

23 May 2016

Public

Submission for Chorus in response to
Review of the Designated and Specified Services under
Schedule 1 of the Telecommunications Act 2001
(29 April 2016)

EXECUTIVE SUMMARY

- 1 We offer our comments on the Commerce Commission’s Review of the Designated and Specified Services under Schedule 1 of the Telecommunications Act 2001 (**Draft Decision**), released on 29 April 2016.
- 2 Since the Commission last reviewed the Schedule 1 services, there have been significant changes in the telecommunications industry that have fundamentally changed the competitive dynamics within the market.
- 3 In 2011, New Zealand opted for a structurally separated open access environment and a significant fibre to the home rollout and rural broadband initiative for the benefit of New Zealanders. New Zealand is nearing 50% completion of the fibre rollout, and uptake is at an unprecedented 20% - vastly exceeding expectations 5 years ago, highlighting the pace of change in telecommunications markets. There are aspirations to further improve broadband infrastructure across New Zealand.
- 4 The way consumers are using services has also fundamentally changed. While voice was the primary service five years ago, broadband is now seen as an essential utility. Uptake of both copper and fibre bitstream services has continued to grow, including steady growth in take-up of naked UBA.
- 5 We have responded to this shift by continuing to invest in delivering New Zealand better broadband. 580,000 homes and businesses are now within reach of Chorus’ fibre. 80% of New Zealand homes and businesses are now within reach of VDSL broadband, and 98% are within reach of ADSL broadband. The recent VDSL bandplan change has seen a significant improvement in VDSL speeds. The vast majority of broadband is delivered to New Zealanders using bitstream services, with a steady decline in UCLL uptake over the last 18 months.
- 6 To support the delivery of these bitstream services, we offer a range of backhaul services, with less than 1% of backhaul services purchased from Chorus being regulated services. Since demerger, we have regularly been told by customers that there are competitive alternatives for our backhaul services. We have also recently introduced a TES UFB service in direct response to requests from RSPs to give them more options.
- 7 Against this backdrop, there have been corresponding changes at the retail level. Open access has brought with it increased competition. There are now around 80 retail service providers buying services from Chorus, including new entrants from adjacent markets. There has also been industry consolidation through mergers and acquisitions.
- 8 This type of fundamental market change would ordinarily necessitate a top-down market review which asks questions such as: what is regulation seeking to achieve; what does a market study tell us about the market today; where is there a real risk of that the market won’t deliver on the objectives we are seeking to achieve?

- 9 The current framework drives a narrower consideration: in the context of copper services, where are there grounds to consider the removal of an existing regulated service? While this is a narrower question, the industry changes still provide relevant context.
- 10 In the current market context, we think that there are grounds to investigate the removal of the following Schedule 1 services:
- 10.1 **Resold POTS services** – for the reasons articulated by the Commission, including the fact that VOIP over UBA and other bitstream services is now a viable substitute for voice services. Taking a national approach to the market assessment, even where there are not direct substitutes in every geographic location, is an appropriate approach;
- 10.2 **UBA and UCLL backhaul services** – Less than 1% of the backhaul services that Chorus offers are regulated backhaul services. We have been told anecdotally by our customers that there is competition for our backhaul services. We think there is merit in the Commission gathering updated information from other parties to update the competitive link data. The Commission is in the best position to gather this information. Consistent with the approach for Resold POTS, we also think that it is appropriate to assess the market on a national basis;
- 10.3 **UCLL services** – in a large part of the country, there is a fibre to the home upgrade underway, with transition to that network to continue over coming years. In other parts of the country, there is further opportunity to upgrade infrastructure – including both fibre to the home and vectoring of copper. Unbundling is inconsistent with these opportunities to deliver better broadband to New Zealanders. UCLL uptake has also been steadily declining, and there has only ever been very minimal uptake of SLU (consistent with experience in other countries).
- 11 We also think consistency in market assessments is important for regulatory predictability. We think there is merit in considering whether taking a consistent view on the voice market for both Resold POTS and UCLFS may lead to a conclusion that UCLFS regulation should be considered further.
- 12 Regulation should be imposed (or maintained) only where there is evidence of a market failure and the benefits of regulation are clearly shown to outweigh the regulatory costs. Any regulatory response should also be proportionate to that need. The countervailing principle is that, where there is no evidence of a market failure or no clear benefits to consumers, regulation should be rolled back.
- 13 We do not support regulation being maintained as a backstop just in case a market failure may later emerge. As an open access wholesaler, Chorus has the right incentives to offer commercial services where there is sufficient customer and consumer demand. The threat of a range of regulatory interventions is also a very real, and appropriate, incentive to provide commercial solutions.

14 In the following sections we provide our views on:

14.1 Part A: Resold POTS;

14.2 Part B: UBA and UCLL Backhaul; and

14.3 Part C: UCLL (including co-location).

PART A: RESOLD POTS

- 15 We agree with the Commission’s analysis that there are reasonable grounds to investigate deregulating Resold POTS on the basis that Resold POTS has started, and is likely to continue, to decline given the availability of the alternative wholesale inputs that can be used to provide consumers with voice services. In particular, the Commission observes that:
- 15.1 Interest in Resold POTS has started to decline;
 - 15.2 A range of wholesale inputs can be used as substitutes for Resold POTS;
 - 15.3 Substitutes do not need to be available on the same geographic footprint as Resold POTS.
- 16 For similar reasons there are also reasonable grounds to investigate deregulation of Spark’s “retail services offered by means of a fixed telecommunications network”.
- 17 The Commission appears to accept that deregulation can occur even where the geographic footprint of alternative services is limited. This is more consistent with a national market assessment, and we agree that this is an appropriate approach – particularly when there are only small pockets where competition does not exist.
- 18 For example, UBA and UFB do not have the same geographic footprint as Baseband Copper or Resold POTS. The Commission acknowledges UBA and BBIP are unlikely to reach all end-users with a fixed line.

PART B: BACKHAUL

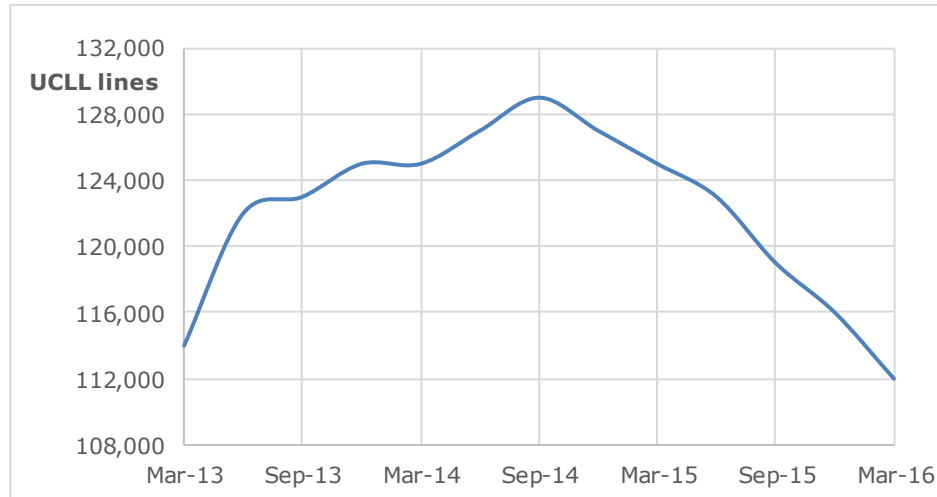
- 19 We think that there are reasonable grounds to investigate deregulation of backhaul.
- 20 Like Resold POTS, there are competitive alternatives or constraints and relatively little take up, though the case for investigating deregulation of backhaul is potentially more compelling. National backhaul is subject to competition and demand for the regulated services is near zero. RSPs (and therefore consumers) also enjoy the benefits of nationwide competition.
- 21 The Commission notes in its report that there is little demand for regulated backhaul and that most backhaul is purchased commercially. There is also strong competition. We agree:
- 21.1 Since regulation in 2008 there has been extremely low demand for regulated UCLL backhaul and no demand for UBA backhaul. As the Commission notes, the vast majority of services taken are commercial services;
- 21.2 Anecdotal evidence from our customers suggests that competition has likely increased since the 2012 assessment. Chorus regularly receives feedback from customers that there is both price and coverage competition for our backhaul services. The Commission also assessed competition in the national backhaul market as “strong” in the Vocus/M2 merger approval decision in late 2015, and Kordia advertises nationwide backhaul with over 51 locations.¹ The Commission is best placed to gather updated information from competitors.
- 22 A key factor that merits further analysis is that the market is not only competitive, but is a national one which acts as a constraint on pricing in any pockets Chorus may still be the only provider. Currently the Draft Decision has analysed competition based on a narrow geographic basis rather than how the market works and the outcomes experiences by backhaul consumers.
- 23 From a theoretical perspective, a national market might develop (in the absence of regulation) across geographically dispersed competitors when:
- 23.1 Large customers require a “one stop shop” for their geographically dispersed purchases and therefore tend to concentrate their purchases from single providers; and/or
- 23.2 The transaction costs (and potentially broader commercial costs) of geographically varied pricing exceed the increased profits from raising price in the non-competitive areas; and/or

¹ <https://www.kordia.co.nz/product/wholesale-backhaul/> accessed on 16/5/16.

- 23.3 The areas with just one backhaul network are nevertheless contestable in some sense, i.e., if the incumbent charged more in them, there would be entry, countervailing power exercised, or regulation.
- 24 Our anecdotal evidence is that reality aligns with the theory:
- 24.1 Commercial services are preferred over regulatory options because they are flexible to meet consumer needs and include value-add services such as potential upgrade paths and the ability to help customers optimise their services given their forward looking view;
- 24.2 Anecdotally, we understand backhaul consumers are prepared to shop around and procure services from several backhaul providers as well as having a geographically dispersed customer base; and
- 24.3 Chorus prices commercial backhaul on a national basis using a distance-based methodology.
- 25 By focusing purely on whether there is localised competition at a wholesale level, the broader competitive dynamics at play in the backhaul market have not been considered.
- 26 The Commission’s view that continued backhaul regulation provides a backstop doesn’t seem well supported by evidence. If the regulated product was fulfilling a “backstop” role, we might expect price discrimination in the areas with no localised competition. This isn’t the case. In addition, the small number of areas where regulation still applies, and the even smaller number of customers that purchase the regulated product indicate that there are reasonable grounds to consider removal of these services from Schedule 1. If regulation has little demonstrable benefit, it should be rolled back.
- 27 Schedule 3 investigations to amend the regulated backhaul service descriptions are also unnecessary. The UCLL/UCLF Backhaul and UBA Backhaul services were regulated to support the take up of the UCLL and UBA bottleneck copper access services. The Commission should not expand regulation in the absence of clear evidence of a regulatory concern and, in particular, given the significant impact regulation has on investment incentives to the market and commercial solutions.

PART C: UCLL (INCLUDING CO-LOCATION)

- 28 We think there are reasonable grounds to commence an investigation into deregulation of the UCLL and UCLL/UCLF Co-location services. This is because:
- 28.1 In a large part of the country, infrastructure is being upgraded to fibre-to-the-home, with 20% uptake to date and consumers continuing to transition. This transition was first signalled in 2008 when the UFB policy was announced;
 - 28.2 In other parts of the country, there is further opportunity to upgrade infrastructure and wholesale services where the business case can be made. This might include rolling out fibre further and vectoring of existing copper access lines. Unbundling is not consistent with these opportunities for improvement for broadband for New Zealanders;
 - 28.3 Regulation should be forward looking and send appropriate signals to both RSPs and network operators about copper investment as New Zealand transitions to UFB;
 - 28.4 It is not clear that UCLL remains an important basis for competition and it is clearly diminishing in importance; and
 - 28.5 Taking a consistent approach to the assessment of Resold POTS is likely to lead to a conclusion that there are grounds to consider deregulation.
- 29 We expand on each of these below.
- Impact on competition**
- 30 The Draft Decision refers to UCLL remaining an important basis for competition in areas where unbundling has occurred. We don't think this is necessarily the case. An investigation into deregulation would present an opportunity to consider the role UCLL is playing, and will play, in the transition to UFB.
- 31 The number of UCLL lines has decreased from a peak of 129,000 at 30 September 2014 to 112,000 as at 31 March 2016, and is now below the level observed three years ago, as illustrated in Figure 1.

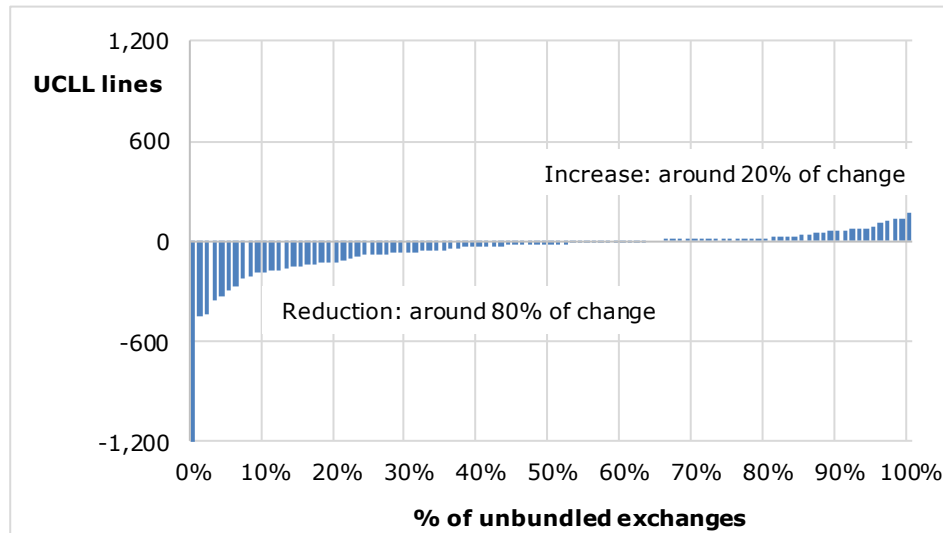
Figure 1 – Growth in UCLL lines (March 2013 to March 2016)


- 32 UCLL lines represent 7% of Chorus copper access connections. The Commission has recognised that RSPs are less likely to invest in UCLL due to the deployment of UFB.⁴ In discussion during the FPP process about how the Commission should appropriately consider the relativity between UCLL and UBA prices, RSPs were sceptical about the potential for further unbundling and suggested it shouldn't be encouraged.⁵
- 33 The Commission has acknowledged the limited importance of UCLL nationally by noting that it is important for competition "in areas where unbundling has occurred". However even in these areas it doesn't seem that unbundling is resulting in innovation or retail price reductions. An investigation would provide the opportunity for the Commission to test the evidence for this.
- 34 Figure 2 shows the change in the number of UCLL lines at each local exchange where unbundling has occurred (as at March 2016).

⁴ Draft Decision para 137.

⁵ See for example: Spark submission on UCLL and UBA FPP pricing review draft determination, 20 February 2015 paragraph 185; and Vodafone comments on further consultation papers on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle, 11 April 2014 paragraph D3.

Figure 2 – Growth in UCLL lines per unbundled local exchange from March 2015 to March 2016



35 The distribution of growth across all the unbundled local exchanges is negatively skewed, with the number of UCLL lines declining in more than half of all the unbundled local exchanges and the volume of reductions significantly more than the volume of increases. The decline in the number of UCLL lines is likely to be linked to a substitution effect, where RSPs decide to substitute the existing UCLL lines for other wholesale inputs.

36 Investment in SLU has been very minimal, which is consistent with experience overseas.

Consistency of approach

37 In relation to Resold POTS, the Commission concludes that there are grounds to investigate de-regulation because interest in the service has started to decline and there are a range of wholesale substitutes. Importantly, these substitutes do not need to be available in the same geographic footprint as Resold POTS. The reasoning (competitive developments) set out in relation to an investigation into deregulating Resold POTS applies equally to UCLL.⁶

38 In particular UCLL has started, and is likely to continue, to decline as a way of providing consumers with broadband and/or voice. This is because:

38.1 The level of investment in copper technologies required to deliver services based on UCLL;

38.2 The transition to UFB fibre and increasing availability of fibre access; and

⁶ Note that Spark takes Baseband Copper and other Baseband variants to provide POTS and Resold POTS. Baseband Copper is available on non-discriminatory basis to all our customers and Chorus is in the process of transitioning to an industry wide Baseband contract.

38.3 The availability of high quality alternative access to Chorus' copper network through UBA requiring less up-front investment.

39 While the Commission hasn't specifically defined the market, the Commission's analysis for Resold POTS implies that it considers UBA, UCLL, Baseband IP, UFB, mobile and fixed wireless services all to be close or near substitutes.⁸ This would then imply that there are a number of substitutes for UCLL.

40 The merits of further investigating deregulation of UCLL are reinforced by thinking about the purposes for which UCLL was regulated and what has changed since.

41 This is also true for UCLF. If UBA is a competitive substitute for resold voice services, it follows that UBA is a competitive substitute for UCLF as a voice input service. There is also no demand for the regulated service. Instead our customers take our commercial Baseband Copper service, so it is unclear how UCLF remains essential to the delivery of voice services.⁹

42 We are not aware of any evidence supporting amendment of the regulated co-location service description. UCLL/UCLF Co-location was regulated as part of a suite of products to support the take up of the UCLL and UCLF bottleneck copper access service. The availability of commercial co-location combined with strong competition in the backhaul market and limited take up of the regulated services indicates to us that competition and market outcomes are satisfactory. The Commission should not expand regulation in the absence of clear evidence of a regulatory concern and, in particular, given the significant impact regulation has on investment incentives to the market and commercial solutions.

Looking forward

43 In the past, UCLL may have provided a cost advantage to those RSPs with sufficient scale but further significant investment is unlikely. However, unbundling has not led to wholesale (layer 2) competition at scale and we're not aware of any service differentiation having taken place due to UCLL.

44 Regulation has to be forward looking. UCLL uptake is declining and this seems unlikely to change given the transition to UFB, which was first signalled in 2008. This decline reinforces the need to consider the role of regulating UCLL – alternative arrangements may be more efficient and/or proportionate. There are very real regulatory costs in terms of maintaining systems, recreating services as new systems are upgraded, and the on-going cost of complexity.

45 With the increasing consumer demand for better broadband, there is a trade-off in continuing to deliver UCLL. For example, vectoring is a technology which uses noise cancellation on VDSL lines to improve the performance for everyone using those lines. It does this by removing the negative impact that interference (or "cross-talk") has on performance. However, vectoring is incompatible with unbundling because for

⁸ See for example paragraphs 148, 152, 139-142 of the Draft Determination

⁹ Paragraph 113 of the Draft Decision.

interference to be cancelled lines need to be on the same DSLAM. As a result, unbundling can limit the opportunities for any improvement for broadband for New Zealanders.

- 46 Even if the UCLL remains regulated there is arguably a case for considering deregulation of UCLL/UCLF Co-location:
- 46.1 Most co-location for UCLL is taken on commercial terms and the STD terms are not often used. As noted above, no RSPs buy UCLF and therefore no UCLL/UCLF Co-location is used for UCLF; and
 - 46.2 Removing regulated co-location would acknowledge the importance of sensible network planning and management in the transition to UFB. Where RSPs have equipment located they will still be able to access MPFs under UCLL but any unbundling of further exchanges would be subject to arriving at commercial terms.
- 47 It is important that regulation is consistent across technologies. Fibre is the future and at a point where it makes sense, we intend to withdraw (on notice) copper services where our fibre service is available. Moving to commercial arrangements for UCLL and UCLL/UCLF Co-location now would recognise the reality of the transition from copper to fibre by ensuring that the regulation is removed when it is not needed to promote competition for the long-term benefit of end-users.