



**RESPONSE TO COMMISSION  
CONSULTATION ON THE REVISED DRAFT  
UBA COMPETITION REVIEW**

PUBLIC VERSION

6 July 2011

## **CONTENTS**

A	EXECUTIVE SUMMARY .....	3
B	INTRODUCTION .....	4
C	MARKET DEFINITION .....	4
D	COMPETITION ASSESSMENT .....	6
E	REGULATED UBA PRICE CALCULATION .....	10
F	CONSEQUENTIAL CHANGES TO THE STD .....	11
G	IMPLEMENTATION & FUTURE REVIEW .....	11
	APPENDIX A – ESTIMATED RETAIL MARKET SHARES IN WELLINGTON REGION .....	13

## **A EXECUTIVE SUMMARY**

- 1 We welcome the opportunity to respond to the Commission's revised draft conclusions on the UBA Competition Review. The Commission has made some significant changes to its approach since its earlier consultation. We support the majority of the Commission's conclusions.
- 2 Deregulation is a key feature of a pro-competition regulatory policy - just as important as regulation, if not more so. To that end, we support the Commission's decision to re-consult on its proposed methodology.
- 3 We are concerned though, that the proposed criteria result in a significant reduction in the number of exchange areas which should be deregulated compared to the previous draft, or compared to the test that is applied by Ofcom in the UK.
- 4 We believe the Commission's proposed methodology can be improved to better reflect the different indicators of competition that exist for different exchange service areas (ESAs).
- 5 This would address what we consider are counter intuitive outcomes of the Commission's proposed methodology - whereby ESAs with a large number of competing operators are not deregulated, and nor are ESAs where Telecom has lost considerable market share but where this competition comes from only one competitor (eg cable).
- 6 Rather than requiring two concurrent criteria to be satisfied, as proposed by the Commission (number of operators *and* market share), we believe that it is more appropriate to establish primary and secondary criteria (number of operators *or* market share) as alternatives, either of which must be satisfied for an ESA to be deregulated.
- 7 We agree that retail prices in deregulated areas should not influence the regulated UBA price in areas which continue to be regulated. Deregulated areas have different characteristics to regulated areas. Linking prices between the two areas creates an effective cross-subsidy requirement on Telecom in favour of access seekers, as well as reducing the 'economic headroom' for wholesale competitors to compete in the regulated areas.
- 8 We continue to consider that quarterly data-only updates are needed to ensure the market assessment remains accurate over time. The Commission should also review the status of mobile and fibre broadband services annually with a view to including them in the scope of the review as they become substitutes.
- 9 Recent changes to the Telecommunications Act (**Act**) mean that the UBA price would effectively be frozen in the event of a demerger of Telecom from separation day for a period of 3 years. The Commission will also face limitations on its section 30R review powers in respect of the UBA STD, except in limited circumstances, from separation day for a 3 year period. This current review should take into account the potential impact of such changes.
- 10 While the Commission will no longer update the UBA price on an ongoing quarterly basis under the above legislative changes, we consider that changes to the STD should be made to ensure that areas where

deregulation is appropriate continue to be carved out from the application of the STD. There is no reason why the Competition Assessment needs to be carried out only by way of a s30R review. Accordingly, we propose that the quarterly Competition Assessment mechanism is implemented into the General Terms of the STD now rather than relying on the Commission's s30R review power in future.

- 11 However, as those legislative changes are triggered by the demerger of Telecom, we consider that in the meantime the Commission should link the implementation of the UBA Competition Test with its parallel review of the UBA Pricing methodology. If the Commission is not able to coordinate the timing of the reviews it should recalculate the UBA price when it implements the Competition Assessment to remove the influence of deregulated areas on the final UBA price.

## **B INTRODUCTION**

*Deregulation is an essential part of a pro-competition regulatory policy*

- 12 Regulation that is put in place to stimulate competition should be wound back when competition is established in order to enable the market to deliver benefits to end-users. Professor Martin Cave points to the importance of deregulation of lower rungs of the Ladder of Investment to wind back regulation as competition develops. Failure to remove regulation risks distorting the market.

*Implications of the recent changes to the Telecommunications Act*

- 13 We note that, under recent legislative changes, the UBA price will effectively be frozen for a period of three years where Telecom structurally separates.
- 14 A further change to the Act restricts the Commission's powers to conduct reviews under section 30R in respect of UBA STD for a period of three years from separation day.
- 15 The Commission is currently conducting its UBA Competition Assessment under its s30R powers. However, there is nothing requiring the Commission to only use its s30R powers for such reviews. We consider that it is important to continue to implement the Competition Assessment mechanism, with or without a demerger, to ensure only areas where there is limited competition are subject to the scope of the UBA STD. Accordingly, an appropriate alternative mechanism to a s30R review would be to include a mechanism within the General Terms of the STD itself as part of the current review.

## **C MARKET DEFINITION**

*The Commission's revised proposals*

- 16 In its first draft the Commission concluded that the relevant markets in which the UBA Service is supplied were:

- (a) the wholesale markets for broadband access in each of Telecom's exchange service areas; and
  - (b) the wholesale market for broadband access in cabinetised areas.
- 17 The Commission has reconsidered its view based on submissions received and in the revised Draft Decision (**revised draft**) the Commission's view is that the relevant markets are:
- (a) Relevant product market: broadband lines includes both cabinetised lines and non-cabinetised lines; and
  - (b) Relevant geographic market: remains each ESA.

*Functional, Customer and Geographic Dimension*

- 18 We continue to support the Commission's unchanged conclusions on the functional, customer and geographic dimension.

*Product Dimension*

- 19 We continue to support the inclusion of the cable network within the relevant product market. Cable broadband acts as an indirect constraint at the Wholesale level due to the possibility of switching by end-users in the downstream retail market.

*ESA based wholesale markets*

- 20 The Commission's proposal to include both cabinetised and non-cabinetised lines within the same ESA is a pragmatic approach in this instance. It reflects the nature of retail competition in the market, simplifies the review process and provides greater transparency on which areas are deregulated. We support the Commission's proposal based on the current market conditions.

*Mobile as a substitute*

- 21 New Zealand enjoys some of the world's fastest and most ubiquitous mobile broadband networks and mobile network based services are increasingly a realistic substitute for fixed network based services. Further, the use of the Vodafone network to deliver high speed broadband services wirelessly indicates the acceptance of wireless broadband services<sup>1</sup>.
- 22 A recent IDC report<sup>2</sup> predicts mobile-only households will grow to 14% by 2015 with mobile broadband substitution being a significant driver. IDC states there were 34,000 mobile-only broadband households in New Zealand in 2010 and predicts this will rise to 118,000 in 2015. Telecom has seen significant increases in mobile broadband usage in some

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<sup>1</sup> <http://www.vodafone.co.nz/about/media-centre/rural-broadband-initiative/our-initiative/>

<sup>2</sup> IDC, Top Ten Predictions for Ultra-Fast Broadband Initiative – fibre-fed; service-slim. May 2011

market segments already and we anticipate that it will become a viable substitute for wider consumer segments in due course. While the Commission may conclude it is too soon to include mobile as a substitute for UBA, it should ensure its approach is sufficiently flexible to recognise wireless based competition as it develops.

- 23 Care needs to be taken when using EU data on mobile substitutability as an indicator for the New Zealand market as the markets are not directly comparable due to differences in fixed and mobile broadband network availability, relative pricing, regulation etc.
- 24 We encourage the Commission to keep an open mind on this issue going forward as both the bitstream and mobile markets develop.

*Fibre as a substitute*

- 25 Similarly, the Commission should be clear on how it expects fibre based broadband services will be captured within the market definition. Providers (existing and new entrants) will be using the new common fibre access infrastructure to build their broadband services. These are likely to be substitutes (either fully or asymmetrically) for the existing bitstream products so it is possible they should be included in the same market in due course. The Commission should explain how fibre services will be captured within the market and geographic definition going forwards.

## **D COMPETITION ASSESSMENT**

*The changes proposed represent a significant shift in approach*

- 26 In its first draft the Commission concluded an ESA (excluding cabinetised lines) would be competitive where:
- (a) two or more Competing Providers are present, or
  - (b) one UCLL-based Competing Provider is present and the exchange will serve at least 6,500 non-cabinetised lines (after the cabinetisation deployment is completed).

Telecom faces limited competition in all other areas, including all cabinetised Lines.

- 27 The Commission's current view is that Telecom does not face limited competition in an ESA (including cabinetised lines) when
- (a) two or more competing providers are present; and
  - (b) Telecom has a wholesale market share less than 80% across all lines in that ESA.
- 28 This represents a significant change in criteria from the first draft and we welcome the opportunity to comment on the Commission's current position.

- 29 The result of the change is a significant reduction in the number of ESAs where Telecom will be deregulated from 51 to 27 ESAs.

*The two criteria should apply separately*

- 30 The Commission's revised draft, which applies the two criteria concurrently, produces an overly conservative view on the level of competition in the market. We believe the two criteria (as amended below), should apply separately as primary and secondary tests because they are both independent indicators of the level of competition in an ESA. If an ESA meets either the number of operators threshold, OR the market share threshold, then it should be deregulated.

### **THE PRIMARY TEST: NUMBER OF COMPETING OPERATORS**

- 31 We agree with the Commission that the number of competing operators in an ESA acts as a competitive constraint on Wholesale's pricing. This has been a core argument in both the Commission's initial and revised conclusions on market tests, so we will not repeat all the arguments to support it here.
- 32 Having multiple operators in an ESA places significant competitive constraints on wholesale pricing. These alternative operators have invested in equipment in the exchange and will have clear incentives to gain market share in the exchanges they have unbundled. Rather than the Commission proposed threshold of two or more operators AND a market share test, the number of competing operators alone should enable the Commission to conclude whether an area is competitive.
- 33 Ofcom uses the number of Principal Operators as a standalone test for competitiveness<sup>3</sup>. In its recent review of the Wholesale Bitstream Market it concluded that Exchanges where four or more Principal Operators<sup>4</sup> are present or forecast automatically fall within the deregulated areas (Ofcom's 'Market 3'). This equates to three or more operators in an exchange area competing against BT (the incumbent).
- 34 It is worth noting that Ofcom also includes operators who are *forecast* to be present in exchanges as well as those actually present, recognising that even the threat of an operator entering the market changes competitive behaviour within an ESA.
- 35 If Ofcom's criteria of 3 or more principal operators were applied in New Zealand it would result in a larger number of ESAs being deregulated than is currently proposed by the Commission even without using forecasts of future UCLL rollout.
- 36 We agree with the Commission that two alternative operators present in an ESA is an appropriate level for the New Zealand market. The chart

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<sup>3</sup> <http://stakeholders.ofcom.org.uk/consultations/wba/>

<sup>4</sup> Principal Operator is defined as an operator (including BT) capable of providing a material constraint in the market

below gives an indication of average market shares across ESAs with different numbers of competing operators. It clearly shows the influence that two additional competing operators have on market shares in the most competitive parts of the ESA (ie MDF lines). As discussed below, competition in the most competitive areas drives behaviour across the whole ESA.

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*Figure 1 – Estimate of average market share by number of competitive operators in an ESA<sup>5</sup>*

### **THE SECONDARY TEST: MARKET SHARE**

- 37 The Commission has introduced a new market share threshold as one of the criteria for deregulation and chosen 80% as the trigger point. Market share should be a secondary standalone test for whether an ESA is competitive as it provides a separate indication of whether an ESA is competitive.

*Impact of the inclusion of cabinetised areas in ESA*

- 38 Part of the Commission's argument for ESAs being the right geographic dimension is that Retail does not differentiate between cabinet and non cabinet areas within an ESA area. However, the competitive effect on Retail is a function of the most competitive parts of an ESA and not based on the average market share across all cabinetised and non-cabinetised lines.
- 39 The Commission must take account of this averaging effect in its market share threshold. This would suggest using a market share figure which better reflects the level of competition which is achieved in the most competitive parts of an individual ESA (ie the market share in the non-cabinetised 'MDF' lines within the ESA).
- 40 Since at present UCLL operators have yet to deploy equipment in cabinetised areas, the loss of market share comes primarily from the direct exchange connected lines and access lines from other providers in that area (eg cable access lines). Figure 1 above shows how market share for ESAs varies between the MDF and cabinet fed lines.
- 41 As noted above, non-cabinetised areas drive competition in exchange areas and the threshold test should take in to account how competition in those lines is averaged over the whole ESA. If, for example, cabinet

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<sup>5</sup> Compass, Kordia, Orcon are counted as a single operator as per the Commission's first draft. TelstraClear is counted as a single operator if the cable network is within an ESA footprint or it has UCLL equipment in the exchange. The number of competing operators is based on the highest number of UCLL operators in any part of the ESA and an estimation of cable coverage.

lines represent 50% of lines in an ESA<sup>6</sup> then Wholesale would need to have a market share of less than 60% in the non-cabinetised areas to achieve the 80% in an ESA figure. This is clearly a high threshold to achieve and beyond the point at which a market should be considered competitive.

- 42 Finally, the Commission must look at market share over all access lines within the ESA, and not just Telecom lines, to reflect the actual market position. This is primarily a concern in cable areas where Telecom is not able to calculate accurate market shares as it does not have a true picture of the number of TelstraClear's access lines.
- 43 We agree with the Commission's threshold figure of 80% across all broadband services in the ESA. This should be used as a secondary test (alongside the primary absolute number of operators test) to capture those areas where effective competition is observable by the reduction in market share in ESAs where there is just one alternative operator.

#### *The impact of cable networks*

- 44 We are concerned the Commission's proposed methodology fails to adequately capture the significant influence of cable on the wholesale market in those areas where it has been deployed. The Commission states that TelstraClear has only provided its total number of cable broadband customers which the Commission has used to produce an average of take-up. This averaging approach underestimates the influence of cable in certain areas.
- 45 Our own retail research, shown in Appendix A<sup>7</sup>, indicates TelstraClear's impact on the market in Wellington is significant. [ ]TNZRI. At the least this warrants more granular analysis.
- 46 A risk in the Commission's approach is that it downplays the impact of competition from alternative access infrastructure providers. Rather than indicating a lack of competition, the absence of UCLL operators (when coupled with a significant loss in market share) suggests strong competitive tension in these areas. TelstraClear's cable presence and market share in these areas acts as a significant constraint on UCLL market entry. A market which is already competitive will deliver lower returns to UCLL operators and makes new entrant UCLL economics challenging.
- 47 The impact of cable is so significant that arguably all cable areas should be deregulated. However, a more pragmatic approach is to link deregulation in cable areas to market share. This is addressed by our proposal to have a secondary test of market share.
- 48 We also seek further clarity on how the Commission decides whether to include cable within a particular ESA based on coverage. It is important

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<sup>6</sup> It is estimated that 50% of lines will be cabinetised in an urban ESA once cabinetisation is complete (the actual proportion of cabinetised lines varies by ESA).

<sup>7</sup> Some of the TelstraClear broadband services in the Wellington area may be provisioned using Wholesale services in TelstraClear's off-net areas.

to have a consistent and agreed measure of market share (including the share of cable customers) to support the market share threshold in the competition test.

### *Conclusion*

- 49 We conclude the appropriate criteria for assessing whether an area should be deregulated is whether the ESA has EITHER:
- (a) Two or more alternative operators; OR
  - (b) Wholesale has a market share of all broadband lines in the ESA (including cable broadband lines where applicable) of less than 80%.

## **E REGULATED UBA PRICE CALCULATION**

- 50 The Commission separately consulted<sup>8</sup> on the pricing implications of UBA deregulation. The Commission has now concluded that the UBA price should only be calculated from UBA prices in regulated ESAs. The Commission has reviewed the UBA Price List to incorporate this current view.
- 51 The UBA Pricing Review has been conducted separately from the UBA Competition Assessment. However, there are linkages between the two. We provided a detailed response to the Commission's consultation on the recent UBA Price Calculation consultation so will not repeat all our arguments here.
- 52 Generally, the Commission's proposed approach means that, from a pragmatic perspective, no consequential changes are required in the UBA pricing review. However, if the Commission were to depart from its proposed approach it would need to consider price review related issues.
- 53 In its arguments for including retail prices in competitive ESAs, the Commission states 'The result would be that the benefits of competition would be spread more widely across end-users in New Zealand'. From a policy perspective this approach would introduce an explicit cross subsidy between the competitive and non-competitive areas which only applies to Telecom. As noted by the Commission, this would dampen Telecom's incentive to compete in competitive areas to the detriment of consumers in these areas.
- 54 Instead we support the Commission's proposal that retail prices in deregulated areas will not contribute to the regulated UBA price in the regulated areas. This is sound regulatory policy which clearly delineates the regulation that applies between competitive and non-competitive areas.

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<sup>8</sup> <http://www.comcom.govt.nz/assets/Telecommunications/STD/UBA-Backhaul/Updated-STD/Telecom-UBA-Price-calculation-request-for-clarification.pdf>

55 As set out above, the price for UBA will effectively be frozen from separation day in the event of a demerger of Telecom. We support the changes to the STD that provide that Telecom will not be required to supply UBA in deregulated areas. This is consistent with international regulatory best practice.<sup>9</sup> This principle remains relevant with or without a demerger.

## **F CONSEQUENTIAL CHANGES TO THE STD**

56 The Commission has helpfully provided marked up versions of the Schedule 1 STD Service Description and Schedule 2 UBA price list.

57 Our other consequential changes are largely consistent with the changes proposed in the revised draft. Our only comments are as follows:

(a) Schedule 2, UBA Price List there are a number of places in the document where the proposed changes state that amendments are applicable only in Regulated Exchange Service Areas (clause 2.1, 2.1, 2.3, 4.1.2, 4.1.3, 4.1.4A, 4.2.1, 4.2.3, 4.2A, 4.3, 4A.3, 4B1.2, 4B.2, 5.1.3, 5.2, 6.3, 7.1.1, 7.2.2, and footnote4). We recommend that, for the sake of simplifying the drafting, it would be possible to simply state in paragraphs 1.1 and possibly 2.1 to 2.3 that:

“1.1 This schedule sets out the Charges for the UBA Service that are applicable in Regulated Exchange Service Areas only...

For the avoidance of doubt, all data required to be used must be drawn only from Regulated Exchange Service Areas and all adjustments apply only to Regulated Exchange Service Areas”

(b) Schedule 2, Price List, Clause 4.3.3 – the reason for the change is not clear nor do reasons for its inclusion appear from the draft decision.

58 However, given the recent changes to the Act discussed above, some of these changes may no longer be relevant in a demerger. We also think that it is important that the General Terms of the STD are also amended to embed the mechanism for quarterly competition reviews without the need for a section 30R review to be conducted.

## **G IMPLEMENTATION & FUTURE REVIEW**

### *Implementation*

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<sup>9</sup> Under the EU framework, deregulation occurs where an operator no longer has Significant Market Power. For example, Ofcom removed ex-ante regulations which applied to BT in competitive areas following its market reviews of the Wholesale Broadband Access Market (2008 and 2010). In addition, Ofcom varied BT’s Undertakings in 2008 to exempt deregulated areas from EoI obligations.

- 59 The revised draft does not discuss how or when the deregulation will take effect or how this might be linked to the implementation of the UBA pricing review which is being performed in parallel. The two reviews are linked because the new UBA price will be calculated only from the regulated areas.
- 60 If the Commission is not able to implement the conclusions of the two reviews at the same time, the Commission must recalculate the UBA price at the time it implements the UBA Competition Test deregulation to remove the influence of the deregulated areas from the calculated figure.<sup>10</sup>

#### *Regular Reviews*

- 61 As discussed previously, we suggest quarterly data updates as a way to more accurately track the market as it develops and regularly update which ESAs are competitive. These updates would simply be a data analysis exercise based on the current methodology followed by updates to the list of deregulated ESAs.
- 62 The Commission should also regularly monitor uptake and use of mobile and fibre broadband services in New Zealand so they can be included in the market definition if and when they reach an appropriate level of substitutability. We suggest the Commission annually reviews whether fibre and mobile broadband should be included within the scope of the review.
- 63 We welcome the Commission's clarification that it will only undertake a review of the competition status in an ESA if there are material grounds to do so, and that this does not include legitimate price increases<sup>11</sup>.

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<sup>10</sup> We note, however, that regular UBA price reviews will no longer be relevant in the event of the demerger of Telecom from separation day.

<sup>11</sup> As discussed in Section F, the mechanism for future regular reviews should be built in to the STD as the Commission's ability to carry out 30R reviews is limited by the Act in the

## **APPENDIX A – ESTIMATED RETAIL MARKET SHARES IN WELLINGTON REGION**

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Source: Telecom's Monthly Market Monitor Programme, conducted by Telecom's research partner TNS New Zealand.<sup>12</sup>

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<sup>12</sup> The programme involves asking New Zealand consumers who their broadband provider is; and is therefore related to the 'retail' company a consumer purchases from; as such it does not include any wholesale information. The data is current up until May 2011, and is shown as a three month rolling average to minimise normal sampling fluctuations. The Monitoring programme is robust, nationally representative and in addition is post-weighted to the New Zealand population.