Telecom New Zealand Limited

Submission in respect of the

Consultation on the Commerce Commission's Telecommunications Sector Monitoring

Public Version

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A EXECUTIVE SUMMARY

1 The Commerce Commission (the "**Commission**") currently provides quarterly and annual monitoring reports. These are typically based on analysis of information which relates only to a small number of telecommunications service providers, or in many cases, only one service provider – Telecom. As a result, the existing monitoring reports provide only a limited insight into existing market and competition dynamics.

2 This reporting could be significantly enhanced if the following steps are taken:

(a) **information gathering is extended to include information from all the operators who are operating in the markets that are being monitored –** this is necessary to ensure the Commission is getting the full picture of the dynamics in the market;

(b) **information gathering is extended to include information on a regional basis where appropriate** - this is important because different regions have different products on offer and different types of competition;

(c) **monitoring of pricing is extended to include greater analysis of the products and services that are being delivered** - As the Commission has correctly pointed out *"It is difficult to accurately measure how prices faced by telecommunications end-users are moving over time because of changing buyer behaviour, changing products and complex tariffs like capped calling and on-net/off-net pricing."* [1] In order to develop a deep understanding of the markets being monitored, the Commission needs to better understand how these changes in product and traffic profiles are affecting, or are likely to affect, the relevant markets; and

(d) **the Commission conducting benchmarking based on New Zealand data rather than on the OECD data** - this will ensure that the Commission has an accurate picture of what is happening in the New Zealand markets as opposed to relying on comparisons with markets which may be subject to quite different influences.

3 The purpose of these monitoring reports should be to inform the Commission's ongoing regulatory market and competition assessments. These incremental changes will increase the Commission's understanding of current and emerging

[1] Commerce Commission – Telecommunications Key Statistics – June Quarter 2008, pages 5 and 6.

market and competition dynamics, and therefore significantly improve the usefulness of the Commission's sector monitoring reports in this context.

4 However, market monitoring is only one component of a best practice regulatory framework based on transparent market analyses and competition assessment.

5 Market monitoring is useful for providing initial and informed indicators of when potential issues may require further review or when opportunities for de-regulation arise, and providing the base information for the Commission's market analyses and/or competition assessments. These will, in turn, inform the Commission on areas for further regulatory attention and/or de-regulation. However, to actually monitor "competition in telecommunications markets" as required by s9A(1)(a), the markets need to be defined and assessed in the first instance.

6 As has occurred in the EU and UK, Telecom proposes that the Commission should commence a separate market definition programme to underpin its market monitoring and review functions in a logical, consistent way.

7 This will give an accurate picture of the entire range of service providers and markets subject to regulation, give confidence to the industry that a consistent approach is being taken across the Commission's varying market-related functions, and maximise the effectiveness of any market monitoring.

8 Telecom encourages the Commission to engage further with the industry on how it should best approach a comprehensive market definition consultation.

B INTRODUCTION

1. Telecom acknowledges that the Commerce Commission's (the **Commission's**) Telecommunications Sector Monitoring is a key part of the Commission's functions.

2. Telecom offers its views on the current quarterly and annual reporting and its view that the Commission should consider moving to a market based monitoring approach. In Appendix 1, Telecom answers the specific questions posed by the Commission in its letter of 4 November.

C COMMENTS ON CURRENT QUARTERLY AND ANNUAL REPORTING

3. The Commission currently provides quarterly and annual monitoring reports. The Commission uses information that is readily available and on that basis the reports are good because they align with the Commission's goal of providing information without imposing significant extra cost on the industry.

4. However, Telecom considers that the information supplied could be enhanced if the following steps were taken.

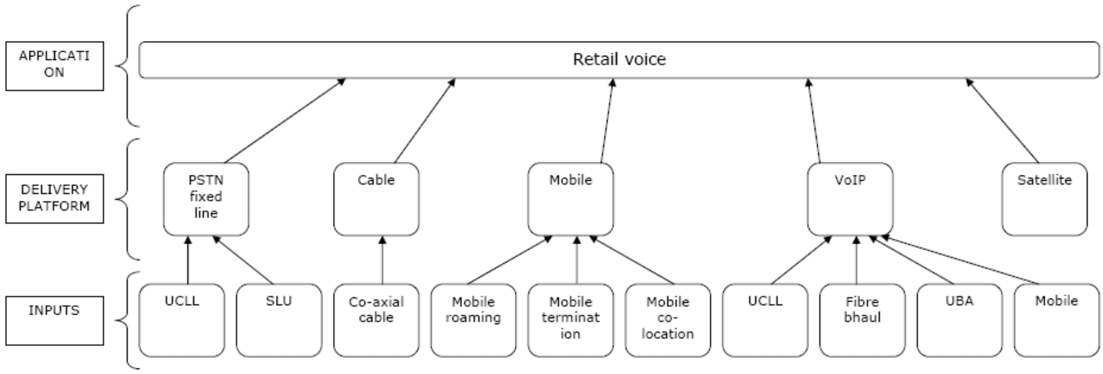
Information should be obtained from the market as a whole

5. It is important that when the Commission is conducting its monitoring that information is obtained from all the parties who are operating in the market. At this stage this is not occurring. There has been a proliferation of operators, there are now over 50, and the monitoring needs to take into account the impact they are having. Operators include: TelstraClear, Vodafone, Orcon Kordia, NZ Communications, Black and White, Vector, FX Networks, CityLink, Christchurch City Networks, Auckland City Council, Tasman, Wired Country, Smartlinx3, Inspire.net, Hamilton City Council, Manakau City Council, Actrix, Compass, WorldNet, Max Net, Snap, Woosh and WorldxChange

6. An example of why information from all the operators is important is the *Telecommunications Market Revenue data* that is provided in the quarterly reporting. The Commission states that *"comparing the trends in revenues in the different telecommunications markets gives an indication of the dynamics of the market",* but then goes on to look solely at Telecom's revenue. It is difficult to know whether Telecom's revenue provides an accurate reflection of what is happening in the telecommunications market as a whole. These figures only reflect what is happening to Telecom. If we take VoIP substitution as an example, some Telecom customers might have replaced their PSTN services with VoIP services from another supplier. By focusing solely on Telecom, the Commission would not have visibility that this was happening.

7. Retail Voice also provides a good indication of why it is crucial that we get information from the industry as a whole. This diagram shows the different platforms for delivering voice and the relationships between these platforms. It also shows the inputs into those platforms. It is important to remember that the relationships between the platforms are evolving through regulatory and technological change.

Retail Voice

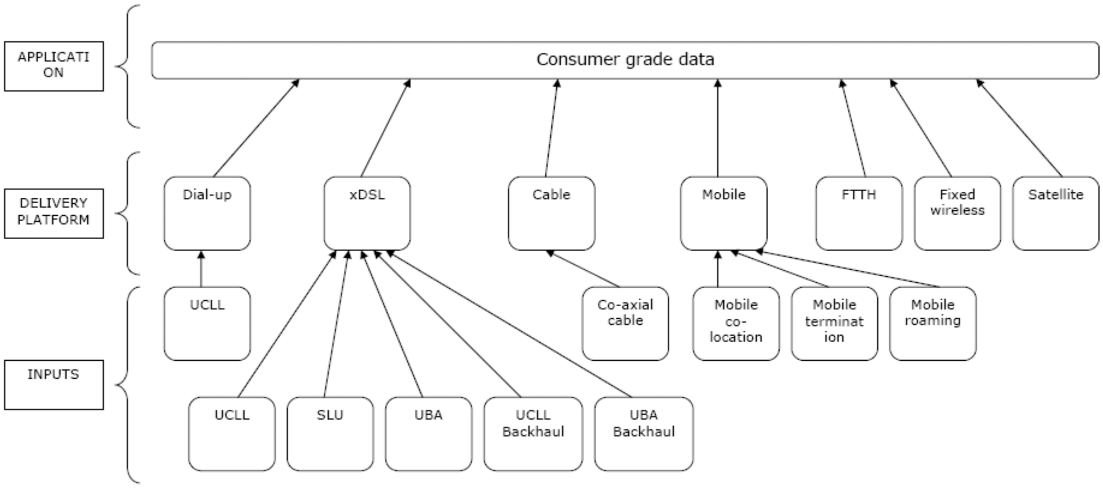


8. Customers are able to replace PSTN services with mobile or VoIP services. Substitution trends are readily observable internationally and are starting to become visible in New Zealand. As set out previously, it may be that data from other players would provide the clearest indication of a move by consumers toward mobile or VoIP services. By focusing solely on Telecom the Commission does not capture this type of information.

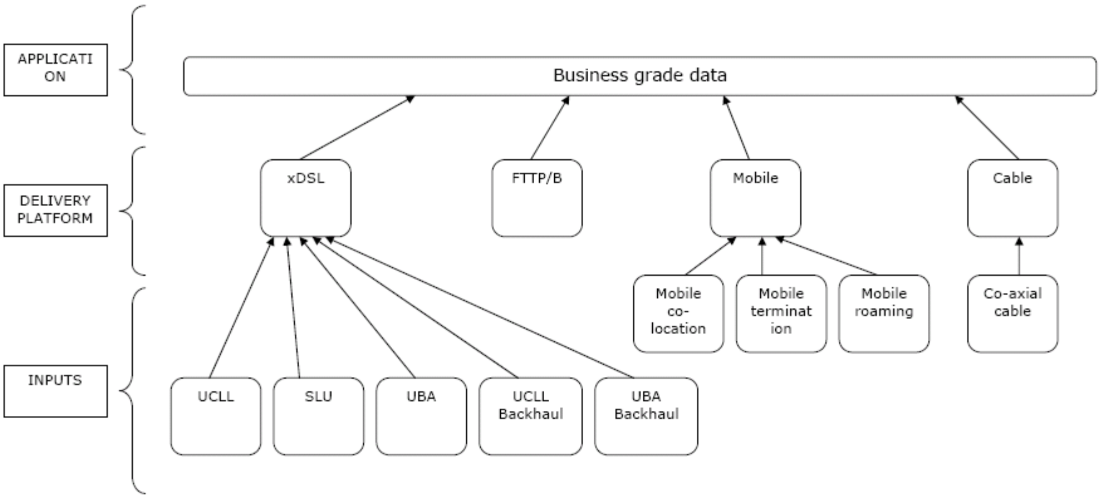
9. This potential for substitution also illustrates that it is important that the Commission avoid a technology bias or focus because NGN and convergence mean that market boundaries are changing.

10. Retail Voice is only one example of an application where information is required from the whole of the industry. Telecom would also consider that industry data in regard to consumer grade data services and business grade data services are also important. The diagrams set out below illustrate the different inputs and platforms that make up these applications.

Consumer Grade Data



Business grade data



11. Finally, information from the whole of the market is also important because it encourages ongoing assessment and an evaluation of current regulatory initiatives. In the longer term – it will provide a better ability to undertake benefit cost analysis and analysis of how effective the regulatory initiatives have been.

Information gathering should be extended to include information on a regional basis where appropriate

12. Telecom also considers that, where appropriate, monitoring should also take into account differences in the competition that is occurring in different geographic areas. As the Commission has concluded in previous market analyses, market and competitive conditions can differ between geographical areas. The current information the Commission collects will not provide information on the extent to which consumers are taking up those other services.

13. The information in table 1 of the Commission's 2008 June Quarter statistics provides an example of why geographic information is important. It notes that 5.9% of all Broadband connections are cable connections. However, this statistic only tells part of the story. When you take into account that cable is only available in Kapiti, Wellington and Christchurch it becomes clear that the uptake of cable is significant in those regions.

Monitoring of pricing should be extended to include greater analysis of the products and services that are being delivered

14. In its June Quarter 2008 Key Statistics document the Commission quite rightly points out that *"It is difficult to accurately measure how prices faced by telecommunications end-users are moving over time because of changing buyer behaviour, changing products and complex tariffs like capped calling and on-net/off-net pricing."* [2] Despite this valid observation it goes on to provide details of Telecom's average calling prices. If the Commission is going to provide this type of information it should also provide details of the extent to which changing buyer behaviour, changing products and changing tariffs impact on these prices. Not only has it not attempted to do this, it has not attempted to provide details of the prices of the other telecommunications operators in the market.

15. Without developing a deep understanding of how customer behaviour and usage patterns are changing and why, it is difficult to see how the Commission can conduct market and competition assessments, or make long-term decisions about the addition or removal of regulation with confidence.

The Commission should place less reliance on information about overseas jurisdictions

16. While OECD information is useful it cannot be used as a substitute for New Zealand data. While it can be used as a comparator in some circumstances it

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[2] Commerce Commission – Telecommunications Key Statistics – June Quarter 2008, pages 5 and 6.

will not help explain why a certain aspect of the New Zealand market is competitive or experiencing limited competition.

17. OECD data should not be used as a proxy for the state of competition in telecommunications markets in New Zealand. This is because selecting the average price for a particular service from a range of OECD countries and comparing these average prices against New Zealand does not indicate the state of competition in New Zealand markets. It demonstrates that one price is different to another but nothing more. To understand the state of competition in New Zealand telecommunications markets whole of sector domestic data needs to be collected and analysed.

18. It is also important to be cautious when benchmarking data from foreign markets against New Zealand markets. This is because a number of country specific factors such as topography, population density, dispersion, household size and GDP per capita will all shape markets and therefore the data collected from these markets. For example, if we look at other OECD countries, what may be appropriate for a small densely populated country like Japan may not be appropriate for New Zealand. To undertake meaningful benchmarking, similar to the process required for establishing initial prices through a benchmarking principle, the Commission should only consider similar markets in comparable countries.

D MOVING TO A MARKET BASED APPROACH

19. In Telecom's view, the Commission must design its market monitoring approach in concert with the design of its ongoing market review role. The first step should be to define a set of markets across which monitoring and reviews will take place.

20. An assessment of the relevant markets is a large undertaking and would likely be a separate consultation on its own, but is vital to developing a stable regulatory framework going forward.

21. This type of assessment is essential because an appropriate regulatory environment needs to be informed by ongoing market analysis. That is why the EU and UK environment requires a market analysis before regulation is imposed.[3]

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[3] The regulatory principles in Ofcom's simplification plan dated 6 December 2007 include commitments to:

- operate with a bias against intervention, but with a willingness to intervene promptly and effectively where required;

22. This type of analysis ensures that a regulator is able to follow best practice and target regulation in response to particular issues in a market following competition analysis.[4]

23. In New Zealand, in key markets (e.g Telecom's unbundled bitstream access and Telecom's unbundled bitstream access backhaul) the Commission has been prevented by legislation from carrying out market reviews for three years. This means there is a "gap" in the knowledge informing decisions in the New Zealand regulatory environment that needs to be filled through market reviews.

24. The EU regulator initially identified 18 markets which they perceived to have operators with substantial market power, which were to be the subject of regular market reviews in each of the EU member states, and has now concluded that as the markets have developed they have been able to reduce these 18 markets down to seven. The markets are "access to the public telephone network at a fixed location for residential and non-residential customers" at the retail level and then at the Wholesale level:

    (a) Call origination on the public telephone network provided at a fixed location;

    (b) Call termination on individual public telephone networks provided at a fixed location;

    (c) Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location;

    (d) Wholesale broadband access;

    (e) Wholesale terminating segments of leased lines, irrespective of the technology used to provide leased or dedicated capacity; and

    (f) Voice call termination on individual mobile networks.

- seek the least intrusive regulatory methods of achieving our policy objectives;
- strive to ensure that our interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome;
- Research markets constantly and will aim to remain at the forefront of technological understanding; and
- Consult widely with all relevant stakeholders and assess the impact of regulatory action before imposing regulation on a market.

[4] For example, see Para 27 of Directive 2002/21/EC of the European Parliament which states: *It is essential that ex ante regulatory obligations should only be imposed where there is not effective competition… National regulatory authorities should analyse whether a given product or service market is effectively competitive in a geographic area…*

25. The EU has completed two comprehensive market definition exercises, while New Zealand has yet to commence even one, instead relying on discrete market definition and analyses on an ad hoc investigation-by- investigation basis.

26. While the EU example provides a good example of how market analysis could help with monitoring, it is important to recognise that each jurisdiction is unique. New Zealand has a wide variety of regulation right across the value chain, so the markets that have been used in the EU may not be appropriate for New Zealand. It is important that New Zealand conducts its own market analysis to determine what markets should be monitored to help deliver long-term benefits to end users of telecommunications services.[5]

E OTHER KEY PRINCIPLES FOR SEEKING INFORMATION

27. Finally, there are some other key principles that Telecom considers the Commission should bear in mind when it is conducting monitoring. The Commission should:

- assess whether the information it needs is available in the information it already receives through its various review and monitoring functions, including Accounting Separation and STD reporting.[6] By doing this it will be able to ensure that the reporting under S9A of the Act will complement rather than overlay or replace the reporting required elsewhere in the Act;

- Ensure requests do not impose unnecessary compliance costs. The information required needs to be targeted and sufficient to support the Commission's purpose and framework. Going beyond this point may impose unnecessary costs on the industry; and

- Take into account confidentiality concerns, but recognise that this should not stop the Commission getting information for its own internal use.

[6] see http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/Guidelines/ContentFiles/Documents/Commissions%20Telecommunications%20Monitoring%20Functions.pdf

APPENDIX

1. Are the Commission's key statistic quarterly monitoring reports useful?

Telecom considers that the information supplied could be enhanced if the following steps were taken:

(a) information gathering is extended to include information from all the operators who are operating in the markets that are being monitored;

(b) information gathering was extended to include information on a regional basis where appropriate;

(c) monitoring of pricing is extended to include greater analysis of the products and services that are being delivered; and

(d) the Commission conducted benchmarking based on New Zealand data rather than on the OECD data.

Beyond these incremental changes, for the Commission to maximise the value of the quarterly reporting it would need to adopt an approach which is centred on relevant markets. As discussed in the main submission, Telecom considers that the Commission should conduct detailed market assessments.

A market based approach is fundamental to minimising the risk that competitive markets are regulated. It is also a fundamental process for determining which services to regulate in order to overcome competition problems and to identify which regulation should be removed because competition has been established.

a. Is the OECD benchmarking information useful?

This information can be used as a comparator in some circumstances but it is not useful for assessing the state of competition in the New Zealand market.

Currently the Commission uses OECD data as if it is a proxy for the state of competition in telecommunications markets in New Zealand. Selecting the average price for a particular service from a range of OECD countries and comparing these average prices against New Zealand does not indicate the state of competition in New Zealand markets. It demonstrates that one price is different to another but nothing more. To understand the state of competition in New Zealand telecommunications markets whole of sector domestic data needs to be collected and analysed.

It is also important to be cautious when benchmarking data from foreign markets against New Zealand markets. This is because a number of country specific factors such as topography, population density, dispersion, household size and GDP per capita will all shape markets and therefore the data collected from these markets. To undertake meaningful benchmarking, similar to the process required for establishing initial prices through a benchmarking principle, the Commission should only consider similar markets in comparable countries.

Consider the example of price comparisons across OECD countries above. A service which involves a large fixed cost will inherently be cheaper on average per customer in Country A with high population density compared to Country B with low population density. In this instance Country A having lower prices compared to Country B is not representative of a competition problem. Rather it demonstrates the differences in key underlying market drivers. Domestic data and analysis is important for the promotion of informed debate about the performance of the domestic market and when to remove regulation.

b. Is the reporting of Telecom data useful?

A reliance on Telecom data is not useful for advancing the understanding of the state of competition in telecommunications markets.

c. Should the Commission try to get quarterly industry data from parties in addition to Telecom?

Yes.

d. Would it be better to report more comprehensive industry data (if possible) but on a less frequent basis?

This would depend on the nature of the markets the Commission was looking at and the speed at which they are developing.

The Commission should collect the information it requires to monitor the relevant markets in New Zealand and to understand the state of competition in these markets. At a minimum, this means the Commission should require information from all operators.

e. What information in the quarterly reports would you like to see presented differently and why?

As above, the current use of OECD data is of limited value assessing New Zealand markets.

Further, the ranking of domestic operators is unlikely to be useful. It is the interplay between participants and competitive process that is important to assessing markets rather than the ranking of a particular provider. The Commission would be better to focus on understanding the state of competition in markets and publishing its conclusions about whether relevant markets face limited or are likely to face limited competition.

f. What other information would you like to see included in the quarterly reports and why?

As above, sufficient information from all participants, both operators and end users, in relevant markets.

To date data used in the quarterly reports by the Commission is:

- Telecom, TelstraClear and Vodafone Teligen (OECD) data; and
- Telecom only data.

Data that will be relevant to understanding the state of competition in telecommunications markets, to list a few, can be sourced from, for example:

TelstraClear	Vodafone	Orcon
Kordia	NZ Communications	Black and White
Vector	FX Networks	CityLink
Christchurch City Networks	Auckland City Council	Tasman
Wired Country	Smartlinx3	Inspire.net
Hamilton City Council	Manakau City Council	Actrix
Compass	WorldNet	Max Net
Snap	Woosh	WorldxChange

Each operator plays a role in markets shaping the competitive interactions.

g. What information do you think should be removed from the quarterly reports and why?

Telecom considers there is value in having two separate reports or sections to a report. There should be a single report or section dedicated to analysis of domestic markets in order to understand the state of competition, performance and development. This New Zealand centric section will then enable the Commission to focus on markets where there is limited or likely to be limited competition, and on markets where regulated services have delivered competitive outcomes in order to roll back the regulation of a service or services.

The second report or section could take more of an environmental scan of telecommunications in New Zealand highlighting interesting and important developments over the year. The Commission could look at OECD or other useful international comparisons in this document.

2. Was the Commission's 2007 telecommunications market monitoring report useful?

The basic structure of the annual 2007 telecommunications market monitoring report was good. However, as above, the monitoring can be made more effective by taking a market based approach. As it stands, the Commission has only looked at certain technology platforms and over relied on limited price, OECD and connections data.

Telecom believes that the "Year in Review" section is a valuable component to the report. It provides a useful flavour of the developments over the year and is a useful way of highlighting significant developments and changes. We would encourage the Commission to retain this section.

a. What information in the annual report would you like to see presented differently and why?

As above, greater use of domestic data from all operators.

The current reporting places undue focus on Telecom data and inhibits market analysts from forming their own view about the state telecommunications markets.

b. What additional information would you like to see included in future annual reports and why?

As above, the Commission collects data from Telecom, TelstraClear and Vodafone. This should be extended to all market participants and made publicly available.

c. What information do you think should be removed from future annual reports and why?

See above.

3. Do you support the Commission using an annual industry survey (which is generally supported by the TCF) to collect much of the aggregate industry data not already disclosed by Telecom?

Telecom supports an industry approach to data collection similar to that which is conducted through the TCF. It provides a useful forum for the consideration of the information which is most relevant to assist the Commission discharge its monitoring function. This approach enables the Commission, Officials and industry participants to work together.

a. Once respondents have systems set up to extract the required data, would it be relatively easy and cheap for respondents to provide the data more often than annually?

Depends on the nature of the data and, in turn, this depends on the market based approach proposed above.

b. Would it be better to have Statistics NZ collect industry statistics if this was able to be organised?

As above, this depends on the nature of the data to be collected and pros and cons of engaging Statistics New Zealand to collect industry statistics. Telecom would be happy to explore this option but would need more information on the positive and negatives of this approach.

c. Are there other ways of collecting industry information that the Commission should consider, and what are they?

As above, this depends on the nature of the data to be collected.

4. It has been proposed that the Commission construct consumption baskets for New Zealand usage of fixed and mobile phone service, and use these to compare New Zealand prices to those in other countries. This would be in addition to rather than in place of OECD benchmarking. Do you support such a proposal, and what suggestions do you have for progressing it?

Without the overarching markets defined, its difficult to form a conclusion on this. Information on price and changes in price are a useful input but only one input from a large information set.

Its likely that, if the Commission wants to benchmark prices, relevant New Zealand baskets should replace OECD benchmarking. This is because the OECD baskets are quite different to the type of plans in New Zealand and, as a result, fail to capture many of the benefits to New Zealand consumers.