



**Vector Limited**  
101 Carlton Gore Road  
PO Box 99882, Newmarket  
Auckland, New Zealand  
[www.vectornetworks.co.nz](http://www.vectornetworks.co.nz)  
Corporate Telephone  
+64-9-978 7788  
Corporate Facsimile  
+64-9-978 7799

Chris Abbot  
Commerce Commission  
PO Box 2351  
Wellington

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## **SUBMISSION ON TELSTRACLEAR BITSTREAM APPLICATION STATEMENT FOR CONSULTATION**

### **Introduction**

1. This letter constitutes Vector Communications' ("Vector") submission on the Commerce Commission's ("Commission") statement for consultation on the TelstraClear bitstream application ("paper", "proposal"), published by the Commission on 12 October 2005. Vector appreciates the opportunity to make this submission.

### **Request for confidentiality**

2. Vector seeks confidentiality for parts of this submission contained in square brackets. This information should be withheld under section 9(2)(b) of the Official Information Act 1982. Vector submits that the withholding of this information is necessary because the making available of that information would unreasonably prejudice Vector's commercial position.

### **Summary of views**

3. Vector has serious concerns with the Commission's proposal. In our view, if implemented, it will undermine the position of companies trying to compete with Telecom at the network level, both currently and in the long term, by severely damaging incentives for new entrants (as well as Telecom) to build and extend new network infrastructure.

4. This, in turn, will decrease the likelihood of achieving the Government's goal of New Zealand gaining and maintaining an upper quartile position for broadband uptake in the OECD by 2010. It is only through significant new network investment from both the incumbent and new entrants that New Zealand will be able to catch up and keep pace with the rest of the world in the digital age.

5. In Vector's view, long term benefits to consumers will be much greater from network level competition than retail competition based on reselling the incumbent's regulated services. The Commission's proposal effectively trades off those small short term competition gains in the retail market for a loss of future competition at a wholesale level (through competing networks). Such an approach is inappropriate, as it focuses too much on static efficiency benefits, without giving due consideration to dynamic efficiency detriments, which are significant. It is also important to note that this principle is not restricted to fixed networks, but is equally applicable to wireless and cellular networks – innovation and investment over the long term are driven by competition, not regulation.

## **Vector Communications**

### About the business

6. Vector Communications is an independent owner, operator and wholesaler of open access fibre networks in Auckland and Wellington, providing connectivity for an IP based broadband network from Albany to Manukau in Auckland, the Wellington CBD to Petone, and between Auckland and Wellington.

7. Vector Communications:

- provides true broadband services in, and between, Auckland and Wellington;
- delivers services over a 320km fibre-optic network;
- offers a top quality, high speed service at a competitive price;
- partners in an open-access model to deliver to customers a wide range of services;
- currently provides backhaul services to mobile and wireless businesses;
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8. Similarly, the New Zealand Government's has set the goal of New Zealand being in the top quarter of the OECD for broadband uptake by 2010. Given the growing uptake of broadband throughout the OECD, it is important to understand that the "top quarter" target is constantly shifting and is not a static goal.

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### **Government objectives with respect to broadband**

10. As noted above, a key goal of the Digital Strategy, published by the Government in May 2005, is for New Zealand to be in the top quarter of the OECD for broadband uptake by 2010. However, the latest figures released by the OECD show New Zealand ranked 22 out of 30, with broadband uptake (6.9%) well below the OECD average (11.8%). If New Zealand is to turn this trend around (noting that the goal posts for the "upper quarter" are constantly moving and New Zealand is currently falling further and further behind), significant new infrastructure investment is required. It is important, therefore, that incentives for such investment and network level competition are enhanced, rather than impaired. In our view, the Commission's proposal runs contrary to this principle.

### **Network competition – cornerstone of broadband uptake**

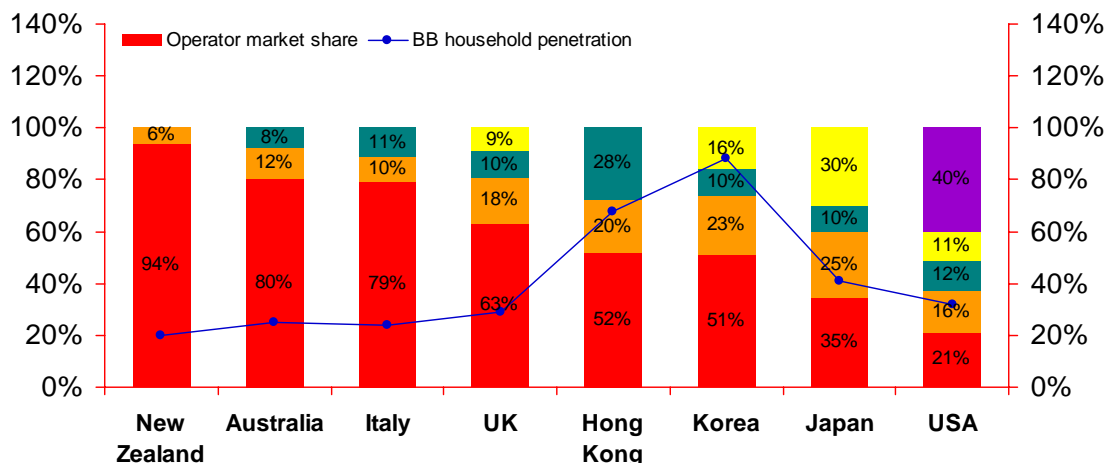
11. Vector accepts that, in the short term, the Commission's proposal will enhance competition in the retail market for reselling Telecom's wholesale services. However, international experience shows that this is simply not enough to facilitate

rapid uptake of broadband. That uptake is driven much more by competition at the network level against the incumbent, rather than retail competition based on reselling the incumbent's wholesale offerings.

12. Even if the short term increase in retail competition, resulting from the Commission's proposal, creates a growth spurt to move New Zealand into the top quarter, this will not be sustainable over the long term without significant innovation and investment in infrastructure. As technology develops and data exchange speeds increase, the definition of "broadband" may well be different in 2010 to what it is today.

13. Vector notes that competition for the provision of broadband in New Zealand is very low relative to a number of other OECD countries (as demonstrated in the graph below). In many of the markets illustrated below, vigorous competition is developing between telecommunications companies (providing xDSL) and cable companies (providing fibre and cable television), with both types of companies converging on providing fibre to the home. New entrants, competing with the incumbent at the network level are a key driver of these developments. It is, therefore, critical to ensure that New Zealand provides the right incentives to new entrants. However, as discussed below, the Commission's proposal can be expected to slow the emergence of competition at the network level, significantly delaying for New Zealand consumers the benefits currently being enjoyed by many of their counterparts in the OECD.

**Broadband market share and penetration of selected countries 1Q05**



Notes:

1 "Operator" refers to incumbent telecommunications network operator

2 Figures for UK, USA, Italy and Korea as at 2Q05.

3 Figures for NZ estimated as at 2Q05.

Source: Informa, Point Topic, Spectrum.

## **Commission proposal undermines market position of new entrants**

14. Vector is concerned that the Commission's proposal will undermine the market position of new entrants. The underlying reasons for this (discussed in more detail below) relate to two key aspects of the Commission's proposed design for regulation for bitstream access:

- increasing the speed of the service and setting a single, undifferentiated price; and
- requiring the regulated service to be available nationwide, even where competing networks are present.

### Increasing the speed of the service and setting a single, undifferentiated price

15. In its local loop unbundling (LLU) report<sup>1</sup> the Commission recommended the designation of a set of services, which were carefully defined to limit the extent to which their regulation would erode incentives for investment in future broadband services. For example, in relation to the bitstream service the Commission stated (paragraphs 804 –806):

"The Commission has modelled the bitstream access service based on Telecom's current JetStream products. In terms of potential dynamic efficiency gains, the Commission distinguishes between the effects of designating access to:

- (a) An ADSL bitstream access service which does not incorporate the future features and functionality of Telecom's NGN network, such as video over DSL services; and
- (b) Business grade quality of service bitstream services that would enable access seekers to share the benefits of the future features of Telecom's NGN.

The Commission considers that the direction and magnitude of dynamic efficiency effects from designating access to bitstream service differs between these two cases, and that they depend upon the precise way a bitstream access service is specified.

In its assessment of dynamic efficiency, the Commission concludes that availability of an ADSL bitstream access service is likely to encourage innovation through greater competition. Compared with reselling an access provider's end-to-end retail service, such a service would allow access seekers increased flexibility to offer different product types e.g. products with unlimited download caps. As the scope of the service would not encompass the future features of Telecom's NGN, the Commission considers the potential investment risks for Telecom would be lower compared with a higher quality of service product."

16. However, in the design of the technical specifications of the bitstream access for this determination, the Commission appears to be focusing entirely on connection speeds that are possible from a technical perspective, and product specifications that would be most desirable to promote retail competition. The Commission appears to have lost sight of the very important trade-off it is making

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<sup>1</sup> "Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network Final Report Public Version", Commerce Commission, December 2003

in this determination (and as reflected in the LLU report) between promoting retail competition now (static efficiency) relative to preserving incentives for investment in future and improved networks (and the emergence of competition at the network level – dynamic efficiency). The proposed bitstream service would compete with many of the services that are able to be delivered over other delivery systems (e.g. fibre) in a much more substantial way than envisaged in the LLU report.

17. The implications of this approach for investment incentives are compounded by the Commission's proposed single, undifferentiated wholesale price for the service. The Commission justifies its single price on the basis of the costs of supplying the service, namely (paragraphs 23 – 26):

"The key driver of variable costs to deliver an internet-grade best-efforts service is the SIR. TelstraClear has requested an averaged SIR based on Telecom's own SIRs averaged across its network. For this reason, the Commission is satisfied that there would be no material difference in the variable cost of delivering a regulated bitstream service to TelstraClear rather than Telecom providing a datastream to itself.

Telecom provides internet-grade best-efforts Jetstream services with the equivalent quality of service characteristics to both residential and business customers. The costs to deliver the network components of the service to either a residential or a business end-user will be the same. Different retail pricing is likely to reflect differing demand elasticities between different customer types rather than any network cost differentials. Telecom has not argued that, notwithstanding its current differentiated business and residential Jetstream pricing, the pricing for either customer type is insufficient to recover its fixed and common costs of delivering those Jetstream services.

Faced with differing demand elasticities, and with the need to efficiently recover its own common costs, the provision of a uniform wholesale price for the unconstrained bitstream service will not remove incentives for TelstraClear to product differentiate and price discriminate in the retail market.

The Commission will require that Telecom provide the bitstream access service to TelstraClear at a single uniform wholesale price irrespective of the ultimate end-user of the retail service provided by TelstraClear."

18. The Commission appears to accept the presence of differing demand elasticities (and the implication of that for the desirability of differentiated retail prices) but does not make the link between that and the desirability of differentiated wholesale prices. It notes that a single undifferentiated price would not remove TelstraClear's incentives to product differentiate and price discriminate in the retail market. While it may not remove this incentive (which is debatable), it is likely to remove its ability to do so, if other retailers are able to access the same wholesale terms.

19. Importantly, there is no mention, in the Commission's report, of the implications of a single undifferentiated price for the ability of other network providers to differentiate their prices (either at the wholesale or retail levels). In Vector's view, this is a major oversight, and strengthens our concern that the Commission has, in the pursuit of retail competition, lost sight the implications for network investment and network competition.

### *Recommendations*

20. Vector recommends the Commission reconsider the technical specifications of the regulated bitstream service and the proposed undifferentiated single price, with respect to their implications for diminishing investment incentives for entrants to invest in higher speed competing network services. Vector recommends the Commission restrict the connection speed for this regulated service to a relatively modest internet-grade level described in the LLU report, and that in all cases the wholesale price be defined with reference to the retail price for the same retail service (e.g. that the wholesale price be differentiated with respect to speed, customer type or geography to the extent that the retail service is differentiated)

#### Requiring the regulated service to be available nationwide

21. Vector is concerned that the Commission has concluded the market for bitstream services is national in geographic terms. This conclusion appears inconsistent with the Commission's findings for other wholesale access services (e.g. in Decision 497) and the market definitions used in the LLU report and has substantial implications for potential network competition.

22. Network competition, due to its technical nature, proceeds on a geographical basis, but the Commission does not recognise this in its market definition. The draft determination, and the proposed implementation, has no mechanism for rolling back regulatory intrusion as competition emerges. The likely result is the continued need for regulation and inferior service provision, whereas in many areas competition would have otherwise emerged.

### *Recommendations*

23. Vector recommends the Commission reconsider its conclusions on market definition and the requirement that regulated bitstream service be made available where network competition exists. Vector also recommends that, in addition to restricting the connection speed for the regulated service to an internet-grade level, the Commission should not require the service to be made available in geographic areas where there are competing network providers to the Telecom service.

## **Conclusions**

24. Vector is concerned that the Commission's proposal reflects a singular focus on the desire to promote retail competition and, if implemented, would come at the cost of the development of competing broadband networks.

25. In Vector's view, long term benefits to consumers will be much greater from network level competition than retail competition, which is reliant on reselling the incumbent's regulated services. The Commission's proposal would effectively trade off small short-term gains in the retail market for a loss of future network competition. Vector recommends the Commission reconsider the specification of the proposed regulated bitstream service, the proposed single undifferentiated price for this service, and the requirement that it be made available even where competing networks are present, with a view to ensuring this determination does not inadvertently delay and discourage investment in competing network infrastructure.

### **Closing comment**

26. Thank you for considering this submission. Should you require further assistance, please contact Anton Murashev, Vector's Regulatory Analyst, in the first instance, ([anton.murashev@vectornetworks.co.nz](mailto:anton.murashev@vectornetworks.co.nz); 021 273 0709).

Kind regards

A handwritten signature in black ink, appearing to read 'Simon Mackenzie', written in a cursive style.

**Simon Mackenzie**  
Divisional CEO, Technology