VODAFONE NEW ZEALAND LIMITED

SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION

Draft determination to amend the price payable for the regulated service Chorus' unbundled bitstream access

1 February 2013

Summary

1. Thank you for the opportunity to comment on the draft determination to amend the price payable for the regulated service Chorus' unbundled bitstream access ('the Draft Determination') published by the Commerce Commission ('the Commission') on 3 December 2012.

2. This submission is made by Vodafone New Zealand Limited ('Vodafone'). On 31 October 2012, Vodafone acquired TelstraClear Limited ('TelstraClear'), which had previously participated in this and other Commission consultation processes. The views expressed by TelstraClear prior to its acquisition are largely consistent with Vodafone's. Where this submission uses the word "we" it is referring to Vodafone.

3. We endorse the Commission's decision. It has properly undertaken its functions pursuant to legislation, and its analysis and proposed decision are entirely appropriate. The prices suggested in the Draft Determination are consistent with both international prices for similar services and underlying costs of service provision in New Zealand.

4. Various parties have criticised the Draft Determination alleging that it is unpredictable and inconsistent with their expectations. The Commission is right to reject these criticisms,[1] which ignore the fundamental issue of whether it has properly applied legislation.

5. We also think it is wrong to claim that the Commission's decision could not have been expected. It was clear from the outset of the UFB initiative that UBA prices would remain regulated and that *"[i]t is impossible for anyone to determine at this point the exact UBA price, or pricing structure (including whether prices will go up or down)"*.[2] No party had any credible grounds for assuming that transition to cost based pricing would leave UBA prices unchanged, particularly as retail-minus pricing typically results in higher access charges than cost based pricing.[3] This was the context in which Chorus and other parties chose to participate in the UFB initiative.

6. In terms of next steps, cross submissions are due on 2 February 2013 and a conference, if required, will take place on 27-28 March 2013. We think that written submissions on the Draft

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[1] Dr Mark Berry, "Keeping prices down is not the Commission's job" Dominion Post article, 17 December 2012.

[2] Officials' Report on the Telecommunication (TSO, Broadband, and Other Matters) Amendment Bill – Specific Amendments that will be made if Telecom becomes a partner in the Ultra-Fast Broadband Initiative (11 April 2011), page 16.

[3] Indeed, reduced UBA prices were expressly contemplated in disclosure documents prepared by Telecom Corporation of New Zealand Limited ('Telecom') in connection with the demerger of Chorus Limited. See Telecom Booklet "Share in two journeys – Your opportunity to own interests in two leading New Zealand telecommunications companies", paragraph 9.25: "*In addition, if the prices that the regulator sets for copper-based products and services are significantly below the prices for comparable fibre-based services, fibre uptake may be negatively affected...it is possible that either the Commerce Commission or the Government may nevertheless elect to impose additional regulation, including requiring lower pricing*" (emphasis added).

Determination will likely provide sufficient input to support a final decision. A conference is therefore unlikely to be necessary unless submissions on the Draft Determination raise significant new issues.

7. Our more detailed comments on the Draft Determination are set out below and in the report prepared by Network Strategies for Vodafone that is annexed to this submission.[4]

The Commission's analytical framework

Section 18 of the Telecommunications Act 2001

8. The framework that the Commission must apply when resetting UBA prices is specified in legislation and in the UBA service Initial Pricing Principle ('IPP'). The Commission cannot depart from this framework.

9. The Commission's review of current UBA prices is required by the Telecommunications Amendment Act 2011 ('TA11'). The objectives and scope of this review are specified in section 77 TA11 and the UBA service IPP. Specifically, section 77 directs the Commission to make "*…any changes that may be <u>necessary</u> in order to implement the initial and final pricing principles applicable after the expiry of 3 years from separation day (emphasis added).*"

10. The outcome of the Commission's review will be a decision under section 30R of the Telecommunications Act 2001 ('TA01'), which is subject to and must be consistent with section 18. The Commission's primary duty under section 18(1) is "*…to promote competition in telecommunications markets for the long term benefit of end-users of telecommunications services.*" Other considerations are subservient to this primary duty and cannot displace it.[5]

11. The UBA service IPP must be applied in a manner that is consistent with its design (i.e. such that it operates as a proxy for the cost based price that would pertain under the relevant Final Pricing Principle ('FPP')). The very purpose of the UBA STD review directed by section 77 TA11 is, importantly, to enable transition to a cost based price for Chorus' UBA service.[6] When

[4] Network Strategies Report Number 32023 *Benchmarking issues in the Unbundled Bitstream Access Draft Determination* (30 January 2013).

[5] Our previous arguments regarding interpretation of section 18 TA01 apply equally in the context of the present decision regarding UBA pricing. See, for example, TelstraClear Limited *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), paragraphs 9-19; TelstraClear Limited *Submission on Unbundled Bitstream Price Review Consultation Discussion Paper* (24 August 2012), paragraphs 12-16; TelstraClear Limited *Comment on submissions on the Unbundled Bitstream Price Review Consultation Discussion Paper* (14 September 2012), paragraphs 17-23.

[6] See TelstraClear Limited *Submission on Unbundled Bitstream Price Review Consultation Discussion Paper* (24 August 2012), paragraph 26.

applying the UBA service IPP (and FPP) the Commission must set a single geographically averaged price.

12. The Commission has asked whether section 18(2A) TA01 considerations might warrant an increase in the UBA price above the legislated cost base.[7] We have interpreted this question as asking whether a price that exceeds the identified benchmark range could be justified to encourage investment in new broadband services. For the following reasons, we believe that the answer to this question is no:

- The Commission is restricted to making those changes that are necessary. The objective of its UBA STD review is transition to cost based pricing. We doubt that setting a price that exceeds the benchmark range could be shown to be genuinely "necessary" to achieve this objective.
- The Commission may select a higher or lower price point <u>within</u> the range of identified benchmarks. In exercising this discretion, the Commission must take account of its primary purpose in section 18(1), the relevant factors that it is directed to consider in section 18(2) and (2A), and any additional relevant factors.
- However, it is not appropriate to set UBA prices that exceed appropriate benchmarks simply to acknowledge a factor referred to in section 18(2A). This would subvert the core purpose of the UBA STD review (i.e. setting prices that approximate cost) in favour of what should be a secondary consideration. Put simply, the "incentives to invest" tail cannot wag the "cost based price" dog.[8]

Consistency of analysis between UCLL and UBA STD reviews

13. The Commission's approach across both the UCLL and UBA STD reviews must be analytically consistent.[9]

14. The Commission has excluded from its UBA benchmark set countries that apply TSLRIC cost models that have not been verified by the regulator. On this basis, Switzerland, Greece and Slovakia are omitted from the benchmark sample. For the purposes of benchmarking, we do not support reliance on cost models that have not been examined by the relevant regulator.[10] Nevertheless, in its UCLL STD review the Commission did include Switzerland within its benchmark set (despite the fact that in Switzerland a cost model is prepared by the operator and may not be reviewed by the regulator).

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[7] Draft Determination, paragraph 123.

[8] Our additional comments regarding price point selection and adjustment for any asymmetric cost error appear below.

[9] See TelstraClear Limited *Submission on Unbundled Bitstream Price Review Consultation Discussion Paper* (24 August 2012), paragraphs 4c and 19.

[10] See Network Strategies Report Number 31021 "Review of Commission's 2011 UCLL benchmarking" (30 September 2011), page 33.

15. It may be that Switzerland was included in the UCLL benchmark set because the Commission could confirm that the operator prepared cost model was accepted by the regulator and, conversely, excluded from the UBA benchmark set because no equivalent confirmation was obtained. However, this is not clear from the Draft Determination and the analytical approaches therefore appear inconsistent. This issue could be addressed by further explanation.

Interpretation of the UBA service IPP

16. Subject to the above comments, the Commission can choose how best to give effect to the UBA service IPP. Its interpretation of "comparable countries" and "similar services" must be pragmatic, particularly where legislation compels the Commission to set UBA prices using a benchmarking methodology irrespective of practical difficulties.

17. Although we recognise that reliance on a benchmark set comprising only two countries is not desirable, and a larger sample would support a more robust analysis, the Commission is entitled to proceed using the benchmark set already identified (Denmark and Sweden).[11] This is consistent with the objectives of legislation and the UBA service IPP, which does not specify any minimum size of benchmark set. In addition, our own review of countries that narrowly missed inclusion in the Commission's benchmark set (Belgium, Greece, Slovakia and Switzerland) confirms that the decision to exclude them was correct.[12]

18. Absent other valid comparators, the Commission must benchmark New Zealand UBA prices against comparable services in Denmark and Sweden. This approach is a faithful and proper interpretation of the UBA service IPP.

Final Pricing Principle

19. We agree that any party dissatisfied with the Commission's final decision on UBA price can seek a price review under section 42 TA01. This statutory right to review becomes active i) after final UBA pricing decision; and ii) on application.

Benchmarking similar services

20. Vodafone endorses the Commission's consideration of forward-looking cost based pricing and comparable countries. In describing the chief cost drivers for the UBA service both the Commission and its consultant WIK consider i) the location of the handover point; ii) class-of-service; iii) the speed of the service; and iv) technology used to provide the service.

[11] We note that Denmark and Sweden are more comparable to New Zealand, across a variety of relevant statistical measures, than many other jurisdictions.

[12] See Network Strategies Report Number 32023 *Benchmarking issues in the Unbundled Bitstream Access Draft Determination* (30 January 2013).

Handover point

21. Handover point location is a relevant cost consideration when reviewing tariffs in comparable jurisdictions. The TA01 service description specifies that the UBA service extends to the first data switch (and the DSLAM is not a relevant facility).[13] WIK considers various ways of addressing the complexity of different handover options in different jurisdictions. Vodafone supports a reasonable, transparent and logically defensible approach to including services with equivalent characteristics and tariffs in the benchmark set.

Quality of service: BUBA and EUBA Variants

22. Chorus' dimensioning of 32 kilobits per second quality of service for BUBA is low when compared with similar services overseas. We are encouraged by the Draft Determination's review of the premiums for the different higher grade EUBA services.[14] We support review of these premiums as indicated in the Draft Determination.

Impact on results of revised data

23. Network Strategies has reviewed benchmarking data used by the Commission on behalf of Vodafone.[15] It considers that revision to some of this data would be appropriate and has recalculated the Commission's benchmarks using revised data for Denmark and Sweden. The results of this exercise suggest that the monthly cost based price for BUBA should be set at $8.56 rather than $8.93. We recommend that the Commission adjust its proposed UBA prices accordingly.

Price point selection and accounting for asymmetric cost of error

24. The Commission has asked specifically whether a higher price point than the benchmark mean could be justified to account for any asymmetric cost of error.[16] The statutory framework may allow the Commission to set a price point above the mean subject to this point falling within the benchmark range.

25. In contrast, setting a UBA price outside the benchmark range arguably subverts the core objective of the Commission's decision making process (pricing with reference to benchmarks as a proxy for cost based pricing). Assuming such departure were possible, it would require

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[13] In New Zealand, handover to the first data switch occurs irrespective of the traffic protocol (ATM or Ethernet) and may occur at the same geographic location (in some instances) or at a different location from the DSLAM (in many instances).

[14] On their face, current premiums for higher quality services appear to bear little relation to the additional costs of providing these services. For example, the current price of $40.78 per month for EUBA 180 exclusive of the local loop network cost includes a 90% premium over the entry level BUBA price.

[15] See Network Strategies Report Number 32023 *Benchmarking issues in the Unbundled Bitstream Access Draft Determination* (30 January 2013).

[16] Paragraph 118, Draft Determination.

clear and compelling justification. However, available data provides no guidance on whether a New Zealand UBA price should be set outside this range (or, if so, by what value). Accordingly, any decision to set price outside the benchmark range would be arbitrary and involve a high degree of uncertainty and risk.

26. In particular, for the following reasons, we do not support any adjustment for asymmetric costs:

- Such adjustment would be justified only if there was clear evidence of asymmetric cost both i) distorting RSPs decisions; and ii) causing consumer detriment. Available evidence does not support either proposition.
- In addition, it would be necessary to establish the direction and magnitude of an asymmetric cost "effect" to determine an appropriate adjustment. We have no evidence of either the direction or magnitude of this effect.[17] In these circumstances, any adjustment purporting to address an asymmetric cost effect would be arbitrary and open to challenge.
- Different considerations would arise according to the direction of any asymmetric cost error. If a UBA price were set too high, Chorus would retain monopoly rent with a resulting net welfare loss (it faces no competition or incentive to pass on this rent). Conversely, RSPs face strong competition in retail markets and thus pressure on margins, so that any benefit to RSPs of lower prices would be competed away (ultimately to consumers' benefit). Given the consequences of regulatory error, the Commission should give greater weight to avoiding a UBA price that is too high than concerns about the implications of a price reduction for a monopoly wholesaler.

Alternative approaches to benchmarking

27. In the UCLL STD review, the Commission ultimately decided that an indexing approach could be used to adjust UCLL prices. TelstraClear has previously argued against the use of indexing to adjust UCLL prices.[18] Although we recognise the difficulties involved in the current benchmarking exercise, we oppose using an alternative approach to price setting simply to address these.

28. We doubt that proper interpretation of the UBA service IPP supports use of alternative approaches to price setting. Moreover, using an alternative approach is:

- Unnecessary: the Commission is clearly entitled to proceed as set out in Draft Determination.

[17] Obtaining such evidence would require a much fuller analysis (i.e. an FPP type exercise) of a type not contemplated within the UBA service IPP, and therefore inappropriate.

[18] See TelstraClear Limited *Submission to the Commerce Commission on the Revised Draft Determination on the Benchmarking Review for the Unbundled Copper Local Loop Service* (1 June 2012), paragraph 23.

- Unlikely to assist: indexing would not alleviate the problem of small sample size. Equally, the "trend line approach" described by WIK for dealing with different handover points across jurisdictions misrepresents the cost relationship between these points and would deliver spurious results.[19]

Other issues

Connection charges

29. Currently there are a variety of different connection charges relating to transfers and new connections. In relation to new connections the Chorus UBA STD recognises three instances for new connections:

    - connection only;
    - connection and wiring; and
    - connection, wiring and modem installation.

30. The Draft Determination's impact on these three different connection permutations is not clear. The new "connection and wiring" service charge will increase by 20% to $174.02. However, there is no commentary on the impact on charges for a "connection only" service or a "connection, wiring and modem installation" service, which have different connection charges to the "connection and wiring" service. We request that the Commission to further clarify any changes to charges for these services. In particular, their consolidation into a single service would be a significant departure from the *status quo*, which we think would require further consultation.

31. While the UBA price list for transfer charges specifies a number of permutations for customer transfers between commercial broadband services, any variation in charges depends on whether a customer port change is involved. In other words, the difference between the transfer charges turns on is whether or not there is a porting change (meaning, in effect, that there are only two tariffs).

Currency conversion

32. PPP rates alone should be applied for currency conversions. Ideally 2012 PPP rates should be used.

[19] See Network Strategies Report Number 32023 *Benchmarking issues in the Unbundled Bitstream Access Draft Determination* (30 January 2013).

Double recovery

33. The Commission's proposed approach for ensuring that double recovery does not occur appears sensible. This issue was largely resolved in the UCLL review when the Commission decided not to split copper local loop costs between UCLF and UCLL. This decision is pivotal in assuming that the access network for UBA is the full access network irrespective of whether a UBA line is cabinetised. Therefore, the costs involved with UBA exclude all civil works costs associated with the customer access network.