



**Submission to the Ministry of Business, Innovation &
Employment on Review of the Telecommunications Act**

13 September 2013

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EXECUTIVE SUMMARY

1. The Government should not intervene in the Commerce Commission's copper access pricing determinations.
2. The Government should not join copper and fibre together as fibre was a competitive process to build a new network, while copper is a separate regulated service.
3. The Government should hold Chorus to its contractually agreed commitment to roll-out of fibre, without additional subsidy or regulatory relief.
4. Chorus must have been well aware that the Commerce Commission copper access pricing determinations could result in significant price reductions when it entered into the UFB bid process.
5. The Government has already provided Chorus with a substantial subsidy for roll-out of a UFB fibre network. Chorus and Chorus' shareholders should bear the risks of the economics of the fibre roll-out. Consumers should not be required to protect Chorus by providing an additional copper subsidy for the UFB roll-out.
6. The proposed Government intervention would result in a substantial and continued wealth transfer from consumers to Chorus. Based on publicly available information, and the Commerce Commission's Part 4 price determination models, we calculate this would allow Chorus to extract between 20 – 25% Return on Investment (ROI) on its copper network between 2014 and 2019.
7. No other regulated entity is permitted returns of this size. The Commerce Commission applied a WACC of 8.77% (2009) for the electricity distribution default price-quality path (DPP) and 7.44% (2012) used for gas pipeline services. The Commission also applies a WACC of 7.1 - 8% (for 2013-2017) in relation to Airports for information disclosure purposes.¹
8. What this could mean is that: (i) overall demand for broadband services is dampened by higher (than otherwise) copper prices; (ii) Chorus' will be highly motivated to roll-out its fibre network no faster than it is contractually obliged to; and (iii) Chorus will be highly motivated to "pocket price" (substantially below the Government set price) to discourage customers from switching from copper to fibre in LFC UFB areas. None of these outcomes would aid the Government's broadband objectives.
9. If the Government, for whatever reason, decides that copper and fibre prices need to be the same it should: (i) allow the Commerce Commission to set copper access prices unfettered; and (ii) introduce a ring-fenced copper levy (difference between fibre and copper access prices), administered by the Crown, that could be used to promote fibre uptake and promote improved telecommunications services in areas such as health, education and rural communities.

Proposed Government intervention would harm regulatory certainty

10. Vector supports the Government's overarching objective for New Zealand telecommunications that "consumers ... benefit from markets which deliver competitive prices and innovative products, and to have early access to high-quality, widely-available telecommunications services."
11. Vector agrees that "Having a stable and predictable regulatory framework that promotes competition and facilitates significant new investment in infrastructure is essential ..." but having a stable and predictable regulatory framework is important for regulation of

¹ The Commerce Commission's Airport WACC is for Information Disclosure purposes and not for price setting.

all network utility infrastructure, not just copper and fibre. Network utility infrastructure in electricity, gas and other utility sectors is critical to the economy and economic growth of New Zealand, not just fibre.

12. We do not agree with MBIE that the Commerce Commission's changes to regulated copper access prices would create uncertainty or have a destabilising effect on the transition to fibre. The regulated copper prices would need to be set below cost and preclude Chorus from earning a reasonable return on its investment. There is no proof of any of these problems in the MBIE Discussion Document.
13. The lengthy process for price determination is not unique to copper. The Commerce Commission went through a lengthy process to determine mobile termination rates, during a time that Telecom and Vodafone were both rolling out (new and faster) 3G mobile networks. The process the Commerce Commission undertook to undertake initial price resets under the current Part 4 of the Commerce Act 1986 was also very lengthy.
14. The proposal for the Government to overrule the Commerce Commission's copper access pricing decision may bring forward certainty of pricing outcomes at least until 2019; however, it will be the certainty that Government intervention will result in consumers paying higher prices than they otherwise would.
15. Vector believes it is the proposed intervention to overrule the Commerce Commission's copper pricing determinations that would create regulatory uncertainty and interfere with development and evolution of the broadband market.
16. In the context of the country's strong demand for infrastructure investment, the Government needs to ensure its current and future actions do not create regulatory uncertainty and risk. The Government's willingness to overrule a regulator's decisions with new legislation sets a dangerous precedent.

The likelihood that regulated copper access prices would be reduced was well known by Chorus

17. It should be remembered that Chorus entered into the UFB bid process with, probably, better understanding of the risks relating to copper pricing and fibre roll-out than any other bidder. It is Chorus and Chorus' shareholders that should bear the risks associated with its UFB roll-out, not consumers.
18. The MBIE Discussion Document is incorrect to suggest the Commerce Commission's draft pricing decisions, and the significant reduction in copper access prices, were a surprise.
19. The pricing rules for regulation of copper access prices were well known by the participants in the UFB tender. What would happen to regulated copper access prices was a prominent matter in the UFB process and discussions with officials over the bid. It was inevitable cost-based prices would be substantially lower than the previous retail minus prices.
20. The expectation that regulated copper access prices would be reduced was reflected in both Chorus' launch prospectus, as part of its separation from Telecom, and the Government decision to grant Chorus three year relief from the Commerce Commission resetting its prices, from when Telecom and Chorus separated, giving Chorus plenty of time to prepare for new lower copper access prices.²
21. Vector's bid was prepared with the full expectation copper access price regulation would result in significant reductions in copper access prices and, if unfettered, Chorus would

² <http://www.parliament.nz/resource/0000171267>

likely adopt the pricing strategy it applied in response to Saturn’s (now Vodafone) roll-out of cable network services in Wellington and Christchurch where it competed with Saturn on price. A significant advantage Chorus had over other UFB bidders was that it owned the copper network so its roll-out of fibre network would be immune from network competition.

22. The proposed Government intervention would result in significant transfer of value from New Zealand consumers to Chorus shareholders. Vector estimates – based on Chorus’ financial information and the Commerce Commission’s Part 4 DPP Models – that the proposed intervention would result in Chorus’ copper network business extracting a return on investment of approximately 20% for 2014/15 financial year growing to 25% in 2019/20.

Introducing a copper levy would be a better option

23. Vector believes the safest option for the Government, which would best preserve the interests of consumers in relation to broadband services and the roll-out of fibre, would simply be to allow the Commerce Commission to set copper access prices unfettered, and undertake the Telecommunications Act review within the timeframes anticipated by s 157AA of the Telecommunications Act 2001.
24. If the Government nevertheless determines that intervention in copper access pricing is necessary, Vector is of the view that the Government should introduce a copper levy. This option would avoid the regulatory uncertainty created by the Government overruling the Commerce Commission. The levy would be imposed on top of the prices determined by the Commerce Commission.
25. It is notable that the option of a copper levy is something that Chorus has flagged in its submission prior to the Government announcing the proposal to overrule the Commerce Commission’s copper access pricing determinations.
26. The MBIE Discussion Document rejects the levy option on the basis of two disadvantages which are relatively minor compared to the consequences of the three options for overruling the Commerce Commission’s copper access price determinations:

MBIE explanation	Vector comment
“it may create further investment uncertainty until there is clarity regarding how the levy would be used to support the roll-out of a fibre network”	The Government’s decision to intervene in the Commerce Commission’s regulatory price setting, and the lack of clarity around the basis or need for such intervention, creates much more uncertainty than questions about how a levy would be used to support fibre roll-out.
“regulated prices would diverge from known efficient replacement costs” ³	This claim is also incorrect. The Government’s decision to set copper access prices equal to Chorus’ UFB bid price would result in prices that are substantially above cost. Valuing access to the (legacy) copper network on the basis of a new fibre network is equivalent to valuing an old tube TV (which is now largely worthless) at the value of a brand new LCD TV.

³ Paragraph 233, Ministry of Business, Innovation & Employment, Discussion Document, “Review of the Telecommunications Act 2001”, August 2013.

INTRODUCTION

27. Vector welcomes the opportunity to comment on the Ministry of Business, Innovation & Employment's (MBIE) Discussion Document "Review of the Telecommunications Act 2001", dated August 2013.
28. This submission should be read in conjunction with Vector's 20 August 2013 submission in response to the Discussion Document "Review of the Telecommunications Service Obligations (TSO) for Local Residential Telephone Service", dated July 2013. The TSO submission specifically addresses s 157AA(2)(b) of the Telecommunications Act 2001, and whether generic price control under Part 4 of the Commerce Act 1986 should be adopted for Chorus' copper access services.
29. No part of this submission is confidential and Vector is happy for it to be publicly released.
30. Vector's contact person for this submission is:

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VECTOR SUPPORTS THE TELECOMMUNICATIONS ACT REVIEW TERMS OF REFERENCE

31. Vector supports the focus in the statutory terms of reference for the Telecommunications Act review in s 157AA(2) of the Telecommunications Act 2001 on: “(i) promot[ing] competition for the long-term benefit of end-users; and (ii) promot[ing] the legitimate commercial interests of access providers and access seekers; and (iii) encourag[ing] efficient investment for the long-term benefit of end-users, by (A) providing investors with an expectation of a reasonable return on their investment; and (B) providing sufficient regulatory stability, transparency, and certainty to enable businesses to make long-term investments” (emphasis added).

32. Vector reiterates the views expressed in our TSO review submission:⁴

These are matters that should be considered as part of the review and operation of any economic regulation for network utilities, be it under the Telecommunications Act, Commerce Act 1986 or other relevant legislation.

It is Vector’s view that the long-term interests of consumers will not be met unless suppliers of regulated goods or services “have incentives to innovate and to invest, including in replacement, upgraded, and new assets” (as per the objective in s 52A(1)(a) of Part 4 of the Commerce Act 1986) which, as reflected in ss 101A and 157AA of the Telecommunications Act, requires that the legitimate commercial interests of regulated suppliers are taken into account, including ensuring they expect to receive a reasonable return on their investment.

... But the review is premature

33. While Vector supports the statutory terms of reference for the review, we consider it to be premature to undertake the review at this stage.

34. The Minister is only obliged to commence the review by 30 September 2016. This would enable full implementation of the changes resulting from the last amendment of the Act to take effect, including the setting of copper access pricing under the amended pricing principles. Having regards to the relative immaturity of the fibre roll-out, the Minister can only benefit from the passing of more time to conduct a well-informed review, including on the impact of fibre investment.

35. Vector also believes the Telecommunications Act review should not commence until at least after the Productivity Commission has completed its inquiry into improving the design and operation of regulatory regimes in June 2014. The Productivity Commission’s inquiry is likely to have implications for the Telecommunications Act and other economic regulation. Vector considers that the Productivity Commission’s initial Issues Paper contains discussion highly relevant to the Telecommunications Act review, particularly in relation to the appropriate level of regulatory autonomy/Government involvement in regulatory decisions. This is reflected in various references to the Productivity Commission’s Issues Paper in this submission. The Productivity Commission’s inquiry should be treated as an important independent input into the Telecommunications Act review. This can only happen if the Productivity Commission inquiry and reporting precedes the Telecommunications Act review.

⁴ Paragraphs 10 and 11, Vector, “Submission to the Ministry of Business, Innovation & Employment on Review of Telecommunications Service Obligations (TSO) for Local Residential Telephone Service”, 20 August 2013.

REGULATORY STABILITY, TRANSPARENCY, AND CERTAINTY

36. Regulatory stability, transparency, and certainty are important for ensuring regulated suppliers, and businesses more generally, are able to make long-term investments with the expectation of a reasonable return on their investment and confidence their legitimate commercial interests will be protected. Regulatory stability and certainty can only be achieved if policy is applied in a consistent, predictable and transparent manner.
37. One of the challenges the Government faces, given its concern about the operation of the Telecommunications Act, is that the Act has already been reviewed and amended twice (in 2006 and 2011) since its enactment in 2001.⁵ The current review signals two further likely amendments, one to overrule the Commerce Commission's copper access pricing determinations and the other as part of the statutory review of the Telecommunications Act, with no mention of how the Productivity Commission's current inquiry into regulatory institutions and practices⁶ could impact on the Act.
38. There is an absence of evidence in the MBIE Discussion Document of a problem that necessitates the Government to introduce legislation to overrule the Commerce Commission's copper access price determinations.
39. Neither MBIE nor Chorus has provided any evidence that Chorus' copper network profitability would be unreasonably impaired by the Commerce Commission's copper access pricing determinations⁷ or that the Government's UFB initiative would be put at risk.
40. Absent any of this type of information, it is entirely unclear why the Government needs to intervene in the Commerce Commission's copper access pricing determinations.
41. The MBIE Discussion Document simply asserts "The issue that appears to be the most pressing, and which could also have lasting negative effects if no action is taken, is whether the current regulatory framework provides the environment needed to support investments in replacement fixed broadband infrastructure"⁸ and "As the owner of the copper network, Chorus will be directly affected by both lower copper revenue and slower migration to fibre which will affect its ability to fund the roll-out of fibre in the areas where it is contracted to do so" (emphasis added).⁹ The Discussion Document does not provide any evidence Chorus' ability to fund the roll-out of fibre it has contractually committed to would be impacted.
42. The MBIE Discussion Document also asserts that Government intervention is required to rectify the uncertainty created under the current regulatory framework because of the length of time it takes to go through the initial price determinations (benchmarking), final price determinations (TSLRIC cost modelling) and possible legal challenges. This is however an inherent component of the legislative design of the Telecommunications Act and is not specific or unique to copper access pricing. If the process or the time it takes for the Commerce Commission to determine regulated prices or key methodologies is

⁵ As well as various minor amendments.

⁶ <http://www.productivity.govt.nz/inquiry-content/1788?stage=2>

⁷ As discussed in the next section, this is in stark contrast to the level of evidence Orion, and any other regulated party, need to provide as part of a Customised Price-Quality Path (CPP) application seeking prices above that set in the Default Price-Quality Path (DPP), under Part 4 of the Commerce Act.

⁸ Paragraph 58, Ministry of Business, Innovation & Employment, Discussion Document, "Review of the Telecommunications Act 2001", August 2013.

⁹ Paragraph 172, Ministry of Business, Innovation & Employment, Discussion Document, "Review of the Telecommunications Act 2001", August 2013.

considered inappropriate, then this may reflect broader concern with regulation that should be addressed. A “quick fix” for copper access pricing is not an enduring solution.

43. Regulatory certainty requires that regulated suppliers can expect a reasonable return on their investment and the outcomes of the pricing reviews are reasonably predictable e.g. regulated suppliers are able to undertake their own analysis/modelling to forecast with a reasonable degree of confidence the likely outcome of a Commerce Commission pricing decision.
44. This is reflected in Vector’s long-standing position on monopoly regulation under Part 4 of the Commerce Act that a Starting Price Adjustment Input Methodology (SPA IM) would provide regulated suppliers greater certainty about how the Commission will set prices. At present, what is missing is the methodology the Commerce Commission applies to translate the cost inputs from the IMs for setting WACC, asset valuations, cost allocations etc into its price determinations.
45. It should also be recognised there can be trade-offs between regulatory certainty and flexibility of operation of any regulatory regime. The Government’s decision to overrule the Commerce Commission’s copper access pricing decision may bring forward certainty of pricing outcomes at least until 2019; however, it will be the certainty that consumers will face higher prices than if the Commerce Commission were left to set copper access prices. It is the certainty of a worse outcome. By way of analogy, if you jump out of an aeroplane without a parachute, you will increase the certainty of the outcome (whether you will die or not), but you will also substantially worsen the expected outcome (death).
46. The Government should also consider the long-term impact on regulatory certainty of a decision to intervene in and overrule a regulator’s decisions through legislative intervention.
47. While Vector has significant concerns about the Commerce Commission’s price setting decisions, and the outcome of this particular intervention would be favourable (higher prices) for the regulated supplier, there is no certainty a potential future intervention would not be negative e.g. overruling the Commerce Commission by setting lower prices or requiring expansions, upgrades (i.e. enforced investment),¹⁰ or service quality improvements. This increases regulatory uncertainty for regulated suppliers and investors. The ability for a Government to overrule the regulatory decisions of an independent regulator simply highlights for all infrastructure investors the possible risk of *ex post* appropriation.
48. Investors are much more likely to perceive regulatory risk if the Government has shown its willingness to use legislative intervention (as in the case here) to overrule important and recently enacted pricing methodologies or key revenue determinants.

Guidance from the Productivity Commission on regulatory independence

49. While Vector accepts that a balance needs to be struck between certainty, adaptability and flexibility, the Government should restrain itself from intervening in significant regulatory decisions in an ad hoc manner. To create and sustain investor confidence, strong emphasis should be given to building a stable and transparent regulatory environment with a track record of consistent regulatory decision making. Piecemeal, ad hoc or unanticipated changes in policy are likely to erode investor confidence and increase the cost of capital for business.

¹⁰ It is of particular concern when gas transmission providers such as Vector are subject to particular legislative provisions such as s 43F(2)(d) of the Gas Act 1992 which includes draconian provisions enabling the Minister to require transmission investment, and prescribe the extent to which the cost of the investment can be recovered and how it will be paid for.

50. The Productivity Commission’s Issues Paper on improving the design and operation of regulatory regimes makes a number of salient observations in relation to regulatory independence.¹¹ These are highly germane as the Government’s decision to overrule the Commerce Commission’s copper access pricing determinations would clearly undermine the Commission’s independence.

51. The Productivity Commission warns:

Independence from those who make the laws prevents a regulator being used for partisan purposes, promotes public confidence in decisions of the regulator, and allows it to work constructively with the sector being regulated.¹²

Particular challenges may apply in situations where the state’s activities are being regulated. There is a particular need for regulators of significant coercive state powers to be independent, as in the case of the Independent Police Conduct Authority.

However, there may also be challenges in regulating public services provided directly by the government, or which are substantially funded by the government. Where government is a major participant in a market – such as in health or education – then the risks of regulatory capture may be heightened. In particular there is the potential for the tension between the government’s fiscal objectives and its regulatory objectives to be resolved inappropriately where a regulator is insufficiently independent. (emphasis added)¹³

52. The Productivity Commission’s Issues Paper provides an independent and timely framework for determining whether less or more independence is desirable for a regulator.¹⁴ It is clear the majority of factors that would suggest more independence are highly relevant in relation to copper access pricing decisions. Vector’s interpretation of the Productivity Commission’s framework indicates that in this case the Government should clearly not intervene.

Features indicating a need for less or more regulatory independence	
Less independence	More independence
<ul style="list-style-type: none"> • Decisions involving clear value judgements (which might be appropriately made by elected officials) • Where political control is needed to guard against ‘regulatory capture’ • Decisions with significant fiscal implications or which are integral to a government’s economic strategy • Decisions involve the significant exercise of coercive state power (eg, policing, taxation) • Where flexibility is necessary to take account of political imperatives 	<ul style="list-style-type: none"> • Decisions where the costs are long-term, and likely to be undervalued due to a focus on electoral cycles (eg, economic policies that risk long-term inflation) • Decisions weighing a politically-powerful private interest against a dispersed public interest • Decisions requiring a substantial degree of technical expertise, or expert judgement of complex analysis • Decisions whether the causal relationship between the policy instrument and the desired outcome – the <i>transmission mechanism</i> – is complex or uncertain • Regulatory regimes where a consistent approach over a long period of time is needed to create a stable environment

¹¹ New Zealand Productivity Commission, Issues Paper, Regulatory institutions and practices, August 2013.

¹² Page 22, New Zealand Productivity Commission, Issues Paper, Regulatory institutions and practices, August 2013.

¹³ Page 26, New Zealand Productivity Commission, Issues Paper, Regulatory institutions and practices, August 2013.

¹⁴ Figure 4.3, New Zealand Productivity Commission, Issues Paper, Regulatory institutions and practices, August 2013.

Features indicating a need for less or more regulatory independence	
Less independence	More independence
	<ul style="list-style-type: none"> • Regulation of state power, or government-funded services • Regulation of government and non-government entities under the same framework

Items marked yellow signify they are applicable to the copper access pricing regulation.

53. Vector could only identify one factor that could be used to justify reduced regulatory independence (significant fiscal implications). However, even this is contentious as no evidence has been provided that the Commerce Commission’s copper access pricing determinations would unreasonably impair Chorus’ copper network profitability or that this would somehow put the UFB roll-out would be put at risk. Vector’s analysis of Chorus’ copper network profitability suggests the opposite.

IMPORTANCE OF ENSURING REGULATED SUPPLIERS CAN EXPECT A REASONABLE RETURN ON THEIR INVESTMENT

54. The emphasis of the review's statutory terms of reference on investment incentives and the commercial interests of access providers corresponds with Vector's view that the long-term interests of end-users will not be met unless suppliers of regulated goods or services "have incentives to innovate and to invest, including in replacement, upgraded, and new assets" (as per the objective in s 52A(1)(a) of Part 4 of the Commerce Act 1986).
55. The MBIE Discussion Document clearly reflects Government concern that the Commerce Commission would set the regulated price for UCLL and UBA copper network services too low, including below the level of an appropriately established "Modern Equivalent Asset" (MEA). It goes on to suggest this would negatively impact on the expected returns and long-term viability of Chorus and the Local Fibre Companies (LFCs), as well as undermine incentives and capabilities of LFCs and Chorus to invest in the roll-out of fibre.
56. Vector believes "investment incentives should be dealt with holistically, across all regulated network utility sectors, and not as part of ad hoc changes to the Telecommunications Act."¹⁵
57. Vector submits there are legitimate grounds for Government concern about the Commerce Commission setting the regulated price for network infrastructure too low, and that this has adverse implications for incentives and capabilities to invest. This is an issue that is not restricted to copper network access pricing, the Telecommunications Act or even the telecommunications industry. This is a concern Vector has expressed in relation to the Commerce Commission's operation of Part 4 of the Commerce Act more generally.
58. Vector's submission on the recent TSO review stated:¹⁶

Vector's experience under Part 4 (and the previous Part 4A) of the Commerce Act is that the Commerce Commission over-emphasises short-term benefits to consumers from lower prices, at the expense of longer-term investment in maintenance, upgrade and expansion of network infrastructure.

At present, Vector does not have confidence it will be able to earn a commercially sustainable return on energy network investments ...
59. Vector does not believe the Commerce Commission places enough importance on the objective of promoting incentives to innovate and invest. The Commission's price determinations under Part 4 seem to be based on a false sense of precision in matching revenue to forecast costs, akin to determining how many angels can stand on the point of a pin.

Comparison of Orion and Chorus

60. Vector considers it instructive to contrast the positions of Orion and Chorus, and the inconsistent approach that is being taken to price relief. Both are going through pricing reviews; Orion through the CPP application process under Part 4 of the Commerce Act and Chorus through the Government's proposal to introduce legislation to overrule the Commerce Commission's copper access pricing determinations.

¹⁵ Paragraph 11, Vector submission to the Ministry of Economic Development "Changes to the Telecommunications (TSO, Broadband and Other Matters) Bill as a result of the removal of Forbearance", 26 May 2011.

¹⁶ Paragraphs 6 and 7, Vector submission to the Ministry of Economic Development "Changes to the Telecommunications (TSO, Broadband and Other Matters) Bill as a result of the removal of Forbearance", 26 May 2011.

61. Orion provided extensive evidence to justify regulatory relief in the form of higher prices, including provision for substantial investment, which is needed to address the impact on cost recovery, restore network service quality and improve resilience. In contrast, it appears that no evidence has been provided that Chorus' profitability has been or will be unreasonably impaired, or Government intervention in the Commerce Commission's copper access network pricing determinations is either justified or indeed needed.
62. The Commerce Commission has acknowledged that the presence of asymmetric risk means it should err on the side of a higher copper access network price determination. For Orion, in contrast, the Commission has made a draft CPP determination that would seriously prejudice Orion from being able to earn a reasonable expected rate of return (no compensation for lost revenues). It explicitly limits Orion's investment in restoring pre-quake service quality by 2019 and improving network resilience.
63. Vector is of the view that the draft determination for Orion is unduly harsh, and would restrict investment in recovery from the Canterbury earthquakes, while the opposite is the problem with Chorus, with no demonstrated need for intervention. The Commerce Commission is already taking a more favourable approach to Chorus' price determination, compared to Orion, without additional Government intervention.

Comparison of regulatory relief for Chorus and Orion	Chorus	Orion
Control of financial circumstances	<p>Commercial decision to tender for UFB roll-out subsidy.</p> <p>Chorus voluntarily entered into the UFB bidding process to seek subsidy from the Government for roll-out of a fibre network. Chorus was also well aware of the regulatory framework (including pricing rules) and probably best placed of any of the tenderers to understand likely regulatory outcomes (including Commerce Commission decisions on copper access pricing).</p>	Act of god.
Information provided to justify price increases	<p>No evidence provided by Chorus or MBIE to demonstrate Chorus' profitability would be unreasonably impaired, or that it would not expect to earn a reasonable return on its investment, if the Government did not legislate against the Commerce Commission's decision or that its ability to</p>	<p>Orion was required to provide extensive information as part of its CPP application, despite having to prepare the information during recovery from the Canterbury earthquakes.</p>

Comparison of regulatory relief for Chorus and Orion	Chorus	Orion
	<p>meet its contractual obligations to invest in fibre would be put at risk.</p> <p>The information that the MBIE Discussion Document contains does not even attempt to meet the modest requirements of the TSO Deeds for demonstrating price increases are warranted.¹⁷</p>	
<p>Providing investors with an expectation of a reasonable return on their investment</p>	<p>The Commerce Commission has acknowledged asymmetric risk means it should err on the side of prices that are too high:¹⁸</p> <p>... it is our view that on balance there may be greater costs of under-estimating the UBA price than over-estimating the UBA price. We consider that the potential negative impacts to dynamic efficiency outweigh the static benefits to end-users from a lower UBA price ...</p> <p>Consideration of dynamic efficiency is particularly relevant to decisions that may affect major investment in telecommunications services.</p> <p>...</p> <p>We therefore consider that a price point above the median may be appropriate to minimise the risk to investment and the dynamic efficiency gains from incorrectly setting a price below the 'true' UBA cost.</p>	<p>The Commerce Commission made a draft determination that precludes Orion from recovering a reasonable return on its investment (no compensation for lost revenue).¹⁹</p> <p>The Commerce Commission has also rejected asymmetric risk arguments in direct conflict with its Chorus/UBA position:²⁰</p> <p>... providing incentives to invest that depend on allowing excess profits ... would not be consistent with the purpose of Part 4.</p>
<p>Encouraging efficient investment</p>	<p>No evidence provided that the Commerce Commission's copper access</p>	<p>The Commerce Commission's draft determination would impair</p>

¹⁷ Clauses 7 – 12, Chorus TSO Deed, Telecommunications Service Obligations (TSO) Deed for TSO Network Service, November 2011.

¹⁸ Paragraph 78 – 115, Commerce Commission, Unbundled Bitstream Access Service Price Review: Update on matters relevant to the UBA price review, 13 August 2013.

¹⁹ Commerce Commission, Setting the 2014-2019 customised price-quality path for Orion New Zealand Limited: Draft Decision, 14 August 2013

²⁰ Paragraph A8, Commerce Commission, Draft Decision, Setting the 2014-2019 customised price-quality path for Orion New Zealand Limited, 14 August 2013.

Comparison of regulatory relief for Chorus and Orion	Chorus	Orion
	pricing determinations would set prices below cost or preclude Chorus' from recovering a reasonable return on its investment.	Orion's ability to improve network resilience. This is because the Commission has made a draft determination not to fund expenditure to improve resilience as part of the CPP.
Predictability of Commerce Commission decisions	<p>Despite the claim in MBIE's Discussion Document that it was unexpected that the Commerce Commission would set copper prices (well) below fibre, this was anticipated by both the Government, which grandfathered a UBA price freeze for three years to assist Chorus' transition, and Chorus during the UFB tender process.</p> <p>As is standard practice for regulated suppliers, Vector also assumes Chorus acted prudently and undertook forecasts of the Commerce Commission's benchmarked and TSLRIC-based copper access price determinations.</p>	<p>Regulated suppliers had expected the Commerce Commission to fully compensate regulated suppliers for any reasonably incurred losses, arising from catastrophic events outside their control.</p> <p>The DPP IMs do not contain any allowance for recovery of the risk of a catastrophic event on an ex ante basis.</p> <p>The Commission considered this matter and rejected ex ante recovery e.g. through a higher WACC.</p> <p>The Commission instead provided for catastrophic events to be recovered on an ex post basis through CPP applications.</p> <p>This is the only mechanism available to suppliers regulated under Part 4 of the Commerce Act to address such events.</p>
Allocation of risk	Consumers bear risk rather than Chorus shareholders.	Orion bears the demand risk from a largely unpredictable event.

MATTERS THE GOVERNMENT SHOULD CONSIDER BEFORE MAKING A FINAL DECISION ON CHORUS' COPPER ACCESS PRICING

64. While Vector does not agree with the proposal for the Government to intervene in the Commerce Commission's copper access price determinations, greater consideration should be given to the following matters:
- a. What should be done to mitigate against the adverse impact the Government's decision would have on regulatory stability, transparency, and certainty?
 - b. What would be the impact of the decision on the broadband market and roll-out of fibre? Vector does not believe the Government should assume the intervention would have a positive impact on roll-out.
 - c. What other options should be considered? The status quo appears to be ruled out as an option, and the MBIE Discussion Document does not provide adequate assessment of the option of a copper levy.

How can the Government ensure regulatory stability, transparency, and certainty?

65. The best way to provide regulatory certainty would be to postpone the current consultation process until after the Productivity Commission has completed its inquiry in June 2014, and commence the review of the Telecommunications Act by 30 September 2016.
66. If the current copper access review is continued, the Government should try to mitigate the regulatory uncertainty the proposal is causing by ensuring transparency around the decision-making process.
67. **Transparent criteria for Government intervention is needed for stability, transparency, and certainty. The proposal for Government intervention is not based on any evidence of a problem.**
68. It is not clear what criteria the Government is applying to determine whether it should, or when it should, intervene with an independent regulator's legislative responsibilities.
69. Chorus voluntarily entered into a tender process for the UFB roll-out.
70. The pricing rules for regulation of copper access prices were well known by participants in the UFB tender.
71. Chorus must have been well aware of the likelihood that the revision of copper access prices would result in significantly lower copper revenue. We presume Chorus would have undertaken its own forecasting of likely benchmark and TSLRIC based price setting.
72. What is not clear is why the Government should not simply hold Chorus to its contractual obligations for roll-out of the UFB fibre network, and leave any risk related to the roll-out to Chorus and Chorus' shareholders. It is not clear consumers should bear the risk of Chorus' investment decisions through higher prices.
73. The Government has provided subsidies in various sectors e.g. for filming of The Hobbit trilogy, the initial Ultra-fast Broadband (UFB) subsidies, the Rural Broadband Initiative, SkyCity's Convention Centre²¹ and Pacific Aluminium's Tiwai Point smelter, but this will be the second subsidy to Chorus for the same thing. The additional subsidy provided to Chorus through higher than otherwise copper access prices would be a substantial addition to the existing subsidy provided by the Government through the UFB bid

²¹ Indirect subsidy from gambling activity.

process. There is a need for greater transparency about the level of subsidy purportedly needed by Chorus, including whether subsidy is required from consumers that do not have access to UFB fibre.

74. If it is considered that Chorus' copper profitability would be unreasonably impaired by the Commerce Commission's copper access pricing determinations, and that consumers should protect Chorus from this risk, then evidence needs to be provided to demonstrate this.
75. Clause 7 of the Chorus Telecommunications Service Obligation (TSO) Deed provides a useful precedent for determining unreasonable impairment.
76. The TSO Deed requires that "If Chorus considers that the overall profitability of Chorus' fixed business has been, is being or will be unreasonably impaired ... and wishes to increase the price for TSO network service ... above an amount equivalent to the regulated price (as amended from time to time) for Chorus' unbundled copper low frequency service to remove or avoid that unreasonable impairment, Chorus shall notify the Crown of the desire to increase the TSO network service price for this reason." The Deed identifies in detail the evidence that needs considering to determine whether the unreasonable impairment test has been met.²²
77. Vector is not aware of any such evidence having been provided in relation to the impact of the Commerce Commission's copper access pricing determinations on Chorus' profitability or ability to roll-out the new fibre network as required by its agreement with the Crown.
78. **Intervention should be supported by quantified Cost Benefit Analysis (CBA):**
79. The Courts have recognised the importance of quantified CBA as part of the operation of regulatory bodies' decision-making processes.
80. Richardson J observed, in the case of *Telecom v Commerce Commission*:²³

...the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do...there is in my view a responsibility on the regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.
81. The above passage has been cited with approval in a number of subsequent cases including, for example, *Ravensdown Corporation Ltd v Commerce Commission* (High Court, Wellington, AP 168/96, 9 December 1996, Panckhurst J and Professor Lattimore) and *Rugby Union Players' Association Inc v Commerce Commission (No 2)* [1997] 3 NZLR 301.
82. Most recently, in the High Court's decision in *Godfrey Hirst NZ Ltd v Commerce Commission* (2011) NZBLC 103,396 Mallon J cites the decision in *Telecom v Commerce Commission* as follows (emphasis added/footnotes removed):

[52] Since the Act's inception the Commission and the Courts have discussed how the "such a benefit to the public" test should be approached. The leading case is *Telecom Corporation of New Zealand Ltd v Commerce Commission*. It is the first (and only) time the Court of Appeal has considered the s67(3)(b) test. In that case the Court of Appeal accepted that the test involved a "balancing" of likely public benefits from the acquisition and likely public detriments from (what would now be read as) the lessening of competition in a market as a result of the acquisition. It was accepted that the relevant benefits and detriments were almost entirely efficiency gains and losses. **Richardson J commented that the Commission had a "responsibility" to "attempt so far as possible to quantify**

²² Clauses 8 – 12, Chorus TSO Deed, November 2011.

²³ *Telecom Corporation of New Zealand Limited v Commerce Commission* [1992] 3 NZLR 429 at 447.

detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits”.

83. The Commerce Commission has recognised this judgment in its regulatory proceedings, and has noted:²⁴

The Commission considers that it is required to attempt so far as possible to quantify detriments and benefits ... This is not to say that only those detriments and benefits that can be measured in monetary terms are to be included in the Commission’s analysis[.] Those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.

84. The comments made by Richardson J were not specific to the Commerce Commission or to the particular legislation the Commerce Commission administers. The proposal to use the Telecommunications Act review to introduce legislation to overrule the Commerce Commission’s copper access pricing amounts to a transference of regulatory responsibilities from the Commerce Commission to MBIE/the Crown. Accordingly, MBIE should undertake and consult on a quantified CBA and not just rely on provision of a Regulatory Impact Statement (RIS).

85. **Greater certainty is needed about what will happen post-2019.** Will Chorus revert to cost-based price regulation under Part 2 of the Telecommunications Act or Part 4 of the Commerce Act?

86. If the Government wants to provide regulatory certainty, it should determine, or at the very least be signalling, what will happen from 2019 when the rollout of the UFB network will be largely completed. At the very least, Vector believes any legislative provisions overruling the Commerce Commission should be subject to a sunset provision in 2019.

87. When Vector made its Refined Proposal to the Government’s Invitation to Participate (ITP) in the Partner Selection Process for the UFB Initiative, we anticipated that regulation of fibre services would be imposed, but that it would not be “copper equivalent pricing” which we assumed would be materially lower than regulated fibre prices.²⁵

88. Vector supports the option contained in the MBIE Discussion Document of applying generic price control to Chorus’ fixed network under Part 4 of the Commerce Act from 2019. What, if anything, differentiates Chorus from operators of natural monopoly network services in sectors such as electricity and gas?

89. Vector reiterates the following comments made in relation to the TSO review:²⁶

It should be noted Vector has concerns about the way the Commerce Commission operates Part 4 of the Commerce Act, and believes the Part 4 legislation could be improved ...

Part 4 of the Commerce Act and Part 2 of the Telecommunications Act (for access services) are the existing legislative mechanisms for price control of services in markets where there is little or no competition ... Consideration should be given to whether the Commerce Act or the Telecommunications Act would be most suitable:

- a. **Telecommunications Act provides a simpler fit in the short-term.** The Telecommunications Act provides a simpler fit, especially prior to 2020, given that UCLL and UBA copper services are already designated under the Telecommunications Act ...

²⁴ Paragraph 75 of the Commerce Commission’s “Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network - FINAL REPORT”, December 2003.

²⁵ Appendix E, Regulatory Environment and Regulatory Assumptions, accompanying Vector’s RefinAed Proposal to the Government’s Invitation to Participate (ITP) in the Partner Selection Process for the UFB Initiative, 2 August 2010.

²⁶ Paragraphs 36 - 38, Vector, “Submission to the Ministry of Business, Innovation & Employment on Review of Telecommunications Service Obligations (TSO) for Local Residential Telephone Service”, 20 August 2013.

- b. **Commerce Act provides a more business-wide model.** Telecommunications Act access regulation can be contrasted to regulation under Part 4 where, broadly, the regulation is more naturally applied to the regulated entity or particular assets. In this case, the Commission broadly calculates a "reasonable return" for the regulated supplier, but is not necessarily specific about how individual services should be priced.
- c. **2020 and beyond.** Assuming UFB services are regulated following the expiry of the UFB contracts, it would make sense to consider fully regulating Chorus' fixed line network (both its copper and fibre networks) under Part 4 ...

Regulation of Chorus' fixed line network under Part 4 of the Commerce Act, if administered appropriately by the Commerce Commission, could provide greater surety overall prices are at a level that provides Chorus an appropriate return, than regulation of individual copper access services under the Telecommunications Act.

- 90. A move to place Chorus under Part 4 regulation would also be consistent with the Australian Competition and Consumer Commission's (ACCC) approach to Telstra copper regulation in the context of the roll out of a new fibre network. In 2010, in reconsidering the pricing principles it applied to determining Telstra's six fixed line wholesale services, the ACCC set out the case for moving from TSLRIC+ based pricing principles to building block model (BBM) pricing principles more in line with models used in the gas and electricity sectors. The ACCC noted "a consensus appears to have been reached among industry participants that a BBM should replace TSLRIC+ as the pricing approach to telecommunications services. All submissions to the Discussion Paper were in favour of moving to a BBM".²⁷
- 91. In the UK, copper networks are subject to price cap regulation annually updated for inflation minus an X-factor efficiency adjustment and again in a BBM manner consistent with other regulated sectors.²⁸
- 92. The key input methodologies for a BBM approach under Part 4 of the Commerce Act, if operated appropriately by the Commerce Commission, could allow Chorus to recover its efficient actual costs and investments in existing sunk assets, as well as a reasonable rate of return on, and a return of, its investments. This is the approach adopted by the Commerce Commission for other regulated suppliers such as electricity distribution and gas pipelines.

What will the impact be of the Government's decision on the broadband market and fibre roll-out?

- 93. **The Government decision to intervene amounts to trade protection and does not create a level playing field:** If fibre provides superior service to copper, why do copper access pricing need to be set at the fibre price to provide a "level playing field"?
- 94. The real problem, if there is a problem, would be that the base fibre product does not offer a sufficiently superior service to warrant consumers switching from copper to fibre, rather than copper prices being too low. If this is a problem it is a commercial "problem", not a regulated problem, which could be readily addressed by Chorus or the LFCs, e.g. offering superior speed UFB services for any given price point, without Government intervention.
- 95. **Valuing copper on the basis of a new fibre network misapplies MEA.**
- 96. There is no foundation for referring to the fibre network as a replacement network. Chorus has no intention/is not required to retire its copper network post UFB

²⁷ Page 16, ACCC, Review of the 1997 telecommunications access pricing principles for fixed line services, Draft Report, September 2010.

²⁸ See paragraph 3.3, Ofcom, Fixed Access Market Reviews: approach to setting LLU and WLR Charge Controls, 11 July 2013.

deployment. The MBIE Discussion Document recognises that Chorus can even compete with their copper network in LFC areas. The result of the misapplication of MEA is that it would result in a copper network valuation substantially above cost (and above replacement cost (RC), depreciated replacement cost (DRC), optimised depreciated replacement cost (ODRC) and optimised deprival valuation (ODV)).

97. Valuing access to the (legacy) copper network on the basis of a new fibre network grossly misapplies the concept of MEA, by failing to adjust for: (i) fibre being superior rather than equivalent to copper; and (ii) depreciation of the copper network. The approach MBIE suggests is equivalent to valuing an old tube TV (which is now largely worthless) at the value of a brand new LCD TV.
98. In essence, this will have the effect of increasing the regulated price for access to copper services from the price proposed by the Commerce Commission (based on a forward-looking, cost-based benchmarking exercise) so it is in line with the pricing for entry-level residential reference offers for fibre under the UFB Initiative.
99. Vector submits MBIE's proposed implementation of the MEA valuation approach is inconsistent with an appropriate and efficient application of the principles which underpin the MEA valuation approach. With respect, the use of entry-level residential prices for fibre, as proposed by MBIE, would only be "the least likely to lead to an over-recovery of costs" because they are lower than the other costs available if the Government's choices were artificially limited to those set out in the UFB agreements.
100. Vector believes MBIE's proposed application of the MEA-based valuation approach would permit an over-recovery by Chorus. There is no principle to support the application of an MEA-based valuation where it allows prices to be so significantly inflated over the actual costs of providing services (at least as indicated in the Commission's benchmarking exercises undertaken so far, and which Vector would anticipate would be reflected under any forward-looking, cost-based final pricing principle determination) using legacy (depreciated) assets.
101. **Government intervention to keep prices higher than otherwise could dampen demand growth for broadband services:**
102. If the Commerce Commission is left to set copper access prices, this will result in significant price reductions and consequent greater uptake (and upgrade) of broadband services by consumers. Cheaper prices translates to greater demand.
103. Just as dial-up was an important stepping stone for consumers moving to ADSL (and then VDSL) copper broadband services, adoption of copper broadband services is an important stepping stone for take-up of fibre services. A natural evolution is that over time consumers demand is for faster and higher capacity services. As Chorus has noted "Faster copper-based technology forms an important stepping stone to fibre. Like any technology upgrade, the move to fibre will be a long term transition, and VDSL has an important role in the interim and in areas where UFB is not being rolled out".²⁹
104. To the extent that lower copper prices discourage some consumers from transferring from copper to fibre, this simply reflects that the higher cost of fibre needs to be justified by superior quality service. This is a commercial "problem" that could be readily addressed by Chorus or the LFCs, e.g. offering superior speed UFB services for any given price point without Government intervention.

²⁹ Chorus, Report from chairman Sue Sheldon and CEO Mark Ratcliffe, A good operating result: <http://www.chorus.co.nz/file/18080/Chorus-Annual-Report-2013-FINAL.pdf>

105. While the Government's proposed intervention would mean copper prices would be lower than at present, it would also mean consumers would have to pay substantially higher prices than if the Commerce Commission was left to determine the appropriate cost-based prices for copper access services. This might result in faster switchover of some customers from copper to fibre, where fibre is available, but could also dampen overall demand growth for broadband services and, by keeping copper prices artificially high, weaken the stepping stone between copper and fibre services. It is vitally important that MBIE test this tension empirically and quantitatively to determine whether the Government's proposed intervention would have a positive or negative overall impact on take up and development of broadband services. This analysis is presently missing from MBIE's assessment of the Government's proposals for intervening in the setting of copper access pricing.
106. The different impact the proposed intervention will have on Chorus and LFCs, and the implications this has for copper to fibre transition, needs to also be considered.
107. **Chorus will be incentivised to go slow on fibre roll-out:** If the Government sets Chorus' copper access prices at above cost levels (equal to the agreed price for roll-out of a fibre network), Chorus would receive windfall gains. This would heighten the value to Chorus of its copper access network. From Vector's calculations – based on Part 4 modelling – Chorus would be able to extract a ROI of 20 – 25% between 2014 and 2019 if the Government sets its copper prices equal to fibre.
108. It would also heighten the cost to Chorus of its new fibre network cannibalising its copper network's customer base. The incentive this would create would be for Chorus to roll-out fibre no quicker than it is contractually-obliged to, and to retain customers on its copper network. This would seem to Vector to be the exact opposite of what the Government hopes would occur as a result of intervening in copper access pricing.
109. If the Government overrules the Commerce Commission copper access price determinations, it should consider mechanisms to remedy this incentive problem such as tying higher copper access prices with more aggressive UFB roll-out KPIs e.g. timing of deployment or expansion of the UFB footprint to areas where fibre would not otherwise be available.
110. **There are no benefits to LFCs from the copper price intervention:**
111. Vector finds it difficult to see how the intervention would help the transition from copper to fibre in LFC areas. LFCs will not receive the benefit of the copper tax. Only Chorus will. Chorus is the only UFB provider that would benefit from the Government's decision to set the price ceiling for copper access prices at the same level as Chorus' base fibre product prices.
112. Nor should it be assumed the LFCs would see the benefit of higher copper access prices, making copper services less competitive relative to fibre.
113. The MBIE Discussion Document states that if the Government does not intervene, "Fibre revenues for LFCs will be lower than expected (because of the slower uptake of fibre and fibre-based services), affecting expected returns and putting at risk the long-term viability of the firms." This statement presupposes the Government decision to raise the price ceiling for Chorus' copper access prices to that of fibre would result in Chorus setting higher copper access prices in areas where its copper network business is competing with LFCs.
114. Vector does not believe there is any reason to believe Chorus would act any differently in LFC UFB areas than it has in response to the roll-out of Saturn's (now Vodafone) cable network in Wellington and Christchurch.

115. What would stop Chorus from setting copper access prices at the Government set price in areas where it is rolling out fibre/where no one is rolling out fibre, and pricing copper aggressively low (including below the levels that the Commerce Commission would have otherwise set) in areas where its copper network is competing with other LFCs? The experience of Saturn's (now Vodafone) roll-out of a cable network in Wellington is instructive as, the then Telecom matched Saturn's lower residential telephony prices on a street by street basis. This is reflected in current pricing where residential telephony prices are set below the TSO price cap in Wellington and Christchurch. It is not apparent why Chorus would respond differently to LFC fibre roll-out than it has to Saturn's cable roll-out.
116. The higher copper access revenues in other areas could make it easier for Chorus to compete aggressively (on price) against the LFC fibre networks.
117. Unless the Government imposes a legislative restriction on Chorus price discriminating between areas where it is rolling out fibre and areas covered by other LFCs, Vector cannot see any positive impact the Government's pricing decision would have for the LFCs/roll-out of fibre in non-Chorus UFB areas.

What alternative options should the Government consider?

118. The MBIE Discussion Document provides three options only, each of which are simply variations on the same theme with the Government intervening in the Commerce Commission's price determination responsibilities by proposing to set copper prices equal to fibre, and appears to exclude the status quo.
119. **Further consideration of the levy option is needed and warranted:** Vector is of the view that it should be recognised that the proposed intervention strongly mirrors trade/import protection. The Government should give further consideration to imposing a levy (akin to an import tariff) on copper access prices (that the Government would receive) rather than allowing Chorus' to receive a windfall from higher copper access prices.³⁰ The Government could make the levy funds available to: (i) substitute for the Telecommunications Development Levy (TDL) or components of it; (ii) potential use in relation to research and development funding; and (iii) all telecommunications service providers to facilitate provision of fibre services to new customers.
120. Indeed, a copper tax or levy is identified in an expert report, authored by Professor Martin Cave and submitted by Chorus in relation to the Commission's benchmarking review for the UCLL service.³¹ In a separate article, published with two co-authors, Professor Cave provides a broader discussion of the use of a copper levy (which would inflate the copper access tariff to a level which reflects fibre costs). In that article, a levy is identified as an effective tool for promoting the dual objectives of "migration to fibre" and "efficient entry".³² Professor Cave and his co-authors observed:³³

One approach (see figure 5) that respects both objectives ["migration to fibre" and "efficient entry"] is for the difference between the incumbent's copper cost level and the fibre cost level to be dedicated to the funding of fibre deployment.

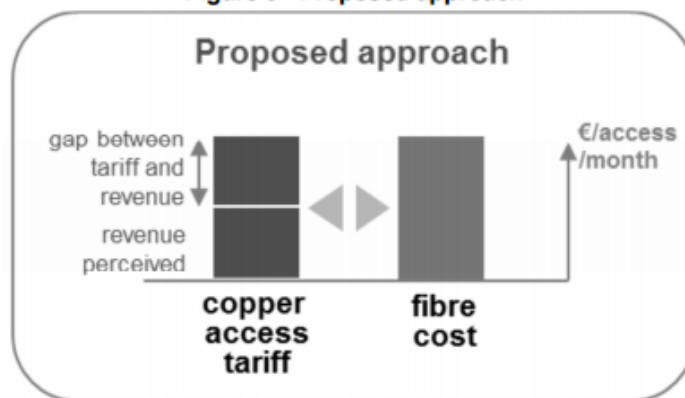
³⁰ Which need not necessarily be as high as fibre prices.

³¹ Martin Cave *Regulating the price of copper in New Zealand* Attachment 2 to Chorus cross-submission in response to revised draft determination on the benchmarking review for the unbundled copper local loop service (18 June 2012) at 7.

³² Martin Cave et al "The price of copper and the transition to fibre" (2012) 85 *Digiworld Economic Journal* 147.

³³ Martin Cave et al "The price of copper and the transition to fibre" (2012) 85 *Digiworld Economic Journal* 147 at 162.

Figure 5 - Proposed approach



121. Professor Cave's analysis of the price of copper and the transition to fibre services, concludes with a levy identified as one possible solution to the types of challenges identified in the MBIE Discussion Document (emphasis added):³⁴

Considering other pricing objectives, regulators need to find a compromise between the objective of no distortion of competition and the objective of migration from copper to fibre. On the one hand, if an incumbent's revenues are too high, it obtains an undeserved competitive advantage. On the other hand, if the wholesale copper price is too low, alternative operators will not be encouraged to switch to fibre. **One of possible ways to solve this problem is to create a fund which will make it possible to reduce the incumbent's revenues without reducing wholesale copper price.**

122. The levy option would have several advantages over what is currently proposed:
- It would avoid the Government intervening in the Commerce Commission's independence and decision-making on copper pricing (and associated regulatory uncertainty costs), and ensure Chorus' copper access prices remain cost-based as determined by the Commerce Commission. Such an approach will minimise the regulatory uncertainty created by the Government changing the regulatory framework and overruling an independent regulatory decision through legislative changes.
 - It provides a policy tool for the Government to lift the price of access to copper services from cost-based pricing set by the Commission (in order to promote uptake of fibre services), without creating a hidden wealth transfer to Chorus.
 - It would ensure a level playing field between Chorus and the LFCs. Chorus would not have the advantage over LFCs of additional copper revenue to cross-subsidise its fibre roll-out and other activities. It would also mean that any equalisation of copper and fibre prices would occur regardless of whether the network area is a Chorus or an LFC region.
 - The additional funds from setting copper service prices to consumers above cost could be made available on a supplier neutral basis, rather than creating a windfall gain for Chorus.

123. The MBIE Discussion Document rejects the levy option, stating "The Government ... has decided not to test this option further", on the basis of what appears a very cursory consideration. While the Discussion Document states the option was rejected "because of two significant disadvantages", the two disadvantages are relatively minor compared

³⁴ Martin Cave et al "The price of copper and the transition to fibre" (2012) 85 *Digiworld Economic Journal* 147 at 167.

to the consequences of the three options for overruling the Commerce Commission's copper access price determinations.

124. The MBIE Discussion Document states the Government has rejected this option on the basis that: (i) "it may create further investment uncertainty until there is clarity regarding how the levy would be used to support the roll-out of a fibre network"; and (ii) "regulated prices would diverge from known efficient replacement costs".³⁵
125. The Government's decision to intervene in the Commerce Commission's regulatory price setting, and the lack of clarity around the basis or need for such intervention, creates much more uncertainty³⁶ than questions about how a levy would be used to support fibre roll-out. The claim that "regulated prices would diverge from known efficient replacement costs" is also incorrect. The Government's decision to set copper access prices equal to Chorus' UFB bid price will result in prices that are substantially above cost, which will not be to the long-term benefit of end-users.

Generic solutions to generic regulatory problems

126. Vector believes generic regulatory problems warrant generic solutions. The MBIE Discussion Document focuses on industry/copper-centric considerations to what, fundamentally, should be considered as a generic concern. There are risks the Commerce Commission price determinations under the Commerce Act and Telecommunications Act set prices too low, undermining the ability of regulated suppliers to recover a reasonable return on their investment, and incentives and capability to invest.
127. Vector believes the Government should widen the Telecommunications Act review to encompass all regulated suppliers, be it under the Telecommunications Act, Commerce Act, Electricity Industry Act 2010, Gas Act 1992 or other relevant legislation. It could assess s 157AA(2)(b) whether it would be more preferable and effective for the telecommunications sector to operate under alternative regulatory frameworks. Consideration should also be given to whether changes would be desirable in other sectors and whether a generic approach should be adopted for regulation across different network sectors.
128. It is important that regulatory settings recognise interdependencies between sectors and that the effectiveness of particular regulatory frameworks are not impaired by consideration of regulation in isolation. More could be done within this review to consider common objectives or approaches, particularly given the common involvement of the Commerce Commission in the pricing decisions of all key regulated sectors. Vector encourages the Government to broaden its consideration of the importance of investment incentives and ensure that experiences from other sectors are learnt and applied and that the interdependencies in policy are considered.
129. We reiterate the following comment from our TSO submission:³⁷

MBIE should identify and review the inconsistencies between the way telecommunications and energy network infrastructure regulation (including in relation to the TSO Deeds) to determine the extent of reforms required to ensure a more consistent, robust and coherent approach to economic regulation. The Productivity Commission inquiry into regulatory design and operation may also help inform this issue.

³⁵ Paragraph 233, Ministry of Business, Innovation & Employment, Discussion Document, "Review of the Telecommunications Act 2001", August 2013.

³⁶ Refer to the section of this submission "Regulatory stability, transparency, and certainty".

³⁷ Paragraph 30, Vector, "Submission to the Ministry of Business, Innovation & Employment on Review of Telecommunications Service Obligations (TSO) for Local Residential Telephone Service", 20 August 2013.

130. There are a number of policy options available for addressing concerns about the way economic regulation is operated in New Zealand. For example, Vector can see strong merit in providing stronger review and appeal provisions that could be applied across all economic regulation, coupled with stronger and more explicit obligations on the regulator to demonstrate it is promoting incentives and capability to invest:

Appeal provisions	Review provisions
Expanding the role of merit-based appeals: currently limited to a narrow number of matters under Part 4 of the Commerce Act and excluded entirely under the Telecommunications Act. ³⁸	Requirement for the regulator/Commerce Commission to demonstrate – under both Part 2 of the Telecommunications Act and Part 4 of the Commerce Act – that it is promoting incentives and capability to invest, and that it is: ³⁹ <ul style="list-style-type: none"> (a) providing investors with an expectation of a reasonable return on their investment [that adequately reflect the risks assumed when the relevant investments were made]; and (b) providing sufficient regulatory stability, transparency, and certainty to enable businesses to make long-term investments; and (c) taking into account the legitimate business interests of regulated suppliers.
Establishing a specialist tribunal to hear appeals modelled on the Australian Competition Tribunal: a pool of judges, economists and business people.	Include a statutory requirement for review of the operation of economic regulation (Commerce Act, Electricity Industry Act Telecommunications Act etc), with terms of reference mirroring ss 101A and 157AA of the Telecommunications Act.

³⁸ Vector recognises one of the reasons the Telecommunications Act limits the scope for appeals is that access providers could game the regime by using appeals to delay access seekers gaining access to their access services, entering the market and competing with the access provider.

³⁹ Proposed drafting is derived from section 157AA of the Telecommunications Act.

CONCLUDING REMARKS

131. The Government should not intervene in the Commerce Commission's copper access pricing determinations. Options 1 – 3 in the MBIE Discussion Document should be rejected.

Proposed intervention could be detrimental to the UFB initiative and make consumers worse-off

132. MBIE has provided no evidence the Commerce Commission's copper access price determinations could adversely impact on the Government's UFB initiative.

133. The proposed Government intervention could have a negative impact on broadband. Consumers would face higher (than otherwise) prices. While this might result in some migration to fibre, where available, it could also dampen demand for broadband services. The high prices/profitability of Chorus' copper network will mean Chorus' incentives will be to roll-out fibre no quicker than it is contractually obliged to.

134. The proposed Government intervention would benefit Chorus but not LFCs or LFC fibre roll-out. LFCs would not receive any of the higher (than otherwise) copper revenue or profits. Nor would they necessarily benefit from higher copper prices making their fibre services appear to be more cost competitive, because Chorus' incentives would be to "pocket price" to retain customers on its copper network in LFC areas. This is the approach Chorus has taken to the building of an alternative cable network in Wellington and Christchurch by Vodafone (originally Saturn). Vector can see no obvious reason why Chorus would adopt a different competitive approach to the LFC fibre roll-outs.

The importance of regulatory certainty and enabling regulated suppliers to earn a reasonable return on investment

135. There has been considerable emphasis placed on the uncertainty created by the length of the process for determining the regulated prices for copper access services.

136. This is not unique to copper access services or even the Telecommunications Act.

137. The Commerce Commission went through a lengthy process to determine mobile termination rates, during a time that Telecom and Vodafone were both rolling out (new and faster) 3G mobile networks. The process the Commerce Commission undertook to undertake initial price resets under the current Part 4 of the Commerce Act were also very lengthy.

138. As a regulated supplier, itself, Vector considers the most important aspect of regulatory certainty is that regulated suppliers can expect a reasonable return on their investment and the outcomes of the pricing reviews are reasonably predictable e.g. regulated suppliers are able to undertake their own analysis/modelling to forecast with a reasonable degree of confidence the likely outcome of a Commerce Commission pricing decision. No evidence has been provided that this is an issue in relation to the Commerce Commission's setting of copper access pricing, and the Commission has explicitly stated that it is erring on the side of setting prices too high rather than too low something that it has explicitly rejected doing under Part 4 of the Commerce Act.

139. A decision to overrule the Commerce Commission's copper access pricing decision may bring forward certainty of pricing outcomes at least until 2019; however, it will be the certainty that consumers will face higher prices than otherwise.

140. The Government should consider the long-term impact on regulatory certainty of a decision to intervene in and overrule a regulator's decisions through legislative

intervention. The decision sets a precedent that the Government will not necessarily preserve the independence of the regulator. While the outcome of this particular decision will be favourable (higher prices) for the regulated supplier, there is no certainty a potential future intervention would not be negative e.g. overruling the Commerce Commission to set lower prices or requiring expansions, upgrades (i.e. enforced investment), or service quality improvements.

Where to from here?

141. Vector believes the Government should reject the proposal to overrule the Commerce Commission's copper access pricing determinations. Vector does not believe the MBIE Discussion Document has demonstrated that Government overruling the Commerce Commission's copper access pricing determinations would promote competition for the long-term benefit of end-users, as per the purpose in s 18 of Part 2 of the Telecommunications Act, or would help promote the Government's UFB and economic development objectives.
142. The Telecommunications Act review should be suspended until 30 September 2016 or, at the earliest, until 30 June 2014 after the Productivity Commission has completed its inquiry into improving the design and operation of regulatory regimes. It should then proceed on the basis that generic issues are identified and should be addressed in a generic way; with consideration given to the differences in approach to generic network utility issues (price control, pricing methodologies, access terms and conditions and service quality setting) across the different utility sectors in New Zealand. If there are concerns about the way the Commission sets prices, or whether it gives sufficient weight to ensuring regulated suppliers have incentives to invest, then these matters should be considered on a generic, rather than sector or network specific basis such as the current copper access pricing review.
143. If the Government does intervene in copper access pricing it should do so by introducing a levy on copper services (limited to areas where UFB roll-out has occurred), rather than by overruling the Commerce Commission, and should make the levy funds available for promoting UFB uptake and supporting rural initiatives etc.
144. If the current copper access pricing review is continued, MBIE should undertake further consultation and provide for cross-submissions and public hearings on the matter. The copper access pricing review is too contentious and too important an issue to be addressed by a single Discussion Document and a single round of consultation.