

SUBMISSION TO

The Commerce Commission

on the

**Telecommunications Act: Section 64 Review and Schedule 3
Investigation into Unbundling the Local Loop Network and
the Fixed Public Data Network**

Draft Report (September 2003)

by

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SUBMISSION ON LOCAL LOOP UNBUNDLING (LLU)

1.0 Introduction

- 1.1 Federated Farmers of New Zealand (Inc) welcomes the opportunity to make a submission to the Commerce Commission on Local Loop Unbundling (LLU).
- 1.2 Federated Farmers of New Zealand is a primary sector organisation that represents approximately 18,000 farmers and various other rural businesses. Federated Farmers has a long history of representing the needs and interests of New Zealand's farming communities, primary producers and agricultural exporters.
- 1.3 The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:
- Our members may operate their business in a fair and flexible commercial environment;
 - Our member's families and their staff have access to services essential to the needs of the rural community; and
 - Our members adopt responsible management and environmental practices.
- 1.4 The total agricultural sector remains even more important to the economy than it was fifteen years ago. Its contribution to the New Zealand economy has risen from around 14.2 percent of GDP in 1986-87 to around 17 percent in 2002/03 (including downstream processing).
- 1.5 The Federation has major concerns with the Commerce Commission's draft report which proposes that there would be benefits in unbundling the local loop (LLU).

Recommendations

The Federation **recommends** that:

Given the potential negative implications of Local Loop Unbundling (LLU) as outlined in this submission, the Commerce Commission should reconsider its draft decision to recommend LLU.

2.0 **General Concerns with LLU**

2.1 The Federation believes that there are serious issues involved with (forced) unbundling which may not have been adequately considered by the Commission.

2.2 These relate specifically to the following:

- Is there a case for Government intervention in this particular market?
- The impact on established property rights of incumbents;
- The impact on investment (and alternative technologies);
- Will it help with the provision of broadband services in rural areas?

Is there a case for Government intervention in the market?

2.3 There are generally considered to be a number of instances where government intervention may be justified in a particular market. Without going through them all in detail, there is generally considered to be a case for intervention where markets work inefficiently, as a result of monopolies or where there are significant externalities which the incumbent firm does not pay for.

2.4 It should be noted that in any analysis it is necessary to first examine the reason why monopolies have developed. For example, a monopoly may have developed as a direct result of previous government intervention or regulation. In this case the appropriate response would be to remove those regulatory impediments that prevent new entrants into the market.

2.5 It should be noted that size (or concentration) in a market does not necessarily result in inefficient behaviour from the incumbent firm. For example, often economies of scale make it efficient for there to be only one (or two) firms in a particular market. There are also cases of natural monopolies where it would be inefficient for duplication of resources in a market - electricity lines companies being a good example.

- 2.6 The Federation would argue that while a number of years ago Telecom had a (natural) monopoly over the local loop, this is no longer the case, with a number of new and innovative solutions being put forward, particularly in respect to broadband developments. A number of these do not require access to Telecom's network, e.g. through wireless solutions, so it would be wrong to assume that Telecom still retains a natural monopoly. The use of wireless data transmission has effectively made redundant the concept that the local loop is a natural monopoly.
- 2.7 In this respect, the Federation believes that the case for LLU has not been clearly established, particularly in terms of the "natural monopoly" argument.

The impact on established property rights of incumbents

- 2.8 As the major representative of the farming community, secure property rights are a significant and ongoing issue for members of Federated Farmers, given the propensity of Government over recent times to effectively take private property without compensation. Telecom's network is privately owned, and has been for some time. To the company the network is a substantial asset that shareholders have invested in, and expect a return on. A decision by the Commerce Commission to unbundle Telecom's network has an effect on the fundamental principles of property rights in New Zealand and could have serious consequences for continued investment in this network. If the Government were to mandate unbundling they would need to be very sure that the benefits of this intrusion of property rights was justified.
- 2.9 The Federation is well aware of the importance of secure property rights to provide for incentives on individuals and companies to invest considerable sums of money into long-term investments.
- 2.11 Interfering with established property rights will obviously impact on future investment decisions and will result in reduced investment compared with what would have been the case had property rights been secure.
- 2.12 Telecom, like other companies and individuals, should expect that their property rights in respect to their assets, and use of those assets, will be respected. Taking away such rights without fair compensation will likely weaken the asset base of Telecom and ultimately adversely impact on the wealth of its investor shareholders.

- 2.13 This indirectly will impact on investor confidence in the New Zealand market as a whole if the Government proceeds to ride rough-shod over well established property rights of companies and businesses investing in New Zealand. In this respect, the flow-on investment implications need to be considered of such a policy decision.

The impact on investment (and alternative technologies)

- 2.14 “Changing the rules” of engagement will adversely impact on the incentives on other investors to enter the market and provide alternative telecommunications systems (e.g. wireless).
- 2.15 Rather than encouraging competitors to seek and offer customer’s alternative cost efficient technologies, they may be discouraged from spending further research funds if they consider that alternative solutions will not be encouraged - simply because the government will step in to ensure “traditional” (copper wire) systems are supplied through forced LLU.
- 2.16 In this respect it is noted that a number of alternative telecommunications providers made submissions to the Commission outlining their opposition to LLU, principally from the detrimental investment signals it would send to companies considering alternate innovative solutions. In many respects it would potentially lock New Zealand into current technologies rather than encouraging cost effective innovative solutions to isolated rural areas.
- 2.17 Submissions of those players in the marketplace who are in the business of providing alternate infrastructure into Rural NZ – BCL, Walker Wireless and Counties Power, are firmly against any decision to unbundle. These are the investors along with Telecom that Federated Farmers looks to for future innovation and for improved services to rural communities.
- 2.18 Federated Farmers is not in a position to judge whether unbundling will make it harder for these investors. Logic says, however, that if you make it easier through regulatory intervention for players to utilise the copper network then those players will see that network as the only way to deliver services, or at least a much lower risk and easier option. This will only blunt the incentives to find a business case for the rollout of alternate networks.

- 2.19 It is this blunting of incentives for infrastructure competition that in the long run will be the biggest downside of unbundling. The Commerce Commission appears to express scepticism that newer technologies will not be competitive against the copper network. Firstly, we respectfully express doubts over whether any regulator is in the best position to make that type of long term call. Secondly, what rural telecommunication users need is diversity, different investors making different bets on different technologies. This is the way to drive dynamic efficiency. The Federation would urge the Commission to carefully consider the investment incentives for alternate technologies for rural regions if a decision to unbundle is made.
- 2.20 The Federation considers that, at the very least, a decision on unbundling should be deferred until the government's own PROBE process has been finalised and the winners of the tenders have had a chance to rollout their alternate infrastructures. If a decision is made prematurely it may have a detrimental impact on those companies' abilities to attract continued investment.

Will LLU help the rural sector?

- 2.21 Farming is a high-tech business. If New Zealand farmers are to remain internationally competitive they have to have continued access to new technologies. To this end rural communities are reliant on continued network investment and development. Closing the digital divide between rural and urban New Zealand is vitally important to the future of New Zealand's economy. The only way of truly managing this divide is through the continued attraction of investment in alternate technologies, such as wireless and satellite, and through continued alternate infrastructure roll out.
- 2.22 Many of our members live in the more isolated regions of New Zealand and often have difficulty accessing new telecommunication services. Factors such as the distance from the exchanges, and external influences, like electric fence interference, can severely disrupt phone and internet connections on the copper wire system.
- 2.23 Rural communities need to receive the most up to date technology and services to not only drive productivity on the farm but to also enable their children to keep up their education standards to that of their city peers. We believe that access to future technologies is only achievable through truly competing telecommunication infrastructures.

- 2.24 Wireless solutions and satellite solutions are the only cost effective solution to meeting the needs of more isolated communities. In this respect it is noted that Fonterra has recently negotiated an agreement for the provision of high-speed broadband services to all its 13,000+ shareholders.
- 2.25 Fonterra considers that a significant proportion of these services will involve the use of wireless and satellite solutions – up to approximately half. In this respect LLU would do little if anything for these customers.
- 2.26 Although LLU may provide short term pricing benefits for some customers of unbundled exchanges, we would note that it would not be cost effective for competing companies to invest in the exchanges that service our rural members. Unbundling in our view, therefore, is a regulatory measure that has no measurable short or long-term benefits for rural New Zealand. Indeed if it undermines the incentives for wireless and other new technologies rural customers will be worse off.
- 2.27 Finally, the Federation notes that advocates of unbundling make much of the fact that other OECD countries have implemented unbundling and that “NZ will be the only country apart from Mexico” that has not gone down this track. This seems to be a particularly shallow justification for a policy change and one that would have worrying consequences if broadly adopted. Good policy settings are not always those that are generally adopted by the OECD. If NZ were to adopt the approach of doing everything the OECD countries do then we would be rapidly reintroducing agricultural tariffs. New Zealand’s experience of the last few decades would suggest this would be a huge backward step. Moreover, significant LLU in the international arena took place well before there were significant cost-effective alternatives to the copper wire network. Technology has moved on significantly since the first LLU took place internationally.

The Federation **recommends** that:

Given the potential negative implications of Local Loop Unbundling (LLU) as outlined in this submission, the Commerce Commission should reconsider its draft decision to recommend LLU.