ihug Limited and CallPlus Limited

Cross Submission in Respect of Applications by CallPlus and ihug for Access and Interconnection with Telecom's Fixed PDN Service ("Bitstream Access")

9 May 2006

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TABLE OF CONTENTS

1 **Introduction and Executive Summary** 4

2 **The Minister's 3 May 2006 announcement** 7

3 **Framework for the Determination** 8

4 **Requested Bitstream Service** 9

Introduction: 9

Spectrum Management: 10

"Conclusion 12

The Brown's Bay and Remuera examples 12

"Bit Rate Limiting PLUS": 13

Reach: 13

Speed and the ACMA Report 14

Cost Benefit Analysis: 14

***ADSL2+*:** 15

Sustained Information Rate (SIR): 15

Interleaving 16

5 **Sundry Charges relating to Supply** 16

6 **Non Price Terms** 16

Term of the determination: 16

Implementation timeframe: 17

Operational support systems: 17

7 **Application of the Initial Pricing Principle** 17

Critical flaw in Telecom approach: 19

Shared VP and backhaul capacity: 20

Evaluation of the reasonableness of the result: 20

Discriminatory Pricing: 20
Product differentiation: 21
Avoided costs: 21
8 Market Definition and Competition Assessment 22
Introduction: 22
9 Developments since 568 23
Annex 1 26
Annex 2 27

1 Introduction and Executive Summary

1.1 Even in the opening paragraph of its 12 April submissions[1], Telecom makes unsustainable and unsupported assertions. This is a strong feature of Telecom's submissions. In para 1, Telecom states:

> "*Our recent Wholesale Charter affirms our self-imposed commitment to the delivery of intermediate products such as UBS with consistent network performance and available at the same time as retail where a retail xDSL service is offered.*"

But the Wholesale Charter[2] states:

> "*… this charter does not create legally enforceable obligations for Telecom or entitlements for third parties.*"

1.2 The access seekers seek Determination 568 as it stands, with a price of $20.74 per month, and they contend that nothing that Telecom has submitted points to a change from that determination made only a few months ago.

1.3 The Telecom submissions are peppered with assertions about what will or might happen in the future without any, or any sufficient, supporting detail. Generalised assurances are given that are not backed up by detail.

1.4 Often Telecom is uniquely in the position of being able to provide the information and yet has not done so. Where providing the information is in Telecom's self-interest, yet it did not do so in its 12 April submissions, that in itself leads to an inference that the assertion being made is not sustainable.

1.5 The *Telecommunications Stocktake* Cabinet Paper, released by the Minister of Telecommunications last week, identified the sort of problem that arises when assertions are made as to future action by Telecom. For example, as to assurances around roll out of investment (there are further extracts to illustrate the problems):

> "*In accepting the Commission's recommendation, the Minister predicated his response on the expectation that the decision would lead to the co-operative development of an effective wholesale market, and provide incentives for Telecom to quickly deploy its Next Generation Network (NGN). The investment in*

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[1] Telecom advises that its 12 April 2006 submissions in respect of ihug and CallPlus respectively are materially identical. This submission deals with the application on behalf of both access seekers. References to the Telecom 12 April submissions are to the same paragraph in each of Telecom's submissions. References to "*568*" are to Determination 568.

[2] Available at http://www.telecom.co.nz/binarys/final_charter_document.pdf.

residential NGN infrastructure has not developed as quickly as anticipated."[3]

"Under status quo conditions, in other words without further regulatory intervention and in the absence of intense competition, Telecom is likely to continue to be incentivised to defer investment on the basis that delay postpones cannibalisation of existing revenues and that costs of investment decline as equipment prices fall."[4]

Then later in the Cabinet paper:

"Telecom's investment in replacing its residential telephone exchanges with Next generation equipment has slipped by a year or more from its originally announced plan. The launch of advanced broadband services has been similarly delayed and there has been little investment in fibre to the cabinet to improve the broadband speed of the copper "local loop" (the subscriber line from the customer's premises to the edge of the network, ie: the nearest exchange). Under the current regulatory environment, it is therefore unlikely that investment will be undertaken fast enough to meet the government's 2010 target for broadband penetration."[5]

And further:

"However, increased investment and service improvements would not be guaranteed and may be difficult to measure and may not be effectively enforceable. Experience to date with voluntary agreements suggests that gaming and delays may occur.

In accepting the recommendation of the Commerce Commission not to unbundle the local loop in 2003, the government predicated its response on the expectation that the decision would lead to the co-operative development of an effective wholesale market, and provide incentives for Telecom to quickly deploy its Next Generation Network. The investment in residential NGN infrastructure has not developed as anticipated.

Since that time, Telecom delayed the availability of the regulated wholesale UBS service and threatened to litigate the determination of an improved UBS offering. While Telecom achieved 279,123 residential broadband connections and exceeded the voluntary target for broadband uptake of 250,000, it did not, in the government's view, meet the wholesale target that a third of these, ie: 83,000, be with wholesale UBS supply agreements. The ability to deliver this target was also

[3] Para 40 Telecommunications Stocktake Cabinet Paper May 2006.

[4] Para 62 Telecommunications Stocktake Cabinet Paper May 2006.

[5] Page 444 Telecommunications Stocktake Cabinet Paper May 2006.

dependent, in part, on Telecom's competitors taking up more wholesale services from Telecom.

International experience also suggests that a market without increased competitive pressures is likely to experience slower evolution of services and prices and the lesser innovations and service improvements that do occur are likely to be delivered to a timetable that suits the incumbent rather than users. Therefore voluntary agreements are unlikely to deliver the service improvements required to catch up with leading OECD countries."[6]

1.6 Telecom faces a clear-cut determination and therefore there is even more reason to disregard or heavily discount any assertion by Telecom that is not adequately supported. Telecom must clearly demonstrate, with sufficient supporting information and data, reason to move away from 568.

1.7 Even if the Commission is concerned about the validity of issues raised by Telecom, there are readily available solutions. To take an example, Telecom outlines in vague fashion some sort of "*spectrum management*" mechanism it is looking at developing during the course of this year (which it has called "*Bit Rate Limiting PLUS*"). Rather than relying on this vague information, the Commission can simply do what it did in determination 568 at paras 241: Provide for an unrestrained service leaving Telecom subsequently to seek the Commission's approval of a spectrum management regime. Ihug and CallPlus commit to using best endeavours to cooperate with Telecom to rapidly resolve spectrum management issues in the hope of expediting consideration by the Commission or, ideally, by commercial agreement of spectrum management issues.

1.8 Telecom has raised numerous issues in its 12 April submissions but the access seekers consider that there are a limited number of key points that should enable the Commission to come to straightforward conclusions. This, the Access Seekers maintain, is an important observation. Unavoidably they have had to deal with numerous issues raised by Telecom. But there is a simple way through this. It is noted in particular that para 241 of the 568 determination remains a safe path along with the Commission's pricing methodology.

1.9 As Telecom has not provided sufficient justification to the contrary in its submissions, the terms of Determination 568 should apply, with a price adjustment to $20.74 per month excluding GST, as set out in the access seekers' 12 April submissions.

1.10 In its 12 April Submissions, Telecom has not produced sufficient evidence or data to support the alternative approaches that it advanced. The Commission should dismiss those alternative approaches.

[6] Page 47 Telecommunications Stocktake Cabinet Paper May 2006.

1.11 Telecom's indications[7] that a new spectrum management regime is to be introduced should be disregarded. If Telecom is sufficiently concerned about adverse implications of introducing the service prior to the "*spectrum management*" plan being agreed by the Commission, it can initially limit provision of the service to ihug and CallPlus thereby keeping any issues it perceives to manageable levels. Ihug and CallPlus do not seek to get a service ahead of other providers: they simply note this as an option that is available to Telecom which the Commission can take into account in making its determination. ihug's and CallPlus's limited traffic, compared to all potential traffic, would have minimal impact on cross-talk. Further ihug and CallPlus will voluntarily agree to application of ACIF spectrum management of their services, pending resolution of issues by the Commission.

1.12 ihug and CallPlus accept the commercial risk for them in taking this approach (for example, that they may need to later reduce the level of service to their customers as that is required by the subsequent spectrum management decision). That is a matter for ihug, CallPlus and their customers and not for Telecom, contrary to the point made by Telecom. It is for them to set (and live with) the expectations of their customers.

2 The Minister's 3 May 2006 announcement

2.1 In these cross-submissions, the access seekers refer to various aspects of Cabinet's 3 May decision. However that decision does not lessen the appropriateness or need for a determination modelled on 568. That is so particularly because of the time lines for introduction of the new services. The Cabinet Paper envisages introduction of a Bill in July 2006 and enactment of amendments to the Act (which will add the altered UBS description and LLU to Schedule 1) by December. As the Cabinet paper notes, this leaves issues such as price and non-price terms to be determined by the Commission should an access seeker make an application. That of course must be preceded by commercial negotiations. After the determination is issued there is an implementation period. Based on past history, it seems likely that there will need to be an application to the Commission in relation to "upsized" UBS and LLU. In the Cabinet paper, it is expected that UBS will be available toward the end of 2007 and LLU available in 2008.

2.2 These time lines assume that matters flow relatively smoothly. Given the extra dimensions to the "upsized" UBS and LLU services, the realities of the parliamentary process, commercial negotiations, the time for dealing with matters before the Commission (a good parallel being the proceedings leading up to Determination 568 itself), and the implementation period post-determination, this appears to be a tight timeline.

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[7] Paras 3 and 8 Telecom 12 April submissions.

2.3 Even if the process runs that quickly (which is questionable), the Commission should therefore not depart from making any determination along the lines of 568, based upon last week's Cabinet decision.

2.4 In any event even if the new services are fully implemented some time during the tail end of the term of the service currently being sought, the new UBS service will probably in practice simply replace the old service. There should be no need to have the period of the determination other than the requested two years.

3 Framework for the Determination

3.1 This section focuses particularly on the approach to information that is not before the Commission.

3.2 However responsibilities are stated, and wherever the legal or evidential onus of proof might lie, the Commission is fully justified in concluding that, where a party has not produced data and information available to it in support of an outcome that it seeks, that is the end of the matter and the outcome is not established.

3.3 That is particularly so where the information is uniquely within the knowledge of the party seeking to support that outcome.

3.4 It is even more so where that outcome is contrary to the position already established in the earlier determination (in this instance Determination 568). It is and was obvious to Telecom that it would have to produce strong information to justify a departure from 568.

3.5 Among other things, conclusions can be drawn by reason of Telecom's failure to produce the underlying information that is not available to others. For the Commission to do otherwise perpetuates the real difficulties created by the information asymmetry as between (a) the access provider (which generally uniquely holds considerably more information) and (b) both the Commission and the access seekers.

3.6 As has been identified elsewhere in these submissions, Telecom clearly knew that it needed to produce particular information such as in relation to reach and in relation to the customer distribution underlying the price model, based on averaging, that it now puts forward. Thus, for example, leaving aside the fact that neither the Commission nor the access seekers can sensibly comment on Telecom's proposed pricing model, it is impossible for the Commission to make a decision on the pricing produced by that methodology because it does not have the information. As decisions well known to Telecom (such as *Wellington Airport)* confirm, the Commission does not have to track down this information. It is up to the party to produce it. There is no surprise in this for Telecom, given for example the history and status of 568 and the repeated and unmet requests for Telecom to provide sufficient information (eg; as to reach).

3.7 The access seekers consider that it is not necessary to revert to issues such as onus of proof to arrive at this outcome but it is noted that this is a determination to which there are specific parties (ihug,

CallPlus and Telecom). The onus of proof on the issues put forward by Telecom lies with Telecom. See paras 78-81 of the Commission's LLU/PDN report The access seekers firmly submit that the Commission must disregard (or if it does not do so, heavily discount) assertions that were not backed up by detail in Telecom's submissions. If the detail underlying the assertions is not in the submissions, that should be the end of the matter.

3.8 Determination 568 provides a default position and Telecom squarely had to justify a departure from that Determination in its 12 April submissions. There is no unfairness in this. The need to produce detail was made firmly in a series of exchanges in the proceedings leading up to 568, most recently in Commissioner Webb's letter to Telecom dated 9 December 2005[8]. See also the detail about lack of production of information about "reach" in each of the 3 written InternetNZ submissions in the 568 proceedings.

3.9 Finally, in relation to framework, reference is made to the sections below headed *"Lack of information from Telecom"* and the subsequent section, *"Critical Flaw in Telecom Approach"*. These sections deal with the Access Seekers' request for information underlying the alternative price methodology put forward by Telecom, together with details of tolls spend. The conclusions there pervade the Telecom approach overall. As outlined in more detail in that section, Telecom has refused to provide key information underlying its submissions, creating the identified problems for the Commission and the Access Seekers. More critically, however, Telecom, by choosing not to provide all information underlying its submissions, has failed to give the Commission the information necessary to take an approach different from that in Determination 568.

3.10 The access seekers wish to note that they recognise that some fluidity and practicality is required in Commission processes and information gathering. It is unhelpful to all, as well as unhelpful to the meeting of s18 drivers, to be unduly hidebound by tight process. But here we have a very recent determination where what Telecom had to do was obvious, and they "hold many of the cards". There are limits to how far a regulatory body can and should go, which is the message from *Wellington Airport* and subsequent well-known cases.

4 Requested Bitstream Service

Introduction:

4.1 The approach in this section is governed by the Framework section of this submission (para 3).

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[8] http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/Wholesale/WholesaleDeterminatons/ContentFiles/Documents/UBS%20Proceeding%20future%20telecom%20broadband%20pricing%20plans.pdf

4.2 Recognising the possible need for spectrum management, 568 provided for unrestrained speeds with the ability for Telecom to come back subsequently to the Commission for approval of a Spectrum management plan (para 241 Determination 568). There is nothing in the Telecom submissions which justifies a change from that approach.

4.3 Further, the material in the Access Seekers' submissions (including these cross-submissions and the Gibson Quai report) provide additional support for the Commissions' approach in 568 (indeed they go further by justifying incorporation of a spectrum management regime in the determination now (although that is not essential)).

4.4 The Access seekers note that there is sufficient pre-existing material, without the additional material now produced, to enable the Commission to make the determination as in para 241 of Determination 568. If necessary, the material in these submissions can be relied upon, or can give greater comfort that the Para 241 decision should stand.

4.5 The Telecom 12 April submissions contain vague proposals around introducing a spectrum management plan towards the end of this year (which Gibson Quai see as implementing the plan sometime no earlier than next year). Telecom lack incentive to expedite resolution of spectrum management (this is the sort of point that also comes out of the Cabinet Paper as quoted above). However, the 568 model contains incentives on Telecom to resolve this quickly and with little or no downside risk. Gibson Quai note that Telecom can simply adopt the ACIF model immediately. Changes can be made later by approval of the Commission. Para 241 of 568 is an appropriate solution that drives the right behaviours and outcomes on the part of all, to best achieve s18 outcomes. It provides a solution to meet Telecom's concerns.

4.6 To the extent that changes might potentially adversely impact on the Access Seekers and their customers (for example, because the service initially given is subsequently curtailed) this is a commercial risk that the Access Seekers (CallPlus and ihug) will accept. That is a risk for them, not for Telecom, contrary to the position put forward by Telecom.

4.7 These submissions and the Gibson Quai report, taken together with earlier submissions, establish that a spectrum management model, such as ACIF is the appropriate approach taking into account the factors referred to in 568. The position has now moved past the Commission's uncertainty, noted at para 240 of 568. However, given the way in which the Commission made its 568 decision (namely, unrestrained speeds with the ability for Telecom to go back to the Commission for approval of a spectrum management model), it is not necessary (even though it is preferable) for the Commission to go as far as accepting applicability of spectrum management as opposed to bit rate limiting.

Spectrum Management:

4.8 Telecom has not only not justified departure from the decision at para 241 of Determination 568. It has not justified departure from ubiquitous international practice: its bit rate limiting solution for all providers (as the method of dealing with spectrum management as opposed to a spectral mask approach) appears to be unique in a world which has unrestrained speeds with a spectrum management regime such as the ACIF model. See further detail in the Gibson Quai report together with the description of the ubiquitous models that are similar to ACIF. Further, Gibson Quai have undertaken a comprehensive comparison of the external plant and environment in Australia and New Zealand: they are largely identical and they conclude that ACIF can readily be used here.

4.9 Why should New Zealand be treated any differently?

4.10 The plausibility of a 3.5Mb limit on speed as the "spectrum management" model becomes decidedly questionable when, at the same time, Telecom looks to roll out a service at up to 7 times that 3.5Mb speed, namely ADSL2+. The Telecom approach is so exceptional and so extreme compared to international practice (and lacks underlying detail despite extended request such as in respect of the "reach" issue) that there is an inference that commercial and regulatory issues are driving this rather than technical and performance issues. How can the Telecom assertion be sustainable when unrestrained speeds at both ADSL1 and ADSL2+ are so commonplace internationally? Why should the Telecom approach stand alone internationally? Telecom have a very high onus to show why they alone should be different.

4.11 In addition to noting the ubiquity of unrestrained services with spectrum management (in scenarios more complex and difficult-to-manage than here: LLU with third party DSLAMs), the Gibson Quai report notes the substantial commonality of masking regimes between different countries and external plant environments. Particular reference is made to the Hong Kong report quoted by Gibson Quai, that concludes the universal applicability of masking regimes very similar to ACIF.

4.12 At para 40 of its 12 April Submissions, Telecom notes that it advised the Commission last year that it wanted to work toward development of a spectrum management regime. By April of this year, it has been unable to articulate that regime in anyway more than simply saying that it was going to develop a regime. Noteworthy is that it says that only **some** customers might get higher speeds. The apparent delay and lack of detail is yet another pointer toward the delays which will result if Telecom is permitted to take time to develop the regime prior to release of this service.[9]

4.13 The Access Seekers are concerned about the assertion at para 49 of the Telecom 12 April Submissions that any plan implemented prior to completion of the work (which it says would be implemented in late 2006 but Gibson Quai indicate would be 2007) is *"highly likely to be more conservative and would not provide an optimal trade-off*

[9] Para 40 12 April Telecom Submissions.

between the various potential speed/reach profile. Telecom intends to work to the later objective". The nature of an incumbent's behaviour, and the history with Telecom thus far, would indicate the converse: left to its own devices, Telecom would provide a conservative plan which has the effect of advancing its own interests (eg higher speeds under ADSL2+), in the face of the international ubiquity of unrestrained speeds managed by largely similar masking regimes such as ACIF. Telecom must not be left to its own devices, for the reasons repeatedly outlined in the May 2006 Cabinet Paper.

4.14 Gibson Quai and its sister company in New Zealand, AAS New Zealand Limited, have provided a comparison between the external plant environment in Australia and New Zealand. Gibson Quai conclude:

> *"**CONCLUSION***
>
> *The cables used by Telecom New Zealand are substantially the same as those used in Australia. The only obvious difference is in the conductor diameter of the mid size cable. In Australia the conductor diameter is 0.64mm whilst in New Zealand it is 0.63mm diameter, this represents a cross sectional area difference of approximately 3%.*
>
> *This very small difference in conductor size will result in minor differences in the primary parameters of the cable however the resultant difference in transmission characteristics will be so small that the ACIF standards would be entirely appropriate to apply in the New Zealand environment. We would therefore expect that there would be no appreciable difference in spectral management requirements and hence bandwidth and reach variables between New Zealand and Australia."*

The Brown's Bay and Remuera examples

4.15 This has all the hallmarks of Telecom continuing to do what it so frequently does: providing limited information (available only to Telecom) from isolated (and often "cherry picked") examples. How can access seekers and the Commission assess this information when it is so limited and they can't sensibly check it? There are any number of examples of Telecom providing cherry-picked information when, vis-à-vis access seekers and the Commission, it "holds all the cards". To accept this type of information perpetuates that notorious regulatory problem: information asymmetry. This should not, the access seekers contend, be allowed or encouraged.

4.16 Moreover, as Gibson Quai point out, even this limited sample is inappropriately interpreted, adopts a target noise margin model which is not in line with international best practice, is overly simplistic and therefore of no use, save that Gibson Quai indicate that it might demonstrate that appropriate targets are not being breached.

4.17 In any event, and mirroring para 37 of Telecom's 12 April submissions, this target noise margin issue can be dealt with as part of the referral back to the Commission for review and approval of a spectrum management plan.

"Bit Rate Limiting PLUS":

4.18 Telecom notes that it expects to move to:

> "*a speed higher than 3.5 Mbps for some customers once Telecom puts in place a new spectrum management regime that enables higher speeds to be efficiently rolled out*"[10].

It says this could be considered to be "*bit rate limiting PLUS*"[11]. Nowhere is the detail underlying "*Bit rate limiting* PLUS" outlined. For the reasons noted above, such general and unspecific indications should be disregarded or heavily discounted. That Telecom has grandfathered full speed plans (which was a rationale for this decision by the Commission) does not alter the underlying reasons for the Commission's conclusion.

Reach:

4.19 It is of considerable concern to the access seekers that Telecom continues to maintain both before the Commission and in its public statements that reach would be reduced with approximately 73,114 lines unable to obtain broadband in the future. Whatever the position as to onus of proof, it is only Telecom that has the information about impact on reach on its own network. Telecom was repeatedly asked in the TelstraClear UBS application to provide the data to back up its reach assertions and yet failed to do so. Well into the proceedings, and well after the point when Telecom could have been expected to provide full information to enable the Commission and other parties to assess the veracity of the assertion, Telecom provided the strongest evidence that it ultimately made available, namely the summary of its **methodology** by which it derived its conclusion that around 70,000 lines were affected. No detail was provided: just the methodology. This left the Commission and the other parties with no ability to check the assertion of matters uniquely within the knowledge and access of Telecom. This "*high point*" (the methodology) was dragged out after a number of exchanges with Telecom and it was still inadequate. The Telecommunications Commissioner, at the outset of the TCL-Telecom conference, commented negatively upon Telecom's reliance on what was then said to be a smaller number of people affected by the "*reach*" issue including its use in opening submissions and in public releases. Telecom, despite having not provided the underlying information on matters uniquely known to it, still continued to rely on what became an assertion based on around 70,000 people including in public releases. It has repeated this again in this application, without further information. Telecom was in the unique position of

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[10] Para 3 Telecom submissions.

[11] Para 8 Telecom 12 April submissions.

being able to provide sufficiently robust information supporting its assertions. Neither the access seekers nor the Commission can do that and Telecom is heavily incented in its own interests to demonstrate this point (its failure to do so is telling). The requirement to produce sufficient data and evidence could not have been made more strongly. The unsupported assertions about adverse impact on reach should be rejected.

4.20 In the face of the position in 568, and lack of detail from Telecom, it is not enough for Telecom merely to state that its *"… commitments to its committed bit rate business services customers may no longer be able to be met."*[12] This mere statement without detail is far from enough to justify departure from the 568 decision. Even if it is a problem, this is something that can be managed within that 568 decision by rapid approval of a spectrum management regime, which provides a strong incentive to Telecom to sort matters out much more quickly than if it is left to its own devices.

4.21 Fortunately, even if Telecom does have the problem that it says it has in relation to spectrum management and degradation of service, this has been markedly reduced quickly as Telecom's fullspeed services are being grandfathered and their usage is being rapidly minimised by way of lower pricing for lower-speed products, and other strategies.[13] The fullspeed services had no artificial speed constraints and thus they had (if Telecom's views are accepted) significantly greater overall impact on service degradation. While a spectrum management plan is being sorted out, this makes the introduction of fullspeed services in the meantime, with a 128kbps uplink, significantly more manageable (that is, assuming there is a problem in the first place, contrary to the Access Seekers' views).

Speed and the ACMA Report

4.22 Telecom's reliance on this report is misconceived as is outlined in detail in the Gibson Quai report. As that report further notes, the 128kbps uplink constrains the downstream speeds to a significantly higher speed than 3.5Mb.

Cost Benefit Analysis:

4.23 The unproven "*reach*' issue noted above is an integral part of what Telecom says must happen: a cost benefit analysis (CBA).

4.24 Telecom simply states that it is the responsibility of the Commission to carry out this CBA and it has not done so. Even if a CBA may normally be required in an application, the Commission is not required to do the CBA unless the party puts forward details and information that is integral to that CBA, particularly where the information is uniquely known to that party. The obvious example here is sufficient information on "*reach*" which, as noted above, has not been made available by Telecom even though it is uniquely

[12] Para 41 12 April Telecom Submissions.

[13] Para 44 12 April Telecom Submissions.

within its own knowledge. In the list of CBA factors provided by Telecom at para 68 of its 12 April submissions, all but 3 of the 7 factors are uniquely or predominantly known only to Telecom. Those 3 factors are (a), (d) and (g) at para 68 of the 12 April Telecom submissions. Those 3 matters are, anyway, matters on which Telecom could have submitted (and has a particularly level of knowledge including some knowledge uniquely known to it). To even get the Commission to consider doing a CBA requires Telecom at least to give it the necessary (or some) information but more likely it must also make a start on such an analysis to put its own theory forward.

4.25 In this instance, there is more reason why Telecom would need to put forward a detailed CBA model and conclusion for there to be a CBA review by the Commission on this point (whether quantitative or qualitative). There is a clear conclusion on that point in 568 and Telecom had an even higher responsibility to put forward the basis for undertaking a CBA, contrary to or in addition to that which was undertaken in respect of 568. "*Reach*" of course is not the only issue in respect of a potential CBA but it would be an essential ingredient. Telecom has held back from providing to the Commission and other parties any basis on which a CBA could be undertaken. For these reasons alone, Telecom has not justified a different approach to CBA.

4.26 In any event, the Commission concluded that a further CBA is not required and no adequate reason is provided to depart from that decision nor is any further information provided to justify departure. The Commission's approach in respect of a CBA (including the conclusion that a quantitative CBA would not be expected in respect of a determination such as this) is outlined in Mr Borthwick's affidavit in the *Telecom v. TelstraClear and Commerce Commission* proceedings arising out of the TelstraClear application.

***ADSL2+*:**

4.27 Telecom expresses concern about continuing the approach in 568, which does not exclude ADSL2+ from the determination that is sought. The access seekers request no distinction between ADSL1 and ADSL2+. It is appropriate to take a technologically neutral approach and have unrestrained services across both. As the Gibson Quai report notes, the speeds achievable over ADSL2+ are no more than the peak speeds achievable over ADSL1 where the uplink is constrained to 128kbps. Importantly, contrary to para 12 of Telecom's 12 April submissions, the access seekers accept that they cannot require Telecom to transfer customers from ADSL1 to ADSL2+ nor require Telecom to (a) invest in particular infrastructure at particular locations or (b) require Telecom to write off old infrastructure. For the purposes of this application, it is accepted that Telecom will invest in new infrastructure and/or write off old infrastructure at their own discretion.

4.28 For these reasons (in particular because the 128kbps uplink constrains speed to the same maximum speed available under ADSL1) there is no impact on Telecom's investment incentives, nor any change needed in the approach to pricing.

Sustained Information Rate (SIR):

4.29 During the 568 proceedings, ihug and InternetNZ expressed considerable concern about the concession made by TelstraClear in relation to SIR.[14] Telecom's Submissions on SIR, para 70 and 71, show a unilateral departure from what was determined in 568 in a way which erodes even further the already unsatisfactory SIR position, to the point where there is no stated minimum throughput

4.30 If Telecom does not reinstate what is in any event an unsatisfactory SIR regime, then the Commission should determine the statutory minimum (that is, downstream throughput rate of not less than 32 kbps with an average of not less than 256kbps in accordance with limit (b) of the Access Principles in the UBS description in Schedule 1 of the Act. This would be a low commitment anyway.

Interleaving

4.31 The access seekers request terms as in 568.

4.32 Telecom should not have the ability to reapply interleaving "off" when the access seeker has requested that it be turned. Telecom is demanding this right because it appears to believe turning off interleaving may adversely impact other users within the same cable. The Gibson Quai report confirms that turning off interleaving impacts that service only and does not have impact on other users in the same cable. Turning off interleaving should be solely at the access seekers' discretion.

4.33 The access seekers accept that Telecom should be permitted to recover the cost of applying or removing interleaving. Those costs must be justified to the Commission's satisfaction in transparent fashion.

5 Sundry Charges relating to Supply

5.1 For the purposes of this application, the access seekers accept the charge for churn fee, new connections and MACs[15]. Telecom receiving access line rental in addition to broadband revenue[16] is neither part of Decision 568 nor, as the May Cabinet Paper points out, is it part of the definition of the service in Schedule 1.

6 Non Price Terms

Term of the determination:

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[14] See the various ihug and Internet Submissions including the Knossos Reports.

[15] Paras 129-131 Telecom's 12 April submissions.

[16] Para 132 Telecom's 12 April submissions.

6.1 In its submissions, Telecom has not proposed any alternative term[17]. No reason to depart from the two year period in Determination 568 has been demonstrated and so that two years should be the term, as sought in para 9.1 of the access seekers' 12 April submissions.

Implementation timeframe:

6.2 The approach is governed by the Framework section of this submission (para 3).

6.3 To be able to justify a departure from the 18 week period in 568[18], which is the period sought by the access seekers[19], Telecom had to provide considerably more detail about reasons for extending the implementation timeframe, particularly in view of the default position in 568 and the fact that the information referred to in para 136 of its submissions is uniquely within its own knowledge. 18 weeks (a particularly long period anyway) should be the maximum period.

6.4 If Telecom seek a longer period, for valid reason, the access seekers would consider a compromise during the implementation period (for example, assuming the RUBS price drops below CUBS pricing, the new pricing applies immediately to the CUBS product).

Operational support systems:

6.5 The access seekers accept the OSS terms as set out in 568. They also accept the points that Telecom have made in its 12 April submissions in relation to OSS.

7 Application of the Initial Pricing Principle

7.1 The approach is governed by the Framework section of this submission (para 3). Note also Para 4.22 above which confirms that Telecom erroneously assume that 3.5Mb is an appropriate benchmark.

7.2 Telecom maintains that the Commission's regression model in Determination 568 is flawed and it proposes instead that price/s are ascertained by a weighted average model.

7.3 In addition, Telecom maintains that the value for tolls to be taken into account has changed and that needs to be factored into the calculations for this application.

7.4 To be able to assess Telecom's proposed approach, the access seekers' solicitor wrote to Telecom requesting the relevant information.

7.5 On 19 April, Telecom replied:

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[17] Paras 133-134 Telecom's 12 April submissions.

[18] Paras 490-492 of Determination 568.

[19] Para 8.1 access seekers' 12 April submissions.

"…you have requested the following information from Telecom:

1. *The data in relation to tolls spend.*

2. *Details of the numbers of customers on each product as at the date of Determination 568, and as at April 2006 before and after the migration of customers to new plans. Confirmation of the plans from which, and to which, customers are being migrated (both for res and biz).*

3. *The base Telecom data on actual or expected Gb usage by Telecom customers.*

In relation to (2) and (3) you have noted that, given the transition, it is not entirely clear what data is required and you have therefore requested the data that is relevant to the proposed Telecom methodology.

Telecom's view is that ihug and CallPlus have all the information that is relevant at this stage of the process. The information you have requested is highly commercially sensitive and we consider that ihug and CallPlus are able to respond to Telecom's submissions without this information. Telecom's submissions are regarding methodology rather than the actual numbers and therefore the accuracy of the numbers is not at issue.

We further note that it is not the usual practice to supply this kind of information between the parties. In general if the Commission considers such information is required it will issue a notice pursuant to section 98 of the Commerce Act. "

7.6 Without this information, the access seekers and their advisers would only be able to undertake a theoretical evaluation of Telecom's proposed model (and likewise as to the impact of what is said to be a new tolls figure). The reality is that the access seekers cannot satisfactorily deal with or comment on the proposed methodology (and the impact of the tolls figure) without that further information.

7.7 Withholding this information as it is "*highly commercially sensitive*" is not a justifiable basis for Telecom to hold it back and is just a smokescreen. As usual, Telecom could have readily supplied the information on a "*restricted information*" basis so that only Counsel and the access seekers' independent economist could see the information. The access seekers do not accept that it was appropriate for Telecom to refuse to volunteer this integral information at this stage for consideration by the access seekers. As is so often the case, Telecom, as incumbent, "*holds all the cards*". The approach by Telecom perpetuates the highly asymmetric holding of information as between Telecom and the access seekers. If the Commission approves or acquiesces in this approach, then the information imbalance is further encouraged and exacerbated. If it has not been an issue thus far, as Telecom maintain, might that be because other access seekers have wanted to protect their own

interests as incumbents in other markets and countries? To CallPlus and ihug, it is concerning that Telecom considers that it is able to take the approach it does.

7.8 In its response noted above, Telecom maintains that the access seekers are "*able to respond to Telecom's submissions without this information. Telecom's submissions are regarding methodology rather than the actual numbers and therefore the accuracy of the numbers is not at issue."* This is not correct. Theoretical models are just that without the underlying data. That point is demonstrated by Telecom's own approach of comparing figures produced by econometric modelling against "*real life*" figures, at paras 118 to 123 of its 12 April submissions. Telecom cannot have it both ways. This recognises the importance of what is self-evident anyway: the importance of the data underlying the modelling.

7.9 Whatever Telecom has done in the past, the access seekers do not accept that it should not be "*the usual practice to supply this kind of information between the parties …*" and that if the Commission considers such information is required it will issue a notice under the Commerce Act. That is a thinly veiled disguise for the party that uniquely holds information (which can easily be supplied under conditions of confidentiality) retaining leverage by still holding all the cards. The negative impacts of information asymmetry in a regulatory environment are notorious and must be well known to Telecom: to allow Telecom to get away with such a statement perpetuates this serious problem.

Critical flaw in Telecom approach:

7.10 There is however a more critical flaw in the Telecom approach. In its submissions, it failed to produce essential information underlying its proposed alternative methodology based on a weighted average model. It has gone even further by refusing to do so despite specific request for the information by the access seekers. It therefore has not established and cannot now establish its case for an alternative methodology (or an approach based on a different amount for tolls). Therefore Telecom's application for alternative approaches (such as the weighted-average model) must be rejected by the Commission. The point is even clearer here. The Commission has available to it the existing methodology in Determination 568 and Telecom has failed to justify a departure from that methodology. Telecom had an even clearer-than-usual requirement to produce all information justifying the change.

7.11 Given the history of the proceedings leading to Determination 568 noted above, let alone authority such as *Wellington Airport*, this is not an unfair or inappropriate approach for the Commission to take. Telecom has been given abundant warning and notice of the requirement to provide information at the right time.

7.12 In conclusion, the access seekers submit that the models put forward by Telecom cannot be further considered by the Commission and that the price should be determined on the methodology outlined in Determination 568, as set out in para 1.2 of the access seekers' 12 April submissions, as adjusted in the manner set out in Mr de Ridder's attached report.

7.13 There is in any event a critique of the Telecom approach (and support for the approach put forward by the access seekers including as to the regression modelling) in the attached report from Mr de Ridder.

Shared VP and backhaul capacity:

7.14 This issue is raised for the first time in the 12 April Submissions (that is, it was not an issue in the 568 matter). The model lacks detail including particularly the data underlying the model and therefore cannot be relied upon by the Commission for the reasons as are identified above in relation to the weighted average model. The Access Seekers concluded that there is no point in asking Telecom for the underlying data given the response from Telecom to the request for other information, recorded above. The Commission does not have the information upon which to add this option to 568 and Telecom must have been even more aware than ever of the need to provide the fully worked upon details.

7.15 In any event, Telecom's assertions that an allowance should be made for shared VP cost is not correct, as shown as Mr de Ridder's report.

7.16 Having reviewed the virtual path matters raised by Telecom, the access seekers have identified, as a result, that the UBR (UBS) backhaul charge must be deducted. Mr de Ridder has concluded in his report that the monthly price should be reduced further by $1.92. The section in his report commencing *"This is based on the actual commercial UBS backhaul charges…"* and ending *"….access seeker is $1.92 per customer"* is taken directly from Telecom charges and invoices to ihug and is therefore known to and could not be disputed by Telecom. The access seekers consider that it is not necessary to disclose the ihug customer numbers and Telecom invoice amounts (which are confidential to ihug and Telecom) as the resulting figure is beyond controversy between ihug and Telecom.

Evaluation of the reasonableness of the result:

7.17 The approach in Telecom's Submissions at para 118-123 is flawed, as identified by Mr de Ridder in his report. Rudimentary assessment of the figures shows that the ISPs are running at or close to a loss. ISPs have no choice but to be price takers from Telecom's price making, In order to grow or retain market share. But these are not the key points, as Mr de Ridder notes.

Discriminatory Pricing:

7.18 What has happened in the market demonstrates that Telecom is wrong when it maintains that "*operators are … unable to charge different prices for different speeds, which in Telecom's view is the effect of decision 568 …*"[20]. The information in Telecom's 12 April submissions alone demonstrates this. The CUBS prices have a range of $8.50. However the products of the various ISPs (examples of which are in Table 2 Of Telecom's 12 April submissions) demonstrate

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[20] Para 10 Telecom 12 April submissions.

a wide variety of price and data cap combinations in the marketplace. On any analysis the array of pricing cannot be attributable to the much smaller CUBS price range. The $8.50 is only a small factor.

7.19 These marketplace developments reflect what the Commission predicted in Determination 568: price discrimination would continue despite a single UBS market price. While there are multiple CUBS market prices, the CUBS price range is so small as to be immaterial to the range of retail price discrimination. It was also recognised in Determination 568 that the pricing would fall and this was seen by the Commission as appropriate.. Far from supporting Telecom's misconceived conclusion that single price UBS would lead to single price offerings, the marketplace demonstrates otherwise.

7.20 For the same reasons, Telecom's concerns that parties other than Telecom or TelstraClear (see para 310 of Determination 568) would not have incentives to price discriminate have also been demonstrated to be unfounded for the same reasons. The information noted above demonstrates that price discrimination is alive and well.

Product differentiation:

7.21 There are signs of similar trends in relation to product differentiation. Again, the tables show that there is differentiation based on data cap for example. As the market becomes more sophisticated, it can be expected that there will be different product mixes and value add services The experience in the UK provides a good example. The market there is now sophisticated enough, for example, to have at least one product comparison site which sets out, among other things, comparative details of numerous broadband offerings. Among the variables that are compared are differing contention ratios. See http://www.broadband-help.com/providers/list/advanced/

Avoided costs:

7.22 As the access seekers have already noted[21], it is regrettable that Telecom chooses not to concede application of the commercially ubiquitous 18% deduction for avoided costs, but this leaves no choice to the access seekers but to seek 16%, and that is not opposed by Telecom[22].

7.23 The refusal of Telecom to concede the move to an 18% deduction in the regulatory environment is yet another indication of the approach that Telecom has historically taken and continues to take to these matters. While the Access Seekers understand that, strictly legally, Telecom is entitled to take this tight approach, this is an indicator of the tough line taken generally by Telecom on matters regulatory and commercial in relation to access seekers.

[21] In their 12 April submissions

[22] Para 24 Telecom 12 April submissions.

8 Market Definition and Competition Assessment

Introduction:

8.1 The approach is governed by the Framework section of this submission (para 3).

8.2 The access seekers have neither the expertise nor the resources to submit in any significant detail on market and competition assessment issues, and are thus unable to submit on matters raised by Telecom in many parts of Annex A of the 12 April Telecom submissions. However, they note that there is no material change since December's Determination 568, which concluded that there is a national market in which Telecom faces limited competition. That is a view that is mirrored in Telecom's Chief Executive's March 2006 address to business analysts, when she said at Telecom's annual Management Debriefing Day:

> *"Clearly we've rolled out DSL to 93% of New Zealand lines. We've got a huge scale advantage over anyone even if there is a technology shift.".*
>
> http://www.telecom.co.nz/content/0,8748,205151-204091,00.html

May 2006's Cabinet Paper concluded:

> *"In the recent past there has been a contrast between high returns to [Telecom] shareholders and delayed investment in residential and small business user NGN infrastructure and services. This may suggest that Telecom faces insufficient customer or market competitive pressure to invest in new services in order to meet user needs and attract and maintain customers, and may be able to delay its network investment.'*[23]

8.3 The Telecom submissions assume that it must be shown that Telecom faces limited, or is likely to face lessened, competition in a market for this service. However, the Commission has the option under condition (b) of the UBS description to determine that the service be made available, in any event, if it has decided to require that service to be wholesaled in that market.

8.4 Thus, even if (contrary to the Access Seekers' submission) condition (a) is not met, the Commission can still decide to require that the service be wholesaled in a national (or other) market.

8.5 The May 2006 Cabinet paper gives an illustration of why this option might apply (the same concerns can be met by the Commission by applying Condition (b)):

> "***Option 4 – Alternative Infrastructure Incentives and Provision***

[23] Para 96 Telecommunications Stocktake Cabinet Paper May 2006.

This approach would involve facilitating alternative investment in infrastructure by addressing barriers to market entry.

Some entry barriers relate to the behaviour of incumbent operators (for example geographic discrimination in incumbent pricing). Telecom has previously met the challenge of alternative infrastructure deployment by matching competitor capability and reducing prices. The net result of this is an entrant has to prise customers away from the incumbent whose prices are commensurately reducing. As a consequence, entrant infrastructure providers are looking for government interventions that resolve the problem of incumbents with market power matching the new entrants' prices where the entrant has invested. Solutions suggested by entrant infrastructure providers could include, for example:

- *revising laws relating to price discrimination as applied to the telecommunications sector;*
- *ensuring that Telecom maintains prices across large geographic areas which the entrant could more easily compete against in higher value, smaller geographic areas;*
- *information disclosure powers for the Commission to require access providers to disclose relevant and sufficient information about their regulated services."*[24]

9 Developments since 568

9.1 There is no material change since December which should lead to a change of the Commission's position. As noted above, such change would need to be clearly demonstrated by Telecom. Little detail is provided except as to 2 developments. The history recited at paras 33 to 41 of Telecom's Annex A shows little change from what the Commission knew and expected in December (save for the new April pricing resulting from CUBS movements, which, being the commercial variation of the subject matter of this application, must be disregarded). Most of these events occurred before the determination anyway. We note further as to Annex A:

9.1.1 Woosh's actual and forthcoming impact on the market is limited, including because it is constrained by technical limitations. 500kbps is a far lower speed anyway than can be expected from a regulated UBS solution and cannot be seen as truly being in the same market. Woosh has been operating for some years and has had negligible impact on the market;

9.1.2 Para 36 is inaccurate: no one followed ihug's price drop to $29.95 for 2Mb/s;

[24] Paras 80 and 81 Telecommunications Stocktake Cabinet Paper May 2006

9.1.3 Apart from the section on Vodafone (dealt with next), para 42 is irrelevant: it is about markets and services that are not material to this application.

9.1.4 Para 55 provides another example of Telecom's approach overall:

9.1.5 **Cellular data**:

9.1.6 Even with the actual and foreshadowed developments, including as to speeds and price, cellular is not going to make a significant impact upon the market applicable to UBS. Price, datacaps, speeds and availability are in a very different league:

> *"Vodafone and Telecom's plans for new technology rollout offer significant improvements to the broadband speeds of existing mobile services. It is unlikely however that these technologies will match the speed and unit cost of fixed network technologies (subject to future technology improvements) but service competition in this market may provide solutions for some customers."*[25]

9.1.7 WiMax

While WiMAX has potential it is still very early in the evolution of WiMAX technology and there are significant barriers, risks and practicalities to deploying networks. That means that it would be premature to take a view on whether the competitive threat from WiMAX FWA over the next two years will present anything other than a very limited competitive threat to Telecom's market dominance. This is supported by the Cabinet's Telecommunications Stocktake paper:

> "*Whilst there may be other more cost-effective technologies (such as WiMAX and other wireless technologies) which are able to be deployed, it is too early to rely on such proven technologies."*[26]

> "*The disadvantages of this approach are that alternative infrastructure build on a ubiquitous scale is prohibitively expensive if involving a high-cost fibre rollout. If reliant on a lower cost model, it would be likely to involve wireless broadband technologies, such as WiMax which is attracting interest, although still in the trial stage in New Zealand. These may be competitive with copper-based DSL services for some services/customers. While this and other wireless options cannot be discounted they cannot be relied*

[25] Para 37 Telecommunications Stocktake Cabinet Paper May 2006

[26] Page 49 Telecommunications Stocktake Cabinet Paper May 2006

upon to provide a cost competitive broadband access alternative at this stage."[27]

There are a number of underlying factors which support this view:

9.1.8 **Standards**: The specific WiMAX deployment to which Telecom refer is using the 802.16d standard which has recently been ratified and certification of suppliers' equipment has just begun. Wave 1 of WiMAX certification testing for FDD equipment operating in 3.5GHZ completed in March 2006. It is important to note that this certification is only a "Radio level air interface". Many of the features of the standard will be tested in future waves 2 & 3 of the WiMAX forum interoperability which is are expected to commence late 2006 and mid 2007 respectively. It will be late 2007 before we can expect to see true interoperability between vendors for many of the features in the 802.16d standard.

9.1.9 **Cost of deployment:** The cost today of deploying a WiMAX solution to a site in terms of equipment purchase and installation (excluding apportionment of any base station, network & other costs) is close to $1,000 for a basic installation suitable for a residential customer (compared to $50 for a self installed ADSL modem).

It is clear that a significant reduction in equipment costs, driven by standards and the economies of production on a global scale is required before this service can be deployed as a national residential broadband service.

9.1.10 **Spectrum**: Any global production of WIMAX equipment in the next 2 years will be focussed on the 3.5GHz & 2.3GHz spectrum. Any new entrant has a significant barrier to overcome in that nationwide spectrum in the 2.3GHz and 3.5GHz spectrum is held in the hands of a few players, the majority of it being held by Telecom itself. Given the cost of deploying WiMAX it is unlikely that Telecom or Vodafone would deploy this as a broadband solution and are more likely to focus on their current DSL & 3G investments.

9.1.11 Other than the current limited regional spectrum auction no further spectrum is likely to be available until the management rights to 100MHz of 2.3GHz spectrum is relinquished by the current holders in 2010.

[27] Para 84 Telecommunications Stocktake Cabinet Paper May 2006.

Annex 1

Annex 2

Annex 3