UBA Price Review Consultation: Discussion Paper

Cross submission | Commerce Commission

14 September 2012

Public Version

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Overview

1. This is the Telecom cross submission on the UBA discussion paper.

2. Submitters have made a number of suggestions relating to the benchmarking methodology. As an industry we should all now be well aware of the pitfalls of applying overly restrictive comparability criteria to benchmarking exercises. These exercises were intended to enable the Commission to utilise already-established overseas precedents to set an initial price, or "proxy" for the final price. Certain basic checks need to be made to ensure the prices used are relevant, but there is a real danger in over-engineering this process such that it becomes almost impossible to build a coherent and meaningful benchmark set. The Commission should seek to capture a wide benchmark data-set; adjusting for differences in reliability of particular data points through the price point selected in the benchmark range.

3. That said, even with a broad approach, in this case there is likely to be limited benchmark data available to the Commission, because of the unique design of New Zealand's regulated bitstream services. Therefore, the Commission should consider actual operator costs as a cross check of benchmark results. New Zealand is relatively unique in that it has several operators who have recently invested in providing their own broadband services over UCLL lines. Where we have a paucity of benchmark data, we have a surplus of actual cost data, and we consider these actual costs can provide a valuable cross check for the Commission.

4. Submitters have also noted the relationship between UBA and UCLL. We agree that it is not possible to divorce UBA from UCLL as UBA benchmarking must capture the additional costs above those recovered through UCLL prices. The Commission is still considering whether the designated UCLL service should reflect the full, or a subset of, local loop network costs and until this decision is made, no-one can know what costs must be allocated to the UBA service. The complexity this adds to setting UBA prices illustrates the wider problems arising from a model whereby services become disassociated from each other.

5. Finally, we consider the approach to connection and transfer charges requires further consideration. Chorus sets out in its submission the activities associated with service connections. However, it's unclear which elements should be recovered by connection charges, or which are implicit to benchmark monthly prices, or where the demarcation between different activities sits. We recommend the Commission undertake a separate workshop to consider these issues further.

UBA pricing cannot be considered in isolation from UCLL

Ensuring Chorus recovers its costs across UCLL and UBA services

6. The submissions demonstrate that UBA can't be divorced from UCLL pricing. TelstraClear notes the Commission is required to benchmark additional costs [23]. We cannot know what these additional costs are until we have identified what costs are already recovered in the underpinning UCLL price. Vodafone note the Commission is limited to benchmarking services above the local access network, which is Chorus' UCLL network [13].

7. We agree. This must be the case as the UBA price is[1]

> the price for the designated UCLL service entitled Chorus' unbundled copper local loop network plus benchmarking additional costs incurred in providing the [UBA service] …

Therefore, in order to ensure Chorus recovers its costs and does not recover some costs twice, the Commission's benchmarking exercise must only capture the costs not already recovered in the designated UCLL price.

8. The Commission is considering, in the context of the UCLL price review, whether to:

- Retain the current methodology whereby UCLL, UCLF and UBA (local loop element) prices are linked and a single averaged price is set that recovers the costs of the local loop network (the averaged approach); or
- Adopt a new approach whereby it sets separate local loop network prices for each of the services using the local loop network – UCLL, UCLF and UBA – based on the elements used by each service (the de-averaged or disassociated approach).

9. This has significant implications for UBA benchmarking. As set out in diagram 1, the UBA service uses a number of local loop elements. For example, UBA can be provided from the exchange using a direct copper loop (A) or from a cabinet, in which case it requires a specific cabinet and transport from the cabinet back to the exchange (B) and (C).[2]

10. The Chorus local loop network costs comprise, for example, the fibre and copper cable, ducts and trenches and cabinets for all scenarios, i.e. A, B and C.

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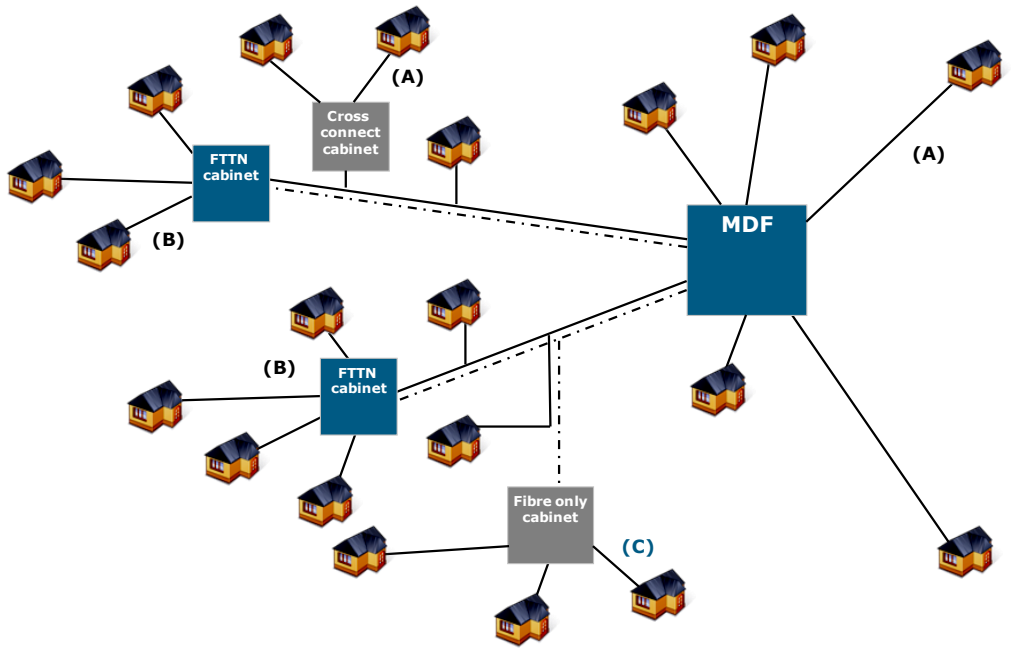
[1] UBA service description in the Act.

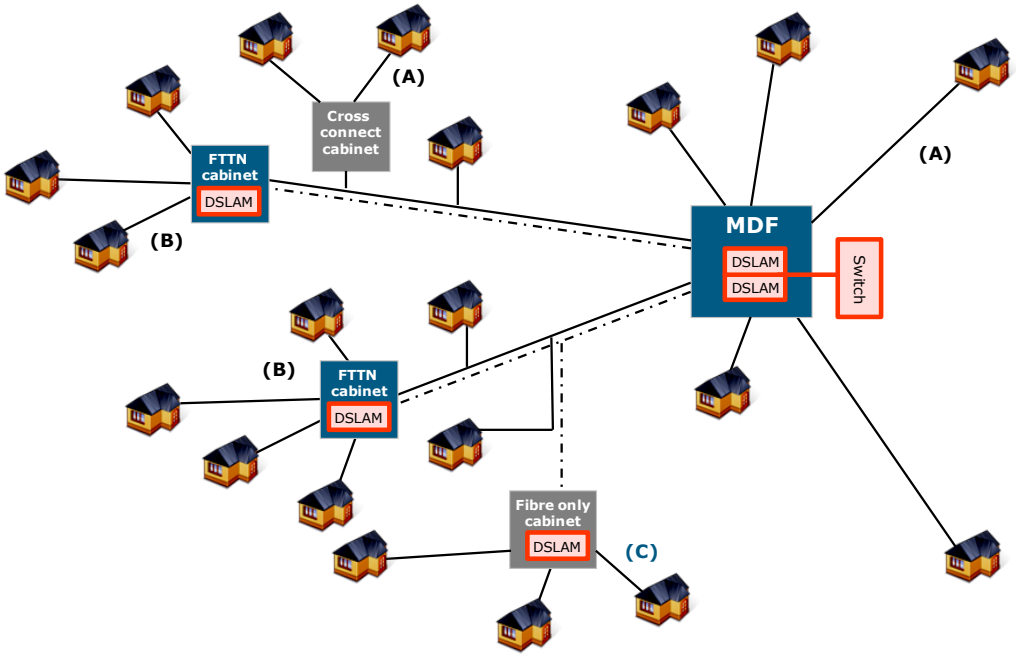
[2] A cross connect cabinet is a passive cabinet for connecting copper distribution lines to feeder cables.

Diagram 1: Local loop network scenarios



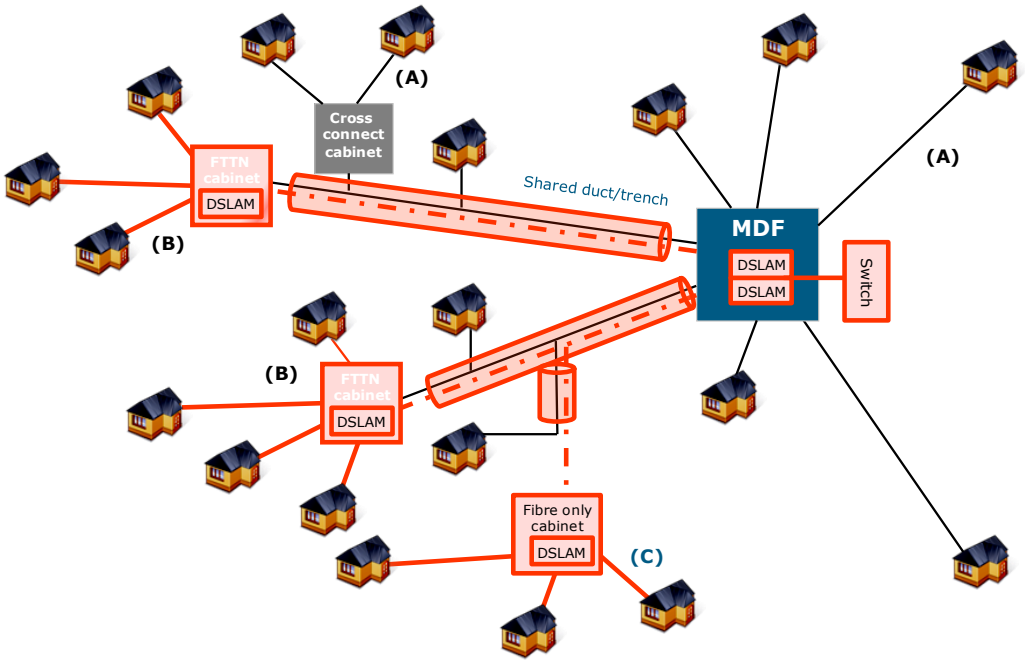
11. If the Commission retains the current approach, setting a single local loop price, then the UBA benchmarking exercise is limited to the incremental bitstream service. Chorus recovers its full local loop network costs through the designated UCLL service price (i.e. including both copper and fibre feeders, cabinets and shared trench costs). Accordingly, the benchmarking exercise is significantly less complex as it captures only incremental UBA costs (in red below).

Diagram 2: Scope of UBA pricing review with local loop network averaging



12. However, if the Commission concludes that local loop prices should be de-averaged, then the designated UCLL service price will capture only a subset of the local loop network costs, i.e. scenario A. Under a de-averaged approach, the UBA benchmarking methodology would need to capture the costs associated with scenario B and C to ensure that Chorus recovers its full costs. This area is set out in red in diagram 3. It's unclear whether, with the de-averaged model, sub loop UCLL forms part of the underlying UCLL price or UBA additional costs.

Diagram 3: Scope of UBA pricing review with de-averaging



13. A de-averaged approach adds significant complexity to UBA benchmarking. Further, it would be difficult to infer costs from overseas benchmarks as these do not typically derive element based prices. It's unclear how the Commission would reliably adjust UBA benchmarks to reflect these costs. Any adjustments made to overseas benchmarks need to be carefully considered to ensure that they do not increase uncertainty in the benchmarking process.

14. This issue is likely to be resolved through the UCLL price review as the Commission considers its proposed approach further. We believe Parliament intended UCLL, UCLF and UBA (local loop component) prices to be linked and this requires the Commission to set an averaged local loop price that applies across all services.

15. While the Commission's proposed approach set out in its 17 August paper is one possible interpretation of IPP, we do not consider it is the correct interpretation. The Commission must interpret the service descriptions set out in the Act based on the practical context in which the legislative service descriptions apply. The alternative de-averaged approach is highly complicated and would require the regulator to have access to information which is not currently available. The risk

of creating incentives for regulatory arbitrage and, as a result, inefficient investment decisions by market participants is significant.

Chorus' proposed adjustment for cabinetisation

16. Further, Chorus has proposed that the Commission consider the degree of cabinetisation as a relevant cost driver [53]. Cabinetised lines have higher per-line costs than non-cabinetised lines, since they have a longer backhaul segment (incorporating the link between the cabinet and the exchange) and cabinet-related costs which are spread over a smaller number of lines.

17. Ultimately, the degree of cabinetisation in the Chorus network is largely irrelevant for UBA benchmarking. This is because key local loop costs – copper and fibre cable, cabinets and trenching for example - are already captured by the UCLL benchmark. In terms of incremental UBA service costs, it's not clear whether differing port utilisation in cabinets relative to the exchange will drive material differences in UBA cost. Accordingly, we have reservations in the value of seeking to derive comparability criteria relating to the efficient mix of cabinet versus exchange deployed UBA lines as a proxy for UBA equipment utilisation. We do not consider the degree of cabinetisation to otherwise be relevant for UBA benchmarking.

18. Even if the Commission were to apply a de-averaged model, and even if sufficient data was available to support a reliable adjustment, the Commission shouldn't adjust the benchmark on the basis of actual cabinetisation in the Chorus network. This is because the objective of the IPP is to identify a good proxy for the result of an FPP determination process using an efficient forward looking cost model. Accordingly, the Commission must benchmark efficient forward looking cost models, whereas Chorus' actual design choices reflect path dependencies and have been driven more by political negotiations, revenue objectives, and commercial and previous network design decisions rather than optimal design for economic efficiency. Chorus will change its network design from time to time (adding cabinets or fibre), but this is independent of benchmark models.

19. However, we agree with Chorus that, if the Commission decides to apply a de-averaged approach, it will need to consider cabinet and backhaul costs further. This is because the incremental UBA service would need to recognise the costs of access scenarios B and C above and to ensure that there is not an over recovery of costs. It's unclear how local loop network costs would be allocated between UBA, UCLL, voice, UFB and other local loop services. For example, as set out in diagram 3, the Commission would need to consider the allocation of FTTN cabinets, trenching and fibre elements across all services that rely on elements of the local loop network.

20. Further, in a forward looking cabinetised network, the voice frequency service consumes a small incremental amount of bandwidth in a forward looking network. In a trench/duct system now shared by fibre and copper cables, a

capacity based allocation of trenching costs would result in a significantly lower cost attributable to existing low channel capacity copper cables used only for voice bandwidth, i.e. the voice channel service will have a lower price than today.

21. The Chorus letter to the Commission dated 31 August 2012 further illustrates the complexity of the model being contemplated by the Commission. The analysis indicates that overall local loop network costs are unlikely to change materially, or may even fall, with cabinetisation. However, while overall network use has seen little change, the costs of specific services appear to change significantly solely on the basis of whether they are categorised as UCLL or SLU (plus an allocation of shared trenching costs).

22. The Chorus proposal and possible Commission UCLL approach will result in significant complexity and potentially very large swings in costs depending on regulatory allocations. It's a tangible example of the complexity and risks in a de-averaged model, with unpredictable results for access seekers.

Benchmarking

23. Submitters also agree that there are likely to be a limited number of benchmark data points which fall within the requirements of the IPP as set out in the Act. We continue to endorse a two step process which, first, takes a broad approach to constructing the benchmark data and, second, selects the price point from within this range.

24. As Vodafone noted in their submission, prices for broadly similar services from broadly comparable jurisdictions embed useful price information which the Commission should consider relevant when analysing the subset of IPP compliant benchmark prices. We agree that the broader group of countries, while not forming part of the benchmark data set, can be used as cross check or to inform the Commission when it exercises expert judgment (i.e. when adjusting the benchmark or selecting a price point).

25. Conversely, Chorus propose that the Commission consider a variety of comparability criteria. There are two principal risks to using comparability criteria to exclude potential benchmarks; first, a smaller benchmark set increases the estimation error around the price point selected; and second, makes the identification of outlier data points more difficult, increasing the risk that estimates of the average or median price are not robust. We believe the Commission needs to be cautious adopting multiple and detailed comparability criteria that, while superficially improving the comparability and apparent reliability of specific data points, actually undermines the accuracy of the overall benchmarking exercise.

26. Nonetheless, there will likely to be a limited number of benchmark data points. Under these circumstances the Commission should cross check benchmark prices against other information. We recommend that without carrying out a full

cost modelling exercise more appropriate for the FPP process, the Commission consider the value of seeking high level indicative broadband cost information from UCLL based operators. A review of the actual costs incurred is likely to be a useful cross check on benchmark results.

Connection and transfer charges

27. There are differing views on connection and transfer charges and this is an area that requires further consideration.

28. Chorus has proposed that UCLL based charges are not a good reflection of cost [62]. Vodafone notes that UBA and UCLL costs are likely to differ, and that the Commission methodology should capture these different costs [55]. TelstraClear notes, however, that there was insufficient clarity on the proposed approach for TelstraClear to comment [58].

29. As set out in our submission, we are open to reviewing the structure of the charges and activities associated with connection and transfer charges. However, we are also conscious that benchmarking remains an important check to ensure there is no double recovery of costs and Chorus maintains an incentive to negotiate efficient service company prices.

The proposals need to be developed further

30. At this stage, it's unclear what approach will deliver efficient connection charges and the Commission may wish to consider this further or hold a workshop prior to releasing a draft decision.

31. On the face of it, it's not clear which costs properly relate to connection charges (as opposed to being implicit to benchmarked monthly rental charges) and where they should be recovered. For example, Appendix A of Chorus' submission illustrates the importance of properly classifying the tasks and costs associated with connections and transfers. We agree that costs associated with site work at the customer premises for the first ever connection to the network of a customer premises could be recovered through connection charges. It is less clear, however, whether Chorus' proposed approach includes network activity necessary to re-connect a customer or manage network capacity. These costs should not be recovered through connection charges.

32. This is because the access provider faces a trade off between pro-actively maintaining - or adding - capacity to the access network (i.e. by re-arranging the network or minimising the disabling and reallocation of presently intact lines, whether essential or not, as a substitute for fixing faulty lines) and reactive connection work in the network. Recovering capacity related costs through connection charges is likely to encourage inefficient operation of the network. For example, Chorus would be incented, if these costs were to be recovered through connection charges, to break down intact lines rather than fix faulty pairs or add capacity to a serving area (as the higher costs of constant network

re-arrangements are recovered from RSPs). The best way to ensure the optimal trade-off between pro-active and reactive management of the network is to ensure the costs are internalised within Chorus. These costs should be recovered through the monthly charge.

33. This approach is also likely to be better aligned with the benchmarking of monthly prices as these are based on efficient forward looking networks, i.e. they assume sufficient capacity to meet demand without network activity to break down and re-establish intact lines. Charging to re-connect a premises to the network risks the double recovery of costs.

34. Further, the proposed approach risks bundling discrete activities for which it is useful to understand the costs of each. For example, there should be a clear demarcation between customer premises work relating to the provision of the access service and customer premises work relating to the home network such as the installation of splitters in the home or additional jack points. Home network related work should have explicit charges rather than be bundled in with access connection charges. This is because customer premises charges are generally on-charged to end consumers.

A simplified model based on the work undertaken

35. We believe that the revised structure would greatly simplify the range of connection charges.

36. In practice, apart from the first time a premises is connected to the network, there should not be any connection charge for subsequent work undertaken by Chorus work that occurs between the ETP and the MDF at the exchange. The categories should also reflect the service order outcome rather than based on specific activity.

37. Further, the approach needs to recognise that, from December 2014, the UBA service will be the primary service on the line (i.e. the voice service is considered the incremental service).

38. Under this approach, the key charges would relate to:

• A records only change.	This could be where it is a records or billing change only relating to, for example, remote activation of an intact circuit or re-assignment of an existing or equivalent service.
• Network connection.	This would relate to activity on Chorus premises (exchange, pole, riser or cabinet) to say jumper between different access seekers, add an additional service to an existing line service or restoration of previously intact circuit. It would not include work in the access network such as re-establishing a line to

	intact.
• First time customer connection.	This relates only to the first time installation of a connection at the ETP or CLNE/CPE installation.

39. This would further simplify customer pre-qualification as RSPs will have certainty over likely Chorus charges by asking end customers to confirm whether the residence currently has or has in the past had a fixed line service. Further, minimising breaking down of intact circuits will further improve customer service.

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