

The Chair
Cabinet Economic Growth and Infrastructure Committee

REVIEW OF THE TELECOMMUNICATIONS ACT 2001: FINAL POLICY DECISIONS
FOR FIXED LINE COMMUNICATIONS SERVICES

Proposal

- 1 I propose that Government agree to final policy decisions on reform to fixed line communications regulation, and to issue drafting instructions to amend the Telecommunications Act 2001 (the **Act**) accordingly.
- 2 There are three relevant markets that the overall policy package will address:
 - the market for ultra-fast fibre (**UFB**) fixed line services, which is growing as the Government and its partners continue to roll out the UFB programme and its extension programme;
 - the market for copper fixed line services, which has matured and is now reducing in size as customers migrate to UFB services and other technologies where they are available; and
 - the market for mobile services, which is served by three operators and is continuing to grow in speed, coverage and capability, including the development of 'fixed wireless' services which provide high quality broadband using wireless technology.
- 3 In October 2015, the Government announced a bold new connectivity target for areas outside the current UFB footprint. Under this target virtually all New Zealanders, regardless of where they live or work, will be able to access broadband at peak speeds of at least 50 Mbps. To achieve these goals, it is important that the regulatory regime is predictable, stable, and that network owners have the right incentives to invest and expand their networks. A regulatory framework that supports efficient private sector investment should decrease dependence on government intervention to drive network upgrades and meet the growing needs of consumers.
- 4 In formulating the proposals in this paper I have been mindful of regulating activities only to the extent necessary to address a lack of competition. The proposed framework applies regulation proportionately by allowing competition to drive consumer outcomes where there is scope for doing so, and by using regulation to achieve similar outcomes in areas where competition is weak or absent.
- 5 In April 2016, Cabinet decided to proceed with a move to a utility-style regulatory framework for fixed line (UFB and copper) communications services, and to other high level aspects of a reform package.

- 6 I am presenting this policy package to Cabinet in two parts:
- this paper seeks agreement to the key policy settings that define the pricing of wholesale fixed line services. The detailed settings are set out in the recommendations in this paper, and described in the Annex; and
 - a second paper that I intend to bring to Cabinet early in 2017 will seek agreement to proposals for mobile markets, and dealing with non-price issues such as dispute resolution, fault rectification and installation service levels.

Background

The Telecommunications Act review

- 7 The Act provides the underlying economic regulatory settings for communications markets in New Zealand. Under section 157AA of the Act, the Minister for Communications must commence a review of the regulatory framework (the **Review**) by 30 September 2016, and use best endeavours to complete the Review by 31 March 2019.
- 8 In September 2015, I released the discussion document *Regulating Communications for the Future*. This document took a broad look at the underlying regulatory settings for communications markets, and set the scene for reform after 2020. Responses were received from a variety of submitters representing users, retail service providers (**RSPs**) and network owners.
- 9 In April 2016, Cabinet agreed to high level policy decisions, to inform the next steps of policy development for the Review (EGI-16-MIN-0040 refers):
- a utility-style regulatory framework with ‘building blocks model’ (**BBM**) pricing for fixed line services (both copper and ultra-fast broadband (**UFB**)) will be implemented from 2020;
 - this regulatory framework will be established in the Act (rather than the Commerce Act 1986 (the **Commerce Act**); and
 - the current obligation to unbundle the point-to-multipoint parts of the UFB network from 1 January 2020 will be retained.
- 10 In July 2016, Cabinet agreed to the release of an Options Paper seeking feedback on detailed aspects of a reform package (EGI-16-MIN-0164 refers). A large number and variety of submissions were received, supported in some cases by expert reports.
- 11 Throughout this process I have given extensive consideration to the issues as they apply to this new and fast-evolving world of digital communications, and I have now finalised the proposals for post-2020 price regulation of fixed line services. Alongside the usual channels of advice and policy development my officials have been aided by an independent expert in both areas of utility and telecommunications regulation, who has provided advice on design as well as critical feedback throughout the process on officials’ advice. I am confident this represents the best package to deliver on our objectives.
- 12 While the operation of the current regime in the Act has been reasonably successful, there has been a prolonged regulatory process for the setting of

wholesale copper service prices which has driven considerable uncertainty, complexity and cost into the industry.

- 13 In contrast, the proposed pricing framework is designed to be stable and predictable and to promote the delivery of high quality fixed line communications services at fair prices for consumers. We want a framework that provides a reasonable expectation of returns in order to promote ongoing investment, but one that also limits excess profits arising from natural monopoly services.
- 14 We are in the midst of an unparalleled transformation in the capabilities of our communications services, with New Zealand well into our programme of rolling out a world-leading ultra-fast fibre broadband network to replace the aging copper network. The bulk of the UFB build will be complete by 2020, with the extension programme expected to be complete no later than 2025. These networks will be long-term infrastructure with natural monopoly characteristics, so we need a durable regulatory framework for the delivery and pricing of the underlying wholesale services. We want high-quality services with fair pricing, and we also want to provide a predictable environment to further encourage network investment so that services keep evolving.

The landscape for communications services in New Zealand

- 15 The UFB network is currently being built and operated by Enable Networks in Christchurch, Ultra-Fast Fibre in the central North Island, Northpower in Northland (Local Fibre Companies or **LFCs**) and Chorus. Chorus is a wholesale only fixed line network operator, managing both the existing copper fixed line network which serves most of New Zealand, and rolling out the bulk of the UFB network build.
- 16 The structural separation of Telecom in 2011 resulted in Chorus operating as a 'pure' wholesaler with a restriction on any retail operations. This change has removed the incentive and ability for the vertically integrated incumbent to discriminate against competitors. We are seeing vibrant competition emerging in retail markets following this change.
- 17 Chorus' copper services are already subject to price regulation under the Act. UFB pricing is currently controlled by the build contracts, which expire at the end of 2019. UFB and some copper services will be regulated under the proposed pricing framework from 2020.
- 18 Vodafone also operates hybrid fibre-coaxial (**HFC**) networks in Wellington, Christchurch, and Kapiti, and there are some commercial operators providing fibre services (usually to business and enterprise clients) in competition with the UFB and copper networks. These networks do not have significant market power and have not been regulated under the current regime. The Commerce Commission (the **Commission**) is able to recommend regulation of these services if required, and I am not considering imposing additional regulation of these services through this process.
- 19 Vodafone, Spark and 2degrees operate competing mobile networks covering most of New Zealand. Vodafone and Spark also offer fixed wireless services. These networks are subject to various forms of control including regulatory and open access obligations under the Act, contractual requirements and requirements imposed through spectrum auctions. At this stage I am considering the commercial conditions in the mobile roaming and mobile virtual network operator markets, and will present proposals on how to best promote ongoing

innovation and diversification of service provision in the mobile market in a second Cabinet paper that I will bring to Cabinet early in 2017.

Scope of the policy package

- 20 The proposals in this paper will introduce a new pricing framework for UFB and copper services which will operate from 2020 alongside the existing regulatory framework that will apply to all other forms of communications services (for example mobile).
- 21 The proposals focus primarily on the UFB networks operated by Chorus and LFCs (collectively referred to as the **UFB providers**) and on parts of Chorus' copper network. Services delivered on these networks are referred to as **fixed line services**. The package will also apply to UFB networks which will be rolled out under the extension to the UFB programme.
- 22 UFB wholesale pricing is currently controlled by the build contracts with Government, which expire at the end of 2019. Following the decisions made by Cabinet in April, UFB providers will from 1 January 2020 be subject to a new utility-style regulatory framework. This framework will be based on Part 4 of the Commerce Act (**Part 4**) which applies to electricity distribution businesses, gas pipeline companies, airports and Transpower, but will be contained in the Act alongside the existing regime for communications services. It will be administered by the Commission.
- 23 The fibre pricing framework will apply the following forms of regulation to Chorus' UFB network from the start of 2020:
- **information disclosure regulation**, which ensures that sufficient information about the performance of regulated suppliers is readily available; and
 - **price-quality regulation**, where constraints on revenues and prices, and requirements for service quality are placed on regulated suppliers.
- 24 LFCs will be subject only to information disclosure regulation from 2020 for their UFB networks, with monitoring and oversight by the Commission. Should indications of monopolistic behaviour by LFCs emerge, the Commission will be able to take steps to make one or more of them subject to price-quality regulation if a backstop 'intervention test' is met (after 2020). The LFCs face more competitive constraint on their services than Chorus does, and I believe this proportional approach is justified.
- 25 A full outline of the matters covered in this paper is set out in the Annex.

Pricing framework for UFB fibre services

- 26 Price-quality regulation of UFB services will consist of an annual 'maximum allowable revenue' (otherwise known as a 'revenue cap') for the regulated supplier, calculated as a sum of various network and financial 'building blocks' of costs. This revenue cap should be sufficient to cover all of the supplier's efficiently incurred costs without putting it in a position to earn excessive profits. This is a standard approach used within Part 4 of the Commerce Act for other utilities. The Commission will have an obligation to spread revenue increases over a regulatory period (or multiple periods) by altering the asset depreciation path, in order to "smooth" any changes in revenue, to avoid price shocks.

- 27 In addition to the revenue cap, suppliers subject to price-quality regulation will be required to provide two regulated 'anchor' products with price and quality terms set by the Commission. These anchor products can be requested by an RSP and must then be provided by the regulated supplier. Initially, there will be a basic broadband (100/20Mbps) anchor product and a voice-only anchor product. This is to ensure that the most common residential voice and broadband services are available at reasonable prices on the network, and to create a price and quality 'anchor' for the other services provided by the regulated supplier. I propose that anchor product prices be set at 2019 UFB contract levels, increasing at the rate of CPI until the first price review (2023).
- 28 Subject to the revenue cap, suppliers subject to price-quality regulation will otherwise have flexibility to develop and update their wholesale products in response to RSP preferences and market developments. I believe this flexibility is important in the fast-evolving market for broadband services, but must be balanced against the need for some basic protections for consumers.

Pricing framework for copper services

- 29 I am proposing a pricing framework for copper services based on a 'grandfathering' approach. This recognises that the copper network is near the end of its life and is ultimately being replaced by the UFB network, with the exception of rural areas where UFB is not currently being rolled out.
- 30 Outside areas where UFB or other fibre is available, Chorus will be required to continue supplying copper services at prices that will be capped at 2019 levels without ongoing adjustment for inflation (until such time as deregulation occurs). Inside areas where UFB or other fibre is available, the copper will be deregulated, leaving Chorus free to continue operating it or close it down. Closing it down will be subject to some minimum customer protection requirements (consistent with this, the Telecommunications Service Obligation will also be removed inside UFB areas).
- 31 The price for copper services has already been set by the Commission in a protracted and complex process. I consider it would be destabilising and unnecessary to repeat this process for copper prices post-2020. Including copper in the pricing framework for UFB services would introduce significant complications, lead to an atypical application of the 'building blocks model', and create considerable market uncertainty.
- 32 In contrast to the Chorus fibre network, its copper network will not be covered by a revenue cap-based framework (as described in paragraph 26). This means that, should Chorus lose a copper customer to a competing network, it will not receive any ongoing revenue for that customer. For example, an increasing number of rural customers can now receive 'fixed wireless' broadband and voice services provided on mobile networks, and Chorus faces customer loss to these newer services. Under this proposal, Chorus will have an incentive to respond by upgrading its network or lowering its prices.
- 33 I propose this arrangement be reviewed in 2023 to ensure it remains fit for purpose (the review would provide the opportunity to consider future copper deregulation on an ongoing basis or continued regulation).
- 34 This approach will provide an incentive for Chorus to expand its fibre footprint (subject to Commission efficiency tests) so that such investment can be included

in its fibre RAB, and so that its pre-existing copper services in areas that remain subject to a price cap can be replaced with fibre over time.

Risks

- 35 The most significant risk will be uncertainty around the relative level of fibre prices. For example, if fibre uptake is lower than expected, there will be fewer fibre customers from whom the cost of fibre can be recovered. Significant changes in wholesale pricing during the transition could negatively impact on private sector investment and on outcomes for consumers.
- 36 The risk of price rises for users of the ‘anchor’ products is removed by setting the price for those products at 2019 levels, at least for the initial regulatory period. Remaining users will be protected against significant price rises by requiring the Commission to spread Chorus’ revenue recovery into the future (by altering the asset depreciation path, which is a standard approach in Part 4 of the Commerce Act). Fibre uptake at 2020 and thereafter would need to be significantly lower than forecast in order to pose a risk of a price shock for these users. This is an orthodox approach within utility regulation, particularly where a newly built network is not fully utilised.
- 37 While I believe the overall package will be well received, some aspects may be controversial with some stakeholders:
- the proposal to deregulate copper services may be controversial, as copper customers in fully-fibred areas could face price rises. However, fibre and other broadband technologies will be available in these areas, which will act as a constraint on any copper price increases because they provide affected consumers with the option to switch; and
 - some RSPs have argued that there should be a price-regulated unbundled fibre product required from 2020 (as opposed to following a Commission investigation and recommendation, as I am proposing).

Next steps

- 38 If Cabinet agrees, I intend to undertake further consultation on the policy positions set out in this paper.
- 39 Following this, I intend to make public announcements, and my officials will issue drafting instructions to amend the Act in order to implement the proposals.

Consultation

- 40 The Ministry of Business, Innovation and Employment has consulted the following agencies on this Cabinet Paper: The Treasury, the Ministry of Culture and Heritage and Te Puni Kokiri. The Department of Prime Minister and Cabinet has been informed.
- 41 Treasury supports the proposals and notes that further substantive decisions about implementation details will be delegated to the Ministers of Finance, Economic Development, and Communications. Treasury notes that the proposal departs from Ministers’ previously-consulted option and considers that the risks of uncertainty arising from regulatory discretion over implementation detail outweigh any timing risks. Given the changes relate to creating a new and reasonably

technical regulatory regime, Treasury recommends Ministers agree to a final public consultation process where draft legislation can be tested by stakeholders and interested parties ahead of introduction, in line with the July 2015 *Government Response to the New Zealand Productivity Commission Report on Regulatory Institutions and Practices*.

- 42 However, while there will be further opportunity for detailed comment, I do not support an exposure draft process as it would likely delay the introduction of legislation by more than three months, making a first reading unlikely in advance of the period of restraint that precedes an election in an election year. This would introduce regulatory uncertainty and add to the risk that the new framework is not ready to operate by 2020. Such a delay would be of greater detriment to the industry and consumers than any likely additional benefit of an exposure draft process.
- 43 The Commission has also been consulted and has no major concerns regarding implementation of the proposed approach. Further matters of interpretation will be addressed through planned implementation discussions.

Financial Implications

- 44 The implementation of this policy package will have financial implications.
- 45 There will need to be increased resourcing for the Commission for it to implement the new pricing framework. Advice from the Commission is that the implementation of the framework prior to 2020 is estimated to require an additional multi-year appropriation of [REDACTED] in the baseline requirement for Vote Communications. This includes 10 FTE and approximately [REDACTED] for external advice. Any final budgeting decisions will be subject to a satisfactory business case being prepared by the Commission, which will include examination of additional development costs and associated regulatory obligations.

Human Rights

- 46 The proposals in this paper do not raise any inconsistencies with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Legislative Implications

- 47 These proposals have immediate legislative implications. This is in the form of amendments to the Telecommunications Act 2001.
- 48 I have lodged a legislative bid for the 2017 Legislation Programme for the Telecommunications (New Regulatory Framework) Amendment Bill with a Category of 3 in 2017.

Regulatory Impact Analysis

- 49 The Regulatory Impact Analysis (**RIA**) requirements apply to the proposal in this paper and a Regulatory Impact Statement (**RIS**) has been prepared and is attached.
- 50 Treasury's Regulatory Quality Team has reviewed the RIS prepared by MBIE and associated supporting material, including an earlier RIS in which a wider range of feasible options was examined and narrowed down. The team considers that the

information and analysis summarised in the RIS meets the quality assurance criteria. The evidence and analysis provided is sufficient to provide confidence in the high level decisions being proposed at this stage. However, consultation shows that the detailed design and manner of implementation of these decisions will be critical, and that stakeholders continue hold a range of views on these. Continuing stakeholder engagement should help to inform high-quality decisions and stakeholder acceptance of those details.

Publicity

- 51 The communications approach around this paper and associated issues will be managed by my office, in consultation with other offices as appropriate. The RIS will be published in due course.

Recommendations

The Minister for Communications recommends that the Committee:

1. **Note** that in September 2015, the Minister for Communications consulted on the regulatory settings for communications markets after 2020.
2. **Note** that Ultra-Fast Broadband (**UFB**) pricing is currently controlled by contracts, which expire at the end of 2019, and there is widespread support for the Government to set in place a building blocks (**BBM**) pricing regime after that date.
3. **Note** that in April 2016, Cabinet made high level decisions in relation to the new pricing framework (EGI-16-MIN-0040 refers):
 - 3.1. to move to a utility-style regulatory regime with a BBM pricing methodology for UFB services from 1 January 2020;
 - 3.2. if BBM price control is implemented for Chorus' UFB services, that it also be implemented for its copper services;
 - 3.3. that these regulatory settings be established in the Telecommunications Act 2001 (the **Act**) (rather than the Commerce Act 1986 (the **Commerce Act**));
 - 3.4. that the current obligation to unbundle the point-to-multipoint parts of the UFB network from 1 January 2020 be retained; and
 - 3.5. that the Government support a policy of maintaining price stability in the transition to a new regime.
4. **Note** that in August 2016, Cabinet agreed to the release of an Options Paper seeking input on detailed implementation matters for the pricing framework, and in September submissions were received on this Options Paper.
5. **Note** that following analysis of submissions and receipt of external advice, myself and my officials have resolved a detailed policy package implementing the pricing framework.
6. **Note** that this paper covers the pricing framework for fixed line services, and the Minister for Communications intends to separately bring proposals to Cabinet in early 2017 relating to mobile markets, and dealing with non-price issues such as dispute resolution, fault rectification and installation service levels.

Structure of these recommendations

7. **Note** that recommendations 8 to 55 relate to the fibre pricing framework, and the pricing framework for copper services is separately addressed in recommendations 59 to 71.

Objectives and purpose

8. **Note** that the objective of introducing a new pricing framework is to apply predictable and well-understood regulation to wholesale fixed broadband infrastructure that has inherent natural monopoly characteristics, for the long term benefit of end-users of communications services in New Zealand.
9. **Agree** that the purpose of the pricing framework will be to promote the long-term benefit of end-users in markets for fixed line services by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated fixed line access services:
- 9.1. have incentives to innovate and to invest, including in replacement, upgraded, and new assets;
 - 9.2. have incentives to improve efficiency and provide services at a quality that reflects end-user demands;
 - 9.3. share with end-users the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
 - 9.4. are limited in their ability to extract excessive profits.

Pricing framework for fibre services

10. **Agree** that the pricing framework for fibre will comprise an initial regulatory period of three years (2020-2023) followed by repeating regulatory periods of a length to be determined by the Commission (within a range of 3-5 years).
11. **Agree** that the pricing framework for fibre will consist of two forms of regulation – information disclosure regulation and price-quality regulation.
12. **Agree** that all regulated suppliers (that is, Chorus, Ultra-fast Fibre, Northpower Fibre and Enable Networks plus any new LFC created as part of the UFB extension programme) will be subject to information disclosure regulation from 1 January 2020 onwards.
13. **Agree** that Chorus will additionally be subject to price-quality regulation from 1 January 2020 onwards.
14. **Agree** that the Act include a new Schedule that lists regulated suppliers and the forms of regulation they are subject to, and a process for introducing or removing suppliers from the Schedule and for modifying the form of control of a regulated supplier listed in the Schedule.
15. **Agree** that there will be an intervention test for the introduction of price-quality regulation for regulated suppliers that are subject only to information disclosure, which can be applied by the Commission at any time.

16. **Agree** that this intervention test be based on an equivalent intervention test for introduction of price-quality regulation to consumer-owned electricity lines businesses in section 54H(2)(b) of the Commerce Act.
17. **Agree** that the Commission regularly review whether competition has emerged for a service, market, asset or geographic location and deregulate regulated suppliers accordingly. This review is to be done prior to each regulatory period (except the first).

Input methodologies

18. **Note** that the purpose of input methodologies is to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying within the pricing framework.
19. **Note** that accordingly the high-level rules, requirements and processes for the pricing framework will be set out in the Act, and the more detailed implementation aspects of these matters will be developed, consulted on and included in input methodologies.
20. **Agree** that the framework utilise input methodologies with the same features as for input methodologies in Part 4 of the Commerce Act, with additional requirements for the matters the input methodologies must cover as required under the new framework (including quality and reliability requirements for the operation of networks).
21. **Agree** that the processes for developing, consulting on and implementing input methodologies be based on the approach in Subpart 3 of Part 4 of the Commerce Act.

Regulated asset base

22. **Agree** that the legislation will specify that each regulated fibre supplier, irrespective of the form of regulation applying to it, will have a 'regulated asset base' (**RAB**) with the following features:
 - 22.1. each regulated supplier will have a single RAB containing fibre assets used to deliver the 'fixed line access service'; and
 - 22.2. at the outset of the regulatory framework, the Commission will develop an opening value for all fibre assets in the RAB.
23. **Agree** that the opening value of each regulated supplier's RAB will be determined by the Commission on the basis of the unrecovered historic costs incurred by the regulated supplier, but only to the extent that those costs were efficiently incurred.
24. **Agree** that in determining costs incurred for the RAB, the Commission must have regard to the Government's objectives of accelerating the widespread deployment of fibre-to-the-premise and encouraging end-user uptake, including by ensuring that:
 - 24.1. efficient costs incurred as a direct result of meeting specific requirements in UFB or UFB extension programme contracts are included;

- 24.2. efficient costs of 'standard' and 'non-standard' installations are included; and
- 24.3. the value of the opening RAB is increased by the financial losses efficiently incurred by suppliers prior to 2020 to the extent that those losses arose from meeting specific requirements under the UFB or UFB extension programme contracts (including the timeframes for rollout and the prices that can be charged).
25. **Agree** that there will be a 'major capital expenditure pre-approval' mechanism where regulated suppliers will be able to seek pre-approval from the Commission for proposed capital investments that are significant (in value or nature) to be included in their RAB, in order to provide greater certainty of return on investment, based on the mechanism in place for Transpower in Part 4 of the Commerce Act. This will be developed in input methodologies by the Commission consistent with section 54S of the Commerce Act.
26. **Agree** that the RAB will then 'roll forward', adjusted for actual capital expenditure, economic depreciation, disposed or decommissioned assets, and indexed revaluations (where applicable) over time.

Information disclosure regulation

27. **Note** that the purpose of information disclosure regulation is to ensure that sufficient cost, revenue and other information about the performance of the regulated supplier is readily available to interested persons to assess whether the purpose of the new regime is being met (for example, that no monopoly profits are being earned).
28. **Agree** that information disclosure regulation be implemented in the framework with key parameters and requirements set in legislation and detailed rules for implementation being developed by the Commission in input methodologies.
29. **Agree** that, under information disclosure, the Commission be required to publish summary reports containing an analysis of the information disclosed by each supplier subject to that form of regulation, including whether suppliers are making excess profits.

Price-quality regulation

30. **Note** that recommendations 31 to 54 only apply to regulated suppliers that are subject to price-quality regulation.
31. **Note** that the purpose of price-quality regulation is to promote outcomes consistent with outcomes produced in competitive markets, in markets where there is little or no competition and little or no prospect of competition emerging, by constraining the overall revenues and the price and quality of services provided by regulated suppliers.
32. **Note** that a major feature of price-quality regulation is the fact that there are objective and measurable quality standards for the provision of services which are monitored and enforced by the Commission, and which are just as important as the price component, to incentivise ongoing quality improvements and to prevent regulated suppliers degrading quality in response to revenue constraints.

33. **Agree** that price-quality regulation be implemented in the framework with key parameters and requirements set in legislation and detailed implementation rules being developed by the Commission in input methodologies.
34. **Agree** that price-quality regulation will comprise:
 - 34.1. an annual overall 'revenue cap' set for each regulated supplier;
 - 34.2. a 'wash up' for the revenue cap, carried out prior to each new regulatory period (this is expanded on in recommendation 37 below);
 - 34.3. a requirement to provide certain 'anchor' products on price, non-price, quality and reliability standards set by the Commission; and
 - 34.4. a requirement to provide all services on the network to certain minimum quality and reliability standards.
35. **Agree** that the Commission will determine an annual revenue cap for each regulated supplier (applying for the duration of the regulatory period) at the outset of each regulatory period.
36. **Agree** that the Commission will be required to determine the annual revenue cap in a way that promotes price and revenue stability, by spreading any revenue increases over a regulatory period (or multiple periods) via altering the asset depreciation path, in order to "smooth" otherwise sharp changes in revenue affecting consumers consistent with the criteria contained in section 53P(8) of the Commerce Act.
37. **Agree** that the revenue cap will be binding on the regulated supplier, and there will be a 'wash up' if it is exceeded or not achieved, as determined by the Commission in input methodologies:
 - 37.1. if it is exceeded, then the revenue cap for the next regulatory period (or periods if necessary) will be reduced by a commensurate excess amount; or
 - 37.2. if it is not achieved, then the revenue cap for the next regulatory period (or periods if necessary) will be increased by the commensurate shortfall amount.
38. **Agree** that regulated suppliers will be required to provide certain anchor products to customer premises when requested to do so by a retail service provider (**RSP**), as long as the regulated supplier has its network connected to the customer premise, or it can reasonably be connected to the customer premise. Regulated suppliers will not be required to extend their networks only to provide an anchor product.
39. **Agree** that there will be two fibre anchor products in the initial regulatory period:
 - 39.1. a 100/20Mbps UFB broadband product; and
 - 39.2. a voice-only UFB product.
40. **Agree** that, in order to avoid the potential for sharp price changes for end-users, anchor product prices (from 1 January 2020) will be set at 2019 levels for equivalent products, and be adjusted annually at the rate of inflation.

41. **Agree** that the Commission will thereafter be responsible for updating the specifications of the anchor product set, prior to each regulatory period, to ensure that it:
 - 41.1. provides an upper limit on pricing for a product that is attractive to a large number of customers; and
 - 41.2. provides a price and quality 'anchor' for the other 'non-anchor' products provided by regulated suppliers.
42. **Agree** that the Commission will determine the price, non-price and quality terms for anchor products prior to each regulatory period (except the first), with criteria included in legislation for these decisions.
43. **Agree** that the Commission will determine minimum quality and reliability standards for the whole of the regulated supplier's network and services (applying to all types of services).
44. **Agree** that the Commission will set out these decisions in determinations in the same way as it does under Part 4 of the Commerce Act.
45. **Agree** that regulated suppliers will be free to determine the number, specification and pricing of all non-anchor products (except unbundled fibre services, as discussed below), subject to the revenue cap, the requirement for geographic averaging and minimum requirements as follows:
 - 45.1. all services provided by suppliers must comply with minimum network quality and reliability requirements that will be set by the Commission;
 - 45.2. suppliers must conduct industry consultation on price and non-price terms for non-anchor products, and commit to ongoing service development and RSP engagement; and
 - 45.3. suppliers must give at least 6 months' notice for changes to price or material non-price terms or withdrawal of non-anchor products.
46. **Agree** that, in order to enable the Commission to acquire the appropriate information for implementing regulation in accordance with these recommendations the Commission be provided with an information gathering power consistent with that in Subpart 8 of Part 4 of the Commerce Act.
47. **Note** that regulated suppliers are already required under the open access deeds of undertaking (the **Deeds**) to provide an unbundled fibre service on the point-to-multipoint (**GPON**) parts of their networks from 2020, and on the point-to-point parts of their networks.
48. **Agree** that, in accordance with the Deeds:
 - 48.1. regulated suppliers must provide the GPON unbundled fibre service from 1 January 2020;
 - 48.2. regulated suppliers must continue to provide the unbundled point-to-point fibre services; and
 - 48.3. these will not be subject to regulated price caps initially, but the revenue from these services will be subject to the revenue cap.

Commission investigation into unbundling and/or change in form of control

49. **Note** that it is important to provide a degree of flexibility within the pricing framework for fibre, and to maintain a credible regulatory threat of moving to a different form of control if necessary.
50. **Agree** to include a mechanism that, after 2023, enables the Commission to commence an investigation at any time after a certain overall threshold of fibre uptake has been achieved (for example 65%) into:
- 50.1. whether the unbundled fibre services should become price-capped anchor products;
 - 50.2. whether anchor product prices should become purely cost-based; and
 - 50.3. whether the 'form of control' should change from a revenue cap to 'price caps' (where all services provided by a supplier are subject to price caps set by the Commission).
51. **Agree** that the Commission will make a recommendation on any of the above matters and the final decision would be made by the Minister for Communications.
52. **Agree** that, in addition to the fibre uptake threshold that must be met, the Commission will need reasonable grounds to commence such an investigation, and the process and criteria for the Commission to make any recommendation to the Minister for Communications will be set out in legislation.

Appeals and claw-backs

53. **Agree** that the appeal and claw-back rights and obligations in the pricing framework for fibre be consistent with those in Part 4 of the Commerce Act:
- 53.1. input methodology determinations will be subject to merits review on the 'pure appeal' basis (but adopting a 'materially better' threshold);
 - 53.2. consistent with section 91(1A) of the Commerce Act, reviews of final determinations on price-quality paths will be limited to matters not already reviewed under an input methodology review (therefore this would be a 're-hearing' approach for these determinations);
 - 53.3. the Commission must apply claw-back when resetting price-quality paths if input methodologies change due to Court-ordered changes in an appeal process, and the amended input methodology would have resulted in a materially different price path (mirroring section 53ZB of the Commerce Act); and
 - 53.4. consistent with section 52D of the Commerce Act, if the Commission specifies a claw-back will occur, it must not place undue financial hardship on the supplier and any price shocks to end-users must be minimised.
54. **Agree** to include a provision making clear the respective roles and functions of the pricing frameworks for fibre and copper in the amended Act.

Transitional arrangements

55. **Agree** that the Commission may 'roll over' regulated copper and contracted fibre prices at 31 December 2019 for up to 24 months if it is not ready to implement the pricing framework for fibre from 1 January 2020, with the prior written consent of the Minister for Communications.

Open access deeds of undertaking

56. **Agree** that the Deeds (which continue to apply after 2020) will be retained in their current form, and that they continue to apply to all fixed line services provided by regulated suppliers (irrespective of the form of regulation applying to each regulated supplier).
57. **Agree** that the prices of anchor products be exempt from 'equivalence' obligations under the Deeds.
58. **Agree** that, where a regulated supplier has more than one Deed applying to its business, these Deeds be consolidated into a single Deed without removing any of the obligations.

Pricing regime for copper services

59. **Note** that Cabinet agreed in April 2016 to include the copper network in the pricing framework for fibre, but following further submissions and analysis I am now recommending a revised approach on the basis that it will produce better outcomes and greater certainty for consumers, investors and suppliers.
60. **Agree** to rescind recommendation 4 of Cabinet minute EGI-16-MIN-0040.
61. **Agree** that, outside areas where UFB or other (non-UFB) fibre services are available, Chorus will be required to continue providing the 'unbundled bitstream access' (**UBA**) wholesale copper broadband product as well as the 'unbundled copper low frequency service' (**UCLFS**) wholesale copper voice product (which supports the Telecommunications Service Obligation) on the same terms as it is required to do so on 31 December 2019.
62. **Agree** that the 2019 regulated prices for UBA and UCLFS, which have been set by the Commission, will be 'rolled over' annually in nominal terms and continue to apply to those copper services that remain regulated from 1 January 2020.
63. **Agree** that, on 1 January 2020, copper services will be deregulated inside areas where UFB and other (non-UFB) fibre services are available.
64. **Agree** that, after 1 January 2020, there will be a regular review mechanism whereby further deregulation of copper can take place as fibre is rolled out. Deregulation of a particular area will be subject to the Minister for Communications being satisfied that fibre is sufficiently widely available in that area.
65. **Agree** that the pricing framework for copper services be reviewed by the Commission no later than 2023 to ensure it remains fit for purpose, with the Commission making recommendations whether to continue with the arrangements or modify them (for example, by re-regulating copper services if necessary). Final decisions will be made by the Minister for Communications.

Telecommunications Service Obligation

66. **Agree** that the Telecommunications Service Obligation for Local Residential Telephone Service (**TSO**) will be removed from Chorus and Spark inside areas with UFB or other (non-UFB) fibre from 1 January 2020.
67. **Agree** that the TSO obligations will be retained on Chorus and Spark outside areas with UFB or other (non-UFB) fibre (to the outside TSO coverage footprint that applies today).
68. **Agree** that the same mechanism as in recommendation 65 above be used for reviewing the removal of the TSO obligations from Chorus and Spark.

Copper withdrawal

69. **Note** that where copper is deregulated, Chorus will have the option of withdrawing service and removing the copper network, and will be able to do this according to its own timeframes, however some minimum customer protection requirements will apply.
70. **Agree** to implement these customer protection requirements in a regulated code that applies to RSPs as well as Chorus and LFCs.
71. **Agree** the code will include certain requirements that must be met before Chorus is able to withdraw copper:
 - 71.1. the availability of fibre services to the customer premise and the ability to install a UFB connection (if necessary) at no cost (except where the connection falls outside the 'standard' and 'non-standard' installation categories) to all affected premises in a reasonable time frame, so that end-users do not face a 'gap' without service when copper is withdrawn and before UFB is connected;
 - 71.2. notice to be provided by Chorus, followed by a reasonable period of time to enable customers and RSPs to prepare before copper is withdrawn;
 - 71.3. services currently able to be provided over copper must be available over fibre (except for legacy services such as facsimile);
 - 71.4. information must be provided to customers about the change and the availability of services after the change (including in relation to the need for battery back-up on UFB services in the event of a power failure); and
 - 71.5. anchor products are available on the UFB network.

Delegation to Ministers

72. **Authorise** the Minister of Finance, the Minister for Economic Development and the Minister for Communications to make decisions on any further details or matters that arise in the implementation of the proposals in this Cabinet paper.

Next steps

73. **Agree** to issue drafting instructions to amend the Act to reflect the recommendations agreed by Cabinet herein, and any supporting amendments.

74. **Note** there will be further opportunity for detailed comment, and MBIE has advised that an exposure draft process would likely delay the introduction of legislation by more than three months, making a first reading unlikely in advance of the period of restraint that precedes an election in an election year. This would introduce regulatory uncertainty and add to the risk that the new framework is not ready to operate by 2020.
75. **EITHER:**
- 75.1. **Agree** that consultation be carried out on the core policy parameters agreed herein, without an exposure draft process for draft legislation.
- OR:**
- 75.2. **Agree** that draft legislation be exposed to public comment ahead of introduction.
76. **Note** that the Minister for Communications will report to the Cabinet Legislation Committee in early 2017 seeking agreement to introduce amending legislation.

Authorised for Lodgement

Hon Amy Adams
Minister for Communications

ANNEX

Policy package for fixed line communications services following review of Telecommunications Act 2001

Background

- 1 Communications technologies increasingly impact every part of our lives. It is important that the regulatory settings for our communications markets continue to support economic growth by encouraging innovation, investment in high quality networks, and competitive and efficient services.
- 2 The Telecommunications Act 2001 (the **Act**) provides the underlying economic regulatory settings for communications markets in New Zealand. Under section 157AA of the Act, the Minister for Communications must commence a review of the regulatory framework (the **Review**) by 30 September 2016, and use best endeavours to complete the Review by 31 March 2019.
- 3 I have undertaken an extensive consultation process in carrying out the Review. A wide-ranging discussion document was released in September 2015, and a detailed Options Paper was released in August 2016.
- 4 In April 2016, Cabinet agreed to high level policy decisions (EGI-16-MIN-0040 refers), to inform the next steps of policy development:
 - a utility-style regulatory framework with 'building blocks model' (**BBM**) pricing for fixed line services (copper and UFB) will be implemented from 2020;
 - this regulatory framework will be established in the Act (rather than the Commerce Act 1986 (the **Commerce Act**)); and
 - the current obligation to unbundle the point-to-multipoint parts of the UFB network from 1 January 2020 will be retained.
- 5 This paper seeks agreement to the key policy settings that define this pricing framework for fixed line services.
- 6 A second paper that I intend to bring to Cabinet early in 2017 will seek agreement to proposals for mobile markets, and augmenting non-price issues such as dispute resolution, fault remediation and installation service level agreements.

The Government's vision for communications

- 7 In October 2015, the Government announced a bold new connectivity target for areas outside the UFB footprint. Under this target virtually all New Zealanders, regardless of where they live or work, will be able to access broadband at peak speeds of at least 50 Mbps.
- 8 To achieve these goals, it is important that the regulatory regime is predictable, stable, and that network owners have the right incentives to invest and expand their networks. A regulatory framework that supports efficient private sector investment should decrease dependence on government intervention to drive network upgrades and meet the growing needs of consumers.

Markets for telecommunications services

- 9 There are three relevant markets that the overall policy package will address:
- the market for ultra-fast fibre (**UFB**) fixed line services, which is growing as the Government and its partners continue to roll out the UFB programme and its extension programme;
 - the market for copper fixed line services, which has matured and is now reducing in size as customers migrate to UFB services and other technologies where they are available; and
 - the market for mobile services, which is served by three operators and is continuing to grow, including into 'fixed wireless' services which provide broadband using the mobile network.
- 10 The UFB network is being built and operated by Enable Networks in Christchurch, Ultra-Fast Fibre in the central North Island, Northpower in Northland (Local Fibre Companies or **LFCs**) and Chorus. Chorus is a wholesale only fixed line network operator, managing both the existing copper fixed line network which serves most of New Zealand, and rolling out the bulk of the UFB network build. Chorus and the LFCs are collectively referred to in this paper as **UFB providers**.
- 11 Chorus' copper services are already subject to price regulation under the Telecommunications Act. UFB pricing is currently controlled by the build contracts, which expire at the end of 2019. UFB services will be regulated under the fibre pricing framework from 2020, and copper services will be partly deregulated (and partly remain regulated under a copper pricing framework) from 2020.
- 12 Vodafone also operates hybrid fibre-coaxial (**HFC**) networks in Wellington, Christchurch, and Kapiti, and there are some commercial operators providing fibre services (usually to business and enterprise clients) in competition with the UFB and copper networks. These networks do not have significant market power and have not been regulated under the current regime. The Commission is able to recommend regulation of these services if required, and I am not considering imposing additional regulation of these services through this process.
- 13 Vodafone, Spark and 2degrees operate competing mobile networks covering most of New Zealand. Vodafone and Spark also offer fixed wireless services. These networks are subject to various forms of control including regulatory and open access requirements under the Telecommunications Act, contractual requirements and requirements imposed through spectrum auctions.

Proposals

Pricing framework for fibre

- 14 Following the development of LFCs and the structural separation of Telecom and creation of Chorus, wholesale-only fixed line providers are now increasingly regarded as utilities. There is a strong case for regulatory treatment consistent with traditional utilities, by moving fixed line communications services to a pricing framework like that in Part 4 of the Commerce Act (**Part 4**), which applies to electricity lines businesses, gas networks, some airports and Transpower.

- 15 This new pricing framework is based on Part 4, which is familiar to investors, and only differs where it is necessary to recognise the unique features of communications networks and markets.
- 16 The key aspects of the pricing framework I am proposing for fibre are:
- price-quality regulation based on the ‘building blocks methodology’ (**BBM**). In utility-style regulation this tends to focus on the overall revenues of the regulated business, but can also set pricing for individual services;
 - information disclosure regulation; and
 - input methodologies for the regulatory regime (the methodologies for determining the various inputs into the calculation of regulated prices).
- 17 I propose that this pricing framework apply to Chorus’ UFB network, and the UFB networks operated by LFCs. Chorus’ copper services will be dealt with separately, as discussed from paragraph 67 below.

Input methodologies

- 18 A key feature of the fibre pricing framework is ‘input methodologies’, which are methodologies for the various inputs into the regulatory framework. I propose to require the Commission to set upfront input methodologies that bind it to the approach it will subsequently take in applying the regulatory framework.
- 19 Having input methodologies developed under the framework will provide regulated suppliers, RSPs, investors, end-users and others with a transparent and predictable guide to how regulated assets will be treated.
- 20 Input methodologies will be binding on the Commission and regulated suppliers. They must be developed prior to 2020, and reviewed no later than every seven years (mirroring the Part 4 approach). There will be a set of mandatory topics that input methodologies must cover, and the Commission will have discretion to create additional input methodologies on topics it believes are necessary.

Two forms of regulation

- 21 I am proposing two forms of regulation within the new framework:
- **price-quality regulation**, which involves the Commission developing and applying a ‘revenue cap’ to the regulated revenues of suppliers, and requiring the provision of certain regulated services (‘anchor’ products) at certain quality thresholds and within price caps set by the Commission; and
 - **information disclosure regulation**, which involves the Commission developing and implementing requirements for suppliers to disclose certain information on their regulated businesses both publicly and to the Commission.

Implementation

- 22 I am proposing that both price-quality and information disclosure regulation apply to Chorus from 1 January 2020. In my view, this is the appropriate approach because it most transparently protects the interests of end-users given the size and nature of Chorus' business.
- 23 The scale and nature of Chorus' fixed line business, and the limited competition it faces, warrants this approach. Chorus operates the entire nationwide copper network and by 2020 will operate around two thirds of the UFB network nationally.
- 24 The considerations around LFCs are slightly different, and I am proposing that LFCs are only subject to information disclosure regulation from 1 January 2020.
- 25 LFCs face a different competitive landscape, level of market power and corporate structure to Chorus. LFCs are more likely to have their pricing constrained by the market. They compete against Chorus' copper network (and in the case of Enable in Christchurch, Vodafone's HFC network as well). They also face some countervailing buyer power from the large national RSPs. Due to their ownership structures, LFCs have fewer incentives to derive excessive profits than Chorus. Both Northpower Fibre and Ultrafast Fibre are partnerships between Crown Fibre Holdings (**CFH**) and end-user-owned electricity distribution businesses, which are only subject to information-disclosure obligations under Part 4. Enable Services Limited (CFH's UFB partner for the Enable Networks LFC) is fully owned by Christchurch City Council.
- 26 Importantly, I am proposing any LFC could become subject to price-quality regulation at any time after 2020 if an 'intervention test' is met. This threat of regulation should add to the incentives considered above.
- 27 I am proposing to include a specific intervention test in legislation, which would take the form of a short-form investigation by the Commission that could be triggered by the Commission's assessment of competition, resulting in a recommendation to the Minister for Communications whether or not to introduce price-quality regulation for a particular LFC or LFCs. This will provide a safeguard should changes occur in the competitive landscape such that they need to be more heavily regulated.
- 28 I propose the fibre pricing framework include a Schedule listing regulated suppliers and the forms of regulation that apply to each, and a process for introducing or removing suppliers from the Schedule (and for modifying the form of regulation applicable to a supplier as appropriate).

Establishing the 'regulated asset base'

- 29 To implement both information disclosure and price-quality regulation, the regulator needs to first carry out a valuation of the relevant assets of regulated suppliers. This valuation determines the opening value of the 'regulated asset base' (**RAB**) and has a significant impact on the level of prices for those suppliers subject to price-quality regulation.
- 30 I am proposing that the fibre assets of regulated suppliers are included in their RABs. Valuation of these assets will be a complex exercise but outcomes should be reasonably predictable given that the costs of the assets have already been collected during the UFB rollout and disclosed to the Commission.

- 31 However, in order to minimise any residual uncertainty, I propose to provide high level direction on the approach to initial valuation of RAB assets. This will take the form of requiring the Commission to value the assets included in the RAB on the basis of the historic costs incurred by the regulated supplier, but only where these were efficiently incurred.
- 32 I propose to include a statutory definition of 'fixed line access services' which will make clear the elements that make up this regulated service. I intend to base the structure of this definition on that for 'electricity lines services' in section 54C of the Commerce Act.

Information disclosure regulation

- 33 The purpose of information disclosure regulation is to ensure that sufficient cost, revenue and other information about the performance of the regulated supplier is readily available to the regulator and interested persons to assess whether the purpose of the new regime is being met. It is an approach focussed on transparency, but which allows suppliers to operate their regulated businesses relatively freely outside the disclosure obligations. For example, there is no revenue cap or requirement to provide certain regulated products, and suppliers are free to set prices for their services.
- 34 The disclosure of relevant information enables both a supplier's customers and the Commission to assess the performance and pricing of its services. It enables customers to negotiate arrangements for service delivery against a backdrop of detailed information about the supplier, and enables the Commission to assess whether information disclosure regulation is achieving its goals or whether there are grounds to commence an investigation into introducing price-quality regulation.

Price-quality regulation

- 35 The following paragraphs 36 to 66 relate only to suppliers subject to price-quality regulation, and this only applies to UFB services.
- 36 The purpose of price-quality regulation is to promote outcomes consistent with the outcomes of competitive markets in markets where there is little or no competition and little or no prospect of competition emerging. In these circumstances, price-quality regulation constrains the overall revenues and the price and quality of services provided by regulated suppliers.
- 37 Price-quality regulation limits the ability of suppliers to earn excessive profits, provides incentives for suppliers to innovate and invest in their infrastructure, and ensures suppliers deliver services efficiently and reliably at a quality that consumers expect.
- 38 Price-quality regulation is currently included as part of the regulatory framework in Part 4. The operation of the Commerce Act framework has been durable and resilient, and stakeholders are generally comfortable with its performance. Accordingly I intend to mirror or base many aspects of the new framework for fixed line services on the approach in Part 4.

Revenue cap

- 39 When a RAB has been valued, the Commission then calculates a ‘revenue cap’ for each supplier that is subject to price-quality regulation. The revenue cap is sufficient to cover all of the various network and financial costs (‘building blocks’) that are incurred in the delivery of regulated services, and a reasonable margin, but limits excess profits. This is a standard approach used within Part 4 and enables regulated entities to earn no more revenue than is needed to cover a fair return on their regulated asset base, the depreciation costs of their assets, their operating expenditures and their tax requirements.

‘Roll-forward’ of price-quality regulation

- 40 The ‘regulatory period’ is the time frame for which the revenue cap and regulated prices are set, and is followed by a ‘reset’ and ‘roll-forward’ into the next regulatory period, and so on. I propose that the initial regulatory period be three years (2020-2023) given the unique nature of the transition between regulatory frameworks, but that thereafter the Commission have discretion to determine the appropriate length of regulatory period (within a range of 3-5 years).
- 41 The revenue cap is calculated for each regulatory period, and is updated prior to each reset. If the calculations result in a material change in the revenue cap in any given regulatory period, the Commission will be required to ‘smooth’ any change. For example, a significant upward or downward shift in the revenue cap could be implemented gradually over one or more regulatory periods, to alleviate any revenue shock to the supplier or price shock for consumers (as the case may be).
- 42 As the regime rolls forward, suppliers must comply with their revenue caps, and if the cap is exceeded in a given year then there is a ‘wash up’ which commensurately decreases the next regulatory period’s (or several periods’) revenue cap by the exceeded amount. If revenues are not sufficient to reach the revenue cap, then the ‘wash up’ occurs in the opposite manner – the revenue cap for the next regulatory period (or periods) is increased by the shortfall amount. I propose this wash up mechanism be applied by the Commission prior to each regulatory reset.
- 43 As regulated suppliers make investments, they can generally have confidence those investments will be added to their RAB, thereby increasing the value of the RAB (and enabling recovery of the investments via an increased revenue cap in the next regulatory period). This ‘roll-forward’ of capital expenditure into the RAB is a particularly attractive feature of applying BBM to telecommunications and should materially improve incentives on suppliers to continue investing in upgrading telecommunications infrastructure as compared to the status quo.

Efficiency, prudence and other financial issues

- 44 Given the high certainty of recovery of investments under price-quality regulation, there is a need to mitigate the risks of over-investment and inefficient spending. I propose that the Commission will have a role in considering both the prudence and efficiency of past investments when valuing the initial RAB, subject to ensuring that costs incurred as a result of specific requirements of the UFB or UFB extension contracts, including ‘standard’ and ‘non-standard’ UFB installations, are included and that the opening RAB value recognises financial

losses incurred by UFB providers prior to 2020. The Commission will also have a role in pre-approving future prudent and efficient expenditure and investments.

- 45 Consistent with the framework applying to Transpower under the Commerce Act, I am proposing that the Commission have a set of rules and a process for pre-approving capital expenditure that is significant (in terms of value or nature), contained in input methodologies, to ensure that it would be prudent, and to provide predictability for suppliers subject to price-quality regulation on the extent to which major investments are likely to be recovered.

Services offered by regulated suppliers

- 46 Regulated suppliers subject to price-quality regulation will have three broad categories of services¹:
- **‘anchor’ products**, which are price and quality-regulated services determined by the Commission;
 - **‘non-anchor’ products**, which includes all other fixed line services provided by the regulated supplier, except for:
 - an **‘unbundled fibre’ product**, which must be provided under the UFB providers’ ‘open access deeds for fibre services’ (the **Deeds**) from 1 January 2020 but which is priced by the supplier at its discretion.
- 47 Prices for all of the above products will be required to be ‘geographically averaged’, meaning that there must be a single price for the product within a supplier’s network (there cannot be different prices in different places on the network for the same product).

Anchor products

- 48 Suppliers subject to price-quality regulation will be required to offer certain ‘anchor’ products within their networks. The purpose of anchor products is to ensure that basic voice and broadband services are available at reasonable prices, and to create a price and quality ‘anchor’ for the other services provided by the regulated supplier.
- 49 There will be two fibre anchor products. Suppliers should have flexibility to develop and update their products in response to market developments. I believe this flexibility is important in the fast-evolving market for broadband services, but must be balanced against the need for some basic protections for consumers.

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In addition to continuing to provide the rural copper broadband and voice services (discussed further below from paragraph 67).

- 50 The two anchor products for the initial regulatory period will be specified by the Government, and thereafter the Commission will be required to update the anchor products to reflect the current requirements of the average end-user². The two initial period anchor products are:
- a 100/20Mbps UFB broadband product; and
 - a voice-only UFB product.
- 51 The Commission will determine the price, non-price and quality terms for anchor products prior to each regulatory reset. Criteria will be included in legislation for these decisions. I propose the Commission use its standard practice of issuing draft determinations for comment prior to issuing its final decisions in a final determination.
- 52 In order to avoid the potential for sharp price changes for end-users, I propose that anchor products be priced at 2019 levels for equivalent products (based on the contracted UFB prices at 31 December 2019), and be adjusted annually at the rate of inflation. This will require that the 'equivalence' obligations in the Deeds do not apply to anchor products (until such time as they are priced on a pure cost-basis, if that occurs, as discussed from paragraph 56 below).
- 53 Anchor products must be provided by regulated suppliers subject to price-quality regulation on request from an RSP, as long as the UFB network is in place and able to be connected to the relevant requesting premise (i.e. where 'communal' infrastructure is in place). Suppliers will not be required to extend their UFB networks just to deliver an anchor product.

Non-anchor products

- 54 Regulated suppliers will be free to determine the number, specification and pricing of all non-anchor products (excluding unbundled fibre products), subject to the revenue cap, the requirement for geographic averaging and some minimum requirements:
- all services provided by suppliers must comply with minimum network quality and reliability requirements that will be set by the Commission;
 - suppliers must conduct industry consultation on price and non-price terms for non-anchor products, and commit to ongoing service development and RSP engagement. Such a requirement would require regulated suppliers to publish a 'road-map' of future product development and to monitor changing end user demands; and
 - suppliers must give at least 6 months' notice for changes to price or material non-price terms or withdrawal of non-anchor products.

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I propose including a set of criteria, or a formula, in legislation for the Commission's updating of anchor products, in order to provide predictability.

Unbundled fibre products

- 55 Regulated suppliers are already required under the Deeds to provide an unbundled fibre service on the point-to-multipoint (**GPON**) parts of their networks from 2020. This obligation will continue, and so the requirements will be:
- regulated suppliers must provide the GPON unbundled fibre service from 1 January 2020 in accordance with the Deeds; and
 - regulated suppliers must continue to provide the unbundled point-to-point fibre services.

Commission investigation into regulated unbundling and/or change in form of control

- 56 I believe the regulatory framework I am proposing will create strong incentives for UFB providers to offer reasonably priced and innovative services. However, good regulatory design requires a degree of flexibility within the system. In addition, a regulatory threat of moving to a more restrictive form of control will sharpen the incentives on suppliers.
- 57 Accordingly, I propose to include a mechanism within the framework that, after 2023, enables the Commission to commence an investigation into:
- whether the unbundled fibre service should become a price-capped anchor product;
 - whether anchor product prices should become purely cost-based; and
 - whether the ‘form of control’ should change from a revenue cap to ‘price caps’ (where all services provided by a supplier are subject to price caps set by the Commission).
- 58 Certain conditions will need to be met before such an investigation could commence (for example, a certain overall threshold of fibre uptake has been achieved (for example 65%) and there are reasonable grounds in the Commission’s view that the framework is not achieving, or likely to achieve, its purpose), and the process and criteria for making any final recommendation will be set out in legislation. The Commission would make a recommendation on any or all of the above matters and the final decision would be made by the Minister for Communications.

Open access deeds of undertaking

- 59 I propose that, subject to the change to exempt anchor products from ‘equivalence’ requirements, the Deeds be retained in their current form, and that they continue to apply to all fixed line services (both UFB and copper) provided by regulated suppliers.
- 60 I propose that, where a regulated supplier has more than one Deed applying to its business, these Deeds be consolidated into a single Deed without removing any of the obligations.

Other matters

- 61 I propose including a new purpose statement for the regulatory framework which mirrors the one for Part 4 of the Commerce Act, as follows³:

The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—

- (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
- (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
- (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
- (d) are limited in their ability to extract excessive profits.*

- 62 I believe that a merits review process is appropriate for some of the Commission's decisions, because of the increased accountability it would bring to the decisions and given the long-term nature of some of these decisions in the fibre pricing framework. I propose to mirror the approach taken to merits review in Part 4 of the Commerce Act, as follows:

Input methodology determinations	'Pure appeal' merits review with 'materially better' threshold, same as section 52Z of the Commerce Act
Final determinations on information disclosure	Question of law appeal only
Final determinations on price-quality paths	'Re-hearing' merits review, same as section 91(1) of the Commerce Act

- 63 Consistent with Part 4, I propose that input methodology determinations would be subject to merits review on the 'pure appeal'⁴ basis (but adopting a 'materially better' threshold). In addition, consistent with Section 91(1A) of the Commerce Act, to avoid the issue of multiple reviews of the same subject matter, I propose that reviews of final determinations on price-quality paths would be limited to matters not already reviewed under an input methodology review (therefore this would be a 're-hearing' approach for these determinations).
- 64 Also consistent with Part 4, I am proposing a limited 'claw-back' requirement that would apply following some successful merits appeals. Claw-back is where regulatory prices or revenues are adjusted going forward to account for an earlier loss or gain from an action that was overturned by a merits review decision. For fixed line services, the most likely situation in which claw-back would occur is if an input methodology was overturned in a merits review process.

³

Note that I intend to use the phrase "end users" instead of "consumers" in the purpose statement for the fibre pricing framework, as "end users" is more appropriate in the context of fixed line services.

⁴

'Pure appeal' involves a rehearing of the case on the merits, with any new or amended input methodology substituted by the Court – or referred back to the Commission – required to be 'materially better'. No new material can be introduced to the appeal process.

- 65 Under Part 4, the Commission must apply claw-back when resetting price-quality paths if input methodologies change due to court-ordered changes in an appeal process, and the amended input methodology would have resulted in a materially different price path (section 53ZB). Section 52D of the Commerce Act specifies that when the Commission specifies a claw-back will occur, it must not place undue financial hardship on the supplier and any price shocks to end-users must be minimised. I propose to mirror this approach.
- 66 Finally, I note that the existing regulatory framework for communications services in the Act will continue in operation – it already applies to certain mobile services and continues to play an important role in healthy functioning communications markets. In order to ensure the new framework interfaces in a clear and efficient way with the existing framework (and any overlaps or uncertainty are avoided), I propose to include a section making clear the respective roles and functions of the frameworks in the amended Act.

‘Grandfathering’ approach for copper pricing framework

- 67 I note that Cabinet agreed in April to include copper services in the fibre pricing framework, but following further submissions and analysis I am now recommending a revised approach on the basis that it will produce better outcomes and greater certainty for consumers, investors and suppliers.
- 68 Chorus provides fixed line services using both its fibre network and its legacy copper network. I have decided that the fibre pricing framework should focus only on fibre, and not copper, because fibre is the technology of the future and is most likely to be the monopoly asset. Chorus has agreed under the UFB programme to ultimately replace its urban copper network with UFB, and I expect that in time it will seek to withdraw copper services where fibre is available. Copper is accordingly a transitional technology which is likely to be replaced by newer technologies in the short to medium term. I am proposing that Chorus’ copper services be treated as follows.
- 69 Outside areas where UFB or other fibre is available, Chorus will be required to continue providing the Unbundled Bitstream Access (**UBA**) wholesale copper broadband product as well as the Unbundled Copper Low Frequency Service (**UCLFS**) wholesale copper voice product (which supports the Telecommunications Service Obligation for Local Residential Telephone Service (**TSO**)). In these areas, copper customers do not have the option of switching to fibre and many have no alternative to copper at all. I note that alternative wireless broadband technologies are increasingly being deployed in rural areas to compete with the copper network, but at this stage I believe price regulation remains necessary on the copper network.
- 70 I propose that the 2019 regulated prices for UBA and UCLFS, which have been set by the Commission, should be ‘rolled over’ annually in nominal terms and continue to apply to those services from 1 January 2020. This will result in certainty that customers who cannot access fibre will not face any price increase for basic copper services (in fact they will experience a decline in the wholesale price in real terms, with no inflation adjustment to the price).

- 71 Inside areas where UFB or other fibre is available, I propose that copper services be deregulated because they are either facing competition or constrained by fibre regulation:
- copper services in areas where UFB is being rolled out by LFCs are competing with fibre;
 - copper services in areas where other third-party fibre exists (or is being rolled out) are competing with those fibre services; and
 - copper services in areas where UFB is being rolled out by Chorus are likely to be constrained by the regulated fibre prices.
- 72 I propose that there will be a regular review mechanism whereby further deregulation of copper can take place as fibre is rolled out. Deregulation of a particular area will be subject to the Minister for Communications being satisfied that fibre is sufficiently widely available in that area.
- 73 In addition, I propose this arrangement is reviewed no later than 2023 by the Commission to ensure it remains fit for purpose. The review could, for example, result in all copper being deregulated, or the copper services inside UFB areas being re-regulated on the same basis as rural copper (i.e. rolled over 2019 price caps). This review should result in a report to the Minister for Communications containing the Commission's recommendations. The final decision will be made by the Minister for Communications.

Telecommunications Service Obligation

- 74 I propose that the TSO obligations be removed from Chorus and Spark inside areas with UFB or other fibre, consistent with my stance on deregulating copper in these areas. The TSO is aimed at ensuring a basic voice service is available at a capped price, however customers inside areas with UFB or other fibre will have the choice of UFB fibre, copper, in some cases Vodafone's HFC, and up to three mobile networks for their voice services so there is no need for the TSO to continue in these areas. The TSO will be retained on Chorus and Spark outside areas with UFB or other fibre (to the outside coverage footprint that it applies to today).

Copper withdrawal

- 75 Where UFB or other (non-UFB) fibre is available, copper services will be deregulated. Accordingly, Chorus will have the option of withdrawing service and removing the copper network. Chorus should be able to do this according to its own timeframes, however I am proposing some minimum customer protection requirements will apply.
- 76 I am proposing to implement these requirements in a regulated code that applies to RSPs as well as Chorus and LFCs. I will specify minimum requirements that must be met before Chorus is able to withdraw copper:
- the availability of UFB services and the ability to install a UFB connection (if necessary) at no cost (except where the connection falls outside the 'standard' and 'non-standard' installation categories) to all affected premises in a reasonable time frame, to ensure end-users do not face a 'gap' without service when copper is withdrawn and before UFB is connected;

- notice to be provided by Chorus, followed by a reasonable period of time to enable end-users and RSPs to prepare before copper is withdrawn;
- services currently able to be provided over copper must be available over UFB (except for legacy services such as facsimile);
- information to be provided to end-users about the change and the availability of services after the change (including in relation to the need for battery back-up on UFB services in the event of a power failure); and
- anchor products are available on the UFB network.

Deregulation

77 Another important regulatory design principle is to provide for active deregulation where appropriate. I propose that the Commission be required to review whether any geographic area, service, asset or market should be deregulated prior to each regulatory reset. This would include looking at whether any competition has emerged for rural copper services such that they could be deregulated.

Transitional measures

78 There is a need to prescribe transitional arrangements that will apply in the event the Commission determines it will be unable to complete and implement information disclosure and price-quality regulation for UFB services by 2020.

79 I propose including a mechanism for temporarily 'freezing' the price and non-price terms for certain UFB wholesale products as set in the UFB contracts in December 2019 (likely the equivalent of the initial anchor product set) – to be triggered upon the Minister accepting a written recommendation from the Commission that such an action is necessary. Such a 'freeze' would be limited to a maximum of 24 months with the prior consent of the Minister for Communications. The regulated copper service prices will be 'rolled over' as proposed earlier.