



19 September 2005

Osmond Borthwick
Manager
Network Access
Commerce Commission
44-52 The Terrace
Wellington
New Zealand

By EMAIL

Dear Osmond,

TelstraClear Wholesale Bitstream – Comments on Section F of Telecom’s Proposed Technical Specification Response

1. This letter sets out TelstraClear’s comments on the price-related submissions contained within Telecom’s 12 September response to the Commission’s 30 August technical specification proposal.

Telecom’s Pricing Submissions should be Disregarded

2. The Commission’s 30 August consultation was confined to technical matters contained within its draft technical specification proposal. Telecom’s response also addressed pricing matters at length (see Section F: The Commercial Effect of a New Service Specification).
3. Telecom’s pricing-related submissions travel well beyond what was reasonably required to respond to the Commission’s technical specification proposal. Under the guise of making such a response, Telecom takes the opportunity to make further arguments against the Commission’s pricing approach in the Draft Determination and in favour of its own tight link approach. In TelstraClear’s view, the Commission’s proposed approach to the technical issues is not so fundamentally different to the discussion that has come before as to make, as Telecom alleges, everything the parties and the Commission have previously said on pricing “redundant”.
4. The Commission’s 30 August technical proposals, and the parties’ responses, represent variations on the same basic themes which have run throughout these proceedings: whether the bitstream service should be unconstrained (or set at the theoretical maximum line speed), as TelstraClear argues, whether there should be a tight link to retail Jetstream services, as Telecom argues, or whether there should be an alternative model which allows unconstrained (or maximum

constrained) speed for those lines which are technically capable of supporting that service and a high but limited speed service for lines which are deemed to be problematic. The Commission's latest technical proposal and the parties' proposals put in response are, in effect, different versions of an alternative model which has been debated backwards and forwards between the parties in their submissions, at the workshops and at the Conference.

5. While the technical specifications of these three basic models have been debated at a more detailed level over the last several months, the fundamental issues involved in deriving a wholesale price from Telecom's retail Jetstream price in accordance with the Initial Pricing Principle remain the same. The price-related issues arising from each party's primary model and of alternative approaches which combine unconstrained (or maximum constrained) and high but limited speed services have been well canvassed. Both parties, therefore, have had an adequate opportunity to put their views on these issues and further submissions on pricing issues were not necessary.
6. It also should be borne in mind that the process of setting an initial price is, as the Commission noted in the Wholesale Determination, a process of approximation. The purpose of setting an initial price is to avoid the detailed forensic examination of actual costs that have bogged down interim determination proceedings in other countries. That detailed cost examination is left to the setting of the final price. The interim price can, as the recent decision of the High Court held, be replaced by the retrospective application of the final price. Therefore, in determining whether it has sufficient material to make a determination of the initial price, the Commission must be cognizant of the nature of the initial price and, more generally, the requirement to make an initial determination expeditiously.
7. Accordingly, TelstraClear submits that the Commission should disregard the pricing-related submissions that Telecom makes in its 12 September response.

Response to Telecom's Pricing Submissions

8. If, notwithstanding TelstraClear's views, the Commission decides to take Telecom's 12 September price-related submissions into account, TelstraClear should be afforded the right to respond to them and we take the opportunity to do so below.

The need for a new pricing methodology

9. Telecom argues that the Commission's 30 August technical specification proposal differs materially from the Draft Determination, and hence a new pricing approach based on a weighted average of Telecom's retail prices is required. TelstraClear disagrees.
10. Telecom's argument that since TelstraClear's wholesale bitstream SIR will be set at the average SIR achieved by Telecom's retail services the wholesale bitstream service must be priced by means of a weighted averaging of Telecom's retail services is merely a repeat of previous submissions. Telecom is simply exploiting the Commission's averaged SIR proposal to find another angle for remaking its case for a tight link between retail and wholesale prices.

11. In TelstraClear's view, the service proposed in the Draft Determination and in the 30 August draft technical specification share the same fundamental feature that that there is no link between the downstream speed of the wholesale service and the downstream speed of the retail Jetstream service. The only difference between the two proposals is that the 30 August proposal is constrained to 3.5Mbps as a starting presumption to address Telecom's technical concerns. Both proposed services, as they do not relate to Telecom's retail downstream speeds and do not have a monthly data usage cap, do not have a retail service that is equivalent across all parameters.
12. Therefore, Telecom's tight link approach to pricing is as inapplicable to the bitstream service in the Commission's 30 August proposal as it is to the bitstream service proposed in the Draft Determination. The bitstream service, as an unbundled service, is more than the "half a retail Jetstream" of which Telecom conceives and therefore a technical tight link is inappropriate.
13. The same initial step applies whether the Commission then goes on to provide for an unconstrained (or maximum constrained) speed service, as TelstraClear has requested, or the alternative model of some combination between an unconstrained (or maximum constrained) speed service and a high but limited speed service, as the Commission proposes in its 30 August technical specification. In either case, the Commission must impute a starting retail price for the bitstream access service before applying the retail minus component to derive the wholesale price. The retail bitstream access price imputation should not be viewed as an averaging of retail prices. As Professor Ordober pointed out at the conference, the imputed bitstream access price should be thought of as an "option value" price imputed from a range of prices rather than any kind of weighted average.
14. The large variances between retail prices depending on speed, data cap and customer type relate principally to the downstream elements that the network access seeker provides rather than the access component. Therefore, an averaging exercise rather than a modeling of relationships using regression will significantly overstate the wholesale bitstream access price and reduce the long-term benefits to end-users from bitstream-enabled competition.

The cost impact of a higher PIR:SIR ratio or a PIR above 3.5Mbps

15. Telecom submits that the application of an average SIR generally means that there would be no difference in the cost of the regulated service and Telecom's average service. However, Telecom states that this is not the case where there is a higher PIR:SIR ratio or where the PIR is above 3.5Mbps.
16. Telecom has previously, and extensively, made the same argument that a higher downstream speed has cost implications for its network. The price related issues which arise from a higher speed under the Commission's 30 August proposal are, in substance, no different to those which arise in relation to the TelstraClear request for an unconstrained (or maximum constrained) speed service or, for that matter, any of the previously discussed alternative models which provide for the bitstream service to be offered at higher speeds than the retail Jetstream service across at least some lines. The Commission may be proposing a different "trigger" for the unconstrained (or maximum constrained)

speed service, but the price and cost issues for an unconstrained (or maximum constrained) and high but limited speed service are the same.

17. As TelstraClear has previously submitted, we do not believe that the downstream speed has any material impact on the cost of providing bitstream access. The only element of the access service that has scope for the resources utilized by a wholesale service to be different to that for Telecom retail services is the link from the DSLAM to the ATM and we consider that this is a small element of the end-to-end cost. However, at the technical workshop we proposed that TelstraClear's minimum speed per end-user at peak congestion (Sustained Information Rate (SIR)) be set at the average allocated throughput per end user achieved or planned by Telecom for its own retail services across the network. This means that the resource utilization of the wholesale bitstream access service will be consistent with the average resource utilization achieved across all Telecom retail services reliant on the same access network resources.
18. It is the SIR that determines virtual path dimensioning, something Telecom acknowledges in its 12 September submission.¹ The PIR cost impact Telecom argues for is an "opportunity cost" of spectrum and of virtual path capacity during non-peak periods. TelstraClear does not accept that a PIR above 3.5Mbps will cause interference problems, and if the Commission considers that this is a risk higher PIRs will only be set in instances where this risk is not considered material. Further, virtual path capacity is provisioned for peak congestion. In TelstraClear's (and Telstra's) experience differing PIRs sold in the retail market have very little effect on the SIR and, in any case, by accepting Telecom's average SIR we are avoiding any increase in resource utilization. It therefore follows that at non-peak times there should be sufficient capacity to support all user's requirements.
19. The "value/cost/price" of having a higher PIR, and hence the retail price premium that Telecom refers to² is in fact a value/cost/price difference related to the elements of the end-to-end service that TelstraClear provides. Building these differences into the access price through a weighted average retail price exercise will merely lock into the bitstream access service the high prices and inefficiencies that bitstream-enabled competition needs to address. It seems to us that Telecom is again trying to exploit the opportunity of responding to the Commission's 30 August technical proposal to remake the kind of price arguments that Telecom made at length in previous submissions and at the Conference.
20. We look forward to receiving the final determination.

Yours sincerely,

¹ See footnote 15, page 39.

² Page 40, 12 September submission.



Grant Forsyth
Manager, Industry & Regulatory Affairs

DDI: 09 912 5759

Fax: 09 912 4077

Email: grant.forsyth@team.telstraclear.co.nz

cc: Vanessa Oakley, Telecom
Michael Wigley, InternetNZ