TELSTRACLEAR

Reply to Submissions on the Commerce Commission's Draft Report on whether resale services should be omitted from Schedule 1 of the Telecommunications Act 2001

PUBLIC

13 October 2010

1. This cross-submission provides TelstraClear's reply to the submissions made by Telecom, Vodafone, Vector and 2degrees on the Commission's draft report on the removal or amendment of resale services in Schedule 1 of the Telecommunications Act.

2. TelstraClear agrees with the other non-Telecom parties that the Commission should not take a decision to scale back resale before there is more certainty about the Government's UFB project, and in particular whether a structurally separated Telecom will end up as the major UFB provider. Accordingly. TelstraClear suggests that the Commission defer completion of its inquiry into resale services until mid-2011.

3. The future wholesale market is likely to look very different depending on whether an 'intact' Telecom is competing on its existing copper network against a wholesale-only third party UFB provider or whether the demerged Chorus2 is the monopoly provider of upstream inputs across copper and fibre. To take a few examples of potential issues which would be relevant to resale regulation:

    a. Would Chorus2 focus the initial UFB deployment in areas where the Telecom network had not already been cabinetised? This would have the effect of further truncating the geographic areas in which there is a copper-based ladder with rungs 'above' resale services. If this was the case, access seekers may not make further investment in DSLAMs and UCLL in those areas;

    b. How will responsibility for current resale services be allocated between ServiceTel and Chorus2? As the MED acknowledges in its structural separation paper, how the current Telecom Wholesale service portfolio is split between the demerged entities has important competition implications. This will be particularly the case if, as MED seems to propose, there will be no internal separation walls between self supply and external supply with each of the two new boxes. ServiceTel may emerge as a supplier of crucial PSTN resale services as well as retail PSTN services with virtually no separation requirements and limited equivalence obligations;

    c. There remains considerable uncertainty about which and how current retail and wholesale services will be supportable in a fibre environment. While many of these questions arise if the UFB is deployed by a third party, end users and access seekers would still have the alternative of the 'known world' of copper-based services which may not exist if Chorus2 is the main UFB provider. Decisions on whether the current resale services should be retained, withdrawn or amended, for example to become less technology-specific to copper, necessitates the Commission knowing how Telecom will approach the relationship between current copper-based wholesale services and future UFB, including whether:

        i. Would Chorus2 continue to operate the copper and fibre networks side by side or would retail and wholesale customers be required to migrate to the UFB network?

ii. How will Chorus2 and ServiceTel (if the wholesale provider of legacy layer 3 services) manage migration to ensure retail and wholesale customers – including those supported by resale services – are managed on a non-discriminatory basis?

iii. What will be the process for withdrawal of current copper-based services? TelstraClear expressed concern that one consequence of the wind back of resale regulation could be the loss of the current grandfathering rules and this issue would be even more significant if Chorus2 proposed to progressively withdraw current services in place of UFB services;

iv. How would Chorus2 support telephony-only end users on the new UFB? For example, would the Chorus2 active termination equipment (ONT) in the home have an analogue port which supports current end user telephone handsets and does not require additional wiring? Who will meet the costs of migrating these end users?

4. TelstraClear agrees with Vodafone and Vector that, in the meantime, the Commission has existing power to roll back resale regulation if current market conditions warrant, irrespective of the UFB uncertainty. In contrast to resale regulation in most other jurisdictions, the New Zealand service definition embeds competition criteria through condition (b). Using this existing mechanism to make more granular adjustments to resale regulation is a more prudent next step than the "all or nothing" approach of removing resale services from Schedule 1.

5. In its submission, Telecom argues for the removal of this condition:[1]

> *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.*

6. However, Telecom comes at this issue backwards. Telecom reaches the view that condition (b) is no longer appropriate only because Telecom assumes that the outcome should be the complete removal of resale services from Schedule 1. Further, the reason the Commission has had no cause to use condition (b) is because Telecom's retail market dominance has been so persuasive across product and geographic sectors. In the current 'in between' environment while we await the resolution of the UFB issues, condition (b) could, as we have said, come into its own.

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[1] Telecom submission, 24 September 2010, paragraph 16.

7. TelstraClear does anticipate that if a structural separation proceeds and Chorus2 becomes the main UFB provider, removal of resale services from Schedule 1 might form part of a larger package which addresses the issues set out above.

8. TelstraClear agrees with Vodafone that, as a test for resale wind back, a replicability test needs to consider not only technical but also economic replicability. We agree that access seekers can technically replicate most Telecom retail bundled offerings from the individual resale services which will continue to be regulated, but like Vodafone we find it difficult to match the prices of the Telecom retail offerings unless we have access to resale of the bundle. Many overseas regulatory regimes can operate if necessary to ensure access seekers can compete fairly in downstream bundled offerings using upstream inputs through their telecommunications-specific competition regimes. New Zealand does not have comparable retail level regulation and instead the ability to replicate retail level bundles on competitive terms needs to be addressed at the wholesale level in circumstances where replicability is not feasible using existing wholesale inputs or alternative infrastructure. .

9. Turning to Telecom's submission, Telecom makes two main arguments: first, that resale is a relic of the pre-unbundling era of regulation in New Zealand and second that the time has come to remove resale regulation to ensure access seekers keep climbing the ladder of investment.

10. On the first argument, Telecom's submission states:

> *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*[2]*...... 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.*[3]

11. Although Telecom has some basis for this view, unbundled access came to New Zealand much later than in all other comparable markets while the incumbent's deployment of fibre in the local loop – which has the practical effect of forestalling unbundled access – is happening much quicker than in most markets. Access seekers like Vodafone and TelstraClear have not 'squatted on the resale rungs' of the ladder of investment but where it is available and deployment is economic, have moved from resale to UCLL. However, the market that has developed in New Zealand means that access seekers will be more dependent on a mix between unbundling and resale services to compete against the incumbent's ubiquitous copper network than access seekers in other markets.

12. On the second argument that removing resale will encourage access seekers to climb the ladder of investment, Telecom says[4]:

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[2] Telecom submission, 24 September 2010, paragraph 3.
[3] Telecom submission, 24 September 2010, paragraph 14.
[4] Telecom submission, 24 September 2010, paragraph 20(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).

13. We agree on the principles. However, to make the investment needed to climb the ladder of investment, access seekers need to know what the rungs on the ladder above them are. But we currently do not know what the ladder looks like in the future because of the uncertainty surrounding the UFB project:

    - based on the original UFB announcements, dark fibre would have been a new rung on the ladder, which would have required access seekers to make substantial investment in layer 2 as well as layer 3 electronics. Now that UFB providers will have an access holiday for 10 years; and the dark fibre rung will not be there for most customers, there will be a need to plan around a layer 2 bitstream service which involves a very different investment profile. However, there are not enough details of the layer 2 service - speeds options, downchannel/upchannel capacity, level of QoS control - to do much detailed investment planning at this stage;

    - if Chorus2 becomes the main UFB provider, we don't know whether and for how long the copper network will be operated beside the fibre network, so we do not know whether the ladder will include copper and fibre products, whether there will be a single integrated provisioning process or separate processes which make it difficult for access seekers to operate across both Chorus2 platforms.