

**Counties Power's Submission
on the Commerce Commission's
October 2003 Amended Draft Report
on its Investigation into
Unbundling the Local Loop Network
and the Fixed Public Data Network**

28 October 2003

INTRODUCTION

1. Counties Power makes this submission to the Commerce Commission in response to the commission's amended draft report on its investigations into unbundling the local loop network and the public data network.
2. First Counties Power must make it clear that it does not support enforced unbundling. At para 592 of its report the commission lists Counties Power among those it describes as broadly in favour of unbundling. As we tried to make clear in our submission of 14 May, Counties Power does believe that unbundling is desirable, however we believe that to be effective this needs to be achieved by Telecom choosing to unbundle the relevant services, in response to market forces and appropriate regulatory mechanisms. We emphasise that we do not believe that enforced unbundling is either desirable or likely to be effective.
3. It should not be thought that Counties Power holds this view because we fear the increased competition which unbundling could bring to parts of our own network. In fact we would welcome unbundling and would probably make use of the Telecom network in places to complement our own network investment. We simply hold the view, based on electricity industry and telecommunications industry experience, that unbundling won't work unless Telecom wants it to work and that enforcement is likely to have unintended negative effects.
4. In short, Counties Power submits that the commission should not embark on enforced unbundling. Rather, as we stated in our submission of 14 May, we submit that the commission should

focus on creating a regulatory environment which will provide Telecom with incentives to open its networks to competing retailers, and which will remove obstacles to the construction of new generation networks. We reiterate that in our view the matters most urgently in need of resolution are quick, free number portability and quick, cost-effective interconnection arrangements.

THE EXTENT OF COMPETITION

5. Counties Power applauds the sentiment expressed at para 333:

The Commission has taken a principled and careful approach in exercising the power to regulate in competitive markets. Regulation in such circumstances should only be required where it is very clearly in the long-term interests of end-users.

We are concerned, though, by para 583, in which the commission says that where markets are not competitive it will:

... make a comparison between the different scenarios (counterfactual versus factual(s)) to assess whether designation or specification would address the competition problem and whether it best gives, or is likely to best give (sic), effect to the purpose of promoting competition in the relevant ... markets for the long-term benefit of end-users ...

There is inevitably a high level of speculation and subjectivity in this test, so we submit that the commission must apply it with considerable caution, particularly in fast developing markets. With respect it does not appear to Counties Power that the amended draft report demonstrates an appropriate level of caution. In particular we are surprised by the commission's draft

conclusions re the likely extent of market competition over the coming five years.

6. In paras 335 to 581 the commission reaches the view that there is a degree of competition in all relevant markets, albeit this is limited in most of them. We have little argument with the view that this is the position today, however it appears to us that the commission has given too little weight to the speed at which the markets are changing, and the likely position in the near future.
7. At the time that the commission's April 2003 Issues Paper was being drafted, there was limited competition in south Auckland. Today Counties Power has a wide reaching open access broadband network, mainly fixed wireless though with a fibre component. Our retail partners are serving a rapidly growing number of satisfied Internet customers through our network, and many of these customers are paying significantly less than they previously paid for service through the Telecom network.
8. We have also proved Voice over IP to the satisfaction of retailers and pioneer customers, and we last week announced an agreement with WorldxChange to provide voice, fax and EFTPOS services across the network forthwith. Other voice retailers are close to signing similar agreements. We expect that this introduction of voice services will significantly increase our rate of new customer acquisition.
9. In short, our Wired Country network is a completely viable substitute for the Telecom network, and it can deliver broadband voice and data services to places which Telecom will be hard pressed to reach without itself investing in fixed wireless solutions –

though of course Telecom is welcome to use our network if it wishes!

10. At question 4.1 the commission asks about the disadvantages of new technologies compared to the existing networks. One issue sometimes mentioned is the fact that line of sight radio entails cover constraints, particularly in rural areas where soft obstacles like trees absorb rather than reflect. In Counties Power's view this is simply an issue to be managed, for example through the use of multiple transmission sites, radio repeaters and complementary media like short distance power line carrier. Furthermore in terms of competition analysis we submit that entirely ubiquitous cover is not needed. Even partial cover will create real competitive pressure.
11. We note from para 362 *et seq* that BCL has told the commission of some of its market development plans. Counties Power has not done the same, however we do have definite plans to extend the Wired Country network well beyond our south Auckland base within the next 12 months. Furthermore it has been our experience that the entry barriers to this market are not particularly difficult to over-come. From discussions with electricity lines companies and others we are aware that many parties are considering similar initiatives in many other parts of the country, some of them in partnership with us and some of the separately.
12. No doubt some of these initiatives will fail. On the other hand there are no doubt other initiatives under consideration about which Counties Power knows nothing. In short we submit that, without enforced unbundling, there is a very high probability that

significantly more than the 5 ESAs named in table 4.1 will experience “Not Limited” local loop and PDN competition within two years, let alone within the 5 year time horizon which the commission has adopted. Consequently we respectfully submit that the level of competition over the next 5 years will be significantly greater than the commission has determined in the amended draft report.

THE COUNTER-FACTUAL

13. Counties Power is concerned by the counterfactual which has been used as a basis for the economic analysis. At para 642 the commission adopts the counterfactual outlined in the April 2003 Issues Paper, which is a continuation of the *status quo*, tempered by regulatory and technological factors. In their paper “Modelling the Impact of Unbundling the Local Loop and Fixed Public Data Network”, OXERA have interpreted this to mean that in the absence of enforced unbundling, existing prices will remain in force and will rise with inflation. We see this at their para 4.1.4:

It was assumed that prices would remain static in real terms for both voice and data services over the period of the analysis. This applies to both the connection charges for data and voice, and the monthly line-rental and service charges.

And again at their para 5.1.4:

Retail prices in the counterfactual are assumed to be the same as those currently charged by TCNZ ...

14. No doubt the commission is aware that Telecom does not operate with uniform national pricing. Rather it varies its prices to

respond to different market forces in different areas. We have already seen this in south Auckland, with Telecom significantly reducing its new subdivision reticulation charges as soon as it faced competition from Counties Power.

15. In paras 5 to 12 of this submission Counties Power has indicated that we believe that there will be more competitive activity over the next five years than the commission apparently anticipates. Obviously the extent of such competition is a topic on which competent people may reasonably hold differing views. It seems to us to be undeniable, though, that there will be some level of increased competition; there are simply too many commercial, community and government initiatives under way for this not to be the case.
16. It seems to Counties Power to be absolutely inevitable that Telecom will respond to this increased competitive pressure by enhancing its services and / or reducing its prices, just as it has done in the past. In our view the counterfactual described in the OXERA paper simply is not credible. Prices will not remain “static in real terms” over the next five years. Rather Telecom's average price will drop to some extent, and the commission needs to take this into account in its analysis.

ANOTHER COUNTER-FACTUAL

17. As mentioned above, at para 583 the commission reports that it seeks to assess whether its proposed action “is likely to best give (*sic*), effect to the purpose of promoting competition in the relevant ... markets”. With respect, it appears to Counties Power that the commission has not in fact addressed this question.

18. The commission's evaluation has been limited to three scenarios:
- (a) specification,
 - (b) designation,
 - (c) no action.

Among these scenarios the commission has selected (b) as the most likely to improve competition. We have explained above and below why Counties Power is of the view that the commission has not made a convincing case for its choice of scenario (b) over scenario (c). We also suggest, though, that there are other scenarios which the commission should evaluate before deciding which is likely best to give effect to the promotion of competition.

19. As outlined in our submission of 14 May, Counties Power believes that quick and decisive action on number portability and network interconnection would do most to enhance competition. Again these are matters on which competent people may reasonably hold differing views, however what concerns us is that the commission does not appear to have considered them in establishing the counterfactual for analysis. We respectfully submit that until the commission has evaluated these matters and any other steps that it could reasonably take, then it cannot be in a position to determine what actions are most likely to promote competition.

THE ECONOMIC ANALYSIS

20. Counties Power has no reason to doubt that OXERA have carried out their analyses and predictions competently, however such predications are inevitably uncertain and their results must be

treated with caution. We are surprised that the commission apparently sees the predictions as being compelling enough to justify enforced unbundling.

21. The amended draft report predicts that enforced unbundling of the local loop network and the fixed public data network will result in customer gains totalling about \$150m (present value) over five years, or about \$30m a year.
22. In arriving at this figure of \$30m a year the commission has taken into account some risks and uncertainties, however it does not appear to have attempted to quantify or account for the following:
 - (a) the price decreases and increased service uptake which will result from increased competition without enforced unbundling – see paras 5 to 12 above,
 - (b) the risk that enforced unbundling will limit the speed of technological development and / or the geographic spread of broadband communications, by effectively locking customers in to legacy copper networks,
 - (c) the risk that enforced unbundling will inhibit investment in competing networks, resulting in a lower level of competition than would otherwise occur.
23. In our 14 May submission we suggested that enforced unbundling and the accompanying price regulation will create uncertainty for investors. This is true both for competitors and for the incumbent. Telecom is likely to remain the largest telecommunications provider for many years to come, but why should it be as ready to invest in new generation networks if it is

obliged to open them to competitors while having its return capped by a regulator?

24. The key point here, though, is not how Telecom or other investors will behave; it is that the commission has not taken the matters listed in para 22 into account in its analysis of the expected impact of enforced unbundling.

25. The predicted benefit of \$30m a year is approximately 0.5% of Paul Budde's estimate of New Zealand's annual spend on telecommunications. This seems to Counties Power to be far too small a proportion to justify the commission's draft recommendation of enforced unbundling. This is particularly so in view of the unquantified risks mentioned in the para 22. In our view only a small impact on investment plans would more than wipe out the benefit which the commission has predicted.

CONCLUSION

26. Counties Power submits that the amended draft report and the accompanying economic analysis and predictions do not justify the recommendations in the report.

27. Counties Power urges the commission to:
 - (a) refrain from embarking on enforced unbundling at this stage,
 - (b) address the issues of number portability and interconnection urgently,
 - (c) monitor market developments, particularly in respect of network competition,
 - (d) review the issue of enforced unbundling in 18 months time,
 - (e) consider a wider range of scenarios and possible impacts before adopting enforced unbundling, whether now or in the future.

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Chief Executive Officer
28 October 2003