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Daniel Vincent
Commerce Commission
Wellington

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Dear Daniel,

Re Unbundled bitstream access (UBA) price calculation – Telecom request for clarification interested party submissions (public version)

The Commerce Commission has sought submissions on Telecom's proposed amendments to the UBA price list. Specifically, Telecom is seeking to have the regulated UBA price, currently determined on a retail minus basis, to be calculated only from retail prices prevailing in areas where the UBA continues to remain a regulated service.

We support the unwinding of regulation where it is no longer warranted. However, Telecom's proposal for UBA pricing has the potential harm UCLL competition. There is the risk of Telecom aggressively pricing its UBA service in deregulated areas and foreclosing UCLL providers access to markets before they have become a meaningful competitive presence in deregulated ESAs.

Vodafone has unbundled in [] of the 51 exchange service areas (ESAs) the Commerce Commission proposes to remove UBA regulation for. We currently service [] customers (including at wholesale) from our UCLL investments. We serve [] customers on non-cabinetised UBA in those areas.

Considering Vodafone's naked DSL broadband offerings provided over UBA and UCLL shows that we currently earn [] margin for naked DSL supplied over UBA and [] margin on naked DSL offered over UCLL. Vodafone earns a [] margin on clothed UBA versus a [] margin on voice plus DSL broadband offered over UCLL. There is a real risk that the UCLL margin will contract relative to UBA to the detriment of UCLL unbundlers in deregulated ESAs if Telecom's proposal is accepted. Such an outcome presents a real commercial challenge for UCLL providers and for future unbundling.

Adopting Telecom's changes to the UBA retail minus methodology will discourage further UCLL competition. UCLL has brought significant benefits to end-users in terms of competitive pricing and services innovation. The potential harms possible from Telecom's proposed approach to UBA pricing will damage UCLL competitors and therefore the change is not in the long term interests of New Zealand end users.

In terms of transitioning to a deregulated UBA market an approach consistent with the Australian Competition Tribunal's approach for unwinding regulation on an ESA-by-ESA basis provides certainty that UCLL competitors are in fact an effective competitive constraint for UBA in deregulated ESAs. We explain this further below.

Background

The Commission's section 30R review of the UBA service under the *Telecommunications Act 2001* draft decision recommended the unwinding of regulation in ESAs for the UBA service where there are either:

- (a) Two or more Competing Providers (defined to include both UCLL providers and HFC providers) present or
- (b) One UCLL-based Competing Provider is present and the exchange will serve at least 6,500 non-cabinetized lines (after the deployment of cabinetization is completed).

Vodafone supported the Commission's initiative to undertake this competition review and to recommend the unwinding of regulation where it is no longer warranted.

Telecom's proposal

Telecom submits its proposal for de-coupling the wholesale UBA service from retail prices prevailing in deregulated areas does create some concern, namely:

- A potential risk that Telecom could inflate prices in regulated ESAs by increasing retail level prices (with flow through to wholesale prices) and/or
- A perceived risk that Telecom could price wholesale services in deregulated ESAs to the detriment of UCLL competitors.

Telecom submits that such risks are unlikely to materialise because there would be competitive pressures from competing ISPs and the possibility of UCLL entry. For the reasons outlined below, we have reservations about Telecom's assertion that there are effective constraints on it from acting in the manner described above (particularly in relation to deregulated ESAs).

Telecommunications (TSO, Broadband, and Other Matters) Amendment Act and supplementary order paper (SOP) 204.

The current circumstances surrounding the future of fixed-line regulation will materially change UCLL entry into ESAs.

The SOP proposes to average the price for the UCLL service. The SOP will also change the methodology of the regulated UBA from retail minus to cost plus after a three year transition. The uncertainty on the passage of the proposed legislative amendments and, if implemented, the resulting changes to UCLL and UBA pricing as a result of the amending legislation will cause a "chill" on competitive unbundling beyond current investment plans from competing infrastructure providers.

While Telecom's assertion of UCLL entry being a constraint does have some validity, the current uncertainty and proposed changes to UCLL service terms will blunt the competitive impact this service will impose on Telecom. The effective increase to UCLL pricing from averaging will detract and may even effectively kill the current business case for investing in UCLL in some areas.

The Commission submission to the Finance and Expenditure Select Committee warned of the impact resulting from an increase of UCLL prices from averaging in combination with a foreshadowed decrease to UBA prices resulting from moving to a cost plus methodology as proposed by the SOP.

"The combination of the increase in the urban UCLL price with the decrease in UBA price will further erode access seekers' margins in the wholesale market, since they purchase UCLL add electronics to compete with UBA. This will have a detrimental effect on competition in the copper-based broadband market."¹

¹ Commerce Commission, Submission to the Finance and Expenditure Select Committee, p. 14 (par 72)

'Relativity between UBA and UCLL'

The pricing principles for UBA requires the Commission to consider the relativity between UCLL and UBA pricing. The relativity of the price terms between these two services, in part, informed the business case for providers that have invested in UCLL. Telecom has previously attempted to frustrate access to UCLL from its 'loyalty offers' that were deemed by the Independent Oversight Group on 27 August 2009 to be a breach of Telecom's operational separation undertaking regime.

De-coupling UBA wholesale prices from deregulated ESAs does give Telecom the opportunity to aggressively price its UBA service-to the detriment of UCLL providers in such ESAs. Given Telecom's previous form in this area we suggest the Commission must be cautious in enabling circumstances for Telecom to engage in similar conduct again.

ESA deregulation in Australia

As the Commission's section 30R draft decision noted, the Australian Competition and Consumer Commission (ACCC) also engaged in a similar ESA by ESA geographic analysis when issuing Telstra (the incumbent operator) with Exemption Orders under the *Competition and Consumer Act* (formerly the *Trade Practices Act*) from supplying the regulated wholesale line rental (WLR) and local call service (LCS) in ESAs in that country. The ACCC decided to unwind regulation in ESAs that had:

- (a) 14,000 addressable services in operation (SIOs), addressable SIOs referring to lines not affected by CMUX/RIM pair gain systems or
- (b) 4 or more ULLS competitors including Telstra within an ESA.

The competition test used in that instance has significant parallels to the Commission's draft decision. However, the ACCC's final decision was subsequently appealed to the Australian Competition Tribunal² (the ACT) which revised the Exemption order to the following criteria:

- (a) Three or more ULLS-based competitors;
- (b) an aggregate market share equal to or greater than 30%; and
- (c) ULLS Spare Capacity equal to or greater than 40% of the aggregate number of WLR lines in that ESA.

According to the Tribunal,

"the purpose in introducing the second limb is to enable the Tribunal to be satisfied that the ULLS-based competitors who have entered an ESA are likely to be commercially meaningful competitors who can constrain Telstra in the long-run."³

The second limb in the ACT test for removing regulation is to ensure exchange based competitors are able to impose an effective constraint on Telstra (the incumbent). Similarly we suggest that ensuring competitors are an effective competitive constraint on Telecom in deregulated ESAs addresses the risks raised by Telecom that could occur as a result of decoupling the UBA price from deregulated areas.

The Commission should consider an equivalent approach to deregulation of ESAs in New Zealand. This is particularly relevant given the relative infancy of UCLL access in New Zealand compared to Australia and the continuing reduction in the addressable market for UCLL resulting from Telecom's cabinetisation program, a feature that is not prevalent in the Australian market.

² Application by Chime Communications Pty Ltd (No 3) [2009] ACompT 4 (24 August 2009)

³ Ibid, par18

Alternatively, the Commission only remove from its retail minus methodology those ESAs where UCLL providers do have an aggregate market share of 30% to mitigate against the likelihood of the concerns specified by Telecom from actually materialising.

Conclusion

We support the continuation of the current approach of determining the UBA price from both regulated and deregulated areas. Alternatively, the Commission only immunise ESAs from the calculation where UCLL unbundlers have an aggregate market share of 30% or greater.

The risks identified by Telecom from scenario one in its example are not remote or fanciful. And they are heightened by the current uncertainty surrounding future copper service regulation, Telecom's history of manipulating access terms to discriminate against UCLL providers and international experiences with geographic deregulation on an ESA basis.

If you have any further questions in relation to anything in this letter please contact Kelvin Binning, Senior Public Policy Advisor by email at kelvin.binning@vodafone.com or by phone on 021 224 6636.

Yours sincerely,



Kelvin Binning
Public Policy
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