TelstraClear Limited

Submission in response to the Commerce Commission's

"Schedule 3 investigation into the extension of regulation of designated and specified services - Draft Report" dated 30 May 2006

28 June 2006

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1 EXECUTIVE SUMMARY

1. 1. TelstraClear agrees with the Commission's recommendation to the Minister to:

   a. extend regulation of the 10 services the Commission decided to investigate that are currently included in Schedule 1 to the Act. In particular, the wholesale markets in which Telecom supplies designated access services and the downstream retail markets in which entrants compete using these wholesale services are not yet effectively competitive; and

   b. not to extend the remaining 3 services the Commission decided not to investigate for extension as commercial and industry arrangements for these services have stabilized and the removal of these services from the portfolio of regulated access services represents a prudent adjustment to New Zealand's regulatory regime.

2. TelstraClear agrees with the Commission that a pragmatic approach to market definition and the investigation of the competitiveness of markets is appropriate given that:

   a. the services are currently regulated services, and as a "known" quantity, the benefits and risks of continued regulation are more apparent than may be the case with proposed regulation of new services;

   b. the rollover period is only for 2 years, and the risks associated with regulation are reasonably judged to be much lower than for regulation of a previously unregulated service for a full 5 years;

   c. access seekers have not had access to the regulated services for the full initial 5 year period due to delays in resolving the terms of access and a further period of 2 years would go some way to offsetting those delays;

   d. the Act does not require the Commission to demonstrate a measurable increase in competition from a rollover of the current services but only that the rollover will create the conditions or environment for improving competition;

   e. the evidence in the draft report demonstrates that, while competition has increased with the availability of the regulated services, Telecom continues to have substantial market power in the markets relevant to the services the Commission proposes to recommend for rollover. At the same time access seekers have continued to invest in their own infrastructure in those market sectors where there is a sustainable business case for deployment; and

   f. while the dividends of regulation for end users have so far been modest, this is due, in TelstraClear's view, to the delays in gaining regulated access, the limited wholesale discounts, particularly for residential services, and the non-price terms of supply not conforming to world's best practice. While not matters for these proceedings, these issues need to be addressed if the full potential of the current regulated services and the new services proposed by the Government are to be realised.

2 INTRODUCTION

3. On 30 May 2006, the Commerce Commission released a Draft Report[1] recommending to the Minister of Communications (Minister) that 10 of the 13 services originally incorporated in Schedule 1 of the Telecommunications Act 2001 (Act) should continue to be regulated for 2 years beyond their expiry date of 19 December 2006. This submission provides TelstraClear's response to the Draft Report.

4. The rest of this submission is set out as follows:

    a. section 2 provides an executive summary;

    b. section 3 contains TelstraClear's comments supporting the decision making framework and the overarching analysis that the Commission used to reach its recommendations;

    c. section 4 draws some conclusions that emerge from the Draft Report in relation to the state of competition in New Zealand telecommunications markets and the effectiveness of regulation; and

    d. section 5 contains TelstraClear's submissions on the more detailed analysis that the Commission carried out in relation to each of the 10 services.

[1] Commerce Commission, *Telecommunications Act 2001 - Schedule 3 Investigation into the extension of regulation of designated and specified services: Draft Report*, 30 May 2006

3 THE COMMISSION'S DECISION MAKING FRAMEWORK AND APPROACH

5. For the reasons outlined in this section, TelstraClear considers that the Commission has followed the necessary procedures, and conducted the necessary analyses, proscribed by the Act in reaching its recommendation in the Draft Report for the extension of regulation for the relevant designated and specified services.

3.1 Market definition

6. The Commission did not conduct a precise market definition exercise for the following three of the retail services under review: retail services offered by means of Telecom's fixed telecommunications network, bundle of retail services offered by means of Telecom's fixed telecommunications network and retail services offered by means of Telecom's fixed telecommunications network as part of a bundle of retail services. Rather, the Commission found that these regulated services can be considered 'umbrella' services covering a large range of telecommunications services that are likely to fall within multiple markets, including markets that have not yet been identified by the Commission. The Commission considered it was not necessary to apply the kind of detailed market analysis for the retail services that it conducted in previous bilateral access determinations for the purposes of this review.

7. TelstraClear agrees with the pragmatic approach taken by the Commission to market analysis for the purposes of this review for the following reasons. First, the market definition process is not an end in itself, but is only a tool to understand the state of competition and whether a supplier has market power. The approach by the Commission accords with that taken by the Australian High Court in *Queensland Wire Industries v BHP*[2] of not precisely defining markets, and not taking too rigid an approach to market definition, when this is not needed for the purpose of the relevant competition analysis. In *Queensland Wire,* Dean J noted that:

> *The economy is not divided into an identifiable number of discrete markets in one or other of which all trading activities can be neatly fitted. One overall market may overlap other markets and contain more narrowly defined markets which may, in their turn, overlap, the one with one or more others.*[3]

8. Dean J goes on to state:

> *It is unnecessary to seek to identify the precise structure and boundaries of what should be seen, for the purposes of the present case, as what I have described as "the steel market".*[4]

9. Dawson J stated in *Queensland Wire*:

> *... the concept of a market, a concept which is sometimes dealt with in a more complex manner than is necessary.*[5]

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[2] Queensland Wire Industries Proprietary Limited v The Broken Hill Proprietary Company Limited and Another (1989) 167 CLR 177
[3] at page 196
[4] at page 197

... Too rigid an approach in defining a market is apt to lead to unrealistic results.[6] *...*

.... it is less important to arrive at a precise meaning than to recognize the assistance given by the identification of conditions, in the nature of barriers to entry, for the purpose of defining the relevant market, measuring the extent of market power and determining whether that power has been exercised.[7]

10. As also noted in *Re Queensland Independent Wholesalers Ltd*,[8] identification of the relevant market is a focusing process. The Court must select what emerges as the clearest picture of the relevant competitive process in the light of commercial reality and the purposes of the law. This is precisely the construct that the Commission has followed in the Draft Report.

11. Telecom's market power is both so substantial in degree and so far ranging across the suite of products falling within the designated services for which Telecom is the access provider that more precise definition of market boundaries is unlikely to change the Commission's assessment.

12. Second, the approach that the Commission has adopted in relation to market definition for the 3 umbrella retail services is consistent with the Commission's previous approaches in bilateral determinations made over the last 3 and a half years:

- the TelstraClear application for determination for 'wholesale' designated access services[9];
- the TelstraClear application for determination for 'residential wholesale' designated access services[10]; and
- the TelstraClear application for determination for private office networking.[11]

13. Third, as discussed below, the conditions of each of these designated services requires the Commission to undertake a further competition analysis before the Commission can make a determination to require supply of the designated services to access seekers. It is appropriate that the more precise examinations of markets take place at the determination stage than at this threshold stage of recommending rollover of the designated services. The particular markets which the Commission has to determine will be shaped by the access seeker's application: for example, the access seeker may request access only to some of the products falling within a designated service (as happened in both TelstraClear's business wholesale and residential wholesale applications) or the access seeker may only seek access in particular geographic regions (as happened again in TelstraClear's business wholesale and residential wholesale applications).

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[5] at pages 198 - 199
[6] at page 200
[7] at pages 201 - 202
[8] (1995) ATPR 41-438
[9] Commerce Commission, *Determination on the TelstraClear Application for Determination for "Wholesale" Designated Access Services*, (Decision 497), 12 May 2003, see pages 29-64`
[10] Commerce Commission, *Determination on the TelstraClear Application for Determination for "Residential Wholesale" Designated Access Services*, (Decision 525), 14 June 2004, see pages 31- 43.
[11] Commerce Commission, *Determination on the TelstraClear Application for determination of designated access services (including Private Office Networking*, (Decision 563), 9 December 2005, see pages 20-40.

3.2 Commission's competition analysis

14. TelstraClear also agrees with the approach that the Commission has taken in conducting its competition analysis for the purposes of the review of the regulated services. The Commission rightly considered it must satisfy itself that, for the two year period of analysis between 19 December 2006 and 19 December 2008, there are benefits to end-users from extending the existing regulated service over allowing the service to expire.

15. TelstraClear agrees that the Commission is not required to undertake a quantitative cost-benefit analysis (**CBA**) for the purposes of considering whether or not to recommend the extension of the currently regulated services for two years. The Act does not expressly require a CBA. The Commission has considered a CBA to be a useful, although not determinative, tool in considering whether to recommend the designation of an entirely new service, such as local loop unbundling and bitstream. However, these services involved the extension of regulation to previously unregulated services, the impact of regulation on the investment incentives of Telecom and entrants was in dispute, the outcome for the level of competition was uncertain and the designation would have lasted at least 5 years. The CBA allowed the Commission to "stress test" the competing assertions on these matters put forward by Telecom and entrants.

16. However, in the case of the rollover of the 10 designated services, the Commission is considering a "known quantity". The Draft Report provides evidence that competitive activity of entrants has increased over the last 5 years through access to the designated services. Telecom's worst predictions about the impact of regulation both on investment by it and by competitors also has not been realized: Telecom has continued to invest in its NGN and the Draft Report shows that, as well as supplying services by using regulated access, entrants also have continued to build their own network directly connecting customers.

17. In any event, TelstraClear disagrees with the proposition that the Commission bears an onus of proof to establish a causative, measurable relationship between regulation and an increase in competition. The long term benefit of end users test only requires that the Commission be satisfied that regulation will create the conditions for a more competitive market. As the Australian Competition Tribunal stated in the Sydney Airports case:

> *The Tribunal does not consider that the notion of "promoting" competition in s 44H(4)(a) requires it to be satisfied that there would not be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of "promoting" competition in s44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.*[12]

18. The extent of the required analysis is also influenced by two temporal factors. First, the rollover is only for a two year period. The risks associated with regulating a service, or more correctly continuing existing regulation of a service, are likely to be significantly lower if the renewal is for a relatively short period of two years compared to designation of a previously unregulated service for 5 years. The Commission is entitled to and should take this into account in deciding the extent and depth of its investigation.

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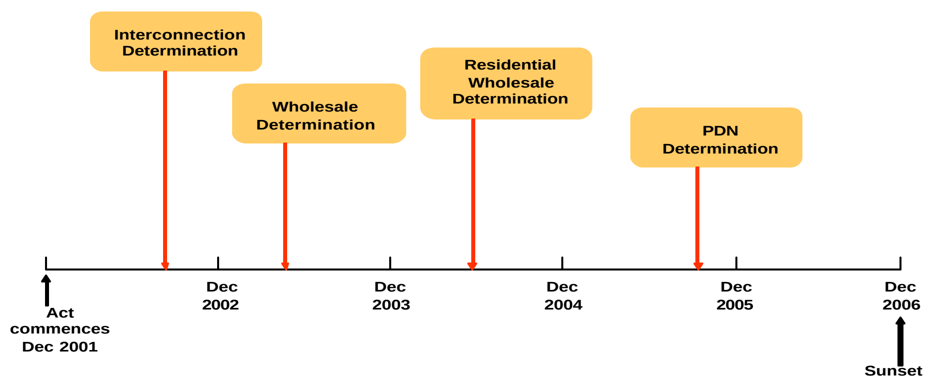
[12] Re Sydney International Airport [2000] ACompT 1 at paragraph 106

19. Second, the Commission is also entitled to and should take into account that most of the designated services for which Telecom is the access provider have been supplied on regulated terms for much less than the 5 year designation period. As figure 1 below shows, residential resale has only been available for the last 2 years, with Telecom refusing to provide the service prior to the determination. While some of the business services were available on a wholesale basis prior to the Wholesale Determination, the terms were comparatively unfavorable and TelstraClear has only had access to the improved terms for a little over 3 years. Moreover, the price of these services was not resolved until January 2006 when Telecom and TelstraClear reached commercial agreement over the price terms for these services.

Figure 1: Time line of Interconnection, wholesale and PDN determinations



20. As the Commission notes,

> *"the mere existence of [the currently regulated] services in the Act suggests at the time of the enactment of the Telecommunications Act in 2001, it was decided that regulation of these services would be likely to promote competition during the period of designation or specification".*[13]

21. It follows, in TelstraClear's view, that the Commission can take into account that, due to the delays in obtaining regulated access, access seekers have been able to compete in downstream markets using regulated services only for part of the original 5 year designation period. In fact, by recommending the two year extension, the Commission will ensure that the effect of the "upfront" delays in getting regulated access are offset. The limited impact which regulated access has had, as illustrated by the evidence in the draft report, partly reflects the impact that the process delays have had on the Act's ability to achieve its objectives within the originally intended period of 5 years.

13 Draft Report, paragraph 32.

3.3 Two-step regulatory process and short extension of regulation

22. The appropriateness of the competition assessment carried out by the Commission for the purpose of the Draft Report is reinforced by the fact that the New Zealand regulatory regime involves a two-step process with different competition analyses required at each of these steps.

23. The first step in the regulatory process is examining whether a service should continue to be regulated. As outlined above, this involves a competition analysis for the purposes of sections 18 and 19 of the Act, namely whether extension of regulation of the service will best, or be likely to best, promote competition in telecommunications markets for the long-term benefit of end-users.

24. The second step in the regulatory process occurs when an application is made to the Commission to resolve a dispute in relation to the provision of a regulated service and the Commission decides to investigate that dispute. This step includes examination by the Commission of whether the relevant service provider (Telecom) faces limited, or is likely to face lessened, competition in a market for the service or, where this is not the case, the Commission has decided to require that the service be wholesaled in that market.

25. Given this two–step approach in New Zealand, it is entirely appropriate that the Commission does not conduct a full-blown competition review, including detailed cost-benefit analysis, for the purpose of the first step. The second step in the process affords the opportunity for a more in depth competition analysis.

26. The approach in New Zealand contrasts to that in Australia where competition analysis is only required to be carried out when the regulator is considering whether to extend regulation of a service, and not at the stage when a dispute is referred to the regulator for arbitration. In the Australian case, one would expect a detailed competition analysis to be carried out at the first stage, given that no such analysis is carried out at the second stage. However, given New Zealand's regulatory regime, it is appropriate that a less detailed competition analysis is carried out at the first stage, particularly where continued regulation would clearly satisfy the relevant legislative requirements.

3.4 Conclusions in Draft Report supported by Commission's LLU review

27. The local loop unbundling (LLU) review that the Commission carried out in 2003 involved an extensive review of services provided downstream of Telecom's local loop network and Telecom's fixed public data network. For the purpose of that review, the Commission assessed the state of competition in the relevant wholesale markets and also in the retail markets in which those services could be used to deliver telecommunications services to end-users.[14] As in the Draft Report, the Commission's competition analysis in its LLU review was guided by sections 18 and 19 of the Act to make a recommendation that best gives, or is likely to best give, effect to the promotion of competition in

[14] Commerce Commission, *Telecommunications Act 2001 – Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network*, Final Report, December 2003, pages i and 78

telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand.[15]

28. The Commission found in the LLU review that unbundling may potentially impact upon a large number of downstream telecommunications markets and rather than to attempt to quantify the impact on the entire set of markets that are likely to be affected, the Commission chose to focus on competition in a number of key downstream markets. These markets were the provision of broadband internet access, local voice access, calling services and retail data services.[16] The Commission's competition analysis in the LLU review, including its detailed cost-benefit analysis, showed that in December 2003 there were positive gains to consumers from regulation.[17]

29. The services the Commission considered in its LLU review represent the ultimate or primary upstream input, although bitstream is a further downstream input than LLU. Between them, LLU and bitstream are essential inputs to almost every product falling within the 10 designated services. As Telecom is vertically integrated from these upstream markets into the downstream markets in which the designated services are traded, it must follow that there is a material risk that the limited competition upstream will be reflected in those downstream markets.

30. There have not been any significant changes since the LLU Report in the degree or extent of competition in New Zealand's telecommunications industry. The Government's decision to regulate LLU and expand the bitstream service demonstrates the competitive problems in the primary upstream markets continue. Accordingly, it would sit oddly with the Government's decision to regulate these upstream inputs for the Commission to conclude that Telecom no longer faced limited competition in the downstream wholesale services.

31. The proposal to designate LLU and enhanced bitstream does not obviate the need for regulated access to the downstream access services that are currently designated. On the overseas experience, resale and unbundling are complimentary strategies for entrants, with the use of one form of wholesale access over the other determined by customer spend, geographic location and therefore the economic viability of the investment required for unbundled access.

3.5 Conclusions in Draft Report supported by international practice

32. The conclusions reached by the Commission in the Draft Report are consistent with international practice.

3.5.1 European approach

33. The regulatory experience in the European Union of continued regulation of the former incumbent telecommunications providers, despite decreases in their market shares in relevant markets over time, broadly supports the approach taken by the Commission in the Draft Report. In many cases the decreases in the market shares of former incumbents in European Union countries, has been more substantial than the decreases in market

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[15] Ibid, page 77
[16] Ibid, page 81
[17] Ibid, pages 189 - 203

shares that Telecom has experienced, and yet regulation remains in the European Union countries. This big picture comparison gives comfort that the Commission's approach is appropriate and within the bounds of European practice.

34. As set out in schedule 1, every EU regulator that has completed the telecommunications market reviews for PSTN calling markets and PSTN line access markets, as required under the EU legislation, has found that the former incumbent has significant market power (SMP) in these markets, with a few exceptions (i.e. Sweden and Finland for some markets). In Sweden, the regulator only withdrew its SMP finding in the local calls market after the incumbent lost nearly 50% of its market share. However, the regulator has still found the incumbent to have SMP in the access (i.e. telephone lines) market and in other wholesale markets, such as leased lines.

3.5.2 Australian approach

35. Amendments to Australia's Trade Practices Act 1974 (TPA) which came into force in 2002 required the Australian Competition & Consumer Commission (ACCC) to specify expiry dates for services regulated under the Australian telecommunications access regime in Part XIC of the TPA.[18] These amendments also granted the ACCC the power to extend or further extend the expiry date for regulated services for periods of not more than 5 years.[19]

36. The ACCC has completed a number of investigations on whether regulation of services should be extended. The ACCC's approach in such investigations includes consideration of whether or not the relevant markets are effectively competitive and whether continued declaration has the potential to help promote competition in the relevant markets.[20] Most recently, the ACCC conducted a Strategic *Review of the Regulation of Fixed Network Services*, looking at whether existing declared services should be re-declared for a further period. In its review, the ACCC in its favoured a framework for regulation that considers whether there *effective* facilities based competition or contestability (i.e. from alternative networks); and whether there is there effective quasi-facilities competition (i.e. ULLS).[21]

37. The ACCC has stated in relation to the Australian process:

> *When considering whether a service declaration should be maintained or changed, the Commission's task is to determine the extent to which declaration (and changes to it) is likely to promote competition. The question of whether competition will actually improve or increase will be highly relevant but is not determinative of this issue. The key issue is whether declaration and its scope will assist in establishing conditions by which such improvement will be more likely to occur.*[22]

38. The ACCC therefore conducts its competition analysis in much the same way that the Commission has done for the purposes of the Draft Report.

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[18] Section 152ALA of the TPA
[19] Section 152ALA(4) of the TPA
[20] See for example the ACCC's approach in the Mobile Services Review: Australian Competition & Consumer Commission, *Mobile Terminating Access Service – Final Decision on whether or not the Commission should extend, vary or revoke its existing declaration of the mobile terminating access service*, June 2004, pages v-xi
[21] ACCC, *A Strategic Review of the Regulation of Fixed Network Services –Position Paper*, June 2006, page 14.
[22] Australian Competition & Consumer Commission, *Transmission Capacity Service – Review of the declaration for the domestic transmission capacity service*, Final Report, April 2004, page 12

39. The ACCC has produced its position paper[23] which sets out the following intentions:

- declaration of ULL for a further 3 years;
- declaration of PSTN originating and terminating access for a further 3 years.

[23] http://www.accc.gov.au/content/index.phtml/itemId/719844.

4 The state of competition and the effect of regulation

40. Before turning to consider the individual designated services that the Commission has recommended for renewal, TelstraClear has some general observations on the current state of competitive and the role of regulation based on the evidence set out in the Draft Report.

41. TelstraClear agrees with the Commission's conclusion that it does not necessarily follow that a finding of limited competition in a market relevant to a particular designated or specified service suggests that the regulation of that service has been ineffectual during the 5 year period. TelstraClear agrees with the Commission that competition may have been more limited if it were not for the presence of a regulated service.

42. The evidence in the Draft Report demonstrates the fallacy of Telecom's constant refrain over the last 5 years that access seekers will rely on regulated access to Telecom's network in substitution for investment in their own network infrastructure. The "off-net" and "on-net" revenue data that the Commission collected from service providers in relation to a number of services shows that there has been growth in both service-based and facilities-based competition in New Zealand. The greater growth in "off-net" revenue as compared with "on-net" revenue is not surprising given the limited scope for alternative fixed network deployment in New Zealand and the lack of an effective suite of unbundling services. Nonetheless, the Draft Report provides clear evidence that both service-based and facilities-based growth are occurring.

43. However, it is also clear that the impact of regulation has been relatively modest. The increase in the growth rate of services provided by entrants following the Commission's primary determinations has been relatively modest and 5 years after the implementation of Act Telecom's market share remains high across most markets. Further, it would appear that the initial success of regulation may be wearing off as growth in entrant services has leveled off in recent years.

44. One clear example of where regulation of services may need to be reviewed is in relation to business grade services. The Draft Report includes "on-net" and "off-net" revenue data for a selection of services provided by operators other than Telecom, including in relation to business grade services. This data shows that generally there has been growth in both service-based and facilities-based competition for the relevant periods for which the data was collected. Figure 3 in the Draft Report, however, shows that there was no revenue growth in business grade services delivered by alternative providers over 2004 to 2005.

45. This does not, in TelstraClear's view, suggest regulated access cannot be successful but rather that the availability of access services and the terms and conditions of regulated access do not permit access seekers to compete on a level playing field with access providers. While not within the scope of this review, the evidence set out in the Draft Report suggests that regulation needs to be much more effective than it currently is.

5 Analysis of Commission's competition assessment for each of the 10 regulated services

46. In this section, TelstraClear provides its response on the recommendations for each individual designated on specified service.

5.1 Retail Services

47. TelstraClear agrees with the Commission's conclusions that:

   a. Competition from alternative fixed and wireless networks has only occurred in pockets across New Zealand and that Telecom's network remains the sole ubiquitous network in New Zealand. The Commission's comment that "fixed wireless operators such as Woosh Wireless offer a degree of infrastructure competition in some telecommunications markets"[24] needs to be, in TelstraClear's view, further qualified. TelstraClear notes that, as the Commission found in its Unbundling Report and in the PON determination, wireless networks do not provide services at a level of service quality or capacity which matches services provided over fixed networks, especially for business grade services, and therefore are unlikely to provide an effective competitive constraint on Telecom for many of the services falling within this designated service, even in those areas in which wireless networks are deployed; and

   b. Entrants wishing to deploy competing infrastructure face significant barriers to entry, such as the sunk costs of physical deployment. New Zealand has narrower infrastructure sharing requirements, such as for buildings, towers and ducts, than in many overseas markets.

48. The Commission makes a number of observations "that might suggest that the previously defined markets are no longer as relevant"[25]:

   a. The Commission notes that there appears to be an increasing level of bundling which "suggests that the drawing of market boundaries by specific service type is less meaningful." TelstraClear strongly agrees with this comment. Bundling is relatively straightforward for a multi-product firm supplying services on a single platform but Telecom's product and geographic spread allows it to offer bundles that its competitor cannot match. For this reason, we endorse broader market definitions. While bundling, including by an incumbent, can be pro-competitive, it can also be a means by which the incumbent leverages its market power between products. As the Commission is aware, TelstraClear has been concerned that Telecom's product family approach is overly complex by too thinly slicing Telecom products. Thus far the product family approach has been utilized only for the purposes of establishing regulated price but our concern has been that it would be transposed to the definition of product markets. That would, for the reasons the Commission notes, run counter to the direction of competition in the telecommunications industry;

   b. The Commission notes that the line between voice and data services is becoming increasingly blurred. While TelstraClear agrees that this is the clear trend in overseas

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[24] draft report, para 61.
[25] Draft report, para 55.

markets, there is little evidence that this trend is yet occurring in New Zealand. The development of competing IP services is likely to be impaired by:

(i) The lack of unbundled access products that can support business grade IP connectivity needed for provision of VoIP. IP technology can substantially lower costs and support new functionality but the fundamental challenge of competition in the traditional switched world remains: the incumbent's control of the local loop. Given the limited prospects of alternative network deployment in many areas of New Zealand, the extensive deployment of IP services depends on the availability of unbundled access to Telecom's network by means of bitstream services which supports quality of service or LLU which allows entrants to extend their own quality of service IP networks to end user premises. The Government has decided to introduce both LLU and an improved bitstream service, and a rapid and efficient implementation of these services will be required if New Zealand is to catch up with the IP transformation, including VoIP, occurring overseas; and

(ii) The Commission identifies a shift both the national pricing and to identical pricing between residential and business services. TelstraClear agrees with this observation, and it reflects end users' desires to have connectivity "any where, any time". End users want to be able to access and use their email services, voice mail and telephone accounts seamlessly between home, the office and other locations as they move around. This actually increases the challenges which entrants face in trying to provide ubiquitous, uniform service nationally when competing infrastructure is only ever likely to be deployed in pockets, as the Commission notes. Although an entrant's network may run past a business customer's front door, it is increasingly difficult to sell services to that customer at that location unless the entrant can also offer seamless service for employees at home, sales representatives on the road and suppliers and large customers at their offices in other locations, most of which will not be near the entrant's, or another entrant's, network. The inappropriateness of wholesale sub-national markets when dealing with downstream services requiring ubiquitous connectivity was aptly demonstrated by the bitstream and PON proceedings.

5.2 Residential Local Access and Calling Services

49. The evidence in the draft report clearly shows that it is in this market that Telecom's market power is the most persistent and deeply entrenched. As the Commission notes, Telecom's share of the retail market has fallen by only 1% in recent years.

50. The prospects for deployment of alternative network deployment to primarily serve residential customers are not only low, as the Commission notes, but are significantly lower than for deployment of competing networks to serve business customers or central business districts (which may have some residential buildings). It is generally not economic to deploy residential networks due to a combination of the low densities of residential areas in New Zealand and the lower revenues from residential customers. While "triple play" services will provide additional revenue streams, the networks required to support those services also can be more costly and, in any event, will be insufficient to tip the economics in favour of deployment in many residential areas.

51. Paradoxically, while the prospects for competing infrastructure serving residential customers is lower than for business customers, the terms of regulated residential access service are the least favourable. The 2% discount in the final pricing principle does not

provide a sustainable business case for resale. This is clearly demonstrated by the minimal impact which resale has had on Telecom's market share.

52. Inadequacy of the current residential access service is not, of co urse, a reason to remove all regulation from Telecom by not renewing the access service. As the Commission notes, the issue of the adequacy of current regulation will have to be addressed through other proceedings. However, plainly the poor level of competition in market for the supply of residential services warrants continuing regulation.

5.3 Interconnection Services

53. The Commission states:

> *"When there is more than one telecommunications network, there is a need for networks to interconnect so that calls made on one network can be terminated on another. Access to interconnection with Telecom's ubiquitous network is therefore essential for any new network operator in order to provide any-to-any connectivity to its customers.*
>
> *"Where competition is not effective, or where substantial market power exists in telecommunications markets, regulatory intervention may be required to facilitate efficiently priced interconnection between networks."*[26]

54. TelstraClear agrees with this statement. The ubiquity of Telecom's network combined with its high market share – as indicated by Telecom's overall market share of the New Zealand telecommunications market of around 70%[27] and the Commission's findings in the Draft Report on retail and residential local access and calling competition - means that Telecom is likely to continue to have substantial market power in telecommunications markets. This situation is likely to persist into the extension period. This, combined with the fact that, as the Commission notes, no other party can facilitate origination and termination on Telecom's fixed PSTN, means that interconnection should continue to be regulated.

55. The Commission goes on to state:

> *"In the absence of technological developments that might allow direct access to a fixed PSTN subscriber for the purposes of origination or termination of voice and data calls, there appears to be an absolute barrier to entry into the wholesale interconnections markets."*[28]

56. TelstraClear agrees with this statement. TelstraClear is not aware of any technological developments that would mean that a party other than the network provider could facilitate origination or termination on that provider's PSTN in the next 2 years.

[26] Draft Report, paragraphs 97-98.
[27] Telecom's share of the Telecommunications Service Obligations (TSO) costs, which are based on share of total telecommunications revenue, was 72.84% for 2002/03 and 69.48% for 2003/04. Telecom's share of the Telecommunications Relay Service TSO for 2004/05, which is also based on the share of total telecommunications revenue is 68.54%. Source: Commerce Commission.
[28] Draft Report, paragraph 114.

57. The Commission states that the following markets are relevant downstream markets for the purposes of investigating whether to extend the interconnection services:

a. fixed-to-mobile/tolls market;

b. local access market; and

c. market for mobile subscription and origination services.

58. The Commission concludes that the fixed-to-mobile, tolls and local access markets are all subject to limited competition. In relation to the national retail market for mobile subscription and origination services, the Commission states that it did not form a definitive view on whether the retail mobile services market is subject to limited competition. However, the Commission notes that it "did not believe that existing or potential competition at the retail level was sufficiently intense to ensure that any excess profits were dispersed through competition at the retail level" [29].

59. The inference that could be taken from these findings of limited competition in these downstream markets (though the Commission does not say so explicitly) is that this is caused, at least in part, by limited competition in the markets for origination and termination on each fixed PSTN. TelstraClear would agree with this conclusion. Until the commercial agreement between Telecom and TelstraClear in January 2006, the interconnection price that Telecom charged TelstraClear was 1.13 cents per minute. However, the Commission's draft pricing review determination for fixed interconnection calculated that the cost of a fixed origination/termination service (the "interconnection cost") is 1cpm.[30] This implies that the price that Telecom charged TelstraClear for interconnection exceeded cost by 0.13cpm up until the time of the January 2006 commercial agreement. This pricing in excess of cost would have had a consequential negative impact on competition in downstream services where interconnection is an input, and the Commission's findings reflect this.

60. Furthermore, interconnection costs are not likely to be static. The Commission's estimate of the cost of a fixed origination/termination service of 1cpm was actually a weighted average of estimated costs for three successive periods, as follows:

Table 1: Commission estimates of TSLRIC interconnection cost[31]

Period	***Price***
5 November 2002 – 4 November 2003	1.03 cpm
5 November 2003 – 4 November 2004	0.99 cpm
5 November 2004 - 19 July 2005	0.95 cpm

[29] *Ibid*, paragraph 122.
[30] Commerce Commission, *Draft Determination for Pricing Review for Designated Interconnection Services*, 11 April 2005.
[31] *ibid*, table 5.

61. Table 1 shows that the Commission's calculations of the interconnection cost indicate that the interconnection cost fell during the period of calculation. Falling costs of telecommunications technology suggest that this trend of falling interconnection costs is likely to continue into 2006 and through to 2007 and 2008. If this is the case, the interconnection price is likely to continue to exceed cost during the extension period. This will flow through to continuing limited competition in the downstream markets identified in paragraph 57.

62. Telecom's substantial market power in telecommunications markets means it has the incentive and ability to continue to set interconnection prices above costs. The negative consequences of this for competition in downstream m arkets means that there is a strong case for regulation of interconnection to continue.

63. As illustrated in Schedule 1, the Commission's approach to fixed origination and termination and mobile termination is consistent with the European regulatory approach.

5.4 Co-Location on Cellular Mobile Transmission Sites

64. The Commission "notes that existing second and third generation cellular sites owned by the incumbent MNOs (mobile network operators) could be utilised for co -location by both incumbents as well as new entrants".[32] TelstraClear agrees with this statement. To the extent that there are any exceptions to this generalisation, TelstraClear considers that they are likely to be very isolated.

65. The Commission continues:

> *"In theory the number of sites available for the co-location of cellular transmission equipment is unlimited. However, in practice, this is limited due to the suitability of sites for transmission, planning, resource management, health and environmental considerations and lease terms, which all require additional time and cost for a site to be suitable for cell site location."* [33]

66. TelstraClear also agrees with this statement. As the Commission states: "Whilst the number of cell sites available for co-location in theory is limitless, the Commission considers that the most optimal sites available for the location of cell towers are already in use and controlled by the incumbent mobile network operators."[34] This fact, combined with restrictions resulting from "transmission, planning, resource management, health and environmental considerations and lease terms" means that, in the absence of co - location, access to suitable cell sites is likely to represent a barrier to entry to the telecommunications market.

67. The Commission notes that:

> *"There is scope for some substitutability as new cell sites can be co-located with sites used by organizations (broadcast, high voltage power transmission, and wireless*

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[32] Draft Report, paragraph 130.
[33] *ibid*, paragraph 132.
[34] *ibid,* paragraph 147.

operators) with towers/masts that are structurally capable of co-locating with cellular transmission equipment."[35]

68. The Commission considers, however, that the potential of broadcast towers to provide an adequate substitute for co-location on incumbent MNO equipment is limited because of the relatively low number of sites occupied by broadcast towers and the height of broadcast towers.[36] TelstraClear agrees with this conclusion. While broadcast towers provide possible sites for locating some equipment, this does not obviate the need for a large number of other suitable sites if a cellular network is to deliver the level and quality of coverage expected by customers.

69. The Commission does not consider that high voltage power transmission towers provide an adequate substitute for co-location on cellular transmission sites because of their location relative to customers and the lack of facilities to house base stations and other equipment. TelstraClear agrees with this conclusion. The location of high voltage power transmission towers relative to the location of customers would mean that it would still be necessary for an entrant to find a significant number of other suitable locations for locating equipment. Moreover, high voltage power transmission towers are only in relatively limited locations. Therefore, even if they did provide opportunities for co-location, sites would still need to be found in areas where they were not present. The lack of facilities to house equipment would raise costs relative to the cell site co-location alternative, meaning that they could not be considered a true substitute even if they were present in a suitable location.

70. With respect to wireless networks, the Commission does not consider that these offer a true substitute to cellsite co-location because of the minimal coverage in New Zealand. TelstraClear agrees with this conclusion. While wireless equipment may provide suitable opportunities for co-location, the minimal coverage of wireless would mean that sites would still need to be found where wireless equipment is not present.

71. The Commission therefore concludes that there are no suitable substitutes for co-locating cellular transmission equipment. TelstraClear considers that the co-location opportunities on other equipment are, at best, very limited. In practice, therefore the Commission's conclusion is correct.

72. The Commission states that:[37]

> *"The structure of demand for co-location is national given that the current geographic coverage of the two existing mobile networks is national. While potential operators may wish to enter the cellular market on a regional basis, absent roaming agreements, the demand for co-location is likely to be on a national basis in order to provide customers with ubiquitous coverage."*

73. TelstraClear has two comments to make on this statement.

74. First, the current mobile roaming service is a transitional service. The access seeker is required, as a condition of its entitlement to roaming, to aggressively rollout

[35] Draft Report, paragraph 133.
[36] *ibid,* paragraph 134, 135.
[37] *ibid,* paragraph 141.

infrastructure. The availability of collocation is, therefore, consistent with the roaming service because access to existing towers will facilitate deployment by the access seeker. Without regulated collocation, it could prove very difficult to comply with the conditions for roaming.

75. Second, even if an entrant entered the cellular market on a regional basis only, entrants are unlikely to wish to limit themselves to an initial regional market if entry is successful. Eventually, they are likely to wish to enter other areas. This is after all the pattern that both Telecom and Vodafone followed in extending both their 2G and 3G networks. TelstraClear therefore agrees that the market for co-location is geographically national.

76. Third, TelstraClear notes that the existence of a roaming agreement does not necessarily mean that an entrant would not still seek national co-location over time. TelstraClear notes that the national roaming specified service applies only to 2G cellular services and not 3G cellular services. Yet, as the Commission has stated,[38] a new entrant is likely to enter the market with a 3G network. Therefore, an entrant that has obtained a roaming agreement negotiated under the framework of the specified national roaming service would still have incentives to extend its network if it wished to provide 3G services beyond the location where it entered initially. The fact that the regulated service only covers 2G services would mean that the incentive for the entrant to seek to extend its network would apply nationally.

77. The Commission has concluded that competition in the market for co-location on cellular mobile transmission sites is limited on the basis that most optimal sites are controlled by the incumbent MNOs. TelstraClear notes that the control of optimal sites *per se* is not what limits competition in the market for co-location. The existence of these sites would after all provide the basis for a co-location market. Rather, TelstraClear submits that the key factors that have led to competition in the market for co-location on cellular mobile transmission sites to be limited are:

    a. the limited competition in cellular telephony markets resulting from the fact that there are only two MNOs;

    b. the incentives on these operators to seek to restrict entry in order to be able to continue to be able to price above cost (as the mobile termination proceedings demonstrated);

    c. the lack of any suitable substitutes for co-location on cellular mobile transmission sites, because of a combination of a lack of suitable co-location facilities (as the Commission has noted) and the barriers to entrants building alternative transmission facilities because of RMA and other restrictions.

78. TelstraClear also notes that there are no developments that it is aware of that would result in a change to the Commission's finding of limited competition in cellular co-location transmission services changing during the next two years. TelstraClear therefore agrees that regulation of co-location on cellular transmission sites should be extended for a further two years.

[38] *ibid,* paragraph 145.

5.5 National Roaming

79. The Commission states that:

> *"New Zealand currently has two cellular mobile network service pr oviders. Given the incompatibility of the GSM and CDMA technologies, it is the Commission's view that the market for roaming in New Zealand is made up of two wholesale markets, one for GSM roaming and one for CDMA roaming.* [39]

80. TelstraClear agrees with this statement.

81. The Commission continues:

> *"A potential entrant into the market has a choice of two markets to roam on to before making the decision on which technology to use. The Commission's view is that once in the market, the new entrant would be unlikely to switch technologies in response to a small but significant non-transitory increase in price of the roaming charges from the visitor network."* [40]

82. TelstraClear agrees that once in the market a new entrant is unlikely to switch technologies in response to a small but significant non-transitory increase in the price of roaming charges. TelstraClear considers that the key reason for this is that the substantial costs involved in building a mobile network are effectively sunk once entry has occurred. As a consequence, a small but significant non-transitory roaming price increase will not result in the entrant changing cellular technology because it will still wish to attempt to recover the costs of its initial investment.

83. TelstraClear also agrees with the Commission's conclusion that there are currently no substitutes for roaming services in New Zealand. A requirement to use co-location as the sole means of attaining national coverage would involve unreasonably high costs for an entrant that would be likely to prevent entry.

84. TelstraClear also agrees with the Commission that an entrant seeking roaming would wish to obtain national coverage. Even if an entrant entered as a regional operator, having access to national roaming would enable it to serve a much wider pool of customers than regional roaming only, improving the business case for entry. Roaming is an important part of the service proposition for many customers.

85. The Commission states that it "considers that it is unnecessary to discriminate between pre- and post-paid customers when considering the market for roaming services"[41]. While sub-groups of these customers may have more or less extensive roaming requirements, it is likely that a proportion of both groups will require some form of roaming if the entrant does not provide ubiquitous coverage.

86. The Commission notes that it "understands that there is the prospect of wide availability of dual mode handsets CDMA/GSM in the future"[42]. While there may be such a prospect,

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[39] Draft Report, paragraph 160.
[40] *ibid,* paragraph 161.
[41] *ibid*, paragraph 167.
[42] *ibid,* paragraph 169.

the key issue for this Investigation is whether such a development is likely during the extension period and, if so, what its impact would be. TelstraClear considers that for such a technology to have a significant impact on the roaming market during the extension period, the technology would need to be available now. If it is, it is certainly not widely available so its impact on the roaming market would be very limited. Moreover, as the Commission notes, such a technology would blur the boundary between the two identified markets for roaming, but would not remove the need for roaming *per se*.

87. TelstraClear agrees with the Commission that Telecom and Vodafone do not face competition for the provision of roaming services on their networks because they are the only access providers of CDMA and GSM mobile communications services. This situation is unlikely to change during the extension period. Even if there is new entry, the period of time it took Telecom and Vodafone to build their mobile networks suggests that it will be impossible for a new entrant to build a network sufficient to provide national coverage as extensive as Telecom's and Vodafone's in the next two years.

88. TelstraClear agrees with the Commission that it is unlikely that potential entry would constrain the market power that Telecom and Vodafone exert in the markets for roaming,[43] especially during the extension period. This is because of the level of investment and time required to build a mobile network as extensive as Telecom's and Vodafone's.

89. TelstraClear therefore agrees with the Commission that there is limited competition in the wholesale market for roaming on both the CDMA and GSM cellular networks. This situation is likely to persist during the extension period. TelstraClear therefore agrees that regulation of national roaming should be extended for a period of two years.

90. While there are a number of deficiencies in the current specified roaming service – in that the 10% coverage requirement is uncertain and price is not addressed – potential changes to regulated services are being considered as part of the Commission's mobile market stocktake. In the interim, the existing regulated service should be extended.

5.6 Number Portability

91. The Commission states that:

> *"The Commission considers that the ability for consumers to retain their telephone numbers when switching between telecommunications providers removes an impediment to the development of competitive markets by lowering switching costs. Number portability is expected to promote competition for the long-term benefit of end-users by enabling customers to switch service providers while maintaining their existing telephone numbers.*
>
> *"The absence of number portability hinders the competitive process by raising switching costs that customers must incur in order to change the service provider. Switching costs are generally detrimental to welfare because they make entry more difficult and markets less competitive."* [44]

[43] *ibid,* paragraph 180.
[44] *ibid,* paragraphs 185-186.

92. TelstraClear agrees with this statement. The fact that New Zealand does still not have number portability over ten years after TelstraClear's predecessor companies first sought it is a key reason why competition continues to be limited across so many telecommunications markets in New Zealand.

93. The Commission identifies competition concerns in the retail markets for both mobile services and local access and other associated markets.[45] The Commission considers that in at least one of these markets – the retail market for residential local access services in non-networked metropolitan areas - there is likely to be limited competition in the next two years. The Commission considers that local number portability will enhance competition in this market and TelstraClear agrees that this will be the case.

94. However, even in markets where the Commission has not yet determined that competition is limited, notably the retail mobile services market, the Commission has noted a lack of competitive entry.[46] Moreover, the Commission is currently determining whether to conduct an investigation of competition in this market. The ability of number portability to lower the barriers to entry to this market means that it would undoubtedly promote competition.

95. TelstraClear considers that the fact the number portability is regulated is a key reason why New Zealand now at least has a target date for delivery of number portability of April 2007. Retaining regulation of both fixed and mobile number portability is critical to ensuring that number portability is delivered by this date and that it lives up to its promise. TelstraClear therefore agrees with the Commission that the regulation of number portability should be extended for a further two years.

[45] *ibid,* paragraphs 189-192.
[46] *ibid,* paragraph 178.

6 Recommendation

96. TelstraClear recommends that the Commission confirm that regulation of the following services be extended for a period of two years, in accordance with section 65 of the Act:

    a. Retail Services offered by means of Telecom's fixed telecommunications network;

    b. Bundle of retail services offered by means of Telecom's fixed telecommunications network;

    c. Retail services offered by means of Telecom's fixed telecommunications network as part of a bundle of retail services;

    d. Residential local access and calling service offered by means of Telecom's fixed telecommunications network;

    e. Interconnection with Telecom's fixed PSTN;

    f. Interconnection with fixed PSTN other than Telecom's;

    g. Local telephone number portability service;

    h. Cellular telephone number portability service;

    i. National roaming; and

    j. Co-location on cellular mobile transmission sites.

Schedule 1: EU Decision on SMP

	Market 1: Access to public telephone network at a fixed location for residential customers	Market 2: Access to the public telephone network at a fixed location for non-residential customers	Market 3: Publicly available local and/or national local telephone services provided at a fixed location for residential customers	Market 4: Publicly available international telephone services provided at a fixed location for residential customers	Market 5: Publicly available local and/or national telephone services provided at a fixed location for non-residential customers	Market 6: Publicly available international telephone services provided at a fixed location for non-residential customers	Market 7: The minimum set of leased lines	Market 8: Call origination on the public telephone network provided at a fixed location (incl. call origination and local-tandem conveyance and transit).	Market 9: Call termination on individual public telephone networks provided at a fixed location.
Austria	✓	✓	✓	✗	✓	✓	✓	✓	✓
Belgium	✓*	✓*	--	--	--	--	--	--	--
Cyprus	--	--	--	--	--	--	--	--	--
Czech	✓*	✓*	✓*	✓*	✓*	✗*	--	✓	✓*
Denmark	✓*	✓*	✓	✓	✗	✗	✓	✓	✓
Estonia	--	--	--	--	--	--	--	--	--
Finland	✓	✓	✓[47]	✗	✓①	✗	✓	✓	✓
France	✓	✓	✓	✓	✓	✓	--	✓	✓
Germany	✓*	✓*	✓*	✗*	✓*	✗*	--	✓[48]	✓
Greece	--	--	--	--	--	--	--	--	--
Hungary	✓	✓	✓	✓	✓	✓	✓	✓	✓
Ireland	✓*	✓*	✓*	✓*	✓*	✓*	✓[49]	✓*	✓*

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* The decision has not been finalized is pending (e.g. matter under appeal, draft decision only made by NRA, final decision by NRA notified to Commission but not yet adopted, new consultation has been announced).

[47] SMP for local services, no SMP operators for national services.

[48] DT is appealing aspects of BNetzA's findings re call origination for data services.

[49] No SMP in leased lines above 2Mbps.

	Market 1: Access to public telephone network at a fixed location for residential customers	Market 2: Access to the public telephone network at a fixed location for non-residential customers	Market 3: Publicly available local and/or national local telephone services provided at a fixed location for residential customers	Market 4: Publicly available international telephone services provided at a fixed location for residential customers	Market 5: Publicly available local and/or national telephone services provided at a fixed location for non-residential customers	Market 6: Publicly available international telephone services provided at a fixed location for non-residential customers	Market 7: The minimum set of leased lines	Market 8: Call origination on the public telephone network provided at a fixed location (incl. call origination and local-tandem conveyance and transit).	Market 9: Call termination on individual public telephone networks provided at a fixed location.
Italy	✓	✓	✓	✓*	--	✓*	✓*	✓*	✓*
Latvia	--	--	--	--	--	--	--	✓*	✓*
Lithuania	--	--	--	--	--	--	--	✓*	✓*
Luxembourg	--	--	--	--	--	--	--	✓*	--
Malta	✓*	✓*	✓*	--	✓*	--	✓*	✓*	✓*
Netherlands	✓	✓	✓	--	--	--	✓	✓	✓
Norway	✓	✓	✓	✓	✓*	✓	--	✓	✓
Poland	--	--	--	--	--	--	--	--	--
Portugal	✓	✓	✓	✓	✓	✓	✓	✓	✓
Slovakia	✓	✓	✓*	✓*	✓*	✓*	--	✓	✓
Slovenia	✓	✓	✓*	✓	✓	✓	✓	✓	✓
Spain	✓*	✓*	✓	✓	✓	✓	✓	✓	✓
Sweden	✓	✓	×	×	×	×	✓	✓	✓
UK	✓	✓	✓	✓	✓	×[50]	✓	✓	✓

50 SMP obligations imposed in Hull area for Kingston.