

Submission on consultation on setting prices for service transaction charges for UBA and UCLL services

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1. Introduction

- 1.1 Last week's Boost Dialogue update shows how material the service transaction charges are. From 1 December, Chorus will charge an additional \$115 (amortised by a monthly fee uplift from \$5 to \$10) for work it was doing up to 30 November without charging this (it was included in the amortised \$5).
- 1.2 \$10 is nearly half the monthly \$10.92 charge. Even the \$5 for the same work prior to 1 December is big.
- 1.3 The ability to unilaterally increase the charge by \$115 for the same work, from 1 December, clearly demonstrates use of a substantial degree of market power requiring regulation.
- 1.4 The scale of the issues on transaction charges is reflected in the other service transaction charges. Plus there are other ways in which Chorus is squeezing higher pricing, such as price points in the Boost Dialogue update. Thus they are not just side issues: they contribute greatly to RSP and end-user cost (and to Chorus revenue).
- 1.5 These are not issues on which to cut corners.
- 1.6 For completeness, we note that in our Boost 2 October cross-submission, we proposed that the \$115 increase from 1 December noted above be dealt with under s 30R. In fact there seems to be a simpler solution; just resolve the pricing on the FPP.

Summary as to the questions

- 1.7 TSLRIC prices are to be set for **all** prices in the Schedule 2s which are attachments to the UCLL and UBA IPP determinations, respectively.
- 1.8 The transaction charges are to be determined by TSLRIC, and that is not an uncomfortable approach as is suggested in the consultation document.
- 1.9 Bottom up modelling is both legally required and also the right approach to take for the optimal outcomes.
- 1.10 The prices and services can be merged, de-merged, included and excluded in monthly charges, and/or treated as bulk charges.

Structure of this submission

- 1.11 We address some process points below followed by each of the consultation paper's questions in order.

2. Initial consultation on transaction charges is helpful, but our substantive process and timing concerns remain

- 2.1 The current consultation is a first step to addressing the concerns expressed on timing and detail as to service charges.¹ That is welcome but the timing issues and concerns remain. There is so much to be done on service charges and yet we are less than two months away from the draft decision.

¹ See for example CallPlus and Orcon, Submissions by CallPlus and Orcon following the further consultation paper and the workshops, 11 April 2014, paragraph 11.1.

- 2.2 We agree with Chorus' view that if transaction charges are first addressed in the UBA and UCLL FPP draft determination, along with all of the other issues the draft determination will need to cover, there will be insufficient time to work through the issues to the satisfaction of all parties. However, transaction charges are only one, albeit important, part of the FPP determinations.
- 2.3 Consistent with our previous submissions, separately consulting on transaction charges prior to the release of the FPP draft determination will not adequately deal with the problem that there will be insufficient time to adequately work through all the issues that will be covered in the determination; particularly given the severely limited statutory timeframe for submissions. Our views on this point, including the consultation steps the Commission should undertake prior to the release of the draft determination, are canvassed in more detail in previous submissions.² Our concerns about the Commission's process and timetable remain unchanged.
- 3. It is important to ensure transaction charges link in with the monthly price modelling and don't provide Chorus with opportunities to double dip or further inflate access prices**
- 3.1 The biggest risk with consideration of transaction charges, particularly if they are considered remotely from the TSLRIC modelling process for UCLL and UBA, is the prospect of additional transaction charges resulting in an undue uplift in the revenue Chorus is able to extract for UCLL and UBA services. It appears that this is why Spark did not support a separate consultation of transaction charges divorced from the other elements of the model:³

Chorus has also requested that the Commission consult on transaction charges prior to the release of the draft determination [159]. We do not support a separate consultation of transaction charges divorced from the other elements of the model.

We accept that some transaction charges can be divorced from key asset parameters. For example, when connecting a dwelling to the network, end user customers are required to provide an open trench and Chorus charges connection charges to recover the cost of materials. At this stage, Chorus charges \$195 to install a service lead in up to 100 meters in length, plus time and materials for any additional distance [updated in 20 February 2014 Informer]. Therefore, the FPP network demarcation is at the street and the cost model would not include any lead-in costs/assets beyond the street. Accordingly, these transaction costs which do not rely on the network modelled and could be derived separately from the general model.

Conversely, some transaction charges relate to the modelled network. For example, some connection charges relate to reconfiguring the network to make capacity available for new customers or are due to

² Refer to Wigley and Company, Submission on consultation paper outlining the Commission's proposed view on regulatory framework and modelling approach for UBA and UCLL, August 2014, section "TSLRIC FPP determination process is still too truncated". Refer also to CallPlus and Orcon, Submissions by CallPlus and Orcon following the further consultation paper and the workshops, 11 April 2014, section "The Sprint, the tortoise and the hare".

³ Spark New Zealand "UCLL and UBA FPP: consultation on regulatory framework and modelling approach - Cross-submission Commerce Commission" 20 August 2014, paragraphs 158 – 161.

faults. A modern network will not require the same level of network rearrangements or faults and, therefore, we would expect an adjustment to reflect lower volumes. For example, a modern network would have sufficient capacity such that network re-arrangement would not be required to connect customers previously connected. Therefore, access seekers would not expect to be charged for these connections.

The difficulty of separating out transaction changes from this second category means that, in practice, the charge cannot be divorced from overall model design.

3.2 There are a number of ways the Commission could deal with double-dipping risk:

- (a) It could, for example, set the TSLRIC prices as the overall cap; Chorus would have to ensure that any transaction charge revenues remained within the overall revenue cap e.g. the higher the transaction charges the lower the UBA and UCLL charges would need to be to remain under the cap. This would be the safest option if the Commission relies on Chorus' service costs and allows them to be treated as a pass-through cost.
- (b) Specific assets/costs could be ring-fenced as associated with "transaction charges" and excluded from the UBA and UCLL TSLRIC cost determination or unbundled as part of the TSLRIC cost determination.
- (c) As reflected in the comments by the Commission and Spark, some of the current transaction charges could simply be removed (left at zero, where applicable) with cost recovery through the overall TSLRIC price. This would be the simplest and safest approach.

4. Q 1 and 2: Prices being reviewed on the FPP

4.1 TSLRIC prices are to be set for **all** prices in the Schedule 2s which are attachments to the UCLL and UBA IPP determinations, respectively.

4.2 The prices to be reviewed are not limited as set out on a draft basis in the draft consultation paper:

- (a) As set out at Para 20 of the consultation paper, a party "may apply for a review of that part of the determination that relates to the price to be paid for the service.": that is s 42(1) of the Telecommunications Act.
- (b) Chorus has applied for a review of all of the new Schedule 2 pricing. (That is stated at Para 7 of its pricing review application dated 2 December 2013 as they seek review of the prices in Attachment G, which is the new Schedule 2).
- (c) For various reasons, the Commission did not address all the prices in the then existing Schedule 2. But it has made a clear decision on all those prices, even though not always expressly addressed. Attachment G (namely the new Sch 2) records that decision.
- (d) A decision which is reviewable under the FPP regime includes as to prices where a decision not to change the position (which of itself is a decision).

- (e) It is unworkable for the Act to be interpreted so that only a subset of the then Schedule 2 is to be reviewed on the FPP. The effect would be that multiple prices would never get the benefit of FPP review and would be left in limbo, whether as IPP prices as determined and/or POA prices. It must have been intended that all Schedule 2 prices are reviewed and the Act should be so interpreted.

5. Q 3 and 4: TSLRIC applies

- 5.1 We do not understand why transaction charges fit uncomfortably in the TSLRIC model.
- 5.2 First, there is no choice but for them to fit into TSLRIC, because that is what the Act requires. Standard statutory interpretation requires a solution to ensure TSLRIC workably applies.
- 5.3 Second, they fit comfortably anyway. The TSLRIC definition exactly fits one off charges such as for labour, truck rolls and so on. We cannot see any reason why this is any more challenging than determining monthly charges.

6. Q 5 and 6: Chorus' actual costs are not permitted and would inflate costs/Only bottom up is permitted

- 6.1 We have submitted a number of times that the Act only permits TSLRIC pricing and that must be fully bottom up. That is the legal position and there can be no compromise on what the Act requires, on a proper construction of the Act. There is no alternative.
- 6.2 While not necessary to consider the reasons for this, there are multiple practical reasons why bottom up is required, such as:
 - (a) A hypothetical network is being modelled, not the Chorus network. As outlined in our various submissions and those of our clients, using Chorus data takes the Commission away from that hypothetical network;
 - (b) The consultation paper identifies Chorus data as the source of top down pricing with cross checks only against data from off shore (that is what Para 37 of the consultation paper states). We are surprised there is no reference to data available from more modern networks such as those of LFCs. This highlights that top down would be an even more erroneous approach as there is other, and often better, data available in New Zealand.
 - (c) Chorus data is at risk of not reflecting true TSLRIC. It does not follow at all that competitive tenders of Chorus' suppliers produces TSLRIC even if, which is not the case, Chorus' network is the proper hypothetical network. There are multiple variables, such as cross-subsidy between work categories and so on.
 - (d) But in any event an MEA that is the hypothetical will incorporate efficiencies that are not in the Chorus network, with improved OSS/BSS, and so on. Using the Chorus network is an unreliable start.
 - (e) We anticipate that RSPs will have data available showing that Chorus' charges and payments to service providers are on the high side.

6.3 Chorus' transaction charges should not be based solely on service company contracts. This would result in transaction charges based on actual cost rather than TSLRIC or the costs of a hypothetical efficient service provider.

6.4 We share the concerns raised by Spark and Network Strategies on this matter:⁴

Chorus has proposed that the transaction charges be based on service company contracts as these are the result of a competitive tender process [166]. As set out in the IPP consultations, we are not confident that service company prices are necessarily efficient and risk departing further from cost over time (depending on the incentives provided by the pricing construct).

The service company and Chorus arrangements take a whole of business view under their contracts and, accordingly, there will be overs and unders on particular services within the contract. It's wrong to assume for the purposes of the model that just because service company contract sets a specific charge for a particular service, that that charge matches the actual costs incurred for the services performed. Chorus has a strong incentive to "rebalance" charges between regulated and commercial services.

Network Strategies notes similar risks in paragraph 6.3 of its report that Chorus may have a range of bulk contracts which apply to the supply of services for regulated and non-regulated businesses. They recommend as a preliminary step that the Commission should determine which charges relate specifically to the regulated activities and then that the Commission should subsequently assess whether the charges are reasonable. Chorus should provide access seekers with cost information relating to proposed charges and there should be transparency to assure access seekers that any double recovery of overheads recovery have been or can be removed [3.3].

6.5 We also agree with Spark that if charges from its service company contracts are simply allowed to be passed-through this would not incent Chorus to operate efficiently or ensure the costs are kept to a minimum:⁵

Further, Chorus' proposed pass through does not encourage Chorus to reduce the cost for RSPs or end consumers in performing the services or ensure that service companies are correctly applying the correct charges for the services performed. If Chorus simply passes the service company costs onto RSPs "as is" and clips the ticket in the process, Chorus has little interest in challenging service company charges or service company compliance with charging arrangements.

⁴ Spark New Zealand "UCLL and UBA FPP: consultation on regulatory framework and modelling approach - Cross-submission Commerce Commission" 20 August 2014, paragraphs 150 – 152.

⁵ Spark New Zealand "UCLL and UBA FPP: consultation on regulatory framework and modelling approach - Cross-submission Commerce Commission" 20 August 2014, paragraphs 153 onwards.

6.6 Vodafone share similar concerns which we support:⁶

In our view, the calculation of transaction charges must be transparent, similar to all other modelling inputs and assumptions. It would not be reasonable for the Commission to simply accept that Chorus' assertion that charges are efficient as a basis for setting accurate activity based costs.

Chorus's contractors perform tasks for both Chorus and other entities. Contracts are likely to cover the supply of services across both regulated and non-regulated activities, in which case the Commission will require information about the activities covered in the contract fee. If contracts are written on a time and materials basis, then this would imply that Chorus does have the granularity of information required for activity based costing, or at least the contractors would have this information. Service provision costs would necessarily have been a key factor determining the commercial negotiation and agreement between Chorus and its contractors.

Chorus recommends that the Commission adds a margin to cover Chorus overheads, but this implies that access seekers will be paying both the contractor's overhead costs, and Chorus' overhead costs – a double counting of overhead costs if compared to a single HEO. We do not agree that this is a reasonable assumption, especially without more granular information on activity costing.

7. Q 7 to 11: Merging and altering transactions, and merging one-off charges into monthly charges

- 7.1 We agree with the analysis at Para 41 to 45 of the consultation document.
- 7.2 Taking a purposive approach to interpretation reinforces the analysis in those paragraphs. As above, the Commission is to review all prices in the new Schedule 2 including all transaction charges and all monthly charges. Within that framework, the Commission can re-order, merge and de-merge various existing payment categories.
- 7.3 That gives best effect to s 18 and the Act should be interpreted accordingly.
- 7.4 We have nothing to add under Question 11.

⁶ Vodafone "CROSS-SUBMISSION ON CONSULTATION PAPER OUTLINING COMMISSION'S PROPOSED VIEW ON REGULATORY FRAMEWORK AND MODELLING APPROACH FOR UBA AND UCLL SERVICES" 20 August 2014, paragraphs E1.4 and E1.5.