that market). That market is supplied via DSL services, mobile (including LTE), other wireless services, HFC, fibre (UFB and non-UFB, etc. Increasing above cost the copper input price payable by one category of supplier into that market clearly distorts the overall retail market.
- 3.8 There are impacts too on other markets. For example, there are around 700,000 customers still on dial up and or basic POTS. Artificially increasing the copper price above cost distorts incentives for them to migrate to broadband. Even if it can be argued that this does not raise dynamic efficiency issues in relation to new Telco services (i.e. this does not involve s18(2A) services), clearly there are substantial dynamic efficiencies around migration from dial -up to broadband. The overall efficiencies and net benefits must be considered. 700,000 is a high proportion of New Zealand end-users and a major factor to be considered in a net benefits assessment. Section 18(2A) dynamic efficiency is only one type of efficiency that must be considered by the Commission, albeit an important one.

Copper is designed to be a competitive constraint

- 3.9 The regulatory model introduced in 2011 has competition between copper and fibre at its heart. Regulated access to the copper network is intended as a competitive constraint on fibre.
- 3.10 That was a careful policy choice by the Government of the time and by Parliament, and contrasts with Australia, where the decision was to mandate

³ At Para 161, 202-207 of its submission

migration (with compensation) from copper onto fibre, instead of retaining two competing networks. The Commission must implement that policy choice, set out as it is in the legislation.

- 3.11 Regulatory economics suggests that allowing a party to charge above cost is generally inefficient, and moves away from the competition model. The problem with juggling the figures is it artificially takes away copper's competitive constraint and defeats the purpose. Of course, some meaning must be given to s18(2A). There are multiple ways it can be applied, as we outline in Section 5 below. Increasing the price beyond cost is not one of them. On that basis, there is nothing inconsistent with the Act and s18 by pegging the copper price to cost.

Chorus wrongly submits that Commission's focus should not be on fibre/copper competition

- 3.12 Chorus has submitted:⁴

Chorus is concerned that the Commission's focus has remained on the competition between copper and fibre, contrary to the intent of section 18(2A) and the UFB investment.

- 3.13 In support of that conclusion, Chorus relies on material such as Ministerial press statements and MBIE website commentaries⁵, none of which is legally available or admissible to interpret legislation, as we explain below in Section 4.

- 3.14 If such material was admissible, one can point to other statements that in fact copper is designed to be a competitive constraint on fibre, contrary to what Chorus say.

- 3.15 However, it is not necessary to go behind the legislation to see its clear meaning, which is that copper, priced at cost, is to be in the market competing with fibre. Section 18(2A) must be applied subject to and in that competition context.

Chorus: Growing copper based services is an enabler, supporting UFB growth

- 3.16 The copper based services however are not just a competitive constraint. As Chorus point out, growing copper services encourages uptake of fibre services. We strongly agree with the following submission by Chorus:⁶

“Chorus believes that encouraging growth over copper will itself lead to uptake of fibre services. But a UBA price below cost will choke off competition on the fibre platform by deferring the migration to the UFB network...”

⁴ At Para 174 of its submission

⁵ Para 169 to 173

⁶ At Para 207 of its submission

- 3.17 It will be up to 7 years before many potential UFB customers can migrate to UFB in view of the extended roll-out plans. Growing the DSL-based retail broadband customer base, as Chorus say, “will itself lead to uptake of fibre services”. For example, migration of the 700,000 still on dial-up or POTS to DSL-based broadband ultimately leads to uptake of fibre services. But that migration from dial-up to copper broadband is slowed if the copper prices are increased. In turn the migration to fibre services is slowed.
- 3.18 The Chorus submission, with its reference to “*a UBA price below cost will choke off competition*”, implicitly accepts that the proper approach is to price UBA at cost.

History shows why infrastructure competition is effective

- 3.19 As noted above, the sole purpose of the relevant parts of the Act “*is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services...*”. That includes s18(2A).
- 3.20 That is the correct focus, as very recent history shows. This is because competition drives investment - a truth that has been proven by the experience of the New Zealand market, and one that is pertinent to the Commission in this proceeding. It's also a truth that Telecom last decade tried to deny and argue against, despite it being proven again and again.
- 3.21 Dynamic efficiencies - and consumer welfare - are maximised when there is the greatest possible space for innovation and investment. That is why the telecommunications regulatory framework focuses on cost based access to the assets that constitute bottlenecks - in this case, the local copper access network owned by Chorus. As this regulatory approach bedded in after 2006, the expected happened: investment rose, services improved, costs to consumers declined. Competing firms could use basic inputs and add their own improvements to give the best outcomes for consumers. Dynamic efficiency was gained, as well as other forms generally expected to arise from competitive markets.
- 3.22 The new situation with a new fibre access network rolling out does not change this insight - it does not follow that raising prices above costs on any network will lead to greater net benefits for the public.
- 3.23 Critically, the Commission has too little information and certainty at this stage to decide issues such as artificial price increases. Nobody knows with certainty what technology will do in the long run. (That is one reason why regulation is technology neutral). Nobody knows with certainty the impact of LTE or new copper technologies on the fibre rollout. Nobody knows with certainty how accurate Chorus's fears are regarding the impact of the proposed regulated UBA price on their on-going economic prospects or the prospects for New Zealand generally. Nobody can know with any certainty what the technology and market dynamics will be in the last part of this decade when the bulk of the UFB footprint will be built.

- 3.24 What can be known is the cost base for regulated UBA, allowing the Commission to price the service at cost and to apply the long standing fundamental in regulated access infrastructure markets of not pricing above cost.
- 3.25 We can also reasonably assume that such an approach is likely to lead to the best outcomes for consumers. It will drive investment not only in copper, but in the industry as a whole. Copper cannot compete with fibre on a whole range of criteria. It does not need a falsely high price to reinforce its flaws as an access network technology - they are well known, as demonstrated elsewhere in this submission.
- 3.26 It would be an unjustified assumption of omniscience to dismiss the evidence that suggests competition is the key to delivering consumer outcomes, to reverse the understanding that competition drives investment and consumer welfare, and that the contest between technologies will lead the migration to fibre without heavy handed, beyond-cost pricing initiatives for the old copper network. InternetNZ cannot accept that any party in this debate possesses such knowledge of the future.
- 3.27 That is why, fundamentally, we support the purpose of the Telecommunications Act and believe the competition it is founded on is the best way to secure the interests of telecommunications and Internet users in the long run.
- 3.28 Our support for regulation based on clear principles, such as the promotion of competition and the importance of technology neutrality, does not diminish our passion for the transition from copper to fibre. We do not believe the two views pose any conflict: rather, the opposite is the case. A pro-competition framework with copper access prices set at cost will help secure a predictable, stable and orderly transition from copper to fibre, based on what consumers need as shown by the choices they make in purchasing services – rather than the second-guessing of consumer choices by the state or by the regulator

History is repeating itself: an example of Chorus failing to innovate

- 3.29 Chorus's submission shows why it is so critical that copper should compete with fibre. Chorus demonstrates the hallmarks of a monopolist that doesn't innovate – a trend that it had begun to move away from and which the regulatory environment should continue to reinforce.
- 3.30 Chorus states:⁷

In an environment where Chorus cannot sell directly to end-users, and demand is uncertain, RSPs will ultimately determine the pace of uptake. That means that the key mechanism for ensuring the success of UFB is the current relativity between the copper and fibre prices.

⁷ Para 7 Chorus Submission

- 3.31 That is what a monopolist would say, operating in an environment without competitive pressure. Just increase the copper price as that is the “key mechanism”.
- 3.32 That approach is wrong. And, in fact, it could be much worse for Chorus. A high UBA price may drive Chorus’s biggest customer, Telecom, to unbundle when the moratorium ends. Given that the Government’s planned legislation, based on announcements to date, will only extend the date of the implementation of the new UBA price and not the date at which Telecom can unbundle, this factor should be carefully borne in mind by Chorus and by the Commission.
- 3.33 A fibre provider, under competitive pressure, will rapidly come up with multiple other “key mechanisms” or solutions to deal with the challenge. Price is not the only issue. Those other solutions are likely to be much better for consumer welfare and possibly for excellent outcomes for Chorus too. That fibre provider, under competitive pressure, will innovate. Much of this submission is devoted to those other “key mechanisms”. For example, options include:
- (a) Leveraging the superior service of fibre over copper, even at entry level;
 - (b) Offer better services at the same price;
 - (c) Drop the UFB pricing;
 - (d) Provide packages that encourage RSPs to migrate, especially Telecom with its ability to unbundle when the moratorium ends;
 - (e) Create growth via demand side initiatives: that’s the classic focus of any supplier in a competitive market. Supply what the customers (RSPs and their customers) want, and market accordingly.
- 3.34 The view that the “key mechanism” is only increasing the copper price is the talk of a monopolist that is not innovating. History tells us how to deal with that and how to deal with telecommunications suppliers who argue such points. Net benefits and consumer welfare come from competition, time and again.
- 3.35 We understand and accept – and to a degree admire – the transformation that Chorus has been undertaking since it separated from Telecom. We do not wish to see it moving down a path that sees these monopoly instincts return to the fore. The Commission, and in a broader policy context the Government, should bear this in mind in the decisions they make under, and with respect to, the Act. Chorus’s better instincts, to serve the market and invest in the new UFB infrastructure, should be rewarded instead.

4. Section 18 has no effect on price

- 4.1 Chorus submit⁸ that the price must be adjusted to reflect s18 and s19 requirements, and that consideration of s18 issues must be given at each stage of the price setting process. In this section of our submission, we submit that, as a matter of straightforward interpretation of the Act:
- (a) There is little, or no, ability to adjust the price above cost; and
 - (b) s18 is only to be considered at the end of the process that establishes the cost-based price.
- 4.2 We agree with the submission on s18 and 19 in the CallPlus/Kordia submission. Summarising that submission:
- (a) The Act contains a prescriptive method for determining the IPP price. That price is a proxy for the price that would be determined under the FPP: TSLRIC;⁹
 - (b) In each step of the process, the Commission faces often complex choices in the approach to take. Sometimes there will be a range of approaches available. But those choices must be solely driven by the objective of achieving a proxy for the cost-based FPP price, and nothing else (that is, before s18 purposes are considered). The Act contains a specific IPP process from which there cannot be deviations, prior to considering s18 issues. The Commission must derive an initial view on price determined solely by cost factors;¹⁰
 - (c) Price point choices (e.g. between the 25th percentile, median and 75th percentile) can only be used to better achieve a proxy for the FPP price (i.e. the choices can only be cost-based);¹¹
 - (d) While the Commission must consider s18 when it makes the price review determination, the IPP process is constrained in such a way that there is little or no room to adjust the price due to s18 considerations;
 - (e) That is consistent with the Act, particularly when it is recognised that the IPP price decision is only one of multiple decisions covered by the s19 obligation. Expanding on this:
 - (i) The s19 obligation applies to a wide array of decisions that are to be made by the Commission or the Minister. The CallPlus/Kordia submission lists 16 categories of decisions which

⁹ Para 1.10 Appendix to CallPlus/Kordia submissions

¹⁰ Para 1.12 Appendix to CallPlus/Kordia submissions

¹¹ Para 1.13-1.14 Appendix to CallPlus/Kordia submissions

in turn break down into multiple types of decisions by the Minister and by the Commission;¹²

- (ii) Those decisions lie on a spectrum of decisions from discretionary Schedule 3 investigations - on which s18 purposes dominate the approach, through to price reviews - on which the prescriptive IPP and FPP process allows little or no movement away from cost-pricing;¹³
- (iii) It is therefore not inconsistent with the Act that, on some decisions at one end of the spectrum, there is little or no ability to adjust to accommodate s18 purposes. It is important in that regard to interpret the legislation having regard to all the potential decisions and not just to one type of decision: price determination: that explains why s18 discretion at one end of the spectrum is so limited;
- (iv) Generally when price is set, non-price terms are set at the same time. Price is interdependent with non-price terms.¹⁴ Adding two examples to the CallPlus/Kordia submission:
 - (A) In the draft UBA price review decision, the service delivery point as to Belgium is determinative as to whether Belgium is in or out of the benchmark set. Currently it is excluded and that has the impact on price noted in the draft decision. In other words, the nature of non-price terms (the service delivery point for NZ's UBA in this instance) factors into price. There is substantially more s18 discretion as to non-price terms as the non-price term process is only minimally prescriptive. The decision on non-price terms (on which s18 has broad application) flows through into price.
 - (B) RSPs are increasingly taking higher quality commercial (i.e. unregulated) UBA services from Chorus – at a higher price – than the lower quality regulated UBA service. If a party sought a Schedule 3 investigation with a view to getting regulated access to those currently commercial services, the Commission's decision would be dominated by s18 including s18(2A). We consider this is the correct point at which s18 and s18(2A) should apply.

An earlier example of this happening is the Commission's decision not to regulate VDSL-based bitstream, based on dynamic efficiency considerations.

¹² Para 11-1.18 Appendix to CallPlus/Kordia submissions

¹³ Para 1.19-1.21 Appendix to CallPlus/Kordia submissions

¹⁴ Para 1.22 Appendix to CallPlus/Kordia submissions

- (v) It can be seen that there are numerous possible decisions to be made by the Minister and/or the Commission, affecting investment in UFB, where they have broad discretion to apply s18 considerations. In respect of a price review (one of many possible decisions), there is no such broad discretion.
- (vi) All decisions to which s18 and 19 apply must be made within the confines of the Act such as, in the case of non-price terms, the Schedule I service descriptions. Likewise as to price.¹⁵
- (vii) The Commission, as a matter of law and statutory interpretation, cannot stretch the plain meaning of words or fill in gaps. That would be usurping Parliament's role;¹⁶
- (viii) Parliament also has chosen not to expressly extend the application of s18(2A) to one species of decision - price review – despite the limitation of the application of s18 on price to only the price point selection in past determinations: implicit is that wider application was not intended, as a matter of statutory interpretation.¹⁷

4.3 We add – in relation to the Sapere report – that the clear trend away from setting the price at the 75th percentile to the median in large measure recognises the reality noted above that Telecom was not innovating and that competition was needed to encourage that to happen, and to provide stronger competition between access seekers. The success of the 2006 initiatives followed by, for example, the 2007 UCLL STD, shows how effective that approach is. For the reasons outlined above, the same dynamics apply as UFB is introduced.

Chorus submission that Ministerial and departmental statements are relevant to application of s18(2A)

4.4 Chorus has submitted that:

- (a) The Commission should have regard to Ministerial and departmental statements – such as MBIE web site statements - when interpreting its obligations under s18 and s19;¹⁸
- (b) It should also have regard to s157AA (the provision requiring a telecommunications review to start by 2016), and the Government Policy Statement, when considering and interpreting s18(2A).¹⁹

4.5 When deciding upon its obligations under the Act, in relation to s18 and s19, the Commission must do what a court would do: interpret the Act applying established statutory interpretation principles.

¹⁵ Para 1.231.24 Appendix to CallPlus/Kordia submissions

¹⁶ Para 1.26-1.28 Appendix to CallPlus/Kordia submissions

¹⁷ Para 1.25 Appendix to CallPlus/Kordia submissions

¹⁸ Para 170-174 Chorus submission

¹⁹ Para 166 and Chorus submission

- 4.6 That requires and enables the Commission to consider context. But that can only be admissible context. It is well established by the Supreme Court that surrounding material including Ministerial statements and departmental statements (except in limited contexts) are not admissible.²⁰ The statements listed by Chorus at Paras 169 to 174 are all not admissible and Chorus cannot rely on them to draw conclusions, as it does at Para 174, for example. The inadmissible documents relied on by Chorus in those paragraphs comprise Ministerial press releases and speeches, views expressed by MBIE on its website, and briefing notes provided by officials to the Finance and Expenditure Committee.
- 4.7 The context that can be considered by the Commission includes the framework of the Act. However, where the meaning is plain, it is not a permissible approach to statutory interpretation to rely upon other provisions in different parts of the Act to interpret a section. Here, s157AA cannot be used to assist interpretation of s18(2A). The context is different. If anything, the lack of reference in s18(2A) to the matters outlined in s157AA implies that the s157AA matters are not to be included when considering and applying s18(2A).
- 4.8 Likewise as to Chorus's reliance on the Government Policy Statement (GPS): that statement only applies to Sch 3 investigations and the telecommunications review under s157AA. By clear implication, the GPS is not relevant to interpreting s18 widely: to the contrary, as reference is limited to s157AA and Schedule 3 investigations, the clear implication is that s18 would receive a narrower interpretation, if anything (but in fact the GPS is irrelevant to interpretation).

Section 18 consideration is a single-step not multi-step process

- 4.9 Chorus submits that the application of s18 must be considered by the Commission at each step (benchmark choices, price point, etc).²¹ That is not correct, both under the Act and in terms of appropriate and pragmatic approach:
- (a) Section 19 materially provides that
- “..if the Commission...is required.... to make the [price review] determination..., the Commission...must... consider the purpose set out in section 18; and....make the ...determination ...that the Commission ...considers best gives, or is likely to give, effect to the purpose set out in section 18.”
- (b) That requires Section 18 action only when the determination is being made, and not Section 18 action at each step leading to the final determination;

²¹ See for example Para 197 and 198 of the Chorus submission

- (c) The Act contains a closely defined path to determine the IPP price and that path, absent s19, does not permit variations due to s18. All the steps involve cost.
- (d) The Commission must make the assessment of price following the path in the Act. Only then can it consider the s18 purpose and make the final decision accordingly.
- (e) In any event, even if the Act permitted an s18 assessment at each step in the path, it is impractical and unwieldy to do so when the appropriate approach is to undertake that exercise only once.
- (f) The s18 exercise should be kept separate from cost-based pricing exercise, as they are two different steps involving different considerations. In particular, the cost based price must be derived solely from cost-based information. The potential adjustment of that price under s18 involves entirely different considerations.

4.10 It is submitted above that there is little or no discretion to adjust an IPP price under s18. If however there is discretion:

- (a) It should be limited to that one point at the end of the process; and
- (b) At most it should extend only to – as has happened so far in determinations – the price point selection at the end of the IPP process.

Application of s18 to price point selection: Sapere report

4.11 In the past, as Sapere list in their report for Chorus, the Commission has applied s18 when selecting the price point.

4.12 An approach in the past that is outside what is permitted legally by the Act does not justify continued breach of the Act in this way. This is the first time the issue of the scope of s18 and 19 in a price determination has been closely considered by the Commission.

4.13 However, if the Commission concludes that there can be an adjustment by way of price point selection, the adjustment should be limited in the following way:

- (a) Sapere consider that the Commission faces choices where there is a range of alternatives when endeavouring to determine price, and that there can be estimation error. They submit that the IPP method of estimating the UBA price is “prone to error”,²²
- (b) Where there genuinely is a range of alternatives in selecting a solely cost-based price, it may be that the Commission can make a choice from that range, adjusting by applying s18 purposes, including s18(2A).

²² Para 6, Sapere Report

However, we submit that, in that event, there is no justification for exercising s18 discretion to increase the price beyond cost: the exercise must still follow the principles and the evidence.

- (c) Having such s18 discretion should however be unusual, and the Commission should generally be able to determine the price, including at the price point selection phase, solely based on cost factors.

5. Price increase on s18 grounds not justified

- 5.1 We have submitted above- in Section 4- that s18 and s19 have little or no impact on the price, as a matter of statutory interpretation. Essentially, the Commission is legally constrained from having regard to s18. However, if we are wrong in that submission, and there is discretion to adjust price under s18, we submit that there are no grounds to increase the price for s18 reasons. We deal with that point in this section of our submission.
- 5.2 This is illustrated by Chorus’s flawed approach to the application of s18, when it deals with the need to demonstrate net benefits and efficiencies overall including dynamic efficiencies. We deal first with the efficiencies and net benefits analysis. We then turn to the substantial list of factors that indicate that the price should not be increased beyond cost.

Net Benefits: The Chorus submission

- 5.3 Applying, as Chorus says, orthodox regulatory economics, Chorus criticises the Commission for failing:²³

“...to consider adequately, or at all, the mandatory efficiency criteria in the section [18] which requires it to determine whether or not the result of its decision will achieve (in the long run) *a net benefit* to New Zealand.

- 5.4 “Net benefit” in that quote was highlighted – appropriately – by Chorus. The requirement to consider net benefits is reinforced two paragraphs later by Chorus:

“164 However, [the Commission] has done [the price review] without any attempt to weigh up or balance the net benefits to end-users of either technology, and in doing so, has not given proper weight to dynamic efficiency and the significant capital investment in new technology – as it is required to do under section 18(2A).”

²³ Para 163 Chorus submission

- 5.5 To be clear, Chorus are correctly treating this net benefit requirement in the context of net benefit for New Zealand end-users, a consumer welfare focus.
- 5.6 We agree with Chorus that:
- (a) the s18 analysis requires the Commission to consider consumer welfare net benefits including dynamic efficiencies (and that includes as outlined in s18(2A)).;
 - (b) the Commission must, when doing the efficiencies and net benefits tests, “weigh up or balance the net benefits to end-users”.
- 5.7 That is a comprehensive assessment taking into account the various factors and efficiencies, but having a priority focus on dynamic efficiencies.
- 5.8 Critically, however, Chorus largely confines the analysis in its submissions to a rudimentary and linear comparison of price points between copper and fibre services. For example, in dealing with the application of the net benefits test, Chorus states:²⁴
- By arriving at draft prices that will clearly affect the incentive for access providers to promote UBA over UFB and reduce materially the incentive for consumers to switch from UBA to UFB, the Commission has implicitly (if not expressly) adopted the view that the long term interests of end-users are best served by a regime that promotes existing technology.
- 5.9 The price point comparison is just one of multiple factors to be considered, and falls well short of an adequate net-benefit assessment proposed by Chorus itself.
- 5.10 The overall Chorus approach is based on the simple assertion that having the regulated price of copper at a price point that is “too low” relative to the contracted fibre price does not fulfil the appropriate efficiencies, s18 and the net benefits tests. In its submission, and in its other publicly released material, Chorus takes for granted – with little analysis – the idea that a lower regulated copper price of itself is inefficient and fails a net benefit test.
- 5.11 Considering efficiencies under s18, and considering net benefits, requires a much more comprehensive and careful analysis. If such an independent analysis had been undertaken it would have shown that the case to increase the price based on s18 is not made out.
- 5.12 Sapere correctly states²⁵ that, all things being equal (including quality differentiation, which of course is not and never will be equal to fibre), a lower copper price will reduce migration from copper to fibre. But that

²⁴ Para 46 Chorus submission

²⁵ At Para 82 Sapere submission

simple observation in a broader context does not tell the full story: it is just one narrow and linear aspect. We now outline other factors as examples:

It's not just about price

- 5.13 Copper and fibre services are not the same. A fibre service, even one dimensioned with the same PIR, is markedly better and more consistent than a copper service. Even now, when copper services can meet the majority of end-users' demands, such as video downloading, fibre still provides a significantly better service than copper-based services. For example, a fibre service can have a much higher CIR for a service dimensioned with the same PIR. DSL has the well-known problems with QoS, including attenuation of the service based on distance from the DSLAM, line quality, etc. A consistently high CIR is not available over copper. Additionally, unlike fibre services, the consistent CIR is not available at all locations: that means ubiquitous high QoS cannot be marketed by RSPs either. The ability to sell a consistent product at retail across the entire UFB footprint (so-called over the top marketing) is a powerful and attractive advantage for RSPs.
- 5.14 In the future, especially in 3 to 7 years when most residential roll out occurs, fibre speeds and reliability will be much more desirable to end users as greater speeds and reliability become necessary. The difference in QoS will of itself increasingly encourage end-users to migrate, and encourage RSPs to move to fibre to meet those needs, especially with the greater demands and array of services even in regard to the low PIR/CIR UFB entry level products, even before considering the far higher QoS options available over fibre beyond the entry level offerings. Increasingly it will be the superior features of fibre based services - as demand for such features inevitably increases – that will drive migration by RSPs and their customers. Comparing copper and fibre services will increasingly compare apples and pears. The price differential becomes considerably less significant.
- 5.15 One facet of relevance is that data caps which were introduced, among other reasons, to moderate demand on congested copper networks and which infuriate consumers become superfluous. Better (or better still no) data caps on fibre will be a major incentive for customers to migrate away from copper services.

Regulated UBA is an artificially constrained service

- 5.16 So far, we have assumed that the regulated UBA service is unconstrained. But in fact it is artificially constrained to very low speeds. The 2007 UBA STD constrains speeds to 32 kbps. In practice, Chorus constrains BUBA to 45 kbps at the handover point. That is a far poorer service than DSL is capable of achieving and far poorer than even the entry level low PIR/CIR UFB service.
- 5.17 Thus, the non-price differences between the actual regulated copper service and the UFB services are considerable and of themselves are enough to drive RSPs and end users to migrate.

- 5.18 Chorus makes no mention of these non-price drivers towards migration, nor do they mention the other non-price drivers and options referred to below.

Commercial unregulated UBA services

- 5.19 In view of these limitations on regulated UBA speeds, Chorus currently offers commercial variants - at higher prices - with a range of dimensioning up to 150 kbps (plus the commercial VDSL service). It is able to offer higher QoS solutions at higher prices if it so chooses.
- 5.20 CallPlus and Kordia have submitted that they:²⁶

“will likely be purchasing non-regulated bitstream variants (VDSL or higher performing UBA) rather than the regulated product”

- 5.21 They go on to say that “*the regulated product remains critical as it is transparent and the baseline for commercial discussions*”.²⁷ We consider that CallPlus and Kordia have misplaced reliance on the regulated price. Chorus is free to price its commercial offerings at whatever price it chooses. In particular, it is able to price those offerings at price points that meet its objectives as to migration to fibre. If the regulated service has QoS that is too low to stop RSPs and end-users migrating to fibre, their only option is to take the higher QoS UBA services. Chorus has unilateral control on that pricing and therefore can manage the transition by price points that it chooses.
- 5.22 In summary, the regulated UBA offering has artificially low QoS, such that RSPs are moving to commercial UBA services. To that extent, the price of the regulated service is not causing a problem in relation to uptake on the fibre: Chorus controls the commercial UBA pricing.

The fibre prices can change

- 5.23 It cannot be taken as a given, without analysis and evidence, that the fibre price must remain unchanged in the face of a lower copper price. The contracted UFB prices are price caps. To encourage migration, and to build up the volumes of fee paying customers, Chorus can drop its fibre pricing. It is not enough simply to say something like: lower prices produce lower returns for investors so the net benefits test is not met. Efficiencies including dynamic efficiencies are far more complex than that. So is commercial reality: lower pricing attracting greater numbers of customers can lead to higher revenues overall, for example.
- 5.24 The net benefits analysis requires comprehensive consideration of whether the price differential should change by fibre price reduction or copper price increase.

²⁶ Para 27 CallPlus and Kordia submission

²⁷ Para 27 CallPlus and Kordia submission

- 5.25 We appreciate that price drops may be unattractive to Chorus, but all options should be carefully considered before the copper price is increased, with all the negative aspects entailed in that course.

Chorus can change the service offering

- 5.26 This is a more likely scenario than a price reduction. Chorus can – and should – attract RSPs and their retail customers by providing improved quality of service (QoS) such as increased speeds for the same price, etc, if that is needed. An entry level product with QoS closer to the QoS of the regulated copper service can have its PIR and CIR increased, for example, to make it more attractive.
- 5.27 It would not be enough for Chorus to simply say that selling higher QoS products at the same prices eats into overall revenues and therefore is inefficient. The wider efficiencies and net benefits must be considered. It does not automatically follow that higher QoS at the same price reduces revenues, given the considerable head room for increasing QoS, the increasing demands for higher QoS, and the increased numbers of end-users on UFB as a result (potentially leading to greater revenues overall than would otherwise be the case).
- 5.28 To take an example – an important example – there will be price points and levels of QoS which would be so superior for RSPs and their customers that they would be attracted in large volumes to move to the fibre network. That leads to more rapid migration. Chorus can put together packages for RSPs that achieve this, to make UFB more attractive than copper based services.
- 5.29 Government is currently addressing having regulation requiring retail disclosure around QoS of the various broadband services. In this way, RSPs that might otherwise wish to stay on copper services would be required to disclose the inferior performance of copper services relative to fibre. That disclosure is one of the key objectives of the proposed regulation. This increases the effect on the market as to the choice between copper and fibre services – that is, it assists with driving migration from copper to fibre.
- 5.30 An assessment of net benefits for New Zealand (and even net benefits for Chorus as a business) cannot be undertaken without considering the prospect of higher QoS UFB products being sold at the same price points.

Chorus can encourage migration

- 5.31 Chorus can also make it attractive for RSPs to migrate in large scale, which is significant, given the cost of the RSP setting up for UFB and the markedly improved ability to market consistent fibre services across the footprint.
- 5.32 A particularly important example is the choice that Chorus has when Telecom is able to unbundle. No market participant, regulator or Government today can know what Telecom will do when faced with the choice of, either, unbundling, or placing immense commercial pressure on

Chorus to come up with a better deal for UBA or equivalent services. We are intrigued by the fact that this matter has received little attention in the current debate.

Increasing UBA price beyond cost is inefficient

- 5.33 Solving one efficiency requirement (migration to fibre) by, as we note in Section 3, increasing the price beyond cost creates another efficiency problem.

UBA is already well above true cost anyway

- 5.34 The UBA price is made up of the TSLRIC costing of UCLL, plus the TSLRIC cost of the UBA increment. The IPP is a proxy for TSLRIC for both UCLL and UBA.
- 5.35 In terms of calculating “cost” the Commission has no choice but to use the TSLRIC methodology, as the Act requires that. For the reasons outlined below, there should be a move away from TSLRIC to an approach such as SRIC+, but that is not an option for the Commission.
- 5.36 However, the Commission is not, and should not, be constrained to TSLRIC considerations when assessing efficiencies and the net benefit test. It can, and should, look to more reliable measures of “cost”.
- 5.37 TSLRIC is an artificially high price for services over copper at the end of the life of the copper network. This is comprehensively analysed by WIK-Consult in its 2011 report, *Cost Methodologies and Pricing Schemes to Support the Transition to NGA*.
- 5.38 WIK focus on 5 key reasons why FL-LRIC is no longer appropriate for copper networks:

The FL-LRIC cost standard, however, no longer is appropriate to be applied for the copper access network for five reasons: (1) Copper access is no longer the modern equivalent of a fixed-line access infrastructure; (2) Demand for copper access is declining; (3) No newly entering operator would invest in a copper-based access network anymore; (4) Given the actual lifetime of the copper access network and its status of depreciation, applying FL-LRIC furthermore would lead to a (significant) over-recovery of costs for the network owner; (5) Given the cost drivers of an access network, applying FL-LRIC furthermore would lead to increasing costs, in contrast to the real market value of the copper access network assets and the opportunity costs of the operator.

5.39 WIK concludes:

For regulatory decisions that involve chronically underutilised facilities typically in a multiproduct context, the so-called short-run incremental cost (SRIC) is the relevant concept. It is the short-run cost caused by a particular service or a particular asset among many services the operator produces or many assets that make up a network. Regulated prices should at least cover the SRIC; they should correspond to SRIC+ where the "+" refers to a margin above SRIC that may not be determinable on the basis of cost concepts but would be the result of decisions that depend on the demand for the services by that facilities.

5.40 WIK had earlier concluded that:

“Copper access prices regulated at FL-LRIC will lead to inefficiencies and welfare losses in such a market environment.”

5.41 Based on SRIC+, WIK concluded that the current average European UCLL prices (8.55 Euro) would be in the range of 1.5 to 3 Euros.

5.42 While this review is about the UBA increment over UCLL pricing, (a) the issues overlap and (b) the all-up pricing for UBA –including the UCLL component – is material when considering s18 and the overall efficiencies and net benefits. It is the total UBA price that is relevant to that consideration.

5.43 In New Zealand, there are additional factors:

- (a) In relation to bitstream, the monopoly rents that have been extracted for years under the retail-minus model (the scale of which is apparent from the difference between the retail-minus and the cost based pricing of UBA). A significant return has already been achieved in New Zealand and will continue until the moratorium ends. While Telecom rather than Chorus has directly benefitted for many years, that position is ultimately reflected by pushing down the price Chorus effectively paid on the transfer of the copper network to its ownership;
- (b) By the averaging decision, Chorus already has artificial price uplift over the UFB footprint, for the reasons articulated by the Commission in its submission to the Finance and Expenditure Select Committee on the 2011 Bill and SOP to amend the Telecommunications Act. The uplift is further artificially increased as the Commission’s calculation compares all rural against all urban lines in doing the averaging, when in fact this should be limited to comparing only all broadband capable

lines: that substantially changes the pricing. InternetNZ is aware that this is an issue raised on the final pricing review for UCLL.

- 5.44 Viewed in the context of efficiencies and net benefits, Chorus is therefore already benefiting from artificially high prices, substantially above a realistic and appropriate assessment of cost for present purposes. Based on the WIK opinion, the TSLRIC prices may be as much as 300% higher than a more appropriate assessment of cost. To further increase cost beyond a proxy for TSLRIC is to distort this even further.
- 5.45 It is acknowledged that the EC Commissioner, Neelie Kroes, has foreshadowed that an EC direction might be given – this has not been finalised yet – to European regulators that they should set the price at or near FL-LRIC, based on setting prices to incentivise investment in fibre networks. However (a) that does not take away the underlying analysis as to efficiencies and the appropriate cost to take into account and (b) the EC is not suggesting a move to pricing beyond the equivalent of TS-LRIC, as Chorus submit should happen here.

LTE: Increasing copper prices above cost does not solve the UFB challenges

- 5.46 Chorus nowhere mentions other competitive constraints on fibre pricing. In particular, over the next few years, LTE and 4G will enable, as contention and other issues are solved, fast broadband services. Often, the LTE-based service will have better and more reliable QoS than copper-based broadband (whether regulated and constrained copper access or unconstrained commercial copper access). LTE comes with the advantage of mobility, on top of nomadic/fixed location suitability.
- 5.47 In the key period (3 to 7 years away), LTE will be having a substantial impact on the markets.
- 5.48 In view of LTE in the market, artificially increasing the copper pricing will not solve the problem that Chorus suggests it has.
- 5.49 But the artificial increase in copper prices beyond cost would further distort the market, and competition as between mobile/LTE and copper-based services. Yet the problem that Chorus says it has would not be solved. That cannot be justified.
- 5.50 The changes proposed by Chorus also increase uncertainty for mobile network operators. This will suit fixed line provider Chorus, as it will frustrate the investment plans of Telecom, Vodafone and 2degrees.
- 5.51 This will also be detrimental for rural users who have no fibre coverage planned. For rural, that negatively impacts the position as to wireless and LTE where there is no fibre and generally poor copper services. Yet to follow the Chorus argument to its logical end rural end users should pay more for copper services with no countervailing benefit.

Copper is designed to be a competitive constraint

- 5.52 The regulatory model introduced in 2011 has competition between copper and fibre at its heart. In Section 3 above, we have explained the central importance of copper.
- 5.53 Critically, if there is a problem (and that is not apparent), there are other solutions apart from juggling with price.

Cost based copper pricing is an enabler for UFB

- 5.54 This is acknowledged by Chorus in its submission:²⁸

“Chorus believes that encouraging growth over copper will itself lead to uptake of fibre services. But a UBA price below cost will choke off competition on the fibre platform by deferring the migration to the UFB network...”

- 5.55 We have covered this in detail at Section 3 above.

There isn't a demonstrated problem

- 5.56 The case for increasing price beyond a cost-based price is not made out. Nor is it readily apparent. The period of key concern is 3 to 7 years out. Chorus would need to demonstrate and have independently verified a real likelihood of a problem that cannot be solved, by other means such as those outlined above (e.g. by improving the QoS of offering at the same price point). It is far from adequate to point simply to the relativity between the regulated UBA price and the contracted UFB price caps, without addressing this, as Chorus acknowledge must happen, from an overall efficiencies and net benefits perspective.
- 5.57 The solutions in the following three sub-sections better deal with any issues, instead of increasing the price beyond cost at the end of the moratorium.

Any IPP problem can be solved by going to FPP

- 5.58 Chorus submits that there is a high level of regulatory risk, given the potential range of benchmarked prices. Chorus also says that, due to this risk, the Commission should err on the side of keeping the price higher.
- 5.59 The answer to that is the safety net of a more accurate FPP. It is not necessary to err on the high side for that reason. Unusually and fortunately, even without the extension of the moratorium indicated by the Minister, there is time to do this. Alternatively, the gap between the FPP process finishing and the end of the moratorium will not be lengthy. Any increase is back-dated, applying the High Court's decision in relation to TelstraClear's interconnection pricing review application.

This also enables the Commission to make a better informed decision including under s18: there will be more information available during the FPP.

²⁸ At Para 207 of its submission

Any above cost price increase should not apply for another 3+ years

- 5.60 Across the residential UFB footprint, there will not be a substantial fibre network to transition to until the period 3 to 7 years from now. If an increase is justified, that can and should happen at that point, and not earlier. The Commission can do a further price review then. It can even require that to happen by putting an expiry date on the current decision, as the Act permits.
- 5.61 Again, this enables the Commission to make a better informed decision closer to the key time. Increasing the price beyond cost cannot be justified now (and “certainty” would be illusory in doing so) relative to the efficiencies of staying with cost based pricing at this stage.
- 5.62 There is a further reason to reconsider the price in 3+ years’ time. CEG submit that the numbers of users on the copper network will fall, as users migrate to UFB. That increases the unit costs of the service and thereby, they say, increases the wholesale monthly price per user, as there are fewer users to share the TSLRIC total cost. If this in fact is the case, and the Commission applies a model based on higher unit cost, the TSLRIC price increase could be substantial.
- 5.63 The data used by CEG indicates, however, that the customer base on UBA remains largely static for at least 3 years, and then it falls in proportion to increasing fibre uptake. That is further reason to review, including for s18 adjustments, in say 3 years’ time rather than earlier.
- 5.64 We do not accept that the TSLRIC model would produce the outcomes outlined by CEG. But, regardless of that position, the prospect of a price increase, for whatever reason, should be addressed 3+ years away and not before.

Glide path

- 5.65 The last point raises the prospect of achieving certainty by regulating for a glide path with changed pricing introduced over time. This should be a customer-focussed glide path, done in a manner that does not penalise rural users outside the UFB footprint, or copper customers that will not have access to UFB for a number of years.
- 5.66 While an optimal glide path would eventually require legislation (possibly arising out of the telecommunications review) there is much that the Commission can achieve in the current framework. For example there can be a range of regulated and commercial (unregulated) copper services with different QoS and pricing (via reviews of the STDs) that both (a) encourage dial-up and POTS customers to migrate to copper and fibre broadband and (b) encourage copper customers to migrate to fibre.

Why should Chorus' problem become a problem for end-users and RSPs?

- 5.67 Chorus has contracted to deliver UFB over its footprint. Even if the circumstances have changed since it contracted, that is part of the commercial risk that it took. In effect, it is seeking to off-load its exposure – if any - to RSPs and, ultimately, end-users.
- 5.68 If that change of circumstances is so great that Chorus is at risk of failing:
- (a) That firms fail, and should fail, is a part of business life and regulatory economics;
 - (b) It is inefficient to prop up companies that should fail;
 - (c) The network would still be built as someone would acquire the distressed assets and suitable arrangements can be made with Government.
- 5.69 Of course dynamic efficiencies appropriately incentivise investment, and that is an important consideration on the net benefit analysis. But adjusting the price away from cost to prop up Chorus comes at considerable cost for end-users and RSPs, and that should not be done lightly. The case to do so must be clearly demonstrated. It has not been.
- 5.70 A careful assessment should be done transparently and, most importantly, done equitably and without departing from the regulatory system and policy. Once the problem is accurately defined and independently verified, there are likely to be a number of potential solutions of which moving price beyond cost is only one. It is wrong to pick out a single solution (copper and fibre price relativity) without defining the problem first.

Circumstances have not changed

- 5.71 In the immediately preceding sub-section of this submission we have assumed that Chorus is confronted by changed circumstances. InternetNZ is particularly concerned with the Chorus assertion that there are changed circumstances as that is not so. We are also concerned with Chorus' assertion that the current scenario with the draft UBA decision engenders "uncertainty" (the repeated Chorus catch-phrase) when the opposite is the case.
- 5.72 When Chorus signed up to the UFB agreement, it knew with complete clarity what the regulatory model would be. At some stage, sooner or later, UCLL pricing would be reviewed by the Commission (and surely by say 2016 when pricing is particularly important for Chorus). It also knew, as the Act required it, that the UBA price increment would be reviewed and migrated from retail-minus to cost.
- 5.73 Chorus must have modelled all its business cases (such as for UFB, for the overall business, and for the demerger) in considerable detail, feeding in a

range of scenarios into the modelling. Levels of returns from regulated services are critical to the business.

- 5.74 As modelling goes, estimating the likely range of TSLRIC prices for the UBA increment is one of the most straightforward. So is modelling of the benchmark proxy of TSLRIC, although the key focus would have been the ultimate price: TSLRIC on the FPP.
- 5.75 It is relatively straightforward to do the estimates, even if the UBA increment includes more than just the electronics, as Chorus contend.
- 5.76 The scenarios modelled by Chorus will have predicted the UBA increment pricing range to include the \$8.75 price point and lower. Informed commentators say that the predictable range of figures would include prices well below \$8.75.
- 5.77 There are no changed circumstances. The price point must have been in Chorus' predicted range. InternetNZ is concerned if Chorus contends otherwise: if that happens, it is submitted that the Commission should exercise its powers to require disclosure of relevant internal modelling, etc.
- 5.78 InternetNZ is also concerned that Chorus is contending that the price review creates uncertainty when the price would have been within its predicted range. Seeking early change to regulation creates uncertainty not certainty. The regulatory and contractual environment was predictable and therefore certain.
- 5.79 Chorus' request to increase the price beyond cost in those circumstances would have an unacceptable negative impact on the market, end-users and RSPs.
- 5.80 We are not encouraging failure on the part of Chorus and that would be unlikely and unsatisfactory. But in the context of overall efficiencies and net benefits, there must be limits as to how far price should be increased (and, based on an overall assessment, it should not be increased).
- 5.81 This week, Chorus has announced a \$300M blow-out on UFB roll-out. This highlights the concern that Chorus' problems are due to internal error and incorrect modelling, rather than regulatory and policy uncertainty. Of particular concern is that Chorus, having committed to the UFB contract at prices which saw Chorus selected over other competing bidders, appears now to be seeking to escape problems of its own making (by reason of faulty analysis or by any other reason) through seeking above cost regulated prices (attracting monopoly rents) from RSPs and New Zealanders. If the Commission is considering increases in price in determining the UBA price, it should first obtain verified detailed information including business cases from Chorus that prove to all parties that this is required.
- 5.82 If there are problems under the contracts between CFH/Government and Chorus, the answer is not to increase prices paid for copper services. That

is distortionary, unfair and in the end, opens a Pandora's box of on-going regulatory uncertainty (including inviting endless lobbying for future, consequential regulatory change) which is not in the interests of Chorus, the Government, RSPs or end-users. Government and Chorus should look to other solutions if there are problems.

Impacts on rural providers and end-users

- 5.83 A price increase beyond cost also increases costs for customers outside the UFB footprint, as well as costs for RSPs serving the rural community. Chorus gets monopoly rents as a result without any countervailing benefit going to rural. The digital divide increases. It is difficult to see how those outcomes can be justified, particularly as Chorus has other options available to it.

Demand side initiatives

- 5.84 Chorus (and possibly the Government) can and should develop and implement demand side initiatives to encourage migration. We appreciate that the target for these initiatives should include the RSPs. There are a number of options including for example, offering attractive product/price combinations so that UFB is attractive for RSPs relative to other options.
- 5.85 There should be no adjustment in regulated price above cost unless and until Chorus shows that demand side initiatives are insufficient to deal with the migration concerns, along with the other solutions noted above.

6. The Section 18 Relativity requirement

- 6.1 Finally, the Commission is required to consider, in terms of s18, the relativity between UCLL and UBA pricing.
- 6.2 If the UCLL and UBA prices are calculated on cost, the relativity requirement is met, as the Commission has observed.
- 6.3 Chorus agrees. It states:²⁹

“To clarify, appropriately determined cost-based prices should result in the right relativity.”

- 6.4 As with the UBA price and the obligation under s19 to consider and implement s18, there is little or no room to move from solely cost-based relativity. The same tight cost formula also applies. The relativity requirement in the service description of UBA in Schedule 1 doesn't just cover price. It also applies to non-price terms on which there is far more discretion. In short, there is a spectrum range of decisions. The Commission has s18 flexibility on non-price terms but little or no room to move on price.

²⁹ Para 217 Chorus submission

With many thanks for your consideration,

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