

Bitstream pricing: draft NZ Commerce Commission decision

Expect plenty of debate for and against the proposed price change.

December 2012

The draft decision drops the bitstream (UBA) price from \$44.98 to \$32.45 when the new pricing regime kicks in on 1 December 2014.¹ (The higher quality-of-service variants have changed pricing too, up to 21% higher than the basic UBA price of \$32.45). Parties have until 1 February to submit (and to cross-submit by 22 February).

As part of the structural separation package, UBA moves from retail-minus to TSLRIC, a cost based model. Until December 2014, the retail-minus regime applies. Then there's the change to cost-based pricing.

The \$32.45 is based on the Initial Pricing Principle (IPP), a benchmarking approach by which the price is derived from pricing in comparable countries. Parties can, if unhappy with the IPP price, obtain a more detailed assessment by the Commission of actual cost – TSLRIC.

The scale of this drop is such that, assuming as is likely the benchmarked price broadly reflects cost/TSLRIC, the drop demonstrates that Telecom (and now Chorus) have been getting high monopoly profits out of bitstream. Chorus will continue to get these monopoly profits until December 2014. Without something like a margin squeeze test in the pricing model, this was always going to be likely in relation to the heavily criticised retail-minus methodology: see *Retail Minus Pricing Panned by CAT*.²

● *How the price is derived*

The legislation requires the Commission to build up the price by starting with the new averaged UCLL price of \$23.52 – assuming that price survives the Government's talk of legislation to change things. Then it must add the components on top (such as the DSLAM and related services) which make up the UBA service. As with UCLL, that last step is done by benchmarking at this IPP stage.

Benchmarking involves difficult and controversial choices for regulators, so there will be much debate as to whether the right benchmarks and application of those benchmarks were used.

From 30 candidate countries, the Commission got down to only two to use: Denmark and Sweden. The others were whittled out as they didn't have all of the following features:

- Price control on a cost basis;
- TSLRIC or similar;
- Current costs modelling not historic costs;
- Model verified by regulator.

The bitstream component on top of UCLL is \$8.93, which is the average of the Swedish and Danish prices.

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● **Push the price up or down?**

Regulators often then decide whether to bring that price up (e.g. to the 75th percentile) or down (e.g. the 25th percentile). Factors here include the reliability of the data, etc.

On this point – which can substantially affect the price – the Commission signalled it hasn't reached a final view, opting in the meantime not to make an adjustment.

The legislation requires the Commission, when setting price, to have regard to matters such as the long term interests of investors. The 2011 amendment added a further matter to consider: incentives to innovate that exist for, and the risks faced by investors in new telco services that involve significant capex and offer capabilities not available via existing services.

UFB is clearly in the frame here, and there's a question as to whether copper unbundling is too.

The Commission focusses those considerations around the decision on whether to uplift the price to say the 75th percentile, or drop it to the 25th percentile. What implications does the relativity of UBA and UCLL pricing have for investment in those services? Are there asymmetric costs in setting the UBA price too high or too low? How will the price affect incentives to invest in copper or fibre services, and what effects on the users?

The Commission starts to deal with those points and invites comment. We think that is a good approach. Fully worked up drafts can be difficult to deal with for parties in situations such as this. This type of approach leads to better outcomes.

Expect plenty of debate on controversial issues in the next round.

1. <http://www.comcom.govt.nz/media-releases/detail/2012/commission-announces-proposed-wholesale-price-for-broadband-bitstream-service>

2. [http://www.wigleylaw.com/assets/pdfs/2007-\(2\)/retail-minus-pricing-panned-by-cat.pdf](http://www.wigleylaw.com/assets/pdfs/2007-(2)/retail-minus-pricing-panned-by-cat.pdf)

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