

VODAFONE NEW ZEALAND LIMITED SUBMISSION TO THE  
COMMERCE COMMISSION



Vodafone New Zealand Submission on Consultation on the Non-Discrimination and EOI Obligations under the Telecom Separation Undertaking Requirements with respect to the complaints concerning the Telecom Wholesale Loyalty Offers dated 16 October 2009

30 October 2009

## *Executive Summary*

1. Vodafone welcomes the opportunity to provide a submission in response to the Commerce Commission's **(Commission)** "Consultation on the Non-Discrimination and Equivalence of Input obligations **(EOI)** under the Telecom Separation Undertaking Requirements with respect to the complaints concerning the Telecom Wholesale **(Telecom)** Loyalty Offers" dated 16 October 2009 (the "**Consultation**").
2. The Consultation seeks submissions on the preliminary views reached by the Commission regarding the requirements under the Telecom Separation Undertakings<sup>1</sup> **(Undertakings)** with respect to:
  - the non-discrimination obligation provided in clause 56 of the Undertakings;
  - the EOI Standard, particularly the December 2009 Requirements (as those terms are defined in the Undertakings);
  - the relationship between the non-discrimination obligations and the December 2009 Requirements; and
  - regulatory considerations.
3. We note that the Commission is also investigating competition law issues in relation to the Loyalty Offers that arise under the Commerce Act 1986, further to complaints made by Vodafone and Kordia. We believe that the complaints should continue to be pursued by the Commission and we look forward to the results of the Commission's investigation.

### *Non-discrimination*

4. Vodafone supports the Commission's preliminary view in the Consultation, that the offers launched by Telecom in December 2008 (the "**Auckland Offer**"), March 2009 (the "**All of NZ Offer**"), and July 2009 (the "**Regions Offer**") (together, the "**Loyalty Offers**") breached clause 56 of the Undertakings.
5. Vodafone also responds to Telecom's arguments that the Loyalty Offers were not discriminatory, for the reasons set out in this submission.

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<sup>1</sup> As provided to the Minister of Communications on 25 March 2008 in accordance with section 69K(2)(c) of the Telecommunications Act 2001 and as varied by agreement between Telecom and the Minister of Communications on 10 June 2009 in accordance with section 69U of the Telecommunications Act 2001.

*EOI Standard/December 2009 Requirements*

6. Vodafone also supports the Commission's preliminary view that the Loyalty Offers and contracts entered into with service providers based on the Loyalty Offers failed the EOI Standard in the Undertakings, and as a result Telecom breached the Undertakings as the contracts were intended to remain in force at 30 September 2009.
7. Telecom has evidenced a breach of the Undertakings due to entering into contracts with terms of two years such that those contracts anticipatorily breached the Undertakings on the date Telecom entered into the contracts. This is because Telecom was aware on the date that the contracts became effective that it would be obliged to comply with the December 2009 Requirements as an enforceable obligation at 30 September 2009. This anticipatory breach of the Undertakings is a serious matter and Telecom should be held to account by the Commission, as a breach of the December 2009 Requirements.

*Regulatory Considerations*

8. Any guidance provided by the Commission as to how the non-discrimination and the EOI Standard should be interpreted should aim to appropriately take into account the objectives set out in section 69A of the Act: investment in infrastructure (including UCLL), and competition in both the retail and wholesale markets.

*Further Guidance from the Commission*

9. We agree that the Undertakings are broad and we believe that focusing on the on the meaning of non-discrimination and the EOI standard in the context of this investigation into the Loyalty Offers will provide useful guidance to all parties. However we consider that guidance on the meaning of these terms at a broader level can be dealt with by the Commission at a later stage.
10. We are however encouraged that the Commission is carrying out this consultation, which can provide all parties with a greater degree of certainty going forward.

## 1. *First Principles*

11. Part 2A to the Telecommunications Act 2001 (Act) sets out the statutory process for the Minister to finalise legally enforceable undertakings in respect to the operational separation of Telecom. Vodafone considers the policy framework behind Part 2A of the Act provides an important starting point and a context in which to interpret the non-discrimination and EOI provisions on which the Commission is consulting.
12. Section 69A of the Act provides that the purpose of Operational Separation is to:
  - promote competition in the telecommunications markets for the long-term benefit of end-users of telecommunications services in New Zealand;
  - require transparency, non-discrimination and equivalence of supply in relation to certain telecommunications services; and
  - facilitate efficient investment in telecommunications infrastructure and services.
13. This purpose statement should be front of mind when interpreting clauses 47 and 56 of the Undertakings. In respect of section 69A, we also note the following:
  - 'telecommunications markets' includes the retail and wholesale markets, for both broadband and voice; and regulation of UCLL (as that term is defined in the Undertakings) and UBS/UBA services promotes competition in both of these retail and wholesale markets;
  - to ensure that competition can be achieved in these markets, Telecom is subject to transparency, non-discrimination and equivalence of supply requirements, the subject of this Consultation; and
  - the Undertakings and the regulation of UCLL have made it possible for Vodafone and Kordia to invest in UCLL telecommunications infrastructure, and to provide wholesale bitstream services based on this infrastructure.
14. In Parliamentary debates, in considering the Telecommunications Amendment Bill, The Hon David

Cunliffe stated (emphasis added):<sup>2</sup>

We will end up with an enforceable, binding, robust, three-way operational separation **that will require non-discrimination in wholesale markets and fair access to bottleneck and wholesale services.**

15. The Ministry of Economic Development, in the Consultation document in 2007, also provided (emphasis added):<sup>3</sup>

**LLU and bitstream services are considered critical wholesale services to promoting competition** and critical to delivering on the government's objective of reducing New Zealand's broadband performance gap relative to other OECD countries. (...)

16. The interpretation of clauses 47 and 56 of the Undertakings must be considered in the context of the purpose statement in section 69A of the Act, and may be further aided by reference to Government statements (including those set out above, and those listed in Vodafone's submission to the Independent Oversight Group (**IOG**) of 24 July 2009).
17. We believe section 69A requires the Commission to take into account the objective of investment in infrastructure (including UCLL) and the objective of competition in both the retail and wholesale markets.

## 2. *Non-Discrimination*

18. Vodafone supports the Commission's preliminary view reached on the non-discrimination obligation set out at clause 56.1 of the Undertakings.

### *Clause 56.1*

19. Clause 56.1 of the Undertakings provides:

When doing or omitting to do anything in respect of the provision of a Relevant Wholesale Service, the Wholesale Unit (including its Employees, agents and contractors) will not discriminate between Service Providers and Retail Units or between Service Providers.

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<sup>2</sup> Parliamentary Debates, (Hansard) Volume 636, page 7129, Tuesday 12 December 2006 (Telecommunications Amendment Bill –Third Reading).

<sup>3</sup> Ministry of Economic Development, *Development of Requirements for the Operational Separation of Telecom: Consultation Document* 3 September 2007, Chapter 6 Equivalence requirements for service delivery, paragraph 156 [http://www.med.govt.nz/templates/MultipageDocumentPage\\_29991.aspx](http://www.med.govt.nz/templates/MultipageDocumentPage_29991.aspx)

20. "Relevant Wholesale Service": This is defined at clause 45.2 of the Undertakings. Clause 45.2(a)(ii) notes that it includes all other Designated Access Services and Specified Services. All of Telecom's Loyalty Offers include UBA, a Relevant Wholesale Service, and therefore fall within the scope of clause 56.1 of the Undertakings.
21. "Provision of a Relevant Wholesale Service": Vodafone agrees that 'provision' includes the act of supplying or delivering a service and so would include supplying or delivering the service(s) that were the subject of the Loyalty Offers. The clause extends the scope of the obligation to 'doing or omitting to do anything in respect of' the supply or delivery of the service(s). Making an offer to a service provider falls within the ambit of 'doing or omitting to do anything in respect of' the supply or delivery of the service. Telecom's offer to service providers, embodied in the Loyalty Offers, therefore falls within the scope of this clause.
22. "Discriminate between Service Providers": We support the Commission's approach that to discriminate means to differentiate or distinguish between service providers.
23. The fact that clause 56.1 prohibits discrimination between both Telecom's Retail Units and service providers, and between service providers, is, in our view, material. This recognises that, as set out in the Undertakings, Telecom is required to treat service providers the same, to ensure competition at all levels: some service providers are going to invest in UCLL, while others will not. It is contrary to the policy behind operational separation to allow Telecom to discriminate between service providers, with the effect of treating service providers who are both competitors and customers of Telecom differently from those service providers who are only customers of Telecom.

#### *Discussion*

24. Clause 56.1 must be considered in the context of operational separation. As noted earlier, Vodafone and Kordia have taken advantage of the regulation of UCLL and operational separation, with Vodafone launching a competing wholesale bitstream service. Vodafone and Kordia are therefore both customers and competitors, and are treated differently from others who are only customers because the offers are not capable of being accepted by Vodafone and Kordia.
25. This discrimination is wrong on the face of clause 56.1, and must also be considered wrong when the purpose of the Undertakings is taken into account. The Loyalty Offers discriminate against Vodafone and Kordia as they deter the parties from competitive conduct in the wholesale bitstream access market, and make it unviable for the parties to consider wholesale entry in those geographical areas currently without UCLL investment. This form of discrimination is not

acceptable under a regulatory regime which expressly promotes infrastructure-based competition.

26. Vodafone would have no issue with the Loyalty Offers if they were a simple price reduction on the broadband plus phoneline bundle. The 'discriminatory' aspect of the offer was that in order to obtain a discount, a service provider was required to give Telecom all (or 90%) of its business, and the discount in non-competitive areas was linked to the discount in competitive areas.<sup>4</sup>

*Response to Telecom's arguments*

27. Telecom asserts:

- (a) *the offers were open to, and could have been accepted by all service providers, and different treatment is not discriminatory if it simply reflects a customer's different circumstances;*

Vodafone does not accept Telecom's argument. An offer may be open to all service providers, but if the offeror is aware that particular conditions of the offer will effectively exclude a class of service providers from accepting the offer (a service provider would be severely disadvantaged (whether technically, commercially or operationally) if it were to accept it), then the offer is discriminatory.

Vodafone submits that an offer available to all service providers may constitute discrimination where it is contrary to the principles underlying the Undertakings, competition law or any other matter the Commission considers relevant. For example, an offer to the world that is structured in such a way that only a Telecom group company may accept the offer would be likely to be discriminatory.

- (b) *wholesale service providers cannot be expected to second guess every service provider's business requirements in order to create generic offers that are appealing in every respect to all service providers;*

Vodafone agrees that Telecom is not required to second guess every service provider's requirements when making an offer. However, Telecom is required to comply with its obligation of non-discrimination. Vodafone submits that this obligation of non-discrimination requires Telecom, when it makes an offer, to consider whether the offer is likely to produce outcomes consistent with the purpose of operational separation and, in

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<sup>4</sup> Vodafone NZ, Letter to IOG, 24 July 2009, page 4, paragraph 4.

particular, whether the offer intends to, or has the effect of, discriminating between service providers. Telecom should not be permitted to “leave its common sense by the door” when making an offer.

- (c) *a decision favouring service provider investments into UCLL would amount to a fundamental bias against robust competition in favour of certain policy goals around UCLL penetration;*

We disagree with this statement. It is the fact of discrimination itself that results in disadvantageous treatment of a class of service providers. Vodafone considers that Telecom can and should compete, but it must do so on an equivalent and non-discriminatory basis.

- (d) *if discrimination is equated with commercial ‘harm’ to those customers who are also competitors, then an operationally separated Telecom’s position becomes commercially untenable;<sup>5</sup>*

Vodafone is not suggesting that discrimination equates to commercial harm: the effects of the Loyalty Offers go much further than inflicting commercial harm on Vodafone. The fact that only certain service providers could feasibly accept the Loyalty Offers severely harms competition and acts as a deterrent to ongoing investment in infrastructure, which are each key purposes of operational separation.

The Loyalty Offers, and acceptance by some service providers of the Loyalty Offers, essentially stops wholesale competition, and threatens the viability of UCLL based investment by other service providers. These cumulative effects of the Loyalty Offers are contrary to the objectives of the Undertakings and Part 2A of the Act, and go much further than ‘commercial harm’, effectively resulting in market foreclosure by Telecom.

- (e) *the Loyalty Offers were an alternative commercial option for Vodafone (continue to build/switch back to buy);<sup>6</sup> and*

Telecom suggests that the Loyalty Offers constituted a genuine ‘continue to build/switch back to buy’ consideration for existing unbundlers. However, Telecom’s approach of offering a large discount in areas already unbundled, but only a small discount in areas not yet unbundled, (such that the small discount is not enough to actually discourage UCLL investment), does not constitute an ‘alternative commercial option’ in so far as Vodafone is

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<sup>5</sup> Telecom Wholesale, Letter to the Commission, 2 October 2009, paragraph 18.

<sup>6</sup> Ibid., paragraph 6.

concerned.

- (f) *end users would see great benefits from Loyalty Offers by significantly increased competition at the retail level.*<sup>7</sup>

Competition must be promoted for the long term benefit of end users of telecommunications services in New Zealand. However, end users have not seen great benefits from the Loyalty Offers as Telecom asserts. In fact, we are only aware of one service provider that altered its retail price after accepting the Loyalty Offers.

#### *Clause 56.2*

28. Clause 56.2 provides:

56.2 For the avoidance of doubt:

- (a) clause 56.1 does not prevent the Wholesale Unit from doing or omitting to do something in respect of the provision of a Relevant Wholesale Service that is different for different recipients of that service, where those differences reflect the different requirements of the recipients;
- (b) clause 56.1 is subject to clause 6; and
- (c) this clause does not limit clauses 47 to 49.

29. We agree with the Commission in paragraph 60 of the Consultation that 'different requirements' in clause 56.2(a) must be limited to those of a technical, operational or similar nature. Vodafone considers that clause 56.2 is intended to allow Telecom to offer different terms to service providers, but **only** in the event a service provider required such different terms: clause 56.2 does not apply to a difference in terms, required or proposed by Telecom.

30. Vodafone agrees that clause 56.2(b) has the meaning given by the Commission in paragraph 61 of the Consultation.

31. Vodafone agrees that the exceptions permitted under the EOI obligations at clauses 47 to 49 will not breach the non-discrimination obligations.

#### *Volume discounts (paragraph 70)*

32. Vodafone supports the Commission's approach that volume discounts are not permitted under clause 56.2(a) of the Undertakings. We note that the Commission has suggested it may grant

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<sup>7</sup> Ibid., paragraph 24.

exceptions, under clause 1.2(b)(iii) (although this is likely to be in respect to the EOI Standard), and this may include volume discounts where they reflect fair economies of scale without discrimination.

33. In contrast, individualised targets that do not reflect actual volume commitments, where the same discount can be achieved by large and small customers alike, are difficult to defend in terms of savings from economies of scale. Telecom is depriving service providers of the choice to obtain wholesale bitstream services from Vodafone or other wholesale competitors, and there are no scale economies which would justify this action. Volume discounts must not be used for the benefit of the access provider's own retail customers at the expense of other service providers.

*Commission view on non-discrimination*

34. Vodafone supports the Commission's overall finding on discrimination at paragraph 81:

the Commission considers that any terms and conditions that have the effect of limiting parties to whom the offer is acceptable is likely to be discriminatory unless consistent with clause 56.2.

35. We support the Commission's preliminary view as set out in paragraphs 80 to 83 of the Consultation, and consider that the Commission's preliminary views provide greater clarity on the intent of clause 56 of the Undertakings.

**3. *Equivalence of Inputs***

36. Vodafone agrees that the December 2009 Requirements are a mid-way point in the migration to equivalency. The definition of the December 2009 Requirements include a requirement that:

Telecom Business Units and Service Providers are provided with the same service on the same terms (including price).

37. This is an enforceable milestone as at 30 September 2009, pursuant to Schedule 1 of the Variation to the Telecom Separation Undertakings of 10 June 2009. If contracts entered into as a result of the Loyalty Offers are in force, or intended to be in force on 30 September 2009, those offers and the contracts are in breach of clause 47 of the Undertakings.

38. Vodafone considers that the fact that the contracts Telecom entered into with service providers each had a term of around two years demonstrated a clear and unequivocal intent by Telecom not to comply with the Undertakings as at 30 September 2009. Telecom has made it clear at the time it entered into the contracts that it did not intend to comply with the Undertakings.

39. Where a party has committed to certain obligations, entering into a second contract that will prevent the party from complying with the original obligations constitutes an anticipatory breach of that original obligation. Telecom, by entering into the contracts for a two year period, knowing that performance of the contracts past 30 September 2009 was inconsistent with the EOI Standard and the December 2009 Requirements, intentionally committed an anticipatory breach of the Undertakings.<sup>8</sup>
40. While Telecom terminated the contracts following the IOG decision on 27 August 2009, Vodafone encourages the Commission to take a broader view of what constitutes a breach of the EOI Standard. The fact Telecom entered the contracts for a two year period, which passed 30 September 2009, means that Telecom breached the EOI Standard and the December 2009 Requirements in the Undertakings: Telecom expressed an intention to breach the Undertakings in the future, and took every step it could possibly take to put in place conditions for a breach to occur. We therefore consider that Telecom anticipatorily breached the Undertakings on the date the contracts became effective, and should be treated by the Commission accordingly.
41. We note that section 69R of the Act provides (emphasis added):

If, on the application of the Commission, it appears to the High Court that Telecom **intends to engage**, or is engaging, or has engaged, in conduct that constitutes, or **would constitute**, a breach of the terms of a separation undertaking, the Court may make any orders on any terms and conditions that it thinks appropriate (...)

#### *Relationship between December 2009 Requirement and EOI Standard*

42. Vodafone agrees with the Commission's view of the relationship between the December 2009 Requirement and the EOI Standard.
43. The December 2009 Requirements are a midway point towards delivery of the EOI Standard, which is required by December 2011. The December 2009 Requirements, which allow for Telecom to migrate to the EOI standard over time, are enforceable obligations.

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<sup>8</sup> We note that the case law on anticipatory breach is based on situations where a party, having contracted to do something in the future, tells the other party that they will not perform their future obligations after the contract has been entered into. This is a breach, even though the obligation to do something is not yet due. See *Frost v Knight* (1872) LR 7 Exch 111 at 114. Here, once the contracts took effect, the passage of time alone would have put Telecom in breach of the Undertaking on 30 September 2009 (unless Telecom was to take the unusual or extraordinary step of terminating the contracts). According to the doctrine of anticipatory breach, under such circumstances, the law will not require the non-breaching party to sit back and await the passage of time, but allows the non-breaching party to sue immediately for the breach.

#### **4. *Relationship between non-discrimination obligation and December 2009 Requirements***

44. We agree with the Commission's view that non-discrimination is a broad obligation applicable across all Relevant Wholesale Services provided by Telecom. The EOI obligation is applicable to a smaller group of services, however it imposes greater obligations on Telecom in relation to those services.
45. Clause 56 requires Telecom not to treat service providers differently in respect of the provision of Relevant Wholesale Services. The EOI Standard and December 2009 Requirements at clause 47 is a higher standard which goes beyond a general non-discrimination obligation: it applies to a subset of services; and it requires Telecom to provide to itself and to service providers the same service on the same terms (including price).

#### **5. *Regulatory Considerations***

46. Vodafone agrees that LLU and SLU investment are key components in delivering a competitive wholesale market. The Act and Undertakings are based on the 'ladder of investment' model, encouraging service providers to move up the ladder of investment as their businesses develop. The Cabinet Policy Paper referred to by the Commission at paragraphs 106 – 109 in the Consultation, confirms this is a policy behind the Part 2A of the Act.
47. Vodafone believes that the Commission should consider the policy objectives of promoting service provider investment in UCLL and maintaining incentives for progressing alternative infrastructure investment with a view to promoting infrastructure based competition, and the policy objective of promoting competition in all telecommunications markets, consistent with section 69A of the Act. The Commission's consideration of these objectives should in no way compromise or disadvantage the viability of 'efficient' UCLL investment, a key touchstone of operational separation.
48. See our discussion at paragraph 23 in respect to the Commission's comments at paragraph 112 of the Consultation.

#### **6. *Guidelines from the Commission on what these terms mean***

49. Vodafone agrees that Telecom and the other service providers will benefit from guidance as to the appropriate interpretation of non-discrimination, December 2009 Requirements and EOI in the Undertakings, and welcomes the opportunity to provide input on the meaning of the terms in this submission. Vodafone considers the IOG decision has already gone some way in providing

certainty in respect to these clauses, contrary to Telecom's assertion of increased uncertainty.<sup>9</sup>

50. Vodafone considers that it may be more valuable for the Commission to focus on the meaning of these terms in the in the context of this investigation into Loyalty Offers, while we acknowledge that it may be necessary for the Commission to set more general definitive guidelines in the future.
51. An example of an issue where we would welcome future guidance, is the Commission's statement in paragraph 75 that 'costs of supply by Telecom are not a relevant factor that would justify differential price terms'. Does it follow that Telecom is therefore prevented from setting different prices for UBA provided from exchanges, as compared to UBA provided from street cabinets?

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<sup>9</sup> Telecom, supra note 5, paragraph 39.