



**Telecom's submission on Commission's
Review of Resale Services**

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EXECUTIVE SUMMARY

- 1 Telecom welcomes the Commission's proposal to open an investigation into whether outdated regulation can be removed. It is appropriate for the Commission to use the well established tools to consider reviewing regulation and, where regulation becomes outdated or unnecessary, removing or rationalising it.
- 2 If the Commission chooses to engage in this review, the discretion is clearly available to it to do so. The threshold of "reasonable grounds" for opening this proposed investigation has been well traversed in the Commission's previous Schedule 3 investigations and is met here.
- 3 Telecommunications regulation was first implemented seven years ago in the Telecommunications Act 2001 (**Act**). The regime was then significantly amended in 2006 and has been vigorously implemented by the Commission and Telecom. In addition, operational separation has just had its first anniversary, the Government has launched its Broadband Investment Initiative and the environment and the services that were the focus in 2001 fade in comparison to what is now before us.
- 4 The telecommunications industry today is very different from that which existed in 2001. In those days:
 - (a) Resale services were pursued alongside PSTN interconnection for entry into the telecommunications market;
 - (b) Only TelstraClear appeared as a credible fixed network infrastructure-based player and was the key advocate for resale services;
 - (c) Telecom was not subject to operational separation; and
 - (d) There were no cost-based unbundled services such as UCLL or SLU.
- 5 Today, seven years later, the landscape is fundamentally different. In particular:
 - (a) New Zealand and Telecom have the world's most extensive operational separation regime. This means that Chorus and Wholesale operate effectively as separate businesses developing their own Commercial Policy. Most importantly, they operate at arm's length from each other and from Telecom's retail units. Telecom is committed to the principles underpinning this environment and to making it work;
 - (b) UBS has evolved into UBA services including enhanced services;
 - (c) UCLL is established and is rolling out in New Zealand and SLU is near finalisation;
 - (d) Vodafone, as a global company, has emerged as another formidable infrastructure-based player, leveraging from a powerful position in mobile

markets into fixed (including broadband) markets. Others, such as Orcon, are also emerging, along with various alternative backhaul providers; and

- (e) The focus on the PSTN is moving to a focus on fibre, through the Government's vision for accelerated fibre deployment in New Zealand.
- 6 The regulatory changes, introduced in 2006, were intentional. They sought to drive the market into true "wholesale inputs", in recognition that resale was a first step, permitting only limited innovation. The Act today promotes and enables infrastructure-based competition wherever this is possible. Telecom's competitors are now able to achieve returns that are directly linked to their level of investment and they have significant scope to innovate. Infrastructure-based competition has already created a step change in the wholesale market that flows through to the retail market.
- 7 These developments clearly support a rethink as to the ongoing role for regulation in the area of resale services. The Commission is empowered to find reasonable grounds and conduct such a review when it chooses. There will be plenty of opportunity within that review process to consider full submissions from all parties. Closing the door on a review now would be closing the door on best practice principles for New Zealand regulation.
- 8 Of course, resale services remain vibrant within Wholesale's business today – as a matter of commercial arrangements with its customers. There are no old resale determinations in force today – they have all expired. There have been no applications for resale services in recent years and the focus of the industry and the regulator is firmly on wholesale inputs like UBA, UCLL and SLU as well as a future NGN and fibre world.
- 9 Regulation should not be retained with a view to retention of layer upon layer of regulation just in case it may be sought again at some time in the future. The aim of regulation should be targeted, ideally at a single point. Regulation should promote competition for the long term benefit of end users and ultimately, a competitive landscape where regulation becomes unnecessary.
- 10 It is not appropriate to justify retention of regulation for the purpose of providing a regulatory backstop. Best regulatory practice dictates that regulation should only be imposed, and retained, for as long as there is clear evidence of market failure, and where the benefits clearly outweigh the costs. It is well-recognised internationally that regulatory intervention should be the minimum necessary and regulators should review regulation regularly to assess whether it remains necessary or can be rationalised.
- 11 Maintaining good regulatory practice is as important for New Zealand as it is for other OECD countries. There is an increasing trend and commitment to encourage commercial solutions, simplify regulation and reduce the burdens to the minimum necessary and maintain continuous review of the effectiveness and appropriateness of regulation. The Commission has significant own initiative powers under the New Zealand regime and has the ability to engage in these best practices. It is well recognised, particularly in a dynamic environment, that de-regulation is just as important as the imposition of regulation.

- 12 Internationally, resale is not a key plank of regulatory focus. Very few countries have a regulated resale regime as comprehensive as New Zealand's. It is not clear why New Zealand would be any different in terms of focus and, given the comprehensive scope of it, removal or rationalisation would appear obvious for consideration. In particular, given the extensive operational separation and regulatory regime that has evolved since 2006, there is no other comparable regime that seeks to retain the breadth of regulation as New Zealand.
- 13 Telecom Wholesale has undergone transformational change in recent years and this is well acknowledged. The operational separation regime has enhanced its arm's length operation from other parts of Telecom and its commitment to its customers. The Commission should not be concerned that resale will disappear overnight just because the potential ability to regulate is removed. Telecom Wholesale remains committed to ensuring its customers have the services they need to succeed. For the moment, in the absence of alternatives, that means resale remains an important offering commercially. Resale will remain available until Telecom Wholesale has delivered, and migrated customers to, its next generation input products.
- 14 Without wishing to pre-empt the Commission's substantive findings, Telecom's view is that the wider environment is now sufficiently sophisticated to support resale on a wholly commercial basis. Competition means there is more choice, and the Undertakings mean there is a level playing field. In these circumstances there are clearly reasonable grounds for commencing an investigation into the ongoing need for resale regulation.

SECTION ONE: INTRODUCTION

- 15 The Commission is considering whether there are reasonable grounds to open an investigation under Schedule 3 of the Act into whether the service descriptions in the Act for “resale services” should be removed. That is, whether there are reasonable grounds to investigate whether we should continue to have a regulated resale regime.
- 16 As outlined in the Commission’s letter of 25 March 2009, there are four service descriptions in Schedule 1 of the Act that cover what are commonly referred to as resale services:
- (a) Retail services offered by means of Telecom’s fixed telecommunications network (**FTN**);
 - (b) Residential local access and calling services offered by means of Telecom’s FTN;
 - (c) Bundle of retail services offered by means of Telecom’s FTN; and
 - (d) Retail services offered by means of Telecom’s FTN as part of bundle of retail services.
- 17 During the first four years of regulation in New Zealand the Commission considered, and ultimately made, three determinations in respect of services covered by those service descriptions, as follows:
- (a) Decision 497 – decision in respect of services covered by (a) above – issued 12 May 2003;
 - (b) Decision 525 – decision in respect of services covered by (a), (b) and (c) above – issued 14 June 2004; and
 - (c) Decision 563 – decision in respect of services covered by (a) – issued 9 December 2005.
- 18 The services that are resold as a result of these determinations are detailed in Telecom Wholesale’s price lists known as DSPL and RSPL (Designated Services Price List and Residential Services Price List). Substantial parts of the delivery of those services were set up through commercial arrangements in parallel to the issues in front of the Commission. And, although all of these determinations have expired, Telecom has continued to offer the services (including successor services) on a commercial basis. Further, the services were only determined in respect of supply to TelstraClear, but Telecom offered them on the same basis to all other Wholesale customers.
- 19 The Act used to contain a sunset provision which provided for expiry of the Schedule 1 services in 2006 (five years after the introduction of the Act). In

August 2006 the Commission conducted a review. No de-regulation or rationalisation was put forward. Instead, the Commission recommended that the majority of the designations be extended for a further two years – to December 2008.

- 20 In February 2009 Telecom wrote to the Commission requesting an investigation into whether the resale service descriptions should remain in the Act. We are pleased that the Commission is at least consulting on a potential willingness to open an investigation. We consider that there are reasonable grounds to, at least, investigate the removal of the resale service descriptions.
- 21 The Commission's previous investigations under Schedule 3 have related only to the imposition of more regulation. This is the first potential investigation to consider de-regulation, and we welcome the intention shown by the Commission to assess the possible rationalisation of the various regulatory layers.
- 22 In the following sections of this submission we address:
 - (a) The legal test to commence a Schedule 3 investigation;
 - (b) Reasons for reviewing resale regulation;
 - (c) What the future holds for resale; and
 - (d) Responses to the Commission's specific questions.

SECTION TWO: LEGAL TEST

- 23 Clause 1(1) of Schedule 3 of the Act provides that the Commission may commence an investigation under Schedule 3, if requested to do so in writing by the Minister or on its own initiative “if the Commission is satisfied that there are reasonable grounds for an investigation into the matter” (emphasis added).
- 24 The Commission currently has one Schedule 3 investigation on foot, and has recently concluded three. They are:
- (a) Mobile termination access services (ongoing);
 - (b) Mobile roaming and co-location;
 - (c) Review of designated access services; and
 - (d) Mobile termination.
- 25 In these investigations the Commission has adopted a low threshold of reasonable grounds to investigate. For example:
- (a) The current mobile termination access services investigation was undertaken even though the issue had already been thoroughly examined reasonably recently. The Commission identified several factors that were significant changes since the previous investigation, including “concerns” about barriers to entry and differentials between on-net and off-net pricing. These observed changes were sufficient to outweigh any concerns around cost and reasonableness of a second investigation¹.
 - (b) In the mobile roaming and co-location investigation the lack of new entry to the mobile market prompted the Commission to assess barriers to entry, including the extent to which the specified services were appropriate in overcoming the barriers to entry².
 - (c) In the 2006 review of designated access services, the Commission specified that reasonable grounds to investigate “relate to the promotion of competition”. In applying that standard for resale, the mere fact that applications had been made in the past for resale services was found to evidence continuing difficulties for access seekers in reaching a satisfactory outcome from commercial negotiations, which itself constituted reasonable grounds to investigate. The Commission also cautioned against conflating the threshold issue with the underlying merits of the issue to be investigated. Hence, it was sufficient in the context of

¹ *Reasons for Commerce Commission decision to investigate mobile termination access services*, 6 November 2008.

² *A Review of Cellular Mobile Market Entry Issues*, 10 October 2006

roaming and co-location that “there is potentially merit” to some complaints that had been made³.

- (d) In the original mobile termination investigation, the Commission decided that there were reasonable grounds to investigate, based on three factors – an indication that mobile termination rates exceeded costs by a significant amount, the potential for competition concerns and the fact that a large proportion of telecommunications spend for end users was related to calls terminating on a mobile phone.⁴
- 26 In review circumstances as here, a lower threshold is potentially more appropriate than in the above situations. Furthermore, if the threshold were a barrier to even carrying out a review, the framework and the exercise of discretion would be to block best practice and continuous reviews to reduce the burdens of unnecessary regulation.
- 27 In any case, the Commission’s primary concern should again be “the promotion of competition”, and that includes wider questions around the incentives to innovate from an infrastructure based platform. Without seeking to decide the merits now, the Commission should acknowledge that there have been fundamental changes in the industry landscape which warrant investigation of removal of resale from the regulatory package.
- 28 We would also like to think there is “potentially merit” in our contention that the resale regime is unnecessarily onerous and does not promote competition in the new environment. Whether the Commission employs a higher threshold test or continues to employ its relatively low test, Telecom considers there are reasonable grounds, outlined in the next section, to investigate whether to remove the regulated resale service descriptions.

³ Review of Designated and Specified Services under the Telecommunications Act 2001: Preliminary view on decision to investigate and procedural matters, 15 September 2006.

⁴ *Decision to Investigate*, Mobile Termination Rates, 29 April 2004.

SECTION THREE: REASONS FOR REVIEWING RESALE REGULATION

- 29 There are numerous factors which support Telecom's view that the Commission should investigate whether regulated resale remains necessary.

Changes in regulatory regime since resale regulation introduced

- 30 In the more than two years since the Commission last considered this subject (August 2006), there have been significant changes in the New Zealand telecommunications regulatory regime. Among other things, we have seen:

- (a) The unbundling of Telecom's network, and delivery (or imminent delivery) of UCLL, UCLL Co-location, UCLL Backhaul, UBA, UBA Backhaul, Sub-loop UCLL, Sub-loop UCLL Co-location, Sub-loop UCLL Backhaul; and
- (b) Extensive operational separation of Telecom and the repositioning of arm's length Chorus and Wholesale businesses.

- 31 The regulatory changes have been brought in to create a fundamentally different regulatory framework from that which existed prior to the 2006 amendments.

- 32 The Undertakings established key principles of equivalence and a "level playing field" model. In conjunction with UCLL, this new model isolates and regulates access to the bottleneck (Telecom's copper local loop). By contrast, resale is an all encompassing mode of regulation that has the tendency to regulate by default, rather than by need. For example, it encompasses services that incorporate "smarts" that are, in no reasonable sense, "bottleneck" services. Additionally, resale regulation is complex as evidenced by the historical determination processes – as innovation is limited and the focus is on reselling Telecom's innovation, there are additional complexities and costs that arise. A rationalised regime, in light of the wholesale inputs available today, would be much more incisive.

- 33 The 2006 amendments to the Act promote and enable infrastructure-based competition. Telecom's competitors are now able to achieve returns that are directly linked to their level of investment. Infrastructure-based competition creates a step change in the wholesale market that is flowing through to the retail market.

- 34 Importantly, across the Tasman, in its determination in respect of local carriage service and wholesale line rental service the ACCC found that UCLL-based competition is more efficient than resale-based competition. The ACCC's basis for this conclusion is as follows:⁵

⁵ Page 28, ACCC (2008), *Telstra's local carriage service and wholesale line rental exemption applications: Final Decision and Class Exemption*, August 2008.

"In relation to provision of voice services, the ACCC considers that ULLS-based competition is a preferable form of competition to re-sale competition because it has longer-term benefits. The ACCC is of the view that ULLS-based competition encourages competitors to compete on greater dimensions of supply, such as price and quality, which allows them to dynamically innovate their services. Also, by reducing reliance on competitors' network assets and related services it can lead to more sustainable competition."

- 35 As our regulatory and competitive environment matures, the Commission should be monitoring developments to ensure the regulatory regime is optimised to promote competition for the long-term best interests of end users and that it is the minimum necessary. The Commission should be alive to the risk that duplicate layers of regulation may harm competitive market dynamics. The harm and risks of regulatory error and distortion of competition are as real as the concerns that lead to the imposition of regulation.
- 36 For example, regulation of various, substitutable access products risks regulatory arbitrage problems. That is, with products that are substitutes, as the ACCC has found UCLL and its wholesale line rental service to be, the relative price will affect uptake and could skew competition inefficiently if the regulated prices are not appropriate. The retention of regulated resale creates a significant arbitrage risk. The Commission already faces a significant challenge in reconciling the "relativities" between UCLL and UBA. The addition of other resold access services adds additional complexity, increasing the prospect of regulatory error.
- 37 It is time the Commission undertook a proper consideration of whether the co-existence of regulated input services with regulated resale services is appropriate when considering the long term interests of end-users. On the face of it, in the landscape today, it is inefficient. In that case it is an unnecessary burden on Telecom and ultimately does not promote competition.

Regulatory best practice supports minimum regulation necessary

- 38 It is a well-recognised principle that regulation should only exist where there is a clear need for it –

"focusing regulation to where it is needed, and withdrawing regulation in those parts of the market where it is no longer necessary. In other words, the concept of regulatory forbearance rests on the goal of a gradual removal of ex ante regulation and an accompanying increase in the use of general ex post competition regulation."⁶

⁶ <http://www.ictregulationtoolkit.org/en/Section.1679.html>

39 For example, Ofcom has enshrined in its regulatory principles⁷ the principle that regulators should have a bias against regulation, and should intervene only where there is a clear benefit in doing so. Any regulation imposed should be the minimum necessary.

40 The MED endorses the same concepts in its Code of Good Regulatory Practice⁸.

41 At paragraph 1.6 of its consultation document on fixed narrowband retail services markets, Ofcom states:⁹

"In the 2005 TSR, Ofcom set out seven principles for the regulation of telecoms markets, including that Ofcom should:

- focus regulation on the deepest levels of infrastructure where competition will be effective and sustainable;

- ensure equality of access at those levels; and

- as soon as competitive conditions allow, withdraw from regulation at other levels."

42 The Commission has recognised a similar concept in its NGN study, in which it has proposed two highly relevant regulatory principles:¹⁰

- *Regulation should be considered only where necessary to constrain market power – where for instance it is conferred by control over bottlenecks;*

- *Regulation should be scaled back as workable and effective competition develops.*

Although the Commission proposed these in the context of the NGN study, these principles reflect general regulatory best practice. Unfortunately, they have not yet been used in the New Zealand environment at all.

43 In Australia, the ACCC has endorsed the ladder of investment approach, with some caveats, but clearly reinforcing the point that this approach *"does not necessarily suggest that multiple forms of mandated access at different network layers should be left in place indefinitely. The Commission's position has consistently been that it will only seek to promote facilities based ...*

⁷ Ofcom http://www.ofcom.org.uk/consult/condocs/plan/annual_plan/regulatory_principles.pdf

⁸ http://www.med.govt.nz/templates/StandardSummary____385.aspx

⁹ http://www.ofcom.org.uk/consult/condocs/retail_markets/fnrsm.pdf

¹⁰ *Discussion Paper on Next Generation Networks*, Commerce Commission 24 December 2008 page 4

*competition where it is likely to be economically efficient*¹¹(and therefore in the long term interests of end users).

- 44 Ofcom, the ACCC, and the Commerce Commission all have recognised the need to review regulatory interventions, and consider whether they remain necessary or can be rationalised. The regulated resale regime was appropriate at an earlier point in the regulatory process, but the removal of bottlenecks, and the increased level of infrastructure competition at a deeper level in the network, mean that review is now appropriate.
- 45 In reviewing regulatory interventions such as these, a few important principles must be considered. It is important that the Commission should not intervene, or continue to intervene, unless there is clear evidence of continuing market failure. In any case, intervention can only be justified on the basis of an analysis which clearly shows that the benefits of intervention outweigh the costs. Further, if intervention, or continued intervention, is necessary, it should be the minimum necessary to address the problem. There should be consultation to ensure the potential effects of the proposed regulation are fully understood. We note that in the UK, Ofcom operates under a legislative requirement to minimise regulatory burdens¹².
- 46 In line with these principles, it is appropriate to consider whether regulated resale remains necessary, given the additional layers of regulation that exist now, that did not exist when the Commission last considered the appropriateness of the resale service descriptions.
- 47 If regulation develops in a piecemeal way and is not rationalised, companies are left with a significant burden. Where conditions exist to warrant the removal of layers of regulation, the regulator should be proactive. Ideally there should be a single point of regulation, rather than multiple layers.
- 48 In our view, the continued regulation of resale is superfluous. The regulatory framework supports UBA and UCLL as well as delivering EOI-based input services via the Undertakings. Maintaining a regulated resale regime in addition is unnecessary and unprincipled.
- 49 It is also worth noting that internationally few countries have a regulated resale regime as comprehensive as New Zealand's. In both Australia and the UK, there is not an extensive resale regime, although there is a wholesale line rental service.

¹¹ Fixed Services Review – A Second Position Paper, April 2007) p 21 The caveats focus on concerns that in certain circumstances, where enduring bottlenecks exist, or where alternative infrastructure based competition is present, the ladder of investment approach may require modification.

¹² Communications Act 2003 (UK).

- 50 To ensure consistency with international best practice, especially in light of the regulatory changes since 2006, the Commission should investigate to be certain that regulated resale remains necessary.

Regulatory benefits must outweigh costs

- 51 The costs to Telecom of maintaining regulated resale services are significant. For example, the requirement to continue to support and build resale variants of existing and new or replacement retail services creates significant systems development costs for Telecom. As outlined in our letter¹³ Telecom's One Office resale service, for example, costs over \$850,000 to develop and is currently delivered to fewer than 100 end users.
- 52 Another example is that if we were required to provide a resale broadband variant, we estimate it would cost something in the region of \$6m. To put this in perspective, uptake of resale broadband services accounts for less than 1% of Telecom's total retail and wholesale broadband connections.
- 53 In addition, the regular work involved in maintaining and updating DSPL and RSPL is significant, requiring two full time employees and additional costs associated with auditing. There are over 6000 price points in DSPL and RSPL.
- 54 Regulated resale also imposes unnecessary costs on Wholesale customers. For example, the pricing construct creates regular price variations leading to billing complexity, lack of certainty and risk for Wholesale customers.
- 55 It is no longer clear that the costs of a regulated resale regime outweigh the benefits. Commercial provision of resold services would be designed to be more efficient and less costly. The Commission should therefore investigate whether the retention of this form of regulation continues to provide the benefits in excess of the costs and risks for Telecom.

Removal of regulation will not compromise Wholesale customers

- 56 The major change in the last few years is Telecom's operational separation. Separation has enshrined Telecom Wholesale's arm's length status. This in itself obviates any need for a regulatory backstop. Wholesale has strong incentives to act in its own best interests, and in a way that is economical and rational for its business.
- 57 The resale of Retail and Gen-i products comprises the large majority of Wholesale's current revenues. Voice and data revenues are almost exclusively resold products. While resale may not be the optimal way for Telecom Wholesale to service its customers, in the absence of alternatives, the services remain popular with Telecom Wholesale's customers. If resale regulation is removed, Telecom Wholesale will not be compromising its own business by

¹³ Letter from T Gilbertson to P Rebstock, 13 February 2009.

removing the core of its offering overnight. A sensible migration is the only commercially acceptable option for its business and its customers in consultation together. Telecom Wholesale is in the process of delivering next generation wholesale inputs and discussing these with its customers, as outlined in the following section.

- 58 Further, Telecom's Annual Report 2008 contained a number of statements relating to Wholesale and its resale revenues:

"In the short term, Telecom expects revenue growth from broadband and IT services in its retail business, continued all-round growth of its wholesale business, and targeted cost reductions as it continues to review the effectiveness and efficiency of current operations. In the longer term, Telecom expects a significant reduction in its legacy operating cost base as it retires legacy platforms and products, removes duplication in systems, and moves to an all-IP network."¹⁴ (emphasis added)

"The performance of Telecom's wholesale business may be adversely affected by competitive forces in the markets in which it operates, such as competition from alternative network providers reducing market share and causing price erosion in its data markets. Also, the successful take-up of Chorus' UCLL product may significantly affect Wholesale's resale product portfolio."¹⁵ (emphasis added)

- 59 Accordingly, Telecom, and more specifically Wholesale, has significant incentives beyond the existing mandated resale obligations to deliver a compelling service proposition to its wholesale customers. For the moment, that primarily involves resale. While Telecom Wholesale expects that will continue for some time, the migration away from resale is a desirable outcome for both for its own business and for competition more generally. This is a significantly new factor since the 2006 review that requires careful consideration by the Commission.
- 60 The incentives of Telecom Wholesale to assist its customers, including those that compete with Telecom Retail, are illustrated by the existing MVNO arrangements with TelstraClear and recent developments with Digital Island.

¹⁴ Annual Report 2008 pg 14

¹⁵ Annual Report 2008 pg 61

SECTION FOUR: THE FUTURE OF RESALE

Next Generation Telecom Wholesale

- 61 Commercially, resale demand is still strong. But that in and of itself does not justify regulation. To the contrary, commercial solutions, not heavy regulation, should be encouraged and promoted.
- 62 Mandated resale hinders the development of a market in which wholesale products are designed for the commercial needs of wholesale customers. Telecommunications wholesalers around the world are focussed on delivering scalable and repeatable products that enable their customers to innovate and obtain appropriate retail margins; the same is also true for Telecom Wholesale.
- 63 Over time Telecom Wholesale intends to move to a product portfolio containing building block inputs, rather than direct resold products. Mandated resale may lead to commodity price competition, leaving no scope for the reseller to differentiate. This also undermines any gains made by the innovative work of Retail and Gen-i – two of Wholesale’s most important customers.
- 64 Importantly, most of the recent feedback Wholesale has received from its customers confirms this. They support a more generic wholesale product portfolio, as it clearly increases their ability to compete in downstream markets and obtain greater retail margins.
- 65 Accordingly, ongoing customer involvement in Wholesale’s industry consultation forum (Dialogue) is vitally important. Dialogue has been established to:
- (a) define Wholesale’s next generation products, services and platforms;
 - (b) determine migration paths and timeframes for existing legacy products, services and platforms; and
 - (c) communicate grandfathering and withdrawal planning and processes.
- 66 Wholesale’s resold products are split into three distinct portfolios, which we discuss briefly below.

Local access services (eg PSTN)

- 67 Wholesale’s next generation voice access portfolio is still in the early stages of development. As yet, we do not have a product roadmap that sets out the migration path onto PSTN Emulation and other next generation voice inputs.
- 68 Accordingly, as residential and business lines are the resale services that our customers purchase the most of, Wholesale is committed to providing resold these services until replacement next generation input products become

available. Telecom Wholesale will work with its customers to determine what their desired replacement input products are.

Data

69 The Undertakings require Telecom Retail Business Units to grandfather certain legacy data products by December 2009, at which time Wholesale's requirement to resell new instances of certain products ceases. These products include:

- (a) Megalink;
- (b) HSDDS;
- (c) ATM; and
- (d) One Office.

70 However, as Wholesale's next generation data portfolio takes shape, its customers currently consuming these products will have a suite of replacement input products and migration paths.

71 Given that any new retail level data products must be based on equivalent inputs, other Access Seekers are equally able to construct and compete with similar data services - eliminating the need for the retail product to be resold. There is no "access bottleneck" that requires resale regulation. In these circumstances, regulated resale is effectively redundant.

Broadband

72 Wholesale's only resold broadband product, WBS, has been provided under commercial terms for some time. However, there remains an ongoing risk that Telecom's retail broadband plans will be the subject of an application for a determination. We consider that there is no justification for Telecom Wholesale being required to replicate a retail broadband offering.

Wholesale market development

73 As outlined earlier in this submission, the face of the telecommunications market in New Zealand has changed markedly, with the introduction of UCLL and UBA and the impending introduction of SLU, as well as EOI-based inputs. In addition, there has been substantial investment in infrastructure assets by market participants. The presence of infrastructure based competitors capable of combining these deeper network services and their infrastructure to build services competing with the regulated resale products inevitably acts as a competitive restraint on Telecom.

74 Further, infrastructure players have strong incentives to resell, so as to obtain economies of scale and to utilise their own capacity. If there was no regulation and Telecom's prices were above what the market thought were acceptable, competitors would have had incentives to enter the market. In other words, there may well be constraints on market entry due to regulation, rather than requiring continued regulation. In fact, the risk is that continuing regulation of access at two points; the regulated resale services, and their regulated building blocks comprising UCLL, UBA and SLU and their associated services, has even more potential to constrain investment at both levels. An investigation of the issues will allow the Commission to satisfy itself of the appropriateness of de-regulation, and enable the Commission to meet its obligations under section 18 of the Act.

SECTION FIVE: COMMISSION'S QUESTIONS

75 In general, many of the Commission's questions seem focused at the next step in this process – the investigation. At this point Telecom is focused on the issue of whether there are reasonable grounds to investigate the removal of the resale service descriptions from the Act.

76 We therefore have not answered all the Commission's questions in detail, but consider they raise issues worth traversing if and when the Commission decides to investigate.

a. Have there been any developments in the specific markets where Telecom supplies Resale Services that would suggest that the Commission's conclusions in its 2006 Schedule 3 review are no longer relevant? What are they?

77 Since the Commission's 2006 Schedule 3 review, there have been major developments, particularly in the regulatory framework, which have had an impact on the overall environment in New Zealand. At this point we have not undertaken a market analysis, but at a high level would draw the Commission's attention to the changes in the last two years which warrant the Commission at least opening an investigation to consider whether regulated resale remains appropriate. The major changes include:

- (a) The unbundling of Telecom's network and delivery (or imminent delivery) of UCLL, UCLL Co-location, UCLL Backhaul, UBA, UBA Backhaul, Sub-loop UCLL, Sub-loop UCLL Co-location, Sub-loop UCLL Backhaul; and
- (b) Operational separation of Telecom, including the detailed obligations of the Undertakings and the required provision of EOI-based input services.

78 The importance of these factors is discussed in the main body of this submission.

b. To what extent has infrastructure-based competition reduced or removed or is likely to reduce or remove the need for regulation of Resale Services or resulted in a decline of commercial uptake of Resale Services from Telecom? Please provide details.

79 The uptake or decline of resale services should have no bearing on the Commission determining whether the threshold of reasonable grounds existing to investigate resale regulation has been met. The substance, and indeed the relevance, of this issue is something to be considered during the actual investigation.

80 As discussed in our submission, a combination of factors imply that the Commission should investigate regulated resale. One of those factors is the

availability of regulated inputs such as UCLL and (soon) SLU. Retailers now have the option of creating their own services, rather than simply reselling those of Telecom. As the ACCC has found, UCLL-based competition is more efficient than resale-based competition.

c. Have the goals of regulation in relation to the Resale Services been achieved, in terms of promoting competition for the long-term benefit of end-users? Please provide details. For example, you may like to consider whether regulatory access to the Resale Services promoted competition by increasing:

- i. The availability of innovative products in the market;**
- ii. The availability of close product substitutes; or**
- iii. The number of alternative service providers.**

81 This question is clearly one of substance that is best addressed comprehensively during an investigation. However, to reiterate some relevant comments already made in this submission, compared to a counterfactual of no regulation, resale is likely to have increased competition on some dimensions. However, that is no longer the relevant counterfactual. Regulatory developments over the past two years mean that the long-term benefit of end-users is more likely to be met by the innovations being developed by Telecom Wholesale and UCLL-based competition. Regulated resale has the potential to chill those forms of competition.

d. Please provide the volumes of retail services supplied or purchased via Resale Services as well as commercial equivalents for each of the past two years:

- i. For Telecom, please provide the volumes supplied to your competitors; and**
- ii. For other providers, please provide the volumes supplied to your end-users; and**
- iii. For Telecom and other providers please provide the resale discount for those services.**

82 The uptake or decline of resale services should have no bearing on the Commission determining whether the threshold of reasonable grounds existing to investigate resale regulation has been met. The substance, and indeed the relevance, of this issue is something to be considered during the actual investigation.

e. Please indicate whether you have migrated, or intend to migrate, retail customers from a Resale Service to a UBA or UCLL-based access service. Please advise the extent (i.e. volumes) of such migration;

83 N/A

f. In what ways has the availability of the designated Resale Service influenced the commercial provision of other services?

84 As discussed in the main body of our submission, designated resale can detrimentally affect the development of new services by:

- (a) Chilling the incentives of Telecom Retail to innovate;
- (b) Skewing the strategies of entrants towards resale and away from more investment-dependent forms of competition; and
- (c) Chilling the incentives on Telecom Wholesale to provide alternative, more targeted wholesale offering.

g. Are there Resale Services that could not be supplied at the same or less cost using either UBA or UCLL access services? If so, please specify.

85 Although this issue is best addressed at the investigation stage, we note that it is important to consider the risk of arbitrage created by the retention of regulated resale, as outlined in our submission at paragraph 36.

h. Telecom is currently augmenting its network with many street cabinets (cabinetisation). This will allow alternate service providers to provide end-users with high speed broadband service. However, this may reduce the take-up of exchanged-based UCLL in those areas. What implication would cabinetisation have in terms of the importance of Resale Service?

86 There is no link between cabinetisation and the regulation of resale. Resellers of Retail and Gen-i products are unaffected by changes at the infrastructure level because resold products can be provided equally at the infrastructure or bitstream levels, cabinet or exchange locations. A service provider that has decided not to invest in DSLAMs (because SLU is considered to have impacted upon their business case) still has the option of dropping down the investment ladder to UBA. If UBA is not viable for this service provider, it suggests they were not a credible infrastructure investor. In any event this is not a reason for retaining regulated resale.

i. What do you expect would happen if the Resale Services were not regulated?

87 We have addressed this above in the section "The Future of Resale".

j. What are the factors that the Commission should consider when assessing the value of retaining the Resale Services?

88 We have addressed this above in the section "Reasons for Reviewing Resale Regulation".