



TelstraClear Limited

**Submission on Unbundled Bitstream Price Review Consultation Discussion
Paper**

24 August 2012

PUBLIC VERSION

Summary

1. Thank you for the opportunity to comment on the Unbundled Bitstream Price Review Consultation Discussion Paper ('the Discussion Paper') published by the Commerce Commission ('the Commission') on 26 July 2012.
2. In this submission we first provide some general comments on the issues raised in the Discussion Paper and second respond to specific questions asked in the Discussion Paper. All confidential information in this submission is highlighted within [square brackets].
3. TelstraClear Limited ('TCL') currently spends approximately \$[**Confidential**] per annum on products covered by the unbundled bitstream access ('UBA') service standard terms determination ('STD'). Therefore, the Commission's decision following UBA service STD review may have a significant impact on TCL's business.
4. Our main comments on the Commission's proposed approach to its review of the UBA service STD are as follows:
 - a. The Commission must closely adhere to the relevant statutory framework in conducting this review and, in particular, its primary duty under section 18(1) of the Telecommunications Act 2001 ('the TA01').
 - b. The Commission must consider all relevant factors in determining:
 - i. an appropriate price for the UBA designated access service;¹ and
 - ii. the means by which that price should be set.
 - c. If applying the initial pricing principle ('IPP') for the UBA service and benchmarking the costs of providing this service:
 - i. the Commission must adopt a pragmatic and sensible approach;
 - ii. its approach must be analytically consistent with that applied in its unbundled copper local loop ('UCLL') service STD review; and
 - iii. any services within the benchmark sample group must have genuinely similar technical and functional attributes to the UBA service.
 - d. It is unlikely that the UBA service IPP can be applied in a reasonable manner if, for example, the benchmark service group is too small to support a credible benchmarking exercise.

¹ The UBA service is described in subpart 1 part 2 of Schedule 1 TA01.

- e. It seems likely that any benchmarking exercise will face substantial challenges arising from sample group size, such that it may ultimately not be meaningful.
5. The absence of specific proposals from the Discussion Paper means that our comments are necessarily high level. We may wish to develop and expand on these comments once the Commission issues a draft determination explaining in more detail how it intends to set the price for the UBA service.

General comments on the Discussion Paper

Relevant statutory framework

6. The Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011 ('TA11') amends the TA01. Section 77 TA11 directs the Commission to make reasonable efforts to:
 - a. review the UBA STD under section 30R "*...for the purpose of making any changes that may be necessary in order to implement the initial and final pricing principles applicable after the expiry of 3 years from separation day*"; and
 - b. give public notice of the result of its review.
7. The result of the Commission's action pursuant to section 77 TA11 will be a decision under section 30R TA01 (and the Commission's powers when conducting this review derive from section 30R²).
8. As the Commission notes, the decision it is making is to determine a new forward looking cost based ('FLCB') price for the UBA service that will apply 3 years from separation day (i.e. from 1 December 2014).³ The Commission intends to set this price by applying the relevant IPP for the UBA service.⁴
9. An IPP is designed to be a cost effective and timely proxy for the price that would apply to a designated access service if the relevant FPP were applied.

² Section 76 TA11 limits the operation of section 30R TA01 in that provisions in section 30R TA01 "*...do not apply to Chorus's unbundled bitstream access service for the period starting on separation day and ending 3 years after separation day...except as provided in sections 73 and 77 [TA11].*"

³ Paragraph 13, Discussion Paper.

⁴ See Schedule 1 Part 2 Subpart 1 TA01 - Initial pricing principle applicable after the expiry of 3 years from separation day: *The price for the designated access service entitled Chorus's unbundled copper local loop network plus benchmarking additional costs incurred in providing the unbundled bitstream access service against prices in comparable countries that use a forward-looking cost-based pricing method.*

Accordingly, the price set under the UBA service IPP should reflect the price that would be set under the UBA service FPP.

10. A decision made pursuant to section 30R TA01 is subject to and must be applied in a manner consistent with section 18 TA01.⁵ The Commission's primary duty under section 18(1) TA01 is "*...to promote competition in telecommunications markets for the long term benefit of end-users of telecommunications services.*"

Relevant considerations

11. In reaching its decision under section 30R TA01, the Commission should proceed in two stages:
 - a. first, it should identify and assess all factors that are potentially relevant to its decision; and
 - b. second, it should consider how such relevant factors ought to be weighted in order to reach its conclusions.
12. Relevant factors inform how the Commission exercises its primary duty in section 18(1) TA01. But consideration of these factors cannot alter this duty. The Commission must weigh relevant factors in a manner that is consistent with its primary duty.
13. Certain relevant factors, which the Commission must consider, are identified in statute:
 - a. section 18(2) TA01: "*...the efficiencies that will result, or will be likely to result, from that act or omission must be considered*"; and
 - b. section 18(2)(A) TA01: "*...consideration must be given to the incentives to innovate that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services.*"
14. In addition, Schedule 1 TA01 requires the Commission to consider "*...relativity between [the UBA service] and Chorus's unbundled copper local loop network service...*"⁶

⁵ As such, observing the Commission's primary duty under section 18 should be the Commission's first consideration, not an "additional consideration".

⁶ Paragraph 23, Discussion Paper appears to suggest that consideration of relativity is largely irrelevant until UCLL and UBA prices are both geographically averaged. To the extent that this reading is correct, we agree with the Commission.

15. However, these factors are not decisive and do not have any intrinsically greater weight than other factors that are relevant to the Commission's decision. The Commission must consider all relevant factors when making its decision, not only those listed at paragraphs 13-14 above.
16. Moreover, the Commission has margin of appreciation as to the weight of any relevant factor. The weight given to any factor must be reasonable in the context of a decision regarding the new FLCB price for the UBA service.

The initial pricing principle for the UBA service

17. The Commission notes that the IPP for the UBA service does not expressly require it to compare the UBA service against similar services.⁷ However, it considers it is implicit that it must benchmark against services that are consistent with the UBA service description.⁸
18. The Commission must adopt a pragmatic and sensible approach to both interpreting the UBA service IPP and benchmarking the additional costs incurred in providing this service. To apply a benchmarking approach as envisaged in this IPP, the Commission must compare the UBA service with similar services. But in doing so it must take an approach that is reasonable and consistent with both the overall scheme of the TA01 and the Commission's previous decisions.
19. In particular, the Commission's approach across both the UCLL and UBA STD reviews must be analytically consistent. In its *Revised draft determination on the benchmarking review for the unbundled copper local loop service* (4 May 2012) ('the UCLL Draft Determination'), the Commission described its three stage approach when applying the UCLL service IPP as follows:
 - a. identify countries in which regulated access to the local loop unbundling is available;
 - b. eliminate those countries that do not use a FLCB pricing method; and

⁷ Paragraph 16, Discussion Paper.

⁸ See Schedule 1 Part 2 Subpart 1 TA01 – Description of service: *A digital subscriber line enabled service (and its associated functions, including the associated functions of operational support systems) that enables access to, and interconnection with, that part of a fixed PDN that connects the end-user's building (or, where relevant, the building's distribution frame) to a first data switch (or equivalent facility), other than a digital subscriber line access multiplexer (DSLAM)*
To avoid doubt, unless otherwise requested by the access seeker, the supply of this service must not be conditional on a requirement that the access seeker, end-users, or any other person must purchase any other service from the access provider.

- c. apply comparability criteria to eliminate countries that are likely to have UCLL costs that differ significantly from New Zealand.⁹
20. We submit that the Commission should apply this same approach *mutatis mutandis* in applying the UBA service IPP.¹⁰
21. When doing so, the Commission must benchmark against services that are truly equivalent (i.e. services with genuinely similar technical and functional attributes to the UBA service). In deciding what services fall within its benchmark service group, the Commission must control for relevant differences such that services within this group are truly equivalent to the Basic UBA and Enhanced UBA 40kbps, 90kbps and 180kbps services.
22. However, we doubt whether the Commission will be able to apply the UBA service IPP service in a manner that is consistent with underlying objectives of the TA01, in the sense that the UBA service IPP should be applied in a manner that generates a proxy for the price that would result if the UBA service FPP were applied.¹¹ This is because our initial assessment indicates that there are very few services with genuinely similar technical and functional attributes in comparable countries that use a FLCB pricing method for bitstream services.
23. The UBA service IPP requires the Commission to benchmark additional costs incurred in providing the UBA service against prices [*for similar services*] in comparable countries that use a FLCB pricing method.
24. One approach that could be taken by the Commission is to use the same benchmark sample used in the UCLL STD review, subject to the criterion that those jurisdictions set FLCB prices for UBA. This approach would therefore (indirectly) encapsulate the relativities of UCLL and UBA prices in those jurisdictions.
25. Our initial investigation of the UCLL benchmark sample indicates that no more than five of these countries use a FLCB pricing method – Cyprus, Denmark, Greece, Sweden and Switzerland (see Annex 1 below). In our opinion, this sample size is not sufficient to derive benchmark estimates for UBA prices, especially given the likelihood that a large number of adjustments will be required to the

9 See paragraph 94, UCLL Draft Determination.

10 See paragraphs 34 *et seq.* below.

11 See Schedule 1 Part 2 Subpart 1 TA01 - Final pricing principle applicable after the expiry of 3 years from separation day: *The price for Chorus's unbundled copper local loop network plus TSLRIC of additional costs incurred in providing the unbundled bitstream access service.*

benchmark data, which may increase the margin of error of the resultant estimates. Detailed checking of the service definitions may reduce this sample even further. We also note that benchmarking does not appear to be a common approach used for bitstream services. Unless the benchmark services group has a sufficient size, any benchmarking exercise will be meaningless and probably misleading.

26. Although the Commission may be tempted in these circumstances to enlarge the benchmark service group by making more generous adjustments to its “comparability” and/or “similarity” criteria, we suggest that doing so is likely to be fraught, contentious and potentially open to challenge. The UBA service IPP can only be used in a manner that is consistent with its design and the scheme of the TA01 if applied such that it does operate as a proxy for the cost based price that would pertain under the relevant FPP. This applies *a fortiori* in the present circumstances, given that the very purpose of the UBA STD review directed by section 77 TA11 is to enable transition from a price based on retail minus to one that is reflective of cost. Enlarging the benchmark service group via strained interpretation of the UBA service IPP is unlikely to yield any reasonable proxy and the UBA service IPP should not be applied in this way. Instead, the Commission should interpret and apply the UBA service IPP according to its plain meaning.
27. If the UBA service IPP cannot be applied in a reasonable manner the Commission must use alternative means for setting a FLCB price. In our view, the only alternative means of setting a price for the UBA service allowed by the TA01 is to apply the relevant FPP.
28. Section 30R(2) empowers the Commission to “*replace a standard terms determination or vary, add, or delete any of its terms, if it considers it necessary to do so after conducting a review*” (emphasis added). It is not clear that this extends to the Commission the ability to determine the price payable for the UBA service according to the UBA FPP if it considers this is necessary following its review.
29. On one reading, section 30R confers on the Commission a broad power to make any changes to the UBA STD that it considers necessary, including setting the UBA service price using the relevant FPP on its own initiative if the Commission considers this appropriate.
30. A more restrictive (and obvious) reading is that the Commission’s powers under section 30R must be understood with reference to its powers in relation to making the original STD that is subject to review (set out in sections 30M-30Q

TA01). The Commission's ability to apply the UBA service FPP is then contingent on it receiving an application under section 42 TA01 for review of an STD determination made pursuant to sections 27 or 30M TA01 and specifying the price for UBA service.¹²

31. According to this restrictive reading, the Commission is required to set the UBA service price by applying the UBA service IPP notwithstanding that this may generate a meaningless, probably misleading result and a price that is a poor proxy for the cost that would be set under the relevant FPP.
32. Although supported by a more obvious reading of the TA01, this seems a perverse outcome. The Commission would be required to undertake a substantial amount of work to produce an unsatisfactory result and to be powerless to remedy this result unless a party to a determination applies for review of the price set, and if no application is made the situation will persist. To the extent that it does persist, this seems very likely to be at odds with the primary purpose of the TA01 to promote competition in telecommunications markets for the long term benefit of end-users of telecommunications services. This is because if a UBA service price is paid that bears no resemblance to actual costs, this will tend to undermine competition and is likely to result in a wealth transfer from consumers to the beneficiary of that high price.¹³
33. In light of our comments above, we invite further clarification from the Commission regarding how it interprets the scope of its powers under section 30R TA01 and, in particular, the circumstances in which it considers the relevant FPP can be used to set the UBA service price.

UBA service costs

34. Service costs will be influenced by the definition of the bitstream service and thus, for benchmarking purposes, it will be important to understand the service definitions used by the benchmark sample in order to assess what adjustments (if any) may be required to obtain an estimate suitable for the New Zealand UBA service.

¹² Section 30P TA01 specifies the circumstances in which the Commission may set prices under the UBA service IPP and FPP following an STD review pursuant to section 30R TA01. Section 78 TA11 specifically provides for an application for a price review following a review pursuant to section 77 TA11 "*as if the review...were a determination made under section 30M...*"

¹³ This assumes i) that service providers cannot absorb any UBA price increase; and ii) the UBA price set is too high rather than too low (both of which are likely conditions). This outcome is relevant for the purposes of interpretation of the Commission's powers, in the sense that the object and purpose of a provision in its proper statutory context must be considered.

Our response to specific consultation questions

35. In the following paragraphs we answer specific questions asked in the Discussion Paper.

Question 1): Do you agree with the Commission's view regarding the absence of "similar services" from the benchmarking criteria for UBA?

36. Please see our comments at paragraphs 17-33 above. We agree that the Commission must take a pragmatic, sensible approach to interpreting the UBA service. We are concerned that it may not be possible to apply the benchmarking approach in the UBA service IPP in a reasonable manner. The Commission should not strain interpretation in order to apply the UBA service IPP where the facts indicate this cannot credibly be done.

Question 2): Given that both the UCLL price and the UBA price will be cost-based in future, are there any other considerations relevant to the relativity requirement?

37. Please see our comments at paragraphs 11-16 above. In general, we consider that allowing relativity to narrow such that it reduces incentives to purchase the UCLL service as opposed to the UBA service is not desirable.¹⁴ As the Commission indicates, any assessment of relativity must occur as between geographically averaged cost based prices for the UCLL service and the UBA service (for new and existing lines) as at 30 November 2014.

Question 3): What should the Commission consider in its section 18 analysis of the price review of the UBA service?

38. Please see our comments at paragraphs 11-16 above.

Question 4): Do you agree with the use of teledensity criteria for determining comparability?

39. In the UCLL Draft Determination, the Commission explained its use of comparability criteria in relation to the UCLL STD review.¹⁵ Once similar services had been identified for potential inclusion within the benchmark service group,

¹⁴ See paragraph 14, TelstraClear submission on Reviews of the Application of the Initial Pricing Principle of, and updated benchmarking for, the UCLL Standard Terms Determinations and consequential changes to the UBA Up-lift (2 October 2011).

¹⁵ See paragraph 129 *et seq.*, UCLL Draft Determination (4 May 2012).

country comparability criteria were applied to establish whether there was any significant difference between countries whose services were included within this group and New Zealand. Where significant differences existed, any service provided in those countries was excluded from the benchmark service group.

40. Comments made in our previous submissions regarding use of country comparability criteria in the context of the Commission's UCLL STD review apply equally to use of these criteria in the Commission's UBA STD review.
41. We have two general comments regarding use of comparability criteria:
 - a. first, the Commission's use of criteria must be consistent between the UCLL and UBA STD reviews; and
 - b. second, any common criterion must be consistently applied in both the UCLL and UBA STD reviews.

Use of criteria must be consistent

42. The Commission's approach to identifying comparable countries and similar services must be analytically consistent as applied in both the UBA service IPP and the UCLL service IPP. In theory, one would expect the comparability criteria to be consistent between UCLL and UBA. Therefore any departure from the comparability criteria used in benchmarking the UCLL service must be properly justified.
43. In the UCLL Draft Determination the Commission endorsed urbanisation and teledensity as country comparability criteria, noting that "*...the following criteria have been used to identify countries where UCLL costs are likely to be similar to New Zealand: i) urbanisation of greater than 60%; and ii) teledensity between 20% and 60%.*"¹⁶
44. The Commission states that it "*...has identified teledensity as the most likely criterion for comparability. The Commission's view is that teledensity is indicative of overall adoption of telecommunications services, including broadband.*"¹⁷ We note that the Commission makes no reference to urbanisation.
45. The applicability of teledensity for the Commission's stated purpose is becoming more problematic with the decline in fixed line penetration in many markets (due to fixed-mobile substitution). For example, teledensity in Finland (which is not in

¹⁶ Paragraph 178, UCLL Draft Determination.

¹⁷ Paragraph 31, Discussion Paper.

the UCLL benchmark sample) has declined from 40 to 20 services per 100 inhabitants over the period 2005 to 2011, according to ITU data. However the OECD rates Finland as having the third highest take-up of wireless broadband services, and thus teledensity would not capture this characteristic of the Finnish telecommunications market.

46. Teledensity would be better described as indicative of overall adoption of fixed telecommunications services. However, we do not believe that naked DSL services (i.e. broadband services without telephony) would be counted within the teledensity measure. Thus it is possible that for countries where take-up of naked DSL services is significant, teledensity may be misleading as an indication of adoption of telecommunications services.

Any common criterion must be consistently applied

47. We also consider that any common comparability criteria used must be applied in same way in both the UCLL and UBA services STD reviews. For example, suppose the Commission i) does apply teledensity as a comparability criterion in the UBA service STD review (for which the UCLL service price is a major cost component); and ii) has already identified a particular country (Country A) as falling within its basket of comparable countries for the purposes of the UCLL STD service review.
48. When benchmarking for the purpose of determining the UBA service uplift, the Commission could in principle apply the teledensity criterion afresh. But an assessment of whether Country A has cost drivers that differ significantly from New Zealand is “built in” to its assessment for this purpose (because it has been considered in the context of UCLL service STD review). Accordingly, we doubt that the Commission could justify excluding Country A as not comparable in its UBA STD review.

Question 5): Are there any other comparability criteria that could and/or should be used?

49. Please see our comments in reply to Question 4 above.

Question 6): If comparable countries that meet the comparability criteria are limited, what other information should the Commission gather in order to establish a price for the UBA services?

50. Please see our comments at paragraphs 17-33 above. The answer to this question really depends on the size of the benchmark service group that remains

once the Commission has applied the comparability criteria and whether this group is sufficiently large to support a meaningful benchmarking exercise. If it is not, then the benchmarking exercise is likely to generate misleading results and be a poor proxy for the price that would apply if using the UBA service FPP.

51. As noted at paragraph 22 *et seq.* above and in Annex 1, it appears that very few similar services in comparable countries use a FLCB pricing method. It is, therefore, unlikely that the Commission will have a sufficiently large group to support a meaningful benchmarking exercise.
52. The Commission must interpret and apply the UBA service IPP according to its plain meaning. It should not seek to strain interpretation of this IPP in order to try to resolve difficulties that arise from the facts on which the Commission bases any benchmarking exercise. The options open to the Commission in these circumstances will depend critically on how it interprets its powers under the TA01 (see paragraphs 27-33 above).

Question 7): What key cost drivers do you think need to be taken into consideration when benchmarking the UBA service variants?

53. The Commission notes that “...a major differentiator between [the UBA service] and wholesale bitstream access services in other countries is likely to be the location of the handover point...these services would still be sufficiently similar for benchmarking purposes, but may need to take into consideration the differences in cost arising from the backhaul to handover point”.¹⁸ We agree that variations in service definition are likely to result in differences in the underlying cost. However it is not always easy to confirm precise service definitions (particularly those expressed in other languages).
54. The Commission also notes that additional costs of the (copper) UBA service are “largely comparable with fibre-based services with similar speed and contention”.¹⁹ In submissions on the UCLL STD review we have previously noted that the Swedish regulator stated that the prices of copper and fibre are similar overall, and this appears reasonable (subject to the Commission being alert to differences in service definition etc.).
55. Three main sources of cost difference between the UBA service and benchmarked services are identified in the Discussion Paper: i) differences in service or performance characteristics, e.g. line speed; ii) differences in service components;

18 Paragraph 36, Discussion Paper.

19 Paragraph 38, Discussion Paper.

and iii) differences in handover location.²⁰ We note that the Danish regulator has stated that there is no underlying cost differences in its LRAIC model due to line speed (for a given technology). Similarly the Swedish regulator's cost model also had no cost differences due to line speed. In both instances regulated prices by line speed were obtained by allocating costs via an assumed distribution curve. However, there may be cost differences due to other performance characteristics. Whether or not there are cost differences in the New Zealand situation depends on whether underlying cost elements for the service differs by line speed and/or performance. Differences in service components and handover location are likely to result in cost difference.

56. Lastly, we note that the Commission says it will accommodate cost differences by making adjustments as described in paragraphs 45.1-45.3 of the Discussion Paper. The description of the nature of these adjustments is incredibly broad and appears to give the Commission flexibility to make virtually any change. We are concerned that the number of adjustments may become excessive. If the benchmarking approach is to be used then, based on our initial view of the potential benchmark sample size, we envisage that a large number of adjustments to the data may be required. As noted above, an excessive number of adjustments – particularly when the dataset is very small – may introduce a large margin of error in the calculation. Moreover, excessive adjustments may mean that the exercise undertaken by the Commission cannot reasonably be described as “benchmarking” as contemplated by the UBA IPP.

Question 8): Do you consider there is any other appropriate approach for determining the price of the UBA variants?

57. See our response to Question 7 above.

Question 9): Do you agree that the Commission's proposal for adopting the UCLL STD core charges for the comparable UBA core charges is appropriate for the purpose of the UBA price review?

58. This depends on the nature of the charges and how they are incurred. We would prefer to comment once we have greater clarity as to the Commission's intended approach.

²⁰ Paragraph 43, Discussion Paper.

Annex 1

1. In its UCLL Draft Determination, the Commission identified 11 countries that had FLCB prices for UCLL, of which two (Romania and Slovenia) failed to satisfy the Commission's comparability criteria and one (Belgium) was rejected due to its high population density and urbanisation (although these factors met the Commission's comparability criteria).
2. The remaining eight countries within the Commission's UCLL benchmark sample were: Cyprus, Czech Republic, Denmark, Germany, Greece, Italy, Sweden and Switzerland.
3. Only a subset of the UCLL benchmark sample use FLCB price controls for bitstream services. Applying this selection criterion in the UBA STD review would see the UCLL benchmark sample reduced to only five countries: Cyprus, Denmark, Greece, Sweden and Switzerland.

<i>Country</i>	<i>Price control methodology</i>
Belgium	LRIC – same as LLU – plus a margin squeeze test
Cyprus	LRIC plus a margin squeeze model
Czech Republic	no price control
Denmark	LRAIC
Germany	<i>ex-post</i> price control
Greece	LRAIC
Italy	cost-oriented
Romania	no price control
Slovenia	Retail-minus
Sweden	LRIC
Switzerland	LRIC