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Vector's submission on the Commerce Commission's Draft Report on whether resale services should be omitted from schedule 1 of the Telecommunications Act

Dear Rebekah,

Introduction

- 1 Vector welcomes the opportunity to submit on the Commerce Commission's (the **Commission's**) 'draft report on whether Resale Services should be omitted from schedule 1 of the Telecommunications Act 2001' (the **draft report**).
- 2 Vector's interests in the draft report are as a both a competitor and customer to Telecom and as a short-listed participant in the Government's Ultra Fast Broadband Initiative (the **UFBI**), where we have wider interests in the shape of the future regulatory environment.
- 3 Although Vector broadly support rolling back regulation where it is unnecessary to promote competition for the long term benefit of consumers, Vector believes that a robust and informed decision on resale regulation can not be made at this juncture given uncertainty over how Telecom will continue to be regulated in the near future. Accordingly, our primary submission is that the Commission delay its Schedule 3 investigation until there is greater clarity over these matters.
- 4 Without prejudice to this view, Vector also submits on the Commission's application of its competition assessment and ladder of investment framework.

The Commission should delay its Schedule 3 investigation

- 5 Vector submits that it is difficult for the Commission to make an accurate or robust investigation into the competitive benefits of resale regulation in the uncertain environment currently facing the telecommunications industry. There are too many unknowns relating to the future structure of the industry and regulatory policy applying to it and, as a result, too many assumptions need to be made by the Commission in its investigation.
- 6 Accordingly, this Schedule 3 investigation should be delayed until there is greater clarity over these outcomes.
- 7 This conclusion is based on the following reasons:
 - (a) Any decision on resale regulation at this juncture seems premature in light of the MED's current review of the regulatory implications of structural separation. If this regulatory policy is adopted then there are likely to be wide ranging impacts on the future application, or even need for, resale regulation. One such example is that applying retail-minus pricing to resale services may be inappropriate if these services are provided from a structurally separated Chorus2, meaning the initial pricing principles applying to resale regulation may need to be amended.
 - (b) Given structural separation is Telecom's choice, there is a great deal of uncertainty over whether the MEDs proposed new regulatory policy will apply. Furthermore, the industry has yet to submit on the MEDs proposal meaning it may change in any case.
 - (c) Competition assessments and regulatory decisions need to be informed by fact, not speculation over future market and regulatory outcomes. The Commission's competition analysis should seek to only reference fact based evidence or trends observed in today's markets and/or future outcomes that have a high degree of certainty.
 - (d) Ideally, the Commission should steer away from making decisions predicated on the likelihood of future legislative change (such as the removal of operational separation and EOI due to structural separation). The Commission needs to enforce the Telecommunications Act 2001 (the **Act**) as it stands today. If there is the potential for the Act to materially change in the near future then the Commission should seek to delay its decision until it has greater clarity.
 - (e) The cost to the industry of resale regulation lying dormant in schedule 1 is relatively low compared to the asymmetric risk of drawing the wrong conclusion over the future state of the industry and regulation. As the Commission concludes in its draft report, the cost of maintaining the

existing resale regulation is negligible, so there is no urgency to push regulatory change through.

- (f) There is a real possibility that the industry and Commission will incur unnecessary costs if resale regulation needs to be re-investigated at a later stage, particularly should competition or regulatory policy differ to that assumed by the Commission in its current investigation.
- 8 To illustrate these concerns, Vector provides two specific examples from the draft report of why a decision on resale regulation cannot be made in the current environment. The first relates to assumptions made on the future applicability of EOI to competition in data services and the second relates to retail minus pricing.
- 9 In its analysis of whether resale data services should be removed from schedule 1, the Commission states that the number of Separation Undertaking variations that Telecom has applied for (four to date) creates significant uncertainty over the future role of Telecom's EOI obligations in respect of the supply of commercial data services¹. If EOI is removed, then the Commission believes this could impair the ability of access seekers to compete with Telecom in the supply of retail business-grade data services. However, the Commission counter that the structural separation of Local Fibre Companies (**LFCs**) and potential separation of Telecom will alleviate the competition concerns relating to the removal of EOI obligations. Combining these arguments with the fact that Telecom faces competition for its HSNS and UPC data services and given low uptake of resold data services, the Commission concludes that there will be effective competition for data resale services.
- 10 As a preliminary observation, Vector agrees that competition to Telecom's commercial data services exists that may have flow on impacts to resale regulation, but this is limited only to areas close to the footprint of competing networks, like Vector Communication's fibre network. Competition for data services is by no means pervasive throughout New Zealand. Furthermore, we have concerns - shared by other market participants - over the difficulty and cost of securing non-regulated interconnection to Telecom's exchanges (e.g. connecting fibre to our client's equipment in Telecom exchanges), which may limit competition for these services.
- 11 More importantly, the Commission's line of reasoning illustrates why a decision on resale regulation cannot be made now. Specifically, our concerns are that:
- (a) Any assumption that lessens the applicability of EOI, due to uncertainty created by the sheer number of Telecom's variation requests, is purely speculative as the Minister has not yet made a decision on Telecom's latest variation request. Vector, and many other industry participants,

¹ Draft Report – Para 187

oppose the dilution of Telecom's EOI obligations, and have submitted to this effect in recent submissions to the Minister. It is our view that the retention of EOI will be important in protecting the benefits to competition achieved in the market to date. Accordingly, EOI must continue to apply and be enforced by the Commission as to assume otherwise sends a mixed signal to Telecom over the enforceability of its obligations.

- (b) As discussed above, structural separation is Telecom's choice - as a result, the Commission should place no reliance on this outcome in its competition assessment until Telecom actually makes this choice.
 - (c) The assertion that structural-separation of LFCs will alleviate the competition concerns that the EOI obligations were designed to address ignores the fact the LFCs will not provide competitive constraint to Telecom's *copper* network for some time (e.g. as it will take some time to build these network), regardless of who the Government's preferred partners are under the UFBI.
 - (d) The Commission's assumptions over EOI and structural separation imply legislative change. In our view, it is potentially dangerous to assume away key aspects of the Act in forming a view on competition under another part of the Act (being Schedule 3).
 - (e) A schedule 3 competition assessment needs to be based on fact; on observable competition and trends, not on future industry events that may or may not eventuate.
 - (f) There is no certainty over the timing of these future impacts if they do indeed eventuate. If the Commission's assumptions prove correct than the timing of resale deregulation should coincide with the assumed events taking place. This would suggest that this schedule 3 investigation should be delayed until that time.
- 12 The second example of why the Commission can not make a robust decision on resale service regulation relates to the uncertainty created by the MED's review of the regulatory implications of structurally separation. Specifically, the MEDs consultation assumes that resale services will be provided from the structurally separated Chorus2. However, the initial pricing principle applying to most regulated resale services is retail minus. Given the MED has rejected retail minus pricing on UBA on the grounds that Chorus2 will no longer be a retailer it would follow that retail minus should not be applied to resale services offered by Chorus2 either.

The competition test should fall under a Part 2 determination not under a schedule 3 investigation

- 13 The Commission's draft view is that maintaining resale services on the schedule 1 list provides an effective regulatory backstop for commercial negotiations, but

the need for this backstop is removed where effective competition for resale services exists.

- 14 Vector agrees. However, we propose that a better approach is for the Commission to make its competition assessment on specific resale services under a Part 2 determination rather than under a Schedule 3 investigation.
- 15 Each of the four resale service definitions within Schedule 1 contains an explicit competition test that the Commission can already use in preference to the relatively more blunt and broad assessment under a schedule 3 investigation. In Vector's view, applying the competition test as part of a determination is preferable as:
- (a) *the risk of incorrectly assessing the state of competition for a specific resale service is lower* - The breadth of resale services covered under schedule 1 is large and a competition assessment under a Schedule 3 investigation is likely to be too broad to accurately provide for specific factors impacting specific resale products. By contrast, a focussed competition test applied to a specific resale service under a Part 2 determination is likely to be lower risk.
 - (b) *it best allows for geographic exemptions to be accounted for* - as the Commission acknowledges itself²
 - (c) *it is a lower cost approach, given it is more targeted, then undertaking regular schedule 3 investigations that cover all resale services.*
 - (d) *the net benefit in removing resale services from schedule 1 is small compared to the cost of incorrectly applying the competition test* - The cost to the Commission and Telecom of having resale services laying dormant in schedule 1 is negligible compared to the potential safeguard it provides service providers, particularly when accounting for the asymmetric risks of drawing the wrong competition conclusions.

Ladder of investment arguments

- 16 At the beginning of its draft decision the Commission outlines the ladder of investment regulatory framework, which asserts that there should be regulatory protection at each level of investment such that service providers can climb the rungs of the value chain as their market share grows.
- 17 The Commission's decision to remove certain resale services from schedule 1 appears to be inconsistent with this framework as it potentially weakens the first rung of investment. Whilst it may be true that service providers have a current preference for unbundled or commercial wholesale services (the second

² Draft report – para 55-57

rung) over resale services (the first rung)³, maintaining that first rung under this framework is important to facilitate the new entry of service providers without sufficient scale to unbundle.

- 18 Current demand for resale services should therefore not be a material consideration in the Commission's schedule 3 investigation. Rather, the Commission should consider whether retaining a resale service in schedule 1 best facilitates the entry of a new service provider that would not otherwise have the scale to invest in unbundled bit stream.
- 19 The Commission has also not asked the obvious question of why commercial resale services are so unattractive. This can partly be explained by the relatively recent ability to unbundle. However, if resale services were priced and specified attractively then the Commission would expect a greater proportion of service providers to show a preference for resale. This would be expected as an efficient investment outcome given the diverse scale of service providers. Indeed, it is possible that the current regulatory backstop is insufficient and needs to be strengthened. For example, the initial pricing principles may not be generous enough relative to unbundled bit stream prices and may need to be recalibrated accordingly.

Contact Details

- 20 Vector would be happy to expand on any of the points raised in this submission if that would be helpful. Please contact Aaron Webb in the first instance, at aaron.webb@vector.co.nz or on 09-978-8288.

³ Ibid – para 176, 188