Submission to the Commerce Commission

on the

Draft Principles and Regulatory Reporting Requirements for the Accounting Separation of Telecom

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1. Executive Summary

1.1 The mission of InternetNZ, the Internet Society of New Zealand Inc, is to protect and promote the Internet for New Zealand. We advocate the ongoing 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.

1.2 InternetNZ strongly supports a robust and comprehensive approach to accounting separation, at least as extensive as the Commission proposes in its draft. Accounting separation is very significant in the regulatory landscape. InternetNZ seeks further and more detailed disclosure by Telecom than is currently proposed in the short term. The benefits of accounting separation substantially outweigh Telecom's costs of disclosure.

1.3 InternetNZ welcomes the indication by the Commission that it would later look at additional and more refined reporting by Telecom. This would follow timelines such as operational separation quarterly reports. InternetNZ considers that Telecom is able to implement the more robust reporting more quickly. For example, even on an historical cost basis, Telecom would not have to report fully until September 2010. This is nearly four years after the Act was amended to introduce accounting separation. The Act required the Commission to wait until around now to introduce accounting separation. Now that it can be introduced, the Commission and Telecom can fully implement quickly.

1.4 The suggested initial approach focuses on historical cost. This historical cost approach does not deliver appropriate regulatory outcomes. As the European Regulators Group has noted:

> Historical cost information is generally accepted as being adequate for financial stewardship purposes but may provide unsatisfactory indicators for regulatory decision making….
>
> ……The use of current cost evaluation is intended to measure the financial performance of notified operators in a way that is broadly consistent with the costs faced by new or potential competitors in a market wishing to offer services at a price that would allow them to recover their current costs.

1.5 There is no need for a transitional year even for the proposed historical cost reporting, let alone current cost reporting. The Commission and Telecom have a robust body of experience and documents to build on, ranging from the Commission's own extensive experience under Part 4A of the Commerce Act (in relation to the electricity sector) through to the pre- and post- operational separation experience of Ofcom and BT.

1.6 The Commission should build upon its electricity sector approach and require forward-looking reporting, particularly in relation to NGN.

1.7 As part of current cost accounting, which should be introduced quickly, Telecom should report information underpinning regulatory pricing (costs-oriented or retail-

minus, as appropriate). This provides first-order information on fulfilment of appropriate pricing.

1.8 Telecom should be required to report on information relevant to the Commerce Act. Bundling for example (e.g. triple and quad play) presents challenges as to horizontal price squeeze (and there are vertical price squeeze issues to consider as well). Reporting on this and other issues relevant to the Commerce Act can provide first-order indications that there may be problems. That reporting may in itself drive appropriate behaviour without more.

1.9 The Commission needs to be well-resourced to implement the regime and use the information flowing from it.

1.10 InternetNZ's expectation (reflected in overseas experience with accounting separation) is that the Commission will receive few submissions from the industry. Providers potentially face accounting separation themselves in New Zealand (such as under the additional disclosure regime applicable to all providers at section 69ZC). Some are on the receiving end of accounting separation/information disclosure obligations in other countries. Absence of submissions supporting accounting separation should not dissuade the Commission from taking a robust approach.

2. The information disclosure requirements are wide

2.1 The Commission correctly identifies that the disclosure regime is wide, and extends beyond the business units and services encompassed within the Telecom Undertakings. Although accounting separation is an essential complement to operational separation, the information disclosure requirements in Part 2B are broad.

2.2 InternetNZ submits that the Commission should widely use the breadth of available disclosure options.

2.3 It is especially significant that Part 2B is based on the similarly wide information disclosure provisions - in respect of large electricity businesses - in sub-part 3 of Part 4A of the Commerce Act. The Commission has taken a much broader approach - than is proposed in the current discussion paper as to Telecom - to what are to be included in the electricity sector disclosure requirements. It appears from the discussion paper that the Commission intends to address wider scope later. InternetNZ submits this can be expedited.

2.4 As the Commission had developed comprehensive information disclosure requirements for large line owners and electricity distributors, it can be assumed that Parliament knew and expected that the telecommunications information disclosure regime would be applied widely.

2.5 The list of things in respect of which the Commission can require disclosure is extensive.[1] Disclosure is not confined to financial disclosure. For example disclosure can be required in relation to *"non-financial performance measures ... plans*

[1] Section 69ZB and 69ZD.

and forecasts ... network capacity information ...[and] policies and methodologies in these and other areas”.[2]

2.6 For example, using legislative provisions that are also in Part 2B of the Telecommunications Act, the electricity businesses are required to disclose considerable detail around their forward-looking plans, including as to proposed investment. This forward-looking disclosure obligation plays a key role. However, at least in the early stages, the Commission proposes that Telecom only provide backward-looking historical information rather than forecast material. As we illustrate below in relation to NGN, requiring forward-looking reporting would be valuable.

3. Why are the information disclosure obligations wide?

3.1 That the Commission is correct in confirming that the disclosure obligations are wide is demonstrated by, in addition to the electricity sector antecedent, the way in which Part 2B is framed in the context of the Telecommunications Act.

3.2 The purpose of the Part 2 regime is to promote competition in telecommunications markets for the long-term benefit of end users. Reliable and timely information is to be made publicly available so that a wide range of people are informed (that includes the industry and the Commission itself).[3]

3.3 There is a particular focus not only on Telecom’s “operation” but also its “behaviour”, which again points to a wide approach.[4]

3.4 There is nothing in relation to Telecom’s disclosure obligation to limit that disclosure to:

- issues relating to operational separation; and
- matters only under the Telecommunications Act.

3.5 The Commission has a broad palette to achieve optimal outcomes.

3.6 Particularly noteworthy is that there is no restriction of the Part 2B regime to reporting on matters directly covered by the Telecommunications Act. Reporting requirements can include information that relates to Commerce Act issues, or even issues that are not underpinned by any legislative basis, beyond Part 2B itself.

3.7 That Part 2B applies to information relevant to the Commerce Act is made clearer by the fact that the statutory delineation in the Telecommunications Act, between that Act and the Commerce Act, still applies only to another part of the Telecommunications Act.[5]

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2 Section 69ZB(g) – (k).
3 Section 69Y.
4 Section 69Y.
5 Section 63 of the Telecommunications Act does not apply to Part 2B.

3.8 We return to the Commerce Act below when dealing with price squeeze as an illustration.

3.9 A further sign that a broad approach is appropriate is that the Commission has developed a considerable body of material, guidance and handbooks as to particular information disclosure requirements in the electricity sector. This has happened under the legislation on which Part 2B is based.

3.10 Although under different legislation, this wider and more detailed approach to information disclosure is reflected in Ofcom's requirements on BT, both before and after the BT Undertakings.[6]

3.11 InternetNZ acknowledges that requirements should be appropriately constrained. The Commission will of course need to prioritise and scope the information it requires so that the most useful information is provided.

3.12 There is also the control mechanism in section 69Z, by which the Commission must take into account, when setting disclosure requirements, confidentiality issues and Telecom's time and cost required to prepare the information.

4. Historic cost reporting is insufficient

4.1 The Commission proposes, in the transitional year (that is, the year ending 30 June 2009), to require reporting on an historic cost basis. There is only brief mention of the prospect of current cost accounting beyond then.

4.2 InternetNZ submits that appropriate current cost accounting (CCA) methodologies should be used from and including the current financial year. It is difficult to understand why Telecom cannot do this, and the reduction in compliance costs (referred to in paragraph 32 of the discussion paper) is minor compared to the considerable benefits to end users and competition. The accounts can be prepared retrospectively, and reporting on a CCA basis for the year ending 30 June 2009 is achievable. There are transitional issues (eg, as to valuation). But that will happen sometime anyway, so it might as well happen now.

4.3 Regulatory reporting should of course be fit for purpose. It is widely recognised that reporting based on historical cost information is inadequate. For example the European Regulators Group (ERG) notes in its accounting separation guidelines:[7]

> Historical cost information is generally accepted as being adequate for financial stewardship purposes but may provide unsatisfactory indicators for regulatory decision making….
>
> ……The use of current cost evaluation is intended to measure the financial performance of notified operators in a way that is broadly consistent with the costs faced by new or potential competitors in a market wishing to offer services at a price that would allow them to recover their current costs.

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6 See for example Ofcom, *Regulatory financial reporting obligations on BT (26 January 2007) and Changes to BT's 2007/08 regulatory financial statements – Explanatory statement and notification* (26 June 2008).

7 ERG common position: *Guidelines for implementing the Commission recommendation (2005) 3480 on Accounting Separation & Cost Accounting Systems under the regulatory framework for electronic communications* ("ERG accounting separation guidelines") paragraph 3.2.

4.4 Before turning to the New Zealand situation it is useful to background the European approach.

4.5 European regulators, recognising the deficiencies of historical cost reporting by widespread use, in their regulatory reporting requirements, of CCA and Long Run Incremental Cost methodologies, based on CCA.[8]

4.6 Reporting on Long Run Incremental Cost provides a "first order" overview of how pricing is tracking. This can be used by access seekers, providers, regulators, and other stakeholders. Ofcom is using a model that identifies a floor and a ceiling for acceptable pricing, on a first-order overview basis. Similarly, as ERG note:[9]

> **4.1. Concept and economic rationale of long run incremental cost**
>
> Conceptually, the LRIC (Long Run Incremental Cost) methodology calculates the cost of providing a defined increment of output, on the basis of forward looking costs incurred by an efficient operator.
>
> When applying a long run perspective, all costs (including capital investments) are assumed to be variable (or avoidable). LRIC therefore provides NRAs with a methodology by which the costs of the capital-intensive electronic communications market, which, at the wholesale market level, is characterized by significant investment costs and long term asset lives, can be analysed and used for cost-orientation and pricing purposes.
>
> The economic rationale behind this methodology is that it identifies the range (between the incremental cost 'floor' and stand-alone cost 'ceiling') between which a pricing signal could be considered rational assuming common costs are also fully recovered. It therefore helps NRAs in setting prices that neither encourage inefficient investment nor discourage efficient investment.
>
> One particular issue for an NRA is to establish a basis for calculating a "forward looking" cost base. Given the uncertainties and difficulties of determining a forward look, LRIC computations normally take a cost base calculation using current cost methodologies. This includes for example the computation of the cost of products and services based on the cost of the most efficient available technology currently available. This will enable new entrant operators to purchase the use of existing network facilities without paying for possible inefficiencies of the notified operator.

4.7 This "first order" overview may be enough to encourage providers to price appropriately. Or, if necessary, it may provide a basis for the regulator, access seekers and others, to consider whether and how to take the matter further.

4.8 Requiring reporting on a cost basis suits New Zealand too. The Commission sets pricing based, almost invariably, on the initial pricing principle (ie, retail-minus or cost-oriented pricing, on a benchmarked basis). Rarely, pricing is set on the final pricing principle (e.g. TSLRIC). One reason that access seekers do not seek final pricing is the high cost and uncertainty in that process, in part due to the limited information available as to likely outcomes.

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8 See *A ERG Report – Regulatory Accounting in Practice 2007* (April 2007), at paragraph A.

9 At paragraph 4.1 in the Guidelines, referred to at Footnote 8.

4.9 If the stakeholders are provided with "first order" information underpinning TSLRIC and retail-minus, they are able to take steps, even though price has often already been set by the Commission (and application under the final pricing principle must be made soon after the initial price is determined). This information would be valuable for several reasons, including:

(a) over time, a body of information develops which enables access seekers to assess whether to seek a determination, and also whether to go to the currently rare step of seeking final pricing (eg, TSLRIC);

(b) an access seeker can seek reconsideration based on changed circumstances since the price was determined (eg, material change in the inputs into TSLRIC);[10]

(c) access seekers and the regulator will be better informed when price re-emerges (such as at the sunset of a determination);

(d) the Commission can instigate a Schedule 3 investigation, possibly following input from more fully informed stakeholders and the Minister; and

(e) a legitimate consideration is the public pressure that can be brought to bear where the information shows a divergence between actual prices and what the reports show is appropriate. That could lead for example to legislative change. Such legitimate considerations can include signals sent to the market by the regulator.

4.10 Therefore, having CCA in place, including reporting on data underlying pricing, would be valuable.

5. Technology and Shared Services: allocation and causation generally

5.1 InternetNZ is particularly supportive of the proposed reporting obligation in relation to Telecom, outside the units and services directly covered by operational separation. As noted above, the information disclosure regime in Part 2B extends well beyond the operational separation componentry in any event.

5.2 Technology and Shared Services (T&SS) forms a particularly large part of the Telecom business. It is critical to ensure accurate accounting and information disclosure in relation to that unit, including because of its relationship to operational separation. Inappropriate allocations between T&SS and other Telecom business units can be materially distort the position.

5.3 T&SS raises the question of whether the Commission should move sooner than later to refine allocation and causation issues beyond the currently proposed application of NZ GAAP principles, and subsequent approval by the Commission of Telecom's methodologies.

5.4 GAAP provides relatively wide ranging principles. It is inevitable that it will be necessary for the Commission to impose specific guidance and requirements for

10 Section 59, Telecommunications Act.

Telecom, given the scale of shared cost which is to be allocated, and the ability for this to be allocated, as the Commission notes, in a way that is favourable to Telecom's position.

5.5 We accept that this will evolve over time and become increasingly defined. That is the Ofcom experience and the experience with the Commission's work in the electricity sector.

5.6 However, many issues are already clear enough to allow refinement of the approach to allocation and causation. The Commission can either draft more detailed guidelines for comment, or invite Telecom to do so, again for comment. Like all companies, Telecom already does this exercise for its internal management accounting purposes, for each product and business unit. It will have been doing so for the new business units (eg, Chorus and Wholesale) since it voluntarily moved to split those operations months before Separation Day (31 March 2008). Internal management accounts go a long way already.

5.7 Among other resources, the Commission and Telecom have the Ofcom material (pre and post BT Undertakings) and the Commission's material for electricity businesses.

5.8 When dealing with implementation issues below, we conclude that a detailed approach to allocation can be achieved quickly, including for the current financial year.

6. GEN-I

6.1 InternetNZ does not agree that gen-i should be excluded from disclosure obligations. As the Commission's discussion paper notes, gen-i is one of two Telecom retail units. Telecom Retail handles consumers and SMEs. Gen-i complements Telecom Retail (it covers business solutions, large customers and ICT integration). There is no logical reason to include one retail unit (Telecom Retail) but exclude the other. The two units together are "retail". Additionally, gaining transparency requires the picture to include the full retail operation. As noted above, the Act is deliberately wide enough to cover disclosure as to all Telecom business and services.

7. Cost imposition on Telecom

7.1 When deciding what Telecom must disclose, the Commission is required - appropriately - to have regard to the time required to prepare the information.[11] This of course raises issues as to the time and cost involved for Telecom.

7.2 InternetNZ submits that the cost for Telecom is outweighed, by a substantial margin, by the interests of competition and the long-term benefit of end-users.

[11] Section 69Z.

7.3 While InternetNZ considers that the reporting requirements will need to be tailored more than currently proposed, Telecom's regulatory reporting would build on its existing and standard internal and external accounting obligations. It already has extensive relevant management accounting.

7.4 It is acknowledged that there will be additional work. There is independent verification that the cost should be relatively modest. BT, in its 29 May 2008 submissions on Ofcom's consultation paper: *"BT's regulatory financial reporting: changes to BT's 2007/08 regulatory financial statements",* notes at page 2:

> BT acknowledges the significance of financial reporting to effective regulation. We continue to invest substantial resources (about £7m per year) to deliver robust financial information in a timely manner through our annual regulatory financial statements.

7.5 BT is a much larger and more complex organisation than Telecom. Telecom's incremental costs would be significantly less (even taking into account initial implementation cost).

7.6 Even if Telecom's incremental costs were in the order of £7m per year, that is modest relative to both:

(a) the benefits in promoting competition for the long-term benefit of end users, and enabling disclosure about Telecom's operations and behaviour; and

(b) as an essential adjunct to operational separation.

7.7 In the market place, the impacts of accounting separation can be expected to be in the hundreds of millions (in this multi-billion dollar market).

7.8 Therefore, the cost to Telecom in complying with wider obligations under disclosure requirements should be a minor factor for the Commission.

8. Commission resourcing

8.1 The real cost and resourcing issue may be at the Commission end.

8.2 InternetNZ considers that it will be important for the Commission to be adequately resourced to:

(a) develop the reporting requirements (which in some instances will be detailed, although they can develop over time);

(b) monitor the reports as well as providing information publicly; and

(c) take action in light of the information received.

8.3 The Commission will, understandably, have real time pressure from the various issues it is dealing with (various STPs, the NGN review, mobile services, and so on).

8.4 If accounting separation is not adequately resourced, there is a serious risk of failure. We expect that the Commission has information available to it, from its experience in the electricity sector, to determine adequate allocation of resource.

9. Confidentiality

9.1 The discussion paper proposes disclosure following the model currently used (presumably based on limited access to Restricted Information (RI) and no access to Commission Only Information (COI).

9.2 InternetNZ supports a confidentiality regime similar to that currently used by the Commission. However three matters are noted:

(a) it is not necessary at this stage to have a default position by which input costs are treated as confidential. This could be judged on a case-by-case basis, under the confidentiality regime. It is particularly important to enable industry commentators, telecommunication providers, etc, to be able to comment in appropriate circumstances, based on their own experience and knowledge. Unduly fettering access to the information may be counterproductive. Assessment on confidentiality (and mechanisms for dealing with confidentiality issues such as providing access only to persons who are not employed by telcos, by aggregating data and so on) can be considered on a case-by-case basis. We expand on this point in the next section of this submission;

(b) there is concern that the Commission has in the past taken an approach which is unduly favourable to the discloser, when either withholding information as COI or treating it as RI. This is not a matter that needs to be resolved now, but InternetNZ would not wish to be understood to be accepting the current application of the Commission's confidentiality regime in this respect; and

(c) InternetNZ considers that the Independent Oversight Group should get all of the information in disaggregated form, regardless of confidentiality issues.

10. How much information should be provided publicly?

10.1 Providing detailed information to the public (in practice, to access seekers and other stakeholders) is generally to be preferred ahead of just providing reassurance (or otherwise) that all is well. When reviewing necessary changes following operational separation, Ofcom commented on this, noting the various benefits of broader reporting:[12]

> Ofcom considers that a regulatory environment where stakeholders are simply informed that the regulator is satisfied that the obligations have been met is likely to be less effective than one where the industry is better informed. Disputes and investigations will be resolved more quickly, efficiently and on the basis of more reliable information. Specifically, Ofcom considers that relying solely on the regulator's assessment of whether compliance has been demonstrated carries the risk that either:
>
> - Important issues that may have been identified by stakeholders will remain unnoticed; or

[12] Ofcom, *Regulatory financial reporting obligations on BT (*26 January 2007).

• Ofcom's allocation of scarce resources to important issues will be reduced as it is obliged to consider an increased number of speculative complaints raised by less well informed stakeholders.

11. NGN

11.1 A recent unsatisfactory step taken by Telecom demonstrates why it is right that the Commission is focussing on disclosure requirements as to investment in key areas such as NGN investment. InternetNZ submits that forward-looking disclosure should be required.

11.2 As part of its Undertakings, Telecom committed to establish a comprehensive industry-wide NGN consultation programme.[13]

11.3 Telecom comments positively on its draft consultation programme that has recently been released:[14]

> We have compared our proposal with the Consult21 NGN consultation carried out by BT in the UK and feel that our proposal is a significant improvement on that. Among other things that process was largely controlled by BT without involvement of a body such as the TCF and involved a wide range of disparate work streams which were difficult for the Access Seekers to manage.

11.4 Disappointingly, Telecom has used, as its benchmark for adequate consultation (BT's Consult21), a consultation programme that failed to deliver. The position was so serious that Ofcom stepped in and effectively replaced BT's Consult21 programme with the independent (and Ofcom-funded) NGN UK, which continues to this day.

11.5 Investment and competition in relation to NGN and NGAN is a key, if not the key, challenge and controversial issue in telecommunications. The prospect of, for example, incumbents regaining monopoly control as the goalposts move, is seen as a major issue.

11.6 Inadequate consultation, and sharing of information, can be highly damaging for competition and the long term benefits for end-users. There is, in the approach noted above, an inference that Telecom is taking a low level compliance approach in relation to its consultation commitment in the Undertakings.

11.7 This concern provides even more reason than exists anyway, for the Commission to continue down the path of focussing on disclosure in relation to major investment (such as NGN, MSANs, etc).

11.8 This is happening overseas. For example, regulatory reporting on NGN issues has recently been strengthened in the UK, by way of Ofcom's 26 June 2008 report on accounting separation.[15] Noteworthy is that detailed regulatory disclosure is required even though the NGN UK consultation is being undertaken. In other

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13 *Telecom separation undertakings* clause 67.

14 *Dialogue (NGN Consult) – proposed engagement with the Telecommunications Carrier's Forum.*

15 Ofcom, *Changes to BT's 2007/08 regulatory financial statements: Explanatory statement and notification* (26 June 2008).

words, there should be regulatory disclosure in New Zealand despite a parallel industry consultation process.

11.9 InternetNZ submits that Telecom should be disclosing its forward looking plans, forecasts, network capacity information and policies.[16] The current proposal to disclose only historical information is insufficient.

11.10 This approach follows that adopted by the Commission in the electricity sector as noted above.

11.11 Such a forward-looking disclosure is not yet proposed for Telecom. The current focus of the Commission's discussion paper focuses upon historical disclosure. That includes disclosure in relation to investment in key areas such as NGN and NGAN.

11.12 InternetNZ submits that Telecom should be required to disclose, applying detailed criteria as set by the Commission, its NGN and NGAN plans and forecasts, network capacity information, etc. This will be key in helping inform the Commission and stakeholders in this crucial area for the sector, going forward.

11.13 We note that forward-looking disclosure does not automatically require disclosure of confidential plans etc by Telecom, beyond the Commission. That is a separate question.

11.14 NGN and NGAN highlight a real difficulty with the current focus on annual historical financial information. Investment expenditure details will not be available until around three months after the end of each balance date. By then, particularly in relation to fast moving events in respect of NGN and NGAN, it will be too late. The next two years are particularly critical for NGAN and NGN yet full historical accounting would not be provided until after the end of the first full accounting period (that is, around September 2010).

11.15 The Commission has available to it models from the New Zealand electricity sector and from the UK to guide it as to how to structure the forward-looking disclosure obligations.

11.16 Finally, we note that Telecom's NGN obligations under the Undertakings are relatively restrained and there should be wide reporting obligations as a consequence, in this pivotal area. For example, there are significant carve-outs that enable the wholesale unit to communicate directly with Telecom retail in relation to the development of bitstream services.[17] This and similar carve-outs, and obligations on Telecom, indicate that robust provision of information under Part 2B will be important in respect of NGN and NGAN.

12. Further investment disclosure, and the level of disclosure

12.1 When considering NGN, InternetNZ considers that other key investment areas should be considered for forward-looking treatment as well.

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16 Section 69ZB (h) to (k) Telecommunications Act.
17 Telecom separation undertakings clause 52.3.

12.2 At paragraph 56 of the discussion paper, the Commission seeks, as to investment and assets, comment on the scope of disclosure, materiality and the level of granularity or aggregation in the statements. InternetNZ submits that Telecom should be invited to provide draft proposals for review by the Commission and by stakeholders, taking into account the treatment of assets and investments by BT under the Ofcom requirements (which include extensive lists, recently updated to accommodate NGN), and the electricity companies, under the Part 4A Commerce Act regime. Materiality should be assessed not only on the financial amounts but also equipment/service volumes.

13. Implementation period

13.1 InternetNZ appreciates that:

(a) there are some practical challenges in expediting implementation; and

(b) the Commission is suggesting some steps which in practical terms will expedite informal compliance.

13.2 However, the implementation period appears to be much longer than it needs to be. The nearly four year delay in getting the first full report is unnecessary.

13.3 The Commission and Telecom already have available to them a wealth of information as to how to structure the disclosure requirements, including the BT experience before and after operational separation (as to which there is extensive documentation), the ERG guidelines and the extensive body of material developed since 2001 in relation to the electricity sector.

13.4 More importantly, Telecom has been producing the great majority of the required information for a considerable period (including as to Chorus and Wholesale for some months before Separation Day).

13.5 The accounts can be prepared retrospectively. They do not need to be provided until three months after the end of each financial year and so Telecom can move to full accounts for the current financial year. The transitional year is not required.

13.6 As we note above, Telecom should be required to move now to a CCA approach.

13.7 One reason to move expeditiously is that, as the New Zealand electricity sector and Ofcom experiences show, these reporting regimes develop incrementally and change over time. Issues get ironed out over time. The sooner fully worked up reports can be started, the sooner those reports can be refined based upon experience.

13.8 InternetNZ recognises that the Commission is taking positive informal steps to develop the requirements including informal meetings with Telecom thus far and more formal and minuted meetings over the coming period. These initiatives are excellent and should continue, and the structure of providing minutes publicly also enables consultation on the various proposed steps. However, InternetNZ can see no reason why fulsome disclosure by Telecom should be delayed.

14. Product statements

14.1 If disclosure is limited to regulated services, the products should include each bitstream variant (covered separately), LLU, and backhaul for those services.

14.2 Going forward, the Commission should consider having product statements for some services that are not regulated.

14.3 It may prove necessary as well, in due course, to drill down to greater granularity than the cost stack underlying a product.

14.4 It is unlikely to be necessary or appropriate to aggregate types of products.

14.5 One-off charges should be reported on: they can have discriminatory effect.

14.6 That assumes an approach based on historical accounting. As noted above, accounting should be based on CCA, with information produced on pricing (e.g. TSLRIC).

15. Audit

15.1 InternetNZ considers that audit, as proposed by the Commission, is essential. The real issue is the nature of that audit and its extent, which is to be reviewed by the Commission.

15.2 The Commission is concerned with accounts that are fit for purpose in regard to promoting competition for the long-term benefit of end-users.

15.3 In the UK, Ofcom has adopted a "fairly presented in accordance with" audit opinion when requiring regulatory reporting. It has further reserved the right to target specific areas of concern on a discretionary basis. This approach should be adopted here too.

15.4 Ofcom has started to relax some of its audit requirements as it becomes more comfortable with BT's approach. It is important that the initial audit includes a full review of the financial accounts down to product statements as well as the forward looking capital expenditure plans. On ensuring a compliant adoption of the Act, we would then expect a relaxation of the detailed approach.

16. Competition law issues (e.g. price squeeze and bundling issues)

16.1 Information disclosure under Part 2B should provide information to assist the Commission, participants and Telecom in dealing with Commerce Act issues.

16.2 As InternetNZ notes above, Part 2B is designed to accommodate this.

16.3 An important example is the impact on the market of the growth in bundles (quad play, triple play etc). This leads to the increased risk of horizontal price squeezes (and related competition problems). There are ongoing challenges in relation to vertical price squeeze. These issues at present are difficult for the regulator and access seekers to handle, in view of cost, court delays, uncertainty, and lack of information (as well as concerns about the interpretation of s36, currently under appeal in the 0867 litigation).

16.4 There is good reason to seek ways to improve the position.

16.5 Australia, under its information disclosure regime, requires Telstra to provide imputation data to enable assessment of the prospect of price squeeze issues. This should happen here too.

16.6 Requiring disclosure of information that points to breaches can have the effect of stopping breaches in the first place, thereby avoiding the multi-year delays, costs and uncertainties of litigation (which dissuades regulators and industry providers from pursuing claims). The comment from Ofcom at paragraph 4.1 above shows that broad disclosure to the industry is useful.

16.7 It is said that the imputation test in Australia in its current form is not optimal. A more robust model could be developed for New Zealand. What is appropriate is data and/or an imputation test that provides a first-level indication of whether there might be price squeeze issues.

17. Price comparison

17.1 The Commission should, using its powers, review financial returns earned by Telecom (eg, EBIT to revenue, and EBIT to average assets), as against international comparisons. This should happen down to product level.

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