



**Submission in respect of the
Commerce Commission's Draft Report on
whether the Resale Services should be
omitted from Schedule 1 of the
Telecommunications Act 2001 (or if not
omitted, amended in some form)**

PUBLIC

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Introduction

- 1 We welcome the opportunity to provide feedback on the Commerce Commission's Draft Report on whether Resale Services should be omitted from (or amended in) Schedule 1 of the Telecommunications Act 2001 (the Act).
- 2 Telecom requested that the Commission initiate the Resale Investigation. We made this request because we believe that the Resale Services, as currently provided for in the Act, are a legacy of a very different regulatory regime and that they are no longer fit for their intended purpose or necessary. The Commission's draft report concludes that significant product and geographic markets are competitive or have equivalent Wholesale inputs available and that the scope of the resale regulation should be significantly reduced. The proposals send an important deregulatory signal – at a time when significant investment will be required to deliver next generation access networks.
- 3 Removing unnecessary regulation is consistent with international best practice. It is desirable to rebalance the regime and avoid the undesirable consequences of unnecessary regulation, including distorted commercial incentives and disincentives for investment and innovation. The real world consequence is a reduction in the efficiency and macro-level competitiveness of New Zealand's economy.

Our views

- 4 We are generally supportive of the direction taken by the Commission in its draft report and broadly agree with the conclusions it reaches. In particular we agree that:
 - (a) The local access (and associated services) markets are competitive in many urban areas and that equivalent wholesale inputs are available for broadband and data services;
 - (b) Three of the four Resale Services should be removed from Part 2 of Schedule 1 of the Act;
 - (c) The remaining regulation should:
 - (i) Be restricted to a specified set of services; and
 - (ii) Be subject to satisfaction of a separate market definition and competition test process;

(d) Recognition that a more precise market definition than applied in this investigation will be required if the Commission is ever required to apply the proposed regulation.

5 We also consider that the proposed service description for the “non price capped local access and calling” regulated service should be clarified, to reduce uncertainty as to its application. In its current form, the service description potentially includes a large number of value added services, and risks reducing service provider incentives to invest deeper in the value chain. We encourage the Commission to define more tightly the scope of this service and to limit the conditions under which it may be applied.

6 The remainder of this letter provides some more detailed comments.

The Commission’s analytical framework

7 It appears that the Commission has found a practical framework under which to assess whether the resale regulation should be removed or reduced in scope. By necessity the market definition and competition assessment are high level and we believe this is a pragmatic approach to take and proportionate to the issue at hand.

Market definition

8 The Commission proposes to apply what could be described as a macro level market definition in the draft report. It categorises the product markets as data, broadband and local access and it categorises geographic markets as national (for data and broadband) and metropolitan areas / rest of New Zealand (RoNZ) for local access.

9 We have no objection to the application of a high level market definition and competition assessment in the draft report. However, though fit for this purpose, it will not necessarily be suitable when considering whether to regulate or deregulate in other areas. It is likely, for example, that different geographic or product markets may be appropriate when deciding whether to apply the resale regulation (should the situation ever arise). Also, it is clear that a national or metro / RoNZ geographic market definition would not be appropriate for the backhaul or UBA competition assessments now in train.

10 The shift from nationally averaged resale based competition to localised infrastructure based competition (exchange level for UCLL / city by city for cable) necessitates a more granular approach when assessing the level of competition in these markets.

Competition assessment

- 11 The Commission proposes to remove the regulatory backstop for resale where there is either competing infrastructure or where substitute regulated wholesale products are available. It concludes that the regulatory backstop is no longer required for data and broadband services because there is competing infrastructure (UCLL / cable) and/or substitute regulated wholesale inputs. It concludes that retail metropolitan markets are broadly competitive for local access but that some local exchange areas within metropolitan markets (for example where there is no cable or UCLL presence) may not be competitive meaning more precise geographic market definitions would be necessary, should a determination arise.
- 12 We broadly agree with the approach and conclusions of the Commission's high level competition assessment. We accept that it is unwieldy to categorise the competitiveness of particular geographic markets in the primary legislation; however, we strongly advocate for limitations in the legislation as to how the regulation could eventually be applied. For example, the Commission should not regulate resale where there is competing infrastructure or the near-entry of competing infrastructure – be that cable, UCLL, fibre, mobile, or fixed wireless. We also agree that application of the regulation, if the need ever arose, should be subject to a separate specific competition assessment and that this would require a more precise (i.e. granular) market definition.

Remedies: changes to the Resale Services

- 13 We agree with removal of the three services and accept the need to retain residential and business local access and certain non-replicable services ancillary to these. However, as outlined above, we are concerned with the broad scope of the proposed new Resale Service and encourage the Commission to: (a) define the conditions on which this service should be offered more tightly and precisely; and (b) limit the conditions under which the service may be regulated. This is important from a policy (and ladder of investment) perspective and to provide investment certainty to all market participants. We include some suggested alterations to the proposed drafting below.
- 14 It is worth highlighting that this form of general resale regulation is uncommon and not evident at all in the UK and Australia, our most commonly benchmarked markets. If resale regulation is required then it must still provide strong incentives for all service providers to invest in and develop their own innovative ancillary services to basic line rental wherever feasible. We have previously accepted that the industry requires a regulatory backstop for a small number of these ancillary services. We remain open as to the specific number of services

but we continue to believe there are pro-competitive and pro-efficiency reasons to limit the scope of resale regulation beyond pure line rental as much as possible.

- 15 We would expect, should it ever be called upon to apply the regulation, that the Commission would carefully assess whether the service(s) in question is reasonably required to enable the access seeker(s) to compete effectively in the market in which Telecom faces limited, or is likely to face lessened, competition.
- 16 Finally, we note that the Commission's policy is to scale back regulation "where effective competition is present and that regulation should not impose or maintain burdens which are unnecessary". We fully support this policy and consequently encourage the Commission (and the Minister) to remove condition (b) – the effect of which appears simply to be to give the Commission a theoretical authorisation to ignore its own policy and regulatory best practice. To the best of our knowledge the Commission has never had cause to use this condition for resale or any other regulated service.

General comments

- 17 We welcome the Commission's draft report which, as noted in paragraph vi, delivers on a crucial aspect of its Statement of Intent. We encourage the Commission to be more proactive and systematic in considering de-regulation and actually rolling it back where appropriate in a timely manner – the telecommunications market place is very competitive, reinforced by the pro-competition incentives on Chorus and Wholesale. We encourage the Commission to consistently adopt a bias against intervention and to encourage / facilitate resolutions without the need for regulatory intervention.
- 18 Recently, in the context of the Commission's UBA competition assessment, we provided the Commission with detailed information about changes in the competitive landscape. This information showed a marked increase in wholesale level competition, brought about largely by UCLL entry, along with significant growth forecasts for the UCLL footprint. At a retail level this competition is manifested in the form of changing market shares, more services, at lower prices with greater flexibility and importantly, this competition increasingly bypasses Telecom's line rental services and resale completely.
- 19 In the Wellington region, for example, we estimate TelstraClear's local access market share at around 40%. This share is even higher for broadband and, bearing in mind the smaller footprint of cable, illustrates just how competitive the market is. The intensity of competition in this region will only increase as UCLL establishes itself. In Auckland, Vodafone now offers bundles with naked DSL and postpaid

mobile telephony that start as low as \$72. This offer illustrates how competition challenges traditional service constructs and highlights increasing fixed-mobile substitution.

Other matters

- 20 There are several matters touched on in the draft report which do not appear to have a material bearing on the Commission's conclusions and on which, in the interests of brevity we will not dwell on here beyond a couple of observations. These matters include:
- (a) The effectiveness of Telecom's Operational Separation Programme (including the competition impacts, if any, of variations to the Undertakings). The Commission seems to ignore the significant market impact of Telecom's operational separation model purely on the basis that it is subject to variation where agreed to by the Minister. Operational separation has fundamentally altered the incentives operating on Telecom's Wholesale unit, and the impact of this must be relevant to this investigation. The Minister may, of his own volition or on the recommendation of the Commission, unilaterally amend his Operational Separation Determination at any time should concerns arise about Telecom's operation of the Undertakings. Indeed, the Commission's own STDs are similarly subject to variation or clarification. There is nothing to suggest that the Minister would agree to a variation that was contra to the long term interests of end users.
 - (b) Without commenting on the underlying merit of the policy, successful application of the "ladder of investment" requires a credible up-front and ongoing commitment by the government / regulator if it is to have the desired effect. Absent this commitment and management the regulation can have the opposite effect – i.e. to deter progression "up the ladder". Steps being taken (notably in this report) appear broadly consistent with the policy but do not appear, of themselves, to qualify as a "credible commitment" to the policy (as advocated by Professor Martin Cave).
 - (c) The importance of structured and objective cost benefit analysis to good policy making, and clearly linking the CBA back to the regulator's underlying telecommunications regulatory principles and regulatory strategy (i.e. the ladder of investment).

Recommended changes to the Commission's proposed regulation

Non price-capped local access and calling service offered by means of Telecom's fixed telecommunications network

<p><i>Description of service:</i></p>	<p>A non price-capped local access and calling service offered by Telecom to end-users by means of its fixed telecommunications network, and required by Access Seekers to enable them in the following markets:-</p> <p>(a) all markets in which Telecom faces limited, or is likely to face lessened, competition for the service-</p> <p>(b) all, some, or no markets in which Telecom does not face limited, or is not likely to face lessened, competition for non price-capped business local access and calling service as determined by the Commission</p>
<p><i>Conditions:</i></p>	<p>That either—</p> <p>(a) Telecom faces limited, or is likely to face lessened, competition in a market for non price-capped business local access and calling service offered by Telecom to end-users; or and</p> <p>(b) Telecom does not face limited, or is not likely to face lessened, competition in a market for non price-capped business local access and calling service offered by Telecom to end-users, and the Commission has decided to require non price-capped business local access and calling service to be wholesaled Resale of the local access and calling service by an Access Seeker is required to enable that Access Seeker to compete effectively in the market in which Telecom faces limited, or is likely to face lessened, competition</p>
<p><i>Access provider:</i></p>	<p>Telecom</p>
<p><i>Access seeker:</i></p>	<p>A service provider who seeks access to the service</p>
<p><i>Access principles:</i></p>	<p>The standard access principles set out in clause 5</p>
<p><i>Limits on access principles:</i></p>	<p>The limits set out in clause 6</p>

<p><i>Initial pricing principle:</i></p>	<p>Either—</p> <p>(a) Retail price less a discount benchmarked against discounts in comparable countries that apply retail price minus avoided costs saved pricing in respect of these services, in the case of a service offered by Telecom in markets in which Telecom faces limited, or is likely to face lessened, competition for that service; or</p> <p>(b) retail price less a discount benchmarked against discounts in comparable countries that apply retail price minus actual costs saved pricing in respect of these services, in the case of a service offered by Telecom in markets in which Telecom does not face limited, or lessened, competition for that service</p>
<p><i>Final pricing principle:</i></p>	<p>Either—</p> <p>(a) Average or best retail price minus a discount comprising avoided costs saved pricing, in the case of a service offered by Telecom in markets in which Telecom faces limited, or is likely to face lessened, competition for that service; or</p> <p>(b) average or best retail minus a discount comprising actual costs saved, in the case of a service offered by Telecom in markets in which Telecom does not face limited, or lessened, competition for that service</p>
<p><i>Requirement referred to in section 45 for final pricing principle:</i></p>	<p>Nil</p>
<p><i>Additional matters that must be considered regarding application of section 18:</i></p>	<p>Nil</p>

In conclusion

21 We welcome the Commission’s Resale Investigation, this draft report and the preliminary conclusions that the Commission has arrived at. We encourage the Commission to continue and extend its focus on refining the regulatory regime to be more targeted. More generally, the fundamental changes in telecommunications markets - and to Telecom as an organisation - should be recognised through a reduced reliance on service specific ex ante regulation.

22 We do not believe that a conference is required (especially given all the other activity now underway) but of course will participate in one should the Commission conclude that one is necessary. In the interim we are available to discuss the content of this submission.