LFC Submission on MBIE Options Paper

2 September 2016

Contents

Executive Summary

1. This submission is made on behalf of the three LFCs, Northpower Fibre, Ultrafast Fibre and Enable in response to the Options Paper released by the Ministry for Business, Innovation and Employment (**MBIE**) in July 2016 as part of its review of the Telecommunications Act (the **Options Paper**).

2. We commend MBIE on a carefully considered and well-presented paper. We endorse the balanced objectives and principles on which it builds and agree with many of the detailed preferences set out for the future evolution of the regulatory regime.

3. The telecommunications industry is currently experiencing strong and healthy competition in the retail and wholesale markets. At the wholesale level, the LFCs compete with other fixed networks, mobile networks and fixed-wireless networks. Our customers (**RSPs**) have significant countervailing power and the largest are actively seeking to displace us. Technology continues to advance in all of these modes, and as a consequence we expect competition for our services to intensify over the next few years and for this to remain vigorous for the foreseeable future. Since our inception, LFCs have been responsive to competition. The most recent evidence of this is our launching of a 1G residential product next month.

4. LFCs are currently constrained by commercial agreements with the Crown and in addition operate on open access terms with RSPs, with no right to vertically integrate or geographically expand – even in response to competition from RSPs who do not have such limitations on them. These agreements with the Crown were always intended to be time-limited and the Review offers a timely opportunity for the industry to agree on new oversight and assurance arrangements for the period beginning in 2020.

5. Recognising that LFCs face strong competition and are community focussed (and mostly community-owned), the Options Paper proposes a "backstop" regime for us. This limits regulation of LFCs to information disclosure (**ID**) unless an intervention test is satisfied. We strongly endorse a backstop regime for LFCs and submit that the existing ID regulation of LFCs, details of which were determined by the Commerce Commission in 2012, remains fit-for-purpose. These existing ID regulations make LFCs unique in New Zealand as the only firms that serve competitive markets but are nevertheless regulated.

6. Our reading of the Options Paper is that, under backstop regulation, LFCs will not be required to supply anchor products at regulated prices or submit capital investment plans to the Commerce Commission for pre-approval.

7. We consider that the currently proposed test for shifting firms from ID regulation to price-quality regulation is inefficient, and is likely to lead to regulation of services when that is not warranted. We submit that this intervention test be the same as the test for bringing any other firm into the regulatory regime.

8. MBIE also needs to be much more directive about the treatment of the initial regulated asset base (**RAB**) valuations for LFCs. MBIE is uniquely placed to determine the fair treatment in

the RAB of expenditures undertaken by LFCs and our owners to deliver on the government's UFB objectives. These determinations should be placed in legislation to ensure that we have a fair opportunity to recover the significant capital investments made by LFCs and our owners in good faith.

9. While LFCs do not expect to be subject to revenue or price caps in the first instance, these provisions may apply to us in the future. Competitive forces, including the countervailing power of RSPs that own their own infrastructure, largely remove the ability of LFCs to manage uptake risk. It would be more efficient for the RSPs to bear the uptake risk by imposing revenue caps on regulated fixed networks, than for price caps to place that risk on UFB networks. LFCs are strongly opposed to the idea of asymmetrical wash-ups on the basis that such a policy could strand our assets. We would therefore require a mark-up on our allowed WACC in order to respect the basic regulatory principle that we have the opportunity to maintain our financial capital intact and deliver a fair return on our investments.

10. Regarding anchor products, we see a distinction between basic lifeline/USO products that the government might want to be offered below cost for social reasons and price-regulated products designed to anchor the structure of prices.

11. We consider that one single layer 2 fibre anchor product can deliver the government's objectives to anchor pricing at layer 2. This anchor product should be specified in collaboration with the industry and upgraded over time. LFCs expect to offer such a product because our RSPs will demand it. We strongly support the price smoothing principles outlined in the Options Paper and will factor these into our pricing calculations.

12. For any basic lifeline/USO product, LFCs consider that further thought is needed on three aspects: its specification; allocating the obligation to supply; and compensation. Further consultation and engagement between officials and the industry would be useful on these matters, as we would like to see these barriers to fibre migration removed.

13. Our submission elaborates on these points and includes an appendix that addresses a number of questions posed in the Options Paper.

1. Introduction

14. This submission is made on behalf of the three LFCs, Northpower Fibre, Ultrafast Fibre and Enable in response to the Options Paper released by the Ministry for Business, Innovation and Employment (**MBIE**) in July 2016 as part of its review of the Telecommunications Act (the **Options Paper**).

15. The UFB and RBI projects are transforming the telecommunications industry in New Zealand. We are now benefiting from structurally separated networks serving a highly competitive retail sector. At the same time, there is strong and healthy competition for our services and we are competing directly with other fixed networks, mobile networks and fixed-wireless networks.

16. As detailed further in section 2, technology continues to advance in all of these modes. We therefore expect that competition for our services will intensify further in the coming years and will remain vigorous for the foreseeable future. The Options Paper recognises that we face effective competition, are community focused and that our retail customers (**RSPs**) have countervailing market power. Further evidence on these points is provided in this submission.

17. We commend MBIE on a well presented and well thought out paper, and endorse many of the preferences set out in the Options Paper, including on major topics such as:

    a. establishing well considered and balanced objectives for the regulation of the communications sector

    b. the move to a more standard utility model of regulation;

    c. the use of backstop regulation for the LFCs; and

    d. geographical averaging within UFB providers' networks.

18. On some other subjects, we have concerns. The most important topics in this category are:

    a. The form of Information Disclosure (**ID**) regulation proposed for LFCs;

    b. The proposed intervention test for transition from ID to price/quality regulation; and

    c. The process for setting the initial RAB.

19. We also comment on the proposed price/quality regulations. These will not directly affect us unless and until an intervention test is satisfied, but we have recorded our views where we think they may assist MBIE in refining its position as the Review progresses.

20. We are willing to interact directly on any of the matters raised in this submission, or the Options Paper.

21. Our submission is structured as follows:

    a. Section 2 contains our analysis of efficient and proportionate regulation;

b. Section 3 covers the valuation of the initial RABs;

c. Section 4 considers the form of control and anchor product definition and pricing;

d. Section 5 presents our views on innovation, unbundling and investment;

e. Section 6 discusses other issues; and

f. The Appendix provides answers to a number of MBIE's questions.

2. Efficient and Proportionate Regulation

22. It is widely accepted that regulation needs to be efficient and proportionate, and that these principles need to be clearly reflected in the policy settings resulting from this Review.

23. For many years, public policy in the New Zealand telecommunications sector was heavily influenced by a desire for infrastructure-based competition. This goal was one of the motivations for the ladder-of-investment theory, under which Telecom's rivals were granted regulated access to its network including through copper unbundling.

24. Infrastructure-based competition is now a reality in all of our footprint areas due to the continued presence and use of Chorus's ubiquitous network. In addition, we face competitive fibre loops targeting high-value customers in CBDs, very widespread availability of excellent 4G mobile broadband,[1] and the strong near-term prospect of robust competition from both fixed-wireless and 5G mobile broadband. Enable also competes against Vodafone's HFC network.

25. Spark's recent announcement of an "owned fibre" initiative in CBDs further demonstrates that this competition is intensifying. The NBR says that "*this initiative (along with the fixed wireless push; below), shows a desire for total control over a service (or vertical integration, in industry speak)*".[2] LFCs agree with that assessment.

26. We also note that while LFCs are geographically constrained (unlike our competitors) and are prohibited from integrating into retail markets, RSPs are free to vertically integrate in any way they choose.

Outlook for Competition and Technology

27. Competition will only intensify in the near term, due to three inter-related factors:

    a. Growth in user demand for bandwidth;

    b. Technological advances; and

    c. Open access obligations on UFB providers.

28. Growth in user demand for bandwidth is clearly evident from the Commerce Commission's latest monitoring report, which shows 1.4m fixed broadband connections and 5.2m mobile broadband connections.[3] Compared with five years earlier these numbers are up by approximately 40% and 400% respectively. Over the same period average data usage on fixed line broadband connections has increased five-fold, from less than 10GB/month to almost 50GB/month (as shown in fig 13 of the Commission's report). Thus, more end-users

[1] According to an independent study by OpenSignal, New Zealand had the fastest 4G mobile broadband speeds in the world at a real world average speed of 36Mbps in Q3 of 2015 (http://opensignal.com/reports/2016/02/state-of-lte-q4-2015/). The most recent report has New Zealand in second place internationally, having since been overtaken by Singapore.

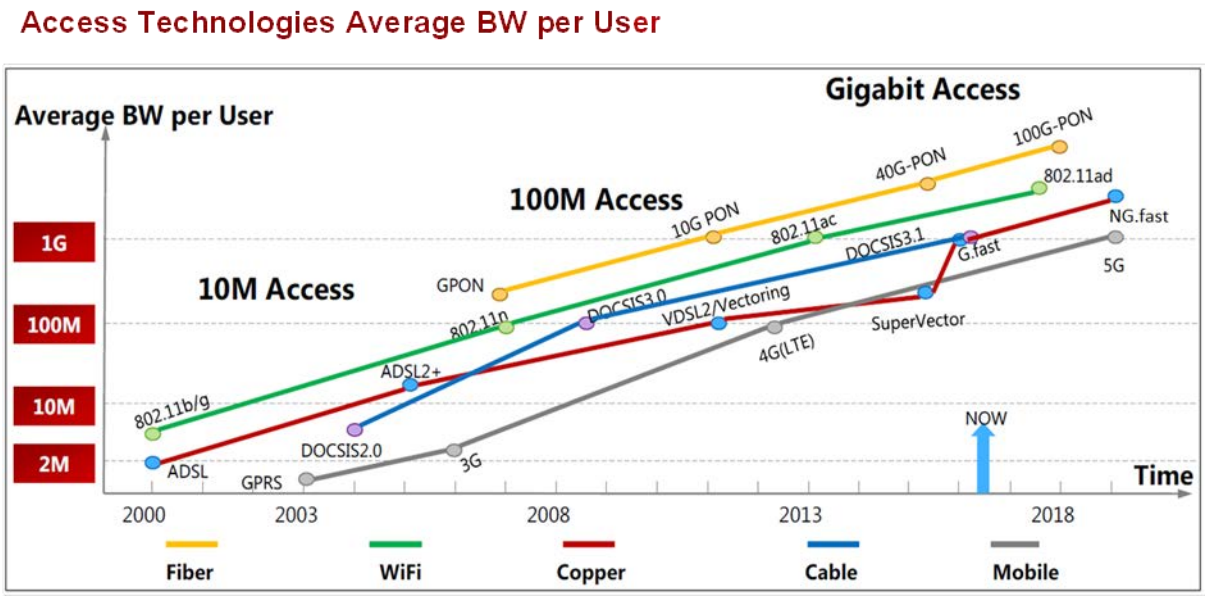
[2] Chris Keall, Top five takeaways from Spark's full year result, NBR, 22 August 2016.

[3] Commerce Commission, Annual Telecommunications Monitoring Report, 2015, published May 2016, figures 3 and 4.

are connecting to broadband networks and, on average, each end-user is using increasing quantities of data. We expect these trends in demand growth to continue for some time, driven by the continual development of services, content and devices that together will promote increased demand for bandwidth.

29. These demand increases could not have occurred without widely available broadband access, including through the UFB and RBI initiatives. However technology continues to advance across all broadband access methods. The following diagram shows how wifi, copper, cable (HFC) and mobile broadband technologies have developed, and are expected to develop, in ongoing competition with fibre technology, over the coming years.

Figure 1 Source: Huawei Access Network, European Operators Conference, 2014



30. Thus, both demand and supply trends are pointing towards better services in the future. The third element needed for intense competition is the absence of barriers to RSPs reaching end-users. This has been addressed in New Zealand through structural separation of most fixed networks including our networks over which we are required to provide open access on a non-discriminatory and equivalence of inputs basis. There is however some existing vertical integration (e.g. Vodafone's HFC network) and a possibility that further re-integration will emerge as our RSP customers' wholesale divisions acquire more of their own network capacity such as Spark's plans for "owned fibre" and a fixed-wireless network[4] and more generally through the use of layer 1 fibre access.

31. LFCs cannot ignore these strong and diverse competitive forces. Working together, we have recently announced our offer of a 1G product from October 2016. The release of this product was not mandated by the UFB contracts, and reflects our ability and desire to respond to high-end demand in a timely manner. This market-leading product will be available to all residential consumers considerably earlier than other offers.

[4] Chris Keall, Top five takeaways from Spark's full year result, NBR, 22 August 2016.

32. LFCs have always served competitive markets and we see this competition becoming increasingly intense over time.

Proportionate Regulation

33. Ordinarily, it would not be considered appropriate to subject firms facing such competition to regulation; for example, the test in Part 4 of the Commerce Act (that the firm at issue faces "*little or no competition and little or no likelihood of a substantial increase in competition*" (s52G)) would not be satisfied.

34. We are currently subject to ID obligations imposed by the Commerce Commission in 2012[5] as one of the obligations imposed by Part 4AA of the Telecommunications Act 2001 on networks developed with Crown funding. As a consequence, we are the only companies in New Zealand that are subject to regulation despite facing active and increasing competition.

35. The Options Paper proposes that we continue to be subject to ID regulation post 2020. As discussed above, there would be no basis for subjecting us to ID regulation if the normal Commerce Act provisions were applied, because we clearly do face competition.

36. Our existing ID regime is sufficient to meet all reasonable policy concerns and we see no reason to incur the costs and uncertainty associated with a redetermination of these obligations. If a real gap is identified at a later stage, a suitable disclosure rule could be added to the existing determination.

Intervention Test

37. The Options Paper proposes that the trigger for moving from backstop regulation to price/quality regulation should be based on a purpose statement modelled on the purpose statement in s52A of the Commerce Act, that is, in essence: *"promoting outcomes that are consistent with outcomes produced in competitive markets".*

38. While this test may be appropriate for assessing the nature of the price/quality obligations to be imposed on a supplier, we submit that it is not suited to determine whether a supplier should be subjected to price/quality regulation.

39. We note that the Options Paper proposes a different and more stringent test for whether a new supplier can be added to the list of regulated suppliers. This test is proposed that its "*services are being provided in a market where the supplier has a substantial degree of market power*".[6] The Options Paper further notes that "*this is the same test for adding or removing gas suppliers from Part 4 under section 55A(6) of the Commerce Act*". Our reading is that s55A(6) applies only to gas pipelines, which would correspond to backhaul providers in this industry. We consider that a consistent approach for our networks would be to use s52G of the Commerce Act which is the standard hurdle in New Zealand for applying economic regulation.

40. While the Options Paper considers the appropriate intervention test for moving to price/quality regulation, it is silent on the process for applying that test. We submit that a

[5] Commerce Commission, LFC Information Disclosure Determination, 28 June 2012.

[6] Options Paper, page 73.

process should be adopted which is equivalent to that which applies under part 4 of the Commerce Act for a move to price/quality regulation under subpart 6. The Commission would be required to hold an inquiry to satisfy itself that the intervention test had been satisfied, and that price/quality regulation should be imposed having regard to the factors listed in s52, and if satisfied, make a recommendation to the Minister, who would follow the process in s52L - s52N.

41. In summary, we submit that the test and process for moving a supplier from backstop ID regulation to price/quality regulation should be the same test as proposed for adding a supplier to the list of regulated suppliers. That should be the test in s52G of the Commerce Act because it includes both a competition test and a cost-benefit test.

Purpose Statement

42. As noted above, the Options Paper proposes that the purpose statement for the Telecommunications Act be changed to one modelled on the purpose statement in s52A of the Commerce Act. During the determination of input methodologies (**IMs**) by the Commerce Commission in 2009-10, this purpose statement provoked very lengthy debates and considerable criticism of the structure and wording of the purpose statement, including over the relative weights that should be given to the stem of the statement and its four sub-clauses. The fact that the sub-clauses each seek something different and indeed are contradictory[7] exacerbated the difficulties (see paragraphs 56 and 57 below for further elaboration of this point).

43. We acknowledge that some of these difficulties were resolved in the context of IMs for other regulated firms, but we think it likely that the same costly debates will be replayed in this industry if the same purpose statement is used. We think that a cut-down purpose statement based on the stem alone would be consistent with the agreed principles of regulation and meet all of government's objectives in this Review, but do so more efficiently. For this reason we invite consideration of the following purpose statement:

> *The purpose of this Part is to promote the long-term benefit of end-users in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets.*

[7] For example, if firms are limited in their ability to extract excessive profits (s52A(1)(d)) they have *weaker* incentives to innovate and to invest (s52A(1)(a)).

3. RAB Valuation Issues

44. In this and following sections we comment on the proposed form of price/quality regulation. While we will not be subject to price/quality regulation, we offer our views where we think they may assist MBIE in refining its position as the Review progresses.

45. As we have previously advised, we support moving to the RAB/BBM method for valuing assets based on historic cost for the purpose of price/quality regulation.

46. We also agree with the Options Paper that "*the initial RAB valuation needs to reflect that the deployment of UFB programme was made pursuant to a Government investment programme that set reasonably rigid requirements for UFB providers' investments*" (p.36) and the proposal that "*the legislative framework make clear that the Commission should not revisit whether it was prudent for regulated suppliers to deploy UFB or RBI infrastructure*" (p.36).

47. We do not however think that this is best achieved by the issue of a Government policy statement, leaving the decision ultimately to the Commission. The Crown, as the counterparty to our contracts, is obliged to ensure that our good faith investments are included in our initial RABs, and that the only way to achieve that outcome is for this to be specified in legislation.

48. Regardless of the number of RABs used, it is critical that appropriate IMs feed into the RAB. The IMs will need to be tailored accordingly depending on the number of RABs.

49. In this section we:

    a. Describe the investments at issue; and

    b. Explain why we believe the government is obliged to deal with these matters in legislation.

Investments Made by LFCs

50. The LFCs and our owners entered into contracts with the Crown to deliver an ambitious infrastructure project in our areas, and to connect end-users to our networks in competition with other fixed networks, mobile networks and fixed-wireless broadband networks.

51. Pursuant to these contracts and the competitive market we were targeting, costs over and above the contractual caps were incurred, all of which should be included in our initial RAB:

    a. Start-up losses (LFCs and owners), being operational losses that are inevitable for firms in our situation (capital intensive start-ups competing against a ubiquitous incumbent);

    b. Actual costs incurred in building the networks following our use of competitive processes to drive costs down;

    c. All connection costs borne by us, including, for example, non-standard installations and beyond the ONT services;

d. Costs arising from building and delivering additional UFB mass market residential products (e.g. 100/20, 200/20) in response to RSP demand; and more generally

e. all costs arising from building contracted assets that were required to deliver UFB fixed line services.

52. We have discussed these issues in previous submissions on this Review and refer MBIE in particular to paragraphs 14 – 20 of our submission on the Discussion Paper.[8] All of these expenditures were efficiently incurred and needed to comply with contractual terms that were effectively dictated to us by the Crown.

53. We note in particular that our networks would not have been built if our owners were not willing to take the risk on construction costs. This capital therefore forms part of our capital base, and is intended to be refunded to our owners as we repay their contributions over time. Thus, like the Crown funding, the capital was and remains necessary, and should therefore be included in the RAB.[9] The key remaining question is what rate of return should be imputed to that capital in each year since we commenced operations.

Why the Crown Must Legislate

54. By contracting with the LFCs' owners to set the contractual price caps, and with the Crown (via Crown Fibre Holdings) taking an equity position in each LFC and involving itself in our governance structures, it is reasonable for the Crown to ensure that cost recovery will not be prevented as a result of the outcome of the Review.

55. This obligation cannot be met by giving the Commerce Commission discretion on allowing or disallowing capital we have invested to date, even where a Government policy statement has been issued.

56. The role of the part 4 purpose statement in determining initial RAB values was hotly contested in the IM litigation. The Court concluded that "*existing regulatory valuations could only be adopted as initial RAB values if they promoted the s52A(1) purpose and outcomes*" (¶756), and that "*an initial RAB value would be fundamentally flawed if it generated prices that were inconsistent with the achievement of the s 52A(1) purpose and outcomes, in particular if it failed to limit suppliers' ability to extract excessive profits over time*" (¶760).

57. The Commission had a great deal of difficulty in reconciling the various purposes and outcomes in 52A(1) when setting the initial RAB values. There is no easy answer as to how to fit the costs we described above into the proposed purpose statement. Delegating these decisions to the Commission would materially extend the period of uncertainty over our valuations and place at risk capital investments we made in accordance with our UFB contractual obligations.

58. Initial RAB value decisions for the LFCs are readily distinguishable from all other decisions needed to implement the new regulatory regime. Firstly, whereas it is natural and efficient for regulators to adopt forward-looking perspectives when making most decisions, the initial

[8] LFCs, Response to MBIE, 3 November 2015.

[9] This applies whether the contributions were in the form of debt or equity.

RAB value decisions are inherently backward-looking: they concern previous agreements, commitments and investments. Secondly, as the counterparty to our contracts and the supplier of governance inputs since we commenced operations, the government (as distinct from the Commission) is uniquely placed to assess the costs we described above (¶51).

59. Setting the requirement out in the legislation would in our view be consistent with the regulatory compact, and is being proposed here with the intention of avoiding unnecessary cost and uncertainty for all parties involved.

4. Products and Pricing

60. In this section we discuss the form of control over prices for a price-quality regulated network, and anchor product issues.

Form of Control

61. The choice between price-cap and revenue-cap regulation effectively allocates demand risk between the networks and the RSPs. It is socially efficient to allocate this risk to the group best placed to manage it, meaning the group that can do so at least cost.

62. We consider that our RSPs are much better placed to manage demand risk than us. They are actively targeting our current and prospective future end-users as outlined above (¶27 to 32). In doing so they benefit from line-of-business restrictions on LFCs that prevent us from responding to this competition, and superior information arising from their direct relationship with end-users.

63. These factors all point towards using revenue caps if the backstop regulation was ever to be triggered for LFCs.

64. We also note that demand forecasts will be less reliable in LFC areas than other UFB areas, because in our areas no revenue can be collected from any end-user until they are connected to our UFB networks. This is an extra source of demand uncertainty for LFCs, and therefore an extra reason for not applying price-cap regulation to LFCs.

65. We suggest that further consideration be given to the proposed combination of revenue caps and price caps with an asymmetrical wash up. There is a natural tension between revenue caps and price caps where the price caps may mean network providers are unable to achieve the revenue cap unless the wash up is symmetrical.

Anchor Products

66. We suggest that further consideration be given to the proposals concerning anchor products. Our understanding is that an anchor product is a price-regulated product which has the effect of constraining the pricing of other products. The Options Paper describes this effect as follows (at page 43).

> *Anchor product regulation can be designed to both protect end-users on basic services from the risks of price shocks (anchoring essential services) and to indirectly constrain the prices and quality of other services (anchoring premium services).*

67. In this section we discuss the specification of anchor products, and the pricing of them for price-quality regulated suppliers, including comment on:

    a. Initial anchor products; and

    b. Pricing of anchor products.

68. Our thinking on these issues has been influenced by discussions at the workshops hosted by MBIE in Wellington on 8th and 9th of August 2016. We consider that there was high-level agreement at those discussions that:

a. One anchor product is sufficient to anchor the pricing for all services that are not loss-making; and

b. If the government also wants a low-level basic lifeline service provided at prices that do not cover costs, then it must clearly explain how this obligation will be allocated and compensated.

Initial Anchor Products

69. We consider that one single layer 2 fibre anchor product can deliver the government's objectives to anchor pricing at layer 2. This anchor product should be specified in collaboration with the industry and upgraded over time. LFCs expect to offer such a product because our RSP customers will demand it. We strongly support the price smoothing principles outlined in the Options Paper and will factor these into our pricing calculations.

70. Our reading of the Options Paper suggests that the proposed 15/1 "*entry level broadband*" product was only envisaged as being required for end-users located in non-UFB areas such as rural areas. For example, its function was described on page 10 of the Options Paper as being "*to ensure a baseline broadband service is available, particularly for rural end-users who may not be able to access UFB".*

71. In our view, lifeline/USO products (such as the proposed voice only product and the 15/1 product) should be explicitly separated from the discussion and analysis of anchor products. These serve quite distinct public policy services: anchor products are intended to constrain pricing across many possible layer 2 products (see ¶60 above) to avoid price shocks; whereas lifeline/USO products that might be provided at prices below cost are a form of social policy designed to ensure connectivity for all members of society.

72. We support the use of social policies to provide basic lifeline/USO services. It is the government's role to define such basic services, assign the obligation to provide them, and consider the associated funding issues. If we are required to provide them, any losses involved in their provision should either be explicitly funded or be reflected in ID requirements as a social cost borne by LFCs for which compensation is allowed to be earned on other products.

73. Once a basic lifeline/USO product is defined, the only remaining product definition task is to select a single product that must be supplied as an anchor product on regulated terms by any supplier subject to price-quality regulation. We consider that this product should be defined through collaboration between industry and officials.

Pricing of Anchor Products

74. The Options Paper appears to be proposing the use of glide paths to smooth the transition in pricing from certain existing products to cost-covering prices for a new anchor product. We agree that it is undesirable for end-users to face sharp price increases, and we support the use of glide paths to achieve this outcome.

75. LFCs will meet the needs of our RSPs by offering a product the same as or equivalent to the anchor product that emerges from further consultation. We each propose to offer our own

pricing for this product, which is consistent with the backstop model of regulation. As noted above, we strongly support the price smoothing principles outlined in the Options Paper.

Geographic Averaging

76. We support the proposal for geographical averaging of prices across each network's footprint. We understand that the defined reach of Chorus's network for this purpose includes its copper network. That is, "network footprint" means the total network irrespective of the technology used and whether the network owner operates through a subsidiary in some areas. Our understanding is that, whatever prices the network provider offers for a given service, that price cannot be reduced in part of the network footprint.

77. We consider that this proposal is in the long-term interests of end-users because it promotes efficient competition between networks by partially redressing the imbalance of market power created by the UFB contracts. While the details vary across LFCs, each of us is prevented from competing outside our defined geographical coverage area. None of our competitors face this restriction. As proposed in the Options Paper, geographic averaging would prevent Chorus from pocket pricing its services in LFC areas, and we support this.

5. Unbundling and Investment

Unbundling

78. Current legislation requires that commercial unbundled layer 1 access be available for our RSPs from 2020. We intend to set cost-based prices for this service.

79. The test for an unbundled layer 1 access anchor product should be network-specific and should only be applied to a firm subject to price-quality regulation. The test should be whether the commercial layer 1 service price is materially above cost, after allowing for all relevant costs of the network owner including opportunity costs such as lost margins from selling layer 2 services.

Investment

80. One remaining concern on these issues is that the Options Paper proposes (page 37) to subject "*regulated suppliers*" to pre-approval screening by the Commerce Commission "*similar to that for Transpower*". LFCs understand that pre-approval requirements will only apply to price-quality regulated firms, but for the avoidance of doubt wish to record the reasons why such a process is not warranted for LFCs.

81. It is difficult to over-state the difference in competitive conditions faced by LFCs and Transpower. Unlike Transpower:

    a. LFCs are privately funded capital intensive start-up companies rather than decades-old state-owned enterprises;

    b. LFCs are not natural monopolies but instead compete directly with other access networks and this competition is expected to intensify; and

    c. LFCs' customers are a set of over 80 competing retailers, each of whom has the ability to churn end-users on/off our networks, in contrast to the other regulated monopolies who Transpower supplies.

82. Apart from the lack of a principled basis for pre-approval screening of LFCs' capital investments, we are concerned about the costs of such a process. There are likely to be significant direct costs of interacting with the Commission over our investment plans. In addition, we have serious concerns over the time required for such processes and the opportunity costs arising from these delays.

83. Consider, for example, our planning for investment in NGPON2 technology. This will be a major investment, far in excess of renewing layer 2 equipment. We anticipate that the timing of our investment in NGPON2 will have a strong influence on the demand for unbundled access to layer 1. As noted above, we want the ability to demonstrate our commitment to networks consistent with leading OECD operators, and show this innovation to RSPs that are considering seeking unbundled access. The aim is not to gold-plate or over-invest, but to retain the ability to make timely investments in our networks to deliver the right outcome for our RSPs.

84. There is a serious risk that imposing a pre-approval process on LFCs would deny us the ability to innovate in a timely manner. This could easily occur if the time required to operate the regulatory process of pre-approvals limits our ability to respond rapidly to changes in conditions in the relevant input and output markets. For example, a price reduction for NGPON2 technology will increase its attraction to LFCs and to RSPs. If RSPs can rapidly trigger unbundled access before LFCs can gain approval for NGPON2 investment, then the regulatory regime will have deterred our efficient investment.

85. For these reasons, and consistent with backstop regulation, we submit that LFCs should not be subject to any requirements that the Commission pre-approve our capital investments.

6. Other Issues

86. In this section we address the remaining issues arising from the Options Paper on which we wish to comment. To be clear, these issues are just as important to us as the topics covered above. The topics covered here are:

    a. Service quality issues;

    b. Dispute resolution; and

    c. Consumer representation.

Service Quality

87. The LFCs have designed and built their networks to contracted standards and SLAs. Our networks are currently operating to the satisfaction of the industry and the standards are best international practice

88. The current arrangements for controlling our service quality operate through the wholesale service agreements (**WSAs**) with RSPs.

89. We consider that there is no need for the Commerce Commission to become involved in our WSAs unless it can be clearly demonstrated that there is an irreconcilable dispute in relation to maintaining and improving on current standards. This is consistent with the 'negotiate-arbitrate' model that has under-pinned the Telecommunications Act since its initial passage in 2001.

90. The service and quality provisions in our NIPAs are due to expire in 2020 however. There might consequently be a case for transferring some service quality provisions from the NIPAs to the already determined ID rules governing us. This would be a relatively straightforward process that would simply augment the Commerce Commission's ID determination, to ensure that service quality continues to be monitored effectively and transparently once our NIPAs expire.

91. We would prefer to build on the existing provisions as described above rather than have the Commerce Commission initiate a new process to prepare, *de novo*, a quality of service IM.

Dispute Resolution

92. We consider it essential for the industry to operate an effective and efficient dispute resolution system. We consider that the existing arrangements are generally working well and embody efficient incentives, while also recognising that improvements can be made (see ¶6 below).

93. We are happy to become members of the TDRS, provided the category of complaint that we are required to respond to directly relates only to end-users and the FTTP install work we perform.

94. As wholesale-only fibre network operators, we are not, and should not be, the first point of contact for end-user complaints. Our RSP customers manage those complaints in the first instance, liaise with us as required and seek to work with us to resolve a complaint. The

TDRS only becomes involved when this process is unable to reach a mutually satisfactory outcome.

95. This line of accountability is natural and efficient and should be preserved. In particular, we must not be the first port of call for broadband service quality issues, because we only deliver wholesale services to our RSPs under our WSA. We do not provide broadband services directly to end-users, and we cannot be expected to carry the additional overhead for directly responding to end-user complaints about their broadband service quality.

Consumer Representation

96. LFCs consider that the processes for involving end-user representatives in industry matters can be improved. This is most evident in respect of dispute resolution. It should be possible for TUANZ and InternetNZ to have a governance role in respect of the dispute resolution process. We recommend that officials pay close attention to submissions from those groups on this topic.

Steve Fuller	**Darren Mason**	**William Hamilton**
Chief Executive	**Chief Executive**	**Chief Executive**
Enable Networks Limited	**Northpower Fibre Limited**	**Ultrafast Fibre Limited**

Appendix: Answers to Questions

1. Please comment on the set of matters that you recommend input methodologies should cover, with reference to the examples.
This is covered in the body of our submission.

2. Should information disclosure apply even if price-quality regulation is applied to Chorus and/or LFCs at 2020?
We consider that the interplay between ID and price quality regulation should mimic that of the Commerce Act unless there are sound reasons to pursue an alternative. As discussed in the body of our submission (¶33 to 35), we consider that LFCs are already subject to sufficient ID rules as determined by the Commerce Commission in 2012, and that these rules should be retained for as long as we have Crown funding.

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

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?
We prefer it to be set in legislation.

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

7. Do you agree that decisions on the RAB valuation methodology should be made by the Commission?
No. As explained in section 3 above, we consider that the government should ensure that all costs incurred by LFCs and our owners to promote the UFB project should be included in the initial RAB unless they have already been depreciated. The government should therefore stipulate these aspects of the RAB valuation methodology in legislation to provide certainty and the timely implementation of the regulatory framework.

8. If you think the Government should provide legislative guidance, what form of guidance do you recommend?
As discussed in section 3 above, we consider that the Telecommunications Act should be amended to ensure that the Commission is obliged to include in the RAB all costs incurred by LFCs and our owners to meet the government's UFB objectives.

9. Do you agree with our proposed approach to enable the Commission to determine the scope and treatment of assets in the RAB?
No. As explained in response to question 8, we consider that the Telecommunications Act should be amended to ensure that the Commission includes all costs incurred by LFCs and our owners in the RAB.

10. Please comment on any matters Government should take into account when developing a definition of "fixed line access services".
LFCs would be concerned if the legislative amendments were to limit the scope of regulation to fixed line access services. We see no reason for such a limit, and consider that it would be contrary to the principles of technological neutrality and would pre-judge the uncertain future evolution of communications technology. Bottlenecks could emerge from unexpected places.

11. Do you think Chorus' assets in LFC areas should be excluded from its RAB?
No. We think these assets should be included.

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.
For reasons discussed in the body of this submission, we consider that the capital associated with this financial support should be included in LFCs' RABs and that allowance for the concessionary terms on which that capital was supplied should be made by applying an appropriate WACC to that capital. We would like this to be in legislation.

14. Do you agree the Commission should decide on the treatment of UFB initial losses?
No. As explained above, we consider that the Telecommunications Act should be amended to ensure that the Commission includes all costs incurred by LFCs and partners in the RAB.

15. Do you agree with our proposed approach to the treatment of networks rolled out under the Government's UFB and RBI programmes?
Partly. LFC's agree there should be no prudency review, but we would like stronger assurances that no optimisation will be undertaken on efficiency grounds. We agree with the proposal regarding non-standard installations, but we strongly disagree that we should be subject to investment pre-approval tests, irrespective of whether the project was procured by the government.

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 are comfortable with the approach and suggest that there is no need for a centrally-determined threshold. All costs incurred by network providers should be included in the RAB. Decisions over whether to charge end-users vary by UFB provider in response to local competitive conditions.

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?
With our existing ID obligations under a backstop regime we do not agree that LFCs should be subject to a pre-approval obligation for capital investment, as discussed further in the body of this submission (¶80 – 85).

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?
We support the use of economic policy statements but our concerns over subjecting LFCs to investment pre-approval tests are not limited to government funded infrastructure. LFCs need to be able to respond in an agile manner to customer demand and the actions of rival networks.

Chapter 6: 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?
We do not consider that LFCs should be subject to regulated price caps or revenue caps because these are inconsistent with backstop regulation. More generally, we consider that RSPs are better

placed than us to manage uptake risk on LFC networks, so we are in favour of revenue caps. See ¶9 above.

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?
Competition is the thing that ensures LFCs are not wholly insulated from competition under a revenue cap model. LFCs should be allowed to capitalise any economic losses into our RABs, exactly as we recommend for start-up losses.

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?
The main risk we see is that price-quality regulation is imposed on LFCs without giving an opportunity for the backstop regime to operate.

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'?
We do not expect competition to be limited to the fringes. In the event that an intervention test triggers revenue cap regulation for LFCs we would oppose an asymmetrical wash up, unless there was explicit compensation for the asset stranding risk in our WACC allowance.

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'.
As discussed in the body of this submission (section4), LFCs would like anchor products to be designed through collaboration between government and the industry. We consider that there should only be one anchor product.

26. How should anchor product prices be determined?
In the LFCs areas, we would set the wholesale prices for anchor products. This is consistent with backstop regulation.

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 like all of these principles and will ensure they are properly considered in setting our anchor product prices.

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?
No. We support geographical averaging and believe it is in the long-term interests of end-users for the reasons described in the body of this submission.

30. Should the following services be anchor products from 2020? Why or why not?
a. layer 1 fibre service; and
b. any other services.

LFCs would like anchor products to be designed through collaboration between government and the industry.

31. What test should the Commission be required to apply to determine whether to introduce a layer 1 fibre anchor product?
The test should be network-specific and only be applied to a firm subject to price-quality regulation. In that situation the test should be whether the commercial layer 1 service is excessively priced, bearing in mind all relevant costs of the network owner including opportunity costs such as lost margins from selling layer 2 services.

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?
With respect to any layer 1 anchor product, LFCs would like anchor products to be designed through collaboration between government and the industry. With respect to pricing of any layer 1 anchor product for a provider subject to price-quality regulation, LFCs consider that this should be delegated to the Commission and determined using the RAB and IMs.

34. Should the Commission have the power to require services based other forms of unbundling (such as wavelength unbundling) to be provided?
No. LFCs do not consider that the Commission should be able to compel investment.

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?
LFCs would like anchor products to be designed through collaboration between government and the industry. In this case we would work with the Commission.

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?
We suggest that the Commission must review every five years or earlier if agreed by the industry.

37. Should there be a limit on the number and type of anchor products, as proposed?
LFCs would like anchor products to be designed through collaboration between government and the industry. As discussed in section 4 above, we think one anchor product is sufficient to meet the government's objectives.

38. Do you think that anchor products should be priced consistently across LFCs and Chorus?
No. LFCs, being subject only to backstop regulation in the first instance, should be free to determine their own prices for anchor products. If LFCs became subject to price-quality regulation, then the anchor product price would need to be determined with reference to our costs.

40. Should commercial services offered by UFB providers be subject to any requirements?
No. All matters relating to commercial services should be addressed by direct liaison between LFCs and our RSPs through our Reference Offer and WSAs.

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 12months' notice must be given of any changes to price or material non-price terms for commercial services?
Partly. LFCs, being subject only to backstop regulation, should be free to determine the timing of changes in their price and non-price terms in accordance with the provisions of the WSA. We agree with geographical averaging. We do not agree that we should be required to publish "a road map of future product development" unless the same obligation applies to our competitors.

42. What is your view on our proposal to carve the initial layer 2 anchor products out from this obligation?
We are not comfortable with this proposal. There are many potential scenarios to consider, some of which would compromise the long-term interests of end-users. Further consultation is required.

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?
We are not sure what this proposal might imply for the intervention test required to shift LFCs to regulation. However we agree that if a network is already subject to price-quality regulation then the Commission should be allowed this freedom. We agree that "*materially better*" would be a reasonable standard to require for such a decision.

44. Should the Minister make the final decision, or should this matter be delegated entirely to the Commission?
Yes, we consider that the Minister should make the final decision on this point.

45. Do you agree that regulated terms should be set by Commission determination?
Yes

46. If so, do you agree that mirroring the approach to section 52P determinations in the Commerce Act is appropriate?
Yes

Options for implementing price-quality regulation: LFCs
52. Is there a case to implement a backstop model, with information disclosure, for LFCs?
Yes. As discussed in the body of this submission, LFCs operate in very competitive markets.

a. To what extent do you think LFCs will be subject to competitive pressure from 2020?
As detailed in the body of this submission, we expect competitive pressure to increase over at least the next decade.

b. Do you expect that they will need to be subject to price-quality regulation at some point? When might this occur?
Possibly but we cannot know when or if this will occur. We would prefer to design a fit-for-purpose intervention test and would like to engage directly with MBIE on this point.

c. Are there any other risks or benefits to a lighter touch approach for LFCs?
Please see the body of our submission.

Intervention test

53. Please comment on the proposed intervention test based on the purpose statement.

a. What are the risks and benefits?

As discussed in the body of our submission, the main risk is that LFCs, who are already the only firms in New Zealand that are subject to ID regulation and face direct and intensifying competition, are subjected to full-scale regulation without proper recognition of the competition we face.

b. Would another type of test be more appropriate, such as that in section 52G of the Commerce Act? Why?

We consider that s52G is the normal test under New Zealand law.

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?

Yes we are comfortable with this.

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?

We have concerns with the proposed purpose statement: please see the body of this submission (¶42 - 43).

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.

No, as discussed in the body of this submission we consider that the test in s52G of the Commerce Act is more appropriate.

58. Do you agree that the new framework should only apply to fixed line services?

No. We see no reason for this restriction.

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?

No. ID regulation is our main concern and we request the same appeal rights as would apply under the Commerce Act for final ID determinations.

60. Do you agree that merits review should not be introduced for the existing regulatory framework in the Telecommunications Act?

Yes.

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?

Yes.

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?

Yes. LFCs consider that the principles MBIE has articulated regarding price smoothing will be sufficient.

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?

Yes.

64. Do you agree with the proposed model of a temporary freeze? Are there any other risks or benefits of this approach?

Yes. We are comfortable with the freeze proposal.

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?

Yes.

Recommending regulation and deregulation

69. Do you agree with the recommendations to make the Schedule 3 process more efficient?

Yes. We generally agree with these recommendations. However we note that (on p.88) they are linked with the intervention test for shifting LFCs to the backstop model, and refer to our above concerns regarding this test.

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?

No.

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.

We support wholesalers becoming members of the scheme in respect of disputes arising from UFB installation work we perform, however we do not believe wholesalers should be primary respondents to an end-user customer complaint relating to their broadband service. RSPs are the natural "primary respondents" and we expect to continue working with RSPs and end-users where we are involved with complaints.

75. Please comment on the alternative option of introducing a new consumer complaints resolution scheme.

LFCs are willing to do what we can to help RSPs resolve complaints. We believe that the scheme referred to in question 74 above can be amended to address all end user complaints relating to telecommunications services.

Housekeeping in the Telecommunications Act

76. Are there any other areas of the Telecommunications Act that you consider need to be updated or removed to be fit for purpose.

No.