COMMERCE COMMISSION

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Telecommunications Commissioner

Thank you for the opportunity to talk to you today.

To begin, I want to mention two important regulatory issues: mobile termination and number portability. I am doing so rather briefly, though that doesn't properly reflect their importance. They are both major issues for the industry and for consumers.

Earlier this month, the commission reported to the Minister of Communications on the case for mobile termination regulation.

Our recommendation to the minister is that mobile termination of voice calls originating from a fixed line should be regulated.

High prices for this service are having detrimental effects on competition in the fixed-to-mobile calling market. Lower prices will increase usage and encourage greater competition.

The mobile operators argued that even if prices are high, there is a corresponding benefit enjoyed by all mobile phone users.

Prices in the mobile market are lower than they otherwise would be because mobile operators recognize the value of new subscribers as a source of termination revenues. While that may be so, the balance of long-term advantage to consumers in our judgment lies on the side of lower termination prices.

The government though will make the final call on this one.

Turning to number portability, we will shortly issue our final decision covering the local and mobile number portability service and the apportionment of the costs between the participating operators.

The implementation date is April 2007, and we will be monitoring progress. Hopefully, the end is in sight.

The decision will deal with any remaining threshold issues and allow the industry to focus on system implementation.

Now I want to come to my main topic for today.

Last month, the government released a digital strategy for New Zealand —
the first document of its kind published in this country.

The strategy sets the goal of making New Zealand a world leader in the use of information and technology for the economic, social, cultural and environmental benefit of New Zealanders.

Not surprisingly, the strategy is underpinned by some key telecommunications goals critical to its achievement—and they are, says the document, to be delivered by 2010.

The goals of the document require, in the words of the strategy document, a high-quality, high-speed communications infrastructure.

And that, in turn, is dependent on the successful maintenance of an open, competitive framework for the operations of the telecommunications industry.

The infrastructure we need will contain a mix of technologies:
fibre, copper, satellite, fixed wireless, and cellular mobile, amongst others.

Inevitably, the government's new strategy sets the context for the discussion we need to have here today.

We need to think about the major technologies available to give us quality high-speed access, and about how to get the necessary infrastructure into place fast enough to meet those goals. In particular, because this is going to be one of the most crucial factors in our progress, we have to think about the role of Telecom in the provision of that infrastructure.

Telecom is moving ahead with the transition to a full IP core and access network, though the timing and scope of the access network rollout in residential and secondary areas is still uncertain.

Clearly there will be other infrastructure builders. The government has announced plans to fund community-based fibre networks in areas that would otherwise get left behind.

Vector and Citylink have open-access fibre networks in Auckland and Wellington.

Broadcast Communications is continuing to expand its broadband wireless access and backhaul network. Local and regional fixed wireless networks are growing in size and coverage.

But Telecom remains, and will almost certainly continue to remain our major national provider of fixed-line infrastructure.

The distribution of telecommunications products and services over Telecom's infrastructure is, however, a somewhat different picture.

While Telecom will probably remain the largest distributor of products and services to residential and business users, it's going to be just one among a number of competing distribution channels.

An open, competitive telecommunications framework requires that those who want to enter retail markets can access Telecom's network infrastructure, and can access, in particular, the Telecom network elements that deliver high band-width.

The availability of access for multiple distributors is essential to create price tension, improve product diversity, and to give consumers efficiently-priced telecommunications services.

The convergence of fixed and mobile services is expanding infrastructure options and blurring boundaries. But for the foreseeable future, copper and fibre continue to have the edge in the transfer of high bandwidth data.

What we need then is a well functioning system that supports efficient wholesale access to the Telecom fixed network. In this way, we will see competition at different levels of the value chain.

I recognize that some important progress has already been made in the development of a wholesale market in network inputs.

In 2003 and 2004, the Commission required Telecom to provide a number of residential and business retail services to TelstraClear for resale at a discount to the retail price.

TelstraClear, internet service providers and other carriers were able to resell Telecom local access, jetstream, messaging, and related products to their own small to medium business and residential customers.

That ability to resell has provided choice to consumers.

TelstraClear, for example, has achieved a significant foothold in the residential local access market.

It has gained more than 50,000 resold lines and offers its own bundling and value proposition.

At the same time, the downside of pure resale is that it allows limited scope for differentiation.

Wholesaling moved deeper into Telecom's network late last year, when bitstream became available to Telecom's competitors.

The next step in the development of a viable wholesale market
is likely to come from a decision the commission will make shortly. That decision concerns an application by TelstraClear for access to an ADSL bitstream service.

Assuming the final decision follows the draft we released earlier this year, TelstraClear will be able to access a non rate-shaped downstream full speed bitstream service.

And TelstraClear can use that wholesale input to innovate and differentiate through the development of its own adsl broadband retail products.

Beyond those decisions, two other important elements have come out of the regulatory process.

First, Telecom has committed itself to develop a 'fair and workable'
wholesale market, and to make available comparable terms to the industry when access is ordered in a bilateral regulatory decision.

ISPs and carriers who were not direct participants in regulatory decisions are, as a result, able to obtain similar access to the wholesale inputs covered by those decisions. There are now eleven wholesale customers using bitstream provided by Telecom to compete in the residential and business broadband markets.

Second, progress is being made on standards for provisioning and fault repair for wholesalers. Telecom has established a dedicated wholesale services team to work with its wholesale customers. The team appears to be working hard to improve response times and reporting systems.

In the context of regulated bitstream access, the Commission has set the goal that there should be no material difference in provisioning and fault repair from the perspective of the end-user, whether the retail broadband services are being provided by Telecom or by a wholesale competitor.

As we all know, there have been problems along the way.

Initially, execution within Telecom against these expectations wasn't up to scratch.

This was most noticeable in the launch of Telecom's commercial bitstream service, and in the rollout of comparable wholesale bitstream products to match new Telecom retail offerings.

To some extent, those process problems have been resolved. But an important core issue remains.

It's this.

Telecom's approach is to treat the regulatory requirements on wholesaling as if they were compartmentalized into some kind of box embedded in its wider operations.

The company works very hard to deliver what's in the box. They are proud of doing so. I give them full credit for that.

But it works equally hard to deliver nothing whatsoever beyond the limits of that box.

That approach is virtually guaranteed to deliver a relatively crippled wholesale space that's incapable, ultimately, of supporting a strong, diverse, competitive telecommunications market.

Telecom has responded to our wholesaling decisions in a manner so unnecessarily defensive that it doesn't just damage the prospects for the effective competition we need in this country. It also puts at risk Telecom's own future opportunities as a commercial venture, to expand its wholesale business, and lift its game in the broadband market.

Two things are essential to create a strong, credible wholesale market in New Zealand. We have to preserve the incentives for Telecom to make large and quite risky investments in new technologies and services and to gain a reasonable risk-adjusted return where those undertakings are successful.

At the same time, competitors must be able to access those elements of the network that can't efficiently be duplicated, so that there is sustainable, infrastructure-based competition.

We've taken a consistent position in our regulatory decisions to support investment incentives over short-term gains for consumers. Our mobile termination recommendation is only the most recent example, where we decided to exclude 3g networks from the proposed regulated service.

This is largely because we want investments in those networks to be made without an overhang of regulatory risk that might slow down or limit that investment, even at the margin.

All regulators face the problem of finding a balance between the competing priorities of new investment and access to critical infrastructure for competitors.

It’s a controversial and difficult area of regulatory policy. While regulators may draw the line in different places, the need to ensure that regulation doesn’t stifle investment is a well-accepted principle.

Those issues are central when considering wholesaling as a means of delivering access to competitors where bypass of an incumbent’s infrastructure isn’t feasible.

Major reviews of telecommunications regulation are under way at this moment, in Australia and the United Kingdom. Regulators in both countries have argued that the only way to achieve competition in combination with adequate investment incentives is to introduce some form of separation between the wholesale and retail arms of the dominant network owner.

The Australian Competition & Consumer Commission describes operational separation this way, and I quote:

“to be meaningful, such a [separation] should be underpinned
with formalised arrangements including requirements
that the network and retail businesses must:

“1. Deal with each other on a commercial arms-length basis
including transparent pricing arrangements
between Telstra’s wholesale and retail arms,
as well as separate invoicing and billing;

“2. Maintain fully separate accounts and reporting systems
capable of capturing all transactions
between the businesses; and

“3. Maintain separate staff at all levels, with remuneration
tied exclusively to the performance
of the relevant separated businesses.” End quote.

I’m not raising this topic to argue for any particular organisational or operational design for Telecom’s wholesale operations.

I want to make a much simpler point.

The goal of an open, transparent and equal-opportunity wholesale market for the national fixed line infrastructure is one widely shared by regulators in industrialized countries.

There are a variety of paths to achieve that goal.

Where an incumbent response is excessively timid or defensive, or ignores the needs of the market, then pressure goes on for stronger regulatory measures.

Alternatively, incumbents can take the initiative themselves and build a fully collaborative relationship with their wholesale customers.

Last week, for example, British Telecom voluntarily undertook to set up a functionally separate division for near all its access infrastructure and facilities. BT also committed to providing the same wholesale products, processes and prices to its retail operations and its wholesale customers.

In regard to its new IP network, BT has invited its wholesale customers to joint it in working groups to deal with the issues involved in migration to that network, including product migration and unbundled access to key network elements.

There are important lessons here for Telecom and for the wider industry.

The direction I suggest we need to take is one where Telecom:

- Makes a commitment to support an active wholesale market that will meet the needs of end-users for strong competition in retail supply;

- Works on a multi-lateral basis to develop a clear and predictable framework for wholesale access to its fixed network;

- Provides access to its network on price and non-price terms that provide similar opportunities to its own retail operations and its retail competitors.

I would expect that a cramped response to wholesaling that doesn't go an inch beyond the regulatory decisions on individual applications will sooner or later lead to the same debate already underway in Australia and the UK on the need for some form of deeper intervention.

AAPT, Telecom's Australian subsidiary, in a submission to the Australian government a few weeks ago, argued that it should be compulsory for Telstra to provide equivalent access to key wholesale services required by competitors. AAPT note that this would prevent Telstra from favouring its own retail arm over access seekers. I am suggesting today that Telecom should follow the lead advocated by its own subsidiary.

I want to come now to a related topic: New Zealand's rate of progress in the take-up of broadband, and what can be done to improve it.

There's been some good news in the past year in the retail broadband market, in particular, for residential and smaller business users:

- Jetstream prices have fallen significantly.

- Data caps have been liberalised and in some cases removed.

- Connection costs have fallen.

- Wireless operators continue to put pressure on pricing.

- Vector has entered the Auckland business broadband market with a fibre-based offering.

- ISPs and other carriers have taken up bitstream and are moving from being simple resellers of broadband to providers of their own product and pricing mix.

At 31 March this year, there were 170,000 residential broadband connections on Telecom's network, and 18,000 of them were the wholesale connections of ISPs and other carriers competing with Telecom.

Telecom is therefore already well on the way to meeting its announced target of 250,000 residential broadband connections by the end of 2005. The wholesale target though of one third or 83,000 connections looks demanding, particularly with TelstraClear's late start with bitstream.

To that 250,000, we can add business broadband connections, and connections made independently by Telecom's competitors on their own networks, in addition to any resales of the Telecom service.

So far so good.

It's been said often enough, but it's worth repeating that, at the end of 2004, we were 22nd out of 30 OECD countries, for broadband connections per 100 people.

It's tempting to take comfort from the fact that Australia was one place ahead of us, in 21st position.

Our broadband connections grew by 80% between the end of 2003 and the end of 2004. And the rate of growth in broadband lines accelerated in the second half of the year, coinciding with the availability of bitstream and improvements in Telecom's pricing and data caps.

But Australia’s total broadband connections grew 50% faster than ours for the calendar year. Assuming that trend continues, the gap between New Zealand and Australia will widen rapidly in the period ahead, and the 20 countries ahead of Australia are not standing still either.

At the end of 2004, the top 10 OECD countries already averaged 17.7 broadband connections per 100 people—while we were at 4.7.

The digital strategy sets the target that New Zealand will be in the top quarter of the OECD for broadband uptake by 2010.

Its intermediate target is the top half of the OECD by 2007.

Those goals require New Zealand to leapfrog ahead of Australia, Italy, Portugal, Germany, Spain, Luxembourg and Austria inside the next two years:

Then in the ensuing three years, further leapfrog the UK, France, US, Sweden, Norway, Finland and Japan, to reach last place in the top quarter.

On our present trajectory, there is no chance whatsoever that New Zealand will achieve those targets.

A major contributor to residential broadband uptake in many OECD countries is cable modem service. Without a national cable network, an improvement in our relative performance will be even harder.

Bypass through the rollout of competitive infrastructure is occurring, both in fixed wireless and fibre — but that’s not going to be anywhere near enough.

This brings me back to the attitude Telecom takes towards the sharing of infrastructure with its competitors.

I have spoken already about the importance of open, transparent and non-discriminatory access to Telecom's fixed network.

To accelerate our broadband performance beyond present levels, we need several things to happen:

- The wholesale access products on Telecom's copper must grow in functionality in response to user demand.

- Wholesaling must become a core function for Telecom, with transparent, non-discriminatory and efficient processes.

- Telecom must continue to invest in network upgrades and accelerate the availability of new technologies that support higher bandwidth.

- Competing providers must drive product differentiation and lower prices.

- Improving broadband penetration must go hand-in-hand with faster speeds.

Present New Zealand residential and smaller business broadband uptake remains overwhelmingly concentrated, at entry level, on speeds of 256/128 kilobits a second.

In leading OECD countries, though lower speed plans are available, the entry level is closer to one to 1.5 megabits.

The government's digital strategy targets for New Zealand are based on connections at 5 megabits per second — 20 and 40 times faster than our current entry level.

Those targets require a supply and a demand response.

On the supply side, they imply more investment in fibre in the access network, a diversity of retail competitors, and a price/function balance that encourages consumers to increase their telecommunications spend.

We're talking timeframes of just two years and five years. We have trouble getting a road built in five years!

The demand side is a mixed picture. Right now, the industry seems to be stretched in managing uptake for the current crop of broadband products. At the same time, the small business sector is expressing demand for higher bandwidth and improved quality of service.

This much is clear beyond a shadow of a doubt.

No matter how we go about it, no matter who joins the party, no matter how much Telecom's competitors put up, no matter to what extent the government and communities decide to invest, the lion's share of the investment involved in reaching government's broadband targets will have to come from Telecom.

There is no other viable option, barring the emergence of a major new network builder.

The best future, for Telecom and for everyone else, is one where:

- Telecom makes the necessary network investments as rapidly as possible
- Moves in a rapid, determined and comprehensive way to open up the wholesale access channel to competitors
- Gives those competitors fair and non-discriminatory price and non-price terms:
- And accepts that a broadband market characterised by widely diverse offerings and strong price competition expands the total market faster than any other strategy.

This is a win-win situation for Telecom, as long as it abandons the restrictive attitude adopted to date, and recognises that it's best future lies in supporting an open, competitive broadband market, with multiple suppliers.

There is no comparable opportunity available to the company in any future if it forces regulators to decide the whole shape of the game for them.

I believe that if Telecom grabs the ball and runs, we can achieve a solution that offers more for everybody than we could ever hope to achieve by deeper, more intrusive regulation.

A regulated outcome would not deliver the benefits that will come from an open, entrepreneurial approach as opposed to one of 'conceding the minimum'.

Inevitably, regulation carries risks to innovation and investment.

Telecom needs to see wholesaling as a profitable strategic business opportunity, whether the customer is a competitor or Telecom's own retail arm.

If Telecom continues to be defensive, instead of delivering an even-handed, transparent, and viable wholesaling platform, it risks losing the opportunity to develop a sound market-led outcome. The likely result then will be that it will inevitably find itself facing what may be a second-best regulatory solution.

Thank you.