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Tom Forster
Manager Telecommunications Operations
Regulation Branch
Commerce Commission
WELLINGTON

Dear Tom,

Cross-Submission on UBA Competition Review

1. Vector welcomes the opportunity to make a cross-submission to the Commerce Commission on its "Revised Draft Review of the Standard Terms Determination for Telecom's unbundled bitstream access", 8 June 2011. No part of Vector's submission is confidential and we are happy for it to be publicly released.

General observations about the submissions made

2. Vector has reviewed the submissions made by CallPlus, Kordia, Telecom and Vodafone. Vector considers each of the submissions, including Telecom's, adds weight to our view that the Commerce Commission should not provide regulatory relief to Telecom at this point in time.
3. The submissions made by CallPlus, Kordia and Vodafone illustrate the reliance of access seekers on the provision Telecom's nation-wide UBA service in order to compete and for there to be healthy development of workable competition.
4. Vector considers that the submissions made by CallPlus, Kordia and Vodafone provided a clear link between the need for regulation, the promotion of competition and, ultimately, the long-term benefit of end-users, consistent with the purpose in section 18 of the Telecommunications Act 2001. This appeared to be lacking in Telecom's submission. At best Telecom made a vague, unsubstantiated, assertion that failure to "wind back regulation ... risks distorting the market", in some undefined way.
5. While CallPlus, Kordia and Vodafone provided arguments why the Commerce Commission's thresholds for measuring whether there is workable competition/removal of regulation of UBA are low, Telecom argued the opposite asserting that the threshold should be:

- 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%.
6. Vector considers that Telecom's proposed threshold would be far too low. Under Telecom's proposal it could have 98+% share of the market, and substantial market power, with two <1% competitors. Clearly this would not be workable competition. If anything, the international benchmarks referred to in submissions, suggest the Commerce Commission should raise its threshold.

Telecom's claims about setting access prices

7. Telecom's discussion on the setting of regulated access prices raises a concern for Vector, additional to those raised in our submission.
8. Both the interim and final regulated access prices are retail minus. This means that any monopoly rents Telecom is extracting from the provision of broadband services will be embedded in Telecom's access price.
9. To the extent that retail prices are restrained or go down in exchanges where Telecom faces some degree of competition, the access prices are also reduced, resulting in a lowering of monopoly rents. However, if exchanges where there is some degree of competition are removed from regulation, and consequently removed from the calculation of the retail minus price for access in the remaining exchanges, this restriction on Telecom's monopoly rents would be removed. The access prices in the remaining exchanges, and the monopoly rents embedded in them, would reflect the profit maximising retail prices Telecom is able to set in areas where competition is limited. This would be likely to result in higher access prices which would, ultimately, be to the detriment of end-users.
10. Telecom has claimed, in contrast, that "including retail prices in competitive ESAs ... would introduce an explicit cross subsidy between the competitive and non-competitive areas which only applied to Telecom."
11. The Commerce Commission should give no standing to this claim unless Telecom substantiates it with evidence of its costs in each exchange, and proof of the extent of cross-subsidies that would result.
12. In reality no such cross-subsidies would develop. The so-called subsidisation is simply a euphemism for lowered monopoly rents.
13. Take the following example.

14. There are two exchanges, ESA1 and ESA2. Telecom faces no competition in ESA1 but faces workable competition in ESA2.
15. Units of supply are 10 in each exchange. Both exchanges have identical costs. The cost of the actual UBA service is \$5 per unit (including cost of capital) and the avoidable cost of the retail service is \$2 per unit. The retail price in ESA1 is \$10 per unit reflecting that there is no competition. This means Telecom is extracting a monopoly rent of \$3 per unit. The retail price in ESA2 is \$8 per unit reflecting competitive pressure Telecom faces.
16. If the Commerce Commission calculates an imputed access price across both exchanges it will be \$7 per unit.
17. This would mean Telecom would extract monopoly rents for each unit supplied by a competitor of \$2. For the units it sells itself it would extract monopoly profits of \$3 per unit in ESA1 and \$1 in ESA2.
18. There is no cross-subsidy. Both exchanges are profitable to Telecom.
19. If the access price in ESA1 is based on Telecom's retail price in that exchange alone the access price would be \$8 per unit not \$7 per unit. The monopoly rent Telecom would extract for each unit supplied by a competitor would be \$3 per unit, rather than \$2 per unit.
20. This example shows that Telecom's concern is not about the creation of cross-subsidies, but preservation of monopoly rents. The example also illustrates how reliance on prices in markets or areas where there is competition would provide a better approximation of what cost-based access prices would actually be than prices in markets or areas where competition is limited.
21. The use of retail minus pricing means that any monopoly rents in Telecom's retail prices will also be reflected in its access prices for UBA. In contrast Telecom's UCLL access prices are cost-based which, if correctly calculated, should exclude excessive rents. Telecom's point about UBA pricing highlights that the greater Telecom's monopoly rents the greater the artificial incentive on access seekers to use UCLL rather than UBA. Access seekers may use UCLL even if it would be more efficient to use UBA because of this price difference or, if UCLL is uneconomic, access seekers may not take service from Telecom or compete at all.

Concluding remarks

22. Vector, again, emphasises that it does not believe the Commerce Commission should offer Telecom regulatory relief in relation to UBA regulation at this time.
23. If the Commission has any queries regarding Vector's submission or would like further information please contact Robert Allen, Senior Regulatory Advisor, on 04 803 9036 or robert.allen@vector.co.nz.

Kind regards

A handwritten signature in blue ink, appearing to read 'R. Girdwood'.

Bruce Girdwood
Regulatory Affairs Manager