TelstraClear Limited

Submission on Unbundled Copper Local Loop Backhaul and Unbundled Bitstream Access Backhaul Standard Terms Determinations – Consultation over the market definition and competition assessment.

20 April 2010

Introduction

1. TelstraClear welcomes the opportunity to comment on the Commission's consultation regarding the market definition and competition assessment methodology for Unbundled Copper Local Loop Backhaul and Unbundled Bitstream Access Backhaul Standard Terms Determinations, issued on 30 March 2010.

2. We support the current distinctions in backhaul links for UCLL backhaul as:

   (a) *transmission capacity on primary links (local telephone exchange to Parent POI Site) of the UCLL Backhaul Service (Primary Backhaul); and*

   (b) *transmission capacity on secondary links (Parent POI Site to ASNAPOI) of the UCLL Backhaul Service (Secondary Backhaul).*

3. We also support the Commission's current view that each segment within the two product markets comprise of a separate point-to-point geographic market.

4. Investment in both primary and secondary backhaul is continuing. As competition develops, it is important that unnecessary backhaul regulation is removed through a regular process of review.

5. Economic theory points to a close relationship between regulation and investment incentives. As Professor Martin Cave has stated, "while regulation properly responds to structure, it also shapes it – in the sense that regulating an asset as a bottleneck will probably keep it one, if it could be replicated."[1]

6. We consider that the current approach, which undertakes a regular review of the development of competition on a route-by-route approach including consideration of near-entrants, remains appropriate, and will significantly reduce any potential distortion that occurs from the initial backhaul services regulated in the Backhaul Standard Terms Determinations.

7. This submission briefly responds to the specific questions raised in the Commission's consultation document.

[1] Professor Martin Cave, *Public submission on the roll-out and operation of a National Broadband Network for Australia,* June 2008, page 6.

UCLL Backhaul

8. The following section responds to the specific questions raised in respect of the UCLL Backhaul Standard Terms Determination.

14. Comments are sought on whether the geographic dimension of the market definition as applied by the Commission is too narrow. In particular, should this be a regional, rather than a route by route, market. If broader geographic market is considered appropriate, how should the boundaries of such a market be defined.

9. TelstraClear supports the existing approach to the market definition that adopts a route-by-route approach.

10. We do not support a blanket regional geographic approach to assessing competition for backhaul links. We do not consider that Primary and Secondary links should be aggregated into a geographic market where competitive conditions are likely to be similar. From a demand and supply-side substitution perspective different Primary and Secondary links are not substitutes for each other. For this reason Primary and Secondary links are separate markets.

11. In its review of the Transmission capacity service in Australia, in 2004, the ACCC noted that:

> *"The Commission believes that broad geographical categories for transmission capacity services are useful in identifying particular transmission markets. It also considers that it is feasible to break these into particular routes where clear distinctions are apparent based on traffic volume and the loci of competing providers.*
>
> *In many cases routes will not be substitutable for each other (ie Sydney-Brisbane is not substitutable for Melbourne-Adelaide). However in many other cases they will be (eg Sydney-Canberra-Melbourne is substitutable for Sydney-Melbourne). Such considerations need to be factored into any competition analysis."*[2]

12. The Commission's current approach considers existing backhaul competition as well as the likelihood and feasibility of additional investment by near entrants. We support a test which provides the appropriate incentives for the further economic investment in competing infrastructure, to minimise any distortion from unnecessary backhaul regulation.

13. TelstraClear expect that the development of further competing network in the medium term is likely to be incremental as investment cases are developed to

[2] ACCC, *Transmission Capacity Service, Review of the Declaration for the domestic transmission capacity service, Final Report,* April 2004.

extend existing primary and secondary backhaul. The outcome of the Government's Ultra-Fast Broadband (UFB) Initiative may result in rapid development of competition on primary backhaul routes within particular urban areas. However, the UFB process is still in its early stages. It remains unclear to what extent the Commission could reasonably consider these developments as a competitive constraint in the short term. However, we do expect that UFB will need to be factored into the Commission's annual reviews of backhaul competition in the future.

14. Different access seekers have taken different approaches to unbundling local exchanges. This impacts the likely demand for UCLL backhaul and incentives for further investment. To date, TelstraClear has unbundled 62 exchanges across New Zealand,[3] Vodafone has unbundled 40 exchanges in Auckland,[4] while Orcon has unbundled 33 exchanges in Auckland and 2 in Wellington.[5] We note that UCLL entry has not occurred on a blanket regional basis.

15. However, while the regulated UCLL backhaul service is limited to the carriage of UCLL traffic, decisions of either vertically integrated competitors or wholesale only competitors for further investment in primary and secondary backhaul links are made on a wider basis than simply the opportunity to carry UCLL traffic. For example, in Australia, transmission is regulated regardless of which service is backhauled. Currently, it is SDH and PRH time dimension multiplexing.

16. For TelstraClear, consideration of opportunities for carrying backhaul traffic include:

- TelstraClear's unbundled exchanges;
- TelstraClear services delivered over wholesale bitstream services;
- TelstraClear's other data services; and
- TelstraClear Wholesale's capacity for third parties.

17. Where TelstraClear considers the extension of its fibre network, these demand factors are considered together with the costs to extend its network. This includes the distance and cost to reach a particular Telecom exchange, competitive carriage options and the nature of the terrain and build. The

[3] TelstraClear media release, *New Zealand's Largest Unbundling Programme Goes Live,* 29 October 2009
[4] Vodafone release, *Vodafone completes Red Network in Auckland*, 6 November 2008
[5] Orcon Media release, *We now have 33 exchanges unbundled, and counting*, Wed 8 Oct 2008, Orcon Media Release, The Orcon+ network grows again as we move into Wellington, 20 Feb 2009

Commission's test includes a stretch factor for near entrants in its assessment.

18. TelstraClear has invested in primary backhaul to a significant majority of the exchanges it has unbundled. Vodafone has an agreement with Vector Communications to provide backhaul in Auckland.[6]

19. As the Commission's paper notes, Vector has previously submitted that competitors tend to enter on a regional basis. While Vector appears to have invested in many of the primary links that are the subject of the Commission's competition assessment, in Auckland and would appear to provide UCLL backhaul to Vodafone, we note that other wholesale providers such as FXNetworks have limited their current investment to accessing a limited number of POIs in a region and appear to be primarily focused on delivering secondary links.

20. If a region by region competition approach was used, this may remove incentives for the incremental investment and extension that currently occurs today. Where a third party did enter and build all primary backhaul links in a region, a regional approach by the Commission would result in all primary and secondary routes being de-regulated. Some links within a regional may be uneconomic to replicate yet they would become de-regulated under a regional approach. The risk of not being able to access uncompetitive backhaul links would be likely to prevent a potential builder investing in any or further primary backhaul links.

21. TelstraClear supports the existing route-by-route approach to market definition and competition assessment. Regulation on a route-by-route basis allows for consideration of the extent of competition according to geographic centres of demand.

17. Comments are sought on whether the Commission's revised approach to 'near entrant' networks is appropriate for determining whether a nearby network exerts a competitive constraint on the supply of UCLL Backhaul Services from a particular exchange. Comments are sought on the use of a one-year timeframe within which to assess supply-side substitution and, in particular, whether it is reasonable to expect a 'near-entrant' to build out to an exchange and commence supply of a backhaul service within a one year timeframe.

22. TelstraClear supports the more flexible approach used in the first and second reviews than the 1km and 2km distance rules used in the Standard Terms Determination. The Commission took the actual build costs and build

[6] Vector Communications Case Study - Vodafone, see http://www.vectorfibre.co.nz/about-vectorfibre/case-studies

intention into account when considering the ability of near entrant fibre networks to provide competitive constraint. The build costs for backhaul can vary considerably dependent on the location and the terrain. We support a one-year timeframe, which is consistent with the Commission's standard assessment of supply-side substitution.

> *18. In particular, views are sought on the Commission's current local exchange by local exchange approach, and on the relevance of the individual elements of the test, specifically the proximity, likely costs, and the intentions of the smaller networks to connect to specific local exchanges.*

23. We consider that the current exchange by exchange approach is appropriate, and provides an appropriate level of 'stretch' for near-entrants. Any decision to build incremental backhaul will be based on the following factors:

- likely usage of the backhaul
    - cost efficiencies to transit retail services;
    - revenue opportunities with wholesale customers;
- likely cost to build the backhaul;
    - proximity to existing network;
    - terrain; and
- alternative sources of backhaul capacity;
    - competitive options available; and
    - availability of regulated backhaul access.

24. For smaller networks, the economic feasibility of connecting to local exchanges to deliver their own UCLL traffic will be lower than for larger providers. All telecommunications providers will have similar build costs for any given primary backhaul route. However the costs savings, and wholesale revenue opportunities, available will differ depending on the size of the provider.

> *22. Comments are sought on whether the Commission should continue to consider that Telecom faces limited competition in relation to routes where Telecom faces competition from one other vertically integrated fibre operator.*

25. We remain of the view that vertically integrated fibre operators such as TelstraClear should be considered as a competitor for the provision of backhaul services. Being vertically integrated does not diminish the competitive constraint that TelstraClear brings to the wholesale markets. TelstraClear operates a significant wholesale division, which provides wholesale data, virtual ISP, telephony and data centres, internet, and voice services. TelstraClear Wholesale markets to carriers, ISPs and resellers.

26. TelstraClear sells transmission capacity to other carriers, but clearly its use is not confined to delivering UCLL or UBA backhaul, but is rather a connectivity product between two points.

27. As we have noted above, investment decisions to extend our existing network include consideration both of the cost saving opportunities available to deliver TelstraClear's traffic, but also revenue opportunities from third party providers.

28. In respect of transmission, TelstraClear Wholesale provides the following services,[7]

> **Wholesale Transmission (W-TX) is one of the digital data communications services from TelstraClear Wholesale's portfolio of Broadband Private Leased Circuit Services. These Layer 1,Time Division Multiplexed (TDM) circuit switched services provide reliable and secure data transport over a dedicated communications channel.**
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>
> **W-TX provides customers a dedicated point to point link supporting a range of discrete transmission speeds between 2Mbit/s and 2.5Gbit/s. W-TX can be used for Inter-Nodal linking between your network equipment or for high speed access linking between your end customers and your network equipment. W-TX is ideal for carrying large amounts of voice, video or data traffic in a secure cost effective manner.**
>
> **TelstraClear Wholesale's W-TX network is available in most major New Zealand cities however it is possible that network coverage will not be available in some remote locations.**

29. To date, TelstraClear has invested in 8,600 km of fibre across New Zealand. TelstraClear has significant capacity within its network, and it is economically rational for TelstraClear to provide wholesale access to third parties where surplus capacity exists. Given the ubiquity of Telecom's network, TelstraClear competes for traffic against both Telecom and other wholesale providers. We do not consider that it is rational to assume that TelstraClear would walk away from revenue opportunities (given the significant upfront cost to build network) where TelstraClear itself faces competition from Telecom, simply on the basis that a wholesale customers has unbundled the local loop.

23. Comments are also sought whether the Commission's approach to market definition and competition assessment adequately addresses investment incentives, so that those incentives

[7] See TelstraClear Wholesale website, http://www.telstraclearwholesale.co.nz/products/data.html

promote infrastructure competition and the introduction of greater service innovation or more efficient technologies.

30. As discussed in response to 18, we consider that the Commission's current approach to its market definition and competition assessment does address investment incentives. We consider that the current approach, with the exception of our concerns around the exclusion of vertically integrated providers, maintains incentives to undertake further efficient investment.

26. Comments are sought on whether there has been a significant increase in the number of backhaul competitors in this market since June 2008, and whether sunk costs and profitability are at levels likely to entice such competition.

31. Competition is continuing to develop in the wholesale backhaul market. This includes ongoing investment by third party providers including TelstraClear, Telecom, Vector, FXNetworks, Citylink, NorthPower, Enable and Velocity Networks amongst others. The increased competition in the primary and secondary backhaul links is being captured in the Commission's regular competition review.

32. TelstraClear expects that the Government's Ultra-fast Broadband Initiative and the development of Local Fibre Companies (LFC) will likely further improve competition in urban areas. However, the UFB is at an early stage and considerable uncertainty remains at this time. The competitive influence of UFB should be considered in the future as the network is rolled out.

31. Comments are sought on the appropriate frequency of competition review every twelve month would appropriately reflect the evolution of the market

33. Comments are sought on whether the Commission should consider undertaking competition reviews on an individual link by link basis, either in response to requests from interested parties or on its own initiative, in addition to conducting a competition review of all links.

33. An annual competition review is a reasonable timeframe to undertake a regular review. However, at the Commission's discretion, or at the request of a party to the Standard Terms Determination, TelstraClear would also support mid-term ad hoc reviews where significant new investment is occurring. For example, decisions around LFC builds in urban areas may lead to the rapid deployment of new fibre in urban areas, and materially impact competition in those areas.

34. We note that the Commission, on its own initiative, or by the request of any party, may reconsider a finalised STD where there has been a material change of circumstances under section 59(1)(a) of the Act.

UBA Backhaul

35. In its paper, the Commission identifies the differences in the descriptions of the UCLL and UBA backhaul services, and the location of the initial handover point in the service description, while noting that the competition test is the same.

> *38. Comments are sought on whether the same framework should be adopted for the UBA Backhaul market definition and competition assessment as is used for the UCLL Backhaul competition assessment.*

36. As discussed above, from a practical perspective, a commercial backhaul link is used to deliver traffic between two locations. Service providers do not purchase backhaul access for UCLL, UBA or other transmission capacity separately. For that reason, investment in competing backhaul infrastructure will improve the level of competition in both the UCLL and UBA backhaul markets at the same level.

37. Accordingly, TelstraClear agrees with the Commission's preliminary view that "UCLL Backhaul and UBA Backhaul Services are sufficiently similar to justify taking the same approach with respect to market definition and competition assessment."[8]

Conclusion

38. TelstraClear broadly supports the Commission existing regular UCLL backhaul competition review, which considers both actual and potential competition when assessing whether Telecom faces limited, or is likely to face lessened, competition on a route by route basis.

39. However TelstraClear remains concerned with the Commission's view that vertically integrated providers, who deliver wholesale backhaul services to other carriers, do not act as a constraint in the backhaul market.

[8] Commerce Commission, *Unbundled Copper Local Loop Backhaul and Unbundled Bitstream Access Backhaul Standard Terms Determinations – Consultation over the market definition and competition assessment*, 30 March 2010, para.37