

BY E-MAIL

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TelstraClear Bitstream Draft Determination
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Comment on the Commerce Commission's draft determination on the application for determination for access to and interconnection with Telecom's fixed PDN service 'Bitstream Access'

This comment on the Commerce Commission's draft determination on the application for determination for access to and interconnection with Telecom's fixed PDN service 'Bitstream Access' is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests. Members of the NZBR include both suppliers and users of Telecom's PDN service. In our view the long-run interests of suppliers and users are maximised when policies favour the maximisation of the sum of producer and consumer surplus.

The focus of this comment is on what we understand to be the proposition in the draft determination that the price Telecom can charge to competitors for bitstream access will not be permitted to increase with increases in the speed of the downstream data transfer services being offered. (This is what we infer the draft determination means in paragraphs iv and 226-228 when it prohibits Telecom from not 'applying rate-shaped' speed to downstream bitstream service.)

The basis for the Commerce Commission's proposal appears to be its 'understanding' in paragraph 159 that the cost of supply of a bitstream service does not vary materially with downstream and upstream speeds. Putting to one side the issue of whether this understanding is accurate, it does not seem to us that it follows that it is desirable on these grounds to prevent Telecom from pricing according to the speed of the service being offered. The Commerce Commission has taken the view that there is limited competition for these services. The most commonly postulated reason for such a situation is declining costs. In such circumstances, economists widely accept that it is necessary and desirable for prices to vary from cost according to the elasticities of demand for the services delivered. For example, a standard textbook on these matters comments that:

The Ramsey pricing rule can be viewed as providing theoretical justification for the so-called "value of service" pricing that has been used for years in the railroad industry. It has been common for rail rates for shipping gravel, sand, potatoes, oranges, and grapefruits to be lower relative to shipping costs than for liquor, electronic equipment, cigarettes and the like. The reason is that the elasticities of demand for shipping products that have low values per pound are higher than for product that have relatively high values per pound.¹

¹ W K Visuci, J M Vernon, J E Harrington, *Economics of Regulation and AntiTrust*, second edition, 1998, p 367.

Even in a static world that ignores all issues to do with dynamic efficiency, pricing according to market demand can be necessary to recover total costs, either because of the need to cover fixed costs in a declining cost situation or because of the need to recover common costs. The Commerce Commission's opposition to such pricing in this case begs the question of the basis for deciding that there is a significant monopoly problem in the first place. In any case, in fast-moving technological situations, such as those associated with broadband, issues of dynamic efficiency are likely to be far more important than static efficiency. In terms of dynamic efficiency, the case for preventing demand-responsive prices is even more difficult to comprehend.

In summary, we are concerned that the proposed limitation on pricing flexibility could reduce economic efficiency. For example, it might increase prices for some users and reduce effective service choice for others, while also deterring future investment in infrastructure.

We regard with considerable concern the Commission's 'no-weight' dismissal in paragraph 231 of the incumbent's doubts about the stability of bitstream services under the proposed approach. We accept that the incumbent is self-interested, but we do not agree that it is in its interest to make claims that have no validity – which appears to be what the Commission is asserting. In our view the burden of proof that its decisions will do more good than harm falls on the Commission, not the incumbent. It can just as easily be presumed that a regulator is self-interested, and the incumbent should not be treated as guilty until proven innocent. To the extent that the Commission's decisions on bitstream and related matters deter future investment in infrastructure, the costs may fall on long-term users, not the incumbent. In any case, we do not understand how the Commission's proposals in the draft determination would allow evolving capacity or stability problems to be efficiently managed. We would seek greater assurances for end-users in these respects than is conveyed by paragraph 231.

In conclusion, we urge the Commission once again to focus on dynamic efficiency, particularly on the need to provide adequate incentives for investors to invest in infrastructure for the long-term benefit of end users, rather than on inducing parasitic competition for existing infrastructure. While the Commission's draft decisions may favour investors in some competitors in the short term at the expense of investors in the incumbent, this is not likely to be in the best interests of long-term users. The matters in the draft determination that we have focused on in this comment give us little confidence that the Commission is putting adequate weight on longer-term efficiency issues. In its final determination we urge the Commission to put more weight on efficient pricing principles and the need to preserve incentives to invest in infrastructure.

Yours sincerely

A handwritten signature in blue ink, appearing to be 'R L Kerr', written in a cursive style.

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