



TelstraClear Limited

**Comment on submissions on the Unbundled Bitstream Price Review Consultation
Discussion Paper**

11 September 2012

PUBLIC VERSION

Summary

1. Thank you for the opportunity to comment on submissions made by other parties on the Discussion Paper published by the Commission on 26 July 2012.
2. In this submission, we use the same abbreviations used in our primary submission dated 24 August 2012. This submission contains no confidential information.
3. We comment on the following aspects of submissions on the Discussion Paper:
 - a. Telecom's arguments regarding:
 - i. the interrelationship between review of the UBA STD and review of the UCLL STD; and
 - ii. the issue of how to account for the UBA competition test when setting the UBA service price.
 - b. Chorus' arguments regarding:
 - i. interpretation of section 18 TA01 and the extent to which its own interest in securing transition to fibre can properly be recognised within this section; and
 - ii. the use of additional/alternative comparability criteria.

Comment on submissions

The interrelationship between review of the UBA STD and review of the UCLL STD

4. Telecom argues that the Commission must recognise linkages between the UCLL, UCLF and UBA services, and set prices for each of these services accordingly. It also argues that any failure to do this "...cannot help but to skew investment incentives".¹
5. Telecom contends that:
 - a. the UCLF and UCLL services should be priced equally;
 - b. the UBA service should be priced at a level that:
 - i. enables UCLF customers to negotiate a commercial and non-discriminatory UBA service price in exchange service areas ("ESAs") where Chorus faces competition; and

¹ Paragraph 20, Telecom submission *UBA Price Review: Discussion Paper* (24 August 2012) ("Telecom UBA submission").

- ii. accurately reflects the average cost of providing the UBA service.²
6. In relation to the second point above, Telecom argues that if the UBA service price is based on national average costs of provision, it is likely to exceed the price that another operator could offer in those exchange service areas (“ESAs”) where Chorus faces competition, and Chorus may therefore be unable to price competitively in those ESAs while meeting its costs.³
 7. We consider that Chorus’ average cost of providing the UBA service should be assessed on a national basis. We do not believe it is appropriate to distinguish between costs incurred in competitive and non-competitive ESAs (for reasons given in paragraphs 12 *et seq.* below).

Accounting for the UBA competition test when setting the UBA service price

8. The UBA STD includes a “competition test” that makes the application of a regulated price for the UBA service subject to the following threshold:
 - a. Chorus faces limited, or is likely to face lessened, competition in a relevant market; or
 - b. Chorus does not face limited, or is not likely to face lessened, competition in a relevant market, and the Commission has decided to require Chorus’s unbundled bitstream access to be wholesaled in that market.
9. Telecom argues that only the costs incurred in uncompetitive ESAs should apply when determining the UBA cost uplift.⁴ If the UBA service price is set at a level that is lower than Chorus’ costs in non-competitive (e.g. rural) ESAs then, Telecom argues, Chorus may not “meet the market” in competitive ESAs (i.e. it will try to recover costs by pricing at a supra-competitive level).⁵
10. This is consistent with Telecom’s previous argument that deregulated areas have different characteristics to regulated areas and that linking prices between the two areas creates an effective cross-subsidy requirement in favour of access seekers, as well as reducing headroom for wholesale competitors to compete in the regulated areas.⁶

² Paragraph 19, Telecom UBA submission.

³ Paragraph 21, Telecom UBA submission.

⁴ Paragraph 26, Telecom UBA submission.

⁵ Paragraph 39, Telecom UBA submission.

⁶ Paragraph 7, Telecom submission *Response to Commission Consultation on the Revised Draft UBA Competition Review*, 6 July 2011.

11. Telecom acknowledges that there may be two interpretations of the competition test. For the following reasons, we consider that any interpretation that invites the Commission to take into account only the costs that Chorus incurs in uncompetitive ESAs when setting the UBA service price is flawed.
12. First, the competition test sets the conditions in which pricing principles in the UBA STD should apply to the UBA service. It says nothing about the means by which the regulated price for this service should be calculated. Rather, it says that in relevant markets Chorus' pricing of UBA services is constrained by the discipline of competition, and so it is inappropriate for a regulated price to apply. This principle is expressed as follows in Telecom's earlier submission: "[r]egulation that is put in place to stimulate competition should be wound back when competition is established in order to enable the market to deliver benefits to end-users."⁷ It does not follow from this principle that differential pricing in competitive vs. non-competitive areas is required. Indeed, setting of UBA service price based only on costs incurred in uncompetitive ESAs would be a significant extrapolation of this test.
13. Second, any approach to setting the UBA service price must be consistent with the UBA service IPP and, as argued in our primary submission, the Commission must be analytically consistent in its approach to applying the UCLL and UBA service IPPs (particularly as the UCLL service price is a component into the UBA service price). In this regard, we note that the Commission's 17 August 2012 paper emphasises that the regulated UCLL service, as described in Schedule 1 TA01, "applies to Chorus' full unbundled copper local loop network, including cabinetised and non-cabinetised lines."⁸ The UCLL STD Service Description states that the UCLL service excludes "access to, or interconnection with, Chorus' copper local loop network at any cabinet or at any distribution point apart from a Chorus Exchange MDF."⁹ This means that the regulated UCLL service price will not apply where Chorus faces competition in the form of cabinetisation (consistent with the principle discussed above). However, it does not alter the fact that this price is set with reference to the costs of Chorus' full UCLL network (and the Commission's UCLL STD review is proceeding on this basis). For consistency, the UBA service price should also be set with reference to Chorus' full costs of providing this

7 Paragraph 12, Telecom submission *Response to Commission Consultation on the Revised Draft UBA Competition Review*, 6 July 2011.

8 Paragraph 11, Commerce Commission *Revised view on whether there are reasonable grounds to commence a schedule 3 investigation into pricing principles for Chorus' UCLF service* (17 August 2012).

9 Paragraph 2.8, Standard Terms Determination for Chorus' Unbundled Copper Local Loop Network Service, Schedule 1, UCLL Service Description (7 November 2007 - updated to incorporate Commerce Commission decisions, amendments, and clarifications through 30 November 2011).

service on a national basis (i.e. costs in both competitive and non-competitive ESAs). The UBA service IPP would make no sense if the major UCLL service cost component were set on a full network basis and the UBA service uplift component set on a part network basis.

14. Third, we think that calculating a UBA service price that separately attributes costs between competitive and non-competitive areas is likely to be technically difficult, particularly as this service is currently priced on a national basis. In addition, any broader implications of transition to a UBA service price set on a sub-national basis would require very careful consideration (in light of the potential for unintended consequences).
15. Fourth, Telecom is concerned that setting a UBA service price with reference to national average costs could result in Chorus under-recovering its costs.¹⁰ In setting the UBA service price the Commission must ensure that Chorus can recover its efficiently incurred costs of providing the UBA service.¹¹ But this does not mean it is required to ensure that Chorus is effectively insulated from competition, including the requirement to make adjustments where competitive pressures dictate. In our view, what matters is whether Chorus can recover the efficient cost of providing the UBA service on a national basis. Where the UBA service price is based on nationally incurred costs Chorus may, in order to meet competition in some ESAs, need to reduce its own costs and increase efficiencies (we strongly doubt that it would instead, as Telecom suggests, decline to “meet the market” in competitive ESAs and maintain prices at supra-competitive levels). This spur to cost reduction and efficiency is consistent with the objectives of price cap regulation and FLCB pricing.¹² Section 30R provides the means for resetting a regulated price for the UBA service in the event that Chorus cannot recover efficiently incurred costs despite having taken reasonable steps to reduce costs/increase efficiency.
16. Finally, the accuracy of a UBA service price set with reference to costs incurred in uncompetitive ESAs only would be affected by the extent of growth in competition. As the number of competitive ESAs increases, any price set on this basis would need to be updated. A price set with reference to national costs is unlikely to be so susceptible to changes in network profile.

¹⁰ Paragraph 27, Telecom UBA submission.

¹¹ Subject to also ensuring that it does not recover costs that it is recovering in the price of any other designated or specified service (section 4B, Subpart 1, Schedule 1 TA01).

¹² Such regulation, by design, provides incentives for firms to reduce costs and increase efficiencies in order to maintain or increase profit. See, for example, Janice Hauge and David Sappington “Pricing in Network Industries” in Robert Baldwin, Martin Cave and Martin Lodge (eds) *The Oxford Handbook of Regulation* (Oxford University Press, 2010).

Interpretation of section 18 TA01

17. Chorus argues that the UBA service price is, in the context of its investment in a fibre based network, “...a balancing act in terms of creating the right incentives for the industry.”¹³
18. The Commission’s decision should not be characterised in this way. The Commission is making a decision on the new FLCB price for the UBA service that should apply 3 years from separation day. It intends to set this price by applying the relevant IPP for the UBA service (which Chorus agrees is a proxy for the price that would apply under the relevant FPP). In the context of this decision, it is entirely unclear to us how the Commission can consider Chorus’ pleas regarding “setting the right incentives for the industry to focus on fibre”¹⁴, “the success of the UFB initiative”¹⁵, “coherent regulatory policy”¹⁶ or “creating the right incentives for industry”.¹⁷
19. In our primary submission we argued that:
 - a. relevant factors inform how the Commission exercises its primary duty in section 18(1) TA01 but they cannot alter this duty;
 - b. the weight given to relevant factors must be consistent with the Commission’s primary duty;
 - c. relevant factors that the Commission is directed by statute to consider are not decisive and do not have any intrinsically greater weight than other factors;¹⁸
 - d. all relevant factors must be considered to ensure that a decision is consistent with the Commission’s primary duty; and
 - e. in principle, all relevant factors have equal weight.

13 Paragraph 4, Chorus Submission in response to the Commerce Commission’s Unbundled Bitstream Asset Price Review Consultation Discussion Paper (24 August 2012) (“Chorus UBA submission”).

14 Paragraph 4, Chorus UBA submission.

15 Paragraph 4, Chorus UBA submission.

16 Paragraph 5, Chorus UBA submission.

17 Paragraph 6, Chorus UBA submission.

18 In addition to these factors, referred to in our primary submission, we note that Government has issued a Statement to the Commerce Commission Concerning Incentives for Businesses to Invest in Ultra-fast Broadband Infrastructure (13 October 2011). Under section 19(A) TA01, the Commission is required to have regard to economic policies set out in this statement. In effect, the statement describes additional relevant factors that the Commission must consider (with complete discretion as to the weight of these factors). The statement does not alter or displace the Commission’s primary duty.

20. The weight given to any single factor must be reasonable in the context of a (relatively narrow) decision about the appropriate price of the UBA service set according to relevant IPP. This IPP contains no reference, for example, to “fibre”, “investment”, “innovation”, “efficiency”, “risk”, “incentives” or “policy”.
21. Chorus identifies “...UFB investment and the transition to the UFB network...”¹⁹ as the key issue in terms of the Commission’s section 18 TA01 analysis. We disagree. In terms of section 18(1) TA01, the key issue for the Commission is securing a decision on the price of the UBA service that promotes competition in telecommunications markets for the long term benefit of all end-users of telecommunications services generally. This may or may not encourage UFB investment or transition to UFB. But reaching a decision that enhances the position of UFB or removes “...risks to the transition to the UFB network.”²⁰, as we have argued previously, is not the Commission’s primary duty.
22. Similarly, Chorus states that “Parliament sent a clear signal that the promotion of competition is not to be pursued at the expense of Government’s UFB programme objective.”²¹ If Parliament had intended that the Commission’s primary duty in section 18(1) TA01 should be subservient to UFB programme objectives, this would be apparent on the face of the TA01 (i.e. the statutory purpose as expressed in section 18(1) TA01 would have been amended). Instead the reverse is true and any consideration of the position of new telecommunications services (including UFB) is subject to the Commission’s overall goal of securing competition in telecommunication markets for the long term benefit of end-users of telecommunications services.
23. Finally, we note Chorus’ statements that “...short term benefits of lower copper prices are outweighed by the longer term detriment to New Zealanders in not receiving superior fibre services...”²² and “[t]he long term benefits of end-users will be best promoted if the Commission takes an approach that does not create risks to the transition to the UFB network”.²³ Chorus does not now, nor has it at any time previously, offered any credible analysis to support these arguments and they cannot be given weight. In reality, these arguments and their previous iterations amount to articles of faith expounding nothing more than a fundamentalist belief in the supremacy of one technology over another. They have no place in

19 Paragraph 23, Chorus UBA submission.

20 Paragraph 27, Chorus UBA submission.

21 Paragraph 26, Chorus UBA submission.

22 Paragraph 28, Chorus UBA submission.

23 Paragraph 28, Chorus UBA submission.

the context of a decision regarding the correct price set according to the UBA service IPP, and should be disregarded.²⁴

Additional/alternative comparability criteria

24. Chorus suggests that a number of additional comparability criteria should be used by the Commission in its UBA service benchmarking exercise. It also makes suggestions on how comparability criteria should be applied. We have the following comments.
25. It is suggested that Peirce's criterion may be used to identify outliers.²⁵ As our consultants argued previously, Peirce's criterion should not be used for small samples.²⁶
26. Chorus advocates sector-specific PPPs.²⁷ We agree that PPP exchange rates should be used in benchmarking of this type. However, the sector PPP proposed by Chorus' consultants CEG should not be used as this proposed index is demonstrably inappropriate for telecommunications.²⁸
27. We agree that comparability criteria should be based on evidence. However, the elements listed in paragraph 53 of Chorus' submission should not be used as comparability criteria. We consider that using these criteria to assess comparability would be problematic and would further impede the Commission's ability to properly apply the UBA service IPP. As stated in our primary submission, the benchmark sample available to the Commission is likely to be insufficient to derive benchmark estimates for UBA prices. Applying the comparability criteria suggested by Chorus would likely further reduce this sample size and, therefore, the Commission's ability to undertake meaningful benchmarking. At most, the alternative criteria proposed by Chorus should be considered as candidates for parameters for normalisation.
28. Our specific comments on each of the alternative comparability criterion proposed is as follows:

24 Please see arguments in our primary submission and at paragraph 59-66, *TelstraClear Cross-Submission to the Commerce Commission on The Revised Draft Determination on the Benchmarking Review for the Unbundled Copper Local Loop Service* (15 June 2012).

25 Paragraph 43, Chorus UBA submission.

26 See section 3.2 and Annex A of *Network Strategies Final Report for TelstraClear* (No. 31022) UCLL Cross Submission (14 October 2011).

27 Paragraph 50, Chorus UBA submission.

28 See section 2 of *Network Strategies Final Report for TelstraClear* (No. 32016) UCLL re-benchmarking cross submission (15 June 2012).

- a. Accounting for scale: Chorus may offer a reasonable hypothesis, but we think scale would be best assessed based on total fixed broadband subscription rather than bitstream subscription.
- b. Uptake of UCLL and UFB services: This is a proxy measure of competition and may be difficult to use in practice. The mix of uptake of these services (plus uptake of the UBA service) may well undergo significant changes over time, particularly in response to RSPs' investment decisions. In addition, uptake of these services is not necessarily a cost driver for an efficient operator.
- c. Handoff points and distance: This factor would be material to costs but it may be difficult to obtain reliable information, particularly for distance.
- d. Degree of cabinetisation: Again, we consider it is likely to be difficult to obtain reliable information.
- e. Labour costs: These costs should be accounted for in the currency conversion (if PPPs are used), so it is not appropriate to include this as a standalone criterion.
- f. Population density and urbanisation: As we have previously argued, national figures are imperfect proxies for trenching costs.