

CallPlus Limited

Submission on the Commerce Commission's Further Draft Pricing Review determinations for UBA and UCLL services

Public Version

13th August 2015



Overview

1. This submission is made by CallPlus, part of the M2 Group and the third largest fixed line carrier in New Zealand operating a number of brands in the retail and wholesale market including Slingshot, Flip, Orcon and 2Talk. We thank you for the opportunity to comment on the Commissions draft determination.
2. The focus of this submission is on backdating and non-recurring transactions. We have previously submitted our views on the monthly recurring charges and our concerns over the fact that the Commissions assumptions are driving a cost of layer 1 copper that is significantly higher than other countries.
3. CallPlus supports the submission made by Wigley & Company "Submission on Further Draft Pricing Review UCLL and UBA Determination" and "Submission as to revised draft UCLL and UBA FPP determinations – backdating".
4. Non-recurring costs, particularly connection costs, are a material component of the overall price as we have previously submitted. Chorus have commercial offers to spread these costs at \$5-\$10 per month as a proxy for the magnitude of these costs.
5. The Commission should not assume Chorus processes and systems are efficient, the copper network is old and the associated systems are complex, piecemeal and the accuracy of records is impacted as a result. CallPlus sees many signs of inefficiencies in Chorus processes and systems however it is often difficult to pinpoint these due to the asymmetry of information.
6. To clearly demonstrate to the Commission examples of the issues that exist ourselves, Spark & Vodafone have worked together in order to get a fuller picture – closer to what Chorus could see if they looked. By sampling recent connections where Chorus are performing 'truck rolls' to exchanges or sites we have been able to demonstrate a significant portion of 'truck rolls' that RSP's are funding should not be occurring.
7. Whilst the RSP's are looking at the mix of connections (as this is what we can see on our bills) and not the cost of the transaction itself, which is the Commissions focus, the results clearly demonstrate issues with systems and process. As such it would be wrong to take Chorus' actual costs as a reflection of an efficient operator.
8. Furthermore the Commissions model is built with adequate capacity which is factored into the monthly charge. CallPlus is of the view that Chorus' current copper network neither has the capacity nor accurate records and efficient processes. The result is constant network rearrangements which are driving operating costs that RSPs are being asked to fund. RSPs face the prospect of higher monthly charges as a result of the MEA being built to cater for demand but are hit by higher operating costs through 'truck rolls' which would not be occurring if Chorus actual network reflected the MEA. i.e. Chorus kept lines intact rather than constantly rearranging the network.

9. RSP's should not have to pay for 'truck rolls' where a premises has previously had an intact line. Connection costs are a barrier to switching and having unnecessary costs can not be in the best long-term benefit of users.
10. CallPlus supports the decision not to backdate. We can see no s18 benefits from backdating, in fact the reverse. As importantly there is nothing in the draft decision by way of very clear, demonstrable, quantifiable consumer and competition benefits from backdating. Without this it seems clear that backdating is wrong.

Non-Recurring Charges (NRC)

11. CallPlus supports the view that the current situation with Chorus and third party contractors would not represent a hypothetical efficient operator.

RSPs have seen no efficiency gains in a similar manner to Fibre!

12. If an operator is efficient you would expect to see process changes and some efficiency gains which customers benefit from. For example in the fibre world we have already seen Chorus trialling new ways to do connections:-

"Chorus is also working to improve its current fibre installation processes and has a wide range of initiatives underway.

"We know where Chorus needs to be focused, and we are working closely with the rest of the industry where we can, and we are confident that if everyone shows the right level of commitment on behalf of consumers and businesses we will make significant improvements,"

Mark Ratcliffe, Telco Review, 'Chorus UFB programme into 'the next phase' May 26, 2015

13. In stark contrast in the copper connection world we have seen little or no change other than an annual increase in costs based on CPI increase

No incentive for Chorus to minimise 'pass thru' copper costs in contrast to other network maintenance activity

Chorus uses the service companies for a wide range of task including network management tasks, fault resolution as well as the regulated services which it can pass on costs to RSP's. As the Commission has observed the outsource agreements are negotiated based on the overall costs. Chorus have little incentive to optimise costs of particular services and, in fact, would be less incentivised to lower 'costs it can pass on' than other network management tasks. The situation is further complicated by the aggregation of many activities into 'group level' items in Chorus' arrangements with its service companies.

14. The Commission is correct to look for an alternative to Chorus' actual data.

RSP 'Bill Shock' post 1 December - the number of truck rolls points to significant issues

15. There is a significant asymmetry of information between RSPs and Chorus.

16. The Commission is looking at the efficient cost of each of the regulated connection services. Whilst it is difficult for RSPs to comment on the cost of each task we can comment on the mix of connection types as we see these on our bills.
17. CallPlus believes that the number of 'non-remote' connections – i.e. those requiring a 'truck roll' either to the cabinet / exchange or site – points to significant inefficiencies in Chorus systems and processes.
18. In CallPlus' 20th February submission on the December draft decision we highlighted [para 64-68] the 'bill shock' we experienced following the 1st December where we got visibility of the Chorus connection charges. CallPlus highlighted its concerns with the mix of remote connections verses exchange and customer site visits. []CI .
19. CallPlus engaged with Chorus over the last 5 months to jointly investigate why we were seeing so many truck rolls. The project was tightly focussed on reducing the number of site visits (not exchange / cabinet visits) that we were experiencing as these were the most expensive at \$169.73 per connection.

We have already made some inroads into the number of site visits

20. The project was able to identify improvements to Chorus' process and systems which, once Chorus have implemented the changes, we expect to see a reduction of []CI% of the number of site visit billed. This is strong evidence that there are significant issues in Chorus' systems and records. Some of the insight by way of example included: -
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21. The project was not a complete review. It focussed on site visits and looked for 'quick wins'. The project did not look at exchange visits and as such is only dealing to part of the problem. We still have concerns with Chorus' 'new connection order' process.
22. By way of clarity, when we say a 'New Connection Order' this does not usually mean that the house is new and has not had a copper connection. In fact the 'New Connection Order' is the order type used the majority of the time a New Zealander moves house or a transfer where the losing service provider has not yet relinquished the service, in which case a disconnect and new connect order are processed rather than a transfer. As such new connections form the vast majority of our orders.
23. As mentioned, there is a significant asymmetry of information between Chorus and RSPs making it difficult for RSPs to pinpoint these issues. In an attempt to get a more complete picture the three largest RSP's – Spark, Vodafone & CallPlus – have worked collaboratively to demonstrate that Chorus is not operating efficiently.
24. Each RSP sampled its June UBA new connection orders and identified orders where Chorus has charged the RSP for a truck roll, suggesting that the line was not intact according to their records.

25. By comparing records with Spark & Vodafone we are able to identify if a service was operating on the line with one of them prior to the 'new connection' order. We exclude cases where the prior service was LLU based off the RSPs own MSAN as this would require a truck roll by definition.

By pooling information RSP's can see that significant numbers of 'truck rolls' are occurring where an intact should be in place

26. CallPlus, Spark and Vodafone shared information on a sample of 450 UBA connections in June. This was split across two scenarios - 300 UBA new connections (100 each) where Chorus have charged the gaining RSP for a cabinet /exchange visit (\$73.51) and 150 UBA new connections (50 each) where Chorus have charged the gaining RSP for a site visit (\$169.73).

27. The purpose of the exercise was for the gaining RSP to get the other two RSPs to look at their records and identify if they previously had a working copper service on the line (as mentioned LLU services were excluded). **If there was a service on the line previously then there should be no need for a truck roll when the gaining RSP placed the new connection order for UBA.**

28. The findings are strong evidence that significant inefficiencies exist in Chorus' processes and systems (note: the result are understated as only 3 RSP's were involved. Including Trustpower and others would increase the number of unnecessary visits)

- **At least one in four cabinet / exchange visits should not have occurred.** In 25% of the cases where Chorus charged the gaining RSP for a cabinet / exchange visit for the UBA connection one of the other two RSP's had a working UBA service in the last 6 months. Of these 17.5% had an intact in the last 3 months. Since 2014 over one third (36%) had an intact in place.
- **At least one in seven site visits should not have occurred.** In 14% of the cases where Chorus charged for a site visit one of the other two RSP's had a working UBA service in the last 6 months, 10% of these had an intact in the last 3 months. This increases to 20% if we look at a previous UBA services since 2014.

Service Date	UBA CABINET/EXCHANGE VISIT	UBA Site Visit Connect Only	Grand Total	Service Date	UBA CABINET/EXCHANGE VISIT	UBA Site Visit Connect Only	Grand Total
⊛ No Previous	50.00%	68.67%	56.22%	⊛ No Previous	150	103	253
⊛ 2005	0.00%	0.67%	0.22%	⊛ 2005	1	1	1
⊛ 2006	0.67%	0.67%	0.67%	⊛ 2006	2	1	3
⊛ 2007	0.67%	0.00%	0.44%	⊛ 2007	2		2
⊛ 2008	0.33%	0.00%	0.22%	⊛ 2008	1		1
⊛ 2009	1.00%	1.33%	1.11%	⊛ 2009	3	2	5
⊛ 2010	0.33%	0.67%	0.44%	⊛ 2010	1	1	2
⊛ 2011	1.33%	2.67%	1.78%	⊛ 2011	4	4	8
⊛ 2012	2.67%	3.33%	2.89%	⊛ 2012	8	5	13
⊛ 2013	6.67%	2.67%	5.33%	⊛ 2013	20	4	24
⊛ 2014	11.67%	5.33%	9.56%	⊛ 2014	35	8	43
⊛ 2015	24.67%	14.00%	21.11%	⊛ 2015	74	21	95
Grand Total	100.00%	100.00%	100.00%	Grand Total	300	150	450

29. RSPs can only speculate at the root cause of the problem of 'intact lines' being broken. Possible causes could be: -

- Poor network records meaning that intacts are not picked up

- Inefficient incentives for Service Companies – currently they are incented to undertake visits and visit sites and cabinets to avoid the risk of faulty connections
 - Insufficient capacity built into the network for spares or demand
30. Chorus' current network and systems are dated. Technicians are paid to perform truck rolls but technicians are not paid for connections which are found to be faulty. If technicians do not have faith in the accuracy of Chorus' network records for ports and intact lines then it is in their best interest to undertake unnecessary truck rolls as a precaution to minimise faults.
31. If Chorus has insufficient capacity in the network then it will drive the unnecessary breaking of intact lines and network re-arrangement. Scenarios include: -
- a technician looking to repair a fault and in the absence of spare ports or pairs the technician may expediently break an existing unused (at that time but about to be used) intact to a site.
 - It may be that there is simply insufficient capacity in the network for demand and, rather than invest in additional capacity, intact lines are being broken and reused driving a 'truck roll' in the following months at RSP's expense.
32. It's worth noting that almost half the UBA connections sampled had a previous intact at some point. The Commission is modelling a modern network with sufficient demand to meet the footprint so that connections to the sites are not constantly broken and reconnected. It would be unreasonable for the model to include higher capex to build such a MEA but also to retain high opex costs passed to RSPs for an under invested, inefficient current copper network.

Tools are inadequate to enable RSPs to operate efficiently?

33. VDSL is the fastest growing service in broadband over the last 12 months. It accounted for []CI% of our net growth in the last 6 months. Chorus is strongly recommending that a technician undertakes a site visit in all instances to undertake connection & wiring activity. Given the high cost Chorus offer to spread this cost for an additional \$10 per month as a commercial offer.
34. However, despite the rapid growth in VDSL, even now, **RSPs still do not have a tool that allows them to identify when the last connection and wiring was performed at a house so that we can avoid unnecessary high cost technician visit.** Of course there is little incentive for Chorus to provide such a tool.
35. Similarly RSPs do not have an accurate tool to identify intact. So we have no way to know if a 'truck roll' will be required for a connection either to the exchange or to the house. Without this it is impossible to pass through any charges on a user pays basis.
36. As we have previously submitted RSPs are in a difficult position: -
- a) The cost of the service is unknown at the point of confirming with the customer as a result of a lack of a prequalification tool;
 - b) There is no ability for the RSP to diagnose and select the appropriate action;

- c) There is no ability for the RSP to verify if Chorus were correct in electing to perform a more expensive option;
 - d) There is no ability for the RSP to verify if Chorus are correct in billing for the service;
 - e) Chorus has no incentive to improve or be efficient (or even worse are incentivised not to be efficient)
37. CallPlus recognises that some of these issues may be picked up by the s30 review however we highlight them here to reinforce that systems and tools do not support efficient operations.

Backdate

38. The Commission is correct that the s18 consideration should be their first concern in considering this issue. From a practical point of view, as the Commission notes, the 'most straight forward' is to implement a forward looking TSLIRC price from the date it is determined (or after it is determined – to provide time for RSPs to adjust their retail prices). This give RSPs a chance to adjust their business models.
39. The current assumption by CallPlus, and presumably other RSPs, is that backdating will not occur given the July draft. It is hard to see any s18 benefits associated with backdating copper prices – effectively a wealth transfer from RSPs and end-users to Chorus, a network operator who is investing in fibre regardless as part of a commercial contract with the Government.

Two 'wrongs' don't make a right!

40. The view presented by Commissioner Duignan seems to be a 'academic view' which assumes that:
- The FPP is the 'correct price' and as such should be applied from 2014.
 - That RSPs could have anticipated the price and backdate and the market quickly adopt and adjust to the new pricing ahead of a final determination
41. Commissioner Duignan implies that because of this consumers and competition are better off. This seems to CallPlus to be incorrect in that it ignores the commercial reality for RSPs and consumers.
- Even if the IPP is 'wrong' it's what RSPs based decisions on being the best information available and in line with an expected price drop from moving to cost-based modelling and the end of a three year UBA price freeze which benefitted Chorus.
 - RSPs can't predict if backdating is going to occur – ironically if we had to guess right now we would assume that there will be no backdate. The argument is self-defeating.
 - RSPs cannot guess the price that may be backdated in anticipation of the final determination. Furthermore, as explained below, unless all RSPs guess the same way the market can't adjust due to uncertainty and competitive pressure.

- Even if the FPP price is a more “efficient” price it does not mean backdating the price will promote efficiency. RSPs and end-users cannot respond to the backdated FPP price retrospectively. They can only respond to the known IPP price or an estimate of an unknown FPP price.

42. Backdating is ‘wrong’ – it doesn’t change the past, the market doesn’t have the opportunity to adjust and consumers don’t benefit from a wealth transfer from RSPs, and ultimately end-users ,to Chorus. Two wrongs do not make a right.

You can be pretty sure the FPP price is only approximately right!

43. However as the Commission observed “*some level of uncertainty is inherent in the TSLIRC model because of the many judgements required to be made when building the model*”¹. As Professor Cave observed at the Commission’s conference in June you can be “*pretty sure the result [of the FPP] is only approximately right*”.

44. Furthermore, Network Strategies, supported by evidence from WIK, have found that the draft decisions result in prices at the upper bounds of plausible TSLRIC prices.

45. The current draft FPP price is also at the high end of any international benchmarks as Spark have clearly demonstrated in their submissions. So there is little comfort or corroboration for the draft FPP price from other countries.

46. Given this it is important that there is some very clear, demonstrable, quantifiable consumer and competition benefits from backdating. CallPlus does not believe that there is anything in the draft determination that clearly makes the case for s18 benefits from backdating.

The backdate only applies to some RSP’s is a very poor precedent!

47. The Commission correctly concludes that the RSPs will bear the brunt of the backdate (although as we discuss later ultimately consumers, including fibre users, will pay through increased price or lower quality of service.)

48. The Commission recognise that impact on RSPs is material. The solution proposed is that backdate apply selectively to those RSPs the Commission think can afford it. This is a very poor precedent to set without some compelling reasons.

Game theory and scale demands means the market can’t adjust ahead of the final determination because of uncertainty and competitive constraints

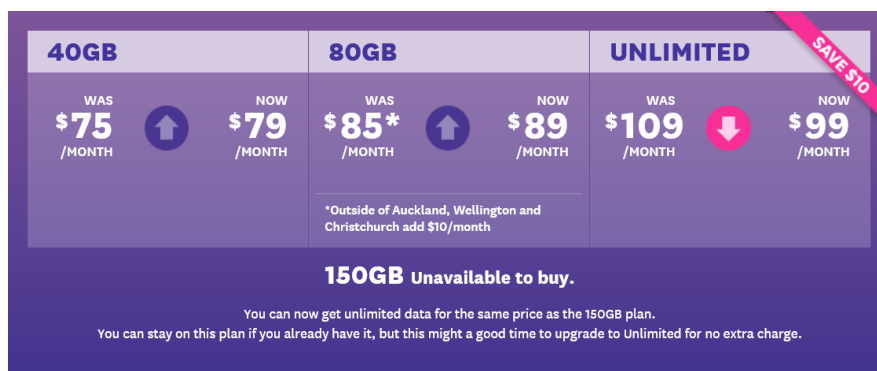
49. It’s also suggested by Commissioner Duignan that RSPs should be able to assess the amount of the final FPP and whether backdating will apply. The Commissioner suggests RSPs manage their pricing and investment decisions on that basis and that the market will therefore adjust ahead of the final determination.

50. A number of submitters have already pointed out that not even Chorus, with all their information and the modelling they have undertaken, have been able to predict the price. As we note later

¹ Para 8 of “Further draft pricing review determination for Chorus’ UCLL” 2nd July 2015

on (point on MTAS para 62) the FPP is arguably more difficult to 'guess' than a benchmarked IPP.

51. It is also ironic that any rational RSP at this time would have to assume that backdating will not apply and make its decisions on that basis – it's self-defeating. Commissioner Duignan recognises the irony of the situation².
52. Commissioner Duignan's view ignores competitive constraints and the fact that the market is unable to adjust because of the uncertainty – whereas once prices are known the market adjusts over time.
53. To explain; even if one RSP could guess correctly the outcome on price and backdate, it is almost certain that different RSPs will conclude different outcomes. The first RSP couldn't adjust its business model ahead of the final determination because other RSP's make their pricing decisions on a different set of 'guesstimates'. The first RSP is subject to competitive pressure and it risks sub-scale network utilisation and loss of market share. **The market is unable to adjust.**
54. Look at what has happened since the 19th December 2014 when the Commission issued its preliminary view that it was considering backdating and sought submissions.
55. It was 3-4 months for some RSPs to start to react. Some RSPs increased prices on some products in March to begin partially recovering the increase, some didn't. Spark the largest market participant raised the price of their entry level plans by \$4 (incl GST) BUT at the same time they dropped the price of their unlimited plans by \$10.



56. In its recent paper on price trends in the retail market the Commission in the executive summary recognise the issue for RSPs.³ "Applying the draft FPP prices reduces the RSP's margin from their post 1 December levels and leaves them in a position of not earning significant margin in any scenarios examined in this report". The report also goes on to recognise that not all RSPs are impacted by the change to the same extent with Spark generally being better off than unbundlers⁴.

² Para 901 of "Further draft pricing review determination for Chorus' UCLL" 2nd July 2015

³ Commerce Commission paper June 2015 "Price Trends in Retail Fixed Line Broadband Services, 2011-14.

⁴ June 2015 "Price Trends in Retail Fixed Line Broadband Services, 2011-14 Table 3

57. The price drop of \$10 on Sparks's unlimited plans significantly impacted CallPlus' ability to try recover increases in connection and monthly recurring charges. Unlimited plans account for []CI our broadband customer base and an even higher % of our acquisition. With Spark's \$10 drop in unlimited price we were unable to recover cost increases for a large portion of the base.

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58. Whilst some moves were made in March to begin to recover increased recurring and non-recurring charges that changed after 3 months. Since the 2nd July 2015 draft the Commission has indicated that it's not intending to backdate, noting Commissioner Duignan's view. RSPs in a competitive market have little choice but to make their investment and pricing decisions on that basis or risk losing market share and triggering an escalating cost per user from sub-scale network fixed costs such as International & national bandwidth, MSANs, Caching etc.

59. As such any further increases in price or impact on investments have likely been deferred.

Backdating the FPP creates competitive distortions retrospectively

60. As the Commission recognises in its recent paper [June 2015 "Price Trends in Retail Fixed Line Broadband Services, 2011-14] the FPP pricing impacts different RSPs to different extents, unbundlers being the hardest hit. Furthermore the Commission is even considering exempting some RSPs from the backdating. It is therefore a given that the FPP will create distortions in the competitive landscape which will take time for the market to adjust, but by definition can't adjust retrospectively if backdating applies.

Consumers both fibre and copper ultimately pay

61. If the Commission were to change its view and apply backdating then post 1 December 2015 the market would seek to recover the backdate cost either by: -

- Increasing costs to consumers over time and / or
- Reducing investments in bandwidth and caching thereby impacting the quality of service – not just copper but also fibre. CallPlus for example is actively looking at []CI

62. Ultimately consumers will pay as RSPs recover the cost of any backdate either through increased prices or less investment in speed and innovation. In fact, Spark have publicly committed to credit their customers the price increase in the event that a backdate does not occur.

Previously the Commission have leant towards glide paths to allow the market to adjust

63. Regulatory consistency is desirable. The approach to UCLL seems to be in contrast to the approach to Mobile Termination regulation (MTAS). MTAS regulation was a situation where there had been a protracted process over many years, with New Zealand being one of the last countries to regulate. Everyone knew the price would come down significantly.

64. Even with the arguably more 'predictable' situation of a drop to an international benchmark price in this instance the Commission granted a 3 year glide path : -

Para 596 MTAS determination 724 May 2011

"While operators have had considerable notice that MTR's are likely to fall, and so have had the opportunity to plan in anticipation of reduced MTR's, the final level has been uncertain up to now."

65. In CallPlus' view the UCLL FPP price that the TSLIRC model outputs is considerably more difficult to estimate than an international benchmarked MTAS IPP price when NZ is one of the last countries to regulate. In the case of mobile termination the Commission made the concession of a glide path in MTAS.

66. In fact CallPlus had expected that the Commission would give consideration to some form of glide path for unbundlers given the extent of our investment and that the averaged draft price of UCLL is increasing significantly from the IPP price. Failing that at very least the FPP price should take effect some period AFTER the final determination.