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Neville Lord
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Commerce Commission
WELLINGTON

Dear Neville,

Submission on Information Disclosure for Local Fibre Companies

Introduction

1. Vector welcomes the opportunity to submit on the Commerce Commission's consultation paper "Information Disclosure for Local Fibre Companies", October 2011. No part of Vector's submission is confidential and we are happy for it to be publicly released.

2. This submission reflects:

   a. **Level playing field:** Vector's concerns about the risk and uncertainty associated with competing against Chorus in the Auckland fibre market, given Chorus will be operating as a subsidised Local Fibre Company (LFC) and not on a fully commercial basis;

   b. **Regulatory consistency:** The desirability of ensuring monopoly network utility operators are regulated in a consistent manner across different utility sectors, both in relation to information disclosure[1] and economic regulation;

   c. **Transparency:** The fundamental function of information disclosure is to ensure transparency of monopoly network utility operations and help identify any mis-use of substantial market power; and

   d. **Value-for-money**: LFCs are the recipients of substantial public subsidies and the public in general, not just users and competitors, need assurance the Crown's investment delivers the public benefits promised at the lowest cost. This is particularly important given the potential detriment, and crowding out affect, the Crown involvement could have.

Market failure problem in the provision of essential broadband services

3. The LFCs will be monopoly providers of fibre network services. This will be particularly the case for Chorus as the ultra-fast broadband (UFB) initiative, and

[1] Noting the enabling provisions for information disclosure by LFCs in the Telecommunications Act are near identical to the information disclosure provisions for Electricity Distribution Businesses (EDBs) and Gas Pipeline Businesses (GPBs) in the Commerce Act.

related legislative changes, reinforce and entrench its pre-existing natural monopoly position.

4. Telecom, TelstraClear and Vodafone have provided evidence the UFB initiative, and the ensuing subsidies, will crowd-out investment in telecommunications infrastructure that would otherwise have occurred.[2] This will entrench the monopoly position of the LFCs and subdue investment by alternative providers in fibre.

5. Information Disclosure Provisions have an important role in ensuring information is available to identify whether a LFC is taking advantage of its substantial market power, and inhibiting competition, which could occur in a number of ways not limited to:

   a. Excess prices;

   b. Poor service quality and/or inadequate investment in infrastructure;

   c. Discrimination amongst access seekers (a particular risk in relation to sharing of assets and legacy arrangements between Chorus and Telecom);

   d. Cross-subsidisation (a particular risk in relation to sharing of assets and legacy arrangements between Chorus and Telecom and important within the context of ensuring appropriate use of public funding[3]); and

   e. Network capacity issues.

6. Information Disclosure is also important for ensuring LFCs are not breaching key legislative constraints, to the long-term detriment of end-users, notably but not limited to the following requirements:

   a. No participation in supply of retail services;

   b. No services above layer 2;

   c. No end-to-end services: all services must have at least one end in a LFC aggregation point and LFC can't sell a service that links 2 or more end-user sites together;

   d. Non-discrimination: LFC should not treat service providers differently, or, where LFC supplies itself with a service, must not treat itself differently from service providers, except to the extent that a particular difference in treatment is objectively justifiable and does not harm, and is unlikely to harm, competition in any telecommunications market; and

   e. Disclosure of all UFB Services Agreements and the ability for service providers to move to the agreement they see is beneficial to them (if more than one variant is ever agreed).

7. Information Disclosure is critical for ensuring the information is available to determine whether action should be undertaken in relation to the Telecommunications Act 2001 (eg by adding a designated access service) and Parts 2 and 4 of the Commerce Act 1986.

[2] Castalia Report to Telecom, TelstraClear, & Vodafone "Getting the Most from High Speed Broadband in New Zealand: Investing in Productivity Growth", December 2008.

[3] Ensuring that LCFs are not able to capture inappropriate gains/functionless rents from the difference between actual costs and Crown funding).

Local Fibre Companies are a Public Private Partnership

8. LFCs are not just another provider of a regulated service. Collectively, they are to receive $1.5 billion in Crown funding to subsidise the roll-out of infrastructure of national importance. The need to ensure this substantial investment in being used wisely and as intended should be taken into account in designing the Information Disclosure regime to apply to LFCs.

9. Vector assumes Crown Fibre Holdings and the Ministry for Economic Development will have put in place governance systems that reflect the requirements of the Treasury's guidance for public private partnerships in New Zealand[4] and the Auditor-General's report on achieving public sector outcomes with private sector partners.[5] Nevertheless, we think the Commission should at least recognise the importance of good stewardship of large sums of public funds when deciding how to regulate LFCs. As a minimum, we suggest the size and economic importance of the public's investment in LFCs should see the Commission erring on the side of a higher degree of disclosure.

10. This is particularly important given the potential detriment, and crowding out effect, the Crown involvement could have.

Public disclosure of information

11. The Telecommunications Act allows the Commission to prepare and publish reports, summaries and analyses of information concerning the LFCs' costs and characteristics. As a market participant, this is an area of key concern for Vector.

12. We suggest these reports should start from the general principle that a high level of public disclosure is desirable.[6] Industry participants – suppliers, competitors, customers and industry groups – can offer a unique perspective on the information disclosed by LFCs. We see real value in exposing non-confidential information to public scrutiny.

13. In a sense, industry participants have the capacity to act as "crowd-sourced" support for the formal oversight of the Commission. The benefits of industry engagements are illustrated by previous issues that have been identified and driven by industry participants, most notably:

    a. Telecom Wholesale offered discriminatory "loyalty offers" for UBA in breach of the Operational Separation Undertakings. This concluded with a $1.6 million settlement paid by Telecom; and

    b. Telecom Wholesale withdrew its discounting offers for HSNS services. Vector Communications had previously complained about the discriminatory effects of the discount structure.

14. On this basis, we suggest LFCs should be required to make the information disclosed to the Commission publicly available on their websites at the same time as it is disclosed to the Commission. This is consistent with information disclosure under Part 4 of the Commerce Act. As with the Commerce Act regime, the Commission could exempt LFCs from publicly disclosing specified information, or classes of information, considered confidential or commercially-sensitive information.

[4] http://www.infrastructure.govt.nz/publications/pppguidance
[5] http://www.oag.govt.nz/2006/public-private
[6] Noting the s 156AW(1) obligation for the Commission to ensure the confidentiality of any information that may reasonably be regarded as confidential or commercially sensitive.

15. Such a requirement would be consistent with the Telecommunications Act: under s 156AU(4), the LFC "must prepare and disclose the information required under this section in accordance with the Commission's requirements". Section 156AV(a) allows the Commission to "prescribe the form and manner in which information must be disclosed". The Commission has broad powers of disclosure, and there is no provision in the Act preventing the Commission from requiring public disclosure by LFCs.

Reports of current developments and emerging trends

16. We welcome the Commission's proposal to prepare reports based on the information disclosed, although this should operate in conjunction with public disclosure of the information. We are concerned, however, about the substantial delay before the first report is proposed. Fibre deployment has already begun. Services are already being offered over LFCs' networks. 2014 is simply too long to wait.

17. We reiterate our comments in the section above regarding the importance – and benefits – of industry participation in the information disclosure process. The Commission should not sit on this important information for three years, keeping industry participants in the dark. The information may be critical in terms of determining the performance of each LFC's performance (and potential mis-use of substantial market power) in each UFB region.

18. Under section 156AW(1), the Commission's reports are to inform the industry and public of "current developments" and "emerging trends". We are concerned that the Commission's proposal to wait until 2014 for the first report is giving undue weight to "emerging trends", at the expense of not reporting on "current developments" in 2012 and 2013 when they are still current. We would much prefer reports to be released in 2012 and 2013 on current developments at least, even if the discussion of emerging trends is limited in these early reports.

19. As a concrete example of the importance of timely disclosure, the Commission will be undertaking a review of telecommunications in 2013, and Vector was anticipating engaging in this process based on the information disclosed by LFCs up to that date.

Information disclosure provisions

20. Recent regulatory reforms in New Zealand have led to the development of three detailed information disclosure regimes. These regimes apply to:

    a. LFCs in relation to the UFB initiative, under subpart 3 of Part 4AA of the Telecommunications Act;

    b. Regulated suppliers (in particular, EDBs and GPBs) under Part 4 of the Commerce Act; and

    c. Access providers, including Telecom, under Part 2B of the Telecommunications Act.

21. In many respects, these three models – rightly - share a number of characteristics.

22. The information disclosure provisions relating to LFCs, under subpart 3 of Part 4AA of the Telecommunications Act, are essentially the same as the information disclosure provisions under Part 4 of the Commerce Act, and a wider form of disclosure requirement than provided for in relation to access providers under Part 2B of the Telecommunications Act.

23. They each have an objective of promoting the long-term benefit of consumers. The Telecommunications Act provisions aim to achieve this by promoting competition, while the Commerce Act provisions aim to achieve this "by promoting outcomes that are consistent with outcomes produced in competitive markets", reflecting that competition is not possible in the provision of services regulated under Part 4 of the Commerce Act.

24. The consistency in objectives across the three models – in addition to other similarities, including their administration by the Commission, their application to network industries and the cross-over between them (with some firms subject to two of these regimes) – suggests consistency in operation is desirable. The Commerce Commission should therefore draw on the approach it is taking to information disclosure under Part 4 of the Commerce Act.[7]

25. On closer inspection, however, a comparison of the statutory provisions indicates that information disclosure for LFCs under the Telecommunications Act should be more comprehensive than the two existing frameworks. The statutory provisions for LFCs are more comprehensive – as a crude measure, they are set out from (a)-(l), with the other two provisions extending only to (g) and (k).

26. This implies there are greater concerns about the impact LFCs could have on competition than for normal access providers under the Telecommunications Act. This may, in part, be an acknowledgement of the weaker regulatory provisions put in place for LFCs than exist for designated access providers, coupled with certain exemptions from the Commerce Act for LFCs.

27. Vector also believes the Commission should interpret the provisions as meaning it should use the Information Disclosure Provisions for access providers under the Telecommunications Act and regulated suppliers under Part 4 of the Commerce Act as a minimum set of requirements (except for industry-specific legislative differences) that should be placed on LFCs.

28. A full comparison of the Information Disclosure Provisions for each of these sectors is detailed in an appendix to this submission.

Regional disaggregation

29. Vector believes the LFCs should be required to disclose information disaggregated by the 33 UFB regions. (It might also be desirable to separate out national back-haul/transmission, from local distribution.)

30. A requirement to provide disaggregated information would help meet the purpose of information disclosure by:

    a. Helping to ensure comparable (like for like) information disclosures amongst the LFCs.[8]

    b. Avoiding the risk that poor performance in some UFB regions is masked or averaged out by better performance elsewhere.

    c. Identifying where an LFC is engaging in differential or discriminatory behaviour amongst UFB regions. For example, Chorus may have incentives to roll-out fibre more aggressively, or offer more favourable access

[7] It should be noted that while Vector believes there should be consistency in approach to information disclosure, we have a number of concerns about the Information Disclosure provisions that are being introduced under Part 4 of the Commerce Act. These concerns have been well documented in our submissions to the Commerce Commission, so we do not repeat them here.

[8] Some LFCs will be operating in more than one regions eg Ultra-fast Broadband Limited is in both the Waikato and BoP regions as proposed by the Commission.

conditions, in areas where competing networks exist or are being rolled-out eg Wellington and Auckland.

d. The flip-side of bullet point c. above, is that UFB roll-out in main centres could occur ahead of, and at the expense of, UFB regions where there is greater need; in terms of poor pre-existing infrastructure.

e. Helping to ensure LFCs are meeting their regulatory obligations in each UFB region.

31. The Telecommunications Act provides for the Commission to require separate disclosures for each UFB region.

32. The Telecommunications Act gives very broad powers to the Commission in setting the requirements for information disclosure. Under section 156AU(3)(b), the Commission may "require the LFC to adopt, in the preparation or compilation of that information, any methodology that is required by the Commission". This is broad enough to allow disclosure based on a regional basis. The regional basis would be a "methodology" under this section. This section would also allow the Commission to set a methodology for the allocation of common costs between each UFB region, as well as between regulated and non-regulated networks and services.[9]

33. Further, under section 156AV(1)(a), the Commission may "prescribe the form and manner in which information must be disclosed". Section 156AV(h) allows the Commission to "make requirements in respect of all or part of the relevant business". This would allow the Commission to set financial templates or other forms (ie that assume a regional basis) that LFCs must follow in disclosing its information.

34. The Commission appears to have accepted the principle of regional disclosure: Appendix B of the consultation paper proposes that for information disclosure the LFCs should aggregate coverage area information into 10 regions, rather than the original 33, in order to lower compliance costs. Similarly, many of the proposed templates require the LFC to specify which region the particular statement is for.

35. As an alternative to our preferred option of separate disclosure for each coverage area, we suggest that LFCs should only be able to aggregate coverage area information for small to medium sized coverage areas. Some coverage areas, such as Auckland and Wellington, already cover a substantial proportion of the population: these should not be diluted further. As a general rule, if the Commission decides not to require disclosure for each coverage area, coverage areas including more than 50,000 residents should be disclosed separately.

36. We have identified three further issues with the 10 regions proposed by the Commission:

a. The Bay of Plenty region includes some coverage areas that were awarded to Chorus (Rotorua, Taupo and Whakatane) and some that were awarded to Ultra-fast Broadband Limited (Taurange and Tokoroa).

b. Likewise, the proposed Canterbury region includes some coverage areas that were awarded to Chorus (Timaru and Ashburton) and some that were awarded to Enable Networks (Christchurch and Rangiora).

[9] To this end, Telecom has previously submitted on its views about cost allocation, and how the cost allocation should be specified to (i) avoid risks that costs will allocated inefficiently and/or inappropriately between regulated and unregulated businesses; and (ii) avoid unduly deterring investment [Telecom "Submission on the Commerce Commission's Draft Reasons and Proposed Regulation of Input Methodologies under Part 4 of the Commerce Act 1986", 9 August 2010].

c. Hawera was a coverage area but is not included in any of the proposed regions.

Discounting

37. Discounts are part of common commercial practice, even among firms with no market power, and they often reflect efficiencies and non-discriminatory, pro-competitive, behaviour.

38. However, in certain circumstances, discounting practices can be discriminatory and anti-competitive. In grappling with this distinction, international best practice has identified specific characteristics that often signal increased cause for concern. LFCs should be required to disclose information sufficient to indicate when the discounts offered raise concerns.

39. One specific concern we have is in relation to the ability of information disclosure to reveal discrimination through the use of skewed or excessive discounting. Discounting practices - particularly the UBA loyalty offers and the HSNS discounting discussed above - have been at the centre of many discrimination issues in the last three years.

40. We acknowledge that the LFC information disclosure provisions are not a straight replacement for Telecom's Operational Separation Undertakings, under which both of the above issues arose (although in the long run, the importance of the LFC undertakings will grow relative to Chorus' copper undertakings). That said, the underlying issues are similar, and the Commission should take these previous incidents into account.

41. The information disclosure schedules in Appendix A of the consultation paper do not provide sufficient information to show whether discounts are being offered in a discriminatory way. The most relevant is Schedule B: Report on Pricing, which requires LFCs to disclose the average discount given for a range of products. Our main concern is that averages can be used to mask the true effect of discounts.

42. We suggest that, for each product, LFCs should be required to disclose on a quarterly basis:

    a. the type of discounts offered for that service eg volume or term discounts;

    b. the thresholds and amounts for each discount eg a 20% discount for a 2 year term, a 30% discount for a 3 year term;

    c. the way the discounts are calculated eg when both volume and term discounts are available, are these calculated sequentially? Are volume discounts calculated on a marginal basis for the quantity above the threshold, or across the entire quantity purchased?; and

    d. the proportion of the LFC's customers that receive a particular discount for that product.

Forecasts

43. The proposed schedules do not appear to require disclosure of an LFC's forecasts, except on a retrospective basis. For example, Schedule 6 requires "actual for current year" and "forecast for current year" in relation to "premises passed" and "premises connected".

44. While there is some benefit in comparing actual results against forecast results, the real value in forecasts is prospective, rather than retrospective. An additional column should be inserted into Schedule 6 to show "forecasts for upcoming year".

45. We believe there is negligible risk that disclosing prospective forecasts would prejudice an LFC's commercial position. First, the disclosed information would only relate to network rollout predictions, rather than financial information. Second, the disclosed information is at a high-enough level to prevent competitors cherry-picking prospective roll-out areas in advance. A forecast that, say, 100,000 residential premises will be connected in Wellington in the upcoming year will be of little commercial use to a potential competitor.

Other comments

46. The Commission has expressed concerns about the reliability of some of the information Telecom has previously submitted. For example, on 3 May 2011, the Commission announced its conclusion that Telecom's regulatory financial statements were unreliable, and could not be "objectively justifiable, with "Telecom's valuation of key assets being overstated, and in particular, that Telecom's access network is overvalued by over a billion dollars".[10] The Commission should, accordingly, give consideration to what forms of safeguards should be put in place including methodologies[11], audit and sign-off and post-disclosure scrutiny and review.

Concluding remarks

47. Vector believes information disclosure can be helpful in terms of identifying mis-use of substantial market power, and determining the appropriate nature of regulation.

48. The Information Disclosure Provisions for LFCs in the Telecommunications Act are: (i) substantially wider than that for designated access providers under the Telecommunications Act; and (ii) substantially the same as that for regulated suppliers under Part 4 of the Commerce Act. Vector believes the Commission should draw on the Disclosure Requirements for these jurisdictions as a starting point for LFC disclosures.

49. If the Commission has any queries regarding Vector's submission or would like further information please contact Robert Allen, Senior Regulatory Advisor, on 09 978 82088 or robert.allen@vector.co.nz.

Kind regards

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Regulatory Affairs Manager

[10] http://www.comcom.govt.nz/telecommunications-media-releases/detail/2011/commerce-commission-concludes-telecom-s-regulatory-financial-statements-are-unreliable

[11] As noted previously, Telecom has previously submitted on its views about cost allocation [Telecom "Submission on the Commerce Commission's Draft Reasons and Proposed Regulation of Input Methodologies under Part 4 of the Commerce Act 1986", 9 August 2010].

Appendix: Comparison of Information Disclosure Provisions

Information Disclosure Provisions for:		
LFCs under the Telecommunications Act	**Access Providers under the Telecommunications Act**	**Regulated suppliers under Part 4 of the Commerce Act**
(a) financial statements:		(a) financial statements (including projected financial statements):
(b) asset valuations and valuation reports:		(b) asset values and valuation reports:
(c) prices, terms, and conditions:	(b) prices, terms, and conditions of supply of prescribed services:	(c) prices, terms and conditions relating to prices …
(d) costs and cost allocation methodologies:		(c) … and pricing methodologies:
(e) contracts:	(a) contracts:	(d) contracts:
(f) transactions with related parties (as if the test for related parties were the same as the test in section 79), including prices and methodologies in relation to such transactions:	(c) transactions with related parties (as if the test for related parties were the same as the test in section 79):	
(g) financial and non-financial performance measures:	(d) performance measures and statistics (for example, response times, technical performance, and service quality details):	(f) financial and non-financial performance measures: (i) quality performance measures and statistics:
(h) plans and forecasts:	(e) plans and forecasts:	(g) plans and forecasts, including (without limitation) plans and forecasts about demand, investments, prices, revenues, quality and service levels, capacity and spare capacity, and efficiency improvements: (h) asset management plans:
(i) transfer payments (whether actual or notional) amongst prescribed business activities:		(e) transactions with related parties:
(j) network capacity information:	(f) network capacity information:	
(k) characteristics of relevant services:		
(l) policies and methodologies in the areas referred to in paragraphs (a) to (k) or other areas.	(g) policies and methodologies in these or other areas.	(j) assumptions, policies, and methodologies used or applied in these or other areas:
		(k) consolidated information that includes information about

Information Disclosure Provisions for:		
LFCs under the Telecommunications Act	**Access Providers under the Telecommunications Act**	**Regulated suppliers under Part 4 of the Commerce Act**
		unregulated goods or services, in which case section 53D applies.