

COMMERCE COMMISSION

Determination on the TelstraClear Application for Determination for 'Residential Wholesale' Designated Access Services

Decision 525

Determination under section 27 of the Telecommunications Act 2001 ('the Act') in the matter of an application for determination for designated access services under section 20 of the Act by:

TELSTRACLEAR LIMITED

The Commission: Douglas Webb

Summary of Application: TelstraClear Limited applied for a determination, under section 20 of the Telecommunications Act 2001, in regard to (a) the price-capped residential local access and calling service offered by means of Telecom's fixed telecommunications network; (b) retail services offered by means of Telecom's fixed telecommunications network; (c) bundles of retail services offered by means of Telecom's fixed telecommunications network; and (d) retail services offered by means of Telecom's fixed telecommunications network as part of a bundle of retail services.

Date of Determination: 14 June 2004

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LIST OF TERMS AND ABBREVIATIONS¹

Access Provider	Telecom Corporation of New Zealand Limited and any of its subsidiaries (together 'Telecom').
Access Seeker	The service provider who seeks access to the service. For the purposes of this application, TelstraClear Limited ('TelstraClear').
Actual costs saved	means the net costs saved by supplying the service on a wholesale rather than a retail basis to the access seeker.
Application	TelstraClear Application for Determination for 'Residential Wholesale' Designated Access Services, 13 November 2002.
Avoided costs saved	means the difference in the access provider's costs between supplying the service on a wholesale basis only and supplying the service on both a wholesale and retail basis, including a share of retail-specific fixed costs.
CPE	Customer Premises Equipment.
Decision 497	The 'Business Wholesale' Determination made by the Commission on 12 May 2003 in respect of an application for determination, under section 20 of the Telecommunications Act 2001, made by TelstraClear Limited and Clear Communications Limited on 16 May 2002. This can be found on the Commission's website at: http://www.comcom.govt.nz/telecommunications/Decisions_TelstraClearWD.cfm
FCC	Federal Communications Commission is an independent United States government agency, directly responsible to Congress. The FCC was established by the Communications Act of 1934 and is charged with regulating interstate and international communications by radio, television, wire, satellite and cable. The FCC's jurisdiction covers the 50 states, the District of Columbia, and United States possessions.
Fixed PSTN	A PSTN, or that part of a PSTN, that connects an end-user's building to the local switches or equivalent facilities; and includes those local switches or equivalent facilities.
Fixed PDN	A PDN, or that part of a PDN, that connects an end-user's building (or, in the case of commercial buildings, the building distribution frames) to a data switch or equivalent facility; and includes the data switch or equivalent facility and that part of the overall telecommunications link within the building that connects to the end-user's equipment.

¹ Where a term or abbreviation is defined in the Telecommunications Act, the statutory definition is adopted for the purposes of this list.

**FTN or Fixed
Telecommunications
Network**

means –

- (a) any lines between a user's premises and the local telephone exchange or equivalent facility:
- (b) any fixed PSTN:
- (c) any telecommunications links between fixed PSTNs:
- (d) any fixed PDN
- (e) any telecommunications links between fixed PDNs:
- (f) any value-added telecommunications services associated with telecommunications services provided by those assets.

ILEC

In the United States, an Incumbent Local Exchange Carrier such as a Regional Bell Operating Company (RBOC), GTE, ALLNET, etc.

PDN

Public Data Network means a data network used, or intended for use, in whole or in part, by the public.

PSTN

Public Switched Telephone Network means a dial-up telephone network used, or intended for use, in whole or in part, by the public for the purposes of providing telecommunication between telephone devices.

PUC

Public Utilities Commissions are governmental agencies in the United States engaged in the regulation of utilities and carriers in the fifty States, the District of Columbia, Puerto Rico and the Virgin Islands. Under State law, these public utility regulators have the obligation to ensure the establishment and maintenance of such utility services as may be required by the public convenience and necessity, and to ensure that such services are provided at rates and conditions that are just, reasonable and non-discriminatory for all consumers.

**Relevant Wholesale
Services**

Designated access services of the type described in sub-part 1 of Part 2 of Schedule 1 of the Act as (i) retail services offered by Telecom to end-users by means of its fixed telecommunications network; or (ii) designated access services of the type described in subpart 1 of Part 2 of Schedule 1 of the Act as a price-capped residential local access service offered by Telecom to end-users by means of its fixed telecommunications network; or (iii) designated access services of the type described in subpart 1 of Part 2 of Schedule 1 of the Act as bundle of retail services offered by Telecom to end-users by means of its fixed telecommunications network.

RI

Restricted Information. Information submitted, under the order made under section 15(i) of the Telecommunications Act and section 100 of the Commerce Act on 4 December 2002, as being only available to the Commission and persons who have signed a deed of undertaking in respect of that order.

TLOC	Telecom List of Charges. The list of descriptions and prices for retail services set by Telecom and published on the Telecom website, http://www.telecom.co.nz
VATS	A Value-Added Telecommunications Service.

EXECUTIVE SUMMARY

Introduction

- (i) The Telecommunications Act 2001 ('the Act') regulates the supply of telecommunications services in New Zealand.
- (ii) The Commerce Commission ('the Commission') has a range of responsibilities under the Act, including making determinations in respect of designated access services. An applicant may apply to the Commission for a determination of terms for the resale of designated retail services and bundles of retail services offered by means of Telecom's fixed telecommunications network.
- (iii) Section 18 of the Act provides that the purpose of Part 2 and Schedule 1, under which this Determination is made, is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers.

Background

- (iv) On 13 November 2002, TelstraClear Limited ('TelstraClear') applied to the Commission for determination of the terms of supply of specific residential designated access services under section 20 of the Act. The application sought a determination in respect of:
 - price-capped residential local access and calling services offered by means of Telecom's fixed telecommunications network; and
 - certain non price-capped services offered by means of Telecom's fixed telecommunications network to residential end users; and
 - bundles of retail services offered by Telecom to residential end users by means of its fixed telecommunications network; and
 - retail services offered separately by Telecom which also are offered as part of a bundle.
- (v) On 20 December 2002, the Commission decided to investigate the application for the first three designated services listed above, but not the final designated service; retail services offered separately by means of Telecom's fixed telecommunications network which also are offered as a part of a bundle of retail services.
- (vi) On 9 July 2003, Telecom and TelstraClear ('the Parties') advised that the Parties were continuing to commercially negotiate, and that TelstraClear would not require a determination until the conclusion of these further negotiations.
- (vii) On 23 December 2003, TelstraClear filed with the Commission an application to resume the Commission's consideration of its application. Concurrent with the Commission's investigation, the Parties continued to commercially negotiate.

- (viii) On 31 March 2004, the Parties jointly informed the Commission that agreement had been reached on all aspects of the Application except for the services to be covered by the Parties' agreed residential supply terms, and the wholesale discount rates for those services.
- (ix) On 16 April 2004, the Commission issued a Draft Determination on the TelstraClear Residential Wholesale Application and sought submissions from the Parties on its preliminary findings. This was followed by an industry conference held on 24-25 May 2004 where the Commission heard from the Parties and their experts.
- (x) Matters to be decided by the Commission are:
 - (a) the identification of markets where Telecom faces limited, or is likely to face lessened, competition for the services and bundles of services contained within the Application;
 - (b) identification of markets in which Telecom does not face limited, or is not likely to face lessened, competition for services and bundles of services contained within the Application; and
 - (c) where a particular retail service falls within a market in which Telecom does not face limited, or is not likely to face lessened competition, whether the Commission will require that particular retail service to be wholesaled in that market.
- (xi) A summary of the Commission's conclusion on the above matters is outlined in the following table:

Figure 1: Summary of Relevant Residential Markets

Market	Competition Assessment
Retail market for residential local access services in non-networked metropolitan areas	Limited
Retail market for residential local access services in non-metropolitan areas	Limited
National retail market for residential directory services	Limited

- (xii) TelstraClear did not require a determination in respect of residential local access services in those metropolitan areas where TelstraClear operates its own residential network ('the networked metropolitan market').

Services

- (xiii) After completing its market definition and competition analysis, the Commission has determined that 28 services or bundles of services satisfy both the jurisdiction and competition thresholds and will be available to TelstraClear in specified markets on a resale basis.

Initial Pricing Principle

- (xiv) The initial pricing principle for the designated service 'Residential local access and calling service offered by means of Telecom's FTN' is Telecom's standard price for that service, minus 2%.
- (xv) The initial pricing principle for the designated services, non price-capped retail services and bundles of retail services, requires that access seekers gain access to services designated for resale at a retail price less a discount benchmarked against discounts applying in comparable countries that apply a retail minus wholesale methodology.
- (xvi) The Parties have reached commercial agreement on how to calculate the retail price for the services applied for, and accordingly the Commission has not been required to assess retail prices.
- (xvii) The Commission revised the wholesale discounts contained in its benchmarking report issued on 12 May 2003. Forty-seven U.S. states were selected as benchmarks in this report. The Commission considers that the discount rates of the selected states in the benchmarking report are current.
- (xviii) Consistent with Decision 497, the Commission is of the view that the selection of a discount rate from within the lower half of the benchmarked range is appropriate.
- (xix) The Commission considers that the 25th percentile value of 16.0% is the appropriate benchmark rate for the IPP, taking into account both the theoretical merit of possible factor cost arguments, as well as the Commission's concerns regarding incentives to invest in infrastructure.

Non-price terms

- (xx) TelstraClear applied for the Commission to decide on various non-price terms in its application. The Parties have subsequently reached agreement on all non-price terms within the application, and accordingly the Commission is not required to make a determination on any non-price terms.

Duration of the Determination

- (xxi) The Parties have agreed that the appropriate term is 18 months from the date of this Determination.

INTRODUCTION

1. The Telecommunications Act 2001 ('the Act')² regulates the supply of telecommunications services in New Zealand.
2. The Commerce Commission ('the Commission') has a range of responsibilities under the Act, including making determinations in respect of designated access services. Subject to sections 22 and 23, applicants may make an application to the Commission under section 20 for a determination of all or some of the terms on which a designated access service must be supplied during the period of time specified in the Determination.
3. Commercially sensitive information cited in this Determination was provided subject to an order made under section 15(i) of the Act and section 100 of the Commerce Act 1986 on 4 December 2002. The order is available on the Commission's website at http://www.comcom.govt.nz/telecommunications/Decisions_TelstraClearRWD.cfm. That order permits the classification of commercially sensitive material as either 'Restricted Information' or 'Commission-only Information'. Information designated in accordance with the provisions of that Order is enclosed within square brackets and marked either CO (Commission-only) or RI (Restricted). All such information has been extracted from the public version of the Determination.

² All terms and phrases that are defined within the Act have the same meanings in this Determination. All references to Parts, Schedules and sections are to the Parts, Schedules and sections of the Act.

THE APPLICATION

4. On 13 November 2002, TelstraClear Limited ('TelstraClear') filed with the Commission an application for determination for designated access services under section 20 of the Act (the 'Application').
5. The Application sought a determination by the Commission with regard to:³
 - (a) price-capped residential local access and calling services offered by means of Telecom's fixed telecommunications network; and
 - (b) certain non price-capped retail services offered by means of Telecom's fixed telecommunications network to residential end users; and
 - (c) bundles of retail services offered by Telecom to residential end-users by means of its fixed telecommunications network; and
 - (d) retail services offered separately by Telecom which also are offered as part of a bundle referred to in sub clause (c).
6. On 20 December 2002, the Commission gave notice to the parties that it had decided to investigate the Application, insofar as it concerned three designated services: the price-capped local access and calling service, non price-capped retail services and specific bundles of retail services.⁴ The Commission decided not to investigate retail services offered separately by means of Telecom's fixed telecommunications network which also are offered as part of a bundle of retail services.
7. On 1 May 2003, the Commission received written confirmation from TelstraClear that 'it is not seeking the regulated resale of telecommunications services (i.e. those falling within the Commission's jurisdiction) within the Wellington and Christchurch networked metropolitan markets'.⁵ As a result, this determination is concerned only with designated access services available to residential customers outside these areas.
8. On 5 May 2003, Commission staff and representatives from the Parties held a workshop on issues arising from the Application. The purpose of this workshop was for the Parties to provide further information to the Commission to assist it in making its determination.
9. On 6 June 2003, the Parties jointly requested that the Commission delay the issue of the Draft Determination while negotiations between the Parties continued.⁶
10. On 9 July 2003, the Commission received a joint letter from the Parties noting that the Parties were unable to agree on:⁷
 - (a) which services will be wholesaled by Telecom to TelstraClear; and

³ TelstraClear, *Application for Determination for Designated Access Services and Specified Services*, 13 November 2002.

⁴ Commerce Commission, *Decision Whether to Investigate the TelstraClear 'Residential Wholesale' Application for Determination for Designated Access Services* (Decision 484), 20 December 2002.

⁵ TelstraClear (Forsyth), Letter to Commission (Borthwick), *Residential Services: Clarification of TelstraClear's Cross Submission dated 26 March 2003*, 1 May 2003.

⁶ Telecom (Haskell) and TelstraClear (Millar), *Joint Statement for the Commission*, 6 June 2003.

⁷ Telecom (Haskell) and TelstraClear (Millar), *Joint Letter to Commission (Dingle), Residential Resale Determination*, 9 July 2003.

- (b) the appropriate discount factor to apply under the relevant initial pricing principles.

The Parties noted that negotiations were continuing and that they were not currently seeking a determination in respect of a number of other matters.

11. On 23 July 2003, the Commission advised the Parties that it was deferring consideration of the designated service ‘bundles of retail services offered by means of Telecom’s fixed telecommunications network’ until after the conclusion of the Commission’s investigation into the initial pricing principle for that designated service.⁸
12. On 14 August 2003, the Commission released its final report on the investigation, recommending that the initial pricing principle set out in Schedule 1 of the Act be altered.⁹ The Minister of Communications accepted this recommendation, and on 8 December 2003 the amendment to the Act was made by Order in Council and came into effect in January 2004.
13. On 23 December 2003, TelstraClear filed with the Commission an application to resume the Commission’s consideration of its Residential Wholesale Application (the ‘Application to Resume’).¹⁰
14. On 20 January 2004, Telecom wrote to the Commission raising jurisdictional issues regarding some non-price terms in TelstraClear’s Application to Resume.¹¹ The Commission requested submission from TelstraClear on Telecom’s letter and this was received on 28 January 2004.¹² Further correspondence on jurisdictional and procedural matters was received from Telecom¹³ and TelstraClear¹⁴ respectively.
15. On 9 February 2004, the Commission informed the parties that it had resumed its investigation of TelstraClear’s Application.¹⁵ The Commission received a further submission from Telecom on TelstraClear’s Application to Resume on 5 March 2004.¹⁶

⁸ Commerce Commission, *Order made by the Commerce Commission under section 9(6) of the Telecommunications Act 2001 (Separating the Residential Wholesale Application into two distinct applications)*, 23 July 2003.

⁹ Commerce Commission, *Final Report on the Initial Pricing Principle for ‘Bundle of Retail Services offered by means of Telecom’s fixed telecommunications network’*, 14 August 2003.

¹⁰ TelstraClear, *Residential Wholesale Application: Resumption of Commission’s Consideration of TelstraClear’s Application*, 23 December 2003.

¹¹ Telecom (Blackett) Letter to Commerce Commission (Borthwick), *TelstraClear’s 23 December Residential Wholesale Application*, 20 January 2004.

¹² TelstraClear (Forsyth) Letter to Commerce Commission (Borthwick), *Residential Resale Proceedings*, 28 January 2004.

¹³ Telecom (Blackett) Letter to Commerce Commission (Borthwick), *Residential Wholesale Application*, 30 January 2004.

¹⁴ TelstraClear (Forsyth) Letter to Commerce Commission (Borthwick), *Residential Wholesale Application*, 3 February 2004.

¹⁵ Commerce Commission (Borthwick) Letter to Telecom (Blackett) and TelstraClear (Forsyth), *TelstraClear’s Residential Wholesale Application: Resumption of Determination Process*, 9 February 2004.

¹⁶ Telecom, *Telecom’s Residential Wholesale Application Further Submission*, 5 March 2004.

16. On 31 March 2004, the Parties jointly informed the Commission that agreement had been reached on all aspects of the Application except for:¹⁷
- (a) the services to be covered by the agreed residential supply terms; and
 - (b) the wholesale discount rates for those services.

The Parties also informed the Commission that the jurisdictional issues in relation to non-price terms had been resolved between the Parties and a decision was no longer required by the Commission.

17. On 16 April 2004, the Commission issued its Draft Determination¹⁸ on the Application ('the Draft Determination') and sought submissions from interested parties. The Commission received two submissions on its Draft Determination from Telecom¹⁹ and TelstraClear.²⁰
18. On 24 and 25 of May 2004, the Commission held a conference on its Draft Determination, and heard submissions on behalf of Telecom and TelstraClear.
19. In making this Determination, the Commission has had regard to all written and verbal submissions made.

Consideration of certain material presented by Telecom at the conference

20. TelstraClear objects to certain evidence, submissions and conclusions²¹ presented at the conference, on the grounds that the evidence represents a series of propositions based on the results of several internal Telecom market surveys. It is argued that neither the propositions nor the surveys comply with established rules of evidence relating to the collation and production of market survey evidence. Accordingly, it is said, it would be inappropriate for the Commission to place any reliance upon it.
21. The importance of the market survey evidence is that it relates to Telecom's position that answer phones and network-based messaging services such as Call Minder are substitutes and are both in a messaging services market that is distinct from the local access market.
22. The Commission accepts that market survey evidence can be helpful in determining product substitutability in differentiated product markets.²² The Commission has considered the particular market survey evidence provided by Telecom in this instance, and the submissions based on it, as well as the objections of TelstraClear. In

¹⁷ Telecom (Oakley) and TelstraClear (Wells) Joint Letter to the Commission (Abbott), *TelstraClear Residential Resale Application*, 31 March 2004.

¹⁸ Commerce Commission, *Draft Determination on the TelstraClear Application for Determination for 'Residential Wholesale' Designated Access Services*, 16 April 2004.

¹⁹ Telecom, *Telecom's Residential Wholesale Application Submission on Draft Determination*, 30 April 2004.

²⁰ TelstraClear, *Submission in Response to Draft Determination on the Residential Wholesale Application*, 30 April 2004.

²¹ In particular, the presentation from Victoria Crone (Telecom), *Messaging in the Residential Market*, 25 May 2004; and the related presentation from James Mellsop (Charles River Associates), *Competition Analysis of Messaging Services*, 25 May 2004.

²² Commerce Commission, *mergers and Acquisitions Guidelines*, 1 January 2004, pp 16-17, <http://www.comcom.govt.nz/publications/pdfs/mergersandacquisitionsguidelines.pdf>

the result, the Commission has rejected Telecom's central propositions relating to substitutability and a separate messaging services market (see paragraphs 143-175).

23. With respect to TelstraClear's arguments as to admissibility, the Commission considers that the nature of its functions under the Act require a degree of flexibility in regard to the application of rules of evidence prevailing in the courts. As a specialist tribunal, the Commission is also in a position to make judgments as to the weight to be given to any disputed evidence. Section 53 of the Act is relevant in this regard and provides that in making a determination the Commission is not bound by technicalities, legal forms or rules of evidence, and may inform itself on any matter relevant to a determination in any way it thinks appropriate.

THE FRAMEWORK FOR THE DETERMINATION

24. Section 18 provides that the purpose of Part 2 and Schedule 1, under which this Determination is made, is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers.
25. In Decision 477, the Commission decided that ‘the ‘end-user’ is the ultimate user or consumer of telecommunications services. It is not restricted to subscribers, but extends to telecommunications’ users generally.²³
26. Section 27 requires that after investigating the matter, the Commission must—
- (a) prepare a determination; and
 - (b) give a copy of the determination to the parties to the determination; and
 - (c) give public notice of the determination.
27. Section 28 requires that the Commission make reasonable efforts to prepare a determination by not later than 50 working days after the date on which it gave written notice to the parties of its decision to investigate. On 6 June 2003, the Parties jointly requested that the Commission delay the issuance of the Draft Determination while negotiations continued.²⁴ As a result the Commission was unable to meet the statutory timeframe.
28. Section 29 sets out that:
- A determination must, in the opinion of the Commission –
 - (a) be made in accordance with -
 - (i) the applicable access principles and any limits on those applicable access principles; and
 - (ii) any regulations made in respect of the applicable access principles²⁵ and any limits on those applicable access principles; and
 - (b) comply with any relevant approved codes²⁶; and
 - (c) in the case of a determination regarding a designated access service, be made in accordance with –
 - (i) the applicable initial pricing principle (as affected, if at all, by clause 2 or clause 3 of Schedule 1); and
 - (ii) any regulations that specify how the applicable initial pricing principle must be applied.
29. Section 30 prescribes the matters to be included in the determination. A determination must include—
- (a) the terms on which the service must be supplied; and
 - (b) the reasons for the determination; and
 - (c) the terms and conditions (if any) on which the determination is made; and
 - (d) the actions (if any) that a party to the determination must do or refrain from doing; and
 - (e) the expiry date of the determination.

²³ Commerce Commission, *Determination on the TelstraClear Application for Determination for Designated Services*, (Decision 477), 5 Nov 2002, page 10.

²⁴ Telecom (Haskell) and TelstraClear (Millar), *Joint Statement for Commission*, 6 June 2003.

²⁵ No such regulations have been issued.

²⁶ There are no such codes yet in existence.

Designated Services

30. This Determination concerns the following designated access services:
- Residential local access and calling service offered by means of Telecom's fixed telecommunications network;
 - Retail services offered by means of Telecom's fixed telecommunications network; and
 - Bundle of retail services offered by means of Telecom's fixed telecommunications network.

Full service descriptions for these designated services are provided in Part 2 of Schedule 1 of the Act.

31. The Commission is required to determine its jurisdiction over the services in the Application with respect to the description of service in the Act. Where a service is within jurisdiction as a price-capped residential local access and calling service, or a non price-capped service, or a bundle of retail services, offered to end-users by means of [Telecom's] fixed telecommunications network, the Commission is required to determine the market or markets in which that service is sold, and assess the state of competition in those markets. Where a service is sold in a market in which Telecom does not face limited, or is not likely to face lessened, competition, the Commission must determine whether that service should be regulated by the wholesale regime.

Initial Pricing Principles

32. The Application has sought a determination on the initial pricing principle for the three designated access services applied for. Under section 21, an application that relates to the price payable by the access seeker for the designated access service must be treated as an application for a pricing review determination under section 42, if the only term at issue is the discount specified in the applicable pricing principle.
33. As the outstanding matters between the parties are the services to be covered by the agreed residential supply terms and the wholesale discount, the Commission is not required to treat the Application as an application for a pricing review determination under section 42. On that basis, this Determination is made under section 27 and in accordance with the applicable initial pricing principles as required by section 29.
34. The initial pricing principle for price-capped residential local access and calling services provides for a discount of 2% from the standard price.
35. The initial pricing principle for non price-capped retail services requires the Commission to fix a discount benchmarked against discounts in comparable countries. Where Telecom faces limited, or is likely to face lessened, competition in a market, that discount must be benchmarked against discounts in comparable countries that apply retail price minus avoided costs saved pricing in respect of these services. Where Telecom does not face limited, or is not likely to face lessened, competition in a market, that discount must be benchmarked against discounts in comparable countries that apply retail price minus actual costs saved pricing in respect of the

services offered in that market.

36. The discount for bundles of retail services varies depending on the types of services contained in the bundle. If the bundle contains only non price-capped services, the discount must be benchmarked against discounts applied to comparable bundles that do not include a price-capped residential access and calling service in comparable countries. If the bundle contains Telecom's price-capped residential access and calling service, the discount to be applied to that particular service within the bundle is 2%. If the bundle contains both these types of services, the overall discount to be applied to the bundle must be determined by weighting the discounts for each non price-capped and price-capped service in proportion to the standard retail price for that service when it is offered outside the bundle.

SCOPE OF THE DESIGNATED ACCESS SERVICES

Services in the Application

37. The Application described twelve retail services for which TelstraClear sought a determination from the Commission²⁷. These services are:
- Residential Connection;
 - 2nd Line Connection;
 - Homeline;
 - Homeline Economy;
 - 60 Plus Phone Option;
 - 2nd Line Rental;
 - Favourite Place;
 - Additional/Enhanced Directory Listings;
 - Message Connect;
 - Local Call Charging - Residential;
 - Jetstream;
 - Home 0800 (National and International).
38. The Commission notes that TelstraClear has applied for 'Local Call Charging – Residential' separately from the 'Homeline', 'Homeline Economy', and '60 Plus' services. Although listed separately in the Telecom List of Charges ('TLOC') the Commission does not consider the call charging component of these services to be a separate retail service for the purposes of the Act. Rather, the rental and local call charging components of these services are linked and together form a single designated service.
39. The Application also included the following bundles of retail services:
- Messageline;
 - Smartline;
 - Flexipack;
 - Smartpack;
 - Familypack; and
 - all other residential packages which include line rental or local line services.

²⁷ TelstraClear, *Application for Determination for Designated Access Services and Specified Services*, 13 November 2002, Annex A, pages 12- 15

40. In its Decision to Investigate the Commission considered that TelstraClear's request for 'all other residential packages which include line rental or local line services' was not an adequate description of bundles of retail services, and that it would not consider any such unspecified packages in its investigation²⁸. The Commission considered that the other five bundles identified by TelstraClear were adequately described and have therefore been included in the investigation.

Services Severed from Decision 497

41. In Decision 497, the Commission decided to sever from that application²⁹, and merge with the Residential Wholesale Application, sixteen services, to the extent that those services are offered in residential local access markets. Those services are:

- Reconnection;
- Service Visits;
- Lead-in Installation;
- Extension of Service Beyond the Telecom PSTN;
- Busy Line Verification;
- Message Manager;
- Caller Display;
- Call Minder;
- FaxAbility;
- FaxAddress;
- Permanent Toll Bars;
- Call Restriction Products;
- Restricted Numbers;
- Direct Connect;
- Operator Assistance; and
- International Operator Assistance.

Services Withdrawn by TelstraClear

42. On 12 December 2002, TelstraClear withdrew one of the retail services, 'Favourite Place', from the Application³⁰. On 26 March 2003, TelstraClear withdrew one further service, 'Home 0800' (National and International), on the grounds that TelstraClear

²⁸ Commerce Commission, *Decision Whether to Investigate the TelstraClear 'Residential Wholesale' Application for Determination for Designated Access Services*, 20 December 2002, paragraph 22.

²⁹ TelstraClear, *Application for Determination for Designated Access Services and Specified Services*, 16 May 2002.

³⁰ Letter from TelstraClear (Forsyth) to Commerce Commission (Borthwick), *Reply to Telecom's Comments on Residential Resale Application*, 12 December 2002, p 7.

considered that Telecom does not face limited competition for the supply of that service.³¹

43. One of the sixteen services severed from Decision 497, 'Restricted Numbers', was withdrawn by TelstraClear at the February 2003 Wholesale Conference.³² It was unclear whether this service was withdrawn only in the context of the proceedings relating to Decision 497. TelstraClear included this service in its Application to Resume.
44. In its submission on the Draft Determination, TelstraClear withdrew its request for the 'Restricted Numbers' service subject to confirmation from Telecom that it no longer offers the receptionist component of the service to any customers.³³ At the Residential Wholesale Conference, Telecom stated that it intends to cease supply of the receptionist service but there are currently 18 customers still using it. Telecom noted that it is now a grandfathered service and that TelstraClear can resell it on that basis.³⁴
45. Three other services, 'Direct Connect', 'Permanent Toll Bars', and 'Call Restriction Products', were all withdrawn by TelstraClear in a joint letter from the Parties to the Commission dated 31 March 2004.³⁵

Services not Transferred from Decision 497

46. The Commission notes that, while not listed in paragraph 41 of Decision 497, 'Smartphone services' sold in the residential local access and calling market are also severed from the Wholesale Application and are merged with the current Application.
47. TelstraClear has submitted that 'Calltrack', 'Telecom Paging Service', and 'Minicall Consumer Paging Service' should also have been included in the list of services excluded from Decision 497 because they are offered to residential as well as business customers³⁶.
48. Telecom argued that the Commission cannot now regulate these three services as they are not the subject of a current application and that if TelstraClear wants a determination in respect of these services it should reapply for access.³⁷ However, during the conference, Telecom consented to an amendment being made to the Determination to include these services in the present Application.³⁸ The Commission has accordingly included those services within this Determination.

³¹ TelstraClear, *Residential Wholesale Cross-Submission*, 26 March 2003, p 30.

³² TelstraClear, *Response to Information Request Following the Wholesale Conference*, 'Scope of Resale Services', Annex 1, p16.

³³ TelstraClear, *Submission in response to Draft Determination on the Residential Wholesale Application*, 30 April 2004.

³⁴ Telecom, *Commerce Commission Conference on Residential Resale: Introductory Comments* (Bruce Parkes), 24 May 2004, page 9.

³⁵ Telecom (Oakley) and TelstraClear (Wells), *Joint Letter to Commission*, 31 March 2004

³⁶ TelstraClear, *Residential Wholesale Application: Resumption of Commerce Commission's Consideration of TelstraClear's Application*, 23 December 2003, p9; and Annexure B p 4.

³⁷ Telecom above, page 12.

³⁸ Telecom, *Commerce Commission Conference on Residential Resale: Introductory Comments* (Bruce Parkes), 24 May 2004, page 7.

Residential Connection Service and Extension of Service Beyond the Telecom PSTN Area

49. Telecom has submitted that in relation to residential customers, 'Extension of Service Beyond the Telecom PSTN Area' has been deleted from TLOC and it is now a component of the 'Residential Connection Service'. 'The deliverables that were provided through 'Extension of Service Beyond the Telecom PSTN Area' are now part of the 'Residential Connection Service' and provided that the latter service is regulated, TelstraClear will still have access to those deliverables'³⁹. Accordingly, the Commission has removed 'Extension of Service Beyond the Telecom PSTN Area' as a separate service in the consolidated list of Relevant Wholesale Services in Appendix 2 of the Determination.
50. Telecom has also submitted that the 'Residential Connection Service' now comprises four components; 'Reconnection', 'New Connection', 'High Cost New Connection' and 'Subdivision Reticulation'⁴⁰. Telecom disputes the Commission's jurisdiction to regulate some of these components. These jurisdictional issues are discussed below at paragraphs 85-97.

xDSL Services

51. In its 'Application for Determination under Section 20 of the Telecommunications Act 2001' TelstraClear applied for access to:
- 'All xDSL services'; and
 - 'Jetstream-Jet Start'⁴¹
52. In Decision 497, the Commission stated that it was satisfied that 'all xDSL services' should be understood as referring to all Telecom's xDSL products marketed under the brand name 'Jetstream'⁴², excluding 'Jetstream Starter'⁴³.
53. Decision 497 set terms for the resale by Telecom to TelstraClear of 'Jetstream' products in the following markets:
- Retail market for residential non-metropolitan broadband internet access; and
 - Retail market for business non-metropolitan broadband internet access.

Accordingly, the Commission is not required to determine terms for any 'Jetstream' products in this Determination.

Reconnection Services

54. Telecom and TelstraClear disagree over the circumstances in which TelstraClear can use the 'Reconnection Service'. Telecom currently offers this service to customers

³⁹ Telecom, *Telecom's Residential Wholesale Application Submission on the Draft Determination*, 30 April 2004, page 12.

⁴⁰ Telecom, *Residential Wholesale Conference Presentation: Introduction* (Bruce Parkes), 24 May 2004, page 11.

⁴¹ TelstraClear, *Application for Determination under Section 20 of the Telecommunications Act 2001*, 16 May 2002, Annexure 1, p 48.

⁴² Commerce Commission, *Determination on the TelstraClear Application for Determination for 'Wholesale' Designated Access Services*, 12 May 2003, p 18.

⁴³ 'Jetstream Starter' was a replacement for 'Jet Start', a product separately applied for in that proceeding

who wish to be reconnected after having requested that their phone line be disconnected. Telecom also reconnects customers who have been temporarily disconnected as a result of non-payment of their account.

55. Telecom argued that ‘temporary disconnection’ (and the subsequent reconnection of the customer) is a credit management tool used by Telecom and not a retail service offered to customers⁴⁴, and that it should not therefore be required to provide the same capacity to TelstraClear.
56. TelstraClear submitted that there are significant differences between ‘temporary disconnection’ and the ordinary ‘disconnection/reconnection’ service offered by Telecom. For example, a customer who has been temporarily disconnected will retain their phone number if the phone bill is paid within seven days, whereas a customer who requests a disconnection will lose their phone number. Also, after a ‘temporary disconnection’ the customer may, in some circumstances, still be able to make outbound calls to emergency services or the Telecom customer help line.⁴⁵
57. TelstraClear argued that the differences between ‘temporary disconnection’ and ordinary disconnection would make it difficult for TelstraClear to use ordinary disconnection and reconnection as a credit management tool. TelstraClear submitted that the ‘Reconnection Service’ necessarily includes temporary disconnection as Telecom charges the customer for a reconnection where Telecom has temporarily disconnected the customer for credit reasons.⁴⁶ TelstraClear therefore consider that the ‘temporary disconnection’ function is a retail service.
58. TelstraClear also argued that even if ‘temporary disconnection’ is not part of the ‘Reconnection Service’, it is a term on which Telecom supplies residential line services to itself. Accordingly, under standard access principle 3 in Schedule 1 of the Act, Telecom would be required to ‘provide the service on terms and conditions (excluding price) that are consistent with those terms and conditions on which the access provider provides the service to itself’.⁴⁷
59. The Commission considers that the ability to flexibly suspend customer service in response to non-payment is a normal feature of the supply of utility services. Alternative means of minimising credit risk, such as larger pre-paid bonds, are likely to be more costly for non-defaulting customers. Accordingly, the Commission is satisfied that the ‘temporary disconnection’ functionality should be provided by Telecom to TelstraClear as a term of the supply of Telecom’s residential local access and calling service. The Commission also agrees with TelstraClear that standard access principle 3 is applicable.
60. In its most recent submission on this matter⁴⁸, Telecom argued that even if ‘temporary disconnect’ was a non-price term of supply of ‘Homeline’, the Commission has no jurisdiction to include it within this determination. Telecom argued that ‘the application for determination of non-price terms of supply of ‘Homeline’ was withdrawn by TelstraClear by letter to the Commission dated 31 March 2004. It is

⁴⁴ Residential Wholesale Conference, *Telecom Introductory Presentation* (Bruce Parkes), 24 May 2004, page 6.

⁴⁵ TelstraClear, *Residential Wholesale: Reconnection Services* (Further submission following the Conference), 1 June 2004, page 2.

⁴⁶ *ibid* page 3.

⁴⁷ *ibid*.

⁴⁸ Letter from Telecom (Parkes) to the Commission (Webb), *Residential Resale – Telecom Outstanding Issues*, 3 June 2004, page 6.

barred by section 22(b) [sic] as TelstraClear has ‘agreed not to have [the non-price]...terms of supply of the [‘Homeline’] service determined by the Commission’.⁴⁹ Telecom argued that ‘even if not withdrawn, the qualification would be barred by section 22(a), as Telecom and TelstraClear ‘have an agreement [on non-price terms] for the supply of the [‘Homeline’] service...’.⁵⁰

61. The Commission does not accept Telecom’s argument that it does not have jurisdiction to set terms of supply in this Determination as a result of the agreement reached by the Parties on non-price terms. The Commission retains power under section 30(c) of the Act to set terms and conditions on which the determination is made, with the limitation that the Commission cannot vary a term of supply agreed by the Parties. The Commission considers that there is clearly no agreement by the Parties on temporary disconnection.
62. Accordingly, the Commission determines that Telecom must provide ‘temporary disconnection’ to TelstraClear as a term of supply of its residential calling services. Telecom must provide this functionality to TelstraClear on terms and conditions that are consistent with those terms and conditions on which Telecom provides this functionality to itself.

Other Services

63. In its Application to Resume⁵¹, TelstraClear referred to a number of services in its ‘TCL Principles and Terms’ which were not included in its original Application. These services are:
 - Premium Rate Services⁵²;
 - Non Code Access⁵³;
 - Provision of telephone books⁵⁴; and
 - Listing of TelstraClear contact details in telephone directories⁵⁵.
64. In its submissions on the Draft Determination, TelstraClear advised that it no longer requires ‘Premium Rate Services’, ‘Non Code Access’, and ‘Listing of TelstraClear contact details in telephone directories’ to be dealt with in these proceedings.⁵⁶ TelstraClear also advised that ‘Provision of telephone books’ is no longer required to be considered by the Commission, subject to confirmation from Telecom that the provision of directories at no charge to residential customers is part of the basic telephone service.⁵⁷ It was confirmed by Telecom that it ‘will provide TelstraClear

⁴⁹ *ibid.*

⁵⁰ *ibid.*

⁵¹ TelstraClear, *Residential Wholesale Application: Resumption of Commission’s Consideration of TelstraClear’s Application*, 23 December 2003.

⁵² *ibid.*, Annexure C, clause 6

⁵³ *ibid.*, Annexure C, clause 17.9

⁵⁴ *ibid.*, Annexure C, clause 23.3

⁵⁵ *ibid.*, Annexure C, clause 23.4

⁵⁶ TelstraClear, *Submission in response to Draft Determination on the Residential Wholesale Application*, 30 April 2004, page 3.

⁵⁷ *ibid.*

customers with telephone books at no charge. This position could however be subject to change in accordance with commercial arrangements'.⁵⁸

Conclusion on Services in the Application

65. A definitive list of services to which this Determination applies is set out in Appendix 2. In describing the Relevant Wholesale Services, the Commission has adopted the descriptions provided by TLOC.

Non price-capped retail services

66. A non price-capped retail service must be:

- non price-capped;
- a retail service;
- offered by Telecom to end-users; and
- by means of Telecom's fixed telecommunications network.

67. Price-capped retail services are those services described in a Telecommunications Service Obligation ('TSO') Deed⁵⁹, which caps the price, and limits any annual increase, Telecom may charge for various services that it offers to residential customers. 'Homeline – Monthly Rental and Local Calling' is the only price-capped service in the Application. All other services in the Application are non price-capped retail services.

The service must be a retail service

68. Telecom noted that the purpose of the Act, as set out in sections 3 and 18, is to regulate the supply of telecommunications services and therefore argued that 'retail service' must be interpreted as 'retail telecommunications service'.⁶⁰

69. Section 5 of the Act provides that:

telecommunications service means any goods, services, equipment, and facilities that enable or facilitate telecommunication

and that

telecommunication –

(a) means the conveyance by electromagnetic means from one device to another of any encrypted or non-encrypted sign, signal, impulse, writing, image, sound, instruction, information, or intelligence of any nature, whether for the information of any person using the device or not.

⁵⁸ Telecom (Oakley), *Letter to Commission* (Borthwick) *reQuestions Arising From TelstraClear's Submission*, 7 May 2004.

⁵⁹ The Telecommunications Service Obligations (TSO) Deed was signed by the Crown and Telecom Corporation of New Zealand Limited and Telecom New Zealand Limited in December 2001. The provisions of the TSO Deed operate in place of, and in addition to, Telecom's Kiwi Share Obligations (KSO) and require Telecom to maintain telecommunications services in New Zealand to specified levels of performance and extent.

⁶⁰ Telecom, *Telecom's Residential Wholesale Application Submission on Draft Determination*, 30 April 2004, page 6.

70. Telecom argued that several of the services applied for by TelstraClear are not retail services as they do not enable or facilitate the conveyance of any information from one device to another. Rather, Telecom argued that these services are ‘repositories of information which can be accessed through other telecommunication services’.⁶¹ The disputed services are:⁶²
- Additional/Enhanced Listings;
 - Call Minder;
 - Message Manager;
 - Message Connect; and
 - Fax Address
71. TelstraClear submitted that a ‘retail service’ does not have to be a ‘retail telecommunications service’. TelstraClear submitted that Schedule 1 of the Act is not limited to ‘telecommunications services’ as that term is defined in section 5 of the Act. Instead, TelstraClear considers that subpart 2 of Schedule 1 of the Act regulates particular retail services, some of which may fall outside the definition of ‘telecommunications service’.⁶³
72. In any event, TelstraClear argued that the definition of ‘telecommunications service’ extends the regime to goods and services other than those that provide connectivity. TelstraClear considers that the phrase ‘enable or facilitate’ is broad enough to include the services which Telecom argues are ‘repositories of information’ as these services form an integral part of modern telecommunications networks and perform functions which enable or facilitate communication across networks.⁶⁴
73. The Commission notes that the designated service is a ‘retail service offered by Telecom to end-users’. There is no need to read down those words in the manner proposed by Telecom. A ‘retail service offered by Telecom to end-users’ is not restricted to retail telecommunications services offered by Telecom to end-users.
74. The Commission considers that it is not necessary to insert ‘telecommunication’ into the text of the designated service to ensure that the designated service is applied consistently with the purpose statements in sections 3(1) and 18 of the Act. Generally, such a measure is only taken to avoid absurdity or where it is quite clear from the scheme and purpose of the legislation that such a reading is necessary to make the Act work as it was intended to. The Commission considers that none of those scenarios apply.
75. In conclusion, the Commission does not accept Telecom’s interpretation of ‘retail services’ as meaning ‘retail telecommunications services’. The Commission considers that all of the services in the Application are retail services offered by Telecom to end-users.

⁶¹ *ibid* page 7.

⁶² *ibid*.

⁶³ Residential Wholesale Conference Transcript, 24 May 2004, pages 93-100.

⁶⁴ *ibid*.

The Service must be ‘offered by Telecom’

76. The description of the service requires that the service be ‘offered by Telecom’. The Commission considered the meaning of ‘offered’ in Decision 497.⁶⁵
77. In that decision the Commission found that Telecom does not maintain a standing ‘offer’ of services to the public capable of being converted into a binding contract as a result of acceptance by an individual consumer. The orthodox analysis of the operation of a retail market, as in the case of goods displayed for sale, is that the supplier is not making an offer to sell, but rather invites the public to make an offer to buy. Accordingly, the Commission is satisfied that all the services in the Application are offered by Telecom to end-users.
78. In Decision 497, the Commission set out rules concerning the treatment of services which are no longer offered to new customers but are available to existing subscribers to that service. This practice is known as ‘grandfathering’. The Commission adopts those rules in respect of this Application.
79. Telecom has noted that the following services (or parts of services) in the Application are currently grandfathered:⁶⁶
- Caller Display Service, Monthly rental for RenTel Display Telephone;
 - Restricted Numbers; Receptionist Service;
 - Flexipack;
 - Smartpack; and
 - Familypack.

By means of [Telecom’s] fixed telecommunications network

80. The retail service must be offered ‘by means of’ [Telecom’s] fixed telecommunications network. In the context of the proceedings for Decision 497, Telecom advanced a number of arguments as to the meaning of these words. In summary, Telecom argued that ‘by means of’ should be understood as ‘by means *only* of’.
81. Telecom repeated those submissions in these proceedings and submitted that 7 services (or parts of services) are not offered ‘by means of’ Telecom’s FTN:⁶⁷
- Service visits;
 - Additional/Enhanced Directory Listings;
 - Caller Display CPE;
 - Message Connect;

⁶⁵ Commerce Commission, *Determination on the TelstraClear Application for Determination for ‘Wholesale’ Designated Access Services* (Decision 497), 12 May 2003, pp. 20-21.

⁶⁶ Telecom, *Telecom’s Residential Wholesale Application Further Submission*, 5 March 2004, Appendix 6; and Telecom, *Telecom’s Conference Presentation: Introduction* (Bruce Parkes), 24 May 2004, page

⁶⁷ Telecom, *Submission on the Wholesale Draft Determination*, 24 January 2003, Appendix A; and Telecom, *Residential Wholesale Application – Submission from Telecom*, 7 March 2003, Appendix One.

- Call Minder
 - Message Manager; and
 - FaxAddress.
82. TelstraClear similarly relied on its earlier submissions in regard to Decision 497.
83. While maintaining that ‘by means *only* of’ was the correct interpretation of the phrase, Telecom also proposed an alternative test for ‘by means of’. Telecom’s alternative formulation was that there be ‘substantial and actual use of the FTN’ for delivery of the retail service in question⁶⁸. Employing this alternative test, a number of services (or part services) excluded by Telecom’s narrower definition would be retained.
84. The Commission is not persuaded that Telecom has provided any compelling reasons for the Commission to reconsider its conclusions on the scope of ‘by means of’ in Decision 497. For the same reasons as those in Decision 497, the Commission considers that ‘by means of’ is to be understood as requiring a meaningful or not insignificant participation by Telecom’s FTN in the provision of the service.

Telecom’s Residential Connection Services

85. Telecom argued that three components of the ‘Residential Connection Service’ are outside the Commission’s jurisdiction as they are not provided by means of Telecom’s FTN.⁶⁹ Those three components are:
- New Connections;
 - High Cost New Connections; and
 - Subdivision Reticulation.
86. Telecom stated at the conference that it is willing to waive its jurisdictional concerns regarding ‘New Connections’ but not the other two components as they are subject to different investment considerations.⁷⁰
87. In relation to ‘High Cost New Connections’ and ‘Subdivision Reticulation’ Telecom argued that these services **create** the network and therefore they cannot be services which are offered **by means of** that network⁷¹ (emphasis added). Before a retail service can be offered by means of the FTN, the FTN must already be in existence. Telecom also argued that the Commission’s ‘meaningful or not insignificant participation with Telecom’s FTN’ test does not resolve this issue. These two components of the Residential Connection service largely involve activities such as digging trenches, and laying cables, which Telecom argues have an insignificant connection with the FTN.⁷²

⁶⁸ Telecom, *Submission on the Draft Wholesale Determination*, 24 January 2003, p. 44.

⁶⁹ Telecom, *Telecom’s Conference Presentation: Introduction* (Bruce Parkes), 24 May 2004, page 11; and Telecom, *Telecom’s Residential Wholesale Application Submission on Draft Determination*, 30 April 2004

⁷⁰ *ibid* page 12.

⁷¹ *ibid*.

⁷² *ibid*

88. TelstraClear submitted that:

A customer of a 'Residential Connection' service is purchasing connection to the FTN, not an extension to the FTN. As with the provision of any other service, if it becomes necessary for Telecom to make additions or changes to its FTN in order to provide a retail service to a particular customer, this addition or change does not become part of the retail service that is being supplied to the customer. Rather it forms part of the means of supply.⁷³

89. Accordingly, TelstraClear submits that 'New Connections', 'High Cost New Connections', and 'Subdivision Reticulation' are all offered by means of Telecom's FTN.

90. The Commission is not convinced by Telecom's argument. The 'High Cost New Connection', 'Subdivision Reticulation' and 'New Connection' services all involve the trenching and installation of a line. In addition, 'Subdivision Reticulation' may also include the installation of a cabinet. The line is an extension of the existing FTN, but does not create the FTN. These services are retail services offered by Telecom to end-users by means of Telecom's fixed telecommunications network.

91. Telecom also argues that the actual connection component or 'plugging in' to the FTN would cost a few dollars in comparison to the amount spent on trenching and line installation. Therefore Telecom submits that the connection with the FTN would not be significant, and would not satisfy the Commission's approach of requiring 'meaningful or not insignificant' participation with the FTN.⁷⁴ The Commission considers that the actual cost of the connection is irrelevant when determining whether a retail service is offered by means of Telecom's FTN. In any event, the cost to Telecom of providing the connection service includes both the cost of trenching and cable laying, and the cost of the connection component. It is highly artificial to focus only on the connection component as though it were a separate service.

92. In relation to 'Subdivision Reticulation', Telecom argues that the subdivision developer is not an end-user of telecommunications services. Telecom argues that it sells trenching and line laying services to subdivision developers, who then sell the developed subdivisions, including all services, to purchasers. Telecom considers that it is not until the purchasers buy New Connection services that they begin to receive services 'by means of' the FTN.

93. TelstraClear argues that both the developer and the purchaser are end-users. The developer purchases the 'Subdivision Reticulation' for its own use, and the purchaser is the ultimate recipient of services whose provision is dependant on the 'Residential Connection Service'⁷⁵

94. Section 5 provides that an end-user, in relation to a telecommunications service, means a person who is the ultimate recipient of that service or another service whose provision is dependent on that service. In Decision 497, the Commission considered that a service provided by Telecom to a wholesale customer as an intermediate input, and not otherwise available to be obtained by an end-user from Telecom, is not a service offered by Telecom to end-users.

⁷³ Residential Wholesale Conference, *TelstraClear's Reply on Residential Connection Services*, 25 May 2004.

⁷⁴ Telecom, Telecom's Residential Wholesale Conference Presentation: Introduction (Bruce Parkes), 24 May 2004, page 13

⁷⁵ Residential Wholesale Conference Transcript, 24 May 2004, page 37 (Bruce Parkes, Telecom)

95. The subdivision developer is not a wholesale customer, as the trenching and line installation services offered as part of 'Subdivision Reticulation' are also offered by Telecom to other end-users as 'High Cost Connections'. Further, the subdivision developer is not a retailer of telecommunications services, as the services provided to third parties are property development services. Therefore, the subdivision developer is an end-user of the 'Subdivision Reticulation' service. Once 'Subdivision Reticulation' is complete, and the reticulated property is purchased by a third party, a 'New Connection' can be purchased by the third party to connect to Telecom's FTN. Therefore, the third party is also an end-user of retail services.
96. Accordingly, the Commission considers that all four components of Telecom's 'Residential Connection Service' are retail services offered by Telecom to end-users by means of its fixed telecommunications network. The Commission has listed each component separately in its consolidated list of Relevant Wholesale Services in Appendix 2. The Commission has adopted the descriptions of these components provided by Telecom⁷⁶, and largely agreed to by TelstraClear in its most recent submission to the Commission.⁷⁷ The Commission has also retained the 'Residential Connection Service', originally applied for by TelstraClear, as a separate service in Appendix 2 to ensure that all components of this service are covered.
97. The Commission's conclusion in respect of each service challenged by Telecom on the basis that it is not offered 'by means of' Telecom's FTN is described in Appendix 2.

'Telecom's' FTN

98. Broadcast Communications Limited ('BCL') submitted that the Draft Determination does not appear to preclude access to wholesale services that are provided to Telecom through third party wholesale suppliers such as BCL, and requested that the Commission apply the same interpretation to Telecom's Fixed PDN and Fixed Telecommunications Network that was agreed by the Commission in the Final Report on Local Loop Unbundling, being that it includes assets that Telecom owns, leases or over which it has exclusive control under any arrangement.⁷⁸
99. The Commission agrees that it is appropriate to take a consistent approach to the interpretation of 'Telecom' as taken in the Section 64 review. The Section 64 review required that the Commission assess whether access to the unbundled elements of **Telecom's** local loop network, and access to the unbundled elements of, and interconnection with, **Telecom's** fixed PDN, should be designated or specified services [emphasis added].
100. The relevant wholesale services in this determination relate to services offered by means of Telecom's FTN only, in contrast to both Telecom's Local Loop Network and Public Data Network which was the focus of the Section 64 Review. However,

⁷⁶ Letter from Telecom (Parkes) to the Commission (Webb), *Residential Resale – Telecom's Outstanding Issues*, 3 June 2004, pp 6-8.

⁷⁷ Letter from TelstraClear (Wells) to Commission (Webb), *Residential Wholesale Determination*, 9 June 2004, pp 9-11.

⁷⁸ Letter from Broadcast Commissions Limited (Bowron) to the Commission (Borthwick), *TelstraClear Application for Residential Wholesale Determination, Fixed Wireless Access Network*, 2 June 2004

consistent with the Section 64 Final Report⁷⁹ and to the extent relevant in this proceeding, the Commission agrees that Telecom's FTN does not include network elements of other parties which are the subject of normal commercial wholesaling arrangements that do not give Telecom exclusive control over those elements.

Value-added telecommunications services

101. The designated access service is described under the Act as a retail service offered 'by means of [Telecom's] fixed telecommunications network'.
102. In clause 1 of Part 1 of Schedule 1, a fixed telecommunications network is defined as:
 - (a) any lines between a user's premises and the local telephone exchange or equivalent facilities;
 - (b) any fixed PSTN;
 - (c) any telecommunications links between fixed PSTNs;
 - (d) any fixed PDN;
 - (e) any telecommunications links between fixed PDNs;
 - (f) any value-added telecommunications services associated with telecommunications services provided by those assets
103. Telecom proposed an analysis requiring five affirmative answers to five questions before a service can be considered a VATS. Those five questions are:⁸⁰
 - (a) Are there relevant services *provided by the assets* in paragraphs (a) to (e) of the definition of fixed telecommunications network?
 - (b) Are the relevant services under (a) *telecommunications services*?
 - (c) Is the alleged VATS a *telecommunications service*?
 - (d) Is the alleged VATS *associated* with the relevant telecommunications services under (a)? and
 - (e) Does the alleged VATS *add value* to the relevant telecommunications services under (a)?
104. TelstraClear considers that Telecom's five question analysis does not add clarity to paragraph (f) of the definition of FTN. TelstraClear agrees that a VATS must be a 'telecommunications service', but disagrees with Telecom's construction of that term. TelstraClear argues that 'telecommunications service' is defined in broad terms by section 5 of Act and expressly extends to "goods, services, equipment, and facilities" which do not themselves provide connectivity to end-users, but rather enable or facilitate telecommunication.⁸¹
105. The Commission does not agree that Telecom's analysis is correct. The analysis suggests that the VATS must be offered by the network elements in paragraphs (a) to (e) of the definition of FTN. In Decision 497 the Commission dismissed this and noted that 'paragraph (f) does not constrain the VATS to only those provided by network elements, so long as they are associated with telecommunications services

⁷⁹ Commerce Commission, *Telecommunications Act 2001, Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network*, Final Report, December 2003, paras 156 - 166

⁸⁰ Telecom, *Telecom's Residential Wholesale Application Submission on Draft Determination*, 30 April 2004 page 8.

⁸¹ TelstraClear, *Residential Wholesale Conference TelstraClear Comments in response to Jurisdictional Issues Raised by Telecom*, 24-25 May 2004, page 7

provided by such assets'.⁸² Accordingly, the Commission does not accept Telecom's analysis.

106. The Commission maintains the position on VATS as outlined in Decision 497. Appendix 2 provides details of the Commission's application of the VATS test to the services in the Application.

Price-capped retail services

107. One service in the Application, 'Homeline – Monthly Line Rental and Calling', is a price-capped retail service under Schedule 1 of Part 2 of the Act. 'Homeline' is a local free-calling option for local residential telephone service that is provided by Telecom to Telecom residential customers in accordance with the TSO Deed⁸³. The 'Homeline' service provides customers with a local residential voice telephone service, and a local residential dial-up data service.
108. The Commission is satisfied that 'Homeline' is a price-capped residential local access and calling service offered by Telecom to end-users by means of its fixed telecommunications network.

Bundle of retail services

109. There are four elements to the designated service 'bundle of retail services offered by means of Telecom's FTN'. The service must be:
- a bundle;
 - of retail services;
 - offered by Telecom to end-users; and
 - by means of Telecom's fixed telecommunications network.
110. In Decision 497, the Commission defined a 'bundle' as 'two or more services that are offered at a retail price less than the price of the aggregate parts where such discount arises from a specific combination of services purchased'⁸⁴.
111. The Commission considers that the 'Messageline', Smartline', 'Flexipack', and 'Familypack' packages are 'bundles'. These packages are all made up of 'Homeline' plus one or more 'Smartphone' services, and the price of all these packages is less than the price of the individual services when purchased separately.
112. Telecom argued that the 'Smartpack' package does not fall within the Commission's definition of 'bundle' as this package involves a series of percentage discounts which

⁸² Commerce Commission, *Decision 497*, paragraph 84.

⁸³ TLOC – Telephone Services 3.2.1; Telecommunications Services Obligations (TSO) Deed for Local Residential Telephone Service, December 2001

⁸⁴ Commerce Commission, *Determination on the TelstraClear Application for Determination for 'Wholesale' Designated Access Services*, Decision 497, 12 May 2003, paragraph 678.

are applied depending on the volume of 'Smartphone' services purchased.⁸⁵ Telecom disagrees with the Commission's definition of 'bundle' and proposed the following alternative definition: 'any two or more services sold together, that are otherwise available singularly, with a financial incentive to take as a bundle, or to take together'.⁸⁶

113. TelstraClear submitted that 'Smartpack' meets the Commission's definition of a 'bundle' because a customer can only get the 'Smartpack' discount if they purchase specific services from the 'Smartphone' product family. Accordingly, the discount arises from a specific combination of services purchased.⁸⁷
114. The Commission is satisfied that 'Smartpack' is a 'bundle'. Although there is no one specific combination of services that will always constitute a 'Smartpack' package, the Commission considers that all the possible combinations that an end-user of this package could acquire from Telecom would be a bundle. In other words, no matter what 'Smartphone' services a customer chooses within a 'Smartpack' package, that customer will be offered the package at a 'retail price less than the price of the aggregate parts' and that discount arises because of 'a specific combination of services purchased'.
115. In summary, the five packages applied for by TelstraClear, namely Messageline, Smartline, Flexipack, Smartpack and Familypack, are all bundles of retail services.
116. In the Draft Determination, the Commission suggested that it only has jurisdiction to regulate access to a bundle if each individual service within a bundle is offered to end-users by means of Telecom's fixed telecommunications network. The Commission noted that some bundles offered by Telecom contain services which may not meet these criteria, for example those packages that contain the Sky television service.
117. Telecom agrees that the Commission's jurisdiction is restricted to those bundles in which each individual service is a retail service offered to end-users by means of Telecom's FTN.⁸⁸
118. TelstraClear disagrees with the Commission on the extent of its jurisdiction to regulate bundles. TelstraClear argues that the bundle, rather than its constituent parts, must satisfy the test of provision 'by means of' Telecom's FTN. A 'bundle' is provided 'by means of' Telecom's FTN so long as the FTN has a 'meaningful or not insignificant involvement' in the provision of the bundle considered as a whole.⁸⁹
119. The five bundles applied for by TelstraClear contain non price-capped and price-capped retail services, each of which has been applied for separately by TelstraClear. As the Commission has determined that all the individual services making up the

⁸⁵ Telecom, *Telecom's Residential Wholesale Application Submission on Draft Determination*, 30 April 2004, page 23.

⁸⁶ *ibid.*

⁸⁷ Residential Wholesale Conference Transcript, page 92.

⁸⁸ Telecom, *Telecom's Residential Wholesale Application Submission on Draft Determination*, 30 April 2004, page 14.

⁸⁹ TelstraClear, *Submission in Response to Draft Determination on the Residential Wholesale Application*, 30 April 2004, pages 4-5.

Messageline, Smartline, Flexipack, Smartpack and Familypack bundles are Relevant Wholesale Services for the purpose of this Determination, there is no remaining ground of challenge to the bundles themselves.

120. TelstraClear has expressed a concern that a strict interpretation requiring each element of a bundle to meet the standard for regulated resale would open the door to future 'gaming' by Telecom, through the inclusion of a non-complying element in a regulated bundle. Since it is not necessary in this Determination to anticipate the future shape of regulated bundles, the Commission accepts that there is no need for the Determination to adopt a definitive definition of bundles.

MARKET DEFINITION

Introduction

121. The analysis of competition is a critical part of the Commission's implementation of the wholesaling provisions of the Act for a number of reasons. First, the outcome of such an assessment may have implications for the range of services to be included in any wholesale determination. A finding of limited, or likely to be lessened, competition in the relevant market is an important pre-requisite for regulated wholesaling of a service⁹⁰. Second, the assessment of competition will determine the type of discount to be applied. Where Telecom is found to face limited, or is likely to face lessened, competition in a market for non price-capped retail services, the discount is to be based on the 'avoided costs saved'. Where Telecom does not face limited, or is not likely to face lessened, competition in a market for non price-capped retail services, and the Commission has decided to require the service to be wholesaled in that market, the discount is to be based on 'actual costs saved'.
122. The Commission notes that the Parties have reached agreement on both the market and competition assessment for a number of the services applied for by TelstraClear. While the Commission has taken this agreement into account, the Commission conducts its own market and competition assessment.
123. The conditions for each designated access service are that:
- Telecom faces limited, or is likely to face lessened competition in the market for the relevant service, or:
 - Telecom does not face limited, or is not likely to face lessened competition for the relevant service, and the Commission has decided to require the service to be wholesaled.

One of these conditions needs to be satisfied for the designated access service to be available to the access seeker.

124. The residential markets discussed below form the basis for the competition assessment. However, the concept of a market is an instrumental one, the defining of which is not an end in itself, but rather is an exercise intended to cast light on, or to assist with the analysis of, the conduct at issue. In *Queensland Wire*, the Court stated:⁹¹

In identifying the relevant market, it must be borne in mind that the object is to discover the degree of the defendant's market power. Defining the market and evaluating the degree of power in that market are part of the same process, and it is for the sake of simplicity of analysis that the two are separated...

125. The process of identifying the relevant market(s) should keep in mind the object of so doing. In the present case, the objective is to determine whether Telecom faces limited, or is likely to face lessened, competition in a market, as a pre-requisite for regulated wholesale access.

⁹⁰ If limited competition is not found in a market, the Commission may nonetheless require regulated wholesale access.

⁹¹ *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177.

126. For the purpose of undertaking an assessment of the level of competition within a market, the standard process of establishing market boundaries can be seen as one of identifying the smallest area of product, geographic and functional space over which a hypothetical monopolist could exert a significant degree of market power⁹². This approach focuses on all those close substitutes whose presence would prevent a hypothetical monopolist from exercising market power by raising its price or by other means. Such substitutes must be included in the market within which the hypothetical firm is to be a monopolist. Included are both actual and potential substitutes on both the demand and supply sides of the market.
127. An appropriately defined market will include products which are regarded by buyers as being similar or close substitutes ('product' dimension), and in close proximity ('geographical' dimension), and are thus products to which they could switch if the monopolist were to attempt to exert market power. It will also include those suppliers currently in production who are likely, in that event, to shift promptly to offer a suitable alternative product even though they do not do so currently.
128. One approach to identifying a significant degree of market power (in the context of market definition) is in terms of the ability of the hypothetical monopolist to increase profits by imposing a small but significant and non-transitory increase in price (a '*ssnip*') above the competitive level. For the purposes of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five to ten percent increase in price for a period of at least one year. Starting from a small initial group of close substitutes, other potential substitutes are added to the group, until the hypothetical monopolist is able to profitably impose a *ssnip*. When this occurs, then all possible close substitutes must be encompassed by the proposed market definition⁹³.
129. The degree of substitutability between telecommunications services, and thus the definition of telecommunications markets, is likely to be influenced by advances in technologies, and in particular the convergence of different technologies. The *ssnip* test allows for this. For example, by focusing on the relative functionality and pricing of services, the *ssnip* test assesses the extent to which services are regarded as economic substitutes. When considering the market for one service, if a second service passes this test, in the sense that sufficient switching would be expected so as to defeat the attempted price increase, that service should be included in the same market, irrespective of whether similar or different technologies are involved.
130. Therefore, in terms of the product dimension of telecommunications markets, the Commission considers this test to be a useful tool in assessing the likely demand-side and supply-side responses to a change in the relative price of functionally similar services. Importantly for a dynamic industry such as telecommunications, the New Zealand regulatory system allows for frequent regulatory reviews, at which point market definitions can be revisited in light of any technological or other developments.

⁹² In some instances, it may also be relevant to consider a temporal dimension of market definition. However, as noted later, this is not considered relevant in the current case.

⁹³ If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then added to the group should be that good that is the next-best substitute for the good in question. This incremental process requires those goods considered the most likely to be close substitutes for the good in question to be added first to the group subject to the *ssnip* test. If this did not occur there may be goods or services which are added to the group which are not close substitutes.

131. The Commission defines relevant markets in terms of the following characteristics or dimensions:⁹⁴
- the goods or services supplied or purchased (the product dimension);
 - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic dimension);
 - the level in the production or distribution chain (the functional dimension);
 - the temporal dimension of the market, if relevant (the timeframe); and
 - the different customer types in the market (the customer dimension).
132. While telecommunications services often have a temporal dimension, for example the use of peak and off-peak pricing, this is not considered to be of particular relevance to market definition in the current context. Most of the discussion below is in relation to the product and geographic dimensions of telecommunications markets, although the relevant customer and functional levels are also briefly considered.
133. However, markets are not always easy to define in practice. In part this is because the process itself is inevitably an imprecise one since transactions in the economy do not always fall neatly into a series of discrete and easily observable markets. Hence it may not be practical—nor, indeed, always necessary—to identify the precise boundaries of the activities included in a market. Moreover, as already noted, it is appropriate to tailor the definitions used to meet the requirements of the case in hand.
134. Market definition can be further complicated in the case of differentiated products. Where products are largely undifferentiated, the key attribute on which consumers base their purchasing decision is price. However, where products have differing characteristics or functionality, these differences may represent an additional influence on buying decisions. In its Mergers and Acquisitions Guidelines, the Commission notes that:⁹⁵
- in differentiated product markets, market boundaries are often difficult to delineate precisely, as the different products can vary in the degree to which they are substitutable, with the result that it may be unclear which products fall in one market and which in another.
135. The issue of product differentiation has arisen in this determination in the context of the provision of messaging services, and is discussed further below.

Product Dimension

136. The Commission has defined a market for the provision of local access services (encompassing the connectivity service in the form of a line rental, and local calling services) to residential customers.
137. The Parties agree that there is a residential local access market, in which access lines and local calling services (and various combinations) are supplied. The services applied for under the current Determination only relate to residential customers.
138. The Commission has considered the provision of messaging services in the context of the local access market, on the basis that exchange-based messaging services are

⁹⁴ See Commerce Commission, Mergers and Acquisitions Guidelines, December 2003, section 3.

⁹⁵ Commerce Commission, Mergers and Acquisitions Guidelines, December 2003, page 17.

provided in conjunction with the access line,⁹⁶ and there is unlikely to be sufficient substitution between answer phone-based messaging services and exchange-based messaging services to provide a constraint.

139. The Commission has found that various bundles of retail services offered by Telecom and included in the Application, namely 'MessageLine', 'SmartLine', 'Flexi-Pack', 'SmartPack', and 'FamilyPack', are supplied in the local access product market.
140. Finally, the Commission defined two additional markets in the Draft Determination, namely a market for residential directory assistance, and a market for operator services. TelstraClear's submission on the Draft Determination notes that its application in respect of operator assistance services has been withdrawn.
141. 'Directory Assistance' relates to the provision of assistance to customers seeking a listed or unlisted telephone number. For example, the customer may dial the Telecom short code 018 and request a telephone number. Telecom would then extract the number from its directories database.
142. The directory assistance market is relevant to the listing of numbers in a telephone directory. A supplier of directory assistance will require access to the underlying telephone directory database; in order to build up such a database, a supplier will want to allow customers to list their contact numbers.

Views of the Parties

TelstraClear

143. TelstraClear supports the product markets defined by the Commission.⁹⁷ In particular, TelstraClear argues that it is appropriate to include messaging services in the local access market:⁹⁸

TelstraClear agrees with the Commission's conclusion that 'there is unlikely to be sufficient substitution between answer phone-based messaging services and exchange-based messaging services' and hence messaging services are properly considered as being traded in the local access market.

144. TelstraClear submits that Telecom's Call Minder messaging service offers significantly greater functionality than answering machines. For example, Call Minder can take a message when the called party's line is engaged; can forward the caller to an alternative number (such as a mobile); and can alert the called party (for example, through a text alert to a mobile) when a message has been received. In addition, Call Minder can pick up messages from up to 5 phones (for example, from a home line, a work line, and a mobile).
145. These functions cannot be provided by an answer phone. TelstraClear submit that the ability of Call Minder to take a message when the line is engaged is particularly important.⁹⁹
146. As a result, TelstraClear submits that answering machines cannot be regarded as close substitutes for Call Minder.

⁹⁶ Decision 497.

⁹⁷ *ibid*, paragraphs 22, 23.

⁹⁸ *ibid*, paragraph 24.

⁹⁹ TelstraClear also refers to Telecom's website, which states that 'Call Minder is better than an answer phone. It can answer calls when your line is engaged and doesn't require batteries, mains power supply or cassettes.'

Telecom

147. Telecom submits that there is a separate market for messaging, in which network-based messaging services such as Call Minder compete with CPE-based messaging services provided by answering machines. Telecom argues that it is incorrect to treat both messaging services such as Call Minder, and access line services, in the same 'cluster' market. Telecom asserts that there are viable stand-alone suppliers of messaging services, including CPE-based messaging (answer phones) and network-based messaging services.
148. According to Telecom, answering machines provide a broadly similar functionality to Call Minder, with some advantages and some disadvantages. One advantage given of answer phone messaging is the ability of customers to 'screen' calls, while Telecom's market surveys suggest that customers value the reliability and simplicity of the Call Minder service.
149. Telecom's submissions include market survey results. Telecom relies on these results to demonstrate that consumers regard answer phones and Call Minder services as substitutable. Telecom note that []RI % of its residential access customers use Call Minder, while []RI % of its residential access customers use an answer phone.¹⁰⁰ There is a level of churn or customer switching between Call Minder and answer phones: Telecom noted that in 2003, []%RI of Call Minder customers churned away from the service for various reasons.¹⁰¹ Previous Telecom research has indicated that of those churning away from Call Minder, []%RI replace the service with a different product, which is usually an answer machine ([]%RI of churning customers purchased an answer machine).
150. Telecom therefore concludes that there is evidence of significant substitution between Call Minder and answer phones, which supports the definition of a separate messaging market.
151. Charles River Associates argues on behalf of Telecom that the conditions for treating Call Minder and the access line in a cluster market have not been satisfied. In particular, there is substitution between Call Minder and answer phones; prices of both have been declining, volumes increasing, and functionality improving; consumers purchase messaging and access on an unbundled basis; and providers of answer phones place competitive pressure on Telecom.¹⁰²

Commission View

152. The Commission proposed a cluster market covering the provision of network-based messaging services (such as Call Minder) and the access line.
153. A cluster market comprises two or more services where those services cannot be supplied or purchased independently:

... to say that good A and good B form a cluster is to imply that a firm selling only A or only B would not be able to compete with one selling both A and B – either because the supply cost of producing A and B jointly is substantially below that of producing them separately, and/or because consumers incur additional costs when they purchase A and B separately as against purchasing them jointly.

¹⁰⁰ The latest market survey data from Telecom suggests answer phone penetration has increased to [] RI%. Telecom (Parkes), Letter to Commission (Webb), *Residential Resale- Telecom's Outstanding Issues*, 3 June 2004, page 1.

¹⁰¹ 'Messaging in the Residential Market', Victoria Crone, Head of Consumer Marketing, Telecom.

¹⁰² Charles River Associates, *Follow up Points to Residential Wholesale Conference Discussion*, 1 June 2004.

...cluster markets arise when unbundled supply is impossible or (more usually) uncompetitive because of economies of scope which may arise in either demand or supply.¹⁰³

154. Messaging services can be supplied either by way of a CPE-based product such as an answer machine, or by way of a network-based messaging service such as Call Minder. If these two forms of messaging services are close substitutes, this would suggest that messaging is in a separate market from local access, due to the ability to supply CPE-based messaging (in the form of answer machines) on a stand-alone basis.¹⁰⁴
155. If, however, these two forms of messaging are not close substitutes, the next question is whether network-based messaging services (such as Call Minder) can be supplied on a stand-alone basis, distinct from the access line. If so, Call Minder should be considered outside of the local access market. However, if stand-alone supply of network-based messaging is not feasible, Call Minder and access services are supplied within the same cluster market.

Substitutability of CPE-based and network-based messaging

156. In examining the substitutability between two services, it is important to try and test how customers might react to a change in the value-for-money proposition. In the case of undifferentiated products, this amounts to positing a *snip*, a small elevation in price, to see whether customers would be likely to switch in sufficient numbers to defeat the attempted price increase. This assists in delineating the boundaries of the relevant market.
157. However, in the case of differentiated products, such delineation may be difficult to determine, given the different attributes of the products being tested. Relative prices, and differences in functionality, and the valuation of those differences, become important.
158. The relative functionality of Call Minder and answer phones has been discussed by both parties. TelstraClear considers key advantages of Call Minder to include the ability to record messages on an engaged signal, the ability to forward the caller to an alternative phone, the ability to alert the called party of a message, as well as the ability to record messages from multiple lines. TelstraClear also notes that Call Minder customers can remotely pick up their messages free-of-charge from any fixed Telecom line in New Zealand.
159. Telecom points to evidence that customers value the 'call screen' function of answer phones, and also the one-off cost of an answer phone, thus avoiding ongoing payments to Telecom.
160. The Commission considers that Call Minder has a number of functional advantages over a CPE-based messaging service. However, it is difficult to objectively assess the functional differences between the products. Customer survey data may be useful in revealing the value consumers place on them.

¹⁰³ Ergas, H., 'Cluster Markets: What They Are and How To Test For Them', page 3-4. This definition is also quoted in CRA's conference presentation, and is similar to that used by the ACCC.

¹⁰⁴ If answer phones and Call Minder are considered to be close substitutes, then, as CRA note, suppliers of answer phones will be "able to place sustainable and viable competitive pressure on Telecom." However, the lesser degree of substitutability, the weaker these competitive pressures will be.

161. Telecom presented a considerable amount of market research information at the conference. This included data on the level of churn between Call Minder and other messaging products, as well as information on some of the reasons why people churn, and the messaging features that customers value.
162. However, the Telecom research on the reasons for churn was undertaken in 1997, which is likely to limit its applicability,¹⁰⁵ as customer tastes and valuations of different features of products change over time.
163. Since the reported research was undertaken, internet usage has significantly increased. For example, one commentator¹⁰⁶ has estimated that in 1997, there were around 393,000 internet users in New Zealand; by 2002/03, users were estimated to number approximately 2 million. To the extent that dial-up usage has grown, the inability of answer phones to record messages when the called party's line is engaged (for example, due to a dial-up connection) is likely to diminish the value of this form of messaging.¹⁰⁷ This issue does not arise in respect of broadband internet connections, where the access line remains available for incoming calls, although growth in residential broadband numbers between 1997-2003 is unlikely to have accounted for much growth in overall internet usage.
164. TelstraClear also make this point, noting that in 1997, internet penetration was relatively low at 12% of the population; by 2001, penetration had reached 36%; and currently is around 50%. At the same time, TelstraClear presented some evidence that the importance of answer phones may be diminishing,¹⁰⁸ possibly in part due to higher internet penetration and the need to receive messages while online. According to TelstraClear, sales of answer phones by Telstra in Australia have declined by 12-15% per annum over 2000-2002, with further significant falls projected for 2003 and 2004. These declines have occurred despite reductions in the unit price of answer phones over the period.¹⁰⁹
165. In terms of the relative prices of answer phones and Call Minder, allowance needs to be made for the different way in which these services are sold. Customers using an answer phone incur a one-off payment, while Call Minder customers pay a monthly charge for the service. TelstraClear presented a graph depicting the relative price of Call Minder and answer machines, plotted against the assumed life of the answer machine. For example, if the answer machine has a life of 2 years, the price of the Call Minder service is 400% above the price of the answer machine. This differential

¹⁰⁵ The []%RI of Call Minder churn that replaced the service with a different product is based on a telephone survey undertaken for Telecom by CM Research: 'Understanding Churn, Call Minder Research, CM 1997'. Telecom notes that more recent research confirms the earlier findings. According to survey data from July 2003, []%RI of respondents expressed a preference for answer machines. However, the survey sample size (N=89 customers) appears to be very small. See conference presentation, 'Messaging in the Residential Market', Victoria Crone (Telecom).

¹⁰⁶ Paul Budde Communications '2003 Telecommunications and Information Highways in New Zealand', Table 44.

¹⁰⁷ One possibility may be to use an answer phone on a second line to record messages while the primary line is engaged. However, the cost of a second line (compared to the alternative of using a Call Minder-type service) is likely to render this option unattractive.

¹⁰⁸ Telecom, however, submitted that answer phone penetration has been increasing. See James Mellsoy presentation on behalf of Telecom 'Competition Analysis of Messaging Services' (24 May 2004), slide 14.

¹⁰⁹ TelstraClear (Dean Edwards) conference presentation, 'Why Messaging is Critical for Resale' (24 May 2004), slides 13-14. In a letter to the Commission dated 28 May 2004, TelstraClear confirm that the sales figures shown on slide 14 of the above conference presentation relate to both telephones with answering machine capability as well as stand alone answering machines.

increases with the life of the answer machine. TelstraClear submit that this is indicative of the services being supplied in different markets.

166. Telecom's survey information provides some indication of the reasons why customers choose the Call Minder service or an answer phone. One suggested advantage of the answer phone option relates to the one-off cost, with no further ongoing costs (as there is in the case of a service such as Call Minder, which has a monthly charge). Conversely however, Call Minder customers do not need to purchase hardware which may be superseded over time. With a service such as Call Minder, new functions can be added to the messaging service. Telecom referred to a number of such enhancements, including recording messages from multiple lines; 'Message Alert'; and the ability for the caller to be transferred to another number.¹¹⁰
167. Despite the reported level of churn, the overall trend is for an increasing number of consumers to purchase Call Minder, and most of these purchase the service as part of a bundle. According to Telecom, around [] RI of its Call Minder customers take the service in a bundle (for example, paying \$7.00/month for Call Minder as part of a package), with the remainder paying the standard retail price (\$9.95/month). This increased bundling appears to be one factor driving the apparent reduction in the average weighted price of Call Minder in recent years.¹¹¹ While this by itself may not be determinative, the increasing popularity of Call Minder taken within a bundle adds some support to the view that a cluster market should be adopted.
168. Given the differences in functionality, the differences in pricing, concerns over the currency of available survey data, and the prevalence of bundled supply of Call Minder, the Commission concludes that Call Minder and answer phones are not close substitutes.

Stand-alone supply of network-based messaging

169. Telecom suggests that network-based messaging services can viably be supplied independently of the access line.¹¹² Network-based messaging is available from Telecom, TelstraClear, and Vodafone.
170. The scenario relevant to this issue is where TelstraClear is reselling a Telecom residential access line. TelstraClear has its own voice messaging platform (VMP) which it uses to provide network-based messaging to its own direct-connect access customers.¹¹³ However, there appear to be potentially significant difficulties for TelstraClear in using its own VMP to supply messaging services in conjunction with resold access lines. A key feature of network-based messaging services is that the customer hears a 'stutter' dial tone when they pick up their handset. This stutter tone informs the customer that a new message is waiting for them. A non-Telecom VMP used in conjunction with a Telecom access line cannot currently provide this feature. In order to provide this function, Telecom would have to provide the reseller with an interface with Telecom's network, such as is the case in the UK.¹¹⁴ However,

¹¹⁰ Telecom (Victoria Crone) conference presentation, 'Messaging in the Residential Market'.

¹¹¹ This reduction is reported in the CRA presentation on behalf of Telecom at the conference. CRA, 'Competition Analysis of Messaging Services', 24 May 2004, page 10.

¹¹² Telecom 'Residential Wholesale Application Submission from Telecom on Draft Determination', 30 April 2004, paragraph 81.

¹¹³ TelstraClear's 'Voice Messaging' service is equivalent to Telecom's Call Minder service.

¹¹⁴ For example, BT Wholesale's Call Mapping service enables competitors to 'use BT's network functionality and conveyance to offer BT residential and business customers a voice messaging service equivalent to BT's own Call Minder and BT Answer. It also provides the opportunity to add value to your market offering with

Telecom informed the Commission that it cannot currently provide such an interface, and that it is unlikely to be able to do so.

171. In the absence of a stutter tone, the customer would have to contact the VMP in order to find out whether any messages had been received. This is likely to be a considerable inconvenience for the customer.
172. TelstraClear has previously commented on the limitations of this type of arrangement:¹¹⁵

TelstraClear cannot offer a messaging service to resale customers which would be competitively comparable with the Telecom messaging services. It is not technically feasible to replicate across the TelstraClear and Telecom networks several key features of the current Telecom messaging service. In particular, the TelstraClear network-based solution would not be a 'push' mail service (i.e. would not automatically inform the customer once a message has been received, such as by a light flashing on the phone or a stutter in the dial tone) but would be a 'pull' service (i.e. which requires the customer to dial into the TelstraClear message bank, and pay a local call charge for the inquiry or TelstraClear would pay an originating access charge of a toll free number was used).

It may be technically possible to rig up an outbound call from the TelstraClear network to the customer to notify of a message, but TelstraClear then would pay a termination charge to Telecom and customers may find a ringback approach more intrusive than the use of a flashing light or a dial tone, which allows the customer to decide when to retrieve the message.

173. In the absence of a network interface allowing the use of a stutter tone, a reseller of a Telecom access line is unlikely to be able to independently supply a competitive network-based messaging service.
174. Combined with the earlier conclusion that CPE-based alternatives are not a sufficiently close substitute for the Call Minder service, this suggests that the clustering of local access services with Call Minder is appropriate.
175. The Commission considers Call Minder to be supplied in the local access market.¹¹⁶

Conclusion on Relevant Product Markets

176. The Commission has concluded that the relevant product markets for this determination are the residential local access market and the residential directory assistance market.

Functional Dimension

177. In its decision to investigate, the Commission noted that:¹¹⁷

The services considered in the decision are provided to retail residential customers, and indeed the services must be retail services offered to end-users in order to meet the jurisdictional requirements of the wholesale clauses of the Act.

your own messaging services. With Call Mapping, calls are diverted on busy or 'ring-tone-no-reply' to the {competitor} voice messaging platform. Customers retrieve their messages either from their own line using the short access code 1571 or from another line via the use of a PIN number.' BT Wholesale website.

¹¹⁵ TelstraClear submission on draft business determination, 24 January 2003, page 31.

¹¹⁶ This is consistent with the conclusion in Decision 497.

¹¹⁷ Commerce Commission, *Decision Whether to Investigate the TelstraClear 'Residential Wholesale' Application for Determination for Designated Access Services*, 20 December 2002, p 14.

The Commission has therefore concluded that the relevant functional level of the market is retail.

178. The Commission has concluded that the relevant functional level is retail.

Geographic Dimension

Draft Determination

179. In the Draft Determination, the Commission defined a number of geographic residential access markets. Separate markets for networked metropolitan, non-networked metropolitan, and non-metropolitan areas were proposed. These markets were depicted as per the following diagram.
180. For example, in Wellington, the solid oval area covers all residential customers who receive the reduced line rental (currently \$32.85). This region is broken down into two markets: the networked metropolitan market, which follows the presence of TelstraClear's residential network (by applying a 'network stretch factor'), and is represented by the dashed oval; and the remaining non-networked metropolitan area. A similar representation could be constructed for Christchurch.

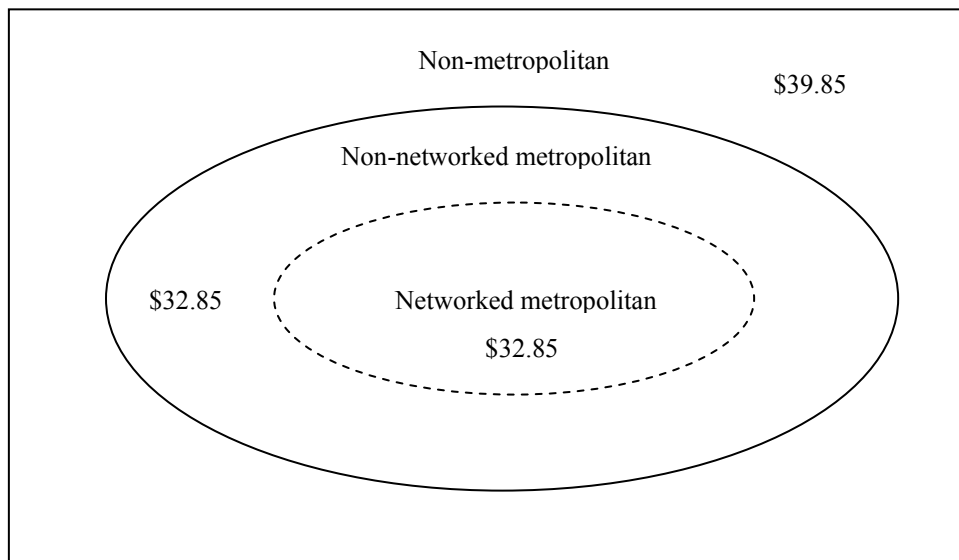


Figure 2: Residential Access Markets

181. All regions beyond the metropolitan markets are collectively referred to as the non-metropolitan residential access market, in which the higher line rental (\$39.85) applies.
182. The Draft Determination noted that distinguishing only between a metropolitan and a non-metropolitan market, with the boundary (i.e. the dashed line in the diagram) set by a distance rule (100 metres) applied to competing residential access infrastructure,¹¹⁸ would not reflect the actual residential pricing differentials offered by Telecom (represented by the solid line). On this basis, the Commission defined a non-networked metropolitan market. No distinction was drawn between Wellington and Christchurch.

¹¹⁸ For the purposes of the Draft Determination, the distance rule was applied to TelstraClear's residential network in Wellington and Christchurch.

Views of the Parties

TelstraClear

183. TelstraClear broadly agrees with the Commission's approach to defining geographic markets for residential access. However, TelstraClear submits that it was inappropriate to define a separate non-networked metropolitan market, and instead argued that this area should be encompassed within the non-metropolitan market.
184. TelstraClear argued that the Commission's approach in defining a non-networked metropolitan market applies a 'double hypothetical': a hypothetical price movement from a hypothetical network competitor.
185. TelstraClear also submitted that the inclusion of a non-networked metropolitan market:

... would set a dangerous precedent of effectively allowing incumbent pricing structures, in the absence of competitive activity, to be determinative of market definition.
186. TelstraClear referred to the market definitions contained in the parties' commercially agreed position, which defines a residential metropolitan access market (within 100 metres of competing residential access network), with all other areas lying within a non-metropolitan market.
187. TelstraClear agreed that there is a national market for the provision of directory assistance services.

Telecom

188. At the conference on the Draft Determination, Telecom expressed agreement with the Commission's approach to geographic markets. Telecom referred to its submission of March 2003, where it defined separate markets in networked metropolitan, non-networked metropolitan and non-metropolitan areas. This characterisation of geographic markets accords with the Commission's approach in the Draft Determination.
189. Telecom noted that the effect of defining markets in this way would be equivalent to the approach set out in the parties' agreed position.

Commission View

Networked Metropolitan Market

190. The Commission considers the presence of competing access infrastructure can be used as a basis for establishing market boundaries.
191. On that basis, the Commission considers that a relevant geographic market boundary for residential access should be set with reference to TelstraClear's fixed residential network in Wellington and Christchurch. The Commission considers that there is a networked metropolitan market for areas lying within 100 metres of TelstraClear's residential access network.

Non-Networked Metropolitan Market

192. The Commission does not find TelstraClear's 'double hypothetical' argument against a non-networked metropolitan market convincing. In defining the geographic markets for residential access customers, the Commission is interested in identifying the areas over which Telecom appears to be price-constrained in setting its residential line rentals.
193. In the case of residential customers, Telecom's line rental differentiation has been based on the entire Wellington and Christchurch regions, rather than the more targeted approach taken with respect to business access pricing (which is more focused on areas within reach of a competing network). As a result, Telecom now offers reduced residential pricing across Wellington and across Christchurch, even to customers beyond the immediate reach of competing network.
194. This suggests that Telecom faces a geographically broader pricing constraint in respect of residential customers, and that a single (networked) metropolitan market, defined as those areas within immediate reach of competing access network (i.e. within the dashed oval in Figure 2 above), may not be sufficient to reflect this broader constraint. Consequently, the Commission considers it is appropriate to define a non-networked metropolitan market.¹¹⁹

Fixed Wireless Networks

195. [

]RI, though for the reasons below the Commission has not defined the networked metropolitan market boundary with reference to wireless operators.
196. For the reasons given in Decision 497, cellular networks such as those operated by Vodafone and Telecom Mobile are not considered to compete in the same market for voice calls as fixed networks¹²⁰.
197. The Commission considers 'fixed wireless' network operators as potential new entrants under the competition assessment because of the prospective nature of their entry into the local access market.
198. An important factor in the Commission's definition of sub-national markets is geographically differentiated pricing. However, outside of Wellington and Christchurch, Telecom has maintained residential line rentals at \$39.85, even in Auckland where Woosh has been signalling entry. This pricing uniformity over areas which include areas in which wireless operators are present and capable of providing voice services suggests that they do not provide a significant constraint.
199. The Commission has received considerable information on the viability of extending fixed residential networks. This information has enabled the Commission to form a view on the appropriate network stretch factor to be applied. However, there is no

¹¹⁹ The Commission also notes that TelstraClear's cross-submission in respect of its application agreed in principle with a distinction between networked and non-networked metropolitan markets. See TelstraClear Limited, 'Cross-submission: Residential Wholesale Application' (26 March 2003), page 16.

¹²⁰ See discussion of fixed and mobile networks, Draft Wholesale Determination (25 November 2002).

comparable information on the economics of building and extending wireless networks for the provision of voice services.

200. Areas covered by competing residential networks are referred to by the Parties as ‘excluded areas’, where TelstraClear does not seek wholesale access.
201. If in the future, alternative networks compete with Telecom in the provision of residential local access services, there are mechanisms available for the Commission to take into account the change in market conditions. For example, at the expiry of a determination, an application can be made to the Commission for a new determination, at which point the Commission will reassess markets and competition. As the wholesale determinations tend to be of a relatively short term, the risks associated with regulation of what may emerge as a competitive market are lessened. Parties can also apply for a reconsideration prior to the expiry of an existing determination.
202. For the purposes of this determination, the Commission has defined a networked metropolitan local access market, with a boundary measured as being within 100 metres of TelstraClear’s residential access network in Wellington and Christchurch.
203. A non-networked metropolitan local access market is defined to include those areas lying between the 100 metre boundary referred to in the preceding paragraph and the outer limits of Telecom reduced residential line rentals.
204. A non-metropolitan local access market includes the remainder of New Zealand.
205. A national market for directory assistance is adopted.

Conclusion on the Relevant Markets

206. The following table summarises the markets relevant to this determination. The Commission notes that TelstraClear has not sought a determination in respect of networked metropolitan access (i.e. areas within 100 metres of its residential access network), and has also withdrawn its application in respect of operator services.

Figure 3: Relevant Markets

Product level	Functional level	Geographic level
Residential local access	Retail	(i) Non-networked metropolitan; (ii) Non-metropolitan
Residential directory assistance	Retail	National

COMPETITION ASSESSMENT

Introduction

207. The wholesale provisions in Schedule 1 require the Commission to consider whether ‘Telecom faces limited, or is likely to face lessened, competition’ in a market or markets. As noted earlier, this assessment of competition is an important factor in determining whether a particular service is to be subject to the wholesale regime, and if so, on what terms¹²¹.
208. The Commission has previously set out a framework for determining whether Telecom faces limited, or is likely to face lessened, competition in a market¹²². Rather than repeating the development of that framework in this determination, the Commission has listed below the factors that it considers to be pertinent to the assessment of whether Telecom faces limited competition in a market:

Existing Competition

- the number and relative size of competitors in the market, including where possible an assessment of trends in shares over time;
- the extent to which there is product differentiation;
- the degree to which competitors engage in independent rivalry;
- the degree of vertical integration;
- the absence of barriers to customer switching;
- the movement in prices over time, and any evidence of their broad relationship to underlying costs;
- the existence of any countervailing power;
- the constraints imposed by the regulatory environment; and
- evidence that the access provider is acting inefficiently or achieving excess returns.

Potential Competition

- the potential for entry and the significance of any barriers to entry that may exist, and evidence of recent entry;
 - the movement in prices over time, and any evidence of their broad relationship to underlying costs;
 - the constraints imposed by the regulatory environment; and
 - evidence that the access provider is acting inefficiently or achieving excess returns.
209. In Decision 497, the Commission paid considerable attention to these factors in each of the markets under examination. In the current context, the Commission notes that there is a significant level of agreement between the two parties in relation to the level of competition.

¹²¹ Specifically, at what discount off the retail price.

¹²² Decision 497, paragraphs 275-313.

210. In summary, Telecom and TelstraClear both agree that there is limited competition outside of the networked metropolitan areas¹²³.

The Retail Market for Residential Local Access Services in Non-Networked Metropolitan Areas

211. This market refers to the supply of local access services to residential customers in areas beyond 100 metres of TelstraClear's residential network but within the Wellington and Christchurch areas subject to Telecom's reduced residential line rental. These services include the various connection and reconnection, line rental, local calling, and messaging services contained in the Application.

Existing Competition

212. Telecom accepts that competition is limited in both the non-networked metropolitan market and the non-metropolitan market and that wholesaling of services (which otherwise satisfy the requirements of the Act for wholesaling) is required in these markets¹²⁴, though disagreeing as to the product dimensions of the markets.
213. TelstraClear agreed with Telecom's assessment of competition in these markets¹²⁵.
214. The Commission agrees that Telecom faces limited competition in the market for residential local access services in non-networked metropolitan areas. Telecom is virtually the only existing supplier of residential access and local calling services in this market. Residential customers are also unlikely to possess countervailing power with which to constrain Telecom.

Potential Entry

215. A number of entry barriers exist to reduce the effectiveness of any threat from new entry into this market. These include the presence of economies of scale and sunk costs in relation to a customer access network. The absence of full local number portability may also deter residential customers from churning.
216. One possible new entrant is TelstraClear, through the extension of its residential network in the adjacent networked metropolitan areas. However, neither Telecom nor TelstraClear have placed significant weight on the threat of such entry. TelstraClear has indicated that it is unlikely to build out its existing residential network in the foreseeable future, in particular given the planning and consent process that must be undertaken, especially in relation to aerial networks¹²⁶.
217. Fixed wireless networks are likely to support voice services in the near future. Woosh is currently rolling out a wireless broadband network in Auckland, Wellington, and Southland, and has plans to extend its coverage to other parts of New Zealand throughout 2004 and 2005. Woosh intends to offer voice services as well as high-speed internet access to its customers.

¹²³ The parties' agreed position includes a metropolitan market (areas within 100 metres of competing access network) and a non-metropolitan market (all other areas; this encompasses the Commission's non-networked metropolitan and non-metropolitan markets). The parties agree that Telecom faces limited competition outside the metropolitan market.

¹²⁴ Telecom 'Residential Wholesale Application Submission from Telecom' (7 March 2003), paragraph (j).

¹²⁵ TelstraClear 'Cross-submission: Residential Wholesale Application' (26 March 2003), paragraphs 5.4, 5.6, 5.11, 5.13, 5.15, and 5.17.

¹²⁶ *ibid*, paragraph 4.6.

218. []CO.
219. BCL has recently launched a broadband wireless network ('Extend') throughout parts of New Zealand, which it is marketing as being capable of delivering both data and voice services¹²⁷.
220. In its recent investigation under section 64 of the Act, the Commission concluded that fixed wireless access networks were unlikely to represent a significant constraint on Telecom over the next five years in relation to either voice or broadband services.¹²⁸ It is noteworthy that that investigation used a longer timeframe than the two-year forward-looking period being considered in this determination.
221. Telecom does not suggest entry by operators such as Woosh and BCL is likely to significantly constrain Telecom in local access markets.
222. The Commission does not consider potential entry by either fixed wireline or wireless operators to represent a significant constraint on Telecom in the non-networked metropolitan market.

Conclusion

223. The Commission concludes that Telecom faces limited competition in the retail market for residential local access services in non-networked metropolitan areas.

The Retail Market for Residential Local Access Services in Non-Metropolitan Areas

224. This market refers to the supply of local access services to residential customers in areas outside of Wellington and Christchurch¹²⁹. These services include the various connection and reconnection, line rental, local calling, and messaging services contained in the Application.

Existing Competition

225. Telecom agrees that in the non-metropolitan market, it faces limited competition in the provision of residential local access services.
226. TelstraClear agrees with Telecom's assessment of competition in this market.
227. Telecom is currently the only direct supplier of local access to residential customers in non-metropolitan areas. However, Telecom is now offering a wholesale residential local access service. Telecom announced on 8 April 2004 that agreement has been reached with Orcon which will enable Orcon to resell 'Jetstream' and residential phone access, as well as national and international calling¹³⁰.

Potential Entry

¹²⁷ Extend's initial coverage tends to focus on rural areas, outside on the main centres. These areas appear to fall within the non-networked metropolitan and non-metropolitan markets being considered in this determination.

¹²⁸ For example, see Commerce Commission 'Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network' (22 December 2003), paragraphs 411-416.

¹²⁹ That is, beyond the networked and non-networked metropolitan areas of Wellington and Christchurch.

¹³⁰ Telecom Website (Media Releases), *Orcon and Telecom Achieve Wholesaling First*, 8 April 2004.

228. As with the non-networked metropolitan areas, the Commission's view is that new entry into the non-metropolitan market for residential local access is likely to be limited in the near future.
229. As noted above, Woosh is deploying a fixed-wireless access network in Auckland, Wellington and Southland. Its intention is to offer voice as well as data services. Woosh is also operating a network in Southland, as part of the Project PROBE initiative. Woosh believes that its network will in time present residential consumers with a complete alternative to Telecom.
230. Counties Power's Wired Country broadband network offers broadband services (primarily data) to business and residential customers in the Counties/Waikato and Auckland (where it is the Project PROBE supplier) regions, []CO. Ihug is in the process of launching a voice service in Auckland using the Wired Country network.
231. TelstraClear appears unlikely to deploy a fixed wireline residential network in Auckland.
232. Therefore, while there is likely to be some entry, particularly at a localised level, within the period of this Determination, the Commission is not convinced that the scale of this entry will be sufficient to constrain Telecom in providing residential local access services, such that it no longer faces limited competition.

Conclusion

233. The Commission concludes that Telecom faces limited competition in the retail market for residential local access services in non-metropolitan areas.

The National Retail Market for Residential Directory Assistance Services

234. This market refers to the provision of assistance to customers seeking a listed or unlisted telephone number. As noted above, the Commission also considers that this market encompasses the listing of numbers in a telephone directory.

Existing Competition

235. The Commission understands that Telecom is the sole provider of directory services to residential customers. While Telecom has previously submitted that there are a number of competing directory services, such as Wilson & Horton's Universal Business Directory, these do not appear to relate to residential numbers.
236. TelstraClear has noted that:¹³¹

While there are some business directories, the production of geographic residential directories requires access to Telecom's directory information and entrants are unlikely to match the scale economies which Telecom realises: for example, Telecom is able to market enhanced listings through existing customer channels, such as its billing, or when a customer calls to connect a new service. Telecom can readily verify data against its current customer databases and, as customers have to contact Telecom to change their service details, Telecom has an up to date database for use in its directory products. Accordingly, Telecom faces limited competition in the national market for directory listings.

¹³¹ TelstraClear Cross-Submission (26 March 2003), paragraph 5.27.

237. TelstraClear agrees that Telecom faces limited competition in this market. TelstraClear notes that in Australia an Integrated Public Number Database has been established, to which all service providers are required to contribute. The database is set up and managed on a stand-alone basis, accessible to all service providers at a charge.
238. The Commission considers that Telecom faces no existing competition in the provision of directory listings services.

Potential Entry

239. In Decision 497, the Commission referred to a number of barriers to entry with respect to the provision of directory assistance. These include the costs in building a competing database of telephone number listings, and the level of recognition of Telecom's 018 short code through which directory assistance services can be accessed.
240. The Commission believes that these factors remain relevant. In particular, residential customers are likely to want to list their contact details with a comprehensive numbering database which is widely available to other telecommunications users as a single point of reference. This is likely to inhibit the entry of a competing supplier of directory services.

Conclusion

241. The Commission concludes that Telecom faces limited competition in the retail market for residential directory assistance services.

Conclusion on Competition Assessment

242. Telecom faces limited competition in the following residential local access markets:
- the non-networked metropolitan market; and
 - the non-metropolitan market.
243. Telecom faces limited competition in the national retail market for residential directory assistance services.

Figure 4: Summary of Competition Assessment

Relevant Market	Competition
Residential Local Access Services in Non-networked metropolitan areas	Limited
Residential Local Access Services in Non-metropolitan areas	Limited
Residential Directory Assistance	Limited

APPLICATION OF THE INITIAL PRICING PRINCIPLES

Retail Services Offered By Means Of Telecom's Fixed Telecommunications Network (Non Price-Capped Services)

241. The initial pricing principle for 'retail services offered by means of Telecom's fixed telecommunications network', i.e. non price capped retail services, is:¹³²
- retail price less a discount benchmarked against discounts in comparable countries that apply retail price minus avoided costs saved pricing in respect of these services, in the case of a service offered by Telecom in markets in which Telecom faces limited, or is likely to face lessened, competition for that service; or
 - retail price less a discount benchmarked against discounts in comparable countries that apply retail price minus actual costs saved pricing in respect of these services, in the case of a service offered by Telecom in markets in which Telecom does not face limited, or lessened, competition for that service.

Retail Price

242. The initial pricing principle requires the deduction of a discount from the 'retail price'. The final pricing principle by contrast requires discounting from the 'average or best retail price'.
243. As the Parties have agreed to all non-price terms, including those relating to the calculation of retail price, the Commission is not required to determine the retail price under the initial pricing principle for non price-capped retail services.

Residential Local Access and Calling Service (Price-Capped Service)

244. The initial pricing principle for the designated service 'Residential Local Access and Calling' is:¹³³
- Telecom's standard price for its price-capped residential local access and calling service offered by means of its fixed telecommunications network in the relevant market, minus 2%.
245. The Commission has determined that only one service in the Application, 'Homeline – Monthly Rental and Local Calling', requires the application of this pricing principle.

Standard Retail Price

246. The initial pricing principle requires the deduction of a discount of 2% from the standard retail price.

Wholesale Discount for Price-capped Services

¹³² Telecommunications Act 2001, Schedule 1, Part 2, Subpart 1.

¹³³ Telecommunications Act 2001, Schedule 1, part 2, Subpart 1.

247. The wholesale price for ‘Homeline’ will be the standard retail price (as agreed by the s

Bundle of Retail Services

248. The initial pricing principle for the designated service ‘bundle of retail services offered by means of Telecom’s fixed telecommunications network’ is:

The Wholesale price for the bundle is the amount calculated in accordance with the following formula:

$$a \times \left(\frac{100 - b}{100} \right) = c$$

where -

a is the retail price for the bundle

b is the discount (as a percentage) off the retail price for the bundle calculated in accordance with the following:

- (a) if a bundle includes non-price capped services, the discount applied to non price-capped services within the bundle must be benchmarked against discounts applied to comparable bundles that do not include price-capped residential access and calling service in comparable countries; or
- (b) if a bundle includes Telecom’s price-capped residential access and calling service, the discount applied to Telecom’s price-capped residential access and calling service within the bundle is 2%; or
- (c) if a bundle includes non price-capped services and Telecom’s price-capped residential access and calling service, the overall discount *b* must be determined by weighting the discounts for each non price-capped and price-capped service (determined in accordance with paragraphs (a) and (b)) in proportion to the standard retail price for that service when it is offered outside the bundle

and any service within the bundles specified in paragraphs (a), (b), or (c) that is not a designated service under this Act must be weighted in proportion to the standard price of the service when it is offered outside the bundle and must not be discounted

c is the wholesale price.

249. For illustrative purposes, the following (hypothetical) example shows how the initial pricing principle formula for bundles would work in practice:

Bundle Components	Price of component when offered outside the bundle
X (a price-capped service within jurisdiction)	\$45
Y (a non price-capped service within jurisdiction)	\$6
Z (a non-price-capped service within jurisdiction)	\$9
Total (i.e. if not offered as a bundle)	\$60

250. Assuming that:

- the retail price of the bundle 'a' is \$50; and
- the benchmarked discount applied to non price-capped services within the bundle is 16%

the wholesale price of the bundle would be calculated as follows:

$$a = 50$$

$$b = [(45/60) \times 0.02] + [(6/60 \times 0.16)] + [(9/60 \times 0.16)]$$

$$= 0.055$$

$$= 5.5\%$$

$$c = 50 \times [(100 - 5.5)/100]$$

$$= \$ 47.25$$

251. The Act requires that the discount applied to non price-capped services within a bundle is a discount benchmarked against discounts applied to comparable bundles that do not include price-capped residential access and calling service in comparable countries. The Commission considers that the same discount should be applied for bundles as that for separate services. The Commission has found no differential in discounts in the benchmarking process.

THE WHOLESALE DISCOUNT FOR NON PRICE-CAPPED RETAIL SERVICES AND BUNDLES OF RETAIL SERVICES

252. In connection with Decision 497, the Commission undertook a benchmarking study of wholesale discounts in comparable counties in order to fix the wholesale discount for non price-capped retail services (the 'Benchmarking Report')¹³⁴. The Benchmarking Report is reproduced as Appendix 1. The Commission found that the use of a regulated wholesale pricing policy based on retail minus avoided costs was rare, and only in use in Australia, the United Kingdom and the United States. The Commission identified individual US states as potential comparators, for the reasons sets out in its Benchmarking Report. The Commission ruled out the use of both the United Kingdom and Australia on the basis of the different discount methodologies adopted in those countries.
253. Forty-seven U.S. states were selected as benchmarks in Decision 497. As with the interconnection benchmark study¹³⁵, the Commission sought to refine the range of comparators based on a measure of comparability against factors considered to be relevant indicators of cost differentials. These factors were labour cost, population density, GSP, tele-density and urbanisation.
254. After conducting a series of regression analyses, the Commission concluded that there was no systematic link between individual variables and the discounts offered in each respective state. Given this lack of observable correlation, the Commission decided not to exclude any states from the range.
255. In some benchmark jurisdictions, discounts differ depending on whether the wholesale services offered are to be resold to business or residential customers. Such a differential should ideally reflect differences in the retail costs saved. However, in Decision 497, the Commission found no clear pattern in these differentiated discounts that would unambiguously suggest that retail costs incurred in serving residential customers are higher than those incurred for business customers or vice versa. Therefore, in order to include those states that adopt variable business and residential discount rates in Decision 497, a simple weighting was applied.
256. For the purposes of this Determination, the Commission has undertaken a review of the regulated wholesale rates in the forty-seven states used in the Benchmarking Report. The Commission has contacted each Public Utility Commission ('PUC') to assess whether the discount rates in November 2002 remain unchanged or have been subsequently amended. The Commission has received responses from 30 of the 47 benchmarked states.¹³⁶ Only one PUC has advised that its wholesale discount rate has changed. The applicable discount in the state of Oregon has increased to a discount of 17% for all types of services.

¹³⁴ Commerce Commission, *Determination on the TelstraClear Application for Determination for 'Wholesale' Designated Access Services*, Decision 497, 12 May 2003, Appendix 1, *International Benchmarking Study, A comparative review of retail minus discounts*, November 2002

¹³⁵ Commerce Commission, *Determination on the TelstraClear Application for Determination for Designated Access Services*, Decision 477, 5 November 2002, Appendix 4, *International Benchmarking Report: A Comparative Review of Interconnection Pricing*, 5 November 2002

¹³⁶ The Commission has received responses from the following states: Oregon, Washington, South Dakota, Nebraska, North Dakota, Alabama, California, Minnesota, Nevada, Montana, Michigan, Missouri, Oklahoma, Maryland, Delaware, New Jersey, Virginia, Indiana, Arkansas, Texas, Connecticut, Pennsylvania, Massachusetts, Iowa, Colorado, Wyoming, Kentucky, Florida, Georgia, North Carolina

257. The Commission has updated the state discount data to reflect this change and is satisfied that there has not been a significant change, other than in the state of Oregon, in individual state discount rates subsequent to the Benchmarking Report.

State	Company	Decision 497 Discount	PUC Response?	Amended Discount?	Applicable Discount
Oregon (i/c)	Qwest	8.46%	✓	✓	17.00%
Iowa	Qwest	14.39%	✓	✗	14.39%
Arizona (i/c)	Qwest	15.00%	---	---	15.00%
Utah (i/c)	Qwest	12.20%	---	---	12.20%
Colorado (i/c)	Qwest	14.35%	✓	✗	14.35%
Wyoming	Qwest	14.35%	✓	✗	14.35%
Wisconsin	SBC	16.00%	---	---	16.00%
Washington	Qwest	14.74%	✓	✗	14.74%
South Carolina	Bell South	14.80%	---	---	14.80%
New Mexico	Qwest	15.05%	---	---	15.05%
Kentucky	Bell South	16.17%	✓	✗	16.17%
South Dakota	Qwest	15.55%	✓	✗	15.55%
Mississippi	Bell South	15.75%	---	---	15.75%
Nebraska	Qwest	16.00%	✓	✗	16.00%
Tennessee	Bell South	16.00%	---	---	16.00%
North Dakota	Qwest	16.15%	✓	✗	16.15%
Alabama	Bell South	16.30%	✓	✗	16.30%
Rhode Island	Verizon	17.60%	---	---	17.60%
Florida	Bell South	19.32%	✓	✗	19.32%
California	SBC	17.00%	✓	✗	17.00%
Georgia	Bell South	18.80%	✓	✗	18.80%
North Carolina	Bell South	19.55%	✓	✗	19.55%
Minnesota (i/c)	Qwest	17.66%	✓	✗	17.66%
West Virginia (i/c)	Verizon	17.84%	---	---	17.84%
Nevada (i/c)	SBC	18.05%	✓	✗	18.05%
Montana	Qwest	18.10%	✓	✗	18.10%
Michigan	SBC	18.15%	✓	✗	18.15%
Idaho (Southern)	Qwest	18.25%	---	---	18.25%
New Hampshire	Verizon	19.65%	---	---	19.65%
Missouri (i/c)	SBC	19.20%	✓	✗	19.20%
Idaho (Northern)	Qwest	19.37%	---	---	19.37%
Oklahoma (i/c)	SBC	19.80%	✓	✗	19.80%
Maryland	Verizon	19.87%	✓	✗	19.87%
Delaware	Verizon	20.00%	✓	✗	20.00%
New Jersey	Verizon	20.03%	✓	✗	20.03%
Ohio	SBC	20.29%	---	---	20.29%
Vermont	Verizon	24.05%	---	---	24.05%
Louisiana	Bell South	20.72%	---	---	20.72%
Virginia	Verizon	21.30%	✓	✗	21.30%
Indiana	SBC	21.46%	✓	✗	21.46%
Arkansas (i/c)	SBC	21.60%	✓	✗	21.60%
Kansas (i/c)	SBC	21.60%	---	---	21.60%
Texas	SBC	21.60%	✓	✗	21.60%
Connecticut	Verizon	21.70%	✓	✗	21.70%
New York	Verizon	21.70%	---	---	21.70%
Maine	Verizon	24.39%	---	---	24.39%
Pennsylvania	Verizon	25.69%	✓	✗	25.69%
Massachusetts	Verizon	29.47%	✓	✗	29.47%

Figure 5: State Discount Data

Single or multiple discounts

258. In Decision 497, the Commission noted that it could either fix a single discount for all services, or individual discounts for each service. A single benchmark discount offers considerable advantages in terms of convenience and simplicity of the regulatory framework. However, a single benchmark discount might be less appropriate where retail costs as a proportion of total costs differ significantly across services. For example, the cost of retailing to business and residential customers expressed as a proportion of retail prices or revenues may differ significantly. However, the Commission considered that it was unclear whether the proportion of retail costs that would be saved if the service were supplied on a wholesale basis would be higher or lower for business customers than for residential customers. Although business customers may require more customer care services (a potentially significant element of ongoing retail costs) than residential customers, the cost of providing these services would be spread across larger volumes.
259. Fourteen of the forty-seven benchmarked states apply different discounts for business and residential services. In Decision 497, the Commission found no systematic differentiation in the sense that discounts for business services would in each case be higher than discounts for residential services (or vice versa). In cases where business discounts are higher than residential discounts, this might simply be the result of lower retail prices for business customers (which, given the same level of retail costs, would correspond to higher discounts). If differences in discounts were simply the result of differences in retail prices, applying a single discount on the basis of a weighted average retail price would not be in any way different from applying different discounts to different retail prices.
260. In contrast to Decision 497, which included services provided to business and residential customers, the current application applies to residential services only. While the Commission notes that it is possible to use only data from those states that utilise a specific separate residential discount, the Commission is not satisfied that it would give best effect to the Act given the relatively small number of benchmarked states that use separate discounts and an apparent lack of systematic variation of discounts by states using multiple discounts.
261. In Decision 497, the Commission also noted that applying a single discount in the presence of systematic and significant differences in retail costs could lead to distortions. For example, if retail costs of serving business customers were lower than retail costs incurred in serving residential customers, a single discount based on average retail costs might distort retail competition in favour of reselling to business customers, leaving the access provider mainly with residential customers. However, if the mix of services offered by Telecom on a wholesale basis to TelstraClear is similar to the mix of services offered by the access provider to its retail customers, divergences between actual retail costs and retail costs implied by a single percentage discount that would exist for individual services would cancel out.
262. The significant difficulties in establishing systematic differences in retail costs across services with sufficient precision support the adoption of a single benchmark discount for application to the initial pricing principle, absent evidence of significant differences in the mix of services that are sought on a wholesale basis and the mix of services offered by the access provider to its retail customers, which would suggest distortive effects from using a single discount. The evidence, both anecdotal and

empirical, leads the Commission to conclude that, consistent with Decision 497, where both business and residential discounts exist, they are to be averaged into a single discount on an equally weighted basis. The Commission has therefore decided that a single discount structure is appropriate for application to the initial pricing principle.

Absolute or percentage discounts

263. The Commission could in principle express wholesale discounts as an absolute value or a percentage of the retail price.¹³⁷ However, as in Decision 497, the Commission regards percentage discounts as preferable for a number of reasons:
- **Simplicity:** To the extent that retail costs vary with the value of a group of retail services, a multitude of absolute discounts that would be required if there were significant differences in the retail value of these services can be captured through a single percentage discount. Thus, a percentage discount appears to be simpler to administer than absolute discounts in the presence of value differences across different retail services (without leading to material distortions as long as there is a relatively constant relationship between retail values and retail costs).
 - **Less need to update:** Provided that changes in overall costs and retail costs are similar over time, there is no need to update percentage discounts, whereas absolute discounts would need to be modified (or reviewed) in order to ensure that they still appropriately reflect the retail costs that would be saved as a result of offering a service on a wholesale rather than a retail basis.
 - **Percentage discounts would take account of the possible change in retail costs that the access provider might make in response to changes in the value of the retail service.** It may be reasonable to assume that the access provider would reduce its retail effort in response to falling prices, which would imply a fall in the absolute value of retail costs.

Additional Costs of Wholesaling

264. In Decision 497, the Commission considered whether it was necessary to further adjust the benchmarked discounts for additional costs arising from wholesale activities. The Commission noted that it:

... is not satisfied that it is necessary to make an order for the recovery of onset costs, or to make adjustments to the benchmark discount to reflect these costs. There are several reasons for this. First, it is unclear whether Telecom will incur any such costs during the period of this Determination. Second, the Commission has insufficient evidence as to the amount and timing of such costs. Third, it is unclear whether and to what extent onset costs are already allowed for in the U.S. state-level wholesale discounts on which the Commission relied.¹³⁸

265. Telecom noted that the benchmarked rates were prior to any adjustment for additional costs of wholesaling, and requested that the Commission indicate what adjustment it

¹³⁷ Note that this is not affected by whether discounts in comparable jurisdictions are expressed as percentages or in absolute terms, as it would be relatively easy to convert one into the other.

¹³⁸ *ibid*, para. 709

expected to make for additional ongoing costs.¹³⁹

266. The Commission in turn requested that Telecom provide details at the conference as to the nature and quantum of any such additional costs if it was Telecom's position that those costs are a relevant factor in setting the discount.¹⁴⁰
267. At the conference, Telecom noted that 'in the interests of implementing the wholesale regime without first having to exactly identify what costs it will entail and incorporate them into the discount, Telecom is willing to accept the Commission's view that the benchmarked discount should not, at this stage, be adjusted to account for these costs. Telecom considers that a comprehensive examination of these additional costs would be required should there be a final pricing review determination when the Commission must consider actual costs saved.¹⁴¹
268. In the absence of any further evidence of additional costs of wholesaling and Telecom's advice that further adjustment is not necessary for the purposes of this proceeding, the Commission is satisfied that, consistent with Decision 497, further adjustment to the benchmarked discount to account for any additional costs of wholesaling is not required.

Selecting a Discount Point

269. Under the initial pricing principles for this determination, the selection of a discount rate from within the benchmarked range is an important step in setting the wholesale price. The Commission's benchmarking of wholesale discounts (including the amendment to the state of Oregon), produces a range from 12.20% to 29.47%, with a mean discount of 18.62% and a median of 18.20%.
270. In Decision 497, the Commission noted that in its earlier Interconnection Determination¹⁴²
- 'the Commission acknowledged the importance of dynamic efficiency and emphasised the asymmetry in selecting a price point that both encouraged retail-level competition in the market, while not discouraging investment and innovation in infrastructure in the longer term. It is the view of the Commission that in a situation of imperfect information, the loss in efficiency that would result from under-pricing wholesale access by any given margin outweighs the risks of over-pricing by the same margin. Therefore, a modest conservative bias in setting the initial benchmark may be appropriate.'
271. In Decision 497, the Commission also attempted to identify any empirical relationship between discount rates and their expected determinants. The evidence failed to reveal such a relationship. The Commission decided to place some weight on the need to preserve incentives to invest in infrastructure and was also noted that this range was before any adjustment for additional costs of wholesaling.

¹³⁹ Telecom, *Residential Wholesale Application, submission from Telecom on Draft Determination*, 30 April 2004, p. 21

¹⁴⁰ Letter from the Commission (Borthwick) to Telecom (Oakley), *TelstraClear Application for Residential Wholesale, Additional Costs of Wholesaling*, 12 May 2004

¹⁴¹ Commission conference transcript, Telecom (Parkes), 24 May 2004, p. 110

¹⁴² Decision 497, paragraph 712.

272. The Commission also considered in Decision 497 whether it was necessary for any specific adjustments to be made to the benchmarked discount rates. Telecom proposed that a number of adjustments should be made to the benchmark discounts¹⁴³, including the recalculation of discounts based on changes in the regulated accounts¹⁴⁴, adjustments to the discounts because those discounts were not based on an ‘avoided costs saved’ methodology¹⁴⁵, and the relationship between the discount rates and relative factor costs.¹⁴⁶
273. For the reasons set out in Decision 497, the Commission is satisfied that, for the purposes of the initial pricing principle, there is insufficient justification for adjustments to its benchmarked discounts.
274. For reasons of asymmetric risks and consistency with Decision 497, the Commission has decided to apply discounts from the lower end of the benchmarked range.

Selection of a Discount Rate

275. The Commission believes that the selection of a discount rate from within the lower half of the benchmarked range is appropriate. A relatively high discount may increase the risk that investment in infrastructure will be deterred, while inefficient investment in resale functions may be encouraged.
276. In determining how much weight to place on the need to protect incentives to invest and innovate at the infrastructural level, the Commission is mindful of the approach it took in the Interconnection Determination (Decision 477) and Decision 497. In setting the final interconnection price in Decision 477, the Commission decided to shift from the median value of benchmarked prices to the 75th percentile of the range. This had the effect of raising the access price for interconnection services.
277. In the current case, the Commission considers that the 25th percentile value of 16.0% is appropriate, taking into account both the theoretical merit of the relative factor cost arguments, as well as the Commission’s concerns regarding incentives to invest in infrastructure.

Price-capped / Non price-capped services

278. Telecom generally supports the Commission’s approach to determining the wholesale discount, but has raised a concern about the effect that the wholesale discounts could have on the ‘HomeLine’ and the ‘HomeLine Economy’, ‘60 Plus and ‘Second Line’ services.¹⁴⁷

¹⁴³ See Telecom ‘Submission on Wholesale Draft Determination’, 24 January 2003, Section 9.1.

¹⁴⁴ See discussion in Commerce Commission, *Determination on the TelstraClear Application for Determination for ‘Wholesale’ Designated Access Services*, Decision 497, 12 May 2003, paragraphs 716 - 718

¹⁴⁵ *ibid*, paragraphs 719 - 730

¹⁴⁶ *ibid*, paragraphs 731 - 732

¹⁴⁷ Telecom, *Residential Wholesale Application, Submission from Telecom on Draft Determination*, 30 April 2004, para. 89

279. 'HomeLine' is a price-capped residential local access and calling service. The initial pricing principle for this service is Telecom's standard price less 2%. In contrast, the Commission has determined that 'Homeline Economy', '60 Plus' and 'Second Line Services', while exhibiting characteristics similar to the 'HomeLine' service, are separate retail services offered by means of Telecom's fixed telecommunications network. The relevant initial pricing principle for those services is retail price less a benchmarked discount which the Commission has determined is 16%.

280. Telecom submitted that

[o]ne potential effect of this could be a skewing of Telecom's provision of Local Access services towards the discounted retail products which would reduce Telecom's revenues (even after allowing for the benefit of avoided retail costs) for no reduction in cost. This would then require Telecom to consider whether it is worth the risk of continuing to provide such services at retail.¹⁴⁸

281. TelstraClear submitted that:

...the whole purpose of the tight link approach applied promoted by Telecom was that the individual pricing plans would be passed through at the wholesale level, and all these services Telecom are now concerned about are just pricing plans. The Telecommunications Act applies separate initial pricing principles for price capped and non-price capped services. The Commission cannot dilute one pricing principle by reference to the other. In any event, the arbitrage opportunities essentially don't exist... [I]astly, both parties have signalled to the Commission that they will be seeking a price review, and the discount will be addressed then.¹⁴⁹

282. While there is a difference in the discount between 'Homeline' as a price-capped service, and 'Homeline Economy', '60 Plus' and 'Second Line Services' as non price-capped services, the Commission notes that either party has the opportunity to seek a pricing review if they consider that the initial pricing principle does not reflect the costs that Telecom would avoid by offering the service on a wholesale rather than retail basis, and any resulting arbitrage opportunities.

¹⁴⁸ *ibid*, para. 95

¹⁴⁹ Conference transcript, TelstraClear (Wells), 24 May 2004, p. 52

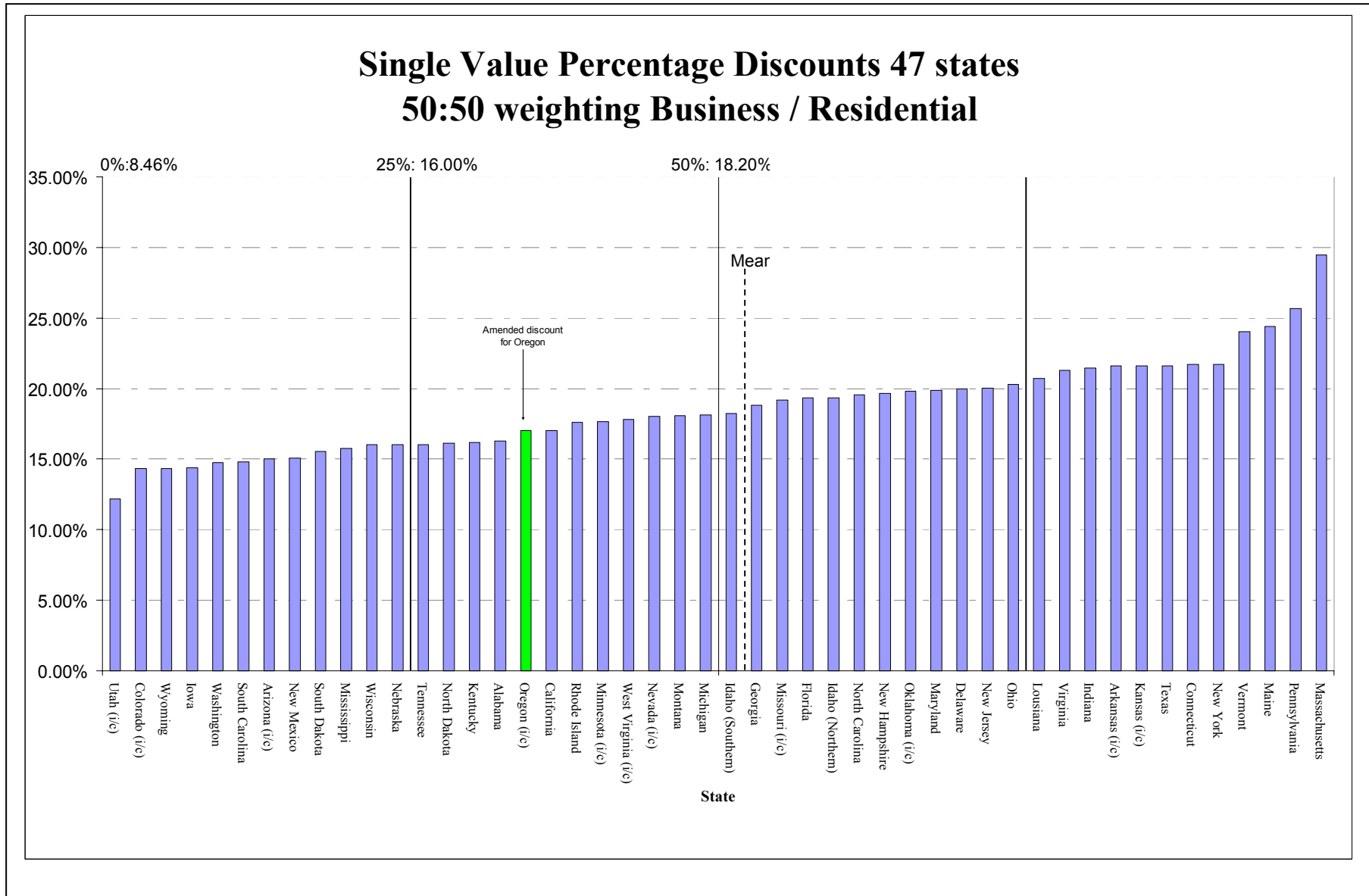


Figure 6: Single Value Percentage Discount

DATE OF INCEPTION AND EXPIRY OF THE DETERMINATION

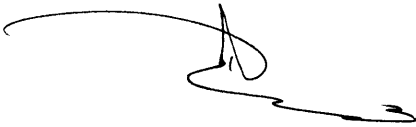
Date of Inception

283. The Commission considers that the date of Determination is the appropriate date of inception for this Determination. Therefore, the parties will be required to apply the terms of this Determination from 14 June 2004.

Date of Expiry

284. The term of this Determination is fixed as 18 months from the date of the Determination. This is consistent with both Decision 497 and reflects the agreement reached between the parties at the Residential Wholesale Conference.¹⁵⁰

DATED this 14th day of June 2004



Douglas Webb
Telecommunications Commissioner

¹⁵⁰ Telecom, *Telecom Conference Presentation: Introduction* (Bruce Parkes), 24 May 2004, page 8.