

Submission

by

Business|NZ

to the

Commerce Commission

on the

**Draft determination for the
Telecommunications Act 2001:
Section 64 reviews into unbundling the
local loop network and the fixed public
data network**

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PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

1. INTRODUCTION

- 1.1 Encompassing five regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, Canterbury Manufacturers' Association, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 52-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 1.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 1.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term. Given the increasing need for businesses to receive information at a quicker pace than ever before, the telecommunications industry plays a vital role in ensuring businesses receive information immediately and effectively.
- 1.4 Business New Zealand therefore welcomes the opportunity to briefly make some general comment on the Commerce Commission's draft determination report regarding unbundling of the local loop network. In addition, we would like to take the opportunity to re-iterate some points we made in reply to the

initial discussion document on local loop unbundling (LLU) that was released in April of this year.

2. GENERAL DISCUSSION ON THE DRAFT LLU REPORT

2.1 Business NZ does not have sufficient confidence in the model used by the Commerce Commission in determining the effects of introducing LLU in New Zealand, as well as the draft recommendations made by the Commission which are based on the model. Therefore, we wish to make some broad comments in regards to the draft recommendations, rather than answer the 48 questions asked in the draft report. Also, we wish to reiterate our viewpoint made in our earlier submission on the issue.

2.2 While the Commerce Commission has detailed the views of both proponents and opponents of LLU in their draft report, Business NZ does not support the draft findings of the report that recommends a highly intrusive regulatory option for LLU. The Commerce Commission has provided four LLU regulatory options (full unbundling; line sharing; bitstream access, and unbundling of, and interconnection with, the fixed PDN), each showing national benefits based on a cost-benefit analysis that we do not have confidence in. In addition, we believe that the net benefits stated from any of the four options are not sufficient to outweigh the likely negative costs on investment, property rights and technological development.

***Recommendation:* That any form of LLU should not take place in New Zealand.**

2.3 Notwithstanding the fact that Business New Zealand would not like to see any form of LLU introduced in New Zealand at this point in time, if the Commerce Commission intends to continue to support some form of LLU in its final report, we would want to see the least intrusive form of LLU take place. Therefore, the negative effects of LLU would be minimised as much as possible.

Recommendation: Notwithstanding the fact that Business New Zealand would not like to see any form of LLU introduced in New Zealand, if the Commerce Commission intends to continue to support LLU in its final report, we would want to see the least intrusive form recommended.

3. BROADBAND PENETRATION IN NEW ZEALAND

3.1 One of the main reasons for the introduction of LLU by supporters is to improve the uptake of broadband. While Business New Zealand agrees that increased broadband uptake is an important facilitator for growth, we do not believe that the Commerce Commission, or indeed any other organisation, is in a strong enough position to ascertain future developments of broadband in New Zealand. In addition, we do not believe that the Commerce Commission has sufficiently taken into account past developments in the uptake and price of broadband that have recently occurred when its draft recommendations were made. Furthermore, we do not view LLU as a 'magic bullet' that would be the key factor for lifting broadband use that supporters of LLU have suggested it would be. In our opinion, increased broadband uptake in New Zealand is more likely to occur through the continued promotion of new technology, protection of property rights, a supportive environment for investment and a review of the Kiwi Share Obligation (KSO).

3.2 Between the release of the initial LLU discussion report and the subsequent publication of the draft recommendation document, broadband providers have continued to introduce initiatives that have increased access to existing and led to establishment of new broadband services. Woosh (formerly Walker Wireless) have recently launched new business and residential broadband packages, as well as developments to provide broadband beyond the Auckland region. BCL will be introducing its wholesale broadband service by the end of October 2003, with the capacity to immediately reach at least 90,000 households and businesses. Telecom, as the incumbent market leader, announced a strategy earlier in the year to have broadband taken up by 100,000 households by the end of 2004, almost three times the current

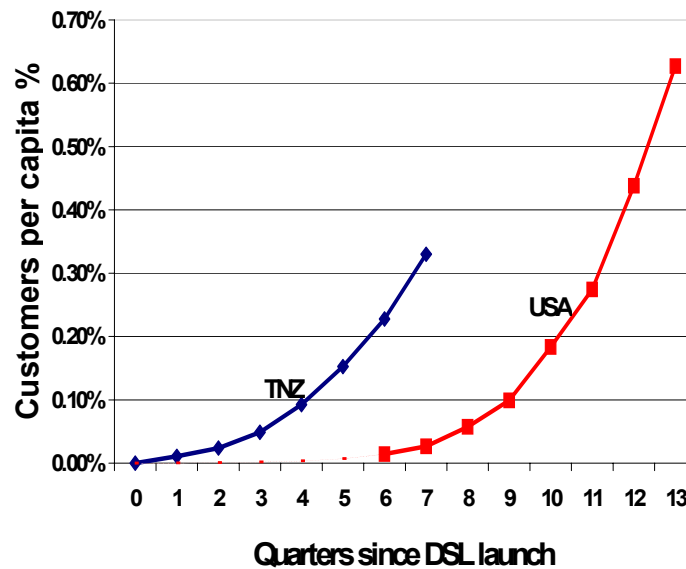
number of households (36,000)¹. As part of this strategy, they have recently launched a campaign to increase the number of broadband subscribers that also markets the benefits of broadband compared to dial-up Internet, which are not often recognised by consumers.

- 3.3 In a recent article by Andrew Odlyzko entitled *The Many Paradoxes of Broadband*², the author points out that while broadband is a useful technology, it is generally poorly understood, in terms of both delivery and how it can best be used. Although Odlyzko's article is generally focused on developments in the U.S, his concerns and conclusions also have strong relevance to New Zealand, as many countries still share the problem of low broadband uptake, whether they have introduced LLU or otherwise. While there have been calls by some in the U.S for increased government regulation to boost the current slow pace of broadband uptake, the author advises caution before any drastic regulatory action is taken.
- 3.4 Odlyzko asserts that history is littered with examples of new infrastructure and technology that have taken time to be fully integrated into society. It is usually businesses that first uptake new technologies, while residential customers follow after it has been established in the business community. The history of the mobile phone market in New Zealand shows initial uptake was largely within the business community. For the majority of the 1990's, mobile penetration was low across the whole country (around 1% in 1991, to 14% in 1998). However, by 1999 the demand from the residential community had begun to filter through, which meant by 2001 mobile penetration had reached around 52%, and by 2006 is expected to reach 64%.
- 3.5 In terms of broadband uptake, New Zealand is still in its relative infancy, but was quick to adopt the new technology when it was first introduced. Graph 1 shows that for take-up of broadband services per capita as a function of time when they were first launched, the take-up of Telecom's Jetstream package during the first seven quarters since its launch in June 1999 was actually faster than the comparable period in the U.S. Broadband uptake in the New

¹ Telecom Reports Solid Half Year Performance, Telecom Media Release, 4 February 2003.

Zealand business community is already ahead of other countries with which we generally compare ourselves. Latest figures show that 8% of New Zealand businesses have broadband, which is higher than that of the U.K (5%) and Australia (3%). For enterprises in New Zealand that have 10 employees or more, 50% have broadband uptake. All this has been achieved without the need for intrusive regulation.

Graph 1. DSL (Per Capita) Uptake³



3.6 Those in support of LLU in New Zealand have often highlighted the country’s slip down the ranking for broadband uptake. While New Zealand ranked 21st out of 30 OECD countries in 2002 for broadband penetration (slipping from 16th in June 2001), New Zealand’s broadband subscription ratio is still very close to countries it traditionally compares itself to that already have LLU, such as Australia and the U.K (ranked 18th and 19th respectively).

3.7 Furthermore, when cross-country comparisons are discussed, proponents of LLU point out that New Zealand is one of only a handful of countries that have not unbundled their local loop, making New Zealand a member of a very small club with countries such as Mexico. However, the proposed positive

² www.firstmonday.org/issues/current_issue/odlyzko/index.html, 2003.

³ Telecom New Zealand, 2003.

relationship between adopting LLU and increased broadband uptake seems erroneous given the fact that New Zealand currently ranks 30th out of 73 countries for broadband uptake per 100 inhabitants. More importantly, any justification for the introduction or amendments of regulations should be based on sound economic reasoning, rather than a simple desire to follow the practice in other jurisdictions. LLU may have been warranted for countries given the particular circumstances of some jurisdictions, however, the rapidly changing face of telecommunications through viable alternative technologies in recent years means that these same countries might have come to different conclusions if they were assessing their options today.

3.8 Supporters of LLU have argued that LLU would bring lower broadband costs if it were implemented in New Zealand. However, the findings of International Telecommunications Union (ITU) report on the Birth of Broadband show that New Zealand is already cost effective when compared to other countries⁴. The report found that despite Australia having LLU in place since 1999, the cost of the lowest broadband price per month was considerably higher than that of New Zealand (US\$91.77 in Australia compared with US\$38.34 in New Zealand). The same table also showed that of the 50 countries evaluated, New Zealand ranked 17th in terms of the lowest broadband price offered per month, as well as the 9th equal cheapest country in terms of 100 kbit/s as a percentage of monthly income. The recent introduction of new pricing structures for broadband usage requirements in New Zealand will no doubt continue to improve its position.

3.9 Given the continual increase in those with broadband, the future development of broadband penetration, and the falling cost of current broadband services in New Zealand, Business New Zealand does not see the need for LLU to contribute to already improving domestic broadband developments.

⁴ International Telecommunications Union, *The Birth of Broadband*, 2003.

4. INVESTMENT AND PROPERTY RIGHTS IMPLICATIONS

- 4.1 The Commerce Commission's draft report noted that various companies that were directly competing with Telecom but using alternative technologies had indicated their opposition to LLU. These submissions clearly stated that LLU would hamper the progress of new technologies, as it would advantage traditional infrastructure such as the copper lines instead. Although there is no definitive evidence that new entrants would choose existing technology over new technology, the copper wire option becomes a far more viable new entrant option given its lower risk and easier establishment advantages.
- 4.2 New technology that is proven to work also brings in investment as investors see areas where new technology could phase out existing technology. Business New Zealand is concerned that LLU may contribute to a fall in investment on the grounds that doing so would place another layer of regulation upon businesses. Telecom is currently New Zealand's biggest public company and largest investor of capital. Worryingly, investment by Telecom has continued to decline over the last two years, and we fear that the draft recommendations of the Commerce Commission may continue this trend.
- 4.3 Property rights are also an important factor to take into consideration if the Government were to take regulatory steps to introduce LLU. A requirement for a successful open-market economy is the need for clear specifications and enforcement of property rights, which are crucial for production as a company (and shareholders of the company) that invests in productive assets requires assurances that they receive suitable rewards for their investment. Ownership of property rights means that shareholders of the company have the right to use the asset, exclude others from using the asset, and transfer control of asset rights to others if they wish. Regulation would undermine these rights, and although regulatory measures are often introduced in pursuit of the public interest, they remove the incentive to invest because there are no assured rewards for incurring the costs of investment and ownership.

- 4.4 In the case of Telecom, shareholders would relinquish one of their property rights if LLU were mandated. Those in support of LLU have argued that Telecom's property rights would not be trampled on, as adequate compensation would be provided. However, in our view, Telecom has already been under compensated for key facilities, such as those under the TSO agreement, where the WACC value determined by the Commerce Commission was in Business NZ's view substantially lower than that to provide adequate compensation. There is every reason to believe that the Commission may again designate a value for the service that is not at an adequate level for the incumbent for their loss of market share and business advantage to competitors. Under compensation would undoubtedly leave the incumbent with little option but to further scale back investment.
- 4.5 Telecom has already expressed concerns that increased regulation in areas such as telecommunications would continue to lower capital investment by the company with serious consequences for New Zealand's infrastructural development and economic growth. Business NZ is also concerned that LLU may hamper the continued development of network investment in the rural communities. Business NZ wishes to see broadband made available to all businesses and residential homes throughout the country. Given the topography of the landscape, it is often difficult for certain regions to access new technologies through existing infrastructure. In many cases, the only viable option for telecommunication investment is through alternative technologies, such as wireless and satellite. Any regulation that undermines alternative technologies will therefore have possible negative consequences for rural economic growth.
- 4.6 This reinforces the critical importance of a credible evaluation of the benefits of mandated competition in the shorter and longer term respectively, taking into account the particular characteristics of a tiny and highly dispersed market that has demonstrated its appetite for and capacity to absorb rapid technological change. This is not the responsibility of the local loop incumbent whose assets have been acquired in different circumstances. Proponents of LLU need to assure business end users that in the medium to

longer term they may still expect to access a globally competitive and efficient national telecommunications infrastructure that is the product of adequate investment and reinvestment over time. Alternatively, they must show that any short term price gains of LLU accruing to end users would significantly outweigh longer term outcomes that may be at risk to commercial decisions by incumbent operators that better returns on their capital may be obtained elsewhere. In our view, the draft report of the Commerce Commission does not show this to be the case.

***Recommendation:* That the Commerce Commission give stronger consideration towards the negative implications on property rights, investment and the uptake of new technologies by competitors if LLU is introduced in New Zealand.**

5. OXERA COST BENEFIT MODEL

- 5.1 The basis for the decision on LLU has largely been determined by the outcome of the cost-benefit analysis report by OXERA Consulting Limited. OXERA's four case models examining full unbundling, line sharing, bitstream access and unbundling of, and interconnection with, the fixed PDN all showed net benefits from unbundling. However, Business NZ disagrees with key assumptions made for the counterfactual (i.e. the alternative if LLU was not introduced), which the Commerce Commission basically asserts as a continuation of the status quo.
- 5.2 One assumption made in the counterfactual is that effectively, broadband prices would remain static in real terms over time. Recent developments from Telecom and its competitors have already seen increasingly competitive prices being announced for broadband, and there is no reason to believe this will not continue. Furthermore, a glance at other technological developments over time such as computers or mobile phones shows that consumers end up receiving 'more for less'. In our view, broadband supply is no exception.

5.3 Business NZ also disagrees with the assumption that competitors will get little market share of broadband supply. The Commerce Commission appears very dismissive of current developments regarding new technologies, both from domestic providers and the possibility of overseas entrants into the broadband supply market. While one could have justifiably argued some years ago that Telecom had a monopoly in regards to broadband supply, this is certainly not the current case. Woosh continue to extend residential and business wireless packages for broadband that are already competitive in terms of price with Telecom. Although previously, doubts have existed regarding new technologies providing a secure long-term platform in which to provide broadband, Business NZ believes there are justifiable reasons to conclude that new technology such as wireless and WiFi will make a credible and increasing mark on the domestic Internet landscape, provided these alternative technologies are not undermined through LLU.

5.4 In addition, the time period for analysis of both the assessment of competition and that of the counterfactual is only 5 years, which seems an extremely short time span given the ongoing ramifications of the decision whether to unbundle or not. One apparent justification for the short time frame was increasing degrees of uncertainty beyond that period. However, there have been a multitude of assessments that have been carried out on various investment projects both within the public and private sector that stretch far beyond a 5-year period. Business NZ believes that any analysis by the Commerce Commission should focus on the longer-term implications to both competition and the interests of consumers.

Recommendation: That the Commerce Commission either request OXERA, or assign another organisation to conduct a cost benefit analysis of various forms of LLU being introduced in New Zealand, that takes into account a more realistic counterfactual, such as increased future market share gains by competitors and falling broadband prices, as well as a longer time period for analysis.

6. KIWI SHARE

- 6.1 We also would like to take the opportunity to again reiterate from our previous submission that the Kiwi Share Obligation (KSO) needs to be re-examined in light of the issues surrounding LLU. NZIER have recently published a report on the kiwi share, recommending its abolition⁵. Their research concluded that the costs of what Telecom provides under the KSO outweighs the benefits, and that in the absence of KSO line rentals would rise for a small group of customers, but would likely fall for 80% of customers. Also, NZIER found that the argument that the KSO helps low income families does not appear to be substantiated, as average household incomes in the areas which may benefit from the cap on monthly line rentals tend to be above the national average.
- 6.2 As the KSO was initiated when the Internet was hardly a factor, the decision taken on the kiwi share issue has resulted in current local calls for standard dial-up Internet connections remaining free of charge. Given the relative differences in cost between dial-up and broadband connections within New Zealand, dial-up access looks the more attractive alternative if cost is the only issue that customers consider.

Recommendation: That a review of the issue of kiwi share take place in the near future, with specific focus on the current situation of local standard dial-up connections remaining free of charge.

7. SUMMARY OF RECOMMENDATIONS

- 7.1 That any form of LLU should not take place in New Zealand.
- 7.2 Notwithstanding the fact that Business New Zealand would not want to see any form of LLU introduced in New Zealand, if the Commerce Commission intends to continue to support LLU in its final report, we would want to see the least intrusive form recommended.

⁵ NZIER, *The Economic Impact of the Telecommunications Service Obligation: Report to Vodafone NZ Ltd*, September 2003.

- 7.3 The Commerce Commission gives stronger consideration towards the negative implications on property rights, investment and the uptake of new technologies by competitors if LLU is introduced in New Zealand.
- 7.4 The Commerce Commission either request OXERA or assign another organisation to conduct a cost benefit analysis of various forms of LLU being introduced in New Zealand, that takes into account a more realistic counterfactual, such as future market share gains by competitors and falling broadband prices, as well as a longer time period for analysis.
- 7.5 A review of the issue of kiwi share take place in the near future, with specific focus on the current situation of local standard dial-up connections remaining free of charge.