

TUANZ Telecommunications Day
12 May 2009
Commerce Commission address – Anita Mazzoleni

Opening

Kia ora. Good morning. Thank you Ernie for inviting the Commerce Commission to speak at TUANZ telecommunications Day.

For those of you who don't know me, I have worked on all of the Commission's telecommunications decisions since December 2006. I am here today on behalf of the Telecommunications Commissioner, Dr Mark Berry, who took over that role, and as Chair of Commission, in a seamless changeover on 1 April.

This morning we would like to recap on some of the work that the Commission has completed over the year since the last TUANZ Telecommunications Day, and then look at some of our key work programs for the year ahead. As this is a day sponsored by the telecommunications users group, it is appropriate to address those areas where our work has, and is expected to have, an impact on the end users of telecommunications.

However firstly, there is one thing more important than telecommunications, and that is people, and I would like to acknowledge the contribution in the last year of a number of participants in what has been another significant year for this sector.

Since September 2008, three people have held the role of Telecommunications Commissioner. Thanks to the professionalism and dedication of each person within the Commission's Telco team, despite what could have been very disruptive changes, we have never missed a beat with any of our telecommunications work programs, and in fact we have accelerated some. We remain indebted to Paula Rebstock who, despite having now taken up new challenges, continues to provide continuity in our work in the telecommunications sector on important matters such as mobile and sub loop.

I would also like to acknowledge the employees of Telecom, many of whom have been involved with maintaining their networks over many years. Operational separation of your company and the numerous work streams that entailed, including preparing to deliver the new regulated services, would have been a hugely demanding change process for Telecom employees. Rightfully, they recently celebrated their first year of operation under the Separation Undertakings.

Finally, I would like to acknowledge the self styled challengers and their industry groups. Despite your smaller presence, your voice is equally important in shaping the regulatory environment for our sector. Many of you faced very adverse trading and financial conditions before the 2006 reforms of the telecommunications sector. Now, as we get around and talk to you, a common theme becomes apparent. The current optimism with which you now conduct your business, under conditions of greater equivalence and transparency, defies the very tough economic environment in which we all now operate. I

suspect your best is yet to come and that you will be a bright light in our economic recovery.

The year past

In hindsight it has been another significant year for our sector since the last TUANZ Telecommunications Day. I would like to recap that year from a regulatory perspective by looking at some of our key work streams, and developments in the telecommunications markets as touched on in our recent monitoring report.

Firstly, I would like to remind you of our role. Our statutory purpose is to promote competition for the long term benefit of end users of telecommunications services in New Zealand. Competition provides consumers with competitive prices, better quality and more choice.

Workstreams

In 2008 the Commission completed standard terms for the provision of regulated backhaul and non price terms for co location on mobile towers. We initiated, and will shortly complete standard terms for sub loop services. We have just completed our initial investigation into the migration to NGN, identifying potential areas where further work may be necessary. Whilst they were not market facing, establishing processes for enforcement of the Operational Separation Undertakings and the development of the Accounting Separation Requirements have been huge workstreams for us internally in 2008. As the humps of those workstreams tail off, the dividends from these are expected to flow in the following years, by providing a reasonable degree of transparency in respect of Telecom's operations and obligations under Operational Separation. It is important to reflect on the effect in the market place over the past year that those requirements have had. Telecom now operates in a fundamentally different way, both in its regulatory structure and its behaviour. Its actions now have reasonable transparency and any anti competitive behaviour will be reasonably visible, with mechanisms to manage this promptly to remove market detriment.

Investment

I would like to turn now to investment in the sector over the past year. We do not know the impact the economic downturn will have on investment in the telecommunications sector, much of which was committed to before the financial tsunami following from the collapse of the US sub prime mortgage markets in late 2007. Certainly access to both debt and equity funding is at worst non existent, and at best tight, and whilst base rates all over the world have been managed down to extraordinarily low levels, margins, reflecting changed perceptions of risk and capital adequacy rebuilding, have climbed. Nor have we probably felt the full consequences on revenue lines of consumers' tightened cashflow.

In spite of this more than \$1.2bn capex spend was recorded in the telecommunications sector in 2008. This followed approximately \$1bn capex in each of the previous 2 years. That is huge investment, even when considering that around half of it maintains asset investment by matching depreciation.

In addition, our monitoring only captures spend by TCF members. Therefore whilst a big proportion of the 2008 capex was Telecom's spend on its cabinetisation program, as well as the upgrade of its mobile network, and hundreds of millions of dollars were also spent by NZ Communications on the first phase of its mobile network, as well as Vodafone's capex on its 3G network and extended coverage, our monitoring did not capture Vector's spend on its Auckland backhaul network, nor that of FX Networks, which finished its North Island rollout, laying 680km fibre, connecting centers such as Tauranga, Rotoura, Taupo, Napier, Hastings and Masterton. TelstraClear also completed the multi million dollar upgrade of its Next IP network.

This is significant spend in any economic cycle, but particularly stimulating in recessionary times. Much of it is necessary to maintain competitive offerings to keep pace with technology developments, as well as to meet opportunities developing within the market. It is our role when calibrating the regulated wholesale settings, to ensure that the massive investment in this sector continues, by allowing providers of regulated services to receive appropriate returns on such investment, and by continuing to lower barriers to entry for new service providers.

Fixed line services

I would next like to turn to developments in fixed line services. There are approximately 2 million fixed line connections, including just under 1 million fixed broadband connections. Revenue from fixed line voice services is around \$2 billion p.a., with fixed data and internet revenue another \$1 billion. 20% of the total population now use broadband, ranking NZ 19th out of 30 OECD countries for broadband connections.

For the first time in 2008, some of us had a choice of providers, who could offer their own fixed line broadband services rather than reselling Telecom's wholesale services. Some of us also started receiving our broadband services delivered from a nearby roadside cabinet.

Unbundled local loops got off to an encouraging start with 25,000 unbundled lines delivered from around 50 exchanges at last count, mostly in Auckland. More are planned in the very near future with TelstraClear having stated they will install their equipment in 70 exchanges and Vodafone may also be in around 40 exchanges at some stage, given their announced backhaul deal with Vector. There was an immediate price effect on fixed line plans, especially in bundled fixed line services in Auckland, and also in Wellington and Christchurch where TelstraClear competes from its own network.

In my non regulatory life I am one of the approximately half a million SME's that make up 97% of New Zealand businesses and produce 40% of New Zealand's economic output. I telework for 4 of the 6 days I work each week and my business is information centric. For me, the impact of these changes, in the last year, has resulted in a huge uplift in productivity, for two key reasons - faster access to information for less cost. As a result of cabinetisation, my download speeds are 5x faster than last year, and as a result of unbundling price pressure I can now get 10x more capacity for way less than what I was

previously paying. These two developments alone have changed the way I telework and whilst I am cost conscious, now make me much more open to new services which increase my work capacity whilst making my work so much easier. Many New Zealand SME's may not be so information based. But extrapolating the effect to just a proportion of this demographic should have significant productivity benefits to our economy. Many of these SME's are also rural farms and rural service businesses that are the backbone of our economy, making up 60% of our GDP, and whilst most of their work is done on the land, the productivity lift in their businesses does depend on timely access in receiving information and sending production data. I look forward to any initiative that extends the benefits of faster access to broadband to all potential users.

A halt in unbundling could ease this competitive pressure and we will monitor with acute interest over the next year the impact of the standard terms for the regulated sub loop services to see if parties other than Telecom to deliver, initially existing services, to customers from roadside cabinets, and subsequently the new services that cabinetisation is able to deliver to end users. As a regulator it is always a difficult task to set initial regulated prices, to ensure that investors continue to be incentivised to invest by providing an appropriate return on investment, and also that the service is right priced to facilitate access seekers taking up the service. This price setting is particularly difficult where few other jurisdictions have regulated wholesale services delivered from roadside cabinets, resulting in a paucity of comparable pricing benchmarks. Our decision on regulated sub loop services is expected to be available very soon.

Backhaul services

I would like to touch on developments in backhaul since the standard terms for the regulated service were released in 2008. It became clear throughout the STD process, that a number of parties intended to supply backhaul nationally and locally. It was important to ensure that what seemed to be potentially burgeoning investment, should be encouraged to develop, allowing regulation to apply only on those routes where Telecom is unlikely to face competition. We have now made our second assessment of backhaul competition, and of the 135 routes assessed to date, have found 72 to be competitive and therefore not subject to regulation. These are clustered as expected, around the unbundled exchanges in the Auckland, and also in Wellington and Christchurch, and the core backhaul routes between these cities.

A theme that constantly came up in much of the discussion around the investigation of the migration to next generation networks, was the bottleneck in international bandwidth. Kordia's proposed alternative second cable with Pipe Networks announced in September last year was followed in November by a significant price reduction of around 45% from the Southern Cross Cable, as a result of its recent network upgrade. We will watch market developments in this bottleneck with a great deal of interest and, following consultation, the Commission may look at international bandwidth as one of the workstreams carried forward from our recent NGN study.

Mobile services

The area of least change in 2008 was in mobile services and it is that market which is the focus of our attention this year.

NZ now has 4.6 million retail mobile connections compared to roughly 2 million fixed. As a result of requested changes to the Vodafone base plans, they are now included in our measurements. As a consequence of that NZ's ranking for average mobile calling costs changed from 130% of the OECD average to 85%. Nevertheless, mobile calls are only 25% of all retail calls, compared for example to Australia, where mobile's are used approximately 50% of the time.

It may seem odd that at this exciting time when both Telecom and Vodafone are marketing their new 3G networks, and NZ Communications is about to launch its new network, that we are reviewing mobile termination rates and roaming. Whilst you could assume that with 3 providers expected in the mobile market we should just leave them alone to compete in the marketplace. Currently, Telecom and Vodafone have roughly an equal share of that market by number of users and we are already seeing price pressure in mobile plan offerings ahead of Telecom's XT network launch. Our objective is simply to make sure that there are no impediments to efficient entry, so that all providers of mobile services have an even chance of competing vigorously for the \$2bn revenue currently generated in this market, and the benefits of that competition are delivered to end users of mobile services in New Zealand.

Reviews of mobile termination were completed in 2006 and roaming in 2007, resulting in significant pricing changes in response to regulatory pressure. Since then mobile termination rates appear to have been on a downward price path, and the uptake of mobile data services on the increase, areas where New Zealand end users do not appear to be receiving similar benefits.

Consequently, we are revisiting mobile termination and roaming, as it is vitally important that end users of telecommunications receive the best possible services to assist them to be most productive in their work and play, at prices competition would deliver, and which also allow those that have invested heavily in this area to receive an appropriate return on capital.

I referred previously to the fact that I am just one of half a million SME's that make up 97% of New Zealand business, and until recently I operated 2 of the 4.6m handsets. Each one of those handsets will tell a different usage story. For me, mobility is where I can get the biggest uplift in my business productivity, enabling me to use a lot of otherwise unproductive downtime whilst I am on the go. Currently, it is the service I try to utilise the least because of the expense of voice calling, or for me the inappropriateness for business of cheaper texting. I need to travel outside of the major cities, so reasonable domestic geographic coverage now dictates my choice of provider. I travel overseas and colleagues come to New Zealand from both developed and developing countries. In equal measure we have all been bill shocked having made what we thought were reasonable assumptions that we should be able to seamlessly utilise mobile voice and data services in these situations for reasonable cost. I do not know whether this is the best I can expect to

get from mobile services. I expect vigorous competition in the market, arising from a level playing field for all those who wish to provide mobile services, should provide the answers for the different needs of 4.6m mobile end users.

Summary

In closing, how far are we in achieving competition in the telecommunications market for the long term benefit of end users? Much has been achieved when we reflect one year back, and especially when compared to the market before 2006. Investment in the sector is significant, and fixed line services and prices have responded to more competitive conditions. However, much has yet to be achieved for the users of telecommunications in New Zealand, particularly if we are to at least equal telecommunications in the countries whose productivity, workplaces and lifestyle we aspire to equal or exceed. So the answer is we can still do better. Ensuring conditions that facilitate efficient mobile entry, so that all providers of mobile services have an equal chance of competing, and this competition delivers long term benefits to NZ mobile end users, will therefore be the focus of our attention this year. Tena koutou katoa. Thank you for listening.