



**CROSS SUBMISSIONS IN RESPECT OF
THE COMMERCE COMMISSION'S DRAFT
REPORT ON WHETHER RESALE
SERVICES SHOULD BE OMITTED FROM
SCHEDULE 1 OF THE
TELECOMMUNICATIONS ACT 2001 (OR
IF NOT OMITTED, AMENDED IN SOME
FORM) ("DRAFT REPORT")**

13 OCTOBER 2010

Public Version

PART A: SUMMARY

1. We continue to support the Commission's proposal to rollback resale regulation and are encouraged that other submitters on the Draft Report agree on certain key issues.
2. All parties who submitted on the Commission's Draft Report support the rollback of unnecessary regulation. They also support the principles of regulatory best practice and correct application of the ladder of investment (LOI) strategy.
3. However, despite this support for the underlying principles, all submitters conclude that resale regulation remains an important part of the regulatory landscape and should be retained as a "backstop". We think that applying regulatory best practice principles in the way that the Commission has supports a conclusion that resale regulation should be rolled back.
4. We agree with the Commission that the scope of any regulatory backstop should be defined in light of the degree of competition in the relevant market and the availability of alternative inputs deeper in the value chain. Regulation should only be imposed (or retained) where there is a market issue that needs to be addressed.
5. Further, regulation should not be retained as a backstop where there is little or no demand – because in most cases, the cost of retaining the regulation will not outweigh the benefits. The regulation that the Commission is proposing to retain (primarily resold voice services) account for the vast majority (approximately 90%¹) of resale revenues – i.e. this is where there is still demand for products.

The Commerce Commission's principles for deregulation are still valid

6. While the submissions on the Draft Report do not generally support roll back of regulation today, nor do they provide evidence to support a view that there is a market problem to be resolved with regulation. In other words, there is no evidence to show that the competition assessments carried out by the Commission in the Draft Report are wrong.
7. The evidence the Commission relied on in reaching its draft decision to deregulate included the fact that the take up of the resold services it is looking to deregulate is low - this supports a view that access seekers are not relying on those services to compete. The evidence we have provided clearly supports this conclusion, and no evidence has been provided to support a different view.

¹ Subject to subsequent decisions by the Commission's (should it decide to apply the regulation).

8. The Commission has also been provided with evidence that there are other wholesale inputs that can be used as an alternative to resale in certain markets. For example, in its 15 May 2009 submission (para 18 pg 9), TelstraClear noted that the availability of bitstream access from 2004 has enabled it to use wholesale inputs to offer broadband services to its end customers, rather than resold broadband. This is supported by the fact that the vast majority of broadband connections offered by Telecom's competitors today are built using UBS - with Wholesale customers in various stages of migrating to UBA and/or UCLL. This context supports the Commission's view that there is no competition issue to justify ongoing regulation of this type of resold product.
9. Market uncertainty is not a reason to delay the roll back of regulation where there is no evidence of a competition issue today or in the foreseeable future. If anything, markets are likely to get more competitive as end users are provided with greater choice through UFB and other regulatory initiatives.

The cost of retaining unnecessary regulation

10. Parties have suggested there is no harm in retaining unnecessary regulation. This is an easy argument to make, but is not true. The burden on Telecom, the industry and consumers in retaining unnecessary regulation include the uncertainty for all players and the potential for outcomes that are not in the long term interests of end users. Any decision to retain regulation in a competitive market should only happen if a thorough cost benefit analysis shows that it was in the interest of end users. Submitters have not shown any evidence to support this view.
11. Further, retaining unnecessary regulation does not align with any LOI policy. The LOI is not about retaining regulation at every level in the market in perpetuity. Professor Cave notes that regulatory intervention may include limiting price incentives to promote service-based competition, clearly signalling a commitment to remove regulation where workable competition has developed, and removing earlier rungs in the ladder as appropriate.

The Commission's conclusions in its Draft Report are sound

12. While the general view of submitters is that the existing regulation should be retained, we believe that, from a principled perspective, the Commission's conclusions in its Draft Report are robust.
13. The differing views on when deregulation should occur appear to be due to a combination of factors, including uncertainty over what the LOI is and how it is intended to be applied, and confusion arising from complexity in the New Zealand regulatory framework.

14. Standing back, and applying best practice regulatory principles, it is difficult to conclude that resale regulation (in its current form) should be retained.

PART B: KEY THEMES

15. In this section we address some of the key matters raised in the other parties' submissions.

Should uncertainty justify ongoing regulation?²

16. We appreciate respondents' concern about regulatory uncertainty and we share this concern. We are acutely aware that this uncertainty has a real impact on business decision making and investment. However, we do not think that the current uncertainty has or should have any material bearing on the Commission's analysis. The deregulation that the Commission has proposed in its Draft Report has been limited to deregulation of competitive markets – e.g. markets where regulated alternatives exist or services are no longer required to compete.
17. There is also no evidence that the regulatory uncertainty will likely lead to less competition in the resale markets that the Commission proposes to deregulate. To the contrary, we expect that UFB and other regulatory initiatives will only lead to increased competition at the retail level.
18. Because the regulatory uncertainty does not impact the Commission's competition analysis, we don't think that it justifies deferring the finalisation of the Commission's Draft Report.

Parties agree that Resale regulation remains an important part of the regulatory landscape³

19. All parties who submitted on the Commission's Draft Report agree that resale regulation remains an important part of the regulatory landscape. We agree with this view. However, we also share the Commission's view, that the scope of the regulatory backstop should be defined in light of the degree of competition and the availability of alternative inputs deeper in the value chain. A backstop should not be retained where there is no market problem to resolve and where there is little or no demand for those services. In this case, the regulation that the Commission is proposing to retain (primarily resold voice services) account for the vast majority (approximately 90%)⁴ of resale revenues – i.e. this is where there is still a potential bottleneck.

² The following parties discuss uncertainty - Vodafone - page 4, TCL - paragraphs 37-43, Vector – pages 2 and 3, 2degrees final paragraph of their submission.

³ This point is raised by the following parties - Vodafone - page 1, TCL – paragraphs 5-7, 10-12 and 68 -76 Vector – pages 2, 3 and 4, 2degrees throughout their submission.

⁴ Subject to subsequent decisions by the Commission's (should it decide to apply the regulation).

Migration issues⁵

20. TelstraClear proposes that the Commission should not deregulate resold broadband and data for two years because of, among other things, the lack of clarity, migration issues and the introduction of “non-commercial terms” by Telecom.
21. In February 2009 Telecom Wholesale initiated an industry consultation process through the Dialogue forum to ensure a smooth migration off grandfathered legacy resold products and onto Wholesale-built next generation EOI products. There is no suggestion that Telecom Wholesale will “pull the rug” from under its customers as soon as deregulation occurs. Wholesale is committed (and has the right incentives) to ensure a smooth transition. Removing the option to regulate these services will not impact the success of data product migrations.

Whether “bundles” of Resale Services should be deregulated⁶

22. Both TelstraClear and Vodafone have submitted that the removal of resold bundles from the Act will have a detrimental financial impact on their businesses.
23. However, this is not supported by the evidence. Wholesale currently only sells five bundles made up of a combination of voice access plus ancillary smart phone services ‘Family’, ‘Smartline’, ‘Messageline’, ‘Access + Message’ and ‘Smart Bundle’:
 - Of these five bundles, three have been grandfathered by Telecom Retail (‘Family’, ‘Smartline’ and ‘Messageline’);
 - ‘Access + Message’ is a bundle sold commercially by Telecom Wholesale (i.e. it is not available from Telecom Retail, so is not a true “resale” product); and
 - ‘Smart Bundle’ is the only bundle that could fall within the scope of regulation. As at September 2010, TCL had [] TNZCOI ‘Smart Bundle’ connections and Vodafone had [] TNZCOI. The price differential between ‘Smart Bundle’ and its individual components historically sits within [] TNZCOI.
24. The low uptake of existing bundles suggests that the ability to take bundles is not important to an access seeker’s ability to compete with Telecom Retail. In other words, there is no evidence of limited competition in the market that would justify regulation.

⁵ This point is raised by the following parties - Vodafone - page 3, TCL – paragraphs 14-15 of their submission.

⁶ This point is raised by the following parties - Vodafone - page 1, TCL – paragraph 5, Vector and 2 degrees page 1.

25. Further, the 'Access + Message' bundle is provided on a commercial basis by Telecom Wholesale. Telecom Retail does not offer an 'Access + Message' bundle, and there was therefore no regulatory obligation or back-stop incentivising Telecom Wholesale to offer the service. This shows that there are the right incentives in place for Telecom Wholesale to meet its customers' demands for this type of product bundle. As at September 2010, TCL had [] TNZCOI 'Access + Message' connections and Vodafone had [] TNZCOI. The price differential between 'Access + Message' and its individual components [] TNZCOI
26. Removing the bundled retail services from the Act will not remove Telecom Wholesale's incentive to provide bundled services, despite claims to the contrary.

Application of the LOI⁷

27. The concept of the LOI was introduced in New Zealand in 2006. Since then, there have been differing views about how the ladder should be applied. However, what is clear is that the LOI is not about keeping all layers of regulation in place in perpetuity.
28. As Professor Cave clearly states in explaining the operation of the LOI:
- "... it is not a policy of continuous 'easy access', but one of 'tough love' in which CPs are chivvied up the ladder by price incentives or the expectation of withdrawal of the more comprehensive access products corresponding to the lower rungs of the ladder."*
29. The literature suggests that, where regulators do not intervene to adjust the incentives for market entry once competition at a service based level has been established; operators and regulators can easily fall into the trap on the one hand of expecting, and on the other unintentionally perpetuating, incentives providing "easy access".
30. The LOI approach, as envisaged by Professor Cave⁸, adjusts incentives through a series of regulatory interventions. For example:
- New entrants are provided with appropriately designed short-term incentives to enter the market with a service based business model using wholesale products where they only fund limited elements of the value chain. Importantly, the regulator ensures those incentives are limited in duration;

⁷ This point is raised by the following parties - TCL – paragraphs 16 - 19, 24, 25 and 32-50, Vector – para 16-19.

⁸ e.g. *Snakes and ladders: Unbundling in a next generation world* Telecommunications Policy 34, 80-85 ; *Making the ladder of investment operational* Available at <http://www.ictregulationtoolkit.org/en/Publication.2916.html>

- In the long run market participants are incentivised to make efficient infrastructure investments, by removing earlier “rungs in the ladder”.
31. As Professor Cave notes, if comprehensive access products are too cheap, competitive investment will not materialise⁹. Intervention changes the emphasis between maximising static social welfare by price regulation, while providing market participants with sufficient incentives to invest efficiently and innovate. Absent these incentives, there is no reason for service-based competition to evolve into facilities based competition.

Draft Report proposals align with policy objectives

32. We understand that the Commission is appropriately cautious about not removing regulation until it is clear that it is no longer serving its purpose in promoting market entry and workable competition.
33. Resale regulation has been operational since 2003 and 2004, market entry has taken place, competition has emerged, and deeper and more effective wholesale equivalents are now available to access seekers. We think that there is good evidence that there is competitive pressure to promote investment and innovation at the relevant level of the market without the need for resale regulation. On this basis, we think the recommendation in the Draft Report is consistent with current Government and Commission policy.

Other issues raised in the submissions:

(a) The regulation does not impose a burden on Telecom, the industry or end users.¹⁰

34. It is easy for access seekers to argue that regulation imposes no cost on Telecom. But the reality is that the burden for Telecom, the industry and consumers include the uncertainty for all players and the potential for outcomes that are not in the long term interests of end users. There are also negative externalities, including the opportunity cost of innovation and investment – both at the service level, where “me too” competition trumps genuine innovation (i.e. by weakening Telecom and other service provider incentives) and by distorting incentives to invest deeper in the value chain.
35. Unnecessary regulation also sends negative signals to the industry and capital markets that are looking for indications of regulatory best practice and that where regulation is inappropriate it will be rolled back.
36. We agree with Vodafone that there is value in a comprehensive cost benefit or economic impact assessments to understand the true cost of

⁹ *Encouraging infrastructure competition via the ladder of investment* Martin Cave Telecommunications Policy 27, 717-727

¹⁰ This point is raised by the following parties: TCL – paragraph 5, Vector paragraph 7(e) and 15(d).

regulation and the benefits of rolling back regulation where it is no longer necessary. We think that a cost benefit analysis will clearly show that the cost of retaining regulation as a backstop outweighs any benefit – particularly where the evidence shows competition in the market.

(b) The view that Telecom Wholesale is reluctant to engage and hard to negotiate with.¹¹

37. We agree with Vodafone’s assessment of Telecom Wholesale’s incentives. Wholesale’s incentives are strongly weighted toward winning and retaining business; however this does not automatically ensure a meeting of the minds on every issue.
38. We would also emphasise that the Commission has decided to deregulate on the basis evidence of competitive alternatives and market developments rather than on the incentives or behaviour of Wholesale.

(c) Visibility of product lines.¹²

39. Finally, Telecom disagrees with TelstraClear’s suggestion that it does not understand what resold product lines fall within DSPL/RSPL product families. Telecom works with TCL each quarter to update and amend these Price Lists – a joint process that has been undertaken since 2005.

¹¹ This point is raised by Vodafone - page 2.

¹² This point is raised by TCL - page 14.