Submission on MBIE Consultation Paper - Telecommunications Act Review: Post-2020 Regulatory Framework for Fixed Line Services

3 March 2017

Executive Summary

1. This submission is made by Ultrafast Fibre Limited and Northpower Fibre Limited (the **LFCs**) in response to the consultation paper issued by the Ministry of Business Innovation and Employment (**MBIE**) on 17 February 2017.[1]

2. We are generally supportive of the regulatory framework outlined in the consultation paper and the associated Cabinet Paper. In particular, we support the proposal to apply ID regulation only to the LFCs and, except where noted below, we also support the proposal that the Commerce Commission be responsible for determining the detailed rules regarding information disclosure. On this point, we propose that the current information disclosure regime is the appropriate starting point for any determinations and that we are involved in any refinement of those disclosures.

3. Overall, we believe that the proposed framework is likely to provide a good balance between incentivising the continued investment in the LFC networks, promoting product and service innovation and protecting consumers. This submission outlines our views on several topics arising from the consultation paper and answers to MBIE's questions.

Consultation on Legislation

4. We note that for timing reasons officials do not intend to consult on an exposure draft of legislative changes. While we appreciate the Government's desire to introduce the necessary legislation in a timely manner, it is also good practice to carefully review draft wording to ensure that it will be effective and avoid unintended consequences. This is all the more important in the current context because of the significant policy changes that are being implemented.

5. We consider that MBIE must ensure that a suitable process is established that will allow us to review and comment on principal aspects of the draft legislative changes. At a minimum, this consultation needs to occur before such legislation is introduced into Parliament.

Initial RAB

6. It is proposed that our initial RAB values will be determined by the Commerce Commission and that it will be possible for the Commission to include all past investments unless they are deemed to have been inefficient. We remain concerned that this approach exposes us to a risk of capital write-offs. We considered ourselves obliged to use our best endeavours to drive the uptake of fibre services in a competitive environment, not just to build infrastructure. Doing so led to a range of commercially motivated decisions that complicate the usual cost assessment. The Commission would need to consider unique risk and other contextual

[1] Telecommunications Act Review: Post-2020 Regulatory Framework for Fixed Line Services

factors that go beyond the standard parameters of economic regulation and for that reason we consider that the Commerce Commission should not be obliged to second-guess those decisions in assessing whether the capital involved was efficiently deployed.

7. We also have concerns over the precedent that would be set, were the Commission to write-off capital invested in pursuit of the government's UFB objectives. On this point, there are three issues:

a First, as we have previously submitted, our contracts were competitively tendered. We were in competition with rival providers at the time we submitted our bids and during the contract negotiation phase. So there was effective competitive pressure during the contracting stage. Moreover, from that stage onwards we had strong incentives to retain the goodwill of our counterparty, which led us to use our best endeavours to drive uptake in competition with copper, mobile and fixed-wireless rivals.

b Second, for firms subject to price-quality regulation (which excludes us), there is a policy case for the Commission having a role in screening future major investments. However the economic and policy argument for imposing ex-post write downs of capital is far more tenuous. All the more so for firms such as ours that are subject to ID regulation only.

c Third, we refer officials to our previous submissions on the initial RAB, particularly paragraphs 50-53 inclusive of our September 2016 submission,[2] which also references an earlier submission. These submissions set out in detail the categories of capital investment by ourselves and build partners that we consider need to be included in the initial RAB, with supporting reasons.

8. We also note that in setting input methodologies for energy networks in 2010, the Commerce Commission explicitly declined to continue with the previous industry practice of including an "optimisation" step in its asset valuations methodologies.[3] It would be a step away from the now well-established regulatory practices for price-quality regulated firms to now invite the Commission to consider optimisation for recently built networks.

Intervention Test

9. We acknowledge the desire of officials to ensure that, in the event that ID regulation proves ineffective in promoting the purpose of regulation under Part 4 of the Commerce Act, a method is available to readily transition to price-quality regulation. We note that no such mechanism is available for the major airports subject to ID regulation, so the proposal involves imposing more stringent constraints than are used for major airports.

[2] LFC Submission on Options Paper, 2 September 2016.

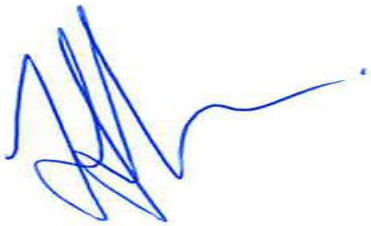
[3] See for example Commerce Commission, Electricity Distribution Services Input Methodologies Determination 2012, Consolidated Version dated 28 February 2017, Subpart 2, Asset Valuation, p112 and following.

10. We have previously submitted[4] that a two-stage intervention test should be applied because this is consistent with the current provisions for regulating firms under Part 4 of the Commerce Act. We said there should be a competition test and a cost-benefit analysis, and that it would therefore be appropriate to base the intervention test on s52G of the Commerce Act. This is an appropriate level of scrutiny for a major change in the regulatory framework, such as the decision to impose price-quality regulation on a new business.

11. By contrast, the discussion document proposes that the intervention test be based on s54H(2)(b) of the Commerce Act, which means that the Commission would need to recommend to the Minister (and the Minister would need to agree) that the purpose of Part 4 regulation would be better met if price-quality regulation were used. It is unclear whether a competition test or other threshold would be required under this approach, even though MBIE acknowledges that we have serious competitive rivals, and it does not explicitly include a cost-benefit analysis. If in the future there really are strong grounds for subjecting us to price-quality regulation then it would be relatively easy for the Commission to document those grounds through a competition test and a cost-benefit analysis. This promotes the stability and predictability of the regulatory regime and we strongly recommend that these are included in the final legislation.

Copper Services

12. We agree with the proposals regarding copper services. In particular, we consider that it is wise to distinguish between areas covered by UFB fibre and other areas, with deregulation in fibre areas and existing pricing being maintained elsewhere. In our view, this avoids regulatory intervention that would potentially be very costly and leaves competition to control pricing in UFB areas.



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[4] LFC Submission on Options Paper, 2 September 2016, especially at ¶37 – 41 inclusive.

Answers to Questions

1. ***What are your views on the proposal to deregulate copper services in areas where UFB or other fibre services are available? What do you see as the benefits and risks?***

   We support this proposal, particularly since it is also proposed that copper withdrawal be subject to a regulated code. There is some risk that end-users will be forced across to fibre services earlier than they otherwise would have, however we consider that the regulated code could potentially mitigate the resulting costs. We note that the LFCs have a Layer 2 voice-only access service, so there is no service-based risk provided that the application services required above Layer 2 for voice or data (e.g. voice communication services, internet, WAN, etc.) are made available by the retailers and we assume that policy makers are comfortable that this will not restrict retail competition.

   The main benefits we see are that fibre uptake may be somewhat faster, and that the industry will avoid a potentially very costly regulatory process for setting copper prices.

2. ***What are your views on the proposal to continue regulation of copper services outside areas where UFB or other fibre services are available?***

   We do not comment on this point directly, as it is not directly relevant to our business. However, in general we support a regulatory approach that is efficient and proportionate to the possible level of consumer harm, and it appears to us that the proposal is consistent with those standards.

3. ***What risks do you see in these proposals? Please comment on any ways you think these risks could be mitigated.***

   Again, while we have not formed a view on the specific risks involved, the proposals appear to be consistent with an efficient and proportional regulatory regime. Regarding competition issues, we continue to believe that the geographical limits on LFC operations may act as a barrier to efficient competition and that the policy rationale for these restrictions has weakened.

4. ***Please comment on the proposal to remove the TSO obligations on Chorus and Spark New Zealand inside areas with UFB or other fibre available.***

   We support this proposal and refer to our response to question 1 above. The TSO is mainly about ensuring that users in high cost areas (such as rural areas) have access to services at similar prices to those in other areas. We see the TSO as a potential barrier to fibre migration and the withdrawal of copper network assets. We believe that competition will be sufficient to keep prices reasonable in UFB areas.

5. ***What risks do you see in this proposal? Please comment on any ways you think these risks could be mitigated.***

   We refer to our response to question 1 above. We consider that there are no material risks to the proposal that cannot be mitigated as long as the LFCs and retailers continue to deliver their respective capabilities. End-users located beyond the UFB footprint will continue to have the protection of the TSO. All other users have a choice of competing network providers, including mobile-only options and

fixed-wireless, both of which are increasingly common. The TSO in its current form is no longer needed in the UFB footprint areas.

6. ***Please comment on the proposed consumer protection requirements, including your views on how each requirement should be framed (for example, how much notice should Chorus provide before withdrawing copper service?).***

   We think it is slightly early to be discussing this detail and would prefer the focus to be on the process for developing the proposed. On that point, we consider it will be important to ensure that there is a "seat at the table" for effective representation for vulnerable consumers, and for other affected stakeholders including ourselves. We support this process being led by the industry, for example through the New Zealand Telecommunications Forum (TCF).

7. ***Does the ability for end-users to switch to fibre services offer sufficient protection for consumers, in areas where copper is deregulated?***

   The availability of fibre services in these areas is a major factor in consumer protection but not the only such factor. As noted above (in response to Q.5), mobile only and fixed-wireless options also contribute to competition between communications access technologies.