

Embargoed until 9.05 a.m., 28 June 2004

Speech To 5th Annual Telecommunications & ICT Summit

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9.05 a.m., 28 June 2004

Stamford Plaza, Auckland

Thank you for this opportunity to set the ball rolling this morning, at this 5th annual telecommunications and ICT summit.

This is, at a policy level, the annual flagship conference of the telecommunications industry.

Pretty much everybody who is anybody in New Zealand telecommunications is sitting here today, in this room.

The conference is an opportunity to review, at the highest level, our progress in the past year, and identify the key problems we need to face, as an industry, in the coming year.

When I spoke here last year, we were at an early stage in the development of the regulatory regime.

Today, we are further down the track. Important issues have been resolved. Others are already in the pipeline for consideration.

Quite clearly, a lot of our attention, over the next two days, is going to focus on broadband services—on how to deliver their benefit, efficiently, to a lot more people.

After all, that's the primary purpose of economic activity—to satisfy the wants of consumers.

The aim of Government in regulating business is to create a framework where producer interests are optimally aligned with the interests of consumers.

Our current regulatory regime is 2½ years old.

It was established by Government to ensure better services, and more diverse services, at efficient prices, to all users of telecommunications products. That's what the game is about.

I want to begin this morning by reviewing progress to date, in delivering long-term gains of that kind, to the consumer.

Then, in my remaining time, I want, with outcomes to date clearly in mind, to focus on some of the most critical problems we face, in the period now ahead, and discuss how to tackle them.

That should hopefully leave time, at the end of the presentation, for questions and discussion.

By way of introduction, let me note that telecommunications, as a network industry, presents a special challenge to its participants.

In most industries, competitors run separate operations, differentiated maximally from each other. That's the normal way to pursue competitive advantage.

Telecommunications carriers are required by the nature of this industry to rely, to a greater or lesser extent, on the capacities of each other's networks

So they face contradictory business imperatives.

To compete successfully, they have to differentiate themselves to the maximum practicable extent from their commercial rivals.

To keep the network platform functioning efficiently, however, they must, at the same time, work in close cooperation.

That conflict of imperatives is never easy for rival telecommunications companies to resolve.

The present regulatory regime arose out of the long-held frustration of the community with the industry's inability, in managing its own affairs, to resolve key access issues.

Since our establishment, we have dealt with a continuous diet of disputes between, in particular, the larger fixed-line carriers, Telecom and TelstraClear—though smaller carriers have also participated.

The Commission has already cleared away to a large extent, if not completely, the two major access issues we inherited 2½ years ago:

- The interconnection of the Telecom and TelstraClear fixed networks; and
- The creation of a wholesaling regime that gives Telecom competitors the ability to resell Telecom retail products to residential and business customers.

Both of those issues are now very substantially settled. I am not, of course, saying they are settled forever. That is not in the nature of this industry.

The nature of the services provided through interconnection will change over time, and technology will also change, altering the way carriers need to interconnect.

The most significant change of that kind will probably be, for example, the widespread commercial availability of Voice Over Internet Protocol, or VoIP.

At that point, the interconnection of IP networks will require a regulatory approach a lot different from the one we take now, to the interconnection of circuit-switched networks.

Of necessity, therefore, once the major issues are dealt with, carriers will need, later, to revisit those topics again and again. This isn't a sign of failure. It's the dynamic nature of the process. Life goes on.

How, then, should we judge the performance of the regulatory regime. What should consumers be looking at, to decide whether we've done our job well?

Success can, I think, be judged at two levels.

The first is the noise level surrounding issues or problems—what some people call the “barking dog” criterion.

When inter-carrier disputes deprive competitors of access, or delay the roll-out of services carriers wish to offer, then companies and consumers will all be complaining at once.

The noise level indicates the unresolved problem.

When those disputes are settled, the noise dies down. Silence is a sign of progress.

That silence will never, however, be more than comparative quiet. The search for commercial advantage is never-ending, and companies are ingenious in pursuing it.

Innovation and efficiency are hard work. A temptation will always exist to supplement, or substitute for them by investing instead in lobbyists, politicking, and the orchestration of a public fuss.

Some of the noise tends therefore to result from strategies of creating public pressure for the desired regulatory outcomes.

We need to be able to distinguish between genuine complaints reflecting real competition problems, and 'strategic complaints'.

Spunky companies springing up to do good things by taking business away from large players like Telecom sometimes feel inclined to judge the quality of the regime by the direct impact on their own bottom line.

Their success *is* clearly important, but it is not the whole story. Their private interest may not encompass entirely the broader interests of the user and the community.

We need to look not just at the actions of new entrants, but also at whether the big established players are responding to competitive pressure by bringing down their prices, and offering new and improved products.

What we should see, in a healthy competitive market, is a multiplicity of companies, all doing good things, and big players who no longer sit on monopolistic bottoms, but are instead actively improving on price, product range, and efficiency.

Yes, the New Zealand market is still characterised by major structural factors that limit the capacity of competition to flourish. That has to be admitted, right up front.

But at the same time, we do see now, on both criteria, the general noise level, and presence of competitive diversity, some real progress occurring in New Zealand today.

Both things, the limitation and the progress, are true—true simultaneously: and what's more, that will continue to be the case.

There is, I realise, a temptation inside and outside the industry to look for “big bang” solutions:

Or to envisage what we are engaged in as some inexorable process where, by piling progress on top of progress, we can achieve, at the end of the day, the ultimate competitive market—in other words, Utopia.

People who see the process in those terms inevitably imagine that, if we move fast and radically enough we can reach that ultimate position next month.

They also tend to feel, if the regulator doesn't take radical action in response to competition problems, that we are giving up on the goal of improving services to consumers.

Those views of the future are a snare and a delusion.

It is in the nature of telecommunications networks that quite major competitive impediments will persist.

Regulators should not imagine any magic bullet can solve all the problems of the industry, either overnight, or in the medium to longer term.

In this business, none of us has 20-20 foresight. We cannot expect to know, accurately and in detail, how telecommunications will develop in the future. We cannot predict always, even the outcome of our own actions, as players or regulators.

This is a business where a certain modesty in approaching the problems of the industry does a lot less long-run damage than Utopian dreams.

Bearing all of those considerations in mind, how do I see the scorecard of the regime to date?

First, the major disputes that kicked off the regime have now been essentially finalised. Stage I, if you like, is in place.

There will be some continuing work to do, on refining access terms. But the big decisions on those original issues have been taken.

The question of price gains and diversity is a harder call.

We are, beyond any doubt, seeing quite a lot of significant new entry and product innovation.

A quick look through the pages of your newspaper shows there are new platforms and offerings out there now.

Woosh Wireless is advertising its wireless broadband offerings in Auckland and Wellington and claims to be signing up significant numbers of new customers.

Those services are different from, and price-competitive with, those of Telecom. It expects to add a voice product in the next few months.

The Wired Country network—fibre and wireless—is supporting a range of service providers in Auckland.

lhug is offering broadband and voice services, including broadband packages that appear to be significantly faster than comparable Telecom products.

Where competition is most intense, prices are falling. The price of Telecom JetStream products has, for example, shifted significantly downward in the past six months.

The long-distance calling market remains intensely competitive.

Everybody can see major carriers now offering low-cost price-capped calling for six or seven dollars, to a range of international destinations, if you call at night or during the weekends.

All this is evidence of an increasingly vibrant competitive space, delivering lower prices and more services to the user. Where competition is intense, prices are falling and competitors are differentiating themselves from one another.

That's one side of the story. The other is this:

Where competition is non-existent or muted, prices are stable. They may even be increasing.

Monthly line rentals show little pricing movement—national or regional pricing remain the norm; and price increases reflect movements in the CPI.

In that market space, competition traditionally was, and continues to be, very limited. But on balance overall, as far as our scorecard goes, the key point is this:

We are now seeing new entrants, new products that differ from the old ones, and prices moving in response to competition.

I do not claim the regulatory regime is responsible for all of those gains: but it is least a relevant and significant contributor.

Access, the original barking dog, has largely gone away.

The resolution of access issues should create the right incentives to intensify retail price competition, while recognizing, as we must, that the commercial pricing responses at the retail level to reductions in access pricing are the responsibility of the carriers themselves.

TelstraClear, and any other company wanting to become a provider of national services—including local access and calling—has the opportunity to deliver those services.

That's never before been true in New Zealand. Local access service has always, in the past, until now, been a monopoly in this country—the ultimate monopoly.

Since the Commission allowed TelstraClear to resell business access lines, that company has taken over around 10,000 business lines from Telecom

In a country the size of New Zealand, that represents a significant shift in market share.

Our decision has also allowed TelstraClear to package the access and calling service with its other products. This month, the Commission has set final terms for TelstraClear to resell residential access lines.

The way is clear for them, and any other carrier interested in doing so, to sign up anybody, now, as a retail customer.

There is no longer a single national retail provider of fixed-line local access services.

Those decisions provide the current context from which we now move on to the question that's been, for the last 18 months, the major issue pre-occupying the telecommunications industry:

Whether Telecom should be required to rent its copper local loops to competing companies—local loop unbundling—has been described as the key regulatory decision of the decade.

I think that vastly overstates its importance.

Given the steps which have already been taken, the question is no longer what can LLU offer New Zealand—it's what incremental gain could LLU offer now, over and above the changes already made.

Under LLU, Telecom would continue to own the last mile of copper, and remain responsible for maintaining and upgrading it. Competitors would be able to rent individual loops and to install their own electronics in Telecom's exchanges.

Telecom then becomes, not a provider of telecommunications service, but instead, a provider of infrastructure.

That is the ultimate step in demolishing a monopoly—as far as you can go, without breaking up the company.

A lot of countries have taken the LLU path. Many people wanted us to take that step here.

The Commission was not convinced that the benefits were clear enough, or that this level of intervention was necessary, to address the competition problem.

Certainly, local loop unbundling offers the greatest possible scope to competitors seeking to take business away from an incumbent.

When you rent the copper, you get sole rights to its full capacity, but the rent you pay will reflect the cost of that full capacity.

It's no problem to recover those costs where the customers are large businesses who need huge complex services, and have the capacity to pay for them.

But the more we investigated, the clearer it became that LLU was not likely to be economic for competitors of Telecom where the user was a householder or a small business.

The access costs and the costs of installing DSLAMs mean that it is not an attractive option, except where large revenue streams can be expected.

The evidence was beyond doubt.

Had we recommended local loop unbundling—and had the Government decided to adopt it—the market response would not have led, in our judgment, to the use of loops by competitors to provide services to residential and small business users.

That outcome is, in fact, reflected in the experience of almost all other countries where LLU has been adopted.

The take-up of unbundled loops by competitors proved in most cases unexpectedly and extraordinarily limited,

That was, for us, one of several key tipping points, in our investigation.

There are people who say, of course, that New Zealand, in rejecting LLU, has thrown away the opportunity of a lifetime: that this country will continue to lag behind.

I don't believe it.

The Commission carried out an exhaustive review of the pros and cons of local loop unbundling: in fact, I would claim a more in-depth analysis than has been conducted by regulators in virtually any other country.

At the end of the day, the evidence for LLU was simply not compelling enough to justify taking that step. Once you look beyond LLU, you are able to focus on more refined and productive approaches to the access problem.

Firstly, we now regulate, in New Zealand, the resale of local access and calling services, and of Telecom's JetStream products.

Competitors can require Telecom to sell its JetStream service, at a discount off the retail price, to reflect the fact that Telecom has avoided the costs of retailing the product.

They can bundle that service with other services, such as national and international calling, if they wish to do so.

Secondly, while not unbundling the local loop, the Government accepted the Commission's recommendation to regulate a bitstream service.

The regulated service will be an asymmetric DSL-enabled service, supporting an average downstream throughput rate of **not less than** 256 KBPS, and a maximum upstream throughput rate of 128 KBPS.

There are several important points to note about this service. First, there is no maximum downstream rate. Competitors will be able to request higher rates if they wish to do so.

Second, the service is defined by throughput rates and not by line speed, in order to avoid much of the uncertainty about what line speed means.

Third, this is a layer 2 service, so that competitors will be able to control the characteristics of their service offerings.

The criticism of the limitations on the regulated service have reflected in part a misunderstanding that this was a low speed service.

As I have said, there is in fact no maximum on the downstream throughput rate.

The other criticism has been that the service has a maximum upstream rate, and would not therefore support VoIP services or other services requiring symmetric higher speed capacity.

That is correct—and it was a key element of our decision.

Our judgment, and I will say more about this later, was that a fully symmetric service capable of supporting retail products that require real-time network functionality should not be regulated at this time.

These approaches are different from that of many other countries.

We think they represent a more advanced and targeted approach.

With a combination of bitstream unbundling and the right to resell local access and JetStream, competitors can offer a combination of voice and broadband services to residential and small business customers across most of the country.

In major CBDs, of course, and in time other metropolitan centers, consumers can expect to be able to choose between TelstraClear voice and broadband services where that company has its own network, and a number of other wireless voice and broadband offerings.

This competitive mix will be further enhanced once 3G is available.

We believe this is a balanced outcome that addresses the major bottleneck problem of local loop access, without the doubtful benefits of a full regulated unbundling of copper loops.

The access problem is similar, but different, in regard to the needs of corporates and other large users for competition in the high speed data market.

Our investigation of the data market focused on the lack of competition in the supply of data tails, used for connecting large users who require dedicated transmission capacity up to 2Mbs.

We were satisfied that there were clear and significant welfare benefits available from regulating access to data tails for Telecom's competitors.

We would have recommended to the Minister that the wholesale supply of data tails be regulated immediately, but for the fact that Telecom announced their willingness to negotiate a suitable commercial data tail offering with their wholesale customers.

We decided that there should be an opportunity for commercial negotiation to work, rather than moving at once to regulation.

We were influenced in reaching that decision by the fact that we saw this service as being straightforward to implement, with only one major issue to be resolved—price.

Here we signaled as plainly as we could that the price should be cost-based.

In other words, competitors should not be expected to pay more than an efficient long-run incremental cost price that would fairly compensate Telecom for the use of these assets, and provide a reasonable return on common costs.

The Minister of Communications agreed with our view that Telecom should be given six months, until 1 July, to offer such a solution to the market.

We have had discussions with Telecom about the data tails service, and our expectations on price structure. Those discussions have resulted in a series of undertakings given by Telecom to the Commission late last week that will achieve the result we sought—cost-based pricing of data tails. Details of those undertakings are being released today by the Commission.

As a consequence, I do not expect there will be a need to revisit a regulatory solution of the data tails problem.

In concluding on this point, the Commission's enforcement arm earlier this year commenced a prosecution of Telecom under the Commerce Act for anticompetitive pricing of data tails. The undertakings concerning future pricing that I have referred to do not affect that prosecution, which is concerned with past behaviour.

In the third section of my presentation, I'd like to talk about some services that are not yet widely available to residential consumers.

These services, such as video-on-demand and home videoconferencing, cannot economically be delivered today to the home by Telecom's access network.

The industry is technically capable of delivering those products, given access to your copper line, but they are not, at this stage, by and large, viable or available on a commercial basis.

What provision should we make, as regulators, for them? I am not so far convinced that the industry wants, at this stage, to make such services available. Nor am I convinced that the general public is willing, as yet, to pay for them.

So far, our experience has been that it is still taking quite a lot of effort to get people to sign up for basic broadband, let alone think about paying what this other higher-end stuff might cost.

The current and reasonably foreseeable demand of residential and small business customers is for access to the Internet, email, web surfing, and services such as downloading audio clips.

Market demand for what most residential and small business customers currently want and use is well capable of being met by the regulated asymmetric bitstream service.

The future is obviously exciting. It's out there. But it's some way off, and it will take a great deal of new investment in infrastructure to deliver those more advanced services to a mass market.

A lot more fibre will have to go into the network. Maybe not right to the individual home, but a lot of copper between exchanges and cabinets will need to be replaced with fibre.

It's not particularly difficult to create a next-generation network to service major business houses and corporations.

The real challenge is how to get these high-end products to residential and small business customers.

But those products are no way, at this point, sure-fire commercial winners.

Demand at realistic prices is, in the foreseeable future, still speculative.

The infrastructure decisions required to upgrade the network and deliver such services are therefore not just large, but also high-risk.

The incumbent faces the greatest incentives to make these investments, because of the aging of its copper-based network.

BT in the UK, for example, has announced that it will spend 3 billion pounds in replacing its current network with an IP-based network, and expects to have most of its customers on that network by 2009.

The Government's draft Digital Strategy envisages a similar future for New Zealand, with speeds of 10-100 MBPS available to residential and SME customers by 2010, capable of supporting video-on-demand and an array of business and entertainment applications.

Telecom should be given every encouragement to make this investment in the next-generation network, and should be able to retain a first-mover advantage to reflect its risk.

Let's be quite clear. That isn't a radical notion. It's core regulatory thinking so far as new technologies are concerned.

Even in the United States, the regulator has rejected the idea of regulating packet-switched IP services.

Obviously, some of Telecom's competitors may say that, given access to the local loop, they too would build a next-generation network.

But in our judgement, a future IP network is more likely to include residential and small business customers if Telecom has appropriate incentives to make the investment.

Equally obviously, we may prove to be wrong about that. Telecom may choose not to roll out its IP network beyond the core CBDs.

In that case, of course, the Commission could reconsider its present position.

I talked earlier about the dangers involved in regulating now, in anticipation of future market developments.

Where technology is evolving rapidly, rather than fully mature, often the most effective way to use the regulatory instrument is, in fact, *not* to use it, but to keep on pushing for what you want, with regulation as a backstop.

It's important to remember that telecommunications regulation was introduced when general competition law proved unable to carry the load of reducing access bottlenecks.

Regulation, in other words, is expected to solve the problems that competition law did not deal with.

Ours is a different evolutionary path to most other jurisdictions, where network regulation has developed largely independently of competition law.

Interestingly, we're now seeing, in a number of countries, strong interest in shifting closer to the New Zealand model, to avoid an ever-deepening regulatory reach.

There is a danger in regulating too much too soon, particularly when regulation relies on anticipating future market evolution.

The action of regulating alters what happens. It determines the outcome. If, later, you find you got it wrong, if history proves you have, in fact, choked off the outcome you were trying to achieve, you can't go back, change history, and start over.

This is exactly the position some countries are now trying to move back from. It is one we can and should avoid. We don't have 20-20 foresight. We are in a position where what we do in many cases is to place bets on the future of the industry.

We'll win some of those bets, and we will lose some. Technology may change. Unpredictable things happen.

We cannot say we know exactly what will happen in the next five years, and, with that limited knowledge, regulate ahead of events.

That approach can close off the future it was intended to open up.

Instead, we have another option. We can say we think something *may* happen in the foreseeable future, so we won't move for the moment.

Not yet.

Then if, in the upshot, our expectation isn't realized, we get a free chance to go back to the topic later, and look again, in the light of known developments.

Understanding that we have that option, is, in my view, one of the important influences on industry behaviour.

A moderate, measured regulatory response when dealing with evolving technologies therefore promises the community a much bigger pay-off over time than we could ever deliver by a radical intervention now.

This is not a one-shot game.

We want the industry to have the opportunity to respond constructively in the presence of the regulatory backstop, to the goal of achieving outcomes that advance satisfactorily the interests of the community as a whole.

Where we take that approach, and it doesn't produce results, the option remains to come back, and take action.

It's in this context that we will be monitoring Telecom's announced residential broadband take-up targets.

Where there's a reasonable prospect that a sensible industry-led solution will emerge to competition problems, that will be our preference over a regulatory outcome.

Data tails is an example of this approach.

Broadband will continue to dominate the industry's agenda, to a significant degree, in the coming year, as the outcomes of our review work through the system.

But other important things are going on simultaneously. In closing, I want to look at two of them.

Firstly, we've launched an investigation into regulation of the mobile termination market,

That's important. Until now, the mobile market has been largely unregulated in New Zealand.

The big problems were, for the most part, in the fixed line market, and that, by and large, remains the case. But the number of mobile phones in New Zealand has grown increased dramatically in the last 2½ years.

We now have around 3 million mobile phones, compared with just 1.7 million fixed-line phones.

A significant shift has occurred in the way we use mobile phones, and traffic volumes on mobile networks continue to rise.

An increasing number of people use mobiles as their only phone. If you want a tradesperson these days, you'll be expected to call on a mobile phone.

Calls from fixed phones to mobile phones now represent a growing proportion of total calls made by business and residential users.

The price of residential calls from fixed landline phones to mobile phones is about 70 cents a minute.

That's a lot more than it costs in most of the countries we ordinarily look at, as comparators, in examining price.

In the light of those circumstances, and complaints from carriers and user groups, we have decided to investigate the key wholesale service that drives the ultimate price paid by the consumer.

That service is 'mobile termination'. It's the price a mobile operator charges for terminating a landline call to a number on its mobile network.

Our decision to investigate was announced about a month ago.

There are only two mobile operators in New Zealand —Vodafone and Telecom.

They have about 50% of the mobile market each, and they compete very vigorously with each other.

But when it comes to terminating any landline call to a Vodafone mobile customer, only Vodafone can do the job.

Only Telecom can terminate landline calls to Telecom mobile customers.

That's to say, despite vigorous competition generally in the mobile market, each of them appears to have its own termination monopoly.

No competing carrier has the ability to step in, and say: "Let me terminate that call on your behalf."

The combination of an upstream termination monopoly with what appear to be comparatively high prices in a related downstream retail market strongly suggests a competition problem.

Our investigation will determine whether the Commission needs to recommend to the Minister that mobile termination rates charged by the mobile operators should be regulated.

I hope to have this investigation completed by the end of the year.

Let me conclude briefly by noting that one further issue, number portability, remains outstanding.

This issue—a source of long-standing frustration to consumers—is still, at this point, quite some distance from resolution.

Users who change their carrier naturally want to take their phone number with them.

For businesses, in particular, changing your phone number can be a very significant and costly matter.

Lack of number portability limits the gains available to users as a result of opening local voice services to competition.

Everybody in the industry agrees we need number portability. You've been agreed on it for years.

But delivering the goods requires an intense level of industry engagement.

An industry-developed scheme for number portability must have, if it's to be adopted, the support of every single carrier providing fixed line or mobile phone services.

The industry forum is currently working on the development of a technical solution.

The Commission has no power to direct them on that. Our role is to determine, once the forum has completed its business, how the costs of number portability should be shared.

The technical work is proving, apparently, at least as difficult as expected.

It is proceeding at a pace nobody can rejoice over.

Number portability is a keystone in any genuinely competitive access system.

The issue will increasingly become a focus of public attention in the future.

And it will become an increasing risk to the public reputation of the telecommunications industry.

This ball is in the industry's court, ladies and gentlemen. It is increasingly overdue for resolution.

Let me now very quickly conclude.

We have come through an era where the bread and butter PR of the industry in support of the quest for commercial advantage has been back-biting, politicking, interminable legal wrangles, apocalyptic demands and phony despair.

Recent regulatory decisions on access, resale and bitstream unbundling, together with the resolution of future data tails pricing, should now shift the focus to implementation by industry. It's time to work with what we have and to concentrate on improving consumer choice, product diversity and pricing outcomes.

Thank you.
