SUBMISSION ON THE MBIE REVIEW OF THE ACT DISCUSSION PAPER

PUBLIC VERSION

SEPTEMBER 2013

Overview

1. This submission is made by CallPlus. We thank you for the opportunity to comment on the discussion paper.

2. CallPlus is the third largest fixed line provider, kiwi owned and the largest unbundler of exchanges in New Zealand with 176 MSANs deployed or due to be deployed by the end of 2013. This service underpins our entire business plan, including our ability to create compelling fibre based services. Any artificial increase in UCLL pricing 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.

3. Firstly, we would like to state that CallPlus supports the UFB initiative and CallPlus is actively developing and promoting UFB services. However we disagree with the Government's stance on copper and believe that a healthy, competitive and innovative copper market will support a successful transition to fibre – not the reverse.

4. CallPlus, alongside the majority of retail service providers, consumer groups and other parties fundamentally disagrees with the need for an early review and the proposed intervention by the Government. It is wrong!

5. It is clear to all parties that the driver for the early intervention by the Government is very focused on two issues which affect Chorus' revenues, both of which were understood at the time of separation:

    - To ensure that the inevitable reduction in the price of UBA in the move to a cost based model does not result in Chorus receiving payments less than a target price (between $37.50 and $42.50) for UBA + Copper services after December 2014.
    - To ensure that Telecom do not unbundle either cabinets or exchanges, thereby reducing the price they pay Chorus below the UBA + Copper price.

6. If there is a problem with funding the UFB rollout then lets understand the extent of, and the nature of the problem. To date there has been no transparency on the issue and consumers' interests shouldn't be swept aside without informed debate.

7. The Government have not asked for feedback on "if they should intervene", but on "how they should intervene" in the market to achieve the objectives in paragraph 5. The paper is premature as it 'jumps the gun' on the Commerce Commissions UBA price determination which, in the event that it comes out with a price close to $14 for UBA (+ $23.52 average UCLL), falls within the Government's own target range.

8. This intervention risks causing significant distortions in the market. Do nothing should be a very real option and the first consideration. If the Government does intervene and levy a tax

then the least change to the status quo for existing investors in unbundling and the protection of competition should be the primary concern. CallPlus' view is that:

- The early review and introduction of a copper tax should not go ahead – do nothing is always an option!

- If a copper tax is introduced levying UBA (Option 2), this has the least change to the current situation and the least distortionary effect on the market. Unbundlers face an increase in copper costs from $19.08 to $23.52 in December 2014. Retail Service Providers (RSP's) get a reduction in UBA prices as expected when moving to cost based, but not as much as the Commissions draft determination.

- If the Government still believes that further investment in unbundling is inefficient (this is a 180 degree turnaround in the policy of the last 5 years) then the issue of further unbundling should be dealt with directly. This can be achieved by precluding further unbundling of new cabinets or exchanges, however existing investments in unbundling should not be constrained otherwise unbundlers will face further escalating costs and stranded investments. This is detailed further below.

- The introduction of copper tax on UCLL (Option 1 or 3) should be discounted. Levying a tax on unbundling will create major distortions in the market, it artificially excludes voice only lines (the majority are with Telecom) and risks having a significant detrimental impact on competition in the market for the reasons detailed.

- If further unbundling of exchanges and cabinets is precluded by the Government then Telecom will argue they are disadvantaged, however this is a very selective view as they have significant advantages over competitors in all areas except non-unbundled, urban, non-cabinetised areas which represent less than 25% of lines in New Zealand. Telecom have a significant advantage in non-unbundled areas due to inadequacies of the regulated Homeline product and Telecom also have options in deploying fixed wireless LTE in selected areas. It is also very speculative as to whether Telecom would unbundle in 2015 on any scale regardless of what happens.

9. CallPlus has 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. CallPlus and others players then successfully fought to get access to UCLFS 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.

10. CallPlus have since then had to deal with the prospect of our costs increasing due to LLU being averaged to accommodate the separation of Telecom and Chorus. We have then had to deal with the Government subsidising a fibre rollout by Chorus. For the Government to then place a copper tax on unbundlers on top of all of this is almost unconscionable.

11. If the Government is going to regulate to protect its investment, and provide Chorus with an adequate rate of return, then it should also be regulating to protect our investment in UCLL and network expansion.

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)*

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. Competition will be critical to UFB to drive uptake and create compelling products. It is the margin that competitors make from unbundling investments that will allow them to create compelling fibre based services for the future.

13. 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 not 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.

Detailed Submission

An early review is the wrong course of action

14. We do not propose to go into detail on the reasons why the proposed intervention is wrong as we are confident it will be covered by submissions from many parties and CallPlus supports the submission made by InternetNZ.

15. We also note that the Ministry did not ask for any feedback on this.

16. However, our position is clear. The proposed review is the wrong course of action for many reasons including:

    - The early review creates certainty for one party (Chorus) and uncertainty for all other investors.

    - The review taxes copper and ultimately consumers. Copper will be the dominant delivery mechanism for voice and broadband for most Kiwis in 2020 and beyond. The proposed tax is a wealth transfer of more than $700 million by 2020 from consumers to Chorus Shareholders.

    - This isn’t really a review. The scope is very specific and doesn’t address the real issues which are likely to evolve around demand side drivers such as content, economic access to bottleneck services such as international bandwidth, operational issues around installations and customer transfers.

    - A review is premature and it should occur in 2016 when these issues will be better understood and the speculation on whether Telecom will unbundle or invest in wireless LTE is known.

    - The Commerce Commission should independently set prices, not the Government. The Government is not following best practice regulatory processes or its obligations under World Trade Obligation (WTO).

    - The methodology is wrong. A fibre to the home (FTTH) rollout is not the replacement cost of copper. Internationally a combination of fibre to the node (FTTN), VDSL copper and Wireless LTE are being deployed.. Again, these developments will be even clearer in 2016.

- Where does this end? The cost of the UFB deployment has a risk of escalating. Chorus' deployment costs will be clearer in 2016. If the Government is determined to tax consumers at that point, at least the extent of the problem will be better understood.

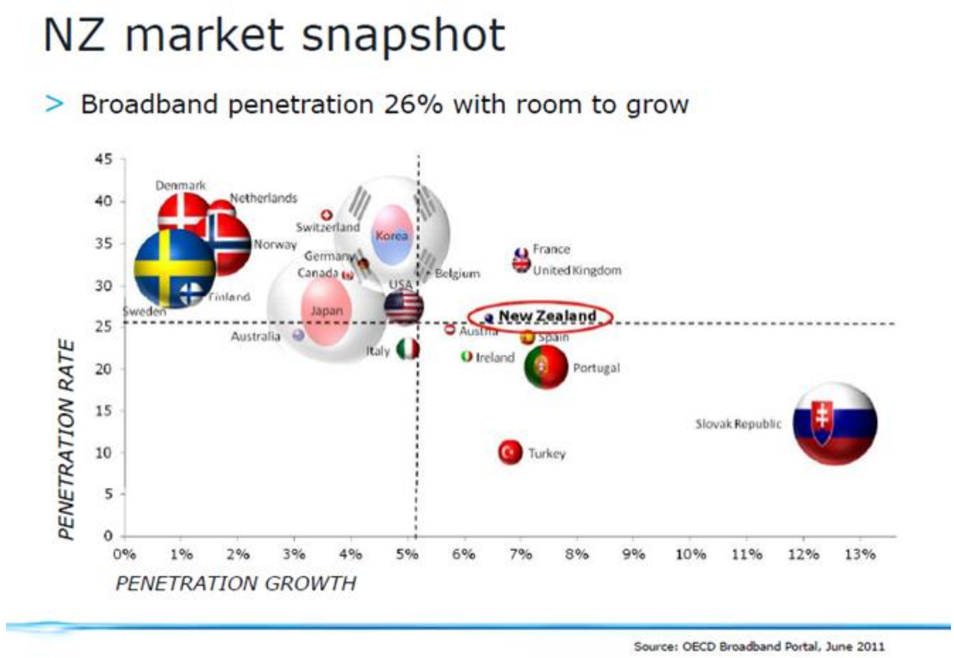
17. It is clear to all parties that the driver for the early intervention by the Government is very specific to two issues which affect Chorus' revenues, both of which were understood at the time of separation:

    - To ensure that the inevitable reduction in price of UBA (as it moves to cost based) does not result in Chorus being able to charge a price less than a target price in the range of $37.50 to $42.50 for UBA + Copper services after December 2014

    - To ensure that Telecom do not unbundle sub-loop or exchanges thereby reducing the price they pay Chorus below the UBA + Copper price.

'Do nothing' is an option!

17. The Government have not asked for feedback not on ***"if they should intervene".*** The paper looks for comments on ***"how the Government should intervene"*** in the market.
18. The paper is premature as it 'jumps the gun' on the Commerce Commissions UBA price determination which, in the event that it comes out with a $14 UBA price (+ $23.52 average UCLL), falls within the Government's own target range. This is now due at the end of October – why not wait?
19. The Government also needs to factor in that there is a cost paid to Chorus to move customers to UCLL. There is an upfront connection fee, unlike UFB, of $70-$155 per customer which over 3 years adds an additional cost of $2-$4 per month, per customer.
20. Furthermore, lower copper prices encourage the take-up of broadband and this must have a positive effect on UFB and on Chorus' balance sheet. Flip is a good example of this (see below) and Chorus themselves acknowledge the opportunity to grow the market and their revenue streams: -
21. *"We've got leaders in there such as Denmark, Netherlands and Sweden, who have broadband penetration between 30% to 40%. So we do believe there is further room to grow in broadband."* (Source of commentary and diagram: Vic Crone, Chorus Investor Day May 2012)



UBA levy is the least distortionary of the options

22 If a copper tax is to be applied, then the option which involves:

- *the least change to the status quo;*
- *the least risk of creating market distortions; and*
- *the least risk of adversely impacting competition*

is clearly Option 2. This option softens the drop in UBA prices by applying a levy over and above the cost based benchmark, noting that he UBA benchmarking exercise in particular has been acknowledged as being difficult by the Commerce Commission.

23 The Commission, in CallPlus' view, took a conservative approach to the averaging of UCLL with a minimal change as a result of moving to a cost-based benchmark. As a result, unbundlers continue to face an increase in Urban UCLL prices of 23% as a result of averaging UCLL.

24 Common sense dictates that reducing the amount of a drop in prices (Option 2) is likely to have a less critical impact on companies compared to increasing the price paid currently (Options 1 and 3). That is particularly so when the service (UBA) with the decrease in cost is lower down the ladder of investment than the one (UCLL) facing an increase - the latter has required more investment (by definition) to move up the ladder.

25 This option also avoids the messy and inconsistent ring-fencing of 'voice only' UCLFS. There is no logical network related reason why a lower cost based price should be paid for

'voice only' copper usage. Furthermore such tinkering creates unintended situations in practice.

- For example, Service Provider A has a 'voice only' customer and is paying a lower copper price for UCLFS to Chorus. The customer takes a broadband service with Service Provider B. Service Provider A with no advice, through no action on its behalf and through no change in how it provides the service to the end-user is suddenly expected to pay more, essentially the copper tax.

26 Furthermore, if the price of UCLL (rather than UBA) is levied with a copper tax, what happens to the price of Telecom wholesale homelines? These wholesale services are currently operating on a retail minus construct, albeit a broken retail minus model as it excludes bundles.

27 The only issue with Option 2 from the Government's perspective appears to be that Telecom may unbundle. Once again we reiterate that it is too early to predict and it is far from certain they will unbundle. In 2015 investments by Telecom may be better made in LTE which is able to provide a fixed alternative at faster speeds than copper for which they will have sunk a significant investment in spectrum and other assets to deliver this service.

If further unbundling is deemed inefficient deal with the issue directly

28 If the Government considers further unbundling of exchanges is inefficient, then deal with issue directly under Option 2.

29 The Government has already indicated it is prepared to prevent any new unbundling of cabinets, so why not simply preclude unbundling of any new exchanges.

30 The split of Exchange and Sub-Loop Unbundling is not a distinction that is made in the Act. The Commerce Commission elected to de-average unbundled lines essentially drawing a distinction between cabinet fed lines and exchange fed lines, and a further distinction was made between urban and rural. In fact, this de-averaging by exchange or cabinet is contrary to the drive to average services post separation and it could be argued that an averaged UCLL price should be somewhere between the averaged SLU and the averaged UCLL price.

31 If the Government is considering withdrawing unbundling of new cabinets (SLU) why not also withdraw unbundling of new exchanges rather than levy a copper tax on unbundlers, the last remaining challengers, to make unbundled investments unattractive?

32 Telecom will of course argue they are disadvantaged as they have been prevented from unbundling post separation. This is a very selective view for the reasons outlined below, however it should be acknowledged that the likelihood of Telecom unbundling is far from certain when considering:

- Investments in LTE and its potential as an alternative fixed delivery
- A potential that unbundling in cabinets will be precluded
- The complexity of such a deployment
- Changes to OSS and BSS to handle ordering, faults, pre-qualification and product management of unbundling

All this development has to compete for resource at the same time that fibre rolls out! There is a limit even to Telecom's deep pockets.

Telecom claims they are disadvantaged is a very selective view

33 Telecom claims that, if they are precluded from unbundling after December 2014, they are disadvantaged. This is a very selective view and no objective review of the market could ever describe or position Telecom as disadvantaged.

34 The fact is that Telecom has a significant advantage over competitors as a legacy of their incumbency and scale. The Commerce Commission also recognise that both CallPlus and Orcon lack Telecom's scale and the benefits that come with it in the Vodafone/TCL merger. The Telecom Homeline service which is wholesaled to other players continues to be a critical input service for all competitors, including unbundlers – this is the only way for a competitor to provide a bundled offering (broadband + POTs) to around half of the households in New Zealand.

35 Whilst it is a critical service for players such as CallPlus, **the retail-minus model used to determine the wholesale homeline price is broken** as a result of the omission of bundles from the calculation. As a result, Telecom has been able to raise the price of wholesale Homelines each year whilst continuing to drop its retail bundle prices which include a homeline.

36 By way of an example wholesale homeline pricing in Wellington and Christchurch recently increased by 10% in July 2013 (to $37.79) despite Telecom aggressively offering its lowest bundled prices for Homeline and broadband in these market. The rest of NZ pricing for Telecom Wholesaled homeliness is $41.50 which is **75% mark-up on the price Telecom pays Chorus** ($23.72). Furthermore, competitors pay additional to Telecom for smartphone features often higher than bundled features sold at a retail level – a

conservative estimate an additional $2-$3 per month on average per Homeline customer for these smartphone features.

37 The table below illustrates the significant advantage Telecom has in the market under the current regulatory regime. There are 440,000 lines where Telecom's competitors face a cost of $20.98 per month per customer more than Telecom AND that monopoly mark-up is being paid to Telecom. There is also a reassignment fee paid to Telecom to transfer the Homeline.

38 In contrast, there are 116,000 unbundled lines (a combination of cabinetised and non-cabinetised lines) where competitors pay either the same as Telecom (cabinetised lines)or have a cost advantage over Telecom for the access input cost.

	Geographic Areas		
	Not Unbundled	Unbundled Exchanges	
		Cabinetised	Non-Cabinetised
Payments for Access			
Chorus Average UCLL			$ 23.52
Chorus Baseband		$ 23.52	
Chorus UBA	$ 21.46	$ 21.46	
Unbundlers MSAN Port costs *			$ 13.00
TNZ Wholesale Homeline (RONZ)	$ 41.50		
TNZ Wholesale H/L Features	$ 3.00		
Unbundler pays	$ 65.96	$ 44.98	$ 36.52
Telecom Pays	$ 44.98	$ 44.98	$ 44.98
Unbundler costs per month higher than Telecom by	**$ 20.98**	**Nil**	**-$ 8.46**
Number of lines			
Resold Telecom Homelines	**440,000**		
Unbundled Lines		**116,000**	
** Note: used $13 port cost as indicative for unbundler*			

39 Artificially ring fencing the copper tax for 'Voice only' homelines further plays to Telecom's advantage as the vast majority of these are Telecom customers. There is little or no competition in the Voice only market due to the high price Telecom wholesales this service to competitors with Telecom applying CPI adjust the prices every year – in stark contrast to the trend in prices in the telecommunications sector globally. There are still a significant number of these customers, as broadband penetration' is only 78% of residential lines. To compete on a nationwide basis, which is essentially for a mass market service provider creates a significant price squeeze on Telecoms competitors based on the manipulation of the current retail minus pricing framework.

40 The reason given in the discussion paper for the carve out is that' voice only' customers don't benefit from fibre. This seems very arbitrary as telecommunications users outside of UFB areas do not benefit from fibre, but get hit with the copper tax. And, let's not forget this is the still the majority of users in 2016 and beyond. If the Government has made a policy decision that New Zealand as a whole benefits from UFB, then all telecommunication users benefit in some manner so why carve out one group from a copper tax? If it is to be applied it should apply to all users of telecommunication services.

UCCL levy could have dire consequences for competition

41 CallPlus is very concerned by the suggestion that UCLL prices might be artificially raised over and above the $23.52 averaged UCLL price.

42 The following sections outline why introducing a levy on the UCLL price would have a critical impact on the existing UCLL investment and potentially the survival of unbundlers business. It also highlights why simply grandfathering existing unbundled lines does not address the issue.

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

43 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.

44 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:

- []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."

45 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

46 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.

47 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

48 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.

49 Telecommunications 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.

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

53 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.

54 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.

55 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

56 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.

57 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

58 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"

59 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.

60 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.

61 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

62 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.

63 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					

64 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.

65 []CI

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

Marketing investment: Flip illustrates the issue

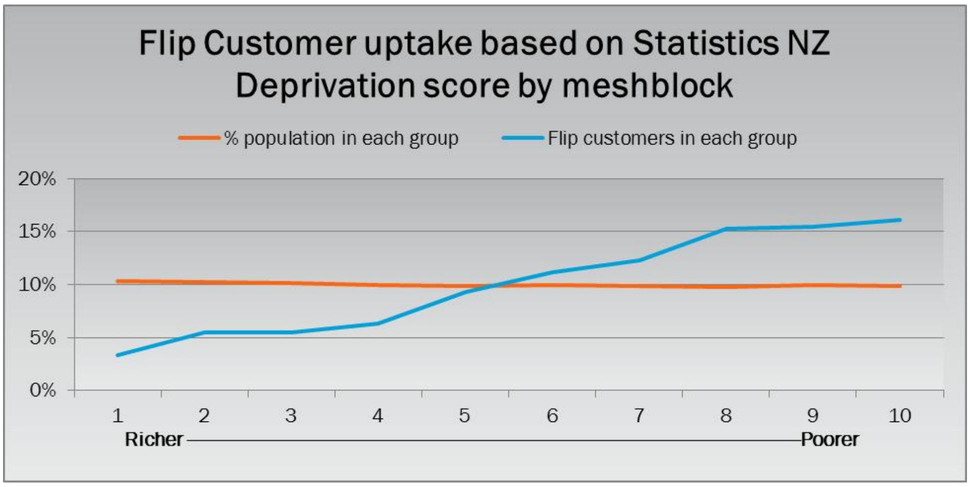
67 This section references the public submission made by Flip, a subsidiary of CallPlus Ltd, to the Commerce Commission on the UBA price review in February 2013.

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

69 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.

70 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.

71 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.



72 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**

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

74 .

75]CI

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

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

77 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.

78 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.

79 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.

80 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.

81 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

82 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.

83 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.

84 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.

85 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):

"Conclusion on Slingshot and Orcon

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."*

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

86 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.

87 In conclusion the Government is about to make a very significant decision if it proceeds with the copper tax. CallPlus urges the Minister to reconsider or tread very carefully as viewing competition on copper as collateral damage could be detrimental to UFB and Chorus in the long term.

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

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