# Commerce Commission Conference on Unbundling

## INTRODUCTION

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1. My name is Bruce Parkes and I am General Manager of Government and Industry Relations at Telecom.

2. It is Telecom's submission that a competitive and dynamically efficient telecommunications market based on competitive networks is developing rapidly in New Zealand. This will deliver substantive benefits for customers.

3. The Commission should not recommend to the Minister any unbundling regulatory intervention. Unbundling in any form is not necessary. The current regulatory settings are delivering exactly what will best serve the long-term interests of end-users in the form of a wide array of competing technologies being rapidly rolled out and competing to offer a huge array of new services.

4. As we will explain, unbundling will jeopardise the investment plans of both Telecom and other network-based investors, hence putting at risk the substantive customer value the industry is now poised to deliver.

5. Unbundling is not therefore a costless decision – it will affect investment by network builders. This will impose welfare losses on consumers and on NZ far in excess of any benefits that unbundling might generate.

6. I would like to make some introductory remarks that set the context for our further submissions:

7. One framework for considering the issues at hand is that the Commission is faced by 3 questions:

   (a) do I regulate the future – that is do I regulate the new IP based or NGN networks and services that Telecom is building;

   (b) do I regulate the past – that is do I focus regulation on existing TDM based data assets as PPC regulation tends to do in other countries;

   (c) do I regulate the underlying physical medium – the copper – being an asset that is relevant to both the past and the future.

8. Of these the first question is the most important - will the Commission regulate the future. To what extent will you recommend regulation that covers Telecom's new networks and assets.

9. Overseas there is extreme nervousness as to the effect of regulation on the future?

10. The FCC's Triennial Review is quite explicit. They will retain regulation of the copper but have sent an overwhelmingly strong message to the industry – "We will not regulate the future- we will not regulate packetised network elements such as DSLAMS – we will not regulate fibre or hybrid fibre/copper loops - we will not regulate NGNs".

11. The striking thing about the Triennial Review is that it sends a clear message on this – it is clear the FCC are looking to create certainty for network builders. Their message is: we know NGNs offer huge potential for customers and we recognise that regulation has risked creating an environment in the past that has caused investment risks.

12. The FCC have therefore made strong statements on what they will *not* regulate. We would ask the Commission to make a strong positive statement that you will *not* regulate so as to create the conditions of certainty the network builders in the industry need.

13. In respect of regulating copper it is clear that copper loop unbundling is likely to focus only on those high profit business areas that other real network builders are covering.

14. It will be a high cost exercise full of sound and fury and signifying nothing as the saying goes.

15. As for regulating the past, the regulation of PPCs is not required. The Government made a clear decision that wholesale as set out in the Act was sufficient. NZ has amongst the most extensive wholesale regimes in the world. The Commission should not extensively regulate wholesale for data services and PPCs. If it recommends regulation of PPCs it should determine wholesale for data services is no longer required.

16. In any event the arrival of widespread alternate networks renders the arguments for regulating PPCs redundant.

17. I have spoken about the future. Indeed this I hope will be a theme for this conference. Discussion and debate on the future is particularly relevant because this conference is happening at a watershed time in our industry.

18. I would like to spend a few minutes reflecting on two of the sea change events occurring in our industry.

19. These are:

    (a) firstly, the migration of multiple existing networks including the PSTN to an NGN – a Next Generation Network - a single IP based network delivering many services;

    (b) secondly, the rise of alternate networks.

Both of these issues have a profound influence on the issues the Commission is considering.

20. Central to Telecom's business strategy is a vision of broadband to every home and business in New Zealand. A huge array of services would be provided over this network - many of which have not yet been imagined even by customers.

21. The network will be an all IP network. It will run seamlessly over different physical networks including cellular, fixed wireless and satellite networks.

22. Thus Telecom will be well placed to deliver finally on the mantra of anything, anywhere, anytime that has oft been the stuff of telecommunications visionaries.

23. The shorthand name for this network is a mass-market multi-service NGN. The good news is that Telecom is arguably better placed than incumbent telcos in other countries to deliver this vision. The bad news is that is very hard, very expensive and very risky.

24. I would also stress that this is not a Telecom-only world.

25. Our business planning anticipates the continuing spread of alternate networks. Other network builders are building NGNs. We see this as a race to deliver these services. But we also see it as a race that can have more than one winner. We intend of course to be one of those winners.

26. Stephen Crombie, Telecom's General Manager of Network Investment, will outline the business choices Telecom has in investing in its NGN. Our bold vision for a mass-market NGN with managed IP services to every home and business in New Zealand is not a foregone conclusion. There are credible and lower risk options that compete with this mass-market NGN business intent.

27. An alternate strategy of a business overlay NGN coupled with an ongoing investment in PSTN assets is a very credible option. Indeed this approach is what most telcos refer to when they say they are building a NGN.

28. Under this strategy risks and costs are much lower. The NGN core is invested in but the investment is lower because the re-engineering of processes is much less as the smaller volumes can be incorporated into existing processes or manual processes.

29. High-value business private networks would be the primary focus. Residential customers would be served by an internet quality style broadband service. It will not be a multi-service broadband network, nor will it be video capable such that for example a cable TV service could be delivered over it. The PSTN for residential customers would still be invested in with NEC switches being replaced, offering a cheap but functional PSTN service.

30. We will outline in our submission how unbundling decisions by the Commission will have a significant impact on which of these options Telecom pursues.

31. The other sea change event I refer to is the rise of competitive alternate networks to the copper loop.

32. Over the last decade or more, customer choice has spread across the telecommunications markets. All customers now have a genuine choice of alternate calling providers, mobile services and ISP services. Increasingly, customers have had a choice in data and access networks.

33. The watershed event in our industry is that we can now say with confidence in the next year or two there will be a rapid expansion of alternate networks. Within 2 years the proportion of customers with a choice to cut the copper wire will reach 80% or more, with this percentage expected to continue to grow beyond that.

34. What this means is competition - real competition such that the customer has the choice of moving completely off the Telecom network.

35. I will say that again though I can hardly bear to – real competition such that the customer has the choice of moving completely off the Telecom network

36. We need to sit back and remind ourselves of just how profound a change this is for our industry. The networks being built by the likes of Woosh Wireless, Counties Power, BCL and others cannot be dismissed with labels such as "fringe", "niche", "experimental" or "undeveloped".

37. The evidence is that alternate networks have come of age.

38. Let's consider some of the facts.

39. **BCL**: Tomorrow BCL formally launches its wireless voice and broadband network. The stage 1 network rollout covers 600,000 businesses and households. This is getting up to a third of New Zealand's 1.8 million fixed lines. The potential coverage could expand even further.

40. **Woosh Wireless**: They have their service up and running in Auckland and the Prime Minister cut the ribbon on their Southland service only a few weeks ago.

41. Woosh has concrete plans for an extensive rollout. They have been successful in a number of regional PROBE tenders, thus giving them a significant input of both local community and central government funding which will enable them to supplement their rollout beyond built up areas.

42. With a rapid and progressive rollout, Woosh will have a widespread network covering, as they say in their submission, not just Auckland and Southland but Wellington, Christchurch, Dunedin, Hamilton, Tauranga, Rotorua, Hastings, Napier, Palmerston North, Taupo, Northland, Wairarapa and regional Canterbury and Otago, all within two years.

43. We are not talking here about a focused CBD network rollout in these cities but extensive coverage of suburban New Zealand and, in a number of regional area, widespread coverage as well. For example, the Southland and Northland rollout under PROBE requires a coverage of 93% of those regions.

44. **ThePacific.net** has won the PROBE tender for the Nelson/Marlborough area and will be covering Nelson and Blenheim and the heartland areas of that region.

45. **Counties Power** has demonstrated a successful model where wireless and a wired network rollout co-exist. As they have said in their submission, they can compete with the copper network and they have a successful business model that will be rolled out to other areas in New Zealand as well.

46. The very scary reality for Telecom, although at the same time an energising and focussing development, is that the large majority of customers will have the option of cutting the copper wire.

47. It is worth reflecting here on the role of the PROBE process in all of this. It looks likely that on the back of the PROBE process, New Zealand will be amongst the leading countries in terms of the proportion of its population that will have such a "cut the copper wire" option.

48. 80% plus coverage of alternate networks will be a phenomenally competitive and dynamic marketplace - the fruits of which we are already seeing in, for example, the shape of Woosh's initial pricing plans which lay down a challenge to Telecom.

49. The Government is now well through its announcements of the various PROBE regions. There are still four to go. This has seen alternate networks get a significant tick from local communities and central government. As the Government has said, it is putting tens of millions of dollars into Project PROBE supplemented in many places by significant contributions from local coffers as well.

50. The criteria for winning a PROBE tender is demanding. A cheap and cheerful "she'll be right" network plan would not have got past the first vetting process.

51. The Government is interested in networks that will provide sophisticated services for communities going forward. First amongst their requirements was videoconferencing for schools. The fact that BCL, Woosh, ThePacific.net and potentially others have won PROBE tenders is firm evidence that these networks will be high quality and able to supplant the copper network.

52. It is this counterfactual that the Commission must assess options for regulatory intervention against.

53. We would suggest that when the Commission does so, the alleged benefits of unbundling will disappear. An intervention such as unbundling simply cannot be justified where customers will have a viable choice of provider.

54. Of course there is never consensus on what the future holds. It is worth reflecting here on the industry dynamics that have emerged over the unbundling debate, particularly in respect of what the future holds.

55. One would have to say that it is a fascinating process to observe and be part of.

56. Broadly speaking, the industry is dividing into two camps. It is instructive to reflect on the make up of these two camps as it is highly illustrative of the debate underlying this conference and of the choices the Commission has to make.

57. In one camp we have a number of players characterised by the following:

- Their business case is based firmly and squarely on building a genuinely competitive alternate network to Telecom.

- They do not require regulatory intervention or assistance for their business case to work.

- These players' are marked by a strong sense of excitement and commitment to new network technologies and their ability to achieve widespread competition to the Telecom network.

- These players are focussing their business plans not on being the same as Telecom, but being different. They know they will struggle if they do not pursue a strategy of differentiation. They know locking themselves to the copper network will not achieve this.

- Like Telecom, they would agree a necessary but minimal set of requirements should be placed on the industry such as interconnect and number portability.

- These players' forecast for the future is a highly competitive market where a number of competing networks co-exist in a highly competitive retail market.

- At the same time these players recognise the need to deal with network-to-network issues such as interoperability, interconnect and the buying and selling of wholesale capacity between networks.

58. The type of players in this camp are BCL, Woosh, ThePacific.net, Counties Power and Team Talk.

59. I would also add Vodafone to this list. Whilst they have not submitted on the unbundling debate, certainly their previous submissions to the Fletcher Inquiry and the general tone of their submissions on the likes of the interconnect determination would certainly, we think, put them squarely in the camp of being a network builder not relying on regulation.

60. I would also add of course Telecom.

61. The Commission will hear from many of these players during the next five days, so I am sure you can test this characterisation with them.

62. In the other camp we have the likes of TelstraClear, CallPlus and ihug, who support unbundling. Players in this camp I would categorise in the following way:

- Their business plans do not appear to be underpinned by any widespread deployment of future competing networks to Telecom.

- Outside public comments on a potential 3G mobile network and the use of wireless for a focused targeting of business customers, TelstraClear's business plan no longer appears to involve widespread deployment of alternate networks outside of CBDs. Indeed, in terms of network build TelstraClear seem to have given up the ghost on residential customers.

Instead, we see a focus on regulated access to the Telecom network or resale as an alternative to building their own.

- These players express a high degree of scepticism over new technologies and the ability of widespread local loop competition to occur. Indeed, they are like King Canute with the tide washing round him saying there will be no wireless. The PM opens Woosh's Southland network – "there will be no wireless" they say ; BCL launches their wireless network covering 600,000 customers - "it is only a small island of competition" they say; the Minister announces more Probe contracts for Woosh in Canterbury and ThePacific.net in Nelson - "it is untried and unproven" they say.

- Telecom's relationships with competitors in this camp have tended to be more fraught.

- The reliance of some players on regulated outcomes creates a set of incentives to be never happy and to be never happy in a visible and noisy way. The regulated price is never good enough, the constraints on Telecom are never strong enough, and so on. This is a familiar pattern – we see it in every country where telecommunications is regulated. The network builders' camp within the industry tends to be of course much more the quiet achievers type. They are if you like the Reuben Thornes of the industry. The other camp of course is the sort of player constantly yapping at the ref – George Gregan springs to mind perhaps!!

63. So the industry players making submissions on the unbundling issue are presenting in broad terms the Commission with two futures for the industry.

64. The first is one where the industry is firmly based on a range of alternate networks competing vigorously at the retail level and inter-operating at the network-to-network level. Regulated access to unbundled elements of the Telecom network does not feature as a regulated requirement although significant network-to-network buying and selling of services can be expected to develop quite rapidly.

65. The second future is one where copper is seen to dominate the market and dominate other technologies. Alternate networks such as Woosh will either fizzle and fail or struggle to such an extent that their rollout is limited and their ability to put any significant pressure on Telecom is small.

66. The primary form of choice (and it is debatable if it can be called a choice) for customers is the players using the Telecom network with these players using the regulatory regime to get access to these network components.

67. Absent regulatory intervention on unbundling, it is Telecom's pick that the New Zealand market will look like the first of these two futures. Telecom is preparing for just this competitive environment. We recognise that it will be challenging and that we have to continue to learn how to win in such an environment.

68. As I said earlier, however, there is room for more than winner in this marketplace. Telecom's business strategy is about ensuring we are one of those winners.

69. One of the key issues the Commission will need to grapple with is, are these futures mutually exclusive? Could we have a vibrant rollout of alternate networks and regulated access to unbundled elements of some sort?

70. We will demonstrate in our submission that unbundling is not a costless decision. The Commission cannot introduce unbundling and expect it not to have a pronounced effect on the ability of network builders, including Telecom, to deliver to their full potential.

71. We will elaborate why unbundling is not a costless decision as we go through our submission.

72. In brief though, the following are the reasons why this is so:

1.Unbundling will introduce costs and complexities into the industry. Inevitably these costs will be under estimated.

2. It will undermine the economics of new alternate networks being built by artificially skewing the industry's investment incentives towards Telecom's copper.

3 it will make Telecom's NGN plans much more risky and hence significantly impact on the scale and timing of that migration.

4. It will undermine the ability of the industry to undertake value-based price differentiation. This in turn will shrink the market for broadband and other new services risking substantive welfare losses for customers as well as removing critical revenue streams from the industry needed to fund new networks including Telecom's NGN.

73. The fundamental risk of unbundling in any shape or form is that it rewards those who are not prepared to take risks , those who are not prepared to do the hard work and find the right combination of technology, funding and services.

74. Building a network is hard work and risky. It results in sunk assets that are not generally redeployable. Unbundling is a free option for players – the effects differ depending on the form of unbundling but all forms of unbundling have the same underlying effect. Unbundling gives you access to a network on a variable cost basis. You can rent it by the month and discard it if a better option comes along at no or little cost. You can pick out the cream customers and leave the rest.

75. If only real life was like that for those of us in the network builders' club.

76. The FCC put it well in its Triennial Review in deciding not to regulate the future. They said, and this quotes in para 878 of our submission:

> ***"The effect of unbundling on investment incentives is particularly critical in the area of broadband deployment, since incumbent LECs are unlikely to make the enormous investment required if their competitors can share in the benefits of these facilities without participating in the risk inherent in such large scale capital investment. "***

77. The FCC are of course being very polite. What they are really saying is why reward free loaders, who is going to do the hard work when the fruits of your hard work are handed over to free loaders not prepared to take the risks themselves. What's worse, who is going to bother doing the hard work if a regulator is going to give you a network on a plate.

78. Unbundling strikes at the heart of the market system. It blunts the incentive to win the race to get the prize of profitable returns and it blunts the incentive to find new and better ways of doing things and taking risks.

79. Its this corrosive undermining of market incentives through unbundling that is a big reason why our industry across the globe has failed to deliver on what we could do for customers.

80. Telecom's prediction of a world without unbundling is one where New Zealand customers reap the tremendously exciting benefits of genuine network-based competition. The race between these networks to deliver value for customers will create huge incentives to be allocatively, productively and dynamically efficient. The Commission cannot intervene in a way that does not disturb these incentives.

81. The best thing the Commission can do for the New Zealand telecommunications customer is to create certainty for those investing in genuine alternate networks. Give us all the certainty that we can proceed with ambitious plans to upgrade and expand existing networks or to roll out extensive new network offerings.

82. This is what Telecom and the industry's network builders are asking for.

83. You can create that certainty by determining that you have confidence in new technologies, that you have confidence in the new competitors who are changing the face of our industry, that you have confidence that Project PROBE will deliver as the Government has stated it will.

84. You should say, of course, that you will be closely monitoring the industry to see that it delivers but overall don't reward those who want a free ride.

85. Instead, reward those who are investing in new networks and let the marketplace deliver the goods for customers.