Telecommunications Act Review: Options Paper

Two Degrees Mobile Limited Submission to the Ministry of Business, Innovation & Employment

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Confidential and market sensitive information

- Confidential and market sensitive information that Two Degrees Mobile Limited (**2degrees**) has included in this submission, based on the view that it can be withheld under the Official Information Act 1982, is marked in bold square brackets **[C-I-C]**. We ask that we be consulted on any request received for the release of such information.

1 Introduction

2degrees welcomes the opportunity to provide further comments on the Ministry of Business, Innovation and Employment (**MBIE**) Consultation Document, *Telecommunications Act Review: Options Paper, July 2016* (the **Options Paper**).

As a national full service telecommunications provider, with over 1.3 million mobile customers, and a growing base of fixed fibre and copper customers nationwide, 2degrees are strong supporters of the Government's 2025 vision of *"a vibrant communications environment that provides high quality and affordable services for all New Zealanders, and enables our economy to grow, innovate and compete in a dynamic environment"*, and the supporting goal of ensuring access to speeds of at least 50Mbps for 99% of the population and 10Mbps for the remaining 1%.

2degrees envisages a New Zealand where high speed mobile broadband services will be increasingly ubiquitous - with 4G, 4G+, 5G and beyond rolled out to all New Zealanders, where emerging services including the Internet of Things are widely deployed, and where the benefits of mobile are complemented by high speed fibre and fixed wireless networks.

This requires a robust and transparent regulatory framework that supports a healthy communications sector beyond two dominant retail players, and at the same time respects investor's legitimate expectation of a reasonable return on investment over time.

The Government's proposed changes in the Options Paper represent significant changes to the way the telecommunications industry is regulated in New Zealand. As 2degrees continues to invest in its network, and ultimately serve its growing number of customers, it has a keen interest in ensuring the new regulatory framework provides the certainty and ability it requires for the planned investment in future services.

To this end, 2degrees supports:

- Ensuring a smooth transition to the proposed utility-style framework, which provides regulatory certainty and predictability to industry investors and protects end-users from price shocks. We consider this is likely to require:
  - Ensuring the Government's legislative proposals do not overreach into matters that should be the responsibility of the regulator;
  - Genuine industry-specific differences between telecommunications services and services currently regulated under Part 4 of the Commerce Act are clearly identified and addressed; and
  - Avoiding 're-inventing the wheel' if this is unnecessary, noting that Part 4 of the Commerce Act does include provisions for dealing with transition and price volatility/shocks that could merit transfer to the Telecommunications Act.
- Addressing long-term spectrum disparities between the three full service national mobile networks;
- Ensuring certainty of supply of national roaming service, at reasonable prices; and
- Supporting efficient pro-competitive rollout of infrastructure in rural areas that provides for long term equal access to RBI infrastructure for Access Seekers.

This submission sets out our initial views and positions on the proposed new framework. Sections 2 to 4 summarise our views on each of the proposed fixed framework, mobile issues and the regulatory toolkit. Section 5 responds to the specific questions of the Options Paper.

2 Adoption of a new utility-style framework for fixed line services

The large majority of the Options Paper focusses on change to the fixed regulatory framework.

2degrees supports the Options Paper proposals that:

- The utility-style framework (based on Part 4 of the Commerce Act) for fixed line services would be included under the Telecommunications Act, rather than the Commerce Act. 2degrees considers that all aspects of economic regulation of telecommunications networks (price, service quality and access terms and conditions) should be retained under a single regulatory 'umbrella'.

- The new utility-style framework would be set out in a new Part of the Telecommunications Act for fixed line services, with a separate purpose statement to the current section 18 to ensure changes to the fixed regulatory regime do not increase uncertainty and unpredictability in relation to regulation of other non-fixed line access services under the Act.

- The Commerce Commission would be required to develop input methodologies (IMs) and an information disclosure regime prior to 2020, regardless of whether price-quality regulation is implemented from 2020 or remains a 'backstop'.

- The matters that must be covered in the IMs would include all of the provisions in Part 4 of the Commerce Act and the approach to setting quality and reliability requirements.

- The Commerce Commission would be responsible for determining the valuation methodology for the Regulatory Asset Base (RAB), the scope of the assets in the RAB, the treatment of UFB assets (including any initial losses made by UFB providers), and the treatment of decommissioned copper assets as part of the IMs.

- Price-quality regulation of layer 2 anchor products would apply from 2020 if a commercial solution is not in place by this time. We agree "This option provides a high degree of certainty and reassurance that end-user interests will be addressed".[1] 2degrees considers that the backstop option would only be desirable if Access Seekers were able to negotiate alternative arrangements to apply from 2020.

- The Commerce Commission would be able "to classify a layer 1 (i.e. unbundled) fibre service as an anchor product with cost-oriented pricing, if a statutory test is met".[2] (To ensure consideration of further regulation of fibre unbundling does not delay setting of Layer 2 anchor product prices, the Commission should be directed, through legislation, to consider this only once it has competed its information disclosure, IM and Layer 2 price setting process, which need to be prioritised).

- The introduction of a pre-approval mechanism for future major capital expenditure, for example such as the Individual Price-Quality Path (IPP) regime that applies to Transpower, warrants further consideration.

- A transitional arrangement should be introduced to address the case where regulatory proceedings are not completed by 2020. While we expect that prices will be able to be determined before 2020,[3] we consider there is merit in considering such mechanisms

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[1] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 11.
[2] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 10.
[3] Encouragingly, in Australia the ACCC went from releasing a draft report proposing a shift from TSLRIC to BBM in September 2010 to a Final Access Determination in July 2011. We expect some aspects of establishing the IM could potentially be quicker

to ensure certainty in the case of time overruns. (Part 4 of the Commerce Act includes provisions for managing the transition (if needed) such as roll-over of existing prices and provision for subsequent reset to include clawback of any consequent under or over-recovery. We do not support backdating and consider it should be prohibited).

- If merits review is introduced, we agree this should be subject to limitations as per the existing Part 4 Commerce Act arrangements; including that the merit appeals are limited to the IMs and do not extend to price (and service quality) determinations, and do not apply to other services regulated under the Act.

Given the Government's decision to shift to a utility-style framework for fixed line (telecommunications) services, 2degrees considers the current proposals that leave decisions on price and asset valuation to the independent regulator are superior to the previous consultations.

We note care should be taken in transplanting an utility-style framework under the Telecommunications Act that:

- The proposals do not overreach into matters that should be the responsibility of the regulator, such as decisions on definition of anchor products (including service quality levels, whether the anchor products should be defined as "basic services"), and the form of control (revenue versus price caps) that should initially apply. We support the use of a section 19A type provision (Government Policy Statement) as the most appropriate vehicle to address concerns the Government may have, for example about "price volatility", asset valuation and use of a revenue cap versus price cap, rather than overriding the Commission's role and responsibilities through legislation.

- Industry-specific differences between telecommunications services and the services currently regulated under Part 4 are properly identified and addressed. A key risk we see in this regard is that a shift to utility-style regulation could mark a shift away from the Part 2 Telecommunications Act focus on "promoting competition" but there are critical elements of regulation of fixed line (telecommunications) services which impact competition; such as, treatment of Chorus' copper assets in LFC areas. The Telecommunications Act review needs to very carefully work through these types of issues to provide suppliers, investors and end-users comfort (and surety) about how the new framework will work.

- The reforms should avoid 're-inventing the wheel' where this is unnecessary. Part 4 of the Commerce Act has provisions for dealing with transition and price volatility/shocks that could be transplanted to the Telecommunications Act.

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for telecommunications compared to the Part 4 electricity experience - given the Commission will be able to draw from Part 4 energy and airports knowledge and precedent, and some aspects of the UCLL and UBA FPP determinations process (for example regarding the WACC). However, other aspects are likely to be more difficult given additional complications in the telecommunications industry (for example, the availability of different retail services and thus the value of having anchor products).

We have concerns with some of the more detailed proposals of this paper relating to the fixed line regulatory framework and note:

- A price cap approach would appear to be most consistent with the Government's objective of promoting uptake of broadband/superior broadband products;
- Layer 2 anchor products for only 'basic services' should not be relied upon to ensure adequate competitive constraint on Layer 2 fibre prices and incentivise innovative products for consumers.
- There must be a clear mechanism, for example as under the KSO, to ensure that any voluntarily foregone revenue from Chorus to compete in an LFC area cannot be recouped in areas where it faces no competition.
- If there is not national averaged wholesale pricing this is likely to result in RSPs offering different retail priced services by geographic area under the proposed approach. We support a single generic price cap for each anchor product across Chorus and the LFCs.

Promoting regulatory certainty in the new fixed regulatory framework

As a party that is making substantial investment commitments, 2degrees considers regulatory certainty to be a critical element of the regulatory regime. The regulatory framework needs to ensure incentives to invest, both by Access Providers and Access Seekers. This is a clear message we get from investors in our business.

Regulatory certainty is also important for ensuring consumers have confidence that services will be provided reliably and at a quality that reflects consumer demands (including through promotion of competition), and that the prices they pay do not include excessive profits.

This review should recognise that certainty of outcome and regulatory certainty are not the same. One of the biggest factors that could undermine regulatory certainty is the Government's willingness to override aspects of the Commerce Commission role. This has occurred to various extents in setting the prices for copper access services (2013), setting the RAB value for copper (2015), and the form of control etc (2016).

Whilst we recognise the desire to fast-track some aspects of the transition, Government should be aware that such intervention (and even the proposal to intervene) can undermine regulatory certainty as it signals a willingness for ad hoc political intervention. Transitioning to a new regime inevitably creates a degree of regulatory uncertainty, however the Government proposal to intervene in matters such as form of control for the first regulatory period (2020-25) would mean the Commerce Commission isn't fully 'handed the keys to the car' until 2025, which would stretch out the transition period.

Investors' perception of regulatory risk, and the potential for political interference in independent regulator's decision-making, increases if the Government is willing to use legislative intervention to override what would normally be part of the regulator's jurisdiction.

3 Ensuring sustainable mobile competition

Pro-competition policy and regulatory settings enabled 2degrees' significant investment in New Zealand's third national mobile network and the competition, innovation and investment that has arisen as a result has delivered substantial benefits to New Zealand mobile users.

2degrees has now invested in providing coverage to nearly 96% of the population, and is continuing to build out its national network to provide service on its own infrastructure to all New Zealanders.

2degrees is at a different stage of investment compared to the existing national mobile players. The regulatory framework needs to recognise this - and the ongoing benefits of ensuring sustainable competition from 2degrees including in not only prepay and postpay markets but other markets such as the business and IoT markets.

Decisions now around spectrum allocation, government funding of rural infrastructure and the market behaviour of incumbents will directly impact the telecommunications experience for consumers.

2degrees supports:

- *Addressing of long term spectrum disparities between mobile network operators:*

  While cell sites represent the last mile of mobile competition, spectrum is the bedrock from which it begins. There should be a greater appreciation of the impact that relative spectrum holdings have on the long term telecommunications industry structure and nature of competition, given the effect spectrum has on the underlying cost of capacity.

  As noted previously, the current spectrum allocation process has no legislative framework, no requirement to consider competition impacts, and no requirement for an independent analysis of the competition safeguards that should be put in place to prevent long term bottlenecks and protect consumer interests over the long term. It instead relies on 'spectrum caps' being set by non-competition experts, who also act for the vendor. These spectrum caps have previously been set at levels above those recommended by the independent regulator.

  2degrees supports the responsibility for spectrum allocation being placed with an independent regulator. However, at a minimum, this review should require the Commerce Commission to conduct an independent assessment of competition issues and identify appropriate safeguards (*prior* to any spectrum assignment process), which are then binding on the vendor/Government.

- *Ensuring certainty of supply of national roaming service, at reasonable prices:*

  We support streamlining of the Schedule 3 process to move from a specified to a designated service, which would provide access seekers with a more viable path to secure national roaming services and enhance the commercial negotiation process because incumbents such as Vodafone would have reduced ability to delay provision of competitive access.

- *Supporting efficient pro-competitive rollout of infrastructure in rural areas, including ensuring RBI2 and MBSF do not increase the competitive advantage of Vodafone and Spark by only allowing current incumbents on these long term towers:*

  These should provide equal open access to all three national network providers to current and future technologies – whether through a better value wholesale roaming solution or colocation for all three operators, and recognise that if a colocation solution is adopted, just as Spark and Vodafone are collocating so too will 2degrees as its

network reaches further out. Schedule 3 colocation and/or national roaming provisions, or incentives to enter commercial agreements, do not achieve this and will see a repeat of the national roaming farce experienced by 2degrees to date, and ultimately see rural consumers miss out on the competitive services experienced in urban areas.

We agree with MBIE's view that if necessary, the Commerce Commission already has the power to initiate a study under the Telecommunications Act to investigate whether there are wholesale barriers to MVNO access (or any other wholesale issues) that may arise. This does not require further Government intervention - if the Commission considers it is warranted, it is able to commence a Schedule 3 process.

2degrees does not consider there is a case for investigation of MVNO access regulation at this time. MBIE will be aware that 2degrees is an active player in the MVNO market, and since the time of the previous consultation has worked with The Warehouse Limited to provide the MVNO, Warehouse Mobile. We consider Government is better to address competitive issues regarding access to Government-funded infrastructure and facilitate three competing infrastructure providers, who in turn will continue to compete for MVNO opportunities on an equal basis, as compared to the current system where the third operator may not be able to offer equivalent access to MVNOs compared to incumbents.

4 Making sure the regulatory toolkit is appropriate

2degrees support:

- The role of Telecommunications Commissioner being maintained. We consider this is a specialist role, with expert telecommunications knowledge developed over time, and complementary to the panel approach to Commissioners.
- The copper to fibre migration process should be consumer/industry-led, with the TCF well-placed to develop and manage codes to address issues associated with general migration.
- Further consideration of the size and the form of the issue with regards to wholesalers being primary responders to a customer complaint, and consideration of TCF clarifications regarding this issue, before any amendments are made. We consider amendments have the potential to increase confusion for both the consumer and industry.
- Streamlining of the Schedule 3 process to:
  - Recognise that changing from a specified to a designated service under the Act should not require the same level of investigation and scrutiny as investigating the introduction of regulation. While conferences or public hearings may not be included as part of this process this would not preclude them as part of the STD process;
  - The Commission being provided discretion to recommend whether a newly regulated service will have a one or two stage pricing process.
  - We do not support the imposition of 'hard' deadlines' as proposed, which have the potential to work against all parties.

5 Specific Questions

These are 2degrees' initial responses to the wide range of questions in the Options Paper, which focus on the transition of fixed line services to a utility-style framework based on Part 4 of the Commerce Act. We note that these views may change as we further understand and consider the implications of the new framework on the telecommunications industry, which does differ in many material aspects to that of industries currently regulated under Part 4 of the Commerce Act. We further note that some responses may differ depending on what decisions are made for different parts of the proposed regime.

Chapter 3: Policy decisions on the framework

The role of input methodologies

1.	Please comment on the set of matters that you recommend input methodologies should cover, with reference to the examples.

We agree that the fixed line service Input Methodologies (IM) provisions should be at least as broad as the existing Part 4 IM requirements.

As set out in the Discussion Document, the IM will need to include:

- Methodologies for evaluating or determining the costs of capital, valuation of assets (including depreciation and treatment of revaluations), allocation of common costs (if appropriate) and treatment of taxation.
- Regulatory processes and rules (including considerations for expenditure proposals) and;
- Price setting aspects and methodologies.

We agree the IM will also need to address network and service quality matters, including (depending on the model decided) requirements for both anchor products and generic requirements. These will establish clear expectations and improve certainty for industry. We agree key quality and reliability requirements will include:

- Requirements relating to throughput on services;
- Provisioning times;
- Times to address network faults;
- The quality of network deployment and installation; and
- Information regarding network outages including duration, reasons and notice where possible.

We consider this should also cover diagnostic tools and processes expected to be available to RSPs to enable improved trouble-shooting with end-users and avoid unnecessary costs and delays (for both industry and end-users) in address end-user queries, as has been discussed as part of the current Commerce Commission section 30R review of non-price terms for UBA services.

For the avoidance of doubt, the proposed requirement that "The Commission would establish its approach to setting these quality and reliability requirements in input methodologies"[4] should not extend to establishing the actual quality and reliability requirements in the IMs. The

[4] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 47.

Commission should be able to revise the quality and reliability requirements for each price reset, which may not be possible if they were specified in IMs.

We note the Commerce Commission's legal opinion in 2015 is that once the initial IMs were established under Part 4 of the Commerce Act it does not have discretion to create new IMs:[5]

> Our preliminary view is that we cannot create an IM on a matter not covered by an existing published IM for a particular type of regulated service as part of the IM review process. The review is of each IM after its date of publication. [footnote removed]

We are not clear this is either a necessary or desirable restriction of the regulatory framework.

The role of information disclosure

2. Should information disclosure apply even if price-quality regulation is applied to Chorus and/or LFCs at 2020?

2degrees support public information disclosure requirements on Chorus and/or LFCs from 2020 regardless of whether price-quality regulation is required (subject to withholding of commercially sensitive information). We agree this provides a standardised and transparent record of performance of regulated suppliers and should help assess whether regulatory goals are being met.

We understand information disclosure applies under Part 4 of the Commerce Act regardless of whether a supplier is exempt or non-exempt from price control. We see no reason for a different approach to be applied in relation to Chorus and/or LFCs.

We also understand that the Commerce Commission uses disclosed information, e.g. forecasts of capex and opex in regulated suppliers Asset Management Plans, as an input into its price determinations.

3. Should the information disclosure requirements apply to Chorus' copper services? Should there be any differences in the information required for the copper network?

We consider information disclosure requirements should apply to copper as well as fibre services. This is particularly given RSPs such as 2degrees will continue to rely on Chorus' copper services outside UFB areas for some time, and given we do not support inefficient provision of copper services in LFC areas (where fibre is available).

We note that whether the information disclosure requirements differ between fibre and copper is a matter that should be left to the Commerce Commission. The Commerce Commission may, for example, want separate copper and fibre disclosures (asset values etc) even if they are bundled together for price setting purposes. This could, for example, be useful for ensuring Chorus doesn't engage in predatory pricing in LFC areas.

[5] Commerce Commission, Input methodologies review, Invitation to contribute to problem definition, 16 June 2015, paragraph 44.

Chapter 4: The role of the regulator

Telecommunications Commissioner role

4. Do you agree that the role of the Telecommunications Commissioner should be reviewed after 2020?

We support maintaining the role of Telecommunications Commissioner and the Telecommunications division in the Commerce Commission. We consider this to be a specialist role, with expert telecommunications knowledge developed over time. While we also value the experience of generalist Commissioners, we consider the current panel approach appropriately balances this wider industry experience with industry-specific knowledge.

If this is reviewed in future, we would be concerned to ensure that such a review did not occur while the new framework was still being settled, or mid-consideration of particular issues. This could include if additional time is required to complete price setting. For this reason, we consider it may be that such a review should occur later than 2020.

Chapter 5: Regulatory Asset Base (RAB)

Revenue cap and number of RABs

5. Do you agree that the number of RABs for price-quality regulation purposes should be set in legislation, or should it be a matter for the Commission?

In principle, we support the independent Commission determining the number of RABs rather than this being set out in legislation, as occurs under Part 4 of the Commerce Act.

We appreciate that legislating the number of RABs may save time and resource, and provide earlier certainty as to the outcome; however direct legislation does not always equate to regulatory certainty. We consider legislating an outcome needs to be balanced against ensuring the 'right' decision, which remains robust when the details are considered.

6. Do you support a single RAB for copper and fibre? Please explain how your preferred approach would meet our policy objectives.

While we see merit in having a single RAB for copper and fibre, as this is likely to best ensure sufficient flexibility during the transition from copper to fibre, this is part of the decisions that would normally be decided by the Commerce Commission, not legislated for.

RAB valuation methodology

7. Do you agree that decisions on the RAB valuation methodology should be made by the Commission?

We agree that decisions on the RAB valuation methodology are appropriately decided by the Commerce Commission, as an independent regulator.

While 2degrees considers that decisions on the RAB valuation should be left to the Commerce Commission as part of the IMs determination, we raise a number of objections to use of the current TSLRIC valuation for copper, and the suggestion this could be treated as a 'line in the sand'.

The Commerce Commission itself has acknowledged TSLRIC can result in excessive profits, and unlike the Part 4 building block price regulation, is not concerned about whether Chorus under or over-recovers costs. The Commerce Commission, for example, made decisions

about how to apply TSLRIC which resulted in a significantly higher (above actual cost) valuation.

There is a large amount of evidence, including from the Commerce Commission and its experts, from the UCLL and UBA price determination proceedings, that the TSLRIC valuation is above Chorus' actual costs and would allow Chorus to earn excessive profits.

In relation to the initial Part 4 RABs the Commerce Commission ruled out the use of current replacement cost valuations as a "line in the sand" to avoid artificially high asset valuations (adoption of TSLRIC would create the situation the Commission was trying to avoid). The Commerce Commission's Reasons Paper, which accompanied the IMs determinations, also expressed concern about the limited applicability of current replacement cost valuation to achieving the purpose of replicating competitive market outcomes.

This was supported by the High Court, in its IMs Merit Appeal decision:[6]

> In the end we have reached a clear view that the Commission was correct not to place reliance, much less sole reliance …on a current replacement cost approach …

Mixing TSLRIC valuations with building blocks could result in the worst of both worlds for end-users. The TSLRIC valuation would lock in a value, independent of actual investment, then the building block approach would add any subsequent actual investments into the RAB.

2degrees agrees with Spark that:

> "… all parties would need to be clear that shifting to [a building blocks] model trades-off a much lower starting valuation relative to TSLRIC, for more certain, increasing, increments to that valuation (and thus to prices) as investment occurs".[7]

If anything, we consider that Government should convey that it does not consider this 'line in the sand' approach should be adopted, nor that it is consistent with the new regulatory framework intentions. The Government could achieve this via a Government Policy Statement (**GPS**) of the economic policies of Government (similar to section 26 of the Commerce Act, or section 19A of the Telecommunications Act, which currently only applies to Schedule 3).

8. If you think the Government should provide legislative guidance, what form of guidance do you recommend?

We do not consider that the Government should provide legislative guidance. The Government should use the existing mechanism of Government Policy Statements if it considers issues are appropriate to be taken account in Commerce Commission decisions. This will increase transparency and predictability for industry and investors.

We note that legislative guidance could lead to unintended consequences and overly constrain the Commerce Commission in its decision-making. This has caused issues in the past, for example requiring an Initial Pricing Principle (IPP) of international benchmarking in the Unbundled Bitstream Access (UBA) process.

As an example, the Government has suggested a potential specification that*:*

> "the Commission must select the methodology that best promotes stability of the revenue cap and avoidance of price shocks for end users".

While both industry and government have an interest in "minimising price volatility under the new regulatory framework" and "generally in a stable transition to the new regulatory

[6] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC, [11 December 2013], paragraph [515].
[7] Spark, Further draft pricing review determination for Chorus' UBA and UCLL services, 24 September 2015, paragraph 23.

framework", requiring the Commission to select a methodology that promotes the stability of the revenue cap and avoidance of price shocks could unintentionally increase consumer prices above what they should be - because the method chosen is based primarily on stability and continuity.

We do not consider this should be the primary driver of important economic decisions on valuation methodology, such as setting of the initial RAB. The independent regulator should be able to consider other relevant aspects, when making a decision, including, but not limited to, stability and minimising price shocks.

As identified later in the Options Paper, other mechanisms are available that may better address the Government's goal, "a clear focus on protecting end-users", such as the Part 4 provisions to deal with "price shocks" (where prices increase) and relatedly "undue financial hardship" for regulated suppliers (where prices go down).

As another example, while we support the proposal in the potential specification that:

> "the Commission must not adopt a 'replacement cost' valuation methodology for RAB valuation (this option would be consistent with our position that TSLRIC is no longer appropriate in a post-2020 environment)"

We note that any legislative guidance that does not also prohibit the related use of a previous TSLRIC valuation (proposed not to be prohibited) does not have "a clear focus on protecting end-users". Indeed, if the legislation were to provide any direction on RAB (which in principle we agree with the MBIE is not appropriate), 2degrees supports the position that this this should go further and prohibit the use of the TSLRIC valuation from the UCLL and UBA decision. This is consistent with our response to Q7.

Other decisions for the Commission

9.	**Do you agree with our proposed approach to enable the Commission to determine the scope and treatment of assets in the RAB?**
10.	**Please comment on any matters Government should take into account when developing a definition of "fixed line access services".**

We support the Commerce Commission determining the scope and treatment of assets in the RAB.

While we understand the intention, MBIE defining 'fixed line access services' with reference to the level of competition may also have unintended consequences. For example, we note the Commission is currently considering whether or not there are competition issues in backhaul - despite the MBIE's apparent position - and it is also not clear how this fits with competition from copper, FWA and mobile over time.

11.	**Do you think Chorus' assets in LFC areas should be excluded from its RAB?**

2degrees would be concerned if Chorus was able to finance price competition in LFC areas by raising prices in non-LFC areas where it faces no or limited competition in provision of copper and fibre broadband services.

Our initial view is that the Chorus copper network in LFC areas could be excluded from the regulated service and RAB if it can be established that competition will be sufficient in those areas, and Chorus would not have substantive market power. Importantly, if Chorus' assets in LFC areas are included in its RAB/any proposed revenue cap, Chorus must be precluded from recouping any voluntarily foregone revenue (from competing in LFC areas) elsewhere

where there is little or no competition i.e., if Chorus chooses to price below the regulated price in LFC areas, this should be allowed, but it should not be able to recover the foregone revenue from other areas (where it has a monopoly).

We note if Chorus was allowed to increase prices elsewhere this would be inconsistent with the government's proposed objective of "promoting outcomes that are consistent with outcomes produced in competitive markets". Firms in competitive markets do not get to increase prices to compensate for the impact of competition.

The prospect of Chorus pricing below the regulated price in the LFC areas where it is not the UFB operator is directly analogous to the response to the roll-out of an alternative cable network in Wellington and Christchurch, which resulted in residential telephony prices in those areas below the level allowed under the Kiwi Share Obligation (**KSO**).

The KSO does not allow the foregone revenue to be offset by increases elsewhere and we consider this provides useful precedent.

A range of alternative options can be considered to ensure that this issue is addressed, including:

- Excluding the Chorus copper network in LFC areas from the regulated service and RAB - as noted in Q10, including these assets appears to be inconsistent with the currently proposed definition of 'fixed line access services' and we consider that definition will need to be more carefully considered and amended;
- Applying a revenue cap adjustment mechanism e.g. each dollar of revenue voluntarily foregone is deducted from the revenue cap;
- Ring-fencing the copper network in LFC areas; or
- Adoption of an asymmetric wash-up mechanism: While the proposal for an asymmetric wash-up mechanism is helpful, we do not consider that it would adequately address this situation. A wash-up mechanism would only remove the ability of Chorus to offset voluntary price reductions it had not anticipated it would make.

12.	**Do you agree the Commission should decide on the treatment of UFB financial support? Do you support the Government providing guidance? If so, please comment on the guidance or approach you recommend.**
13.	**Please comment on our proposed approach to provide guidance to the Commission that it should implement its functions in a way that does not create incentives on Chorus to keep end-users on copper services in areas where there is a choice of UFB services available.**
14.	**Do you agree the Commission should decide on the treatment of UFB initial losses?**

We support the Commission deciding on treatment of UFB financial support and initial losses. As set out above, we consider any guidance required from the Government, including on treatment of UFB financial support and Chorus incentives for copper to fibre migration, should be in the form of a GPS rather than legislative guidance.

While 2degrees strongly supports a transition to fibre (and offers fibre at the same price as copper services), we note additional legislative guidance that "the Commission that it should implement its functions in a way that does not create incentives on Chorus to keep end-users on copper services in areas where there is a choice of UFB services available" could be construed as inconsistent with the government's own goals of "replicating competitive market outcomes" (and inconsistent with its position that in any case "[t]here should be no incentive

under its proposals for Chorus to delay the migration of end-users to UFB or otherwise prolong the operation of the copper network unnecessarily, because the total returns it recovers from its copper network are not dependent on when migration occurs, nor on how long its copper network is operated for".)

Assessing the efficiency and prudency of capital expenditure

15.	**Do you agree with our proposed approach to the treatment of networks rolled out under the Government's UFB and RBI programmes?**
16.	**Do you agree with our proposed approach to the treatment of non-standard installations? What threshold do you propose for charging end-users for non-standard installations?**

We support the proposal to mirror the approach in Part 4 and require the Commerce Commission to have regard to Government Policy Statements when exercising functions with respect to the BBM framework. As noted above, we consider this mechanism should also be used in preference to the Government providing legislative guidance to the Commission.

We note that the current definition of 'non-standard installations' currently captures a very large number of connections, for example, it effectively includes right-of-way connections. We consider this definition should be modified to more accurately reflect actual connections. We would be concerned if this definition and charges for non-standard installations discouraged future take up of fibre services.

17.	**Do you agree there should be a pre-approval mechanism available to regulated suppliers for future major capital expenditure based on the Transpower model?**
18.	**Does the proposal to require the Commission to have regard to economic policy statements provide sufficient certainty to support any future government broadband infrastructure initiatives?**

In principle, we consider that application of the type of pre-approval mechanism for future major capital expenditure that applies to Transpower (sections 54R and S, Commerce Act) warrants further consideration.

We note though that these provisions only apply to Transpower, and not to any other regulated suppliers under Part 4 Commerce Act. It would be useful if an explanation was provided as to why such arrangements are considered appropriate for Chorus (and LFCs), but not other regulated suppliers.

Chapter 6: Price-quality regulation

Form of price-quality regulation

19.	**What is your preferred option for the form of price-quality regulation – price caps, a revenue cap, or our preferred option – and why?**
20.	**How could your preferred option be implemented to manage the risks identified above?**
21.	**If you prefer a price cap approach, how should the demand forecasting risk be managed?**

2degrees does not consider that a decision on whether to apply a revenue cap or a price cap (even if just for 2020-25) should be made through legislation. The Commission should be responsible for determining the form of control, as part of its IMs determination, without reference to the Minister (consistent with Part 4 Commerce Act). This includes consideration of demand forecasting issues.

The legislation does not require any specific criteria for determining the form of control. Part 4 of the Commerce Act does not include any specific criteria. The test is simply which form of control would best satisfy the statutory objective.

If the proposal is retained for legislation to set the initial form of control, we support allowing the Commission to review the matter for the 2025 price reset onwards.

The claim that the Government setting the form of control (revenue or price cap) for the first regulatory period would "limit the degree of uncertainty that will arise from moving to a new regulatory framework"[8] could have equally been made when the current Part 4 was being introduced for energy networks. We consider that setting a precedent of the Government interfering in matters which are normally the domain of the regulator could harm, rather than enhance, regulatory certainty.[9] Similar comments were widely made by stakeholders in relation to the previous proposals for the Government to set copper access prices and the RAB valuation.

While 2degrees recognises there are advantages and disadvantages with both price and revenue caps, we have misgivings about whether a revenue cap should be applied for fixed line (telecommunications) services.

A price cap is likely to be most compatible with the Government's objectives of promoting uptake of broadband/superior broadband products.

The Options Paper recognises "UFB providers should have incentives to maximise demand – having regard to end-user demand and ensuring that service offerings are highly valued by end-users",[10] and "The price cap approach would incentivise the regulated supplier to exceed demand forecasts by connecting new end-users and 'upselling' existing end-users to premium services" (emphasis added).[11]

Under a price cap, Chorus can improve its profitability by promoting greater uptake of broadband services (and premium services) than the Commission has assumed under its demand growth assumptions used to set the price cap. This could be done, for example, by

[8] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 40.
[9] We elaborate on this point in the section of our submission on "Promoting regulatory certainty".
[10] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 41.
[11] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 42.

moderating the price differential between the anchor products and premium services, and improving the service quality of premium services.

Under a revenue cap, in contrast, Chorus gets a 'guaranteed return' regardless of how well it encourages broadband uptake. If, for example, the anchor product prices were sufficient to recover the revenue cap, Chorus would have zero incentive to encourage uptake of anything other than basic services. Where the anchor product prices are insufficient to recover the revenue cap Chorus incentives cease at the point where it expects to hit the revenue cap.

The Commerce Commission's proposal to amend the Part 4 IMs to place EDBs under a revenue cap reflects a different set of drivers – including that it is desirable to incentivise EDBs to promote demand management and energy efficiency - i.e. discouraging demand is considered desirable for electricity, but the Government wants to increase demand for broadband services.

While the Options Paper makes reference to the Commission's proposal to shift EDBs from a price cap to a revenue cap, as support for the proposal to apply a revenue cap for Chorus' fixed line services, it is silent on the Commission's intention to retain a price cap for Gas Distribution Businesses (GDBs).[12] Aspects of the rationale are directly relevant to fixed line (telecommunications) services e.g:

> … the WAPC provides incentives for GDBs to pursue new gas connections (consistent with s 52A(1)(a) and (b)), and we consider this to be a more important factor for GDBs than EDBs.
>
> …Our main reason for favouring maintaining the WAPC is the incentive it provides for GDBs to pursue new gas connections and grow throughput. Compared to electricity which is generally considered to be an essential service, particularly for residential gas demand consumers have more choice in respect of gas, because they can choose whether to use gas and electricity or only electricity for their energy supply.
>
> …We consider that the GDBs have the ability to influence the uptake and use of gas. … We consider that ensuring new connections are incentivised will be in the long-term interests of consumers …
>
> …The WAPC will mean greater price stability within the period for consumers than a revenue cap.
>
> … without the additional incentive provided by a WAPC ... new gas connections may be less likely to happen …

22. Is there any way to make sure that the UFB provider is not wholly insulated from competition under a revenue cap model? For example, could an asymmetric wash up be applied?

As noted in Q11, we consider that if prices are voluntarily lower in some areas, such as LFC areas, then even if a revenue cap applies, this should not enable an increased amount of revenue to be recouped in other areas. We do not consider an asymmetric wash up would adequately address this situation and have suggested a range of alternative options that could be considered.

23. Are there any risks or benefits of Option 3 that we have not identified? Will this option have the incentive effects we are seeking? How could these be addressed?

Please see our response to Q21.

[12] Commerce Commission, Input methodologies review draft decisions Topic paper 1: Form of control and RAB indexation for EDBs, GPBs and Transpower, 16 June 2016, chapter 4.

24.	**Do you agree the impact of competition 'at the fringes' should be managed? If so do you agree with our proposal for an 'asymmetrical wash up'?**

Please refer to our response to Q11.

We would be concerned if under a revenue cap end-users reliant on the regulated service were forced to pay higher prices because their fibre provider lost business at the network fringes. This highlights the importance of an appropriately set anchor product, which is not just a basic service but sets a price for services suitable to the majority of consumers.

Anchor products

25.	**Should the following services (as defined above) be anchor products from 2020? Why or why not? a. voice-only service; b. 'entry-level broadband'; and c. 'basic broadband'.**

2degrees supports the initial inclusion of layer 2 anchor products (with regulated prices) in addition to the overall price or revenue cap, however the anchor products should be set at a level suitable for the majority of end-users.

As a national service provider, we also support the proposal to set a generic price for each of the anchor products across Chorus and the LFCs. This would help mitigate the problems retailers in the electricity sector face as a consequence of having to obtain access from 29 different EDBs, each with their own unique access prices (and often with different pricing on different parts of their networks), in order to provide a nationwide retail product offering.

2degrees considers that the IM provisions should require the Commerce Commission to establish an IM for defining anchor products as well as for setting the service quality requirements and prices for the anchor products.

2degrees does not consider it appropriate for the anchor products to be defined in legislation (even if it provides for the Commission to update the anchor products from 2025 onwards).

We question the merit of defining the anchor product as a "basic service". We consider the Options Paper's proposed 'anchor' products may be set too low to act as a sufficient anchor for "commercial" services in the 2020-2025 period.

One of the problems is that what might be considered to be an appropriate "basic service" or anchor product at the time the new legislation is enacted (say 2017) could be markedly different in 2019 when the Commission would otherwise set the anchor products as part of its price determinations (and/or IMs).

The current proposed anchor products for the first regulatory period from 2020 are inconsistent with current UBA, as well as the Government's vision of 50MBps for 99% of the population by 2025 and 10MBps for the last 1%. A large majority of our fibre products in 2016 are 100/20Mbps products. We do not sell copper if fibre is available, however where we rely on copper this is already a full speed UBA service, which in many cases is above 15/1Mbps and with vectoring can be even higher. By 2020, we expect demand for higher speed broadband to be significantly higher than today. Some areas now already have Gigabit services and we think it would be unwise to assume what is consumed today will reflect typical user demands for 2020 to 2025.

Another problem is that the anchor products identified are not in reality technology neutral. For example, as indicated above, and as acknowledged in the Options Paper, the 15/1Mbps is not relevant to current fibre offerings, which offer higher speeds than this to market as a minimum. We are not clear on the value of having a "technology neutral" service, which in reality both consumers and RSPs know is determined by the technology available. We do not expect anybody to purchase a 15/1Mbps fibre service and do not require this to be offered.

We consider there is merit in defining anchor products closer to 2020, when there is much more information on product demand, to ensure 'anchor' products are set at an appropriate level to be an effective 'anchor' to other products available, and to encourage take up. Notably, anchor products may evolve over the regulatory period – in telecommunications services do not stay still for five years.

Pricing of anchor products

26.	**How should anchor product prices be determined?**
27.	**Do you have any comments on the following principles? a. end-users should not face sharp price increases; b. prices in the initial regulatory period should be set with regard to 2019 prices; and c. anchor product prices should be broadly reflective of the quality of the particular anchor product.**

We agree with the principle that end-users of anchor products should not face sharp increases in pricing of anchor products (indeed the product they consume, regardless of whether this is an anchor product).

We consider any general principles should be included in a Government Policy Statement to the Commission, given the dangers of legislative guidance.

We note section 53P(8) of Part 4 of the Commerce Act provides a mechanism to allow prices to be adjusted to minimise price shocks or undue financial hardship for the regulated supplier.

28.	**Are there any other matters that need to be addressed regarding the pricing of technology-neutral anchor products?**

Please see our response to Q25, which outlines concerns that the anchor products identified are not in reality technology neutral.

29.	**Do you think there would be any negative outcomes from the requirement to provide anchor products on a geographically averaged basis? Do you think the Commerce Act provisions would be a sufficient alternative in the absence of this requirement?**

We note that geographically averaged prices for each UFB provider is likely to result in different prices nationally, particularly where there is significant divergence in cost.

National pricing is desirable from an RSP and consumer experience perspective because it enables simpler and clearer marketing and customer care. As noted in Q25, 2degrees support the proposal to set a generic price for each of the anchor products across Chorus and the LFCs.

Geographic averaging may help address issues of anticompetitive behaviour and assist with the avoidance of price shocks for more rural consumers. The generic provisions of the Commerce Act have been unable to address concerns regarding anticompetitive behaviour in the times required in telecommunications, and are *ex post*.

Layer 1 anchor product

30.	**Should the following services be anchor products from 2020? Why or why not? a. layer 1 fibre service; and b. any other services.**
31.	**What test should the Commission be required to apply to determine whether to introduce a layer 1 fibre anchor product?**
32.	**Would there be any problems with a technology-specific layer 1 anchor product? Should the layer 1 anchor product include UCLL, and therefore be technology-neutral?**
33.	**Should the layer 1 anchor product include both point-to-point and point-to-multipoint configurations? How do you recommend the Commission should calculate a cost-oriented price for the layer 1 anchor product?**
34.	**Should the Commission have the power to require services based other forms of unbundling (such as wavelength unbundling) to be provided?**

As per the initial open access deeds of undertaking, we support the decision to require Chorus to offer fibre unbundling on request, as a 'commercial service'. We agree the Act should provide a process for fibre unbundling (GPON and wavelength) to be price controlled in future by the Commerce Commission if it considers this appropriate. This is what the Government previously agreed (and is consistent with the current Schedule 3 process).

While we support unbundling, we would be concerned if the 2020 price resets for the proposed Layer 2 anchor products were delayed due to consideration of the potential for Layer 1 unbundling and price determinations.

While we think – based on the experience with implementation of the Part 4 arrangements for energy networks and the experience with the shift from TSLRIC to building blocks in Australia – that the Commerce Commission should be able to implement the new regime by 2020, we are conscious that this will entail a considerable amount of work on the part of the Commerce Commission and stakeholders. There was no equivalent to the task of dealing with layer 1 fibre unbundling when the Commerce Commission established the Part 4 arrangements for energy networks. We consider that this additional task could delay the Commission and heighten the risk it would not be able to undertake a price determination by 2020.

We therefore support the Commerce Commission completing the information disclosure, IMs determinations (including asset valuation) and price setting for 2020 Layer 2 services as the priority, prior to consideration of (regulated) pricing for fibre unbundling.

We note RSPs are incentivised to unbundle where UFB providers do not innovate at the Layer 2 level and where commercial solutions are not meeting consumer demands. If anchor products are appropriately set to meet the majority of consumer needs over 2020-2025, this will incentivise innovation and improvements in the Layer 2 service. In contrast, if set too low then the incentive to offer competitive and innovative 'commercial' services is likely to reduce, including higher speed fibre services, and RSPs are likely to unbundle fibre to offer such services to consumers.

2degrees does not require copper unbundling to service our fixed line customers. Our clear preference is to offer consumers fibre where possible. Where only copper is available we support the highest available broadband speed. Not requiring copper unbundling supports higher speeds through vectoring technology.

Updating anchor products

35.	**How should the regulatory framework provide flexibility for the Commission to update anchor products over time? What criteria should be used for the selection of anchor product specifications?**
36.	**Should there be a limit on when the Commission can review and update the anchor product set? What frequency of reviews do you recommend?**
37.	**Should there be a limit on the number and type of anchor products, as proposed?**

Anchor products must be regularly reviewed by the Commerce Commission to ensure they keep pace with changing end-user expectations (as per the purpose of ensuring "suppliers of regulated goods or services … provide services at a quality that reflects consumer demands") and remain an effective anchor. Given the rate of change in telecommunications, a five year review period risks being too long. For example, in 15 years we have gone from dial-up technology to DSL to VDSL to fibre.

We consider this applies to the initial anchor product set also – which is why we have concerns with proposals to set the level of these anchor products for the period 2020 to 2025 in 2016/2017, through legislation, particularly at the levels currently proposed. If the Commission sets the anchor product service requirements, as part of the 2020 price determinations, it will be able to base them on much more up-to-date (2019) information on consumer demand and product uptake.

If there are a limited range of anchor products initially these must be set at a level suitable for the mass market, not just basic services. We agree they should "reflect the typical needs of end-users and act as an economic anchor throughout the value chain".

As noted previously, we do not see an issue with having a separate copper broadband and a fibre broadband service – in practice this is what they are in any case and how consumers will be able to identify what they can receive (they will not be opting for a 15/1 Mbps service when they have a much higher speed fibre connection for the same price).

We do not think that the legislation should limit the number of potential anchor products post 2020. This should be determined by the Commerce Commission. If a fixed line service provider is subject to limited competition (the premise MBIE is shifting to this regime) then if they refuse to provide a commercial service or if that service proves not to be anchored as well as expected by the existing anchor products post 2020, then the Commission should be able to determine whether or not it this should be dealt with through regulation. This would also help incentivise the provision of suitable commercial products.

Consistency between Chorus and LFCs

38.	**Do you think that anchor products should be priced consistently across LFCs and Chorus?**
39.	**Please comment on any alternative ways to achieve consistency of pricing between Chorus and LFCs.**

Please see our response to Q29. We support nationally consistent anchor product pricing.

Commercial services

40.	**Should commercial services offered by UFB providers be subject to any requirements?**
41.	**Do you agree with our suggested requirements, including geographic averaging (noting the question earlier on this point in relation to anchor products) and the requirement that 12 months' notice must be given of any changes to price or material non-price terms for commercial services?**

We support generic quality standards for the entirety of the UFB providers' regulated businesses, consistent with Part 4 of the Commerce Act.

We note that legislating minimum requirements limits flexibility and the ability to change these requirements, which may be required during implementation. The Commission should be able to determine these aspects or at least be able to amend them consistent with the purpose statement.

We support a 12-month notice period for withdrawal of a service.

We do not agree with MBIE's assumption that if anchor products are only basic services UFB providers will have strong incentives to provide higher priced premium services to earn a normal return. This depends on the calculation of the revenue cap and customers' requirements. MBIE's assumption also implies that many consumers will not have the regulatory safeguards of anchor products - such as minimising price shock, because they purchase more than a basic service.

Deeds of undertaking for open access

42.	**What is your view on our proposal to carve the initial layer 2 anchor products out from this obligation?**

Given the government has decided to shift to a utility-style framework, a carve-out of Layer 2 anchor products from the EOI pricing requirements may be required to increase predictability and reduce price shocks for both consumers and industry. This includes during any future unbundling regulatory process: price regulated fibre unbundling under the revenue cap approach without this carve-out could increase the Layer 2 price for consumers, including those without access to unbundled fibre, which we understand is not consistent with the Government's objectives. We would be concerned if consumers nationwide were forced to pay higher prices due to the need for RSPs to unbundle.

Clearly EOI could also impact pricing of commercial solutions (Layer 1 and Layer 2). We recognise the risk regarding pricing of Layer 1 services relative to Layer 2 products. This is an issue with the shift to a utility-style framework based on limited or no competition, because unlike other sectors, in telecommunications there can be Layer 1 and Layer 2 services. While not ideal, we note that non-discriminatory/EOI provisions are normally put in place to ensure access seekers are not disadvantaged by not being able to provide an equivalent retail product. However in this case, all Access Seekers are able match the retail product of its competitors: all operators will be able to access the Layer 2 anchor products (and any commercial services effectively 'anchored' by these products). To further minimise this impact it is important to ensure that fibre providers are incentivised to improve Layer 2 services.

Retaining flexibility as the market matures: the Commission can recommend changes to the form of control; Setting price and non-price terms

43.	**Do you agree the Commission should have the power to recommend changes to the form of price control (including moving to a price cap regime) if certain criteria are satisfied? If so what criteria would you propose?**
44.	**Should the Minister make the final decision, or should this matter be delegated entirely to the Commission?**
45.	**Do you agree that regulated terms should be set by Commission determination?**
46.	**If so, do you agree that mirroring the approach to section 52P determinations in the Commerce Act is appropriate?**

As set out in our response to Q7, we consider the decision on price control (now and in the future) is appropriately decided by the independent regulator rather than the Government of the day. As the Options Paper identifies, this approach is already in place under Part 4 of the Commerce Act.

The regulated terms should be set by the Commission as part of its determination.

Chapter 7: Implementing price-quality regulation

Options for implementing price-quality regulation: Chorus

47.	**Do you support implementing price regulation for Chorus at 2020, or as a backstop?**
48.	**What benefits would a backstop approach have over a 2020 model of the type described in this paper?**
49.	**How could a backstop approach ensure that the interests of end-users are taken into account?**
50.	**Under a backstop approach, how do you suggest copper services be treated? Please comment on the preferred option of ‘freezing’ the copper price.**
51.	**Under this option, how do you propose managing the risk of copper prices becoming out of date over time? Is a CPI-1% adjustment appropriate?**

A key concern is ensuring regulatory and price certainty and avoidance of price shocks for services provided to our customers in 2020 and beyond.

This may be achieved via a regulatory or commercial outcome, however given the time taken to reach a solution and the risks of not having a solution, we consider at a minimum that the regulatory process be carried out in parallel to any commercial discussions that are taking place.

If a commercial solution is not reached, then the regulatory process should continue. In contrast, if a commercial solution is reached, then the Commission should not be required to finish any part of the regulatory process that it considers is no longer required. Such a process, for example developing product and price determinations for anchor products, is likely to take up considerable Commission and industry resource unnecessarily.

We therefore support the Act allowing the Commission to stop a regulatory process if it is satisfied alternative commercial solutions are in place that are to the long-term benefit of end-users.

The outcome of commercial discussions is likely to be better known by the time the Commission has undertaken its initial work on information disclosure and the IMs.

2degrees continues to support regulation if timely commercial alternatives are not viable for the long-term benefit of end-users.

Options for implementing price-quality regulation: LFCs; Intervention test

52.	**Is there a case to implement a backstop model, with information disclosure, for LFCs? To what extent do you think LFCs will be subject to competitive pressure from 2020? Do you expect that they will need to be subject to price-quality regulation at some point? When might this occur? Are there any other risks or benefits to a lighter touch approach for LFCs?**
53.	**Please comment on the proposed intervention test based on the purpose statement. What are the risks and benefits? Would another type of test be more appropriate, such as that in section 52G of the Commerce Act? Why?**

We support both Chorus and LFCs being subject to information disclosure requirements and being subject to full price regulation if required. From our experience, we are not convinced different ownership structures, relative size and competition from Chorus copper services has meant that LFCs are incentivised to act more competitively than Chorus in addressing RSP requirements. Further, we do not use copper where fibre is available, and agree as fibre becomes the norm LFCs' market power will only increase.

This further supports the position that national price caps for anchor products are appropriate.

If a backstop approach to LFCs is adopted, we support a review of whether intervention is required no later than every five years.

Legislative vehicle – Telecommunications Act

54.	**Do you have any comments on our proposal to establish the fixed line regulatory settings within the Telecommunications Act?**

2degrees supports the inclusion of the proposed utility-style regulatory framework under the Telecommunications Act, rather than the Commerce Act. 2degrees considers that all aspects of economic regulation for network services (price, service quality and access terms and conditions) should be retained under a single regulatory 'umbrella'.

We have misgivings about the split of economic regulation of energy networks across multiple legislation (Commerce Act, Electricity Industry Act and Gas Act) and multiple regulators (Commerce Commission, Electricity Authority and GIC), with regulation of price and quality administered by the Commerce Commission under Part 4 Commerce Act, and access regulation administered by the Electricity Authority and GIC. We want to avoid this kind of arrangement developing in telecommunications through regulation under different legislation.

Purpose statement

55.	**Do you agree that it is most appropriate to set out a new purpose statement separately to the existing one, in a new Part to the Telecommunications Act?**
56.	**Do you agree with our proposal to largely replicate section 52A? Will this achieve the outcomes we have outlined?**

a.	**Do you agree with the terminology, including the use of "end-users"?**
b.	**Do you think a single purpose statement derived from section 52A will be adequate to deal with access issues associated with unbundling?**
c.	**Are any other definitions needed?**

As per our previous submission, 2degrees supports the adoption of a new purpose, separate from the existing one, in the proposed new Part to the Telecommunications Act. (An additional purpose would also be required for the IMs as per section 52R Commerce Act.)

We reiterate our view that:[13]

> … changes in the purpose statement of legislation will have unintended consequences. Any utility style regulatory framework that is introduced should have a separate purpose statement to reflect the different nature of that regime and avoid causing additional uncertainty and delays to regulatory issues concerning other services under the Act.

Application of the same purpose statement for Part 4 and the utility-style framework under the Telecommunications Act would help ensure decisions under one regime provide precedent for decisions in the other regime. However, some care is needed about the differences between the section 18 purpose, and the Part 4 purpose under section 52A Commerce Act. Aspects of the proposed utility-style framework, notably layer 1 fibre unbundling, relate directly to promotion of competition (section 18) rather than "promoting outcomes that are consistent with outcomes produced in competitive markets" (section 52A(1) Commerce Act). Consideration needs to be given to how the new provisions can best accommodate competition issues. Section 52A(1)(a) Commerce Act also narrowly refers to the regulated suppliers "incentives to innovate and to invest" whereas section 18(2)(a) Telecommunications Act more broadly refers to the incentives of any "investors in new telecommunications services".

Adding and removing suppliers

57.	**Do you agree with our proposed process and test for introducing a new supplier to the regime (or removing a supplier from the regime)? Please provide additional comments on any other aspects you think should be considered.**
58.	**Do you agree that the new framework should only apply to fixed line services?**

We would be concerned if the reference to "substantial degree of market power" gave rise to arguments about whether a UFB supplier should be a regulated supplier under this framework, where it is the only provider of fibre to an RSP.

We agree it is inappropriate for this framework to apply to other services that are not fixed line services, given it is being implemented as part of a package that addresses fixed line access issues.

[13] 2degrees, Regulating communications for the future: Review of the Telecommunications Act 2001, November 2015, page 3.

Appeal rights

59.	**Do you agree with the proposed approach to merits review? If not, are there any characteristics of fixed line services which mean that Part 4 merits review processes are inappropriate, or any changes are needed?**
60.	**Do you agree that merits review should not be introduced for the existing regulatory framework in the Telecommunications Act?**

If merits review is introduced, we agree that this should be subject to the limitations that apply under Part 4 of the Commerce Act; including that the merit appeals are limited to the IMs and do not extend to price (and service quality) determinations.

As set out in previous submissions, the issue of merits review has already been subject to very considerable debate in telecommunications. Wide-ranging merits review processes are lengthy, costly and uncertain, in many cases suffer from lack of appropriate Court specialists and tend to favour well-resourced incumbents. We consider introduction of merits review for other parts of the Telecommunications Act could further increase regulatory uncertainty, divert industry resources, open up further gaming opportunities and potentially result in further delays in realising competitive benefits to consumers.

While considered, wider merits review was not introduced to the current Telecommunications Act process. Instead, the process requires Ministerial approval of Commission recommendations as the oversight/safeguard.

We note introducing merits review for other parts of the Act would require other fundamental changes – in particular at a minimum it would require removal of this Ministerial oversight step. Not to do so, would only serve to further increase uncertainty and delay.

Backdating and claw-backs

61.	**Do you agree that mandatory claw-backs should be introduced for utility-style regulation of fixed line services under the Telecommunications Act?**

The Options Paper states that:

> "In the interests of being consistent with Part 4, we believe that mandatory claw-backs should be introduced for utility-style regulation of fixed line (telecommunications) services. We do not think that there is a need to specify in legislation that claw-back should apply within the existing regulatory framework in the Telecommunications Act".[14]

Compared to backdating, claw-back is likely to be a superior way to compensate for under or over-recovery of access revenue.

Many of the problems with backdating were canvassed by Access Seekers, and consumer groups, in response to the Commission's consultation on the UCLL and UBA FPP determinations. One of the biggest problems with backdating (or even simply the possibility of backdating) is that Access Seekers won't necessarily know what their access charges are (because they could be retrospectively changed through backdating) when they set their retail prices. (Access Seekers can't then retrospectively change their retail prices.) If an Access Seeker over-estimates what the backdated access charge would be this would result in retail prices to end-users that are higher than they should be, but if an Access Seeker under-estimates the backdated access charge the retail prices may not be sufficient to recover costs.

[14] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 77.

This is inconsistent with "promoting outcomes that are consistent with outcomes produced in competitive markets".

Claw-back overcomes this problem by (temporarily) adjusting future access charges to compensate for any under or over-recovery of access revenue.

In the context of telecommunications, consideration should be given to how claw-back would apply where there are multiple services (e.g. anchor products and commercial products), and the potential to disadvantage those operators that have a growing customer base: the incidence of recovery of any revenue shortfall could be different under claw-back and backdating.

Similarly, also, the parties that may have underpaid (or overpaid) may no longer purchase the same products.

These issues require further consideration, including how the clawback applies (e.g. to the revenue cap or anchor prices) and if a clawback mechanism is introduced, whether it should be mandatory or discretionary (for example, if it is in the long-term benefit of end-users). Notably, Part 4 of the Commerce Act includes both mandatory and discretionary claw back provisions.

Our initial view also is that backdating should be prohibited under Part 2 Telecommunications Act, and/or that it would be better to replace the current (implicit) backdating provisions under Part 2 with discretion for the Commission to apply claw-back, if it is to the long-term benefit of end-users.

Chapter 8: Managing the transition

Managing the transition

62. In your view, do our proposals around smoothing the revenue cap and minimising price volatility for anchor products provide enough protection in reducing the risk of price and/or revenue shocks?

2degrees agrees with the concerns about "the risk of end-users facing material price increases", and "sudden changes in revenue and/or prices can be highly destabilising in the short-term", and that there should be "a clear focus on protecting end-users".[15]

2degrees considers that the provisions in sections 52D(2) and (3) and 53P(8) Commerce Act could be applied to reduce the risk of price volatility and/or shocks.

Under section 53P(8)(a) "The Commission may set alternative rates of change for a particular supplier— (a) as an alternative, in whole or in part, to the starting prices set under subsection (3)(b) if, in the Commission's opinion, this is necessary or desirable to minimise any undue financial hardship to the supplier or to minimise price shock to consumers".

The criteria the Commission has applied for identifying undue financial hardship is that:[16]

> … any supplier that believes the proposed price adjustments would cause undue financial hardship must provide evidence that:
>
> 6.12.1 the revenue adjustment would, or would be likely to, limit the supplier's ability to finance its reasonable investment needs and meet its debt repayments as they fall due; and/or
>
> 6.12.2 it is not reasonable (and/or possible) for the supplier to address its limited ability to finance its reasonable investment needs and meet its debt repayments as they fall due by altering its behaviour.

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[15] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 79.

[16] Commerce Commission, Resetting the 2010-15 Default Price-Quality Paths for 16 Electricity Distributors, 30 November 2012, paragraph 6.12.

The undue financial hardship provision has precedent in telecommunications. Clause 7 of the Telecommunications Service Obligations (TSO) Deed for TSO Network Service provides that the TSO network service price can be adjusted (upward) if there is or will be an "Unreasonable impairment of overall profitability".

Section 53P(8)(a) of the Commerce Act has been applied by the Commerce Commission in relation to EDB services for both the 2010-2015 and 2015-20 price resets to cap the level of price increases consumers face in any given year. The Commerce Commission did not apply alternative rates of change in the initial gas pipeline businesses resets for 2012-17 because all the increases were below the CPI+10% level it had previously used as an indicator of price shock.

Section 52D of the Commerce Act also deals with "price volatility" concerns in relation to the application of claw-back. 52D(2) provides that "If the Commission requires a supplier to lower its prices, it must also require that the lowering of prices must be spread over time in order to minimise undue financial hardship to the supplier. Similarly, section 52D(3) provides that "If the Commission allows a supplier to recover any shortfall, it must require that any recovery must be spread over time in order to minimise price shocks to consumers".

Transitional arrangements

63.	**Do you agree that a transitional arrangement should be in place in case the new framework is not able to be implemented with enough notice before 2020?**
64.	**Do you agree with the proposed model of a temporary freeze? Are there any other risks or benefits of this approach?**

While we hope that prices will be established before 2020, we agree a transitional arrangement should be in place to address the case where regulatory proceedings are not completed by 2020.

We note Part 4 of the Commerce Act includes provisions for managing the transition (if needed) including roll-over of existing prices, and provision for subsequent reset to include clawback of any consequent under or over-recovery. It therefore may be unnecessary for the Telecommunications Act to include an alternative bespoke "mechanism for temporarily "freezing" the price and non-price terms for certain wholesale products in the market 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".[17]

The experience with implementation of Part 4 of the Commerce Act for Electricity Distribution Businesses demonstrated its provisions may be suitable for dealing with the transition from the existing Part 2 Telecommunications Act regime to a new utility-style framework, including the possibility of the Commerce Commission being unable to implement the fixed line (telecommunications) services IMs or price reset by 2020.

The Part 4 Commerce Act provisions (if adopted for the utility-style framework) would provide that:

- The Commission could roll-over prices in 2020 even if all the relevant IMs have not been determined;
- The Commission could adopt a transitional mid-period reset once the IMs were finalised;

[17] Ministry of Business, Innovation and Employment, Telecommunications Act Review: Options Paper, July 2016, page 80.

- The transitional mid-period reset could provide for claw-back (at the discretion of the Commerce Commission) for any revenue under or over-recovery caused by the delay in the reset; and
- If the Commission required fixed line service prices to be lowered, the Part 4 provisions provide that "the lowering of prices must be spread over time in order to minimise undue financial hardship to the supplier".

Chapter 9: Mobile competition and infrastructure sharing

Mobile competition and infrastructure sharing

As stated previously key issues in the mobile sector that the future regulatory framework should address are:

- Long term spectrum disparities between mobile network operators;
- Ensuring certainty of supply of national roaming service, at reasonable prices; and
- Supporting efficient pro-competitive rollout of infrastructure in rural areas.

These continue to be key issues for 2degrees. The following addresses MBIE's specific questions regarding mobile as part of Phase 2 of this review.

65. Please comment on any other measures you recommend to address mobile infrastructure sharing (outside of changes to Schedule 3, which are discussed in the next chapter).

National Roaming

2degrees agree with MBIE's concerns regarding the competitiveness of pricing of national roaming contracts. **[C-I-C]**

In these circumstances, we support streamlining of Schedule 3 (as set out in our response to Q69), which would provide access seekers with a more viable path to secure national roaming services and enhance the commercial negotiation process because incumbents such as Vodafone would have reduced ability to delay provision of competitive access.

Despite securing a national roaming agreement with Vodafone, the ability to retain regulated national roaming remains important. Although 2degrees' own network covers c.96% of the population, the last 2% of population coverage will take significant time to build given the low density per site.

RBI and the MBSF

A key issue that Government needs to address as part of the RBI and MBSF is ensuring that the solution allows competitive access to infrastructure on an equal access basis to current and future technologies. Relying on the Schedule 3 colocation and/or national roaming provisions, or incentives to enter commercial agreements, will not achieve this and will see a repeat of the national roaming farce experienced by 2degrees to date, and ultimately see rural consumers miss out on the competitive services experienced in urban areas.

Like-for-like access to RBI towers is key to brand perception and the ability for 2degrees to compete at a national level. As the Government is aware, consumers' value extended national coverage and are highly mobile. It is not acceptable for Government to provide a long term advantage on terms that fail to guarantee equal access to infrastructure to incumbent operators by subsidising their coverage, including rural coverage, coverage of transport corridors and tourist areas. 2degrees require long term access to this coverage. As the

Options Paper notes, 2degrees loses heavily on perceptions of coverage and confidence. Without equal access to future extensions of the network, the Government is making it even more difficult to compete and will allow incumbent competitors to leverage Government funds to maintain a network advantage over 2degrees. This is despite significant capital investment by 2degrees, which has already expanded its national network reach from 47% to nearly 96% in just seven years and is rolling out a nationwide 4G network.

Notably, 2degrees has proposed a non-discriminatory roaming solution, which reduces network replication in areas designated as uneconomic, supports increased rural coverage, whilst allowing all mobile operators to provide national competition and choice. This option is the best value solution to ensure rural consumers experience true choice via future proof infrastructure.

In the absence of this solution, as a national network provider that is continuing to deploy cell sites, we will require colocation access equivalent to that of Vodafone and Spark on future RBI towers and would support a lower cost colo model (recognising there is room for cost savings relative to the current RBI colocation towers). Just like Vodafone and Spark, 2degrees will build on these towers as it rolls out its national network. 2degrees is aware that a hybrid model has been proposed, whereby two mobile operators co-locate and the third must roam. This would be the worst possible outcome for consumers and punitive to 2degrees, which has proven its ability to invest in competitive infrastructure. As it continues to complete its network deployment, 2degrees should not be penalised via a 'point in time' assessment for not having the same amount of infrastructure as incumbents that have been in operation for more than 20 years. Such an approach is entirely unacceptable.

We are unclear on the RBI2 timing and process, however note to ensure a fair and robust RFP process, and given the current information asymmetry with the current RBI1 wireless provider and the absence of a public evaluation to date, we would value lessons learned from the experiences of RBI1 being shared by MBIE well prior to the forthcoming RFP process.

Radio Spectrum

While cell sites represent the last mile of mobile competition, spectrum is the bedrock from which it begins. There should be a greater appreciation of the impact that relative spectrum holdings have on the long term industry structure and nature of competition, given the effect spectrum has on the underlying cost of capacity.

We understand no questions have been asked of spectrum issues as part of this phase of the Telecommunications Act Review. Given the direct impact this has on the telecommunications sector, the telecommunications team should take a stronger interest in the outcomes arising from the radio spectrum regime. The current situation, which has seen the significant, long term accumulation of key telecommunications spectrum bands by two providers is material to wider mobile competition.

As noted previously, the current spectrum allocation process has no legislative framework, no requirement to consider competition impacts, and no requirement for an independent analysis of the competition safeguards that should be put in place to prevent long term bottlenecks and protect consumer interests over the long term. It instead relies on 'spectrum caps' being set by non-competition experts, who also act for the vendor. These spectrum caps have previously been set at levels above those recommended by the independent regulator. **[C-I-C]**

2degrees supports the responsibility for spectrum allocation being placed with an independent regulator, as is commonplace internationally. However, at a minimum, this review should address the lack of transparency, accountability and investment uncertainty arising from the current ad hoc arrangements by establishing a clear framework for spectrum allocation decisions. This requiring the Commerce Commission, as an independent expert separated from the seller of the spectrum, to conduct an assessment of competition issues and identify

appropriate safeguards (*prior* to any spectrum assignment process), which are then binding on the vendor/Government.

Other issues for mobile regulation

66.	**Do you agree with our views on MVNOs and tools to manage competition in retail markets?**

We agree with MBIE's view that if necessary, the Commerce Commission already has the power to initiate a study under the Telecommunications Act to investigate whether there are wholesale barriers to MVNO access (or any other wholesale issues) that may arise. This does not require further Government intervention - if the Commission considers it is warranted, it is able to commence a Schedule 3 process.

We note 2degrees does not consider there is a case for investigation of MVNO access regulation at this time. MBIE will be aware that 2degrees is an active player in the MVNO market, and since the time of the previous consultation has worked with The Warehouse Limited to provide the MVNO, Warehouse Mobile. We are actively competing for other MVNO arrangements.

[C-I-C]

As noted, in Q69, we support certain improvements to the Schedule 3 process, which would equally be available to Access Seekers of MVNO services.

In contrast, we note that the Commerce Commission is not empowered to address retail anticompetitive behaviour under the Telecommunications Act. This applies to all issues – not just mobile. New Zealand is heavily reliant on what is often viewed as an ineffective antitrust regime under the Commerce Act, including by New Zealand's Productivity Commission, and we remain unconvinced that the Commerce Act can be relied upon to deal with issues in telecommunications before damage is done.

Chapter 10: The regulatory toolkit

Managing copper to fibre migration

67.	**Would a regulated code, applying to RSPs as well as UFB providers, be the best way to protect end-users in the transition from copper to UFB services?**
68.	**If a regulated code is not your preference, what mechanism do you propose to ensure end-users are protected in the transition?**

We support a consumer/industry-led migration from copper to fibre, although acknowledge that at some point it will be uneconomic to continue operating parallel copper and fibre networks and a withdrawal process will need to be managed.

We agree that a regulated code (or codes), developed with end user and industry input, can provide for protection for end users, including minimum standards to be achieved during the migration process.

We note that the TCF is already developing codes to manage some of the issues raised (for example, addressing the use of medical devices and ensuring that end-users are aware of the need for battery backup). We consider the TCF well-placed to help develop a code regarding any withdrawal of copper services.

Recommending regulation and deregulation

69.	**Do you agree with the recommendations to make the Schedule 3 process more efficient?**
70.	**Please comment on whether any other aspects of the Schedule 3 process could be removed or shortened further, or on any other ways to make the process more efficient and timely.**
71.	**Do you recommend any further changes in order to mitigate any potential harm being done in the market while a Schedule 3 process is underway?**
72.	**Should there be criteria specified for the Commission's decision whether to recommend a one- or two-stage pricing process for a potentially regulated service?**

We agree the current Schedule 3 process is inefficient and should be streamlined. However, while we support streamlining of the current Schedule 3 process, we consider there are significant risks with some of the solutions proposed in the Options Paper and do not support these.

In particular, imposing 'hard' deadlines' has the potential to work against all parties and result in ill-informed or 'wrong' decisions, because the Commission and industry are working to a particular timeframe regardless of the information or time they require. This is particularly the case when imposing short timeframes for what both the Commission and Ministerial process have required very significantly longer to achieve in the past.

We do support:

- Recognition that changing from a specified to a designated service under the Act should not require the same level of investigation and scrutiny as investigating the introduction of regulation. While conferences or public hearings may not be included as part of this process this would not preclude them as part of the STD process; and
- The Commission being provided discretion to recommend whether a newly regulated service will have a one or two stage pricing process.

We have previously suggested alternative options the MBIE could consider to streamline the Schedule 3 process, including combining the Schedule 3 and STD processes into a single Commission process and empowering the Commission to make the final Schedule 3 decision.

Convergence: Broadcasting exemption and net neutrality

73.	**Do you agree that the current regulatory framework has sufficient safeguards in place to manage any net neutrality issues that may arise, in light of recent market developments?**

As set out in our previous submission, the key issue is to ensure there is competition at the retail level such that the consumer can choose alternative service should an RSP deprioritise traffic to their disadvantage. Provided the retail market is competitive we do not consider net neutrality is an issue that requires direct regulation. The Commerce Commission can refuse to allow mergers that substantially reduce competition and can monitor issues under section 9A.

The recent proposed merger between Sky and Vodafone does raise potential net neutrality issues given (if approved) the likely negative impact on retail competition that will result in both mobile and fixed broadband markets. This is a merger between the dominant content provider

(and exclusive provider of key services such as premium sport content) and a dominant telecommunications provider. However, as 2degrees and multiple other parties have submitted, the Commerce Commission can and should refuse this merger because it clearly substantially lessens competition relative to the counterfactual (and status quo). For example, prior to the proposed merger being announced, 2degrees had commenced constructive wholesale negotiations with SKY so that it could unbundle SKY's content and develop bespoke packages for use on mobile devices.

Unlike in many overseas jurisdictions, there is no access regulation to key wholesale content in New Zealand. We have previously expressed our concerns that the Commerce Commission is not able to accept behavioural undertakings in considering a merger and that the Telecommunications Act does not allow the Telecommunications Commissioner to address retail market behavioural concerns (including as part of this review). The continued absence of such mechanisms further supports the view that this merger must be declined.

Customer service and quality for telecommunications services

74.	**Please comment on the proposal to amend the Consumer Complaints Code and Scheme TOR to make wholesalers primary respondents to a customer complaint.**
75.	**Please comment on the alternative option of introducing a new consumer complaints resolution scheme.**

It is in the industry's interest to ensure customer complaints are appropriately dealt with and we support a system to ensure this is the case.

We consider that the TCF should be given the opportunity to discuss and clarify MBIE's concerns regarding customer service and quality for telecommunications services. The TCF is already developing a solution that makes clear that consumers can make a complaint to the independent TDRS scheme agent about both wholesale and retail service issues.

In our view, the proposals in the Options Paper have not been adequately justified and require a greater understanding of the size and form of the problem. We have concerns that the proposals could result in increased confusion for both end-users and suppliers, and would not improve consumer experience. RSPs, such as ourselves, have the relationship with the customer, not Chorus or LFCs, and it would be unusual for the retail provider to be bypassed in such cases.

We do appreciate that some issues are related to wholesale supply, however the wholesaler already has obligations to address these and we consider further improvements in transparency and diagnostic tools could minimise customer complaints. Further, many issues can and are resolved by the RSP (who is incentivised to do so) and more often than not, we understand that those issues that are taken further are actually found in favour of the telecommunications provider.