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**Vector Communications' Submission on the Consultation on Market
Definition and Competition Assessment for UCLL/UBA Backhaul**

Public Version

Dear Daniel,

Introduction

Vector Communications welcomes the Commerce Commission's (the "Commission") consultation on the market definition and competition assessment for UCLL and UBA Backhaul links (the "Consultation").

Vector Communications' Auckland-based fibre-network will shortly be connected to 30 local exchanges and all of the nine Telecom NAPOI's in the Auckland region, providing direct competition with Telecom's UCLL and UBA backhaul links.

We have supported the Commission's backhaul competition assessment since its inception and continue to support it in this latest submission. We are firmly of the view that regulation only serves to distort investment and consumer decisions in the presence, or threat, of robust network competition. Deregulation of Telecom's backhaul links, therefore, remains necessary in the face competitive constraint to ensure efficient investment and consumer decisions.

Our answers to your specific questions are provided below.

Geographic Dimensions of the Market Definition

Vector Communications continues to support the Commission's existing narrow market definition, characterised by individual point-to-point backhaul links.

Although a regional market definition seems attractive, it would be difficult, if not arbitrary, to define appropriate regions in which to assess competition. This is because rival network investors usually make backhaul link investment decisions in a very granular fashion (one backhaul link at a time), although they are guided by

a regional strategy, project or an existing footprint. Adopting a regional competition approach could, therefore, potentially skew investment and customer decisions usually made at a link-by-link level, particularly where there is only partial competition within a defined region.

Other issues that arise under a regional approach include defining a threshold for deciding when competition has arrived in that region (e.g. 20 per cent of links are competitive, 90 per cent?). Indeed, it becomes difficult to make an assessment at a regional level short of investigating each individual link. This suggests the appropriate test remains to be a link-by-link, exchange-by-exchange approach.

Despite this, consideration may eventually need to be given to moving to a simplistic regional approach but only as rival network competition matures and becomes fully entrenched, in clearly defined region. It is our view that this has not yet occurred.

Appropriateness of revised approach to near entrant networks

We broadly support the Commission's approach of estimating whether a business case exists for a near entrant network to connect to an exchange and, thereby, whether Telecom's backhaul links are competitively constrain.

A bona-fide intention to build, backed by well progressed plans to connect by a certain date, seem the best indicator that competitive constraint is present, as it represents a decision has been made and that a rationale investor has established an economic business case. The Commission should rely on this in the first instance.

If no clear intention is made by a rival then the Commission needs to satisfy it self that a business case exists and that there is the threat of competition constraining Telecom's backhaul prices. The Commission has shown a clear preference for using actual build costs to establish a rival network's business case, over relying on build cost estimates. However, actual build cost information is often commercially sensitive, misleading without context, incomplete and/or unavailable. Furthermore, the very reason why a rival network may have no intention to build could be because the business case failed (i.e. costs to high, lack of customer demand). Accordingly, it would seem useful for the Commission to widen its line of questioning to establish if the reason for "no intention to build" is because a business case was investigated but rejected.

This wider line of questioning better informs the Commission where there is no intention to build and simplifies the actual build costs analysis to a statement of the rival network's own business case conclusions. This is preferable to the

Commission having to calculate the business case using incomplete and misleading actual build-cost information.

Finally, where a rival network has not considered building a competitive link and, therefore, has no intention to build, then the Commission will then be forced to apply its build cost analysis; presumably using estimates given actual build cost will not exist.

A potential enhancement to this estimate approach would be to develop a distance rule by urban and rural areas¹, as opposed to large and small networks. This would better recognise the greater economies of scale and scope in metropolitan areas and greater potential revenues.

One Year Timeframe

Although the one year time frame in which a nearby rival network could reasonably supply backhaul from an exchange is somewhat arbitrary, it ultimately seems a reasonable simplifying assumption.

Competition from vertically integrated suppliers

The Commission currently does not consider that vertically integrated businesses provide sufficient competitive constraint to Telecom's backhaul prices. Our general view is that vertically integrated businesses must apply at least some degree of downward price pressure on wholesale backhaul links because at a certain price it must become attractive to supply competing wholesale backhaul-services to competitors. Furthermore, competition at the retail level must also create some downward price pressure on wholesale backhaul inputs to retail products.

Vector Communications has no specific comment on the competitive constraint that Telstraclear currently applies to Telecom's backhaul services, apart from noting that Telstraclear does have a wholesale business that would presumably be open to supplying backhaul where it is profitable to do so. Nevertheless, given a lack of local evidence either way, it is important for the Commission to investigate the degree of competitive constraint from vertically integrated businesses further, before deciding on a general rule as to whether competition should be limited or not.

¹ Currently the rule is 2km for large networks, 1km for small networks. It is not completely obvious whether the current rule already implies this as it does mention that 2km's applies to "fibre-based network with existing *inner-city* coverage" vs "smaller networks with *localised* coverage".

Incentives to invest

As discussed in our introduction, Vector Communications are firmly of the view that regulation only serves to distort investment and consumer decisions in the presence, or threat, of robust competition by a rival network. Accordingly, deregulation of Telecom's backhaul links seems necessary to ensure efficient investment decisions, where they are effectively constrained by competitive pressures.

In light of this overarching reason for deregulation, the key goals the Commission should focus on in applying its competition test are: accuracy of the test in assessing competitive constraint; and the timing of deregulation to accurately align with the onset of this competitive constraint. Vector's submits that the Commission's competition test reasonably achieves these goals.

Evidence of increased competition

It is our view that network competition for backhaul services has not fully matured and there remain strong prospects to profitably invest further in backhaul links.

Anecdotally, there is considerable evidence to back up this conclusion. There are a number of significant investments currently being made by existing rival fibre networks in new backhaul links and capacity, such as FX networks' national fibre backbone build and Vector Communications' expansion of its fibre network to most Auckland exchanges. There is also evidence of a number of new fibre network businesses entering the market, such as Unison Networks in the Hawkes Bay, and a number of regional infrastructure businesses expressing an interest in partnering with the Government to build fibre networks under the Ultrafast Broadband Initiative. Presumably, some of these players will anticipate investing in rival backhaul services.

Barriers to competition

Currently, when a stand alone fibre network player (such as Vector Communications) connects to a Telecom exchange, Chorus' terms and conditions require us to connect one fibre per customer. Whereas, by contrast, Telecom Wholesale are able to aggregate customers over one fibre giving them a potential advantage on connection costs. [...] **VCCI** this situation highlights that if backhaul aggregation and complementary services (e.g. hauling fibre into the exchange, other connection and co-location costs) are not offered to all on equivalent terms then they have the potential to skew the state of competition.

To take account of this, Vector Communications would like to see the Commission review the wider set of complementary services to UCLL and UBA Backhaul in its competition assessment, at least as a secondary test of whether its competition assessment is realistic in the actual market place.

Frequency of competition reviews

Vector Communications favours the Commission's suggested approach to move to a twelve month competition review of backhaul links, supplemented by individual link-by-link reviews on request.

We submit that reviews should be able to be requested by the Commission or any party that has an interest in the state of competition over a particular backhaul link. It would also be useful for the Commission to detail the process and criteria for such review requests, in line with good regulatory practice.

Extension of competition test framework to UBA Backhaul

Vector Communications agrees that UBA Backhaul services are sufficiently similar to UCLL Backhaul services to justify taking the same approach with respect to the market definition and competition assessment.

As noted in the Consultation, there are minor differences in the two backhaul services, but these should not alter the fundamental competition assessment framework that would apply to each.

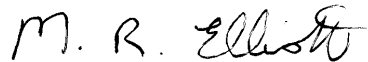
There are two differences the Commission should at least be mindful of though. Firstly, UBA Backhaul is a Telecom Wholesale service whilst UCLL Backhaul is a Chorus service. This will mean that a rival network will need to deal with different parties and on different terms and conditions to connect a competitive backhaul link for each of these services. Secondly, UBA is backhauled to a different part of the exchange, as the Consultation notes. This means, though, that a rival link for UCLL Backhaul will not automatically equate to a rival link for UBA Backhaul, but it does provide for a good nearby rival competition argument.

As a general process matter, Vector would prefer if the Commission assess the state of competition for both these backhaul services at the same time.

Concluding Comments

Vector Communications is happy to discuss our comments in more detail if that would be helpful. Please contact Aaron Webb in the first instance, at aaron.webb@vector.co.nz or on 09-978-8288, or myself at maxine.elliott@vector.co.nz or on 09-978-8224.

Kind Regards,

A handwritten signature in black ink that reads "M. R. Elliott". The signature is written in a cursive style with a large, stylized 'E'.

Maxine Elliott
General Manager
Vector Communications