



**SUBMISSION ON THE DRAFT REVIEW OF
UBA STD – THE COMPETITION
ASSESSMENT**

25 November 2010

Public Version

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A. EXECUTIVE SUMMARY

1. We welcome the Commission's competition test process for the Unbundled Bitstream Access (UBA) Standard Terms Determination (STD) and appreciate the opportunity to comment on it.
2. The draft report builds on the Commission's recent competition assessments for backhaul and the Resale Investigation and provides a further signal that both the telecommunications markets, and the regulation of that market, are maturing. Scaling back regulation in areas where there is effective competition is a fundamental building block of any sustainable and effective regulatory framework, and is even more important now - at a time when significant new investment in our markets is required.
3. We support the Commission's conclusion that a number of exchange service areas (ESAs) no longer face limited competition. We believe that the approach and methodology adopted by the Commission in reaching its view are robust, pragmatic and fit for purpose. We generally agree with the Commission's market definition and competition assessment; for example we support:
 - A product market which includes copper, cable and fibre and scope to include wireless services (see below);
 - An ESA based geographic market – especially given the importance of UCLL to the development of competition in this market – with cabinetised lines sitting within a separate market;
 - The categorisation of operators that provide a serious competitive constraint on Telecom as "Competing Providers";
 - The conclusion that -
 - two Competing Providers in an ESA; or
 - one Competing Provider plus a minimum number of contestable lines;means that Telecom does not face limited competition in that ESA; and
 - The conclusion that vertically integrated operators as well as wholesale only operators act as a competitive constraint on Telecom.
4. Notwithstanding our general support for the Commission's proposed competition test framework, we suggest a few refinements to the proposed method and process that we believe will enhance the test and simplify its future application. These refinements include:
 - To take appropriate account of the competitive constraint imposed by 3G mobile;
 - Define the basis on which incremental entry of close substitutes – for example fibre – would be reflected in the competition assessment;
 - Consider cable as a Competing Provider for cabinetised lines in relevant ESAs and ensure the analysis includes cable in the near entrant test; and

- Undertake more frequent “turn the handle” updates to take account of entry (or exit) with less frequent substantive reviews and ad hoc reviews if required.
5. We make some observations, in the “other issues” section, including about the practical changes that will be required to implement the outcomes of this process. For example, changes will be required to the UBA price calculation so that it draws on regulated ESAs only. We propose that any changes arising from this or subsequent applications of the competition test synchronise with the regular quarterly UBA price reviews.
 6. We have also provided an up-to-date Chorus data set and partially refreshed the analysis (noting we do not have visibility of all the market data e.g. cable subscribers and longer term UCLL plans) using the Commission’s methodology. This results in a further two deregulated ESAs and some minor changes to the categorisation of a few others.

B. MARKET DEFINITION

7. We generally agree with the Commission's approach to the UBA market definition. In our view it aligns with international best practice whilst taking appropriate account of local market dynamics and conditions in New Zealand.
8. We make a few observations on individual aspects of the Commission's analysis below and suggest some refinements and clarifications.

PRODUCT MARKET

9. We agree with the conclusion that the market is for broadband access and that copper, cable and fibre are currently the principal delivery platforms.

Is 3G mobile a close substitute?

10. The Commission invites submissions on whether 3G mobile data services represent a sufficiently close substitute to be included in the same market.
11. Until very recently, 3G mobile data has, for most consumers, been only a complement to, and at best only a weak substitute for, fixed line broadband. Although mobility is valued by end users, the price, speed and data cap disadvantages of mobile have in the past more than offset that utility. It has been widely acknowledged though, that this situation will change as technology improvements, service innovation and competition in the mobile broadband market change the attributes of mobile broadband services and that these changes in attributes alter the cross-price elasticities between fixed broadband and mobile data.
12. There have been several significant recent developments which lead us to believe that mobile is becoming a closer substitute for fixed broadband for New Zealand consumers. In brief these are as follows:
 - **Increasingly competitive mobile data offerings** in the New Zealand market (faster speeds, larger data allowances and decreasing prices) especially for casual internet users (browsing and email) and light and (increasingly) moderate users (browsing, email and some data rich content such as music, gaming and video);
 - **Faster mobile broadband speeds** which now approach fixed broadband speeds and comfortably exceed the speed required for the most common web applications; and
 - An increasing uptake of smart phones and data capable devices by consumers which changes the demand characteristics of the national customer base (and their appreciation of mobile as an alternative to fixed for broadband services – especially for light or moderate users).

13. It is beyond question that increasing speeds, increasing data allowances, decreasing prices and increasing adoption of mobile broadband are combining to fuel a rapid change in consumer perceptions and behaviours around mobile broadband. We note, for example, that even in the last couple of weeks Vodafone has announced it is upgrading its mobile data service to 28.8Mbit/s¹ and 2 Degrees² have introduced a 12GB mobile data pack. The latter, which may be consumed over 180 days and is priced at \$150 – cheaper, with more flexibility than many comparable fixed alternatives.
14. Accordingly, we believe it would be justifiable to consider mobile a close substitute for standard speed broadband. We note that such a conclusion would be consistent with the evolving view of the world being adopted by European national regulatory authorities (e.g. Austria and Spain) and the European Commission³ in deciding that mobile can be considered a close substitute for fixed “standard speed” broadband.
15. We would be happy to discuss this matter further information to the Commission, should that be of assistance. However, in the event that the Commission decided not to include 3G mobile as a close substitute - and “Competing Provider” – at this point then we propose that it establish, in the final report, the process for deciding how when it would do so. Ideally such a process would involve a consultative process and be undertaken before the next review.

An evolving product market

16. It is clear that there is a huge amount of natural market and government sponsored investment which is and will continue to change the number and form of broadband offerings available to New Zealanders. To adequately account for this we encourage the Commission to consider and preferably indicate as part of the current review the basis on which:
 - 3G mobile (or any other wireless technologies) would be included within the relevant product market; and,
 - Incremental geographic introduction of existing and new technologies, specifically fibre but also cable, 3G or LTE mobile will be reflected in the competition assessment.
17. It would provide helpful regulatory certainty if the Commission were to establish both a transparent set of criteria for the inclusion of new or evolving technologies within the product market, and a process for accounting for incremental geographic growth of existing or new technologies. The resulting regulatory certainty will help foster efficient investments. The criteria that most parties - including, we understand, the Commission - appear to consider appropriate are

¹ Meaning that the XT and now the Vodafone and 2degrees 3G networks offer MB+ average speeds.

² <http://blog.2degreesmobile.co.nz/in-the-news/2degrees-mobile-broadband-just-got-better>

³ Who [endorse the market definition of RTR](#) (NRA for Austria) that mobile is in the same market as standard speed broadband

speed, price, data allowance and geographic availability. These would appear to reflect the key attributes required by retail service providers to offer competitive mass market broadband services.

18. With regards data allowances, it is worth noting that relatively few people actually use their full data allowance; indeed, we estimate that []TNZAP of broadband users consume less than 3GB per month and []TNZAP consume less than 10GB per month. We suggest, therefore, that the relevant criteria should be actual data usage rather than headline marketing features. This principle applies equally to the broadband speeds.

GEOGRAPHIC MARKET

19. We agree that the ESA market is the most appropriate unit of measurement.

Cabinet areas

20. We understand why the Commission proposes to separate cabinetised lines and agree with this proposal.
21. We also appreciate the reasoning behind the Commission's proposal that cabinetised lines are not competitive. However, we ask that the Commission revisit this proposal on the basis that:
 - Cable imposes a significant constraint on Telecom and, in relevant geographic markets, should be counted as a Competing Provider;
 - As suggested by the Commission, and outlined above, mobile is increasingly substitutable for fixed broadband and significantly constrains Telecom both for exchange and cabinet fed lines;
 - UCLL operators may continue to provide broadband services from the exchange (albeit at slower speeds) on cabinetised lines. If this situation does eventuate then the exclusion of cabinetised lines in deregulated ESAs would need to be revisited and, we presume, changed.
22. In the light of this we propose that the Commission's competition assessment for exchange fed lines also be applied for cabinetised lines in competitive ESAs. In deciding which inputs represent close substitutes (and consequently should be considered to be Competing Providers) we presume the Commission would, as with the current and other market definitions, link back to the substitutability of inputs to provide the retail service. We believe that it would be relatively simple, from a practical perspective, to extend the application of the competition assessment to cabinetised lines in each exchange area.

FUNCTIONAL DIMENSION

23. We agree that the review is only of the wholesale market and that it is necessary to have regard to the downstream retail market.

CUSTOMER DIMENSION

24. We agree that it is not necessary to define separate business and residential wholesale markets for the purpose of this review.

C. COMPETITION ASSESSMENT

25. We agree with the methodology used by the Commission which we believe is robust. We have some minor comments and requests for clarity.

EXISTING COMPETITION

UCLL

- We agree with the inclusion of competing UCLL operators and agree that these operators act as a constraint on Telecom in the market for UBA services even when the UCLL operator does not offer a wholesale service. We discuss this in more detail below.

Cable

26. We agree with the inclusion of competing cable operators and agree that these operators act as a constraint on Telecom in the market for UBA services even where the cable operator does not offer a wholesale service. It seems disproportionate to consider that Telecom faces limited competition in these areas and, consequently, to continue to regulate access and price for Telecom – and not to impose similar regulation on TelstraClear (TCL). This is relevant to all lines in the relevant ESA i.e. including cabinetised lines.

Fibre

27. We agree that fibre access, particularly consumer UFB fibre may be a substitute for UBA and so should fall within the same market for the purposes of the UBA competition test. Clearly the nature of fibre offerings and their availability will be relevant to this assessment and, as noted above, it would be helpful for the Commission to clarify the process by which fibre network coverage will be included in the market analysis going forward. We suggest that a similar approach is adopted to that taken by the Commission in deciding whether cable is a Competing Provider in a given area.

DEFINITION OF “COMPETING PROVIDERS”

28. Actrix and Airnet have been excluded from the analysis as they are currently too small to act as a constraint on Wholesale. We accept this is currently the case, but to provide certainty to all providers, request that the Commission explains at what point these UCLL operators, or any new entrant, would qualify as Competing Providers.
29. We agree that Vodafone and TCL (UCLL and cable) should be considered Competing Providers. We also agree that Callplus, Compass and Orcon should be considered as an additional single Competing Provider for as long as they continue to share their infrastructure. It would be helpful if the Commission would clarify how the Competing Provider categorisation would be adjusted, should the wholesale collaboration between these three parties break down. We would expect all three would qualify as Competing Providers in their own right.

VERTICAL INTEGRATION

30. We agree with the Commission that indirect constraints from vertically integrated operators constrain Telecom in the Wholesale UBA market. Indeed, it could be argued that these constraints are just as strong as competing direct constraints from wholesale providers due to the link to the retail market. Retail ISPs, including Telecom Retail, who purchase UBA compete with self-providing UCLL operators and cable broadband. They place real pressure on wholesale providers to reduce prices – this occurs in all ESAs and especially in competitive ESAs.
31. There is also a potential competition constraint from UCLL and cable operators who currently self supply but have the ability (with low entry costs and strong incentives) to enter the wholesale bitstream market.

MARKET SHARE

32. We agree with the Commission's analysis on the relevance of the level of market share as an indicator (though not determinative) of the level of competition in the market. The most revealing factor is the difference in Telecom's market share between areas with different numbers of Competing Providers.
33. We note that the market shares given in this section do not appear to include cable broadband lines, which, according to the Commission's research has a amount to more than 50% of the market in the relevant areas.

COMPETITION IN AN ESA

34. We agree with the Commission's view that all ESAs with 2 Competing Providers should be deregulated. The presence of two Competing Providers within an ESA is a clear indicator that the exchange is competitive given the factors summarised in paragraph 123 of the Commission's draft decision. Furthermore we note that:
 - As a small and remote economy NZ is by definition a more concentrated market with a smaller number of operators;
 - This doesn't mean NZ is or will be less competitive than equivalent markets abroad – simply that a different threshold is appropriate;
 - While the Orcon, Callplus and Compass alliance concentrates the market and enables more effective competition on wider scale it also, paradoxically, reduces the number of UCLL operators in a given ESA; and
 - This is reinforced by Commission's analysis which demonstrates a clear correlation between the degree of competition and the number of Competing Providers – specifically the conditions where two are present.
35. We also note the Commission references the continuing role of the Undertakings in reaching this conclusion. Unlike the UK, where BT's undertakings fall away in competitive areas, Telecom's Undertakings continue to apply in Deregulated Areas. This constrains Telecom in a way that does not exist in the UK market

where Ofcom concludes that a market is competitive where three “Principal Operators” are present (or two Principal Operators in certain circumstances).

NEAR ENTRANT CONSTRAINT

36. We agree with the Commission’s conclusion that exchanges which have one Competing Provider and serve at least 6,500 non-cabinetised lines should be deregulated. In the long run we believe that the average unbundled exchange size will turn out to be even smaller as the UCLL footprint expands and operators enter less dense ESAs.
37. We note that this analysis can not accurately reflect actual UCLL operator business cases which will take account of wider issues e.g. whether they already have network in adjacent areas. However, we agree with the Commission’s approach and believe that the conclusion it reaches is both pragmatic and robust. We would, however, propose that the number of addressable lines could be revisited as part of the annual review process (see our comments on review process below). The treatment of cabinetised lines (see above) will also affect this analysis.
38. We note that “Competing Provider” is defined to include cable and UCLL operators (and fibre operators – though none are included at this stage) however the near entrant test appears to exclude cable from the Competing Provider definition. This did not appear to be explicitly stated and no rationale was provided so we presume this was an oversight and request a clarification of the policy proposal and supporting rationale. We note, that while this has only a minor effect on the outcome (we estimate that it adds two additional ESA to the Deregulated Areas), the principle is important.

E. OTHER MATTERS

CHANGES TO THE UBA STD

39. We confirm that we are content with the proposed changes to the UBA STD.
40. We note that, while the changes could probably be implemented without revising the current UBA Price List we propose (for completeness and consistency with the proposal to revise the UBA STD) to flow through the consequential changes to the UBA Price List description in Schedule 2 of the UBA General Terms.

CHANGES TO THE UBA PRICE LIST

41. Like the UBA Service Description, the UBA Price List was drafted when the competition conditions were not in force for the UBA service. Accordingly, like the UBA Service Description, it is appropriate to amend the UBA Price List to remove ESAs where the regulated UBA Service is not available.

42. In particular, the UBA Price List needs to be amended to reflect that the UBA price calculation only draws on regulated ESAs. To implement this, we suggest the following changes:

43. Amend clause 4.1.2, to read (underlined text is new text):

“4.1.2 using data from all Xtra retail broadband plans, but excluding Xtra retail broadband plans:

4.1.2 (a) that use a New UBA Variant that is delivered using VDSL technology (**Commercial VDSL Service**) or VDSL2 technology (**Commercial VDSL2 Service**). (For the avoidance of doubt, where the Basic UBA Service or the Enhanced UBA Services are delivered using VDSL or VDSL2 technology, data on the Xtra retail broadband plans based on those wholesale services must be included in the adjustment.)

4.1.2 (b) where the end user is located in an Unregulated Exchange Service Area.”

44. Amend clause 4.2.1, to read (underlined text is new text):

“4.2.1 whenever Telecom changes its Xtra retail broadband services by:

(a) launching any new broadband product in a Regulated Exchange Service Area;

(b) altering the price of any existing plan in a Regulated Exchange Service Area;

(c) changing the data cap on any existing plan in a Regulated Exchange Service Area.

45. Amend clause 4B2.2, to read (underlined text is new text):

“4B2.2 The **Retail Early Termination Charge** means Telecom’s retail early termination charge for each broadband plan (with and without tolls) supplied by Telecom at retail, excluding Telecom retail broadband plans:

(d) that use a Commercial VDSL Service or Commercial VDSL2 Service.

(e) where the end user is located in an Unregulated Exchange Service Area.”

46. It is unclear how lines which are currently exchange fed - but scheduled to be cabinetised between now and the end of the programme in late 2011 – will be treated. We propose, subject to system constraints (which we are now exploring), to treat these lines as regulated lines. We request clarification of this point from the Commission.

THE UNDERTAKINGS

47. As the Commission has noted in its draft decision, Telecom's Operational Separation Undertakings continue to apply in deregulated areas because UBA remains a Relevant Service under the Undertakings. The Undertakings therefore constrain Telecom in ESAs which are not subject to regulation following the Commission's review. Telecom Wholesale will still be required to supply the UBA service to Telecom business units and other access seekers on the same terms and conditions, including price.

REVIEW PROCESS

48. The Commission proposes 6 monthly reviews with the potential for ad hoc reviews on an exchange by exchange basis in response to requests from interested parties or on its own initiative. The Commission also proposes automatic reviews if Wholesale raises the UBA price.
49. It appears likely to us, evidenced by the continued UCLL roll out (as shown in the most recent Chorus data) and the pending rollout of residential fibre networks that the market will remain dynamic for some time to come. Consequently we support the regular and frequent "refreshing" of the analysis to take account of market entry (and potentially exit); this is consistent with the approach adopted for the UBA data cost review. We therefore propose:
 1. **Quarterly Data reviews:** that the Commission refresh its market data analysis each quarter according to the predefined methodology to ensure currency. This would ensure that changes in the market are captured. If the Commission were minded to adopt this proposal we ask that, since most of the analytical data will be provided by Chorus, the dates for the data review points are consistent with the FTTN notification process. This review period is also consistent with the UBA price review cycle.
 2. **Annual Policy Reviews:** that the Commission reviews the underlying policy or methodology for the UBA competition test once a year initially (though perhaps less frequently as the market stabilises). This would be the opportunity to revisit the market definition and competition assessment.
 3. **Ad hoc reviews:** as required (see comments below)
50. The Commission suggests that an increase in price in an ESA is likely to warrant an ad hoc review. We understand that the Commission would want to monitor developments in both competitive and regulated markets. However, it is not clear why – especially given the constraints imposed by the Undertakings – such a firm stance is required (indeed it may fetter the Commission's discretion and shape behaviour in the market). We note that there are legitimate reasons why prices may rise in competitive markets (increased input costs such as labour or equipment, additional features / value are provided).
51. We would appreciate clarification of the Commission's intentions vis-à-vis grounds for ad hoc review and its rationale for these. If the Commission is minded to

pursue ad hoc reviews initiated by an increase in price in an ESA, such a review should be limited to a check to see if the factual basis on which the ESA was initially found to be competitive is still correct.

LATEST DATA SETS

52. The data analysis in the document is primarily based on information provided by Chorus which took a snap shot of the network at end June 2010. We now have access to end of October 2010 data which we will share with the Commission on a confidential basis.
53. We have re-run the Commission's preliminary definition on Deregulated Areas and there has been some small movement in exchange classification; these are:
 - **New Deregulated Areas:** an additional [] **TNZAP** ESAs should be deregulated because they now have more than one active Competing Provider:
 - **Re-categorised within Deregulated Areas:** [] **TNZAP** deregulated ESA should be re-categorised on the grounds that it previously had one Competing Provider and more than 6,500 lines but has now two Competing Providers.
54. There are another [] **TNZAP** exchange areas which have been unbundled by at least one operator but are yet to show live customers. This suggests there may be further movement in exchange classification in future reviews
55. Finally, we note that the Chorus data used to identify which exchange will have 6,500 lines by end of 2011 is based on an extrapolation of current data, and in particular the number of exchange lines served from the exchange at present. There may be some small change in these figures as we approach the end of the rollout which, in theory at least, could lead to a change in the categorisation of one or more ESAs.