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Dear Daniel

Chorus response to Unbundled Copper Local Loop Backhaul and Unbundled Bitstream Access Backhaul Standard Terms Determinations – Consultation over the market definition and competition assessment

1. On the 30th March 2010 the Commission issued a letter consulting on market definition and competition assessment for UCLL Backhaul and UBA Backhaul. In response to the Commission's questions, Chorus will exclusively address the UCLL Backhaul market. The only reference to be made with regard to UBA Backhaul is to state that we believe it is good practice to align competition tests where practical across markets. We note the Commission's request for conciseness, and therefore we will limit our responses to the questions raised by the Commission in the expectation that there will be an opportunity to provide more specific evidence of competition in the forthcoming section 30R competition review.
2. We commend the Commission for evaluating the effectiveness of the competition test. With nearly two years experience of the UCLL Backhaul market, Chorus agrees it is timely to undertake such a review.
3. The Commission's questions suggest a desire to fine-tune the competition assessment process, and to reflect on how successful the existing regime has been. On balance, Chorus supports the market definition and competition assessment adopted in the STD decision. The questions asked in this paper represent the issues that have been harder to resolve, and are worth revisiting, so we appreciate the opportunity to provide feedback.
4. Our response to the specific questions follows.

Geographic Dimension of the Market Definition

5. We agree with the Commission that the point-to-point geographic market definition is narrow. However in the current market context we believe it to be appropriate. As the Commission predicted, we have seen varying levels of intensity in competition both between and within regions, reflecting the localised deployment of competitive infrastructure.
6. Competition in UCLL Backhaul has logically followed demand for the service. Demand for the UCLL Backhaul service is directly derived from demand for the UCLL service, and UCLL Co-Location service. Growth has occurred in this market to the point where there are now 76 unbundled Exchanges. It is around these unbundled Exchanges where we have seen, and will continue to see, the strongest growth in competition for UCLL Backhaul, as this is where the most traffic growth will occur. In this context of an emerging market, a point-to-point assessment of competition has been appropriate as these Exchanges have been unbundled.
7. This raises the question at what point can the Commission move the market definition to a broader geographic context? It is important that regulatory measures taken to improve competition are scaled back once they achieve their objectives. This principle directly applies to the geographic market definition for UCLL Backhaul. At some point in the not too distant future competition will reach a sufficient level where assessments can be conducted on a regional basis. Arguably the greater Auckland region, with 33 of the 44 assessed links competitive, is nearing this point.
8. It is likely that with the anticipated emergence of Local Fibre Companies (LFCs) and the government's Ultra Fast Broadband (UFB) network there will be sufficient substitutes to UCLL Backhaul. This will occur in many regions. The Commission will then be able to scale back to a regional assessment of competition in this market. A suggested method for defining the geographic markets could be to define each region using the 29 Points-of-Interconnect as a framework.
9. We agree with the Commission's decision to take into account the commercial dynamic of competition via indirect routes for the provision of backhaul services. This factual approach has provided a realistic assessment of competition in the market.

Supply Side Substitution

10. Chorus broadly supports the current definition of 'near-entrant' networks as being appropriate. It is our experience that proximate networks do exert competitive pressure on UCLL Backhaul services, and we support the Commission's decision to take them into account. We believe that the one-year time frame is broadly representative of the time a nearby network may take to build out connectivity to an Exchange within 1 to 2 kilometres, and should be maintained.
11. With regards to the proximity element of the test, the distance definition of the 1-2 kilometres (based on \$150,000 per kilometre) is somewhat of a one-size-fits all approach. As the Commission acknowledges, the costs of deploying fibre can vary considerably due to a number of factors, not least the terrain being traversed. Network deployment costs in the rural environment are typically significantly lower than those for urban areas. Hence we would support this distance being increased to 5 km for rural Exchanges. Should a regional model be adopted in future the 5 km distance could be applied overall for the more rural regions.
12. We think the Commission should also consider the type of competitor in the nearby network. Where that competitor is a lines company, often it will have existing infrastructure in place making traversing distance an easier task than for other providers. Even in an urban environment, a lines company may be able to cover a larger distance for less cost by leveraging its existing infrastructure assets. A line's company's ability to share the cost of this infrastructure across two networks also means they are able to exert a greater competitive threat than other non-lines company market entrants.
13. Lastly, the definition for ease of supply-side substitution will need to be revisited once the UFB network starts being rolled out, as it is likely to have a considerable impact on how competitive pressure is exerted on existing UCLL Backhaul links.

Competition from Vertically Integrated Fibre Network Operators

14. Firstly, it is appropriate to acknowledge the Commission's recognition that Telecom faces competition on links where there is one other wholesale-only backhaul provider. We continue to experience strong competition on links such links.

15. It is also our experience that one other vertically-integrated backhaul provider does provide significant competition on a link. As such we don't consider that regulating such links is warranted. However, should the Commission continue to consider that such operators provide limited competition, then we would call for a cautious regulatory approach, particularly with regard to pricing. If the regulated price for these links is set too low, then incentives to invest in further infrastructure by competitors can be reduced.
16. With regard to incentivising greater innovation and efficiencies. Given the limited attributes of the UCLL Backhaul product we don't believe these need to be given greater consideration in the competition test.

Evidence of Increased Competition and / or Barriers to Entry

17. The chief change since the UCLL Backhaul STD came into effect in June 2008 has been the emergence of the regional lines companies in telecommunications markets, including the UCLL Backhaul market. These players provide, or are planning to provide, fibre services which are substitutes for the UCLL Backhaul service. They have the ability to enter the regional market(s) for backhaul, or expand their existing services beyond their current regional markets. These companies are seeking to position themselves as credible partners with the government for the roll out of the UFB network, and have consequently been busy laying fibre links. These operators should be recognised as potential competition, at the very least within the regions they serve.
18. In its submission on the draft backhaul STD (dated 7 March 2008), Telecom identified 14 operators in the UCLL & UBA Backhaul markets.¹ Since then, a consortium called the New Zealand Regional Fibre Group has emerged, representing 19 lines operators and fibre companies. The NZRFG has been created to "...provide a structure for regionally owned and managed network companies to deliver national wholesale, fibre-based access services to retailers and service providers...".² Those entrants that have emerged since June 2008 include:

¹ Telecom Submissions on draft Standard Terms Determinations for Telecom's unbundled copper local loop backhaul and Telecom's unbundled bitstream access backhaul, Public Version, Appendix A, Part B, Market Overview, page 8, paragraph 15, 7 March 2008

² NZRFG website <http://www.nzrfg.co.nz/>

- Alpine Energy
- Aurora Energy Limited
- Counties Power
- Eastland Group
- Electra
- Electricity Ashburton
- Enable Networks
- Horizon Energy
- Northpower
- Powernet
- Unison
- Velocity Networks
- Waipa Networks
- WEL Networks
- Westpower

19. While admittedly some of these operators are yet to commence network build, others such as Northpower in Whangarei and Unison in Hawkes Bay are rolling out credible fibre networks within their regions. These networks can easily be substitutes for UCLL Backhaul services for the Exchanges they pass near.
20. This emergence demonstrates that the barriers to entry for the UCLL Backhaul market are sufficiently low as to enable significant competition. As previously mentioned, this is particularly true of lines companies. They have the existing infrastructure, experience and capital resource (due to their power revenues) to enter the backhaul market with relative ease. The barriers to entry these operators face are significantly lower than other market entrants, and as such should be recognised by the competition test as exerting greater competitive pressure. All 19 of the NZRFG members have signalled their intent to build fibre networks within their regions.

Frequency of Competition Reviews

21. Notwithstanding the impending emergence of the UFB network, we believe that a review every 12 months is appropriate given the evolution of today's market. This aligns with the Commission's estimate of twelve months for near-entrants to complete build into proximate Exchanges. Competition in the UCLL Backhaul market is intensifying, but often along already competitive links. The Commission could undertake less formal polling of market participants on a quarterly basis, to help identify any changes in market conditions. Consistent with this, we support the Commission undertaking individual link-by-link competition reviews where the quarterly polling highlights market shifts, as well as a formal annual competition review of all links.

22. This approach will need to be revisited as competition intensifies and market dynamics change as a result of the UFB network build.

We thank the Commission for the opportunity to comment, and should this feedback raise any further queries please do not hesitate to contact me at justin.tighe-umbers@chorus.co.nz or by telephone (04) 463 0525.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Justin Tighe-Umbers', written in a cursive style.

Justin Tighe-Umbers
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