



## COMMERCE COMMISSION

### **Final Decision of the Commerce Commission on the request for a Review/ Clarification of the application of the UBA STD to VDSL technology**

#### **Executive Summary**

1. This document records the Commission's decision on the application of the unbundled bitstream access standard terms determination (**UBA STD**) to VDSL technology<sup>1</sup>.
2. The Commission's decision is that when the UBA service is delivered using VDSL technology, the price and non-price terms of the UBA STD (**Decision 611**) will apply. However, Telecom has the ability to develop new bitstream services using VDSL (incorporating features not included in the regulated UBA Service Description), and offer these services on a commercial basis.
3. The Commission's view is that clarifications to clause 10 of the UBA General Terms and clause 4 and 4B of the UBA Price List are likely to best give effect to section 18. Attached to this decision is a draft clarification of the UBA STD which includes the proposed changes.
4. The clarification to clause 10 of the General Terms of the UBA STD is designed to ensure that the Commission receives sufficient information to decide whether to commence a review under section 30R of the Telecommunications Act 2001 (the **Act**) in respect of a new variant of the UBA Service. A section 30R review would enable the Commission to amend the terms of the UBA STD to incorporate a new bitstream service within the existing regulation, should the Commission consider that there are grounds to do so.
5. In respect of Telecom's proposed commercial VDSL2 service, Telecom has advised the Commission it will provide this service on the same equivalence standard as the regulated Basic UBA (**BUBA**) and Enhanced UBA (**EUBA**) services. Therefore, access seekers will have access to a VDSL2-based bitstream service on the same terms and conditions (including price) as Telecom's retail units. Provided this is the case, the Commission would be unlikely to instigate a section 30R Review in respect of this service, but would instead observe its performance in the market, and consider a review only if competition issues arose which necessitated such action.
6. The clarification of clause 4 of the UBA Price List ensures that retail broadband plans which are provided using Telecom's commercial VDSL2 service as the wholesale input are excluded from the retail-minus calculation of the regulated price for the Basic UBA Service.

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<sup>1</sup> In this decision, "VDSL" refers to refers to VDSL technology in general, including VDSL and VDSL2.

7. The Commission considers that the dynamic efficiency benefits associated with investment in new technologies are significant. VDSL2 is an emerging technology which is capable of delivering significant benefits to end-users such as increased speeds and facilitating the development of innovative new services. In reaching this decision, the Commission has been mindful of ensuring that incentives for investment in new DSL technologies are maintained.

## **Background**

### *Draft decision*

8. On 17 February 2010, the Commission released its draft decision on the application of the UBA STD to VDSL and VDSL based services. The Commission sought submissions from interested parties on this draft decision.
9. In summary, the Commission's Draft Decision was that:
  - when the regulated bitstream services, BUBA and EUBA, are delivered using VDSL technology, the price and non-price terms of the UBA STD will apply;
  - Telecom is not required to use VDSL to deliver BUBA and EUBA, except where it is the only DSL technology available at an exchange or cabinet;
  - Telecom may develop new bitstream services using VDSL technology incorporating features not included in the Decision 611 service description, and offer these services commercially;
  - Decision 611 requires Telecom to give prior notice of a new commercial bitstream service to the Commission to allow it time to consider whether it should instigate a review under section 30R of the Telecommunications Act 2001 (the Act) to extend the Decision 611 service description to include the new variant;
  - the deployment of VDSL technology is in its infancy in New Zealand, and there appears, at this stage, to be no evidence of market failure;
  - the Commission's preferred approach is to observe the performance of commercial VDSL services in the market, and to instigate a section 30R review only if competition concerns necessitated such action; and
  - a clarification of two aspects of Decision 611 (relating to the notice requirements when Telecom wishes to introduce a new bitstream variant, and a process to exclude retail broadband plans based on commercial wholesale variants of higher quality bitstream services from the pool of internet grade plans used to calculate the regulated BUBA and EUBA prices) is appropriate.
10. In reaching its draft view, the Commission noted that dynamic efficiency benefits associated with investment in new technologies are significant, and that it is important that incentives for efficient investment are preserved, so that these benefits are realised by end-users.

### *Submissions*

11. Submissions on the draft decision were received from Telecom Wholesale, Vodafone New Zealand Limited and Kordia.
12. The submissions from Telecom Wholesale and Vodafone generally supported the Commission's draft decision, including the proposal to undertake clarifications of clause 10 of the UBA General Terms and clause 4 of the UBA Price List.
13. In its 27 November 2009 submission, Telecom also stated that the provision of a commercial variant (but subject to compliance with clause 10 of the General Terms of the UBA STD) is consistent with the statement in the Commission's draft guidelines on regulatory decision making for the telecommunications sector<sup>2</sup> that:

The objective of regulation is to produce outcomes that are consistent with a workably competitive market. This can be achieved either through direct regulatory interventions such as where the Commission sets the terms of access, **or through incentivising parties to reach the kind of commercial agreements which would be expected of a competitive market, avoiding the cost of the regulatory process and accelerating the delivery of benefits to end-users** [emphasis added by Telecom]

14. Telecom's submission included some matters that it requested the Commission consider in drafting the clarification of clause 10 of the General Terms. Specifically, Telecom stated that two things need to be ensured:
  - first, that necessary information is submitted by Telecom Wholesale to the Commission well in advance of launch; and
  - second, the Commission responds in a timely fashion.<sup>3</sup>
15. The Kordia submission argued that if Telecom has VDSL coverage it must supply VDSL-enabled BUBA and EUBA.<sup>4</sup> Kordia also argued that allowing Telecom Wholesale to provide commercial services will enable Telecom Wholesale to bypass the regulated services of BUBA and EUBA, effectively providing it with a regulatory holiday for VDSL.<sup>5</sup> It stated that:<sup>6</sup>

Further analysis is needed before it can be concluded that dynamic efficiencies indicate that VDSL-based wholesale service should not be regulated in the early stages. Telecom gets a regulatory holiday of at least a year and probably more like two to three years. This is in relation to a critical service based on the jump-shift increase in DSL speeds over VDSL. This is happening at this significant time during NGN evolution. Regulatory holidays are blunt instruments – rejected internationally when other options are available that can be more targeted to the circumstances.

16. Kordia stated that this could erode the underlying policy objectives of Operational Separation because Telecom Wholesale is not obliged to offer services to wholesale customers unless they are subject to a determination.<sup>7</sup>

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<sup>2</sup> Commerce Commission, *A guide to regulatory decision making by the Commerce Commission for the telecommunications sector*, 31 July 2009

<sup>3</sup> Telecom Wholesale, *Application of the UBA STD to VDSL2 and VDSL2 Services*, 3 March 2010, p 2.

<sup>4</sup> Kordia, *Submission on application of UBA STD to VDSL services*, 4 March 2010, p 3, paragraph 2.7.

<sup>5</sup> *ibid*, p 4, paragraph 2.10.

<sup>6</sup> Kordia, *Submission on application of UBA STD to VDSL services*, 4 March 2010, p 2, paragraph 1.3.

<sup>7</sup> *ibid*, p 11, paragraph 5.2(d).

17. In relation to dynamic efficiency considerations, Kordia argued that:<sup>8</sup>

Broad-brush reference to dynamic efficiencies and emerging technologies and services (as in the draft decision) are useful opening points for the analysis. We submit that substantially more analysis is required to decide whether a service should be regulated. That is particularly the case where the services can have such a major impact as here.

Dynamic efficiency and incentives to invest will have a greater or lesser significance, depending on context and the facts. Context is particularly significant.

18. Some of the specific “context and facts” referred to in Kordia’s submission included that:<sup>9</sup>

- the incremental cost of dual ADSL2+/VDSL line cards, compared to ADSL2+ cards, is likely to be close to nil. The incremental cost of provisioning VDSL is also minimal, compared to the major investment (the cabinets, backhaul etc – which were agreed to as part of the Operational Separation Undertakings). This combines to make the investment issue in relation to VDSL itself minor;
- before deciding whether to instigate a Section 30R review, a more comprehensive analysis is needed, informed by the specifics of the commercial offer (including the proposed price). These issues should not be pre-empted even on an indicative basis; and
- TelstraClear’s modest business grade VDSL roll-out is scant evidence of competition evolving in this area.

19. In addition, Kordia argued that when considering whether to instigate a Section 30R review of a commercial service, the Commission should closely consider the ability of SLU-based services to provide sufficient competition. In particular, Kordia submitted that:<sup>10</sup>

The problem faced by wholesalers of providing services via MSANs in cabinets (with high cost relative to a low addressable market at each cabinet) is well known, including the backhaul cost to the exchange. In most cabinets, SLU is unlikely. There may be relatively rare cherry picking for SLU such as in certain urban suburbs. Even then, anything beyond duopoly conditions is unlikely.

## Commission view

### *The UBA STD and new UBA services*

20. The Commission had stated in the Draft UBA STD that its preliminary view was that Telecom should not be able to offer a new DSL-enabled service to its end-users or customers unless the equivalent wholesale service was also available to Access Seekers under the UBA terms.

21. In submissions on the Draft UBA STD, parties argued that:

<sup>8</sup> Kordia, *Submission on application of UBA STD to VDSL services*, 4 March 2010, p 7, paragraphs 4.6 and 4.7.

<sup>9</sup> *ibid*, p 8-9.

<sup>10</sup> *ibid*, p 6, paragraph 4.9(b).

- new wholesale services should be able to be offered commercially between Telecom and Access Seekers at any time without the need for amendment of the UBA terms;
- the market demand for new UBA services is likely to be dynamic as new applications and technologies develop;
- access seekers should be consulted before any new UBA services are made available under the UBA terms; and
- the section 30R process is too slow.<sup>11</sup>

22. Accordingly, in the final UBA STD the Commission stated that it:<sup>12</sup>

...agrees that Telecom should be able to offer new UBA services to its customers or to Access Seekers on a commercial basis but considers that Telecom must give prior notice of the new UBA services. Following the notice, the Commission may amend the UBA Terms to include the new UBA service.

23. In other words, the Commission was persuaded by submissions that Telecom should be able to offer new UBA services on a commercial basis, but a prior notification process should be instituted to enable the Commission, on a case-by-case basis, to assess whether a proposed commercial service was different from the regulated services, and if so, whether there were grounds to include the new services as a regulated service through the S30R process.
24. The requirement to give notice to a new variant is contained in Clause 10 of the UBA General Terms. The process set out in clause 10 of the General Terms was designed to deal with the current issue; namely, whether new bitstream services offered by Telecom should be captured within the regulated UBA terms.

#### *Requirements under Operational Separation*

25. Regulated bitstream is a relevant wholesale service under the Operational Separation Undertakings. Telecom is required to provide those services covered by the UBA STD on an equivalence of inputs (EOI) basis to all access seekers including its retail business arm once the migration milestones in the BUBA and EUBA Migration Plan are satisfied.
26. Telecom Wholesale is not required to provide Access Seekers with wholesale bitstream services that do not fall within the service descriptions in the UBA STD, but if it chooses to do so, it is required to provide them on a non-discriminatory basis under the Operational Separation Undertakings. Telecom is also required to build such commercial wholesale services in a way that, if the service becomes regulated, it will be able to provide access on an EOI basis without Telecom having to reconfigure the service.
27. Kordia is correct that under the Operational Separation Undertakings, firstly Telecom is not obliged to offer a wholesale VDSL bitstream commercial service, and secondly, even if it does, compliance with the Operational Separation Undertakings only requires

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<sup>11</sup> Commerce Commission, *Decision No. 611: Standard Terms Determination for the designated service Telecom's unbundled bitstream access*, 12 December 2007, p 67, paragraph 339.

<sup>12</sup> *ibid*, paragraph 340.

Telecom Wholesale to supply such a service on a non-discriminatory (but not EOI<sup>13</sup>) basis.

*Telecom's proposed VDSL service*

28. The Commission notes that in its submission dated 27 November 2009, Telecom stated that it intended to offer VDSL based commercial UBA services to its wholesale customers.<sup>14</sup>

29. Telecom has since assured the Commission that it will provide its wholesale VDSL2 service to Access Seekers on an equivalent and a non-discriminatory basis. In a letter dated 1 April 2010, Telecom stated that:<sup>15</sup>

...our VDSL2 service will be provisioned and assured on the most equivalent building blocks we currently have available. Retail, Gen-i and external customers purchasing VDSL2 will receive the same equivalence standard, from a technical/operational perspective, as they do for BUBA and EUBA currently.

30. If this is the case, the Commission is satisfied that Access Seekers will have access to a VDSL2-based bitstream service on the same terms and conditions (including price) as Telecom's retail units and to the same standard as the regulated services.

*Dynamic efficiency*

31. The Commission considers that the dynamic efficiency<sup>16</sup> benefits associated with investment in new technologies are significant. As the Commission noted in its discussion paper regarding regulatory decision making in the telecommunications sector (emphasis added):<sup>17</sup>

The Commission previously indicated that where a tension exists between short-term allocative efficiency and long-term dynamic efficiency, the Commission will give greater weight to the promotion of the latter. The Commission considers that this approach remains appropriate. **Ongoing innovation and efficient investment over time can deliver significant long-term benefits to end-users, and the adverse consequences of deterring or delaying such investment may be substantial.**

32. As outlined in the draft decision, the Commission considers that dynamic efficiency considerations are particularly relevant in the present case. VDSL2 is an emerging technology which is capable of delivering significant benefits to end-users such as increased speeds and facilitation of the development of innovative new services<sup>18</sup>. Therefore, it is important that both access providers and access seekers are faced with appropriate investment incentives when considering deployment of VDSL-based services.

<sup>13</sup> See clause 50 of Telecom's Operational Separation Undertakings.

<sup>14</sup> Telecom, *VDSL2 and other future DSL based technologies*, 27 November 2009.

<sup>15</sup> Telecom, *Wholesale's VDSL2 Service – Undertakings Requirements*, 1 April 2010, p 2.

<sup>16</sup> Dynamic efficiency refers to the efficient deployment of resources between present and future uses such that the welfare of society is maximised over time. Dynamic efficiency incorporates efficiencies flowing from innovation leading to the development of new services or improvements in production techniques, and is based on the presence of appropriate incentives for investment.

<sup>17</sup> Commerce Commission, *A guide to regulatory decision making by the Commerce Commission for the telecommunications sector: Discussion paper*, 31 July 2009, p 27-28, para 135.

<sup>18</sup> According to Telecom, the additional capability of VDSL enables the delivery of premium end-user services such as voice and data, multiple video streams, high definition television, interactive gaming and new-wave services such as tele-presence, tele-medicine and online learning.

33. The Commission notes the submission from Kordia arguing that further analysis is required before it can be concluded that dynamic efficiency considerations indicate that VDSL-based wholesale services should not be regulated in the early stages. However, the Commission notes that:
- VDSL2 deployment is in its infancy in New Zealand, with Telecom yet to launch VDSL2-based services;
  - TelstraClear is already offering retail VDSL2 services in the market; and
  - Telecom has committed to providing wholesale VDSL2-based bitstream service on a commercial basis.
34. Therefore, at this stage there appears to be no evidence of market failure in relation to the supply of VDSL2 services.
35. Given that Telecom has committed to provide a wholesale VDSL2 service on a commercial basis, and there is potential for competition to develop in the provision of VDSL2-based retail services, the Commission's view is that a section 30R review is not appropriate at the present time.
36. For these reasons, provided that the proposed commercial VDSL2 service (with higher quality attributes than BUBA and EUBA) is made available on the basis set out in Telecom's letter of 1 April 2010, and includes appropriate price and non-price terms and conditions, the Commission would be unlikely to instigate a section 30R Review in respect of this service. It would instead observe relevant markets, and consider a review only if competition issues arose which necessitated such action.
37. The Commission is satisfied that if Telecom provides the service in accordance with its letter of 1 April 2010 (to supply VDSL2 using the same equivalence standard for internal and external customers) and the Operational Separation Undertakings, the concerns Kordia has raised regarding the issue of regulatory holiday will be addressed.
38. The Commission proposes to closely monitor the VDSL bitstream market. Should competitive market outcomes not arise it would consider instigating a section 30R Review.

### **Final Decision**

39. Telecom's unbundled bitstream access service is described in Part 2 of Schedule 1 of the Act as "a digital subscriber line enabled service". No specific DSL technology is specified in the description of service contained in the Act.
40. Decision 611 sets out the price and non-price terms for the services defined in the decision. It requires Telecom to deliver those services (BUBA and three variants of EUBA) where Telecom has ADSL or ADSL2+, or any future version of DSL coverage. This requirement is, and was intended to be, neutral in terms of the form of DSL service provided.
41. The intent of the STD is clear. Telecom must provide access to BUBA and EUBA in accordance with the terms of the STD. The DSL technology which Telecom elects to use to deliver BUBA and EUBA is a decision for Telecom alone. There is no

compulsion on Telecom to use VDSL to deliver the regulated BUBA and EUBA services, except where they have chosen to make it the only DSL technology available in an exchange or cabinet to deliver the regulated service.

*Application of Decision 611 to DSL enabled services other than BUBA and EUBA*

42. This does not mean, however, that Telecom cannot develop other services using VDSL technology and offer these services commercially. Decision 611 relates only to the services described in that decision, and the applicability of that decision will turn on the nature of the service being delivered, not the technology used to deliver it.
43. The Commission now intends to instigate a clarification to deal with the issues in Clause 10 of the UBA General Terms and Clause 4 of the UBA Price List. A draft clarification addressing these issues is attached to this document.

Dated at Wellington this 16<sup>th</sup> day of April 2010

Dr Ross Patterson  
Telecommunication Commissioner  
Commerce Commission