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Unbundled bitstream Access (UBA) Commerce Commission Competition Review – Vodafone submission

Vodafone welcomes the opportunity to comment on the Commerce Commission's (the Commission) revised draft decision for the competition review of the unbundled bitstream access (UBA) standard terms determination. Vodafone supports the unwinding of regulation where it is no longer warranted and for regulation not to be applied unnecessarily. However, if the draft decision is adopted customers on cabinetised lines in exchange areas where UBA regulation is unwound will likely no longer have the choice of provider for broadband and will no longer receive the benefits of an effective competitive alternative for their DSL broadband.

Vodafone is concerned that relying solely on an all-line retail market share threshold would fail to prevent monopolisation of cabinetised lines to the detriment of telecommunication end-users.

Relying solely on all-line retail market share threshold would result in deregulation of all lines within an ESA even where a large proportion of end-users only have access to a monopoly provider. Vodafone believes that removing regulated UBA access on cabinetised lines will deny end-users the benefits of investments providing them with high quality broadband and competitively priced voice services. We cannot see how a retail market share test including both cabinetised and non-cabinetised lines would be in the long-term benefit of telecommunications end-users.

Vodafone recommends that the Commission adjust its market share threshold to apply only to non-cabinetised lines within an ESA and continue to require UBA be provided over cabinetised lines.

Background

The Commission has revisited its draft decision for the competition review of the regulated UBA released on 28 October 2010. The decision recommended the unwinding of regulation for the UBA as a result of the increasing presence of competitive alternative infrastructure to the UBA service, particularly competitive investment in unbundled copper local loop (UCLL). Given the uneven growth of UCLL, the Commission recommended the unwinding of regulation in certain geographies aligning with Telecom exchange service areas (ESAs) where it has observed competitive UCLL infrastructure competition. The Commission's initial criteria recommended the unwinding of UBA regulation in ESAs where Telecom was competing with:

- (a) Two or more competing providers or

(b) One UCLL-based competitor and the exchange served at least 6500 non-cabinetised lines.¹

Competing providers were defined to include competing hybrid coaxial fibre (HFC) owned by TelstraClear and UCLL.

While the geographic unwinding of UBA regulation was premised on ESAs, the Commission specifically excluded fibre fed cabinetised lines from the roll-back of regulation. It found “there is a material difference in the competitive dynamics between cabinetised and non-cabinetised lines.”²

The Revised Decision 8 June 2011

The Commission’s revised draft decision also recommended the unwinding of the UBA regulation on an ESA-by-ESA basis. However, it revised the criteria for unwinding UBA regulation. The Commission has now decided the UBA STD would not be applicable in ESAs where two or more competing providers are present and Telecom has less than 80% market share in a particular ESA.

Consistent with the previous draft decision, competing providers included broadband providers servicing customers using either UCLL or HFC infrastructure.

Use of all-line market share threshold will re-monopolise cabinetised lines

The Commission has failed to adequately consider how the proposed remedy would impact on competition for end-users on cabinetised lines.

The Commission’s revised decision considers that an 80/20 market share threshold should apply as part of its new rule for unwinding UBA regulation on a geographic basis. Vodafone’s understanding of this rule suggests that alternative infrastructure providers must be supplying at least 20% of retail broadband services in an ESA over competitive infrastructure. Our understanding is that this would include cabinetised lines in the total and exclude customers served using the regulated UBA.

The Commission also appears to rely solely on the market share threshold to assess whether to remove the regulated UBA service.

The justification for including cabinetised and non-cabinetised lines is premised on their being no difference between current retail prices for cabinet fed and exchange DSL broadband (demand-side substitution analysis). However, Vodafone considers the fact that Telecom cabinet and exchange fed DSL broadband are priced the same level is not conclusive evidence that both services constrain each other to the same degree.

In contrast, the October 2010 draft decision considered that infrastructure competition for cabinetised lines within an ESA was likely to be limited. It noted:

“Due to the challenging economics of sub-loop unbundling, the Commission considers that there is little prospect of cabinet-based competition in the foreseeable future. The Commission’s preliminary view is that Telecom faces limited competition in respect of cabinetised lines.”³

The revised draft decision contrasts this previous logic and suggests that Telecom’s wholesale price

¹ Commerce Commission, *Draft Review of the Standard Terms Determination for the Designated Service Telecom’s Unbundled Bitstream Access*, 28 October 2010, p. 29.

² Ibid, p. 11.

³ Commerce Commission, *Draft Review of the Standard Terms Determination for the Designated Service Telecom’s Unbundled Bitstream Access*, 28 October 2010, p. 29.

for cabinetised areas is therefore constrained by the retail prices of UCLL providers in non-cabinetised areas. The Commission considered the relevant constraint imposed on cabinetised lines being:

- (a) The indirect constraint imposed by non-cabinetised lines on cabinetised lines and
- (b) The indirect constrain imposed by TelstraClear’s cable network (in areas covered by TelstraClear’s cable network).

However, non-cabinetised lines are likely to provide little constraint on cabinetised lines as cabinetisation provides a customer with a DSL service subject to higher quality than exchange fed broadband. The superiority of cabinetised broadband is due to the closer proximity of DSL equipment to the customer than a DSL service provisioned from an exchange. Furthermore, Vodafone testing of cabinets has also found the ‘lighting’ of a Telecom cabinet increases the interference to a DSL signal provisioned from an exchange. For these reasons we consider an exchange provisioned DSL service is not equivalent to a cabinetised broadband service.

Accordingly, end-users on cabinetised lines do not face effective infrastructure competition. Vodafone considers it likely that cabinetised lines would be effectively re-monopolised in the absence of regulatory safeguards.

Given the Commission’s finding in its October 2010 draft decision that it is “unlikely that there will be any significant unbundling of cabinets in the foreseeable future” then it is curious why the Commission now finds relying on market share only is a better regulatory approach.

As is shown below in Figure 1, relying solely on market share criteria introduces the risk that market power can be hidden through averaging of market share in competitive and non-competitive lines (cabinetised) within an ESA.

Figure 1
Level of competition in non-cabinetised areas for different cabinet roll-out scenarios

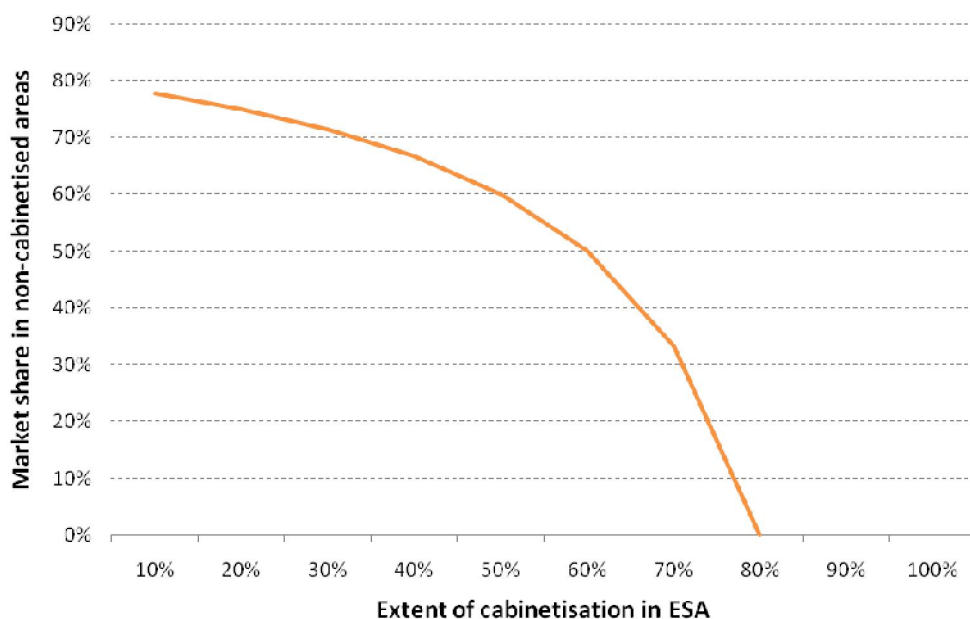


Figure 1 shows the market share in non-cabinetised areas needed to meet the 80% test for the

whole ESA allowing for different levels of cabinet roll-out within an ESA⁴. For example, when cabinetisation comprises 50% of households within an ESA, Telecom would need to have a market share of 60% in the competitive areas (non-cabinetised) of the ESA to meet the all-ESA threshold of 80%. In other words, 50% of households within an ESA would be subject to monopoly fixed-line services and the whole ESA could be assessed as being competitive and not be subject to UBA regulation.

Given the above scenarios, and still assuming that Telecom does not discriminate between cabinet and non-cabinet products in the retail market, it is easily demonstrated that the monopoly rents gained from the cabinetised households could more than offset any losses in the competitive areas of an ESA – in other words, competition in non-cabinetised areas would not provide any constraint to monopoly pricing for both cabinet and non-cabinet households.

Vodafone submits that it is unreasonable to suggest that competitive alternative infrastructure will impose a continuing adequate constraint on cabinetised lines. The imposition of only a market-share threshold will pose little or no restraint on the monopoly behaviour of Telecom in ESAs that have cabinetised lines.

Instead of bundling cabinetised lines within the all-line market share threshold, the Commission should specifically require the provision of UBA for lines not subject to effective infrastructure competition – that is, cabinetised lines.

Separate rule for UBA on cabinetised line consistent with other jurisdictions

Adopting a specific rule requiring the provision of UBA for lines not subject to effective infrastructure competition is consistent with the approach taken in other jurisdictions that have looked at similar issues.

The Commission's October 2010 decision noted that Telecom cabinets typically serve approximately 200 to 300 copper lines. This is in contrast to exchanges which generally have thousands of addressable copper lines. The Commission found:

“the relatively small customer base served from roadside cabinets creates a significant barrier to entry, as it is difficult for an access seeker to generate the economies of scale and density to make the investment in sub-loop unbundling [co-locating at the cabinet] viable.”⁵

Given the performance differences between cabinetised and non-cabinetised broadband and the Commission's finding that competitive alternative infrastructure is unlikely to develop alongside Telecom cabinets it appears unreasonable to suggest that cabinetised lines are effectively constrained by competitive alternative infrastructure.

This view is consistent with the view of the UK regulator Ofcom that the economics of sub-loop unbundling is challenging. Ofcom stated:

“The economics of SLU-based networks are challenging. There are a range of local factors that increase the complexity and resulting cost of SLU-based services. Further, given that street cabinets typically serve a much smaller geographic area than the LLU exchange, the fixed cost of SLU enabling a street cabinet needs to be recovered from fewer customers. These issues cause the unit cost of SLU-based services (per end user) to be considerably higher than for LLU. We concluded that in future the level of demand for services and applications utilising

⁴ Assumes that Telecom will have 100% market share of cabinetised households.

⁵ Commerce Commission, *Draft Review of the Standard Terms Determination for the Designated Service Telecom's Unbundled Bitstream Access*, 28 October 2010, p. 10-11.

SLU's higher speeds could outweigh the higher costs of SLU, however the level of demand for these services was too uncertain to require further action on SLU."⁶

Consequently, Ofcom imposed an access obligation on cabinetised lines⁷ requiring the provision of a service equivalent to UBA⁸. Irrespective of the competition assessment with respect to non-cabinetised lines (we discuss this next section), the access obligation on cabinetised lines remain.

A similar issue was considered by the Australian Competition and Consumer Commission and Australian Competition Tribunal (the ACT) when considering whether the unbundled local loop service (ULLS) was an effective competitive alternative to Telstra's Wholesale Line Rental (WLR) and Local Call Service (LCS) to warrant the unwinding of regulation for the WLR and LCS in Australia. The ACT had regard to the presence of 'pair gain' systems in Telstra's local access network in Australia. Pair gain systems are an electronic box that permits a single line to service multiple end-users. The ACT found:

"a prerequisite to the supply of ULLS is an unconditioned wire between its [Telstra's] exchange and an end-user's premises. Where a pair gain system has been installed on the wire the prerequisite is not met."⁹

The ACT considered the issue of the physical barrier posed by pair gain systems could be addressed in two ways:

- (1) As was suggested by the ACCC in its decision (reviewed by the ACT), addressed by way of limiting the order to ESAs with 14,000 or more addressable SIOs (i.e. SIOs connected to a Telstra exchange by an uninterrupted wire via which an end-user might be provided with an ULLS-based service). The ACCC decision proposed an ESA with 14000 [addressable] SIOs would support Telstra and four entrants. This would provide the basis for effective competition in the downstream markets.
- (2) The ACT also considered this barrier could be overcome was by a condition or limitation specifying that where an end-user cannot be supplied a voice service via ULLS then the exemption should not apply to that end-user.¹⁰

We consider a similar approach to the deregulation of the UBA as considered by the ACT or Ofcom to be appropriate. The presence of an effective competitive alternative should be a prerequisite for the unwinding of UBA regulation on non-cabinetised copper lines. Therefore, cabinetised lines that do not have the exertion of an effective competitive alternative should continue to have a regulatory obligation to provide wholesale UBA services.

Vodafone also considers that such an exemption is consistent with the Commission's oft stated regulatory principle of the ladder of investment. Regulation should be designed so as to encourage access seekers to move up the ladder of investment from UBA to UCLL and to even greater infrastructure investment. However, many rungs in the ladder of investment are removed for cabinetised lines. In effect, alternative providers can also utilise the commercial UBA offering of the monopoly provider Telecom. There is no longer any middle rung between UBA and full duplication

⁶ Ofcom, October 2010, *Review of the wholesale local access market: Statement on market definition, market power determinations and remedies*, p.91.

⁷ In the terminology of Ofcom, the remedy was applied to all NGN lines, including FTTN & FTTH lines.

⁸ Ofcom calls this virtual unbundled local access (VULA). VULA is equivalent to UBA in that it cannot be bundled with voice and must be delivered as a standalone broadband product.

⁹ *Application by Chime Communications (No.2)* [2009] ACompT 2 (27 May 2009), par [123].

¹⁰ *Ibid*, par [125]

of the local loop. Such a regulation would be counter to regulations of the last decade aimed at promoting upward movement on the ladder of investment.

Amendment to 80/20 when excluding cabinetised lines

Vodafone understands that a key reason for proposing deregulation of an ESA with alternative provider retail market share greater than 20% (80/20 rule) was that it reflected 40% alternative retail market share in non-cabinetised lines averaged over cabinetised and non-cabinetised lines. Vodafone notes that adopting a cabinetised-specific obligation and maintaining the proposed 80/20 rule would substantially undermine competition in the market.

Further, the proposed 80/20 rule is significantly out of line with competition assessments undertaken in other jurisdictions. For example, in its December 2010 SMP assessment, Ofcom proposed removing UBA regulatory obligations on non-cabinetised lines in exchanges where:¹¹

- four or more operators are present or forecast to enter; and
- three operators are present or forecast but where BT's share is less than 50 per cent.

Clearly there are substantial differences in market conditions between the UK and New Zealand that indicate the thresholds proposed by Ofcom are too onerous. Nonetheless, it is clear that an 80/20 threshold, without any minimum operator restriction, and applied to non-cabinetised lines only is too low a threshold to represent an effectively competitive market.

Vodafone submits that the Commission remove UBA regulation on non-cabinetised line only where alternative infrastructure providers are supplying through competitive infrastructure at least 40% of retail broadband services over non-cabinetised lines in an ESA.

Conditions and limitations

However, if the Commission is compelled to pursue its current criteria for the geographic unwinding of regulation then we suggest that the Commission consider imposing conditions and limitations on the deregulation of the UBA.

The unwinding of regulation subject to conditions and limitations was the approach taken by the ACT and ACCC in their respective decision to unwind regulation for Telstra's WLR and LCS. The ACT Orders in Clause 6 of the Exemption Order for Telstra required, *inter alia*, that the exemption from regulation would cease to have effect if Telstra discontinued to supply the ULLS, capped an exchange for access seekers or did not implement an adequate line sharing service to ULLS migration process.

Similarly we believe the Commission should consider similar conditions and limitations on the decision to the unwinding of the regulation for the UBA. In particular, deregulation should be subject to the continued availability of UCLL for access seekers and should the Commission persist with its current criteria for the unwinding of regulation, then the Commission's observations on the pricing constraint between cabinetised UBA and non-cabinetised UBA should continue to hold. Any disconnect between the pricing between cabinetised and non-cabinetised UBA in deregulated areas would suggest the competitive conditions observed by the Commission for cabinetised lines were premature or unfounded.

¹¹ Ofcom, *Review of the wholesale broadband access markets Statement on market definition, market power determinations and remedies*, December 2010.

Conclusion

The commercial implications for the fixed line broadband market are real and serious. Therefore we urge the Commission to seriously consider the implications of incorrectly unwinding UBA regulation on cabinetised lines where alternative competitive infrastructure is unlikely to develop.

Vodafone submits that the Commission implement a specific rule requiring the provision of UBA for cabinetised lines and that UBA regulation only be removed on non-cabinetised lines where alternative infrastructure providers are supplying at least 40% of retail broadband services in an ESA over competitive infrastructure.

If you wish to discuss any aspect of the above submission please contact Kelvin Binning on email at Kelvin.binning@vodafone.com or on 021 224 6636.

Kind regards

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