VODAFONE NEW ZEALAND LIMITED

SUBMISSION TO THE

NEW ZEALAND COMMERCE COMMISSION

vodafone

Changing the unbundled bitstream access (UBA) service from retail-minus pricing to international benchmarking from jurisdictions using forward-looking cost-based pricing

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Introduction

1. The changes to the *Telecommunications Act 2001* (the **Act**) resulting from the *Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011* (**Amendment Act**) include an obligation under section 77(1) of the Amendment Act to review the standard terms determination (**STD**) for Chorus' unbundled bitstream access (**UBA**) service. Section 77(1) requires the Commission to determine a cost-based price for the UBA service, which is presently available on historical retail-minus terms constructed on the integrated Telecom's retail broadband pricing.

2. This review is very important to the future of competition for fixed broadband services. The UBA service and previous UBS variants have been the chief services on which fixed broadband competition has emerged in New Zealand. This is due to the late introduction of the regulated unbundled copper local loop service (**UCLL**) into the market.

3. While UCLL growth has been significant since its introduction in 2007, the number of digital subscriber line (**DSL**) broadband customers provided with UCLL is still much less than DSL broadband customers provided with UBA. At the same time as UCLL became available, Chorus undertook its Fibre-to-the-Node (**FTTN**) project that further increased reliance on UBA to serve cabinetised lines. This is in contrast to other jurisdictions where UCLL was available much earlier and, in many instances, UCLL availability preceded the regulation of UBA.

4. The Ultra-Fast Broadband Initiative (**UFB**) will see fibre-to-the-home become available to 75% of New Zealanders in the next decade. However, for many, fibre will not be available for several years, meaning that UBA and UCLL are central to effective fixed broadband competition.

5. Given the significant dependence on UBA for supplying fixed broadband services, the consequences of this review will have a significant bearing on the long-term benefit of New Zealand fixed broadband users even though the decision will not take effect before 30 November 2014.

Telecom NZ and Chorus de-merger

6. Changing the formulation of UBA pricing is premised on the fact that Chorus, the UBA access provider, is prohibited from operating a retail telecommunications business under the Act. Therefore, retail-minus pricing is no longer appropriate.

7. New Zealand has undertaken significant telecommunications reform by structurally separating its former incumbent integrated telecommunications operator, Telecom New Zealand. Chorus, which inherited Telecom New Zealand's ubiquitous fixed-line copper customer access network asset, is prohibited from participating in down-stream retail markets.

Timing

8. As a result of the changes to the Act, the Commission is required to implement a cost-based price for the UBA service under section 77(1) of the Amendment Act, making reasonable efforts to determine this price by 30 November 2012.

9. Section 77(2) of the Amendment Act prohibits the cost-based price for the UBA service from taking effect before 30 November 2014. This is two years after the Commission has discharged its duty under section 77(1).

10. The delay in implementing the cost-based UBA price was most likely a transitory measure to allow Chorus to adjust to the more competitive terms resulting from cost-based pricing. This also aligns with the statutory requirement that an averaged cost-based UCLL price apply three years post separation.

11. In determining the cost-based price for the UBA service, Vodafone suggests the Commission undertakes an approach that enables it to comprise a reasonable benchmark from which to set the cost-based price for the service.

Clause 4B "double recovery"

12. Clause 4B of Schedule 1 of the Act is designed to prevent an access provider of a designated service from recovering costs that the access provider is already recovering in the price of a designated or specified service provided under a determination or on commercial terms.

13. In this instance, the Commission is limited to benchmarking services above the local access network, which is Chorus' UCLL network. The inclusion of benchmarks incorporating the costs of the local access network within their tariff would mean that the access service price would fall foul of clause 4B. The Commission should be careful to exclude copper loop costs in its benchmarks.

Schedule 3: Clause 4A geographic averaging and clause 4B double recovery

14. Clause 4A of Schedule 1 of the Act requires the Commission, in applying the initial pricing principle (**IPP**) or final pricing principle (**FPP**), to determine a geographically averaged price for the designated UBA access service and designated UCLL service.

15. Currently, the application of this clause has only indirectly impacted the UBA service. This is because line rental costs have always been recovered from the resale POTS service when UBA is provided in a bundle.

16. The only impact from the application of clause 4A to date has been the application of the clause to the UCLL STD "uplift" for naked UBA. Since the Commission's decision of 24 November 2011, the "uplift" has increased urban naked UBA prices by 23%.

17. Clause 4A presumes a single price for each of the designated UCLL and UBA services. This will continue the obligation on Chorus to provide a single averaged price for the UBA service across both cabinetised and non-cabinetised UBA areas.

Retail-minus versus cost-based access pricing

18. The combination of retail-minus pricing for bitstream ADSL and ADSL2+ services and cost-based local loop unbundling (**LLU**) is a common method internationally to preserve the "relativity" between bitstream and access seeker investment in unbundling.

19. Retail-minus UBA pricing ensured that UBA access prices were higher than cost but probably not beyond the monopoly level as integrated incumbents would generally not see any take up at all of retail broadband services if the prices for their retail broadband services were significantly above the monopoly level. Therefore, the combination of retail-minus pricing for UBA and cost-based UCLL pricing has ensured natural "relativity" between the two services and encouraged build incentives for access seekers to invest in unbundling.

20. In general, cost-based access pricing is more efficient than retail-minus access terms. Retail-minus pricing, particularly in the context of an integrated access provider, avoids any real examination of the costs for the regulated access service.

21. The retail-minus formulation has allowed some form of monopoly rent margin to benefit the access provider which would have otherwise been subject to competitive pressure if the UBA service was determined on a cost-plus basis.

22. Vodafone anticipates that the shift to cost-based pricing for the UBA service should result in a reduction in the price for the service from its current retail-minus pricing. Indeed the cost-based price should reveal the extent to which the current prices imbedded a monopoly rent for the integrated Telecom.

New forward-looking cost-based initial pricing principle

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

23. Benchmarking the UBA service will potentially be more difficult than other benchmarking exercises the Commission is required to undertake.

24. We agree with the Commission that it must benchmark against services that are similar to the UBA service description despite the omission of the term "similar services" in the requirements of the IPP.

25. We understand there are a number of service elements which are likely to vary from jurisdiction to jurisdiction with the UBA service. Such variations include: transmission protocol (generally either Asynchronous Transfer Mode (**ATM**) or Ethernet); different cost methods for clothed bitstream versus naked bitstream; nationwide versus regional availability of regulated UBA; and different configurations for data interconnect points.

26. Where countries have a forward-looking cost-orientation for a regulated naked-DSL service and not for a "clothed" UBA service, then this in itself should not be considered a reason for excluding the jurisdiction from the benchmark. Rather, where the local loop service price is readily transparent then the forward-looking additional costs for UBA (minus the local loop price) in that jurisdiction should be identifiable and considered by the Commission.

27. While all these permutations do mean the service will vary to some extent between benchmarks, in the interests of generating a reasonable sample size, they should be considered similar services to Chorus' UBA service.

28. Many countries have different access prices for ADSL and ADSL2 variants of UBA. We suggest that an approach consistent with the premiums between BUBA and EUBA that exist in New Zealand for benchmarking should resolve any conflict between service variations.

29. However, the Commission should exclude VDSL variants of UBA from overseas jurisdictions to ensure consistency with the Commission's own decision to offer forbearance on Telecom Wholesale's VDSL service, which effectively resulted in VDSL being outside of the scope of the UBA STD.

30. Including VDSL unbundled bitstream offerings in the Commission's sample will not result in like-for-like services being compared or be consistent with the Commission's own previous decision-making.

31. The following jurisdictions may satisfy the Commission's benchmark:

Jurisdiction	*Access price in NZD*[1]
Belgium[2]	*10.07*
Greece[3]	*16.17*
France[4]	*7.65*
Denmark[5]	*16.99*
Sweden[6]	*21.66*
Switzerland[7]	*11.10*
Average	*13.94*
Median	*13.64*

32. Vodafone understands that in some of these jurisdictions the regulated UBA service is not offered on a national basis. In that respect, we believe such access prices are likely to overstate the costs of UBA, however, in the interests of generating a more robust sample size, we suggest the Commission allow for such considerations with its price point selection, or make an appropriate adjustment to reflect this.

33. In most of these jurisdictions there are multiple bitstream access offerings available to access seekers, but Vodafone has chosen only one service rate from a jurisdiction even though there is likely to be other products more comparable to Chorus' BUBA and EUBA products. However, in some instances we have not been able to verify the Point of interconnection availability in the jurisdiction to see if it is comparable to BUBA and EUBA.

34. The jurisdictions identified in the table above are based on the information Vodafone has been able to gather in the limited time available.

Additional considerations

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

35. Relativity between UCLL and UBA access prices will continue to be important for the foreseeable future. However, the UBA price will not take effect for two years after the Commission's review has been completed. We understand the delay in implementation

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[1] Blended exchange rates from the Commerce Commission Excel Spreadsheet from 21 September 2011

[2] European Commission (EC) decision concerning BE/2011/1228 and Belgacom reference offer for BROBA – Monthly recurring fee End-User line

[3] EC decision concerning EL/2010/1130 and OTE ARYS Price list effective 1/1/2012

4 EC decision concerning FR/2011/12/14 and http://www.echosdunet.net/dossiers/dossier_8777_l+arcep+baisse+prix+gros+france+telecom.html

[5] EC decision concerning DK/2008/0862, TDC A/S, 7 December 2011

[6] EC decision concerning SE/2010/1106

[7] Swisscom Fast-Bitstream Access effective from 1/1/2012

of the cost-based UBA price is intended to allow Chorus to progressively transition to efficient access pricing for the UBA service.

36. Further, any forward-looking (efficient) price the Commission sets for the UBA service will be likely to overstate the forward-looking costs given the rate of technology development or increased obsolescence in ADSL technology for the UBA service when the cost-based access price takes effect on 1 December 2014.

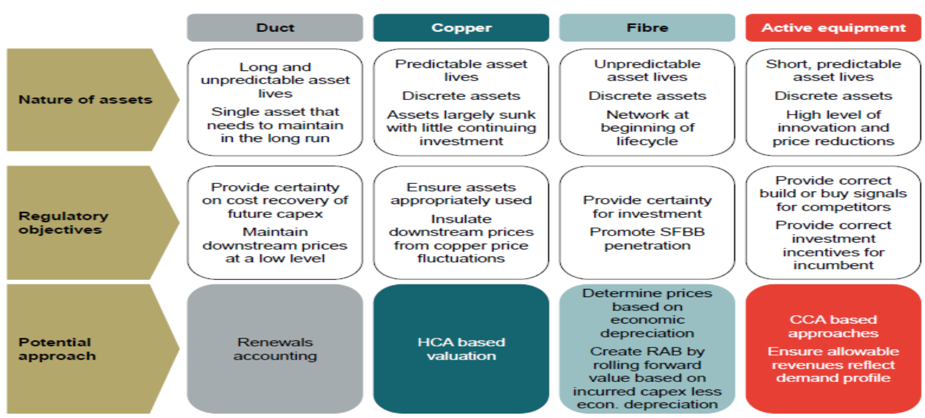
37. As discussed in the Commission's Discussion paper of 26 July 2012, the transition to a cost-based UBA price is limited to the *additional costs* above the price for the designated access service entitled Chorus' unbundled copper local loop network.

38. The additional costs incurred in providing the UBA service, as referred to in the applicable pricing principles, refer to "active assets" used for providing broadband services as opposed to the passive infrastructure comprising the unbundled copper local loop network. The Frontier Economics Report *Access Network Costing*[8] prepared for Vodafone Group noted:

> *Active assets used for providing broadband and/or narrowband over the fixed access networks typically have relatively short economic lives, driven by technological developments making existing assets obsolete. Equipment may be in service for say 10 years, but some of the operational life, the equipment may be used to provide support legacy services in parallel with the latest generation of equipment. Thus some allowance may need to be made for the fact the equipment is not fully utilised for the whole of its operational life. Technological development typically results in comparable equipment either falling in price in real terms over time, or increasing in capability (on a MEA basis resulting in falling unit costs).*

39. Frontier Economics sets out the following recommendations for determining regulated service costs for different access elements:

Figure S1: Summary of recommendations



Source: Frontier Economics

40. Accordingly, the additional costs incurred in providing the UBA service are declining over time and the "forward" looking costs for setting the price of the UBA service should reflect this. As Frontier suggests, forward looking pricing for active equipment provides the correct build versus buy signals for competitors and investment signals for incumbents.

[8] Frontier Economics, *Access Network Costing*, June 2011, p. 18

41. In applying the IPP regulation of comparable bit-stream services some international regulators have also taken explicit allowance for the "economic space" between UCLL and UBA. To the extent that "economic space" is accounted for, we encourage the Commission not to further unnecessarily increase relativity between UCLL and UBA.

42. The Commission is currently reviewing the access price for the UCLL service, which will influence the prevailing de-averaged prices for the UCLL service that will occur now and post-2014 once averaging takes effect for that service. The impact of geographic averaging will also have an equally important influence on cost-based prices.

43. Setting appropriate terms for the UCLL service will encourage access seekers to continue to invest in unbundling for the long-term benefit of end-users.

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

44. The UBA service continues to remain the principal form of broadband competition in New Zealand despite the growing number of unbundled lines and recent developments in fibre-to-the-home. The availability of these services is marginal in contrast to the number of customers provisioned with broadband from UBA.

45. When considering the long-term benefit of end-users, the Commission should consider the extent to which retail-minus pricing for the UBA service has contributed to high access prices for retail broadband. The shift to cost-plus pricing will avoid the continued retention of this monopoly rent and encourage more competition between UBA providers and greater penetration of broadband across New Zealand.

Benchmarking the additional costs of providing the UBA service

Question 4: Do you agree with the use of tele-density criteria for determining comparability?

46. Comparability criteria for the UBA service are much less significant than for comparing fixed local access network costs or mobile access network costs in foreign jurisdictions.

47. In both of those instances, comparability is a low (regulatory) cost method of considering the costs of rolling out a fixed line or mobile network in a jurisdiction. Therefore, comparing jurisdictions where the costs of network roll-out are similar becomes important indicia of whether the costs in a particular foreign jurisdiction are comparable.

48. Given the benchmarked UBA service only measures the additional costs above the access network, we suggest the Commission should not be as constrained by comparability for benchmarking the UBA service as it should with other regulated services.

49. We believe the Commission's task of finding sufficient jurisdictions with forward-looking cost-based UBA prices will potentially be difficult in itself and, therefore, the Commission should not be restrained by the application of unduly restrictive comparability measures.

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

50. Vodafone cautions the Commission against rigorously applying unduly restrictive comparability criteria unrelated to the UBA service for refining its benchmark. However, more suitable indicia of comparability to New Zealand for UBA access pricing than tele-density might be fixed broadband penetration per population.

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

51. The requirements of the IPP are clear - the Commission is required to benchmark forward-looking costs in comparable countries.

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

52. We suggest the Commission considers looking at the replacement costs of equivalent active equipment comprising the UBA service, such as digital subscriber multiplexers (**DSLAMs**), commercial fibre, dark-fibre and other types of backhaul services.

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

53. N/A

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?

54. Currently the UBA service does not incur any connection or transfer charges as a result of its retail-minus formulation. New connection and customer transfers are without a charge.

55. However, customer transfers for UBA are likely to be significantly different to the UCLL. We suggest the Commission consider an appropriate methodology upon which to capture the different costs involved with service acquisitions to the UBA including new connections and the different types of customer transfers, such as customers transferring between different UBA wholesalers or transferring from a UCLL service provider to a UBA provider.