SUBMISSION ON THE FURTHER CONSULTATION ON ISSUES RELATING TO CHORUS UCLL AND UBA SERVICES

PUBLIC VERSION

APRIL 2014

Overview

1. This submission is made by CallPlus. We thank you for the opportunity to comment on the workshop and process and issues papers.
2. This submission should be read in conjunction with
   - Our parallel submission jointly made with Orcon, including the confidential submission;
   - CallPlus submission to MBIE on the review of the act (Sept 2013)
3. CallPlus is the third largest fixed line provider, kiwi owned and the largest unbundler of exchanges in New Zealand with 176 MSANs deployed. This service underpins our entire business plan, including our ability to create compelling fibre & copper based services. Any increase in UCLL pricing above and beyond the increase we already face through averaging or collapsing of the relativity to UBA has a critical impact on the future of our business and our ability to compete in the market for all services – whether copper, fibre or wireless based.
4. As outlined below, if we and other providers such as Orcon cannot competitively provide retail services, or go out of business, that leads to bad outcomes for end-users. In particular, it leads to duopoly conditions with all the poor outcomes that entails for end users and is contrary to the long term best interest of consumers (LTBIE). If the business models of players like CallPlus fail, then 2Degrees may also be impacted in the future as they undoubtedly need to have a fixed-wireless proposition. The proposed changes may eliminate potential partners in the fixed market which will have negative consequences in the mobile retail market.
5. When clearing Vodafone's acquisition of TCL, the Commission recognised, when dealing with duopoly and related concerns the key role that CallPlus and Orcon have as a competitive constraint.

Services

6. CallPlus fought for unbundling for over a decade. After getting unbundling regulated, within weeks cabinetisation was announced - this is a prime example of the threat of competition encouraging investment from incumbents.
7. Access seekers were very vocal about the adverse impact that cabinetisation had on their UCLL plans. Ironically it is the costs associated with cabinetisation that the Commission is considering, as an option, be recovered in part by Non-cabinetised unbundled lines (NUCLL) – the very service it impacted.

8. CallPlus and others players then successfully fought to get access to UCLFS, to at least ameliorate some of the impact of the cabinetisation, after the Commerce Commission investigation into Telecoms actions in delaying and denying access. True to its word, once available CallPlus made a significant investment in unbundling.
9. In this submission and in the joint submissions, we outline our views on which services are being priced and our views on the approach that the Commission should adopt based on the Act and the STD's.
10. CallPlus does not support the concept of 'aggregating' the current copper services NUCLL, SLU, UCLFS and non-copper services such as SLU Backhaul. This is effectively resetting the regulatory landscape by stealth. That is not the purpose of the FPPs. The FPPs are about determining a price for copper services UCLL, SLU and the UBA service. That is what parties asked for in their application, neither SLU Backhaul nor UCLFS were included in the applications (and nor could they be).   Updating the pricing of UCLFS is being processed via the separate s 30R review. While it can be done in parallel to achieve efficiencies, that is ultimately a separate process. We explain in the joint submission why UCLFS is only relevant to the stage of the FPP process where revenue sharing between services is considered. In relation to the SLU Backhaul service, we outline, in our joint submission why that service does not need to be reviewed for the UBA and UCLL FPPs, but that we consider that the Commission should commence a s 30R review of the SLU backhaul service in any event.
11. If Commission decides it should combine the copper local loop services (NUCLL & SLU), or set the same price for both services then SLU backhaul should not be included in the UCLL cost stack for the reasons outlined. If the Commission is looking at which service the SLU Backhaul costs should be recovered from it is UBA and any other commercial services (other than UCLL) that should recover these costs. That is clearly the intent in the Act and it is logical as it is improved broadband that was the driver for the investment – not unbundling and not voice.
12. UCLFS is a legacy service, whilst it shares lines from the cabinet to the exchange with UBA and other services it is clearly the intent in the Act that it is now UBA that should correctly absorb these costs, hence the removal of naked and clothed UBA. UCLFS is clearly a different service to the others in that it is the only service that is defined as using the full unbundled local loop and it is the only service that chorus has no obligation to maintain. Additional marginal costs associated with it are negligible.

Relativity

13. Investments in unbundling have been critical for competition. CallPlus outlines the impact on competition, not just copper competition but competition as a whole including fibre and wireless (given the convergence of fixed & mobile) if the relativity between UCLL & UBA collapses.

14. Without the presence of players such as CallPlus and our LLU investments, there is a very real risk of a duopoly in the fixed line market of integrated mobile-fixed players. In approving the merger of Vodafone and TelstraClear the Commerce Commission concluded (emphasis added):

> *" that, post acquisition, Orcon and Slingshot will continue to act as aggressive, price leading competitors in the market.* ***While they lack the scale of Telecom or the merged entity, they are able to compete effectively, especially in areas where they have unbundled (where Vodafone's fixed network is largest)****. The Commission considers that, post acquisition, Orcon and Slingshot will provide competitive constraint on the merged entity "(Determination 12 Aug 2012 Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33)*

11. If the business models of players like CallPlus fail, then 2Degrees may also be impacted in the future as they undoubtedly need to have a fixed-wireless proposition. The proposed changes may eliminate potential partners in the fixed market which will have negative consequences in the mobile market.

12. Surely we must have learnt something from the mobile landscape of four years ago. In the absence of the threat of competition from CallPlus and players such as Orcon, it would be short sighted to dismiss the prospect of a 'cosy pillow fight' between a duopoly of integrated mobile and fixed players with *'overpriced and underperforming'* fibre plans competing with LTE. That doesn't benefit consumers or Chorus investors.

13. When considering relativity CallPlus believes that the risks associated with underestimating the relativity far exceed the risk of overstating, up to a point, as there are many other factors to be considered before further unbundling in copper occurs (it's not just an investment in MSANs) and the fact that no other unbundler or prospective unbundler has Chorus' scale and so faces higher costs per line.

Grandfathering

14. If the Commission takes actions which result in further increase in cost on NUCLL and UCLFS services then without grandfathered coverage for existing deployments unbundlers will end up with underutilised networks (including MSANs) and a spiral of escalating costs per user.

MEA & Modelling

15. CallPlus has serious concerns about the timetable for the process as outlined in our joint submission and is very concerned that a Chorus centric approach be adopted.

16. CallPlus urges the Commission to look at other deployments and examples of sharing existing infrastructure. Northpower has deployed a fibre network where the majority of lines are overhead and have often commented that their cost of deployment was significantly reduced as a result.

17. Vector bid for the UFB contract and undoubtedly looked to reuse their existing assets. Information in that bid would help inform decisions. Furthermore Vector tried to reach an agreement with Chorus on sharing their assets and failed. The commission should get a better understanding of why that occurred.

18. TelstraClear have experience in deployment and sharing of third party infrastructure which again could better inform the model.

19. To not do this assumes that Chorus' deployment is optimal. To model one option based on Chorus' deployment appears to mainly be driven by a desire to 'time-box' the FPPs.

20. It is important that the model includes revenues earned from other commercial services that share the network – value add-ons, dimensioning or QOS variants, VDSL etc.

21. The model should exclude those Chorus lines that are not able to be unbundled or are not capable of providing a UBA service.

22. CallPlus are also concerned that a single MEA option is being modelled rather than at least consider multiple option in order to assess what is the lowest cost or most efficient option.

23. In conclusion CallPlus does not believe that the FPP process should be used to reset the regulatory landscape and the potential consequences for competition and consumers are significant.

24. If you have any questions on this submission please direct to the individuals below

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Detailed Submission

Section1: The Services

Aggregation of Layer 0, 1 & Layer 2 services

25. The Commission raised the issue at the UCLL & UBA FPP workshop (‘workshop’) that an option being considered was the aggregation of services.

26. CallPlus has previously commented on the fact that the de-averaging of NUCLL and Sub-Loop copper MPF service ‘SLU’ (as distinct from Sub-loop co-location and Sub-loop backhaul) is something of an anomaly since its clearly the intention of the changes to the Act post separation that averaging of the ‘price of a service’ such as rural and urban UCLL, retention of averaged UBA and an averaged UCLFS price.

27. We would like to draw a distinction between averaging the price of a service and aggregating several services. UCLFS for example is a very different service to UCLL, with completely different applications and purpose. UCLFS is a legacy service only available where copper existed and there is no obligation on Chorus to maintain the service. SLU backhaul is a regulated service that is entirely separate from SLU and NUCLL, even though it is only taken in conjunction with SLU. SLU backhaul operates over the path from the cabinet to the exchange. Neither SLU nor NUCLL operate over that path: they are copper only services from the cabinet (where cabinetised) and from the exchange (where not cabinetised).

28. We expand on this in our joint submission.

29. The Commission shouldn’t be using the FPP process to reset the regulatory landscape that requires changes to the Act.

The Act does not contemplate aggregating Sub-Loop Backhaul with other services

30. If the Commission believes that the intent of the Act is that Sub-Loop & UCLL are not necessarily distinct services that does not mean that it is the intent to merge (a) cabinet to exchange backhaul and (b) other access services.

31. In fact the opposite. At a practical level the act clearly distinguishes, as do the STD’s, between SLU backhaul and UCLL access services. The clear intention is that the backhaul

services are a separate service that the Access Seeker may or may not take in conjunction with the access service. There is the potential for alternate suppliers.

32. In CallPlus' opinion aggregation of SLU backhaul with UCLL & SLU is a different issue to averaging of SLU and UCLL MPF services.

33. The definition of Chorus' unbundled copper local loop network *'enables access to, and interconnection with Chorus' local loop network (including any relevant line in Chorus' local telephone exchange or distribution cabinet)".* It seems clear that this intends for the interconnection to be either in the exchange or the cabinet and it is not intended to cover non- copper lines or fibre backhaul from the cabinet to the exchange.

34. If the act intended the loop service to include fibre for example it would have said so as it has done so for the backhaul service. The description of Chorus SLU Backhaul – explicitly states that it is regardless of "whether the transmission capacity is copper, fibre or anything else".

35. We submit further on this in our joint submission

The Commission suggests that de-averaging of UBA & UCLFS is the alternative

36. In the workshop papers the Commission suggest that if the distinction between NUCLL & SLU continues they should consider whether UBA and UCLFS should be de-averaged into cabinetised and non-cabinetised prices to make the approach consistent.

37. It seems self-evident that this is not the intention in the Act for a number of reasons including the fact that the act specifically averaged urban & rural UCLL services into a single averaged UCLL service.

38. It is clear that UBA & UCLFS should remain averaged. That does not mean that the relevant costs associated with delivering those services, whether via SLU or UCLL should not be applied to the service resulting in a single averaged price for each service.

39. If a radical change in approach resulted in a cabinetised and non-cabinetised price for UBA & UCLFS (with the implication that cabinetised services cost more) there would be significant distortions in the competitive market.

a. Unbundlers would be seriously disadvantaged as they would pay a significantly higher price for UCLFS cabinetised (the only UCLFS they use). However Telecom, who are not an unbundler but are the main user of UCLFS would be neutral as the lower priced non-cabinetised UCLFS would balance the cabinetised UCLFS.

b. Unbundlers would also be seriously disadvantaged as they use a higher portion of cabinetised UBA than a non-unbundler such as Telecom. A similar logic to the previous point.
c. It would create significant complexities for consumers whereby people in the same area are priced at different prices. The 'pocket' like nature of cabinets within a populated area would be extremely confusing. For this reason unbundlers have tended to price on-net services at the same price regardless of whether the customer is cabinetised or not.
d. This all has negative effects on end users and the LTBIE such as reducing or eliminating the competitive constraints due to providers like us being in the market.

40. De-averaging UBA & UCLFS does not appear to be an attractive option nor is it consistent with the intent of the act in our view.

If SLU backhaul costs are to be recovered, UBA, UCLFS and other cabinet to exchange services are the correct service

41. If there is a risk of under recovery of SLU backhaul & cabinetisation costs, then the primary service to apply them too is UBA, commercial services, and, if necessary, to UCLFS (to the extent that any of those services use the cabinet to exchange path. Those costs cannot in any event be recovered from the UCLL price.

42. If one considers why cabinetisation occurred it is a good indicator to which service should bear the cost. Clearly UBA was the primary driver for cabinetisation, voice (UCLFS) was clearly not a factor in the decision to cabinetise. Ironically unbundlers were the biggest losers in the decision as it ring fenced 50% of the lines from unbundlers and sparked a lengthy fight for access to UCLFS for unbundlers on an equivalent basis to Telecom.

43. Clearly UBA is the service that drives the need for active cabinets and an increased number of cabinets. In addition it is UBA that uses the fibre that feeds the cabinets. Neither UCLL nor UCLFS use any of these components, UCLFS being a copper-only service. As has been discussed at the very least each of the components should first be identified, e.g. separating duct, fibre, active electronics to understand which service (including non-regulated commercial services & core network services) use these.

44. Clearly the act envisages that UBA should be the service bearing the 'layer 0+1' costs of the underlying network. This is explicit in the removal of the concept naked and clothed UBA to one where UBA bears the cost not UCLFS.

45. **UCLFS is a significantly different service to the other services being considered** in that UCLFS is a legacy service which has limited utility. This is reflected in the fact that

'Chorus has no obligation to maintain the copper from the exchange to the cabinet (SLE's) that UCLFS uses. This is in stark contrast to UBA.

46. CallPlus therefore believes that the intent of the Act is that it is UBA (and any relevant commercial services) that are required to absorb cabinetisation and SLU fibre backhaul costs not UCLFS. There is one exception which is consistent with the approach that has been used in the Act. That is the notion of naked and clothed UCLFS – i.e. where the layer 0+1 costs are not recovered by UBA. In the case of legacy 'voice only' UCLFS it is reasonable to expect that the cost of the legacy copper and the ducts be recovered by the service. However the fact that the service is a sunk cost service with no obligation to maintain it needs to be factored into any modelling.

47. What seems clear is that it is totally unreasonable to expect UCLL to bear the cost of network components it never uses and the very presence of these network components constrain its utility.

Section 2: Relativity – Asymmetric Risk

48. As the largest unbundler this is a critical issue for CallPlus and competition. The Commission is balancing the incentive for further investment in new exchanges and cabinets against the impact on existing unbundlers, their investment (in MSANs and network expansion) and their ability to compete.

49. CallPlus believes that the risks associated with too high or too low a relativity between UBA & UCLL are not symmetrical in terms of their impact on consumers and competition.

Asymmetric Risk:

What is the impact on existing unbundlers if the difference in price is too low?

50. If the differential between UCLL & UBA is set too low clearly unbundlers are disadvantaged. Unbundling has been encouraged by the regulatory regime up to this point and the benefits in terms of competition and consumers has been well established by the Commission itself in numerous monitoring reports.

51. The Commission recognised the importance of unbundling investments in terms of competition. The following two points are an extract from CallPlus' confidential submission on the MBIE Review of the Act discussion paper (Sept 2013) – para 11-12:

> Without the presence of players such as CallPlus and our LLU investments, there is a very real risk of a duopoly in the fixed line market of integrated mobile-fixed players. In approving the merger of Vodafone and TelstraClear the Commerce Commission concluded (emphasis added):
>
> > *" that, post acquisition, Orcon and Slingshot will continue to act as aggressive, price leading competitors in the market.* ***While they lack the scale of Telecom or the merged entity, they are able to compete effectively, especially in areas where they have unbundled (where Vodafone's fixed network is largest)****. The Commission considers that, post acquisition, Orcon and Slingshot will provide competitive constraint on the merged entity "(Determination 12 Aug 2012 Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33)*

52. If the business models of players like CallPlus fail, then 2Degrees may also be impacted in the future as they undoubtedly need to have a fixed-wireless proposition. The proposed changes may eliminate potential partners in the fixed market which will have negative consequences in the mobile market.

53. CallPlus' submission to MBIE on the review of the Act continued to outline why the collapsing of the relativity would have a critical impact on the existing unbundler's

investment in their overall network (of which MSANs are a component) and potentially the survival of their business.

54. Whilst the submission focussed on the prospect of the Minister raising the price of UCLL & UCLFS through changes to the Act the consequence was the same – a collapse of the relativity.

55. As we explain in more detail in our joint submission:

a. The UCLL and UBA service descriptions in the Act are unique in requiring specific focus under s 18 on relativity. Contrary to the general approach, where s 18 has a more limited role, the Act expressly directs the Commission as to application of s 18. Therefore it plays a more central role as to relativity;

b. Section 18 is **solely** about competition in the long term interests of end-users. To the extent that dynamic efficiencies apply, and s 18(2A) applies, that is **solely** from the perspective of competition in the long term interests of end users. Therefore, factors such as investment incentives for UFB, and UCLL, are only considered **solely** from the perspective of competition and end users.

c. The relativity question is **solely** about encouraging competition in the LTBIE, the meaning of which is clarified but not changed by s 18 (2) and (2A).

d. That requires analysis that extends, for example, to the impact on end-users if copper based competition is eroded (or, as may well happen, eliminated as RSPs such as us are forced to exit the market).

56. The following points (57 to 104) are an extract from CallPlus' confidential submission on the MBIE Review of the Act discussion paper (Sept 2013) – para 43-88:

The investment in exchanges is the 'tip of the iceberg'

57. CallPlus is the largest unbundler in New Zealand with 176 exchanges unbundled. , 26 of those currently being deployed and due to go live by the end of 2013. It needs to be understood that the investment is not just in placing equipment into Chorus exchanges, it is about investing in our network reach and scale to support the unbundling.

58. Building to 176 exchanges across New Zealand has meant CallPlus has had to invest significantly in its network capability to support the deployment. By way of example this includes: [

59. .

60. .

61. .

62. .

63. .]CI The Commerce Commission acknowledged the importance of caching in its 2009 report on NZ broadband Quality in September 2009: -

> *"Impact of Caching: Caching of international content is an important factor in the performance of New Zealand broadband services. Caching stores international (and sometimes national) content locally, which enables subsequent users of the same international content to download it at local or national speeds. The impact of caching international content on performance can be significant. … Telecom, TelstraClear and Slingshot are the only ISPs tested that are caching international content successfully. …... It was expected that more ISPs would install caching to improve the performance experienced by their customers. Enquiries suggest that this has not happened because of: - Capital constraints; and/or - Caching is complex and has to be handled carefully to address security issues so is still under consideration by some ISPs."*

64. Telecommunications is a scale game and investments in reach and capacity have high fixed cost components. CallPlus has made these investments in anticipation of being able to grow its business through lower costs from moving up the ladder of investment and better performing services through a greater degree of control.

Further investment required to refresh existing investment

65. It is not just about the investment made to date. We cannot just ignore the existing investment. CallPlus will need to continue to invest to ensure that the current capability keeps pace with the market. This is the norm for technology investments.

66. By way of example, as the market moves to VDSL it will be necessary to add this capability to the nationwide network of MSANs provide a competitive service in unbundled, non-cabinetised areas. This will also give customers a flavour of what they can expect with fibre, so it is a natural evolution.

Growth is critical to prevent sub-scale network utilisation

67. CallPlus has made a major investment, not only in unbundling exchanges but in the core network capability and reach. All of these investments have been made on the premise that CallPlus can achieve a growth in its market share as a result of offering more competitive, better performing services for consumers.

68. Telecommunications is a scale game. Without the growth CallPlus will face high costs per customer due to the fixed component of the investments. To illustrate this point and just looking at the utilisation of our unbundled exchanges, the graph below highlights the importance of CallPlus being able to market its services in unbundled areas to new customers.

69. [.

70. .

71.]CI CallPlus has invested, created compelling propositions and backed itself to grow its market share to achieve a lower cost structure.

72. However, if the Government artificially levy a tax on UCLL and UCLFS (Baseband) and collapse the relativity of UBA to UCLL, CallPlus face additional costs as a result of the levy and the prospect that they are no longer able to sustain competitive prices in the market.

73. By way of example, if the Commission sets a UBA price of $12 and the Government sets a $40.50 target price CallPlus could face a 50% increase in the price it pays for urban UCLL – to $28.50. This would require a very drastic rethink of our entire business plan simply to survive.

74. If CallPlus and others are unable to compete against Telecom in unbundled areas, we will face a downward spiral of lower utilisation of assets and escalating costs per customer per month.

Grandfathering lines doesn't address the issue

75. Simply grandfathering lines does not address the issue. Determining that all existing UCLL and UCLFS lines pay the averaged UCLL price of $23.52 and are exempt from the copper tax **does not** protect our investment. Increasing our costs on further unbundled lines (UCLL or Baseband) inhibits our ability to create compelling prices which in turn inhibits our ability to get new customers. With people moving house every 3-4 years unbundlers could rapidly see declining acquisition levels, on-going churn, reduced utilisation and rising costs per customer – further fuelling the downward spiral. This is illustrated in the graph above.

76. Grandfathering coverage, or effectively precluding the unbundling of any new exchanges and cabinets, is the only protection that may be effective. This would allow existing unbundlers the opportunity to utilise their investment in the manner they expected and pay the copper cost for UCLL and Baseband services they relied on in their business case. Still, we face the risk of not achieving market growth that is inherent in, and factored into, the investment decision. All of these components are critical to competition surviving in the fixed market.

Marketing investment: unbundling underpins entire marketing strategy

77. CallPlus has two residential brands 'Slingshot' and 'Flip' and they have based their entire marketing strategies and business plans on the UCLL network investment – the "Better Network"

78. Slingshot competes aggressively with Telecom and Vodafone nationally, not just in areas where it has unbundled exchanges. This is essential for a mass market retail service provider using above the line advertising given the investment made in the nationwide network and the need to maintain scale. This requires compelling offers in all areas of New Zealand.

79. It is impractical for any national retail service provider (RSP) to micro-market and align price points to costs. It is necessary to cross subsidise between different costs to deliver to simplify marketing and create coverage areas.

80. Slingshot market two price points:

- On-net where services are provided by a combination of baseband + UBA and full UCLL
- Off net where services are provided by Telecom Wholesale Homeline + UBA

81. Slingshot is currently competing with a nationwide bundle of Voice + 30Gb Broadband from Telecom at $75 incl. GST ($65.22 excl. GST). The Telecom offer also includes 1 month free and a free wireless modem. If CallPlus simply matched the Telecom price, the table below shows the relative margin that both parties make by area. Telecom make $20.04 per month after paying Chorus, CallPlus' varies from $0.24c per month in non-unbundled areas and between $7.24 - $28.70 in unbundled areas.

- It is important to note that these figures do not take into account:
- One of costs such as CPE, LLU connection fees, Porting fees
- National and international backhaul
- Servicing and provisioning costs
- Operational overheads
- Marketing and selling costs
- Any promotional offers, for example the first month free

		Telecom	**CallPlus**		
		Averaged Cost	**Not Unbundled**	**Unbundled Exchanges**	
				Cabinetised	**Non-Cabinetised**
Cost of Access					
Chorus Average UCLL	$ 23.52				$ 23.52
Chorus Baseband	$ 23.52	$ 23.52		$ 23.52	
Unbundlers MSAN Port costs *	$ 13.00			$ 13.00	$ 13.00
Chorus UBA	$ 21.46	$ 21.46	$ 21.46	$ 21.46	
TNZ Wholesale Homeline (RONZ)	$ 37.79		$ 41.50		
TNZ Wholesale H/L Features	$ 2.50		$ 2.50		
Unbundler Pays		$ 44.98	$ 65.46	$ 57.98	$ 36.52
Retail price 30Gb Telecom national Bundle	$ 75.00				
ex GST	$ 65.22	$ 65.22	$ 65.22	$ 65.22	$ 65.22
Contribution (after access cost) per month		**$ 20.24**	**-$ 0.24**	**$ 7.24**	**$ 28.70**
% Lines in coverage		**100%**	**45%**	**29%**	**26%**
Note: Does not include one-off up front fee connection for LLU which varies from $70.46 to $155.10					

82. In fact, Slingshot has competing offers in the market at lower prices than Telecom at $69 (compared to Telecom at $75) for on-net customers and $74 (compared to Telecom at $75) off-net. Slingshot also offers 40Gb of data, but no first month free. These offers are necessary to prevent being squeezed out of the market, but come at a significant financial impact.

83. **[ ]CI**

84. Growth is an imperative and CallPlus continues to make marketing investments that are entirely dependent on our UCLL investment.

85. Marketing investment: Flip illustrates the issue

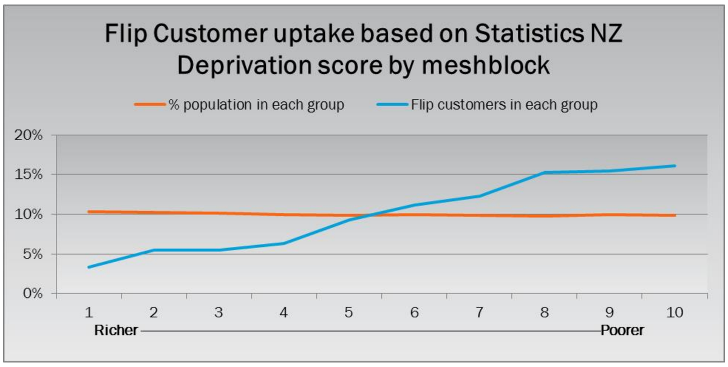
86. This section references the public submission made by Flip, a subsidiary of CallPlus Ltd, to the Commerce Commission on the UBA price review in February 2013.

87. Flip is a marketing investment in a fighting brand designed to grow market share by leveraging our infrastructure investment.

88. Flip commenced operations in New Zealand in September 2012 and focusses solely on the areas where the CallPlus LLU network had been rolled out. This gives Flip a coverage of nearly 450,000 direct-connected residences (where the residence was fed directly from an exchange where CallPlus had installed equipment), and another 550,000 residences that are fed by cabinets that are connected to the exchanges where CallPlus equipment is installed.

89. Flip was established as a specialised voice and broadband supplier, aiming to create the lowest cost and most efficient ISP possible. It focussed exclusively on areas where it has rolled out the CallPlus UCLL network, so that it could control and automate every aspect of the service, thus reducing costs to the extent it was possible to offer a bundled voice and broadband product for around the same price as the incumbent suppliers offered voice only. Flip has made a significant investment in the redevelopment of its IT services to achieve this level of specialisation.

90. Because of this approach, a large percentage of Flip's customer base are both first-time broadband users and come from the most socially deprived regions that we have coverage in.



Flip also outlined that it cross-subsidised the cost in cabinetised lines to margin from LLU areas.

	Cabinetised	Non-Cabinetised urban	Non-Cabinetised rural
Minimum Revenue per customer	$43.43	$43.43	$43.43
Minimum payment to Chorus	$44.98	$19.08	$35.20
Gross Margin(loss)	**($1.55)**	**$24.35**	**$8.23**

91. The launch of Flip and the establishment of the brand through television advertising has been a significant investment for CallPlus. [.

92.]CI

But even if we increase your LLU costs you will still benefit from a reduction in UBA costs. What is the problem?

93. There have been suggestions that the smaller competitors, who have unbundled, will be alright if they have to pay more for UCLL costs because UBA prices come down at the same time.

94. The earlier example of the competitive pricing by Telecom at $75 for a Homeline and 30 Gb Broadband plan demonstrate that there is a competitive market as a result of the threat of competition from unbundlers, however the competition is somewhat fragile and entirely dependent on lower costs as a result of unbundling investments (moving up the ladder of investment). A fact acknowledged by the Commerce Commission on a number of occasions.

95. If the Government were to reduce UBA costs but artificially levy UCLL costs they will destroy the relativity of UBA to UCLL. This leaves smaller, less deep pocketed, unbundlers (including CallPlus and Orcon the third and fourth largest ISP's) very vulnerable to a price squeeze from the incumbents, but Telecom in particular.

96. CallPlus has consistently stated through numerous Commerce Commission submissions that it believes that reductions in wholesale costs will pass to consumers. That being the case, if Telecom sharpens their prices further by passing through the UBA reduction to consumers, this means unbundlers will find themselves in a price squeeze with artificially raised UCLL costs and collapsed relativity of unbundlers to non-unbundlers costs.

97. If the smaller RSPs such as CallPlus and Orcon lose market share they effectively face a cycle of reduced network utilisation, escalating costs on a per customer basis and reduced competitiveness in the market.

98. Paradoxically Telecom only behaves this way because of the competition from CallPlus and Orcon leveraging UCLL investment**. The loss of this competition is not in the long term best interests of consumers, <u>or UFB, or Chorus</u>.** It will ultimately impact innovation that is driven by the challengers as well.

Competition matters to Consumers, Chorus and UFB

99. Artificially increasing the price of UCLL, potentially 50%+ on current urban pricing, will have a major impact on CallPlus and others ability to compete and potentially the long term survival of the third and fourth largest competitors in the fixed market.

100. Other investors such as 2Degrees are also impacted as they undoubtedly need to have a fixed-wireless offering in the future and potential partners in the fixed line market with viable business models.

101. The impact that 2Degrees have had on the mobile market is self-evident in the Commerce Commission Annual Report. 2Degrees have had Venture Consulting estimate the direct and indirect economic benefit from increased competition in the mobile market at over $3.9 billion to the economy to date.

102. CallPlus and other players have played a similar role in the fixed market and arguably their role will be more important looking forward to UFB. Competition from CallPlus based on our LLU investments is critical to the market dynamics and the long term benefit of consumers. In approving the merger of Vodafone and TelstraClear the Commerce Commission concluded (emphasis added):

i. *"Conclusion on Slingshot and Orcon*

ii. *219. The Commission considers that, post acquisition, Orcon and Slingshot will continue to act as aggressive, price leading competitors in the market.* ***While they lack the scale of Telecom or the merged entity, they are able to compete effectively, especially in areas where they have unbundled*** *(where Vodafone's fixed network is largest). The Commission considers that, post acquisition, Orcon and Slingshot will provide competitive constraint on the merged entity."*

iii. *(Determination 12 Aug 2012 Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33)*

103. Competition will be critical to UFB and to Chorus.

- It is the margin that competitors make from unbundling investments that will allow them to create compelling fibre based services.
- It is the scale of their copper based customers that underpins their ability to invest in the network components that UFB will leverage.
- It is the presence of those fibre services from the small competitors that will 'keep the big guys honest' and drive fibre uptake

Without competition it's not hard to envisage a scenario where premium prices are charged for UFB by the duopoly providers who pick and choose, selectively preferring to promote delivery over their own on-net LTE services rather than UFB.

[end of the extract from CallPlus' submission to MBIE]

Asymmetric Risk:

What is the impact if the difference in price is too high?

104. The preceding section outlined the significant impact on unbundlers of collapsing the relativity. In this section CallPlus would like to consider the consequence of the relativity being too high and whether any further investment – above and beyond investment in existing deployments for refresh and items such as VDSL capability – is likely to occur by either existing unbundlers or new unbundlers. In CallPlus opinion even if the price relativity is on the high side it is highly unlikely any further unbundling will occur.

105. In the last 12 months there have been significant developments and other factors that need to be considered when assessing the likelihood of further unbundling, either into new exchanges by unbundlers or a move by Telecom. It's not just the price relativity that needs to be considered.

- Clearly UFB itself is a disincentive for further unbundling. Whilst coverage is currently limited the rollout is accelerating and coverage is increasing. Unbundlers themselves are now actively promoting UFB and the incentive to invest further in unbundling correspondingly reduces.

- For Vodafone & Telecom the investments in 4G / LTE provide very real alternative delivery which are aligned with their strategies and better future proofed. With technology developments unbundling increasingly looks significantly less attractive if you have a mobile capability.

- Chorus' own Baseband IP rollout has a very significant impact on the case for unbundling. That is because the business case for unbundling is a voice plus broadband business case. 50% of the lines can only be reached by a combination of UCLFS (baseband Copper) plus UBA. However this is still better than the alternative of a homeline plus UBA or a CPE based solution. This is supported by CallPlus own usage of UCLFS and UCLL services and the point was well established in the case for access to Sub-loop extension / UCLFS.

- The investment required in OSS & BSS to handle the complexity of multiple choices of access should not be underestimated. Telecom have enjoyed the benefit of being able to consume largely ubiquitous services such as UBA or UCLFS, in contrast unbundlers have had to handle the complexities of pre-qualifications of orders, transfer of services away from UBA & UCLFS etc. Given Telecoms cost of development this represents a major investment and a lengthy time to market.