11 April 2019

Stephen Gale
Telecommunications Commissioner
Commerce Commission
Stephen.Gale@comcom.govt.nz

By Email Only

Dear Stephen,

Fibre unbundling price

In June last year Vocus and Vodafone joined together to announce our intention to unbundle the fibre network. We firmly believe unbundling will be key to unlocking the future potential of New Zealand's fibre network. Competition on the network itself will ensure Kiwis have access to the best technology at reasonable prices, and will allow RSP's to innovate beyond the uniform bitstream access currently offered by wholesalers.

That has now all been put at risk by what is hard to see as anything other than a cynical and protectionist unbundling price from Chorus. The proposed price is constructed in a complex way, but the end result is a charge of around $62 per connection. This makes it more expensive than most bitstream products.

It defies sense that an RSP wishing to access a smaller part of Chorus' network and invest in innovating for consumers should be charged more than the cost of a full bitstream service.

We believe the pricing approach by Chorus flies in the face of the original terms of the UFB build (which was largely funded by tax-payers) and the intention of the rules and regulations established by Government. We also expect the other LFCs to follow Chorus' lead on pricing.

We have asked Network Strategies, to provide an independent view on price based on their experience advising industry and regulators across Asia-Pacific, Europe and North America on similar telecommunications issues. They were asked to calculate what the unbundled fibre price would be if Chorus met all the obligations it agreed to as part of taking on the UFB build. They concluded the price would sit between $27.22 and $30.03 in 2020. This is less than half of that offered by Chorus. Their report is attached to this letter.

We are now forced to ask the Commission to intervene to help secure the future of fibre connectivity for our customers. We have attached a detailed paper to this letter demonstrating that Chorus' proposed price would breach various obligations that they agreed to as part of the UFB build.

We request that this issue is given urgent priority. Chorus was initially required to issue a price by the end of last year. Instead we have suffered continuous delays with no end in sight. For us to have any chance of practically unbundling from 1 January 2020 we need a compliant price in market urgently.

Chorus may argue the nature of fibre means innovation from unbundling is technically limited. Yet Chorus themselves have often argued that fibre will solve problems that are not yet known. As will unbundling. It cannot be left to die before even beginning.

Yours sincerely,

Jason Paris

Chief Executive Officer
Vodafone New Zealand

Mark Callander

Chief Executive Officer
Vocus Group New Zealand

Guidance sought on the layer 1 price

Chorus has recently proposed a price for unbundled GPON fibre (**layer 1**) service at a level that makes any competition unfeasible. The price is inconsistent with a number of requirements across the Deed of Open Access Undertakings for Fibre Services (**the Deed**) and the Telecommunications Act 2001 (**the Act**) that the Commerce Commission (**the Commission**) has responsibility for enforcing.

It is now critical that the Commission steps into this process to avoid serious breaches occurring. We consider that if finalised, Chorus' proposed layer 1 price would breach the Deed and the Act in three ways:

- it breaches the equivalence of inputs obligation (**EOI**) requirement;
- It breaches the non-discrimination and geographic consistency requirements; and
- it is inconsistent with the Part 4AA purpose to 'promote competition' and 'facilitate investment'.

If Chorus finalises the layer 1 price as it currently stands the Commission will have an obligation to apply to the High Court to take enforcement action, including fines of up to $10m.[1]

The Commission now has a limited window to avoid this outcome by providing clarity to the industry on how it will interpret the obligations in the Deed and the Act. This will provide valuable input into Chorus' consultation process, and give commercial negotiations a better chance of succeeding.

Acting now is also critical to ensure that a compliant price is available early enough to make unbundling viable from 1 January 2020, as has long been the policy intent. To allow for industry to get ready for unbundling by 2020, Chorus was required to make best-efforts to finalise a layer 1 price by the end of last year.[2] Instead they only began considering unbundling in September, and after numerous delays have only now started to talk about price. Further waiting for the consultation process to conclude is simply not practical, especially when considering the poor track record Chorus has in adjusting to industry views throughout the process to date.

We have attached a report from Network Strategies to this letter that calculates a layer 1 price consistent with Chorus' obligations in the Deed and the Act. They find that the price should sit between $27.22 and $30.03 in 2020, significantly less than the price offered by Chorus.

The summary report from Network Strategies is not confidential, we are happy for this to be published alongside this complaint. The full detailed report contains considerable amounts of confidential information, and is provided for the Commission's information only.

This request does not extend to more detailed concerns we also have with breaches of the regulatory requirements in the unbundling product construct. We reserve our right to raise any future clarifications on these matters as well if acceptable commercial resolution cannot be reached.

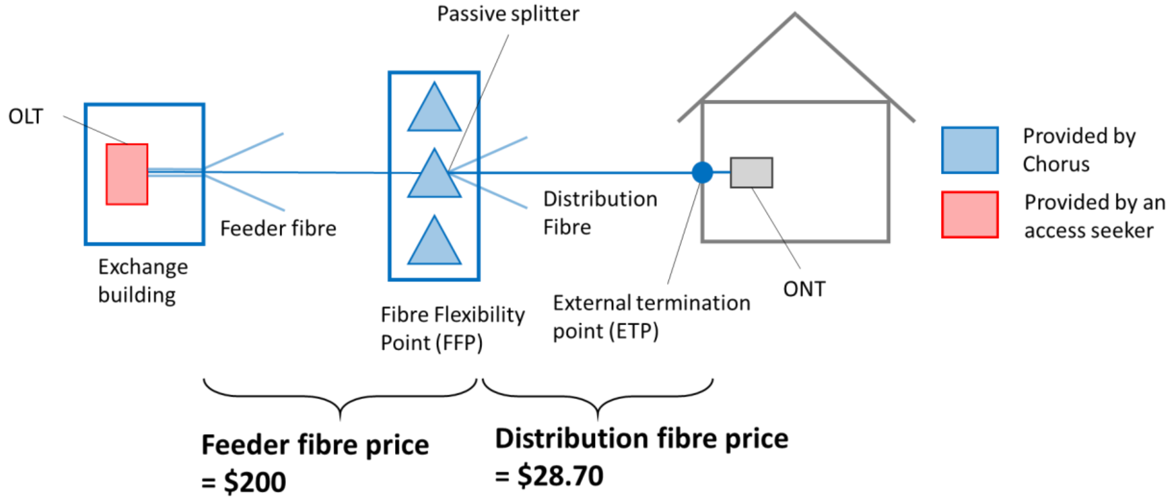
[1] S156AQ and s156AR.

[2]

Clarifying the price

Chorus have configured the layer 1 price in a complex way based on two separate prices that an access seeker must pay for access to different parts of their network. However to be consistent with the requirements in the Act the price must be considered by the Commission on a per-connection basis.[3] The paragraphs below provide an estimate of a per-connection price.

The two components of the price proposed by Chorus are shown in the diagram below.



The cost of the feeder fibre is shared by each customer connected to a particular splitter. The splitters Chorus use can service up to 16 connections. However, it is unrealistic to expect every splitter to be fully utilized. In fact we estimate that on average Chorus itself only has about 12 customers connected to each splitter. The number of customers connected to each splitter is obviously much less for any access seeker.

The attached independent report from Network Strategies assumes a notionally efficient competitor with 20% market share. This notional competitor has about 5 - 6 connections per splitter on average. This is similar to what we expect the Vodafone-Vocus consortium to achieve. Whilst we have a larger market share, the way Chorus have designed the product means we expect only about 50% to take up unbundled fibre, even with a good price.[4]

The table below shows the per connection price with 12 connections per splitter and with 6 connections per splitter.

[3] The definition of 'fibre fixed line access service' in s5 of the Act refers to access to the fibre network from the end-user to the hand-over point at an exchange.

[4] As proposed, the layer 1 service would require a technician visit in every circumstance. This is because Chorus are not allowing access to the existing ONT at each premise. Each access seeker will need to install their own ONT and splice it to the fibre network. This will be disruptive and unwelcome for most customers, significantly reducing uptake of unbundling.

Table 1: breakdown of Chorus' proposed layer 1 price

Average connections per splitters	Per connection feeder fibre price	Per connection distribution fibre price	Per connection layer 1 price
12	$16.67	$28.70	$45.37
6	$33.33	$28.70	$62.03

This stands in stark contrast with the attached report from Network Strategies, which finds that a cost based layer 1 price compliant with the Deed would sit between $27.22 and $30.03 in 2020.

Not an equivalent input

One of the key obligations placed on Chorus in the Deed is to set any input service, like the layer 1 service, on Equivalence of Inputs terms. This means that they must ensure that third-party access seekers have access to the input service on the same basis that the service provider does including in relation to pricing, procedures, operational support, supply of information, and other relevant matters.

In advice previously provided to the Commission, James Every-Palmer QC further clarified the EOI pricing requirement based on his considerable experience in these matters, and international precedents. He clarified that the EOI obligation doesn't allow Chorus to charge itself (and access seekers) any price it chooses. They must instead set price at a level that would allow them to earn a normal profit if it was receiving the layer 1 service from a third party. He goes on to conclude that:

> *the key requirement is that there must be sufficient "economic space" between the Layer 1 and Layer 2 prices such that an* ***equally efficient access seeker*** *purchasing the Layer 1 service from the UFB provider* ***will be able to compete against the UFB provider*** *in respect of the Layer 2 service or against other RSPs at retail. This concept is variously described as the 'efficient component pricing rule (ECPR)', 'economic replicability' or an 'equally efficient rival' test.*

The table below shows the 'economic space' afforded by Chorus' proposed layer 1 price under the two scenarios considered: 12 customers per splitter (Chorus' average), and 6 customers per splitter (the average of an efficient access seeker).

Table 2: Economic space afforded by Chorus' proposed layer 1 price

Scenario	Per connection unbundled price	Network Strategies estimate of average bitstream price in 2020	Economic space
12 connections per splitter	$45.37	$47.38	**$2.01**
6 connections per splitter	$62.03	$47.38	**-$14.65**

This is a clear breach of the EOI obligation. Network Strategies estimate that the economic space for an efficient competitor would be between $17.35 and $20.16 in 2020. This is a far cry from the $2.01 margin Chorus claims it offers to itself, or the ridiculous -$14.65 negative margin offered to efficient access seekers.

The smaller number of connections per splitter for an access seeker does not indicate inefficient scale, it is simply an artifact of the pricing approach proposed by Chorus. In almost all circumstances, Chorus faces next to no incremental cost for provisioning additional feeder fibres. We understand that they have deployed 12 fibres to each fibre flexibility point. In most cases only three of those fibres are currently utilised. An access seeker using one of the 9 unused fibres is of no incremental cost to Chorus, and justifies no incremental charge.

However, in some rare cases Chorus may need to deploy more fibre for larger cabinets, or if unbundling became very popular. To be consistent with the Deed and maintain a competitive margin these small incremental costs must be included in the per-connection layer 1 price so it is equally shared amongst all users of layer 1 services, including Chorus itself. Any other arrangement would again be price discrimination, and hinder competition. This is the conclusion reached by Ofcom in their recent decision on duct and pole access.

The price discriminates against access seekers and breaches geographic consistency

The other key requirement in the Deed is to ensure any service offered by Chorus is not discriminatory. This means Chorus must offer a service on the same terms and conditions, including price, between different access seekers, and between access seekers and themselves

As shown in Table 1, the result of the pricing approach proposed by Chorus is that the average layer 1 price will be different for Chorus and each access seeker. This is precisely the sort of behavior that the non-discrimination requirement is intended to prevent. It effectively shuts any access seeker out of the market, destroying any chance of competition.

The layer 1 price also breaches the geographic consistency requirements in the Act. The estimation of a per-connection price in Table 1 is based on an average across Chorus' footprint. The actual price for any individual connection will depend on how many customers are connected to each splitter. This means the per-connection cost will be vastly different in different geographic locations, and typically more expensive in less densely populated areas. This is a clear breach of the geographically consistent pricing requirement in s201 of the Act.

If this pricing approach is allowed to stand, it sets a dangerous precedent for the pricing of other fibre services when the new regulatory regime comes into effect after 2022. The logic Chorus have used to separate the layer 1 service into two prices could equally stand for bitstream services, allowing Chorus to shut smaller RSPs out from some services if it is in their interests to do so.

A price that obstructs competition

The Deeds are established under Part 4AA of the Act, which includes its own purpose statement to guide any [decision]. This states:

156AC Purposes

The purposes of this subpart are to—

(a) promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services in New Zealand; and
(b) require transparency, non-discrimination, and equivalence of supply in relation to certain telecommunications services; and
(c) facilitate efficient investment in telecommunications infrastructure and services.

Beyond the breach of the EOI and non-discrimination requirements covered above, the price proposed by Chorus would also breach the other two arms of this purpose statement.

As above, taking up the layer 1 service at this price would cost us more than taking the bundled bitstream service. It is like paying more for a smaller block of chocolate. This is predatory pricing at its worst, preventing New Zealanders from gaining the advantages of competition deeper into the fibre network.

The price also means that efficient investment by access seekers will not occur. Allowing further private investment into New Zealanders fibre network through unbundling was a key plank of the original policy intent of the Ultra-Fast Broadband initiative. Chorus is now stopping that from occurring.

Getting to a compliant price

Chorus' attempt at pricing the layer 1 service confirms that they are ill suited to this task. As we have argued countless times, they have all the wrong incentives to establish this product in the best interests of New Zealanders.

If Chorus is left with full discretion on pricing this service, there is no prospect of having a compliant unbundled product in the market by 1 January 2020. This would breach a number of the agreements between Chorus and the Crown, and bring into play the substantial penalties under s156L.

While the Act prohibits the Commission from proposing an unbundled price until 2025, there are a number of actions the Commission can take now to ensure the policy intent is fulfilled.

- Provide guidance on the Deed confirming:
  - James Every-Palmer's conclusion that the EOI obligation requires that "an equally efficient access seeker purchasing the layer 1 service" must be able to "compete against the UFB provider in respect of the layer 2 service"; and
  - That compliance with the non-discrimination requirements and geographic consistency rules requires a single price from a handover point at an exchange to the end user. This price should be the same for Chorus and all access seekers, and be consistent across different geographic locations.

- Confirm that the attached analysis from Network Strategies is consistent with the requirements in the Deed, and offers a cost-based layer 1 price that could be implemented by the Minister from January 2020 under s16 of Part 2 of Schedule 1AA of the Act.

Adopting the price proposed by Network Strategies would not impose any undue financial burden on Chorus. We consider that this price will allow sufficient return on layer 1 assets. However, if this price does not fully cover the costs of the layer 1 network, Chorus will be able to claim any shortfall through the losses that will be added to their regulatory asset base when the new fibre regulations come into force from 2022. After that point Chorus will have more flexibility to price services to fully recover its cost, but maintain an adequate margin between layer 1 and bitstream services.

Summary of recommendations

1. Agree that if finalised the layer 1 price proposed by Chorus would breach a number of requirements in the Deed and the Act, specifically it would:
    - **a.** breach the EOI requirement;
    - **b.** discriminate against access seekers with a smaller scale than Chorus;
    - **c.** breach the geographic consistency requirements in the Act;
    - **d.** be inconsistent with the s156AC purpose statement, regarding the promotion of competition and facilitation of investment;
2. Issue guidance on the Commissions interpretations of the Deed and the Act specifying
    - **a.** that compliance with EOI requires sufficient economic space for an efficient access seeker to compete alongside Chorus;
    - **b.** that compliance with non-discrimination requires the same handover-to-customer price for Chorus and each access seeker; and
    - **c.** that compliance with the geographic consistency requirement in the Act requires the same handover-to-customer price in every geographic location.
3. Agree that the layer 1 price determined by Network Strategies is consistent with the Deed and the Act.