



**Submission in response to
The Commerce Commission's Unbundled Bitstream Access
Service Price Review – Draft Determination**

1 February 2013
Public version (there is no confidential version)

1. InternetNZ

- 1.1. This submission is from InternetNZ (Internet New Zealand Inc).
- 1.2. InternetNZ is a membership-based not-for-profit organisation and is the delegated manager for the .nz country code top level domain.
- 1.3. Our mission is to protect and promote the Internet for New Zealand. We advocate the on-going development of an open and uncaptureable Internet, available to all New Zealanders. The Society is non-partisan and is an advocate for Internet and related telecommunications public and technical policy issues on behalf of the Internet Community in New Zealand – both users and the Industry as a whole.
- 1.4. This submission is based upon InternetNZ’s policy principles, specifically those principles that the Internet should be open and “uncaptureable”; that Internet markets should be competitive and that the Internet should be accessible by and inclusive of everyone.
- 1.5. InternetNZ thanks the Commerce Commission for the opportunity to make this submission. InternetNZ made a similar submission in relation to pricing of the unbundled copper local loop (UCLL). We note that the two pricing reviews are complementary and follow much the same requirement to establish a forward-looking cost-based benchmarking approach.
- 1.6. InternetNZ reserves the right to modify its positions based on information that becomes available from the submissions lodged by other parties and as its own on-going analysis develops. We intend to develop a cross-submission. The views set out in this submission should be read with this in mind.

2. Executive Summary

- 2.1. This submission is in response to the Commission’s draft determination. It is aimed at the Commission but also at a broader audience who may find some of the contextual material included helpful.
- 2.2. The Commission is required to follow the law, which is explicit in that it can only set a forward-looking cost-based price for UBA.
- 2.3. Consequently, we consider that the only adjustment that can be made to the cost-based price in the draft determination is to reflect changes in the calculation of the cost.
- 2.4. We consider that the \$8.93 additional cost of UBA over and above the UCLL price has been based upon forward-looking costs.
- 2.5. InternetNZ strongly reiterates the importance of the Commission’s independence in regulatory proceedings. The Commission’s job is to follow the law, not to respond to views expressed by the Government.

- 2.6. Given the statement by the Prime Minister following the publication of the draft determination it seems possible, or even likely, that the Government might choose to amend the legislation if the outcome of the determination is not to its liking. It is of course the Government's prerogative to submit a Bill to Parliament to amend legislation. Nevertheless, until such time as that draft legislation is passed into law the Commission is bound to implement the current law irrespective of indications of changing government policy.

3. Introduction

- 3.1. InternetNZ was disappointed at the Commission's final UCLL determination which reduced the averaged UCLL price from 1 December 2014 by only 3.85%. The draft UCLL determination calculated a reduction of ~20% - a figure that would provide much greater incentives for the take up of UCLL by access seekers and provide significantly greater benefit to end users. Nevertheless, as we have already said, our interpretation of the law is that the Commission must first and foremost set a forward-looking cost-based price. Whether it provides incentives for unbundling to the benefit of end users is a lesser consideration. Consequently, despite our disappointment, we accept the UCLL price determination.
- 3.2. The total UBA service cost comprises two components: the UCLL cost and the additional cost to provide UBA over and above the UCLL cost. Given this relationship there is an automatic relativity between the prices of the two services.
- 3.3. The Commission has gone to great lengths to determine the draft UBA benchmark price. Our expectation is that Chorus will seek to challenge this price through this submission process. It is clearly in Chorus' best interests for the price to be set as high as possible. In comparison retail service providers (the access seekers) will likely fall into two positions: either they will be relatively agnostic in that they will all take the same price; or they will be seeking the lowest possible input prices in all markets to maximise their profit. We expect the majority will be in the latter position. End-users are significantly affected by a lower (or higher) service price. Consumer organisations such as InternetNZ do not have the level of resources required to undertake detailed analysis of international markets and rely upon the Commission, as the industry's independent regulator, to act in the best interests of end-users. We therefore consider that in setting the initial price the Commission, if in doubt, should err on the side of the consumer.
- 3.4. If the resulting price is too low Chorus always has the opportunity to seek a final price based upon the Final Pricing Principle (FPP).
- 3.5. The new price does not come into effect until the end of 2014, giving ample time for the Commission to set a final price before then if required. The IPP, benchmarking, is designed to be a quick and less-accurate exercise. With this extended time available, there are few consequences in erring on the side of a lower price: if it negatively affects Chorus unduly, Chorus can apply for final pricing.

4. Section by Section Commentary

Statutory Framework

- 4.1. The statutory framework is set out by the Telecommunications Act. The initial pricing principle (IPP) upon which the draft determination is based is:

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.

- 4.2. This differs from the final pricing principle which is:

The price for Chorus's unbundled copper local loop network plus TSLRIC of additional costs incurred in providing the unbundled bitstream access service.

- 4.3. The reason for the difference between the initial and final pricing principles is to allow the initial "proxy" price to be set and implemented relatively quickly but with a degree of real-world experience and credibility, thereby allowing the final price to be determined over a longer period of time.
- 4.4. The Commission has stated that it also sees the initial price principle being a proxy for the final price principle and on this basis has used only comparable countries that have forward-looking TSLRIC (total service long run incremental cost) or similar. Applying this selective criterion reduces the sample size considerably. If Chorus considered that the initial price was too low it has the simple remedy of asking for a final price. As the price is not applicable until December 2014 the final price is likely to be available to be used from that date avoiding the need to use the initial price at all.

Determination Framework

- 4.5. The determination framework sets out the timeframe and requirements that the Commission must meet in its determination – in particular:
- The Commission must make reasonable efforts to review the STD for unbundled bitstream access before 1 December 2012 for the purpose of making any changes that may be necessary in order to implement the initial and final pricing principles applicable after 1 December 2014.
 - The price review is limited to making the amendments necessary to implement changes to the IPP made by the Amendment Act namely: changing the IPP from a retail-minus based price to a forward-looking cost-based price and making the UBA price geographically averaged.
 - The Commission is prohibited from conducting a more general review of the UBA STD or accepting applications for a residual terms determination until 1 December 2014.

- Having already set the UCLL STD on 3 December 2012 (at \$23.52) the Commission only needs to determine the additional costs by benchmarking against the prices charged in comparable countries that use a forward-looking cost-based pricing methodology.
- 4.6. We accept the Commission's general view that the initial pricing principle is intended to be a proxy for the FPP - being TSLRIC.
 - 4.7. We believe that the sooner the determination is based upon the final pricing principle the better it will be for all parties. End-users will get certainty that the service they are purchasing is not cross-subsidising other services that they are not able to receive; Chorus shareholders will get the certainty they have requested; and the Government will get an accurate determination of the true costs of providing the UBA service, based upon its preferred (FPP) pricing model.
 - 4.8. The statutory framework is explicit in saying the IPP and FPP must be forward-looking and cost-based and S18 (1) and (2) are explicit that the Commission must act in the best long term interest of consumers. S18(2a) does not sanction the Commission departing from a forward-looking cost-based price to an alternative price that is not based upon cost.

Application of Final Pricing Principle

- 4.9. InternetNZ submitted in the UCLL price determination that it would be in the best interests of all parties if pricing could move to the final pricing principle as soon as possible. We are of the same opinion in regard to UBA, noting the extensive time available in which this can occur.
- 4.10. As noted in the summary, the response of RSPs to this may vary. One school of thought holds that as long as all RSPs face a common input cost, they are agnostic as to what level it is at due to there being no impact on competition between RSPs. Another school of thought holds that all RSPs will seek the lowest possible input costs from and any all suppliers, to maximise their margins. That an RSP may be liable for the costs of the price review is a further disincentive to them seeking such a review. Whichever school of thought the reader adopts, end-users are clearly one important group that could significantly benefit from the introduction of a FPP. Since end-users are not a party to the determination, they are excluded from seeking a final price review.

The UBA Standard Terms Determination (STD)

- 4.11. The review describes the metrics of the basic and enhanced UBA services taken from the December 2007 UBA STD. As this review is limited to making only those changes necessary to implement the new forward-looking cost-based IPP these metrics have not changed. We expect that costs will be falling over time due to developments in technology and that the Commission should at the appropriate time consider this in its normal STD review process.

Determining the benchmark set within the IPP framework

- 4.12. We agree that the wholesale bitstream access price in the IPP benchmark sample should be subject to regulation using a forward-looking cost-based price method approved by a regulator.
- 4.13. We recognise that a TSLRIC FPP is a requirement imposed by the legislation on the Commission and that the Commission is unable to deviate from that requirement if and when it sets a final price. We have noted that we support the Commission's view that the IPP should be a proxy for TSLRIC.
- 4.14. We agree that the 19 countries that do not regulate bitstream using a cost-based approach should be removed from the sample. Also for the reasons outlined in the report the states of the USA, Poland, Switzerland, Greece, and Slovakia should not be considered.

Section 18 Considerations for Price Point Selection

- 4.15. The Commission has asked for submitters views on three topics:

the relativity between the prices of the UBA and UCLL services and the implications for investment in these services

- 4.16. We agree with the Commission that if both UCLL and UBA prices are based on cost then the relativity between the services will be automatic given that the UCLL cost is a constant factor in the UBA price. In any event, because relativity is a section 18 issue, the Commission has no discretion to move away from cost-based pricing.

whether there are asymmetric economic costs in setting the UBA price too high or too low

- 4.17. There is no discretion under section 18 to move away from a cost-based price. Therefore the price cannot be set too "high" or "low", regardless of any asymmetric economic costs.

the likely impact on incentives to invest in broadband services, whether over copper or fibre, and the effects on end-users

- 4.18. Once again, there is no discretion under section 18 to move away from a cost-based price. Therefore incentives to invest in other services cannot be used by the Commission to depart from the statutorily-required cost-based price.
- 4.19. In any event, we consider that the major incentive for Chorus to invest in the UFB is that it has a contract with the Government – voluntarily entered into, with full knowledge and, presumably predicated on prudent due diligence on Chorus's part – which subsidises the UFB roll out. It entered into this contract in the full knowledge

that the Commission would re-determine the UBA price to meet the cost-based pricing principle of the amended Act. Chorus must also have been aware that a move to cost based services would almost certainly reduce the price of UCLL and UBA services.

- 4.20. Any risks for Chorus were apparent and faced at the time of entering into the contract. If they were not, then the failure lies with Chorus exclusively.
- 4.21. By re-determining the price of copper services the Commission is not introducing any new risk. It is not the role of the Commission, nor is it in the best interest of end-users to ameliorate those contractual risks retrospectively. If Chorus and the Crown agree that circumstances have changed since the establishment of the UFB contract one option could be to renegotiate the contract.

Other Considerations

- 4.22. The conditions the Commission proposes to prevent double-recovery of costs seem reasonable. We would be interested to see the comments of service providers in this respect.

5. Conclusion

- 5.1. Thank you to the Commission for the chance to make a submission on this matter.

Yours sincerely,

Jordan Carter
Chief Executive (Acting)
InternetNZ

+ 64 4 495 2118
jordan@internetnz.net.nz