

**Address by Anita Mazzoleni
on behalf of the Commerce Commission
to 10th annual Telecommunications and ICT Summit
23 June 2009**

Opening

Kia ora. I am Anita Mazzoleni and with me today are a number of my colleagues - Commissioner Gowan Pickering, Director of the Commission's Telecommunications Branch - Osmond Borthwick, Stephen Hudson our Senior Regulatory Economist and Rachel Crystal our Senior Legal Counsel, each of whom are keen to engage with you in the breaks.

We have been asked to comment on current developments in telecommunications. Firstly, I would like to make some general comments about our regulatory framework. Then I would like to recap on some of the recent changes in the telecommunications sector, particularly in investment and broadband. Lastly I would like to talk about our key focus over this year which is mobile, and then our focus further out as we move to converged and all IP networks.

Regulatory approach

When we last spoke to some of you at the TUANZ Day, we acknowledged the contribution over another significant year for our sector of a number of participants. We reflected on the significant changes in the conditions under which many of you now operate following the first year of Operational Separation, and defying our very tough economic environment, the current optimism with which many of you now conduct your businesses, under conditions of greater equivalence and transparency.

I would now specifically like to add a thank you to Ralph Chivers, who has resigned as Chief Executive of the Telecommunications Carriers Forum(TCF) and taken up probably one of the most interesting jobs in our sector, managing the Government's Broadband Investment Initiative at the Ministry for Economic Development. It hasn't always been this way, but the work of the TCF over the past few years has been extremely useful, as the Commission has worked through the standard terms determinations for unbundled local loops, unbundled bitstream, backhaul, mobile co-location and recently sub loop services.

Regulatory processes are cautious and therefore time consuming, as they must be, given their impact on your businesses and the economy. However there is no need to make them unnecessarily time consuming and therefore expensive. We have recently indicated that we would like to formalise the relationship between the Commission and the TCF through a protocol which would streamline the interface of our respective processes as far as possible, without compromising the Commission's unfettered right to challenge the TCF's recommendations within the regulatory framework that we must follow. We wish to do this with the sole objective of avoiding much of the duplication of TCF discussions, although not decisions, in Commission processes.

On the theme of self regulation, we would also like to take this opportunity to underscore the Undertakings procedure under the Telecommunications Act. Undertakings, as an alternative to regulation, avoid the costs of regulation and, provided they are accepted on a timely basis, the significant costs of the regulatory process. They allow you to shape some of the form and content of price and much of the non price terms. They allow faster uptake of the services subject to the Undertaking, which may not appear to be in Access Providers' best interests. However, this also gives certainty to Access Providers much sooner than a regulatory outcome, something which you consistently stress to us is vitally important to you. We take all of these factors into account when weighing up the difference between a counterfactual Undertaking and a factual of a regulated outcome. We strongly encourage you when submitting Undertakings to have regard to these benefits. Similarly, in assessing Undertakings, we would have regard to the potential net benefits of implementation issues such as glide paths, something which may be expected to be assessed quite differently for longer to achieve regulatory outcomes. For example a schedule 3 process takes about a year, and where approved for regulation, any resulting standard terms due process takes a similar time. Undertakings that remove such time periods would also be expected to reflect the time benefit and the significant savings in the costs of the regulatory process and regulation.

I would now like to discuss our regulatory approach and how this might change in the near term and further ahead. Especially in environments of rapid technological and economic change, industry participants are looking for regulatory clarity and certainty. There is always room for improvement in current practice. Many of you have previously told us that our "Guide to the Role of the Commerce Commission in making Access Determinations" has been very useful in assisting you with a framework for approaching the Commission's work. Whilst much of the document framework stands, we are currently updating it. As part of that revision we will include the "Best Practice Principles for Regulatory Decision Making and Use of Regulatory Powers", which the Commerce Commission has been using internally since 2006.

These are currently based on the IOSCO (International Organisation of Securities Commissions) Objectives and Principles of Securities Regulation. Briefly they require, for regulatory decision making, regulators to adopt processes which are fair and equitable by being consistent with international best practice; clearly defined; consistently applied over time, whilst allowing flexibility in response to changing market conditions and experience; and transparent to the public. Where powers are used in accordance with the regulator's chosen priorities, they should be applied in a non-discriminatory manner and, where a regulator is statutorily independent from government, it is fundamentally important that independence be maintained. We expect for the Telecommunications sector, to add to these, some of the guidelines in this area currently provided by OfCom, and we will shortly be coming back to you for consultation on these best practice Principles.

Having commented on our approach to industry self regulation and the Commission's proposed framework for use of its regulatory powers in the telecommunications sector, I

would now like to touch on our approach to deregulation. As the market changes and new services are provided, we are acutely aware that some services may be deregulated. It serves no one to retain regulation where services have been superseded and effective competition has been achieved in the market in question. We have commenced a consultation process to look at deregulation of resale services. Whilst we are keen to deregulate where there is no market need for the regulated services, we are equally keen not to prejudge the market uptake of new regulated services that are expected to replace resale services and, whilst we need to move promptly to remove unnecessary costs of regulation, equally we need to move as prudently as we do when we regulate. Transitional issues need to be managed carefully as it is important for us to consider the risk of undoing the benefits a more competitive environment is delivering. Having received your submissions, we expect to revert to you soon in relation to the deregulation of resale services.

Market led investment

I said that I would talk about our regulatory approach, and I have just touched on that. I would now like to turn to comment on investment, which is so vital in developing our sector.

We are all in the midst of assessing the \$1.5bn Government Broadband Investment Initiative, a targeted Fibre to the Home proposal, which is planned to be rolled out over the next 10 years. However, I would like to comment on the staggering amount of market led investment in our sector that we have observed since we were provided with wider monitoring powers under the 2006 reforms to the Telecommunications Act. I know that I mentioned this at TUANZ day, but its significance means it should be repeated. Despite the economic downturn that started in late 2007, more than \$1.2bn capex spend was recorded in the telecommunications sector last year. This followed approximately \$1bn capex in each of the previous two years. Even when considering that around half of this maintains asset investment, it is significant investment in any economic cycle and is particularly stimulating in recessionary times.

Reflect on what it created. Telecom's spend was mostly on cabinetisation, as well as the significant upgrade of its mobile network and the upgrade of approximately 60 per cent of lines to ADSL2+. 2 Degrees further invested tens of millions of dollars completing the first phase of their mobile network, whilst Vodafone's capex extended the coverage of their 3G network. TelstraClear also completed the upgrade of its Next IP network whilst Vector invested in its Auckland backhaul network and FX Networks finished its North Island fibre rollout.

What is the reason for this massive investment? Much of the recent market led spend in New Zealand is catching us up with technologies that have been used in developed countries for sometime. Much of the spend is now necessary to keep pace with technology developments to maintain competitive offerings. As Ofcom has commented: "Competition is one of the single most effective drivers of investment in new technologies and services ... countries with the most competitive telecommunications industries delivered the highest levels of net investment."¹

New Zealand cannot afford to slow down investment in telecommunications when the rest of the developed world is already better positioned to enhance their global competitiveness using telecommunications as a strong catalyst for economic growth. It is the Commission's role when setting terms for access and interconnection, 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.

As investment in technology changes, in many cases rapidly, bottlenecks and barriers either disappear or shift and we must also review the appropriateness of current regulatory interventions to assess whether they will support robust competition in the foreseeable future. Competition issues in the transition to these new technologies must also be included, and we will shortly respond to your comments on what intervention may be appropriate, if any, in resolving current outstanding issues around IP interconnection.

I would now like to show you a snippet of my favourite video for 2009. It is one investment that is at the start of the production chain that is the face of the future. FX Networks 27 and ½ ton fibre layer. Last year it finished laying around 700km of fibre through the North Island and is now cutting a swathe through the top of the South Island. It is highly mechanical and very dirty, and is completely different to the pristine bits and bytes that eventually fly through my broadband jackpoint and I cannot wait until the day it arrives to deliver fibre to the front door of my home, unless my power company or one of a number of telecom service providers beats a path there first. Investments like this have the potential to provide services that not only enhance but completely transform our lives.

Broadband developments

I said that I would talk about investment and we have just touched on that and our approach to ensuring that investment continues at the pace required to deliver the same telecommunications services that are available in the countries we aspire to be like. I would now like to turn to comment on developments in broadband, on which much has been written to support the view that it has a measurable impact on productivity and GDP and that it is fundamental to both economic and social development.

The 2006 amendments provided a set of regulatory tools designed to deliver effective competition in the New Zealand telecommunications sector, with a significant part of this reform focused on driving competition in broadband, and through the Undertakings, included significant upgrades for wide broadband deployment through new investment. Since it became available in late 2008, around 30,000 lines, mostly in Auckland, have now been unbundled. There was an immediate price effect on fixed line plans, especially in bundled fixed line services in Auckland. TelstraClear have now installed their equipment in around 20 exchanges, and this is expected to reach 40 soon, matching Vodafone and Orcon, with TelstraClear expected to put their equipment in a further 30 exchanges. A halt in unbundling is very likely to ease this competitive pressure and we

are monitoring this and the impact of sub loop unbundling to see if parties other than Telecom continue to deliver competitive broadband services.

Recent OECD statistics reflect this early progress indicating that New Zealand has recorded the 3rd largest broadband growth in 2008. We also now rank a notch higher from last year and are now 18th of 30 in the OECD for broadband connections, a small but important first step towards our national targets. Nevertheless New Zealand still has a very long way to go to at least match the rankings of countries whose productivity we aspire to replicate or exceed. Even the more progressive nations across Europe and Asia, many of whom are ahead of us in the broadband rankings, believe that there remains much to do and a key agenda across these countries is broadband. We are therefore closely monitoring progress in New Zealand.

I would like to point to some fundamental elements present in the more developed markets in Europe and Asia. They are characterised by highly competitive fixed and mobile markets, measured against a variety of factors including coverage, penetration, service choices, and of course, prices.

How does this compare with New Zealand? While the fixed market is now changing to some degree, with improved services and broadband price decreases available to some consumers, the situation may not be the same in the mobile market in New Zealand and it is to that market, which is the key focus of our attention this year, to which I will now turn.

Mobile services

Hardly surprising given its utility, mobile is now the most pervasive telecommunications technology in New Zealand. New Zealand now has 4.6 million retail mobile connections compared to roughly two million fixed.

Following the recent launch of Telecom's XT network, and the extended coverage of Vodafone's network, in 2009 the New Zealand mobile market now has two 3G mobile network operators. They each now have around 97 per cent population coverage and just under 40 per cent geographic coverage. By number of subscribers, they each have roughly an equal half share of the market.

Five Mobile Virtual Network Operators also provide resold services to mobile end users, and the anticipated third network operator, 2 Degrees, is expected to launch this year. Certainly from a service perspective, recent investment means availability of mobile services in New Zealand is now starting to catch up with the rest of the developed world.

The New Zealand mobile market is currently characterised by relatively high SMS usage, possibly reflecting much higher voice prices, and a significant disparity between on-net and off-net retail pricing, with on-net accounting, in 2008, for a very high percentage of Mobile to Mobile voice traffic, with even more for on-net SMS traffic. Mobile phone penetration levels are around 108 per cent and, whilst this is lower than many countries,

many users nevertheless own two handsets, possibly reflecting consumers need to take advantage of on-net pricing.

In terms of retail prices, with the recent inclusion of Vodafone base plans, New Zealand's ranking for average mobile calling costs is now 15 percent less than the OECD average cost for similar calls. However, taking a closer look at retail prices, around two thirds of New Zealand consumers are on prepaid plans. This is a very high proportion compared to, for example, European Union countries, and New Zealand ranks 27th out of 30 of the OECD average for the costs of prepaid plans, making mobile voice calls for two thirds of New Zealand mobile users 70 per cent more than the average cost for similar customers in the OECD.

From a competition perspective high prices may not be a cause for concern by themselves. In fact they can result in positive outcomes if they result in greater investment or innovation and they can signal legitimate increases in the costs to supply services. However, pricing patterns and trends of individual companies and the market as a whole can be important indicators of the competitiveness of the market.

Mobile calls in New Zealand are only 25 per cent of all retail calls, for example compared to Australia, where mobile's are used approximately 50 per cent of the time. Recent changes to retail prices are evident following the launch of XT, and it is not yet known how extensive this will be - particularly with incumbents indicating that competition may be focused around service differences.

Turning to the wholesale market, the Commission completed reviews of wholesale mobile termination rates in 2006 and roaming in 2007, resulting in significant pricing changes at that time in response to regulatory pressure. Since then, internationally, 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 does not appear to be tracking.

Our objective in our current mobile reviews is simply to make sure that at this important time when so much investment has been made into the mobile market to deliver New Zealand consumers improved service offerings like those already utilised in much of the developed world, that there are no impediments to efficient entry or expansion, 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 the end users of mobile services in New Zealand.

As many of you are well aware, the most important influence on market power are the conditions required for entry or expansion. The threat of entry of a new firm into a market operates as the ultimate regulator of competitive conduct. A firm's market power depends in large measure on the height of barriers to constrain entry or expansion in the market.

Where mobile termination rates are significantly above cost, new entry is unlikely to provide competition. This argument forms the main thrust of many reviews into mobile termination rates internationally. For example, in May this year, the European Commission set out guidelines for European Union telecoms regulators on the cost-based method to be used when calculating termination rates. Specifically that termination rates should be based only on the real costs that an efficient operator incurs to establish the connection with another operator. Their aim is to lower current rates by about 70 per cent by 2012 or 2.5 cpm Euro, compared to 9.7cpm in 2007. That price path is shown here on the (pink) line. We have also mapped NZ's historical and current rates alongside. The forward price path that we have shown for New Zealand being the one we indicated to mobile operators in response to their initial undertakings earlier this year.

Similar to what the European Commission has indicated, this indicative initial price path, which is subject to our full consultation process which will fully consider submissions from all parties, shows current voice prices of 15 cpm in 2009 indicatively falling to possible prices of around 4cpm in 2015.

Consequently, we are reviewing 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. Our draft report in relation to mobile termination rates is expected to be released early next week.

The Commission has also been considering whether there are reasonable grounds to commence a Schedule 3 investigation into national roaming. As you are aware, earlier this year we deferred our review of roaming until our draft mobile termination report was finalised, given the linkages historically drawn between mobile termination rates and roaming. We expect to make an announcement in relation to a review of roaming at the time of release of our mobile termination report, early next week.

The Commission also expects this year, as far as possible given international jurisdiction issues, particularly in relation to access to price benchmarking information, to look at international roaming charges.

Convergence

Looking forward, it is predicted that mobile broadband will be the key driver for mobile growth. International markets are gearing up for converged communications and the reduction in mobile termination rates is regarded as a key driver in facilitating fixed to mobile convergence. Already in New Zealand with the changes to price and speed in some of the fixed market, significant differences are opening up between price and capacity for fixed and mobile broadband services, a gap which for many consumers, the high utility of mobile may not be able to bridge.

The European Commission has raised concerns over the large gap between fixed and mobile termination rates in Europe and potential implications for efficient investment. MTRs in Europe are up to ten times the fixed termination rate and, whilst this is high

globally, New Zealand is slightly greater at around eleven times (1.13 cf. 15). “The large gap between fixed and mobile termination rates could ultimately prove to be a barrier to important innovations and investments in the fixed sector such as fibre roll out and the delivery of NGNs which will allow higher bandwidths and more efficient provision of multiple services. Convergent offers from fixed operators may also be impeded because of the disparity between fixed and mobile termination rates which limits the inclusion of mobile calls within fixed bundles. Large transfers from fixed to mobile networks comprise a potentially significant source of economic distortion ... this also leads to a distortion of competition and investments with potentially serious implications for important network and service innovations in the fixed sector.”ⁱⁱ

The future of Next Generation Networks, all IP, converged networks and Fibre to the Home is now within our reach. The Commission has just completed our initial investigation into the migration to Next Generation Networks, identifying potential areas where following consultation with stakeholders further work may be necessary. Whilst our NGN study attempted to identify whether today’s settings for competitive telecommunications markets are appropriate for the environment that will soon be the norm, rather than the exceptional pockets that now exist, it is imperative that the current market settings also facilitate this transition, hence the reason for our current focus on mobile.

Conclusion

In finishing, I would like to turn to our focus beyond the next year, some of which I have just touched on. The Commission is coming to the end of the early phase of the 2006 regime, in which the focus was on setting terms and conditions for regulated services. Our emphasis in 2010 is likely to shift towards monitoring the impact of interventions and assessing market developments as the new technologies emerge.

Beyond 2010, the focus of our work will be the effect on competition of the convergence in telecommunications technology, companies and market structure. Our focus on identifying potential bottlenecks and barriers to competition in such an environment will be crucial to ensure we get the regulatory ground rules right to ensure that investment continues and to avoid potential distortions to competition in the converged telecommunications market. We are very conscious that the initiatives we take now whilst the market transitions to an all IP world will be fundamental in shaping the competition landscape in the future.

In closing, we again ask - how far are we in achieving the Commission’s role, which is to provide competition in the telecommunications market for the long term benefit of end users? Much has been achieved, but we can and have to do so much better. My talk was long, but as you can appreciate, we are currently very exercised, with a clear eye on the issues of today and tomorrow. Heoi ano. Tena koutou katoa.

ⁱ Future Broadband, Ofcom 26 September 2007

ⁱⁱ European Commission Staff Working Document, 7 May 2009