A Final (?) Word on CVC Pricing

NBN Co.'s proposed pricing will harm the communications sector for many years to come; if it is allowed to proceed. Pricing by speed tiers (AVCs) is particularly unfortunate because it lead to massive under-utilisation of a massive investment[1]. But, it is only a rejection by the ACCC of the backhaul (CVC) pricing that can stop the proposed regime. If CVC pricing discriminates against smaller access-seekers directly and/or indirectly, the Commission is obliged to reject the SAU[2].

The ACCC's response to submissions on the NBN Co. SAU this month[3] accurately reports my five issues with CVC pricing:

1. CVC pricing discriminates against small access seekers.
2. CVC pricing has the same effect as volume discounting
3. There would be no discrimination if CVC pricing was per GB (not sold in blocks)
4. Transitory CVC credits do not remove the barrier to entry for small access seekers
5. The difference in the cost of CVC capacity is not in the LTIE

But, the Commission's attempts to rebut each of these miss the mark.

1. CVC pricing discriminates against small access seekers.

The CVC approach does <u>not</u> mean that "*price reflects the capacity that is consumed on the network at any given point of time*" but only the capacity to carry traffic. A far better measure of capacity <u>consumed</u> is gigabytes carried; as NBN Co. acknowledged when it said "*CVCs can be used as proxies for usage charging*" [p103, NBN Corporate Plan, Dec 2010]. Why settle for an imperfect proxy? As described on Whirlpool, "*at least for traffic Class 4, a CVC charge and an outright charge per GB of actual traffic are almost interchangeable. Meaning for this class of traffic you could charge per actual GB used and this would make life much fairer for the smaller ISP*"[4].

With usage ($/GB) pricing, access seekers have a direct incentive to manage consumption of capacity and NBN Co. has more levers to manage usage. For example, it would have the ability to set different $/GB rates for peak and off-peak periods, if it wished. It cannot do this with CVC pricing.

It is true that ISPs are used to buying back haul capacity in blocks of transmission capacity. But, NBN Co. is the natural aggregator and has better visibility of traffic and a better ability to manage the network it is responsible for. It should not be asking its wholesale customers to take on that task.

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[1] See my submission to the ACCC on the SAU in December 2012 for discussion of cost structure and pricing.
[2] The NBN Co. special access undertaking (SAU) sets out the price and non-price terms of access for ACCC approval.
[3] P68, Response to Submissions, July 2013 http://transition.accc.gov.au/content/index.phtml/itemId/1080594
[4] http://forums.whirlpool.net.au/archive/1675718

What NBN Co. is seeking to do is like water, gas and electricity utilities asking retailers to nominate and pay for virtual capacity by distribution area and fined if they exceed their nominations (since throttling is less easy in these older physical networks). Utilities do not do this because it is needless and inefficient; just as it is for the delivery of bytes.

NBN Co. should neither effectively force smaller ISPs to seek intermediate wholesale providers of this capacity nor create a significant barrier to entry and initial growth.

2. CVC pricing has the same effect as volume discounting

The ACCC accepts that there is a volume discount in CVC pricing to the extent that ISPs with fewer customers face a higher average cost per customer. But it says that "*it remains to be seen whether the granularity of CVC tiers will act as a barrier to entry for smaller players".* Why wait? It is clear enough now that it will be a barrier to new entrants and there are already signs of industry consolidation as CVC pricing signals that the NBN's wholesale customers must have scale.

It does not have to be like this. We should not let CVC pricing reduce potential competition in the access market. Pricing $/GB scales perfectly without discrimination and fits the diverse technologies, making it future proof. Replacing CVC fees with $/GB charging make almost all wholesale access costs variable and increases the profitability of marginal customers. This will encourage the emergence of new access-seekers and stimulate retail competition.

3. There would be no discrimination if CVC pricing was per GB (not sold in blocks)

The Commission argues that "*it is not clear that a per Mbps CVC price would have the same effect as a volume discount"* because a small access-seeker purchasing a small amount of CVC capacity could have the same cost per customer as a large access-seeker purchasing a large amount of CVC capacity. Perhaps, but it seems more likely that larger access-seekers can attain greater utilisation of purchased CVC capacity than a small access-seeker.

The Commission argues that there are no volume discounts because the unit price of CVCs is $20/Mbps regardless of the amount purchased. But the issue with CVCs is block pricing. In my view, the unit cost is the cost per Gigabyte (GB) of traffic carried (or per customer served). Since CVC capacity has to be purchased in blocks, the more traffic (or customers) carried on those blocks, the lower the unit cost per GB (or per customer). It is the blocks of CVC capacity that must be purchased that causes different costs per customer in a way that discriminates against smaller access-seekers.

Buying GB of traffic is thousands of times more granular than buying CVC capacity[5]. Buying GB of traffic carried is perfectly scaleable and there are no volume discounts.

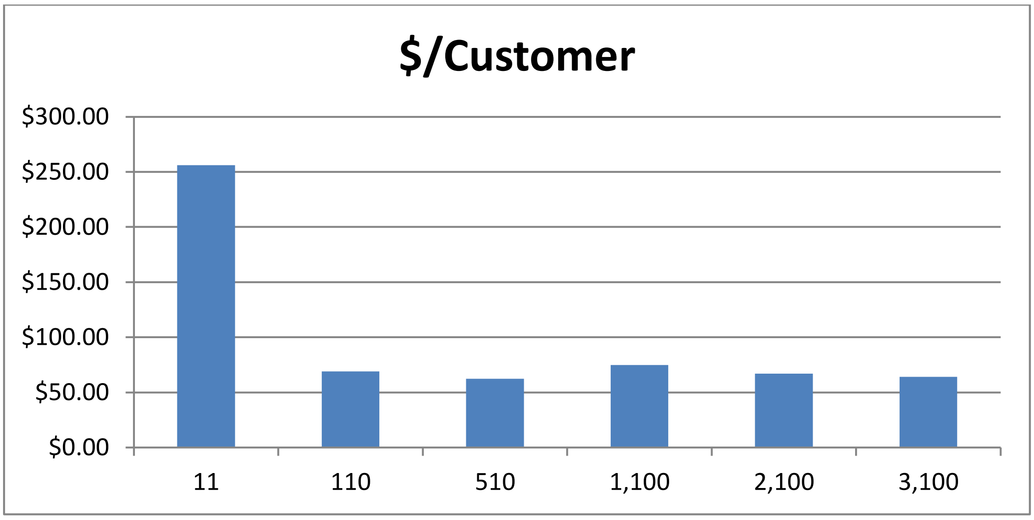
Even if we were to accept the Commission's definition of unit price so that there is no direct discrimination, there is certainly unlawful indirect discrimination: "*The ACCC considers that indirect discrimination refers to circumstances in which uniform terms and conditions between access seekers*

[5] Actually, 15,000 times more granular. Theoretically, the maximum transfer of 1Mbps full duplex (megabit per second, or Mb/s) is roughly 320 gigabytes per month in each direction (320GB in and 320GB out). In practice, 150-200GB per 1mbps outbound is more likely.
http://www.webhostingtalk.com/wiki/How_many_GB_does_1_Mbps_equal

have different impacts or outcomes for different access seekers" [P28, ACCC, April 2012, Part XIC non-discrimination guidelines].

4. Transitory CVC credits do not remove the barrier to entry for small access seekers

Transitory CVC pricing commitments (credits) are not *"likely to reduce any barriers to directly connecting to the NBN that could be created by CVC pricing for smaller access seekers".* The credit is the greater of $1/customer or $3,000 per month. But it is only available during the roll-out: until 30,000 premises are passed in the Connectivity Serving Area. That means that maverick operators are unlikely to emerge post roll-out unless they can achieve scale in every connectivity service area where they want customers:



The minimum CVC purchase costs $2,000 (Traffic Class 4). This makes it unprofitable to serve the first customer; which is not the case with usage pricing. Mavericks cannot emerge with CVC pricing; which will lead to further consolidation of retail service providers (RSPs) and less competition.

Using a wholesale provider is certainly more efficient for a small operator than paying for CVC capacity. But it is better if NBN Co. accepts its anointed role as the custodian of the access network and provides capacity charged on a usage basis.

5. The difference in the cost of CVC capacity is not in the LTIE

Under its own guidelines, the ACCC is required to establish that prices are not discriminatory by establishing that prices satisfy the "two limbs" of its non-discrimination principle (summarised below[6]):

a) Equal opportunity to receive the same terms – which has been debated at length above

b) Be consistent with the long-term interests of end users – where the Commission has ignored my detailed analysis of this [de Ridder, CVC Pricing Discriminates, May 2013].

It is possible that ACCC is reading back into the legislation the exceptions to the prohibition on non-discrimination removed from the legislation by Senator Xenophon's amendments[7]. But, because the

[6] P10, ACCC, April 2012, Explanation of Non-discrimination

legislation does not define discrimination, the ACCC's interpretation may have to be decided by a Federal Court.

It is clear why the Commission is being so obtuse. If CVC pricing discriminates against smaller access-seekers directly and/or indirectly, it is obliged to reject the SAU. If it does not, the prospects of new providers of broadband access emerging are very poor.

The world that would emerge from the current NBN Co. pricing regime would emulate the past. It would lead to further consolidation in the access-seeker market and less pressure on retail margins, making broadband less affordable than it could be.

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[7] Telecommunications Legislation Amendment (National Broadband Network Measures—Access Arrangements) Act 2011 - C2011A00023 Assent 12 April 2011 http://www.comlaw.gov.au/Details/C2011A00023