



Submission on

Potential Review of Resale Services
under Schedule 3 of the
Telecommunications Act 2001

15 May 2009

PUBLIC VERSION

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Public Version

This is the public version of TelstraClear's submission. Commercially confidential information for the Commerce Commission only has been removed, and is identified by square brackets []TCLCO.

A EXECUTIVE SUMMARY

1. TelstraClear supports the rollback of unnecessary regulation over time where sufficient competition has developed. Retail competition in New Zealand is developing, with local loop unbundling providing opportunities for increasing investment and competition at deeper levels of the network. However this form of competition is in its early stages. New Zealand is also in a rapid transition from the legacy network to next generation networks, and to deliver downstream competition across New Zealand, access seekers will require a mixed solution of regulated resale, unbundled loops in non-cabinetised areas, bitstream on Telecom's Fibre to the Node (FTTN) network and the Government's Fibre to the Premises (FTTP) initiative.
2. Resale services are currently provided on a commercial basis between Telecom Wholesale and TelstraClear. These commercial terms are largely the result of previous bilateral resale decisions determined by the Commerce Commission (the Commission) which have now expired. The recourse to regulated resale services provides a valuable backstop and certainty for access seekers where Telecom continues to face limited competition – without occupying regulatory “bandwidth” in setting the commercial terms of supply.
3. TelstraClear is undertaking significant investment in local loop unbundling (UCLL) across New Zealand. While this will allow TelstraClear to migrate many customers from resold services to unbundled loops, Telecom's FTTN programme will limit TelstraClear's ability to deliver services to cabinet-fed customers. The terms for sub loop unbundling have not yet been determined. The bitstream services Telecom is currently required to supply on its FTTN are not an adequate substitute for unbundled loops. As a result, access seekers are not able to replicate or replace the more complex regulated resale services in cabinetised areas. Furthermore, the Government's recent announcement that it will invest in wholesale FTTP networks, while providing potential network-based wholesale competition to Telecom, also raises the risk that further substantial investment by access seekers in DSLAMs on Telecom's copper network could be stranded.
4. With New Zealand's late introduction of UCLL, and the confluence with next generation networks (NGNs) such as FTTN and FTTP, TelstraClear recommends that the Commission defer consideration of changes to the regulated resale services under Schedule 3 of the Telecommunications Act 2001 for two years until 2011. By then, emerging competition from the 2006 amendments to the

Telecommunications Act 2001 will have had sufficient time to embed, and the competitive impact of next generation access will be clearer.

5. In the meantime, the service descriptions of resale services in the Telecommunications Act 2001 already require that the Commission assess competition at the time it makes a resale determination. Where Telecom faces effective competition, the Commission has the discretion not to require regulated resale. This existing mechanism ensures that the dynamics of developing competition are captured over time. An across-the-board withdrawal of regulated resale is, therefore, unnecessary as well as premature.
6. Telecom has raised concerns about the cost to meet specific resale obligations. While these concerns are not relevant to the question of whether the Commission should undertake a review of resale regulation, TelstraClear is always willing to revisit such terms with Telecom Wholesale on a commercial basis (as it has done in the past). However, such obligations must be considered in the context of previous Commission resale decisions where these terms were determined to be a necessary protection for access seekers.

B INTRODUCTION

7. The ladder of investment was applied by the Government in its 2006 amendments to the Telecommunications Act 2001 to designate services (i.e. “adding rungs to the ladder”) including access to UCLL, sub loop and enhanced bitstream services. The cabinet paper minute noted:¹

The proposed policies are consistent with approaches adopted in other countries, including those leading in broadband take up, and will bring New Zealand closer to the international norm...

A commonly adopted approach in the EU and other jurisdictions that attempts to find a balance to increase overall investment levels is the so-called “ladder of investment” that drives wholesale competitors toward investment in their own infrastructure. Commencing at lower rungs of the ladder with basic resale and intermediate wholesale of services while building a customer base, this concept envisages movement via LLU to eventual investment in alternative network infrastructure. The long-run aim of such policies is competition on level terms among operators, and it is important to price wholesale access products appropriately so as to maintain incentives for progressive alternative infrastructure investment.

8. The ladder of investment theory also may be a useful reference tool in decisions about whether to de-regulate existing services (i.e. “removing rungs from the regulatory ladder”). The objective should be to remove regulated resale services at the earliest opportunity when resale is no longer a bottleneck (including because of the availability of upstream access services). However, to do so now would undermine the competitive and investment outcomes beyond the simple resale model sought to be achieved in New Zealand:
 - a. while regulated resale has been available since 2001, New Zealand has only just put in place unbundled access services upstream from resale, with the finalisation of standard terms for unbundled copper local loop service (UCLL) and other unbundled services, completed in the last 12 months;
 - b. once there is clarity about the upstream access services, access seekers require time to complete their capex planning, buy and build their infrastructure, develop or modify products which can utilise

¹ Cabinet Policy Committee, *Telecommunications Stocktake, Minute of Decision*, 27 April 2006, at paragraphs 98-99.

unbundled elements and then migrate large numbers of resale customers to the unbundled services. This process is still in the early stages in New Zealand; and

- c. Telecom is also still in the process of conditioning exchanges to support UCLLS – the regulatory obligation is capped at 15 exchanges per quarter. [

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9. There are also unique circumstances in New Zealand which mean that 2009 is not the right time to withdraw regulation of resale services. As UCLL came so late to New Zealand, it straddles the migration to NGNs, presenting challenges for access seekers attempting to move on from regulated resale services:

- a. legacy wholesale services above resale are either being redefined (e.g. UBS) or are simply vanishing (e.g. UCLL) as Telecom pursues the deployment of its FTTN network;
- b. the next generation wholesale bitstream products Telecom is required to provide in cabinetised areas are not an adequate substitute for many of the legacy resale products and fall short of international best practice for successors to UCLL;
- c. sub-loop unbundling is not yet settled and, based on the overseas evidence, is likely to be economically challenging for access seekers in many areas which have been cabinetised;
- d. the Government is proposing to completely reshape unbundled access products by co-investing with private suppliers to supply dark fibre access services. While TelstraClear supports the Government's initiative, the availability date, characteristics and pricing of this dark fibre product are unclear; and
- e. with all this uncertainty, access seekers face the risk that if they invest infrastructure required to utilise unbundled legacy products, they risk making the wrong investment decisions and could end up stranding their investment.

10. As a result of the above, many of the constraints of competition identified in the Commission's 2006 report into the extension of regulation of retail services still persist. TelstraClear does anticipate that, as the recent regulatory reforms gain traction, competition will grow at a faster pace in the next two years than in the last two years. However, it is likely that competition will continue to develop more strongly in pockets – mainly urban areas which have not been cabinetised.
11. An across-the-board withdrawal of regulated resale is too blunt an instrument to deal with this emerging pattern of competition. The Commission already has a more finely calibrated mechanism: the “Telecom no longer facing limited competition” test which is already inbuilt to the resale service descriptions.
12. The balance of our submission is structured as follows:
 - a. in Section C, we discuss how resale remains a key input to downstream retail competition in New Zealand, but also why, based on the investments being undertaken by TelstraClear and other access seekers, the Commission can have confidence that, if given enough time, there will be a decisive shift from resale to unbundled access products in New Zealand;
 - b. in section D, we discuss why withdrawal of regulated resale services now, so soon after UCLL has been introduced, will undermine efforts to stimulate competition at deeper levels of the network;
 - c. in section E, we discuss the additional challenges which access seekers face moving on from resale in the face of the transition to NGNs;
 - d. in section F, we discuss why the Commission's reasons in its 2006 decision extending resale regulation continue to apply and how an across-the-board deregulation of resale now would fail the tests adopted by overseas regulators for withdrawing resale regulation; and
 - e. in section G, we conclude with our proposal that the Commission wait another two years, when there will be more clarity on the above matters, before opening an investigation under Schedule 3 into the de-regulation of resale services.

C TELSTRACLEAR IS MOVING UPSTREAM FROM RESALE

13. This section discusses how TelstraClear:
 - a. has been using and continues to use regulated resale services; and
 - b. is investing in the infrastructure required to utilise UCLL and how we will migrate existing resale customers onto downstream services supplied over unbundled loops.

C.1 TelstraClear's use of resale services

14. The Telecommunications Act 2001 provided TelstraClear with access to resale services from Telecom. At that time, neither bitstream or UCLL was available to TelstraClear.
15. As a result of protracted bilateral determinations, TelstraClear gained access to resale services that allowed TelstraClear to deliver voice, broadband and data services to customers outside TelstraClear's own network footprint.

C.2 Voice Services

16. TelstraClear currently delivers PSTN voice services to customers outside its network footprint using Telecom PSTN resale. As the following diagram demonstrates, TelstraClear has been able to significantly grow its residential resale telephony customer base (Homeplan) to complement growth of its own PSTN services (InHome delivered by HFC), across New Zealand.

Figure 1 – Growth chart of PSTN services over time

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17. As the Commission noted in its 2006 resale extension report, the availability of resale telephony has enabled access seekers like TelstraClear to offer bundles to customers.

C.3 Broadband

18. In 2004, TelstraClear gained access to bitstream services, allowing TelstraClear to deliver broadband services using bitstream rather than resold broadband.

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19. TelstraClear [

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20. [

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C.4 TelstraClear's investment in UCLL

21. Although TelstraClear fought hard to secure effective UBS access, the Government's subsequent decision to mandate UCLL provides TelstraClear with a better proposition because:

- a. TelstraClear is a full service telecommunications provider and the UBS product does not support a PSTN or PSTN-substitute voice service;
- b. TelstraClear has a substantial corporate and business customer base and the UBS "best efforts" broadband services does not support data services of sufficient quality and reliability to meet corporate business needs; and

- c. the UBA/EUBA services, while an improvement over UBS, cannot support some of the more complex, value added downstream services TelstraClear wished to provide (including some which are provided by regulated resale).
22. TelstraClear, therefore, has focused its resources on a significant UCLL push. TelstraClear is currently in the process of unbundling in [

]TCLCO Telecom operates 637 exchanges.²

TelstraClear's unbundling of []TCLCO cumulatively serve approximately []TCLCO of all customers across New Zealand.

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24. However, as will be discussed in Section E, Telecom's FTTN programme means that approximately []TCLCO of residential and []TCLCO of business lines across target areas will be served from cabinets by 2012. As a result, TelstraClear will be required to deliver services to these customers using resale, bitstream and potentially sub loop unbundling in the future.
25. In cabinetised areas where we cannot use UCLL, our goal is to move from PSTN resale to VoIP offered using bitstream. However as the Commission is aware, BUBA and early variants of EUBA did not support sufficient voice quality to migrate PSTN customers and the later variants of EUBA, which can be used to supply PSTN like services, has been available for less than 5 months. With the completion of its UCLL investment, substantial investment will be required to shift from its existing circuit switched platforms and services to a VoIP platform which can utilise EUBA for retail telephony. This will require substantial resources, effort and capital. While obviously on a larger scale, we note that the Telecom Separation Undertakings do not require Telecom to

² Chorus, Who we are. Available at: <http://www.chorus.co.nz/who-we-are>.

have migrated more than 60% of lines from PSTN until 31 December 2015.³

³ Telecom Separation Undertaking, at page 123.

D TOO EARLY TO WITHDRAW REGULATED RESALE

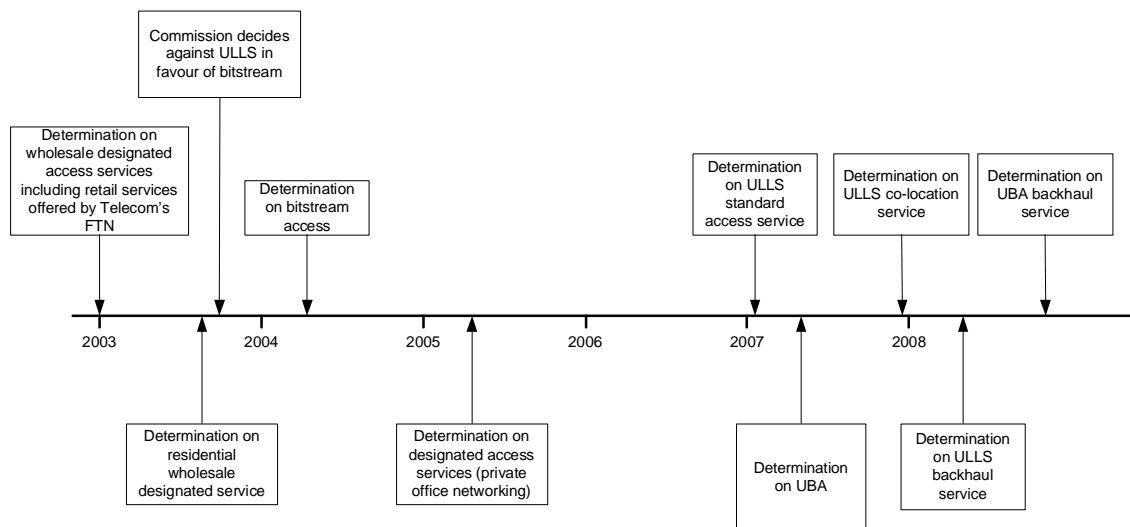
26. In this section, we discuss why it would be premature to withdraw regulated resale because:

- a. unbundled access products to which access seekers could move from resale have only recently been introduced in New Zealand; and
- b. access seekers require a reasonable follow-on period of time to make the required investments and migrate existing customers onto access products above regulated resale.

D.1 Unbundling has come late to New Zealand

27. The following time line summarises the painstaking effort required from the Commission and the Government to get a reasonable compliment of access services in place in New Zealand (see also Schedule 1):

Figure 2 - Timeline of introduction of access services



28. As the following table shows, the availability of a suite of access services comprising resale, bitstream and unbundled products occurred much later in New Zealand than in comparable markets. By 2003, the following countries had all of these access services:

Table 1 – Access Services in other countries⁴

	ULL	Bitstream	Resale
Australia	ü	ü	ü
Belgium	ü	ü	ü
Denmark	ü	ü	ü
France	ü	ü	ü
Netherlands	ü	ü	ü
Sweden	ü	ü	ü
UK	ü	ü	ü

29. While resale services have been designated since the commencement of the Telecommunications Act 2001, it is more relevant, when deciding whether to remove resale to look at, how long the access services upstream from resale have been in place. While access seekers may make their investments incrementally step-by-step, they need to have a clear view of the full pathway ahead of them, for two reasons.
30. First, access services will be alternatives or substitutes for each other and so access seekers can therefore “branch” in different directions for individual access seekers depending on their business plan and competitive profile. As access seekers are usually capital constrained, they will need to choose between different business models based on which access services they choose to use. For example, an access seeker focused on residential customers will build its business case around UBS/UBA and supply broadband services and voice over broadband services. But, as discussed in section C, an access seeker with a broader customer base like TelstraClear will build its business case around UCLL so that it can supply a wider range of higher quality data and voice services.
31. Second, technology investments are often made in a linear fashion – the technology deployed by an access seeker to move upstream will often be upgradeable to move onto access services which are yet further upstream. When making technology decisions, the access seeker will want to know what its pathway forward is beyond the next step.

⁴ EC, *Annex to the Communication from to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: European electronic communications regulation and markets (2005) (11th report)*, [COM(2006)68final]

32. Therefore, it would be inefficient for an access seeker to invest capex to move to the next upstream access service when it is unclear what the access services upstream from that service (or the one above that) will be. In New Zealand, access seekers have had to bide their time on resale services while we waited for access services upstream from resale services have taken shape.
33. Access seekers in New Zealand also have faced more difficulties making headway on resale services than access seekers in other markets:
 - a. until recently, Telecom lacked the “industrial strength” wholesale ordering, provisioning and fault systems to handle large volumes of resale customers. Telstra introduced these kinds of systems over 5 years ago. The introduction of functional separation in the UK 5 years ago, with its requirement for equivalence of input, was also driven by Oftel’s failed attempts to have BT implement “fit for purpose” resale systems. Similar concerns motivated the Government’s decision to introduce functional separation of Telecom two years ago and it has taken time for Telecom to build better systems to support resale products;
 - b. the lack of a process to set supply terms on an ex ante basis, meant that nearly 3 years was lost at the outset settling these terms in bilateral determinations. This has now been addressed by the standard terms process; and
 - c. prior to the UCLLS product being mandated, to provide our customers with a quality telephone and broadband bundle, we had to combine an unbundled bitstream service with a resale telephone service as we could not rely on the quality of the telephone services provided over bitstream. We were forced to keep utilising resale services as there was no other bundled product that enabled us to offer a quality bundled service to our customers.

D.2 Access seekers need time to make the investment and migrate customers

34. Once the regulatory requirements are finally aligned, access seekers are able to get on with the task of planning for the move up to upstream access services. But the business cycles involved in moving from the relatively simple model of resale to unbundled access services are neither simple nor quick.
35. Moving upstream from resale should not be expected to be easy – the reward for the investment, effort and risk involved is the ability to compete against

the incumbent on a stronger differentiated basis. However, access seekers require time to plan and realise new capital investment, build or adapt products which utilise the more unbundled access products and to ensure that there is an effective migration path to move their large base of existing customers from each step to the next.

36. While some new entrants have already entered the market with UCLL services,
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37. As UCLL is in its relative infancy, [

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38. [

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E THE IMPACT OF NGN

39. This section discusses the challenges access seekers face in moving away from resale services in the current climate of uncertainty surrounding what access services upstream from resale will look like in an NGN environment. Professor Cave has said:⁵

This apparent success of the European access model is, however, overshadowed by doubts about whether the ladder approach can be maintained in the same or a similar form as next generation access (NGA) networks are installed. The architectures of such networks differ from those of the PSTN, creating different opportunities for unbundling them. While access to a fibre to the node (FTTN) or cabinet (FTTC) network is available at the sub-loop, and also via a national bitstream product, it seems highly unlikely that the access at the local exchange, the point of origin of ULLs, will survive....

40. In New Zealand, this concern has manifested itself in four ways.
- E.1 Some legacy network access services upstream from resale are in the process of being replaced, such as UBS with UBA
41. With the migration to NGNs, new products are naturally being introduced and services upstream from resale are consequently being replaced with NGN products. TelstraClear recognises that it takes time for the access provider to define and introduce these new wholesale services.
42. However, a natural extension of this, TelstraClear submits, is that it is also not efficient for access seekers to migrate customers to the to an upstream legacy product which will imminently be superseded by an NGN product. This would require, for example in the case of UBS and UBA, access seekers to either;
- a. invest in both UBS and UBA products rather than focusing investment and resources on the ultimate end-game product of UCLL; or
 - b. perform a double migration for those customers who are initially migrated from WBS (resale) to UBS and then migrated onto UBA.
43. Neither of these options make good use of an access seekers' limited resources.

⁵ Cave M, *Applying the ladder of investment in Australia*, 2008, at page 6.

E.2 UCLL has been removed in many areas as Telecom deploys its FTTN architecture

44. Telecom is pursuing a rapid cabinetisation programme. Prior to Telecom's FTTN rollout, there were approximately 1.6 million PSTN lines fed directly by Telecom from the exchanges. After Telecom's FTTN rollout, this number will reduce significantly. For example, 48% of lines will be cabinetised in the key urban centres of Auckland, Hamilton, Wellington, Christchurch and Dunedin.⁶ TelstraClear supports Telecom's right to modernise its network, but it is important to realise the consequences for the access services which are practically available to access seekers when making decisions about whether and when regulated access should be withdrawn.

45. While sub loop unbundling is likely to be available in the future, the Commission has yet to finalise the access terms. Once the decision is finalised, there will also, reasonably, be an implementation period before sub loops would become available to access seekers. Further, internationally, the economics of sub loop unbundling remain unproven.

46. The practical effect of Telecom's cabinetisation programme, therefore, is that access seekers options to move customers upstream from resale are substantially reduced in many areas.

E.3 The current regulated bitstream services do not provide an effective substitute for UCLL or some of the more complex resale services

47. In areas where access seekers lose access to UCLL, the current bitstream products, UBA and EUBA, do not provide complete substitutes for UCLL because they do not allow access seekers to offer a wide range of downstream services. As the following table shows, the current bitstream services will not allow access seekers to offer substitutes for complex regulated resale products which would have been possible with UCLL:

Table 2 - Substitutes for current wholesale legacy services











Wholesale legacy service	Alternative by bitstream	Bitstream service	Notes
Megalink	⊘	-	There is no EUBA throughput rate above 180 kbps so 2 Mbps services cannot be offered.
ATM (Broadband)	⊘	-	There is no EUBA throughput rate above 180 kbps so 2 Mbps services (and higher ATM rates) cannot be offered.

⁶ Telecom, *Telecom Wholesale Customer Briefing*, 22 November 2007

Wholesale legacy service	Alternative by bitstream	Bitstream service	Notes
High Speed DDS	û	EUBA	64 kbps service replacement possible using 90 kbps EUBA.
Frame Relay	û ü	EUBA	64 kbps service replacement possible using 90 kbps EUBA.
One Office Family	û	-	The One Office family of off-the-shelf IP networking tools cannot be integrated with the bitstream offerings of Telecom.
Office Anywhere	û	-	Remote access services cannot be created from bitstream services.
IP Net	û	-	IP net cannot be integrated with the bitstream offerings of Telecom.
DDS Low Speed	ü	EUBA	Sub-64 kbps service replacement possible using 90 kbps EUBA or 40 kbps EUBA.
Analogue Data	ü	EUBA	64 kbps service replacement possible using 90 kbps EUBA or 40 kbps EUBA.

48. Although demand for some of these individual resale products may be low and declining, they can form part of a larger bundle supplied to users who are key customers of access seekers. For this reason, Telecom itself has had difficulty withdrawing the retail versions.
49. The limited ability to replicate regulated resale services with services using upstream inputs points to a larger issue. As TelstraClear detailed in our submission on the Government's Broadband Investment Initiatives, the current regulated bitstream services fall short of international best practice. While the un-rate shaped bitstream service ordered by the Commission in 2006 led the world at the time, the bitstream services subject to declaration under the Telecommunications Act 2001 and specified in the Telecom Operational Separation Plan have fallen behind world's best practice in current generation bitstream services. The following table benchmarks Telecom's bitstream services using information from an Ofcom international comparative survey:

Table 3 - Range of Active Services

Key Characteristics	Case Study Findings	Telecom NZ wholesale
Flexible options for aggregation and interconnect		
Flexible support of UNI and CPE types		
Support for Multicast		
Support for QoS		
Ability to guarantee Security and Integrity		

50. Ofcom is exploring a next generation access product called Active Line Access or ALA:⁷

The limitations of today's active products impose on product innovation could be addressed as a result of technology developments. Since raising this topic in our previous consultation, we have continued to work with industry to explore how the potential of new technologies can be realised in practical future active products.

Two factors lead to potential improvements in the competitive characteristics of active products in the future. The first is the increasing automation of service maintenance and support through Next Generation Operational Support Systems (NGOSS). The second is the rise of Ethernet as a ubiquitous transport in backhaul and core networks – generally termed Carrier Ethernet. Active products benefit from adopting a common interface technology as this gives independence from the underlying infrastructure and economies of scale across different deployments. Ethernet is the obvious choice for such an interface because it is a ‘raw’, relatively simple protocol, which can be used to transparently carry a range of higher level services.

These two factors mean that it may be possible to transfer more control of the underlying infrastructure with active access products. At its most basic it is possible to imagine a very ‘raw’ Ethernet active bitstream product which gives access to the capabilities of the physical, passive, layer whilst simply adding the minimum functionality necessary for the support of competition. Ofcom refers to the set of technical requirements that could deliver this type of active access as Ethernet ‘Active Line Access’ (ALA). We have been actively discussing these with industry since our last consultation.

51. ALA is only one of the range of possible options. However, before narrowing the existing suite of regulated products, it is critical that the industry have clarity on the potential substitutes for the UCLL.

E.4 The impact of the Government’s FTTP proposals are highly uncertain

52. TelstraClear is also aware that there may be opportunities for substitute products if the Government mandates the supply of dark fibre by LFCs.

⁷ Ofcom, *Delivering Super-fast Broadband in the UK, Consultation Paper*, 23 September 2008, at paragraphs. 6.14 to 6.16.

However, it is not as yet clear what those opportunities will be or how these opportunities will present themselves. Nor is it clear what the FTTP access products will look like and what they will mean for access seekers:

- a. the Government says it prefers a dark fibre product – which TelstraClear endorses – but that will require a point to point fibre solution if an unbundled product analogous to UCLL is to be available, allowing house by house activation by access seekers;⁸ and
 - b. if access services are offered by the LFCs at the active layer, whether the FTTP is deployed using a G-PON or AEF architecture will radically alter the characteristics of the active wholesale service and potentially the location of the technically feasible points of interconnection.
53. The equipment in which access seekers will be required to invest to utilise FTTP access products will be different to the equipment required to use UCLL on Telecom’s copper network. While there is a policy hiatus, access seekers will delay investment as there will be no certainty as to an appropriate course of action that will not strand the capital invested. Access seekers will not know whether:
- a. to wait for the deployment of the FTTP networks;
 - b. to “stick with Telecom” and invest in DSLAM infrastructure for use with UCLL; or
 - c. to use Telecom in some areas and the FTTP networks in others.
54. The continuing availability of regulated resale services preserves options for the industry while a clearer picture emerges of both the Government’s FTTP proposal and Telecom’s response.

⁸ Both AEF and GPON architectures are problematic for the deployment of dark fibre as the fibre from the splitter (whether active or passive) to the local office building is shared. That is, neither architecture is suitable for point to point fibre from the local office to the premises.

F PREVIOUS COMMISSION DECISION AND OVERSEAS APPROACHES TO THE WITHDRAWAL OF REGULATED ACCESS SERVICES

55. In this section, we discuss why the withdrawal of regulated resale would be premature based on the Commission's 2006 resale extension decision and decisions of overseas regulators about the withdrawal of resale services.

F.1 Commission's 2006 Decision

56. In 2006, the Commission decided to extend the regulation of resale services in its Schedule 3 investigation into the extension of regulation of retail services. In this investigation, the Commission decided to extend regulation of retail services for another 2 years as it was satisfied that there were benefits to end-users from extending the existing regulated services.⁹

57. The Commission considered a number of factors and ultimately decided that on analysis of these factors regulation was still required. In the following table, applying those same criteria against the current market conditions in 2009, regulation of resale services is still required.

Table 4 – Comparison of criteria in Commission's 2006 decision with today's market

	Criteria	Still an issue in 2009?
1	Lack of infrastructure, or facilities-based competition, in relation to the delivery of telecommunications services	<p>ü</p> <p>There has recently been limited DSLAM entry and TelstraClear will enter the market shortly. The pace of entry is constrained by Telecom's incremental unbundling of exchanges (capped at 15 per quarter) and by Telecom's cabinetisation programme. These factors limit the scale which is achievable by DSLAM-based competitors and the competitive constraint on Telecom.</p>

⁹ Commerce Commission of New Zealand, *Schedule 3 investigation into the extension of regulation of designated and specified services, Final Report*, 28 August 2006.

	Criteria	Still an issue in 2009?
2	Telecom remains the only telecommunications provider of fixed services in New Zealand that has a ubiquitous network	<p>ü</p> <p>No change. The Government's FTTP investment is targeted to reach 75% of the population but this is beyond the timeframe of this review.</p>
3	Low probability that there will be a significant increase in the level of infrastructure based competition during 2007-2008	<p>ü</p> <p>Competition based on UCLL is likely to intensify over the next two years but the pace of the ramp up and the ultimate extent of such competition will be constrained by the factors described in 1.</p>
4	Significant barriers to entry that potential new suppliers of telecommunications service face, including the extent of sunk costs and the presence of economies of scale and density in a local network	<p>ü</p> <p>Still exists and there are additional switching barriers from resale to UCLL. The ability of access seekers to achieve scale using UCLL is constrained by the extent of the Telecom cabinetisation programme. Sub-loop unbundling is not yet resolved and its economics are likely to be challenging in many of the cabinetised areas. Bitstream is not a substitute in terms of price and service differentiation and Telecom will have considerable competitive advantages on its FTTN. Those advantages may be addressed by the Government's FTTP investment but that will be beyond the timeframe of this review.</p>

	Criteria	Still an issue in 2009?
5	Network operators tend to be vertically integrated, which can allow the incumbent to discourage competitors to enter by pricing access services inefficiently high, or refusing to wholesale its services altogether	ü Vertical integration is less the problem than lack of equivalence in price and non-price supply terms. Regulatory reforms over the last two years have assisted.
6	Bundling of telecommunications services is also common with industry and where it is possible for an incumbent to bundle contestable and non-contestable services together, this will provide the supplier of the non-contestable services with a significant advantage over its competitors	ü Still exists as an issue. For example, some of the more complex regulated resale services cannot be supplied using services based on the current bitstream services. The removal of regulated resale would constrain the ability of access seekers to compete on bundles, particularly outside the areas where UCLL is available (and in respect of multi-site customers with premises inside and outside those areas).

F.2 Overseas Decisions

58. An across-the-board withdrawal of regulated resale services would not be consistent with decisions by overseas regulators. Instead, overseas regulators have focused on how to calibrate the withdrawal of access services to the pockets in competition is more intense. As we note in discuss in section G, the existing regulated resale services allow for an incremental withdrawal of regulated resale as pockets of competition develop over time.
59. In 2008 Ofcom decided that sufficient competition existed in the wholesale broadband access market to justify removal of regulated access in exchange areas where:¹⁰

¹⁰ Ofcom, *Review of the wholesale broadband access markets 2006/07: Identification of relevant markets, assessment of market power and proposed remedies*, at page 3.

there are 4 or more operators (inc BT and ntl:Telewest) and where the exchanges serves 10,000 or more homes and businesses.

60. Ofcom considered that only operators who can “*provide a material competitive constraint*”¹¹ should be used in the assessment and concluded that:¹²

..as the number of Principal Operators competing with one another increases, the incremental effect on competitive conditions of an additional competitor is likely to decrease. The precise number beyond which there is no further additional effect will vary from market to market depending inter alia on cost and entry conditions

It is Ofcom’s view that an area with 2 or 3 wholesale broadband access principal operators (one of which is BT and one is likely to be cable) would have an appreciably lower level of competitiveness than one with 4 principal operators. It is less apparent whether, once the number of competitors has reached 4, the addition of more competitors would appreciably change the competitive conditions... it is Ofcom’s view that it is reasonable to regard areas with 4 or more principal operators as having sufficiently similar competitive conditions to be regarded as a single geographic market for the purposes of this review.

61. However, in its recent review of wholesale fixed narrowband services, Ofcom decided not to withdraw regulation in markets for exchange lines (i.e. wholesale line rental), call origination and call termination even though BT’s market shares had decreased. Ofcom decided that a national market should be adopted for narrowband PSTN services and that BT remained dominant in that national market with a share of 81%. Ofcom considered that the conditions which pointed to sub-national markets for broadband, in particular evidence of differential pricing in those areas by the incumbent, were not present in the PSTN markets, where the incumbent continued to charge on a national basis.
62. There also has been substantial DSLAM market entry in Australia based on full and shared unbundled loops. As the following table shows, the footprint of DSLAM competition in Australia is large as a high proportion of exchanges, particularly in the urban areas (band 2), have experienced entry by DSLAM-based competitors and as well, there are a large number of individual competitors in most of these exchange areas, with 5 or more DSLAM based

¹¹ *ibid*, at page 49.

¹² *Ibid* at page 53.

competitors in many exchange areas. The entry of DSLAM based competitors has seen a strong shift from resale services to unbundled services, as the following table shows:

Figure 3 – Comparison of changes to WLR and ULLS

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63. The ACCC decided that Telstra should be exempt from the standard access obligations in respect of wholesale line rental and local call resale when a threshold test was met which states that there is competition within an ESA where there are:¹³
 - a. 14,000 or more addressable Services in Operation (SIOs); or
 - b. four or more ULLS-based competitors (including Telstra).
64. The ACCC's decision to exempt resale services from regulation was overturned by the Australian Competition Tribunal on 22 December 2008.¹⁴ In turn, this decision was set aside by the Full Court of the Federal Court on 11 March 2009 and remitted to the Tribunal.¹⁵ The Tribunal's decision is pending.
65. Whatever the final outcome, there was a strong track record of substantial

¹³ ACCC, *Telstra's local carriage service and wholesale line rental exemptions applications*, at page 4.

¹⁴ ACCC, *Telstra's local carriage service and wholesale line rental exemptions applications*, at page 4.

¹⁵ Australian Competition Tribunal, File No 2 of 2008 RE: Application under section 152 AV of the Trade Practices Act 1974 (the Act) for a review of an exemption order decision (individual exemption order Nos 1-4 of 2008) made by the Australian Competition and Consumer Commission (Commission) in relation to Telstra Corporation Limited pursuant to section 152AT(3)(a) of the Act by Chime Communications Pty Ltd (ACT decision).

unbundled loop based competition in Australia over a period of a number of years before the withdrawal of resale regulation arose for consideration.

F.3 Comparison with New Zealand

66. It is clear that, on any view, the situation is very different in New Zealand when compared to Australia and the UK:

- a. unbundled loop services have been available to access seekers effectively for just over a year in New Zealand, but have been available in the UK and Australia for over 5 years;
- b. Chorus is only required to add 15 exchanges per quarter. In Australia and the United Kingdom, exchanges capable of supporting unbundling account for most of the population;
- c. the overall level of local loop unbundling in New Zealand remains low compared to overseas markets. As at 31 December, total unbundled lines in New Zealand was approximately 30,000.¹⁶ This represents 1.6% of Telecom's copper access lines. In contrast, nearly 15% of lines are unbundled in the UK and nearly 12% of lines in Australia;
- d. there has only been limited entry so far in New Zealand. TelstraClear understands that within Auckland, approximately 40 exchanges have been unbundled and contain 2 operators. TelstraClear [

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- e. competition in individual exchange areas also cannot be viewed in isolation. Even if there are some exchanges in which there will be four competitors (three DSLAM-based operators and Telecom), the ability of the DSLAM-based operators to achieve scale across a large number of exchanges areas is constrained by Telecom's cabinetisation programme. FTTN deployment has only just got underway in the UK and has been stalled in Australia. As the current bitstream services in New Zealand are limited, access seekers are not in a position to use a combination of UCLLS in the non-cabinetised areas and bitstream in the cabinetised areas to offer a seamless suite of services nationally, particularly to business customers.

¹⁶ Telecom New Zealand, *Third quarter 2009 Results Briefing*, 8 May 2009, slide 12.

G TELSTRACLEAR'S PROPOSED WAY FORWARD

67. TelstraClear recommends that the Commission wait another 2 years, until 2011, before commencing an investigation under Schedule 3 into the withdrawal of regulated resale services. By 2011 a number of market developments will have occurred in New Zealand which will make the emerging picture detailed in our submission significantly clearer:
- a. TelstraClear will have entered the UCLL market and others may also entered the market. As in the overseas markets, access seekers will have had an opportunity to establish their competitive positions and the Commission will have more evidence of the impact of DSLAM-based entry. In particular, the Commission will be in a better position to assess the impact of Telecom's cabinetisation programme on UCLL-based competition.
 - b. In accordance with Telecom's Operational Separation plan, by 31 December 2011, Telecom will have met the following enforceable milestones:
 - (i) EOI standard met for the supply of all UCLL services;
 - (ii) UCLL will be consumed by Telecom Business Units as an input in the supply of all UPC services;
 - (iii) EOI standard met for the supply of all UCLL backhaul services;
 - (iv) EOI standard met for the supply of all BUBA and EUBA services;
 - (v) 100% of retail broadband service customers migrated to new retail broadband services that consume BUBA or EUBA as an input;
 - (vi) EOI standard met for supply of all UBA backhaul services; and
 - (vii) EOI standard met for the supply of all HSNS, UNS (over Ethernet) and UPC services.
 - c. Given the significant number of services that Telecom has to provide on an EOI basis by the end of 2011 this would be the appropriate time to review regulation of resale services. Telecom will have 'stress tested' the upstream input services sufficiently to ensure that they can be provided on an EOI basis. To meet their milestones in 2011, Telecom

will have to be confident that the new services can support retail services; and

- d. By 2011, the Government will have decided which model it will be employing for the planned broadband initiative and tenders will be underway. At this stage, it may even be known what type of services can be offered by the LFCs.
68. During the intervening period, competition is more likely to continue to develop in “pockets” than across-the-board, mainly in major metro areas which are not subject to cabinetisation. New Zealand is not alone in the uneven development of competition. Professor Cave has said:¹⁷

There is also evidence that EU regulators in markets without ubiquitous alternative networks are recalibrating regulation to take account of the presence of alternative networks in ‘pockets’. The standard test for a geographic market – homogeneity of competitive conditions within it – tends to yield national markets when there is a ‘patchwork quilt’ of areas with different endowments of infrastructures.

69. As noted above, New Zealand, however, is in a much better position than other countries to respond because there is an existing mechanism built into the service descriptions to address this issue. Schedule 1 of the Telecommunications Act 2001 contains the following condition in the service description of the majority of the regulated resale services. The condition states that the service should be provided if:
- a. Telecom faces limited, or is likely to face lessened, competition in a market for the particular retail service offered by Telecom to end-users; or
 - b. Telecom does not face limited, or is not likely to face lessened, competition in a market for that particular retail service, and the Commission has decided to require that particular retail service to be wholesaled in that market.
70. As a result of this condition, if before 2011 Telecom in particular areas faces more than limited competition, resale regulation can be withdrawn in those areas. If access seekers wish to continue providing the service to their customers in those areas, they must move up onto upstream access services or

¹⁷ Prof. Martin Cave, *Applying the ladder of investment in Australia*, 2007 at page 6.

acquire the resale services commercially.

71. The availability of this inbuilt mechanism is relevant to the Commission's decision about whether to conduct a Schedule 3 review. The Commission has stated the importance of this mechanism in its 2006 investigation into resale services:¹⁸

These conditions act as a competition threshold, whereby the Commission must determine the terms of access to any service that falls within the services description, where it is satisfied that Telecom faces limited, or is likely to face lessened competition, in a market for that services. The Commission also has the discretion to require regulated access to a service where Telecom does not face limited competition. The Commission has previously indicated that it would only require such access if it is satisfied of significant long-term benefits for end-users of requiring such wholesale provision.

72. The “not facing limited competition” test and the Schedule 3 process need to be read together. The Commission should only open a Schedule 3 review where it has reason to believe that the “not facing limited competition” test will be inadequate to deal with the evolution of competition. A Schedule 3 inquiry is appropriate where there is evidence that competition may have developed so ubiquitously (including by reason of more unbundled access products) that a complete withdrawal of the service may be appropriate rather than relying on a more “patchwork” approach under the inbuilt test in the service descriptions.
73. Finally, TelstraClear is aware of Telecom's concerns about the costs associated with compiling the RSPL and DSPL reports, in particular the external audit costs. These costs are driven in large part by the complex hierarchical classification of Telecom services into product and product families which Telecom proposed in the TelstraClear Wholesale Determination as Telecom sought a methodology to delineate a boundary around the services it was required to resell. TelstraClear was concerned at the time that the methodology was overly elaborated and we have agreed to subsequent adjustments to reduce Telecom's costs. We are open to engaging with Telecom over how further modifications could be made to reduce the compliance cost for Telecom, while providing the necessary protection for access seekers.

¹⁸ Commerce Commission of New Zealand, *Schedule 3 investigation into the extension of regulation of designated and specified services, Final Report*, 28 August 2006, at page 16.

74. TelstraClear believes it will be possible to reach agreement on these matters, but in any event, these implementation costs are not relevant to the Commission's decision about whether to open a Schedule 3 inquiry.

APPENDIX ONE FINALISATION OF UNBUNDLED SERVICES

Service		Date
2003		
“Wholesale” Designated Access Services including retail services offered by means of Telecom’s fixed telecommunications network (FTN) (Decision 497)	Commission decided to investigate TelstraClear’s application for a Determination ¹⁹	28 June 2002
	Generic Terms and Conditions and price approved by Commission	12 May 2003
2004		
Determination for “Residential Wholesale” Designated Access Service: (i) residential local access and calling services offered by means of Telecom’s FTN; and (ii) bundle of retail services offered by means of Telecom’s FTN. (Decision 525)	Commission decided to investigate TelstraClear’s application for a Determination ²⁰	20 December 2002
	Generic Terms and Conditions and Price approved by Commission	14 June 2004
2005		
Determination on the application for determination for access to and interconnection with Telecom’s fixed PDN service ‘Bitstream Access’ (Decision 568)	Commission decided to investigate TelstraClear’s application for a Determination ²¹	25 November 2004
	Generic Terms and Conditions and price approved by Commission	20 December 2005
Determination of designated access services (including private office networking) (Decision 563)	Commission decided to investigate TelstraClear’s application for a Determination ²²	3 December 2004
	Generic Terms and Conditions and Price approved by Commission	9 December 2005
2007		
Unbundled Local Loop Standard Access Service	Standard terms determination process initiated	22 February 2007
	Generic Terms and Conditions and price approved by Commission	7 November 2007
Unbundled bitstream service (UBA)	Service description declared	22 February 2007
	Generic Terms and Conditions and price approved by Commission	12 December 2007 ²³

¹⁹ TelstraClear’s application for Determination was made on 16 May 2002.

²⁰ TelstraClear’s application for Determination was made on 13 November 2002.

²¹ TelstraClear’s application for Determination was made on 4 November 2004.

²² TelstraClear’s application for Determination was made on 4 November 2004.

²³ Annual adjustment last made 16 March 2009.

Service		Date
Unbundled local loop co-location standard access service	Standard terms determination process initiated	28 March 2007
	Generic Terms and Conditions and price approved by Commission	7 November 2007 ²⁴
2008		
Unbundled local loop backhaul service	Standard terms determination process initiated	30 April 2007
	Generic Terms and Conditions and price approved by Commission	27 June 2008
Unbundled bitstream backhaul service (UBA backhaul)	Service description declared	30 April 2007
	Generic Terms and Conditions and price approved by Commission	27 June 2008

²⁴ Annual adjustment last made on 21 April 2009.