
# InternetNZ Cross Submission: Further Consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the Final Pricing Principle.

**30 April 2014**

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

# Introduction

Thank you for the opportunity to cross submit on issues relating to determining a price for Chorus UCLL and UBA services under the final pricing principle.

We have had the opportunity to review other submissions and having done so consider there is little to challenge our original view that the determination process is being unnecessarily rushed and that this will lead to significant problems downstream. This is not in the best long-term interest of end-users.

Submissions focus, to different degrees, on four steps:

1. Identifying the regulated service(s) for which prices are to be determined.
2. Calculating the cost of providing that service – including identifying any inefficiency that may be built in and excluding the costs of any "shared services".
3. Identifying the most efficient MEA(s) that is capable of providing a service(s) comparable to the service(s) at 1 above (insomuch as 1 and 2 above may vary it may be necessary to identify and model multiple MEAs).
4. Calculating the cost of providing the service(s) at 1 above via an MEA –i.e. by excluding all the costs of an MEA that provide additional services over and above 1.

As with other submitters we consider these four steps are largely sequential.

Despite the two workshops and subsequent submissions there continues to be a large number of unanswered questions regarding how the Commission intends to progress these four steps and even a large dose of disagreement on what the preferred basis for progressing them should be.

We have attempted to structure this cross-submission in relation to those four steps and the overarching issue of the unnecessarily rushed process.

## Executive Summary

All submissions bar Chorus' are consistent with our view that the determination process is being unnecessarily rushed; that there needs to be a greater level of understanding of the Commission's process and intentions; there needs to be substantial resolution between parties (where possible and reasonable) across a range of issues before real progress can be made; and, that it is only a matter of time before a legal challenge is made or a judicial review is sought.

The Commission is expressly appointed as the guardian of consumer welfare interests by way of s18. The Commission has received strong submissions from all submitters except Chorus that a rushed determination by 1 December is highly problematic and will lead to poor outcomes.

We appreciate that the Commission may have accepted those submissions at this point but that it cannot take action until after the cross-submissions today, as all parties must be heard first and their views considered. As a representative of consumer interests we hope that the Commission – as guardian of those interests - will quickly move after the cross submissions to set a longer time line, with additional consultation steps on sufficiently detailed material. Otherwise we, regrettably, consider that consumers' interests cannot be met.

If it assists we are happy to work with the Commission to facilitate ways to expedite these reviews and conclude this process as quickly and efficiently as possible, whilst ensuring that the process is sound.

Of particular concern is that in order to meet its self-imposed timeframe the Commission will compress the four steps and attempt to run them in parallel rather than sequentially, with consultation associated with each step. Our submission and most others consider that the proposed modelling of an MEA(s) at steps three and four should not commence before there is substantial resolution of the issues set out in steps one and two.

In contrast, Chorus submitted that it is keen to see a rushed process which would see their unique interpretation of the Act determine step one, Chorus data be used for step two and thereafter narrow steps three and four to modelling largely only the current Chorus network using the Chorus supplied data. Consequently, much depends upon reaching resolution on step one.

Chorus' unique interpretation, that the MEA must largely model the current copper/FTTN network, may ultimately have to be resolved by the courts - which would be unfortunate. If that is the case we consider it better to proceed on a broader basis and let legal action occur if it does, rather than to accept the Chorus interpretation and narrow the modelling.

We have previously proposed that there should be further discussion leading to a reasonable level of agreement on the definition of the current services particularly in "functional" terms. We continue to hope that a broad level of agreement is possible in this. However, if it is clear that Chorus is not prepared to reach any reasonable agreement, we have suggested some other options that might be considered.

In our original submission we sought to establish reasons why the Commission would wish to rush the determination process and what would be the benefit to end users of doing so. It is clear from submissions and our discussions with other parties that the majority, other than Chorus, believe that the best interests of end-users will be met by the Commission undertaking a thorough sequential process with significant opportunity for consultation.

Furthermore there is fairly broad agreement that the IPP prices are either about right or inflated. Those prices can – as they are intended to – be relied upon until such time as the FPP process is properly concluded. In this respect the issue of backdating of the determination decision is of secondary importance and should not be used as an excuse for taking insufficient time or care to reach an accurate FPP decision.

We conclude that:

**Step 1** - The regulated service(s) for which prices are to be determined may be insufficiently well defined or are not able to be separated from other services in order to allow any accurate costing of either the existing services or future MEA services.

We proposed in our initial submission that the Commission should undertake additional consultation with parties in order to reach agreement – we repeat that proposal but if, as seems likely, Chorus is unwilling to agree then we suggest that the Commission investigate other options to resolve the issue and achieve greater clarity. These might include:

- the Commission identifying the core functionality it refers to in more precise terms,
- in effect amending the application of the non-price terms of the STD under s 52(d) of the Act or if necessary
- undertake a new STD process.

These options would not be intended to attempt to redefine the service, but rather define the current service in terms that would allow it to be clearly distinguished from other services that may use the same path, or infrastructure, and to allow them to be more accurately compared with potential MEAs.

**Step 2** - Calculating the cost of providing the services, including identifying any inefficiency that may be built in and excluding the costs of any "shared services". This step should be relatively easy if step 1 is resolved but it nevertheless remains complex.

Our major concern – expressed in our submission and echoed in others – is that it is not clear from Commission papers or workshops, the basis upon which the Commission will assess the costs of the services. For Chorus, all the incentives are to maximise the costs whereas consumers will wish to see them minimised - other parties to the determination have a range of desires. The dangers are that the Commission in its haste to complete the determination by December will have to rely on Chorus data, will have little time to audit it and will err on the side of caution to avoid legal challenge. However, depending upon where the FPP price lands, it seems just as possible that parties other than Chorus might sue. Therefore, reducing the risk of Chorus suing may increase the risk of others suing.

As others have also submitted we believe as a minimum the Commission should insert an additional step into its determination process before the commencement of modelling. This step would describe accurately: the basis upon which the determination will be undertaken; what MEAs will be modelled; what service definitions will apply; and how the methodologies it intends to use to calculate and apportion costs and deal with shared services.

**Step 3** - Identifying the most efficient MEA(s) that is capable of providing a service(s) comparable to the service(s) at step 1 above. Without clarity and preferably agreement about the definition of the existing services or how those services are going to be costed and how costs are going to be apportioned identifying the most appropriate MEA is going to be immensely difficult. We have previously indicated that choice of an MEA is a circular argument namely - the Commission asks what the most appropriate MEA to model is, we respond that the lowest cost MEA is the most appropriate, the lowest cost is not known

without modelling. This leads us to the conclusion that it is in the best interest of end users to model multiple MEAs, at least to the level of granularity that enables a sufficient comparison of MEA candidates. Other submissions agree with this. All submitters, bar Chorus, are similarly of the view that modelling the current network is not an MEA and that Chorus data regarding the current network needs to be very carefully audited.

**Step 4** - Identifying the cost of providing a scorched earth FTTH (e.g. Northpower) or cellular service (e.g. 2degrees) should be relatively easy. Much more difficult in the absence of common terms and measures for service descriptions, is the calculation of any abatement to apply and the basis of that abatement.

# Comment

## Issue 1 – Service definitions

There is a significant difference of opinion in submissions between Chorus and others on the definitions of the regulated services being determined. The Commission's preliminary view supported by other submissions is that the practical and sensible way to look at a service is in terms of the core functionality it provides. Further, they say that the Commission has discretion to implement this view. Chorus' submission on the other hand primarily relies upon narrowing legal interpretation to a point where the Commission has little discretion and any future service model would have to be identical to the existing service.

It is clear that Chorus' incentives are to obtain the highest possible price for UCLL/UBA services or a future MEA service. That is understandable; Chorus' primary obligation is to its shareholders. Consumers on the other hand are incentivised to seek lower costs and better services.

Having read both the Commission / James Every-Palmer opinion and the Chorus / Chapman Tripp opinion we agree with the opinion of the Commission. It seems to us an absurd notion that the Act would be written or intend that a competitor, real or hypothetical entering the market would deploy a new network identical to the existing network which was built 50 years ago to provide an entirely different service (voice) and which has been subsequently augmented in a piecemeal manner to provide additional services such as those in this determination. A new competitor would build a network using a different design to remove inefficiencies and to take advantage of new technologies. Most importantly it would design and build that new network to provide the capability for new services that the existing network cannot provide. Those services that are provided on the existing network will be available on the new network and will only be a minor part of the new network's capabilities.

The existing services allow a certain "functionality". In our view, as long as the new "equivalent" services allow an "equivalent" functionality, they do not have to be identical to the $n^{th}$ degree.

It is clear from the Chorus submission that its strategy is to use a very narrow, and unique, interpretation of the Act and the STD – that is its right.

InternetNZ, anticipating this stand-off, recommended in its initial submission that further consultation take place in an effort to reach clarity, and if possible widespread agreement, on what service was currently provided and what MEA would be the best equivalent, rather than resorting to legal interpretations. We continue to believe that such an option is preferable.

Should Chorus wish to continue down its chosen path we consider the Commission have three options:

**Option 1** – Disregard the Chorus opinion and proceed as it intends to focus upon core functional equivalence. A risk with this approach is that Chorus will challenge the Commission through the Courts as it has in other areas.

**Option 2** – Put in place additional processes and mechanisms to bolster its own interpretation; these could include seeking a declaratory judgement; using s 52(d) in effect to make sufficient changes to the STD or undertake a full STD process under s 30R. A risk with this is it will take time and Chorus may still choose to challenge it through the Courts.

**Option 3** – Accept the Chorus opinion in order to avoid legal challenge and to meet self-imposed timeframes.

From an end-user perspective Option 3 is untenable as the best interests of end-users cannot be met by this option. It would only serve the interest of Chorus and its investors. Those interests are expressly stated not to be a consideration in s 18(2A). Only consumer welfare is relevant under s 18.

Having said this we believe that regardless of whether the Commission chooses to follow Options 1 or 2, it would still be in the interests of all parties if the Commission undertook additional consultation and outlined in greater detail:

- what it considers are the core functions;
- how it intends to isolate the regulated services from other services sharing the same path or infrastructure so that respective costs can be ascertained;
- what MEAs it considers are the most appropriate and why; and
- how it intends to measure and cost existing services against the equivalent MEA services.

In this way those parties such as InternetNZ which support the Commission's interpretation will be able to review and suggest improvements and even if Chorus disagrees with the Commission's interpretation it would also be welcome to put its perspective.

In regard to Options 1 and 2 there would seem to be three particular aspects of the service description that might be relatively easy to resolve.

The first is the separating out of different services using the same path (e.g. copper pair) or infrastructure (e.g. duct or pole) so that the different services can be separately costed. It seems to us that where there are different services such as voice and broadband sharing a similar path that they are separated already - one uses the high frequencies of the path and the other uses the low frequencies. How you would allocate costs between them 50/50 or some other formula could be the subject of discussion.

The second relates to the footprint of the existing services - there are hundreds of thousands of end users who either cannot receive a broadband service or will not take a broadband service because it is no better than a dial up service. As with the point above, it should be relatively easy to map the footprint or coverage area of the UBA/UCLL services by reference to line lengths from exchanges or cabinets or use of high frequencies.

The third is defining the existing service and the MEA equivalent service in similar terms and measures so that they can be more accurately compared. This might be more difficult to achieve easily and might require major changes to the STD under option two. For example, the current services are simply defined in the Act and STD in terms of access to and interconnection with the fixed PDN whereas contracts with LFCs to provide the UFB are defined in terms such as Mbps, CIR, PIR – terms that are much more meaningful about the capability that RSPs require in order to provide a service that end-users can understand and will wish to purchase.

This third point will be particularly relevant when it comes to the fourth step in the process of determining the price of the regulated services from the MEA. Clearly the costs of deploying new services over a MEA will include the ability to provide many services besides the services that can be provided over the legacy network. Just as costs of services other than UCLL/UBA that share paths and infrastructure need to be shared with UCLL/UBA costs,

thereby reducing regulated prices so too will the costs of the new services (beyond what the legacy network can provide) need to be removed to derive the correct cost for UCLL and UBA. This task will be much more transparent if both services are defined in similar ways.

## Issue 2 – Accurately Costing Existing Services

We consider there are significant inefficiencies in the current Chorus network and that any other MEA is likely to have lower costs and thus lead to lower prices. In that regard this step might be considered less important than the other three. However, as we and others have submitted there are significant risks, due to the timeframes proposed, that data from Chorus will be used as input not only in respect of costing the current network but also the costing of MEAs. As we have said already, Chorus' incentives are to seek the highest possible cost figures both for its current network and for any alternative MEA. Any data provided by Chorus should be thoroughly audited and the basis upon which core assets are valued made transparent.

For example, say a duct has 50 copper pairs running through it. All 50 pairs and the ducting were originally installed to provide a basic POTS voice service. A D-SLAM has been provided in the exchange which has empty ports but there are insufficient ports to accommodate all 50 copper pairs. Five of the copper pairs are using a UBA+ voice service, five pairs are using a naked DSL service; the other 40 provide just basic phone and dial up as they are so far away from the exchange that no retailer will offer a broadband service. No retail service provider will install its own D-SLAM to be able to make use of a UCLL service and none would buy UBA to service those customers.

First of all, is the cost of access and use of the duct to be calculated on replacement cost, apportioned current cost or historic cost? Secondly is the cost of the DSLAM to be shared across five lines, 10 lines, 50 lines or some other number of lines that can potentially be connected to a port? Thirdly is the cost of duct space shared by:

- 50 lines capable of meeting the current STD standard
- 50 lines capable of providing voice and dial up?
- 35 lines capable of providing voice and dial up plus five lines which only provide broadband, plus five which provide voice and broadband? Or
- 40 lines providing voice and dial up; and five lines providing voice and broadband; Or
- Other combinations of use and potential use?

Also, what of other lines and services that share the ducts such as fibre associated with the core network?

Chorus will be incentivised to maximise the UCLL/UBA components whereas end-users will wish to see them minimised.

Fourthly, on what basis is the apportionment to be calculated – the physical space taken up by the wire, the value of the service to the customer, the revenue accruing to Chorus or RSPs, or the actual use of the different services and if so how is this to be measured?

We consider that answers to these and other questions need to be answered and discussed prior to the commencement of modelling design or modelling to avoid the real danger of having to re-design and re-model as a result of flaws being identified only at the end of the modelling process rather than at the design stage.

In particular, from the information requests it does not seem that information is being sought to undertake anything like the analysis of issues anticipated for Denmark in TERA's 2013 draft Model Reference Paper, or the preceding Analysys Mason Model Reference Paper of 2010. Additionally, it seems is not intended to consult on the draft Model Reference Paper due from TERA in the next few days.

## Issue 3 – Choosing the MEA

Significant portions of submissions were devoted to this topic and most agreed with the InternetNZ submission that it would be necessary to model multiple MEAs for various reasons including:

- Multiple MEAs is the only way the Commission can be certain it has identified the MEA with the most efficient cost;
- Doubts such as those above regarding the definition of the service that will be modelled and therefore which MEA might be the lowest cost equivalent;
- Doubts regarding how different MEA costs would be abated;
- Doubts over which MEA would be the most appropriate in different geographic areas such as urban and rural;
- Doubts as to whether the same MEA would suffice for both UBA and UCLL;
- Few will accept that the current Chorus copper/FTTN network is efficient and is therefore highly unlikely to be a viable MEA – however Chorus may either seek a judicial review, appeal, or undertake its own modelling and use that to challenge any alternative chosen by the Commission if the Commission doesn't model it. Conversely other parties have strong incentives to appeal or judicially review if the Commission choses the copper/FTTN MEA.
- How different MEAs will affect the relativity between UBA and UCLL and how the Commission might deal with that relativity issue.

Having seen submissions it seems reasonably clear that, other than Chorus, most are favouring a fibre to the home MEA in urban/UFB areas - but avoiding cabinets and their associated costs; and a fixed wireless or cellular MEA in rural/RBI areas.

These would seem to be sensible approaches, especially given that in NorthPower there is a modern FTTH network to model from and in 2degrees or Vodafone relatively modern cellular networks. Whether the boundaries between urban and rural are sufficiently clear (or depending upon the current UCLL/UBA service definitions whether there are any boundaries) might suggest that cellular/fixed wireless may need to be modelled on a nationwide basis or as Telecom has suggested resolved by using a cap or caps.

We observe that there has been little discussion in submissions between variants of FTTH and wireless MEAs. For example in the case of FTTH the variants of GPON or point to point and in wireless the variants of fixed versus cellular. In the case of GPON versus P2P it appears to be a relatively even balance between respective pros and cons. In the case of fixed versus cellular however the additional costs of "mobility" (e.g. hand over, and particularly spectrum) contained in cellular costs may need to be discounted if a cellular MEA is chosen. We note that any additional difficulty in modelling the Layer 1 and Layer 2 split in GPON relative to P2P is not a reason to use a P2P MEA. Getting the efficient MEA is the key driver. Estimating considerations for the unbundled split are minor considerations and can and should be managed.

## Issue 4 - Calculating the Cost of Providing the MEA Service and Abatement

The step of calculating the cost of providing the service over the MEA, while a massive and lengthy process, should be relatively straightforward although as we noted in our original submission the risk of minor modelling errors or use of incorrect data might lead to major scaling errors. We also thought that data provided by Chorus would require significant auditing or verification.

If P2P and particularly wireless MEAs are to be considered it would require a rethink of TERA's proposed route modelling of follow existing street/road routes in the same way an FTTN MEA might.

We consider that the major complication at this step is reaching agreement upon how any abatement might apply. Chorus submit that there should be no abatement while we would submit that there should be significant abatement.

As with other problems identified in this cross-submission there are a lot more questions than answers. The only solution we can propose is continued exploration of the issues before commencing any modelling – preferably with the Commission presenting "strawman" proposals for discussion and agreement.

## Issue 5 – Process and timing

As we have mentioned consistently throughout this determination process, we consider the best long term interests of end-users are served by the Commission undertaking a detailed and thorough process.

We said in our submission on this issue of timing that the Commission should not self-impose a deadline of 1 December 2014 for completion of the final pricing principle (FPP) pricing review determinations.

The reasons to take a more careful and considered approach include:

- The need to make a sound decision rather than an early decision;
- The desirability of reaching a substantial level of agreement – or at least clarity about areas of disagreement and clear resolution – between the parties on major components of the pricing model before modelling commences;
- Recognition that the relatively simple IPP process took approximately two years to complete and was still subject to legal challenge by Chorus;
- In the absence of agreement on the major components of the pricing model the need to ensure that there are minimal avenues open for down-stream judicial review of the decisions made by the Commission;
- The dangers of choosing MEAs that are easier to model rather than MEAs that are the most relevant;
- The length of time necessary to accurately model the costs of the current Chorus network in the absence of any resolution on the breakdown and apportionment of those costs;

- The length of time necessary to model multiple MEAs for multiple services in the absence of any agreement on what are the correct MEAs;
- The dangers of putting all eggs into the one basket of a complex modelling process;
- The length of time required to obtain accurate information on the costs of various MEAs and the ability to audit those costs, particularly if needing to seek information from incumbent providers or from overseas;
- The need to allow all parties sufficient time to make submissions given asymmetric resources, incentives and access to information of the interested parties;
- Delays already being experienced in the review.

For a number of reasons we are not convinced of the necessity to meet the 1 December deadline:

- We consider the Commission has already met the Act's requirement to make every effort to complete the pricing determination;
- Achieving the 1 December deadline does not increase certainty for anybody, indeed it increases uncertainty because a rushed process is more likely to be wrong, more likely to be legally challenged or result in government intervention;
- There are mechanisms by which the Commission can reduce uncertainty such as increased modelling, seeking greater level of prior agreement, completing the two (UBA and UCLL) determinations together. However these options will in and of themselves require more time;
- The presentation of the TERA price modelling showed little evidence that the model will be able to provide sufficient cost accuracy to avoid subsequent dispute or litigation.

To this summary we would add that we have seen nothing in other submissions that contradicts these points and indeed many, if not all, were made by other submitters – including in part by Chorus.

Our biggest concern is that the Commission is unnecessarily rushing this process and has to-date provided little explanation as to why.

We would like to emphasise that the purpose of the Telecommunications Act is to promote competition for the long term benefit of end-users. It is not to incentivise investment or to provide certainty to investors.

As a voice for end-users in New Zealand we would respectfully ask the Commission to defer the modelling of the MEAs until such time as there is either substantial agreement from parties on the four steps discussed above or until the Commission has put forward clear proposals for the determination process and they have been tested – if necessary through the Courts.

In the meantime we consider that the prices derived through the IPP are sufficiently accurate to be used. We continue to believe:

- that the decision whether to backdate the FPP prices or not is at the Commission's discretion.
- that there should be no backdating even if the FPP price comes down from the IPP.
- that the Commission is obliged to look at this through S 18 eyes and in those terms if the price falls there should be backdating and if it rises there shouldn't. Nevertheless this issue is much less important that getting the FPP right and it should not have any

influence or provide any incentive on the Commission to complete the FPP by December.

We look forward to participating in this process as it continues to represent the interests of end-users and the wider Internet system within New Zealand.

With many thanks for your consideration.

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