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Public

Submission in response to the
Commerce Commission's Process and issues
paper for determining a TSLRIC price for Chorus'
unbundled bitstream access service in accordance
with the Final Pricing Principle



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Executive Summary



EXECUTIVE SUMMARY

- 1 This submission responds to the Commerce Commission's (Commission) paper entitled "Determining a TSLRIC price for Chorus' unbundled bitstream access service under the final pricing principle" (Paper).
- 2 We agree with the Commission that there are strong linkages between the unbundled copper local loop (UCLL) and unbundled bitstream access (UBA) price review determinations and that the same TSLRIC conceptual framework applies.
- 3 This submission should be read in conjunction with our submission in response to the Commission's paper "Process and issues paper for determining a TSLRIC price for Chorus' unbundled copper local loop service in accordance with the Final Pricing Principle" (UCLL TSLRIC Submission).
- 4 We note that all parties that submitted on the UCLL TSLRIC submission last week agree with modelling the full network and recognise the importance of the linkages between the regulated services as this new phase of TSLRIC is opened up.
- 5 The Paper sets out a timetable for completing the UBA modelling and completing the UBA price review by 30 November 2014. We are already one year into the UCLL price review process and it is reasonable for the Commission to commit to a timetable that indicates the same effort to complete that earlier application by 30 November 2014. Furthermore, as noted above, there is a high degree of alignment on the need for contemporaneous processes in submissions made to the Commission to date. Our UCLL TSLRIC Submission and the accompanying report from Analysys Mason on hybrid cost models detailed a proposal as requested as to how that can be done.
- 6 We agree that the UBA modern equivalent assets (MEA) should be capable of utilising Chorus' copper network. This is what the UBA Final Pricing Principle requires in order to determine a price for the UBA STD service. Our submission on the UCLL STD provided last week is consistent and coherent with this approach.
- 7 We explain in this submission that there are a range of well known and unresolved issues that will need to be consulted on by the Commission that have not been set out in the Paper including the base "price of Chorus' unbundled copper local loop network" and how the Commission will approach the mandatory consideration of relativity and section 18/18(2A) of the Act.
- 8 As a number of important issues are absent from the Paper and there are no cross submissions (in comparison to the UCLL TSLRIC process), we do not consider that the best next step is a workshop in May. By that time the Commission may have taken a number of decisions in isolation of the parties as to how it will approach this matter. Without disturbing the key dates in the Commission's proposed deadline, we make suggestions for better engagement and to better inform the Commission earlier in the process.
- 9 As explained in our UCLL TSLRIC Submission both the UBA and UCLL price review determinations should be carried out contemporaneously and by 30 November 2014.

Timeliness alongside robust outcomes contemporaneously is the best mitigator to the backwards and forwards looking uncertainty that continues for the industry through this second phase of the Act's pricing process.

THE TSLRIC FRAMEWORK

1 Chorus agrees with the statements in the Paper that: ¹

There are strong linkages between the UBA and UCLL price review determinations. Both determinations involve setting forward-looking cost-based prices for Chorus' copper network using TSLRIC cost models.

The UCLL price review process and issues paper describes many conceptual issues associated with TSLRIC cost modelling which are relevant to the UBA price review determination. Rather than replicate many of those issues here, the UCLL process and issues paper should be read in conjunction with this paper. We will take account of relevant submissions made in response to the UCLL process and issues paper as part of our UBA FPP process.

2 Key points in our UCLL TSLRIC Submission that are of relevance to the application of the UBA Final Pricing Principle (FPP) include:

- 2.1 The starting point in the price review process is to identify the service at issue;
- 2.2 The Telecommunications Act 2001 (Act) requires that the Commission to approach TSLRIC on a "forward-looking" basis. There is also a high degree of international alignment that this requires a current replacement cost approach.² A backward-looking historical cost approach has been ruled out by the Act;
- 2.3 Forward-looking also means identifying the efficient costs of the service by considering replacement with MEA. An MEA must be the lowest cost technology that is both commercially available and provides the full facilities and functions of the service being priced; and
- 2.4 The UBA and UCLL price review determinations should be progressed in parallel and completed by 30 November 2014. The UBA FPP requires the calculation of the "additional costs" of the UBA STD service which means it is necessary and appropriate for the Commission to ensure the costs of UCLL are understood (to ensure there is no under or over recovery).

THE SERVICE

- 3 As explained in our UCLL TSLRIC Submission the starting point in the price review process is to identify the service that is the subject of the application.
- 4 In the UBA IPP determination, the Commission was explicit that it has benchmarked the STD service:

¹ Commerce Commission "Determining a TSLRIC price for Chorus' unbundled bitstream access service under the final pricing principle" (7 February 2014) at [7] and [8] (UBA Paper).

² See for example Analysys Mason "Response to Commission" (12 February 2014) at section 1.1.

We are benchmarking against the costs of an efficient operator providing the service as specified in the STD.

- 5 In a letter dated 10 July 2013, CallPlus, Orcon, Vodafone and Telecom's view was that this service was the specified minimum in the STD:³

CallPlus noted that Chorus, currently, in contrast to BUBA, do not impose a constraint at the handover point for the EUBA 0 service but it could so [sic] and so the Commission must benchmark against the lowest service specifications in comparable benchmarked jurisdictions. CallPlus noted that if Chorus were to apply a constraint at the handover point based on the Standard Terms Determination requirements of a minimum throughput of 32 kilobits per second (kbps) within any 15 minute period then this would materially impact the performance of the EUBA 0 service.

RSPs would have to purchase a commercial service, in addition to the regulated UBA service, in order to achieve their preferred handover dimensioning to ensure the UBA EUBA 0 service met their customer's requirements.

- 6 However, in its UBA FPP application, Telecom suggested that the Commission should in fact set a price based on the higher specification service that Chorus actually delivered, despite this being explicitly rejected by the Commission in the IPP determination.

- 7 We assume that the Commission is proceeding on the same basis as in the IPP determination.

- 8 To model the UBA STD service, the Commission's model must identify the geographic scope of service. The UBA STD identifies the geographic scope of Chorus' legal obligations to provide regulated UBA services. The Hypothetical New Entrant modelled by the Commission must serve all of the customers within the geographic scope set by the UBA STD.

- 9 In relation to Basic UBA the geographic obligation is:⁴

Geographic Availability

3.28 The Basic UBA Service is available where Chorus has ADSL or ADSL2+ (or other next generation type technologies) coverage and the line speed meets the minimum rate of 64 kbps. A POTS service will only be available with the Basic UBA Service in areas where Telecom has an active analogue telephone service.

- 10 And in relation to Enhanced UBA the geographic obligation is:⁵

Geographic Availability

³ Letter dated 10 July 2013, signed by CallPlus, Orcon, Vodafone and Telecom at page 1.

⁴ Commerce Commission, "Standard Terms Determination for Chorus' Unbundled Bitstream Access Service" (12 December 2007) Schedule 1, at [3.28] (UBA STD).

⁵ Commerce Commission, UBA STD, Schedule 1 at [4.2] and [4.30].

4.29 The Enhanced UBA Services are available where Chorus has Ethernet-based ADSL2+ (or other next generation type technologies) coverage and the line speed meets the line speed threshold. A POTS service will only be available with the Enhanced UBA Services in areas where Telecom has an active analogue telephone service.

4.30 Where a POTS service is being provided by Telecom to the same End User over the same copper pair, the Enhanced UBA Services with POTS price will be available only until the day before three years from Separation Day.

THE FINAL PRICING PRINCIPLE

- 11 The Final Pricing Principle (FPP) to be applied to the task at hand is:⁶

The price for Chorus' unbundled copper local loop network plus TSLRIC of additional costs incurred in providing the unbundled bitstream access service

The UCLL network

- 12 The term "unbundled copper local loop network" is not defined in the Act. However, Schedule 1 of the Act does define "local loop network" as:

that part of Chorus's copper network that connects the end-user's building (or, where relevant, the building's distribution frame) to the handover point in Chorus's local telephone exchange (including where it passes through a distribution cabinet) or distribution cabinet (or equivalent facility).⁷

- 13 By defining the local loop network as that part of the copper network between the end-user and the hand-over point (whether in the exchange or the cabinet) the Act picks up both cabinetised and non-cabinetised copper lines in full.
- 14 In the UBA IPP determination the Commission said that the "base" price was set in the UCLL STD as amended on 3 December 2012. The Commission also noted that the UCLL price was under review and therefore it may change.
- 15 Given wide spread agreement in submissions last week on UCLL that the Commission should be modelling the full network, the importance of coherency across the processes and that UBA is averaged nationwide, the Commission will need to consider whether or not it is appropriate to continue with its IPP determination approach.

UCLL is only relevant to non-cabinetised lines however the Commission should model the full loop as it is important to identify shared and common costs across the various interlinked services (UCLL, SLU, SLU backhaul, UBA & UCLFS etc.)...Without doing a full model the Commission cannot identify these common shared components (CallPlus).⁸

Vodafone agrees that the UCLL STD final price is limited to non-cabinetised lines (NUCLL) representing approximately half of Chorus' total copper lines...The underlying UCLL service is also

⁶ Telecommunications Act 2001, Schedule 1, Part 2, Subpart 1.

⁷ Telecommunications Act 2001, Schedule 1, Part 1, section 1.

⁸ CallPlus "Submission on the Commissions process and issues paper for determining a TSLRIC price for UCLL in accordance with the FPP" (14 February 2014) at pages 1 - 2.

a necessary underlying cost component for UBA delivered over both cabinetised and non-cabinetised lines. For practical purposes, and in light of the UBA price review applications, the Commission must determine both NUCLL (to meet the UCLL price review application) and FUCLL TSLRIC prices (as an underlying input for UBA, UCLFS and SLU) (Vodafone).⁹

It is most appropriate to model the full UCLL network as the UCLL price flows through to services that run over both cabinetised and non-cabinetised lines and the costs are shared between the services (Telecom, paragraph 49).¹⁰

- 16 The Commission should consult on how it intends to approach this issue.

The additional costs of the UBA service

- 17 The Paper does not address the Commission's task of identifying all of the additional costs of providing the UBA STD service. That is, the costs that are additional to providing Chorus' unbundled copper local loop network.
- 18 To do that, the analysis must start with the unbundled copper local loop network and consider UBA technology consistent with that network that enables delivery of the UBA STD service. In TSLRIC language, the question set by the FPP requires the Commission to use an MEA that is consistent with Chorus' copper local loop network.
- 19 The additional costs of providing the UBA service includes capital and operational costs for the following (which is a non-exhaustive list):
- 19.1 the costs of switches and handover equipment at the first data switch;
 - 19.2 the cost of backhaul from the first data switch to the exchange (including the cost of trenching, duct and cable);
 - 19.3 on non-cabinetised lines, the cost of the DSLAM equipment and exchange space and related costs including resilient power;
 - 19.4 on cabinetised lines, the cost of fibre backhaul from exchange to cabinet (including the cost of trenching, duct and cable), cabinet space and related costs including resilient power, and the cost of the DSLAM equipment; and
 - 19.5 relevant non-network costs including operational and support systems.
- 20 We are aware that Telecom has previously argued that some of these costs are or should be captured in the price set for the UCLL STD service.¹¹ We disagree. It is important that the Commission ensures there is coherency across STD services provided over the same infrastructure. Chorus has proposed that the Commission build a model of the full network in the parallel UCLL price review process (as per our hybrid modelling

⁹ Vodafone "Comments on process and issues paper for the unbundled copper local loop (UCLL) final pricing principle" (14 February 2014) at C6.1 and C6.2.

¹⁰ Telecom "Process and issues paper for determining a TSLRIC UCLL price" (14 February 2014) at page 14, [49].

¹¹ See Telecom "Cross submission: UBA Price Review Consultation: Discussion Paper" (14 September 2012" at [6] to [15], accessible at <http://www.comcom.govt.nz/dmsdocument/9491>.

proposal). Together, the UCLL model and the UBA model will cover the full suite of Chorus' regulated copper infrastructure and will enable an assessment of coherency.

THE MODERN EQUIVALENT ASSET

- 21 The Act specifies that the TSLRIC cost must be estimated on a forward-looking basis. As explained in our UCLL TSLRIC Submission, estimating forward-looking costs means identifying the efficient costs of the service by considering replacement with modern equivalent assets (MEA).
- 22 An MEA must be the lowest cost technology that is both commercially available and provides the full facilities and functions of the service being priced.

The appropriate MEA

- 23 At paragraph 17 the Paper states:¹²

Accordingly, our current thinking is that the UBA MEA will utilise Chorus' copper based inputs potentially with rural broadband initiative (RBI) fixed wireless in place of copper in some rural areas.

- 24 We agree that the UBA MEA should be one that utilises Chorus' copper network inputs (we address below the issue of RBI fixed wireless inputs). Chorus also adds that this outcome – a UBA MEA that utilises Chorus' copper network inputs - is required by the FPP (as explained above).
- 25 The Commission must model the TSLRIC of the additional costs in providing the UBA STD service, not a different service. For this reason we disagree with the focus in paragraph 16 of the Paper on "a hypothetical new entrant seeking to *compete with* Chorus' UBA service" [italics added]. As explained in our UCLL TSLRIC Submission, this is not the question the Commission has to answer in the price review process.
- 26 We note this also differs from the UBA IPP where the Commission said:¹³

Under the IPP for the UBA service, we are not limited to benchmarking against strictly "similar services".

However, given we are benchmarking the "additional costs incurred" in providing the UBA service, we consider it appropriate to consider the **similarity or comparability** of the bitstream services in the countries within our benchmark set to the UBA service, as differences in those services may mean that costs are different from the UBA service **as described in the UBA STD**. [emphasis added]

- 27 Because the IPP is benchmarking, then reference to comparable services is mandated by the Act. However price review is a different process where the Commission has no option but to set a price by reference to the actual service.

¹² Commerce Commission, UBA Paper at [17].

¹³ Commerce Commission "Decision [2013] NZCC 20: Unbundled Bitstream Access Service Price Review" (5 November 2013) at [129] and [130].

RBI fixed wireless network

- 28 At paragraph 17 of the Paper the Commission asks for comment on the suggestion that it use a UBA MEA which utilises rural broadband initiative (RBI) fixed wireless in place of copper in some rural areas. We do not think the RBI initiative is relevant to the Commission's calculation.
- 29 As explained above, the geographic scope of the UBA STD service is set in the UBA STD, which sets the geographic scope by reference to where Chorus provides ADSL or ADSL2+. There are a number of end-users in RBI fixed wireless areas who are currently served by Chorus using ADSL or ADSL2+.
- 30 However in relation to those customers, the MEA should remain compatible with Chorus' copper network inputs for the reasons discussed above.

RELATIVITY

- 31 When setting the price of the UBA service, the Commission is required to have regard to the relativity between this service and Chorus' unbundled copper local loop network service.
- 32 Relativity must be considered whenever section 18 is relevant. Section 18 is relevant to all of the material exercises of judgment that the Commission makes in the course of setting the UBA STD price.
- 33 Historically, the Commission has applied the relativity requirement by reference to the ladder of investment theory. The Commission has stated that its objective is to facilitate Layer 1 investment by RSPs, so that they can compete at Layer 2.
- 34 It is not clear to Chorus how the Commission is interpreting the relativity requirement and the ladder of investment in light of the fact that:
- 34.1 as a result of prices set by the Commission that apply up until 1 December 2014, unbundling has primarily occurred in high density urban exchanges. The UBA price is relevant to investment in rural and cabinetised areas;
 - 34.2 there is effectively de-averaging between the price for UCLL and SLU lines and the Commission will need to consider relativity as between averaged UBA prices and "de-averaged" UCLL and SLU lines; and
 - 34.3 the Commission is setting cost-based prices, but the prices are consistently described as price caps, which suggests Chorus can price below the price set by the Commission.
- 35 We have previously noted our view that the ladder of investment on copper is not relevant where there is migration to fibre. This was supported by Martin Cave in his paper *Regulating the price of copper in New Zealand* (attached to our 15 June 2012 cross-submission on the UCLL benchmarking review).¹⁴ However, if the Commission

¹⁴ Martin Cave "Regulating the price of copper in New Zealand" (13 June 2012).

believes it is working in a legacy framework that requires application of the ladder of investment – is it only considering that in relation to high density urban areas? Or does it need a broader consideration? How does this work with de-averaged UCLL and SLU prices? How does this fit with the price cap regime? And how does this fit with maintaining incentives for the migration to the UFB network?

- 36 As we noted in our UBA IPP submission in February last year, given the importance of understanding what outcome the Commission is working to, the Commission should articulate its view.

The Commission's approach to relativity

- 37 To date, the Commission has interpreted this relativity requirement as an instruction to check that RSPs have sufficient incentive and ability – business case – to take the UCLL service:¹⁵

... The Commission seeks relative prices that will provide incentives to invest efficiently.

In the revised draft determination, the Commission noted that despite reductions in the retail-minus UBA price, there was a significant increase in the number of unbundled lines and exchanges over the period from December 2007 to December 2011. This indicates that access seekers still face incentives to purchase UCLL, so the relatively requirement is met.

- 38 This has been consistently articulated by the Commission in decisions¹⁶ and STDs.¹⁷
- 39 In the UBA Final Determination (NZCC 20) the Commission affirms this approach to relativity. The Commission's provisional conclusion is:¹⁸

Having considered the relativity between the cost of the UBA and UCLL services, we are satisfied that the forward-looking cost for the UBA service is likely to provide incentives to unbundle where efficient to do so.

- 40 This is consistent with the ladder of investment theory. According to this theory, access prices must be set such that access seekers can move over time from Layer 2 services

¹⁵ Commerce Commission "Decision NZCC 37: Final determination on benchmarking review for the unbundled copper local loop service" (3 December 2012) at pages 61 – 62.

¹⁶ See: Commerce Commission "Decision 739: Final Decision on UCLL, UBA and Sub-loop Services STDs" (24 November 2011) at [4], [26] to [27] and [38] to [41]); and Commerce Commission "Revised draft determination on the benchmarking review for the unbundled copper local loop service" (4 May 2012) at [253], [256], [264] and [266].

¹⁷ See: Commerce Commission, Decision 611: UBA STD (2007) at [440]; and "Decision 672: Standard Terms Determination for the designated services of Telecom's unbundled copper local loop network service (Sub-loop UCLL), Telecom's unbundled copper local loop network colocation service (Sub-loop Co-location) and Telecom's unbundled copper local loop network backhaul service (Sub-loop Backhaul)" (18 June 2009) at [525] (Sub-loop services STD).

¹⁸ Commerce Commission "Decision [2013] NZCC 20: Unbundled Bitstream Access Service Price Review" (5 November 2013) at [276].

to Layer 1 services. The relativity consideration in the service descriptions in Schedule 1 has been read as requiring the implementation of the ladder of investment theory:¹⁹

An important role the Commission plays in the telecommunications market is to encourage the uptake of regulated services by Access Seekers, leading to increased levels of infrastructural investment i.e. the ladder of investment.

41 See also:²⁰

According to the 'ladder of investment' concept of access pricing, relative access prices should encourage Access Seekers to make efficient entry decisions, including transferring between access products, such as from the UBA service to the Sub-loop UCLL Service. Specifically, the intention is to provide Access Seekers with an incentive to move from one 'rung' to another (such as from resale to UBA to UCLL), and in doing so to increase their investment over time.

In making such an assessment, it is important to have regard to the relative costs of moving between rungs, as the Commission did in the UBA STD. In the absence of any consideration of relative costs, which is what Telecom (Group) and Telecom (Chorus) propose, the rungs may be too close (thereby encouraging inefficient investment by Access Seekers), or too far apart (preventing efficient investment by Access Seekers).

...

the Commission notes that it has given appropriate consideration to the issue of the relativity between the regulated charges for the Sub-loop UCLL Service and the UBA Service, in setting prices that are likely to give best effect to section 18 of the Act.

42 Telecom has previously characterised this as akin to a price squeeze test. If this is correct, once set by the Commission can the prices for the UBA, UCLL and SLU services ever be reduced?

43 In its UBA section 30R determination the Commission said:²¹

While we consider that relativity between UBA and UCLL remains a mandatory consideration under the Act, we note that 'relativity' between the prices of the copper and fibre services also remain relevant under our general s 18 considerations.

44 We are keen to understand how the Commission is applying relativity in the current context and in the context of outcomes as proposed in its TSLRIC discussion papers.

¹⁹ Commerce Commission "Decision 610: Draft Standard Terms Determination for the designated service Telecom's unbundled copper local loop network co-location" (31 July 2007) at [131].

²⁰ Commerce Commission, Decision 672: Sub-loop services STD (2009) at [519], [520] and [531].

²¹ Commerce Commission "Decision [2013] NZCC 20: Unbundled Bitstream Access Service Price Review" (5 November 2013) at [76].

THE UBA AND UCLL PROCESSES

- 45 The Paper notes that there are strong conceptual linkages between the UCLL and UBA price review processes²² and also identifies the need to consult on an appropriate WACC which (we anticipate) will be common to both processes²³.
- 46 The Paper sets out a timetable for completing the UBA modelling and completing the UBA price review by 30 November 2014 and we agree with this timetable for all relevant processes contemporaneously. We are already one year into the UCLL price review process and it is reasonable to commit to a timetable indicating the same effort to complete it by 30 November 2014. Furthermore, as noted above, there is a high degree of alignment on the need for contemporaneous processes in submissions made to the Commission to date. Our UCLL TSLRIC Submission and the accompanying report from Analysys Mason on hybrid cost models detailed a proposal as requested as to how that can be done.
- 47 We request that the Commission re-considers the steps in that timetable. The current Paper is very high level and only consults on one issue of substance – the appropriate MEA (and even that topic is covered only briefly and in a way that does not clearly set out the Commission’s proposed approach). No cross-submissions are provided for and there are a range of issues that the Paper has not canvassed despite them being raised during IPP processes and in FPP applications. We suggest that the Commission holds a workshop and/or provides further views up front to better inform how it will proceed. If this is not changed, it is likely the Commission will have made a number of decisions about how it will implement the UBA FPP which the parties will only be informed of later in May.
- 48 This will not affect the timing of a later May workshop, draft determination, or the Commission’s ability to complete the UBA price review determination by 30 November 2014.

²² Commerce Commission, UBA Paper at [7] and [8].

²³ Commerce Commission, UBA Paper at [14].