

## **Telecommunications and Broadband Summit 2016**

**11.45am, 2 March 2016, Rendezvous Hotel, Auckland**

Good morning

I am hoping to speak for about 20 mins and to leave 5 mins at the end for any questions.

In this session I'd like to give you a sense of our role, what is happening in the year ahead and how we are contributing to getting the environment right so that Kiwi consumers and businesses can reap the benefits of world class telecommunications services.

The position of the Telecommunications Commissioner within the Commerce Commission was established in 2001. The team that I manage has the job of supporting the Telecommunications Commissioner and other Commissioners to exercise their powers under the Telecommunications Act.

Our team has two general areas of focus :

- We regulate telecommunication services: both considering the need for regulation and writing that regulation, as well as reviewing, amending, augmenting and omitting regulation - it is the latter of those two tasks that we are most focused on currently.
- As part of regulating, we set prices, and also set non-price terms on which a service can be supplied.
- We also monitor and conduct research into telecommunications markets, both fixed line and mobile.
- We don't currently regulate fibre, and won't do so until 2020.

At a broad level I see our role as setting the rules of the game, making sure those rules remain up to date, and monitoring the markets to see how things are developing and whether there are any areas for concern.

While that sounds easy, it raises some unique challenges. These challenges are what make Telecommunications regulation such an interesting area. When I think of how we might face these challenges, the overarching theme I see is one of balance.

The pace of change in Telecommunications is phenomenal.

When we are making decisions and seeking to get the best outcomes for New Zealanders, we are balancing a great number of factors.

- We are balancing complex statutory obligations with a desire to move at an appropriate pace
- We are balancing the right of interested parties to be consulted on issues that have an impact on them against a desire for certainty
- We are balancing the need for timely decisions with the need to get our answers right.

- A need to let innovation and investment occur while seeking to ensure that end users remain protected
- And balancing the right for investors to know that they can get a reasonable rate of return, and the desire for access seekers and consumers to get better quality services for lower prices.

These challenges are not faced by New Zealand alone. Regulators around the world grapple with these same issues but we do need to ensure that our actions take into account our local context.

For that reason, I want to touch briefly on where we have come from before I look at the year ahead.

### *2001-2006*

In 2001 the Commission was given a specific role in overseeing competition in the telecommunications industry. At that time, opening up the industry to market forces was the primary aim, but this needed to be balanced against the ability of Telecom to adapt to that environment and the need to ensure that consumers were protected through these changes.

Telecom dominated both the fixed and mobile markets, with TelstraClear as the main fixed competitor and Vodafone as the only mobile competitor. It would be fair to say that the telecommunications industry back then had far fewer players than it does today.

So the 2001 Telecommunications Act was introduced, with 13 regulated services spread across designated retail services (eg Telecom's four retail services), designated multi-network services (eg number portability), and specified services.

These services reflected areas within telecommunications markets that the government thought had **non-transitory issues** with maintaining competition where regulating (or intervening) would deliver flow-on benefits to end-users.

Due to the smaller number of players at that time, regulation was characterised by bilateral access arrangements, between Telecom and its main competitor (TelstraClear) who was establishing itself in New Zealand through their cable network roll-out, and through wholesale access to Telecom's bitstream services.

### *2007-2010*

Those bilateral determinations that were characteristic of the 2001-2006 era gave way to STDs - multilateral access standard terms determinations created through amendments to the Telecommunications Act in 2006. These changes were underpinned by the ladder of investment theory, which seeks to incentivise competition progressively closer to the end customer. This provided service providers with the opportunity to invest in technology within the network to enhance the services they provided rather than just resell Telecom's services.

2007 to 2009 was a very busy time for the Commission and the industry, as a range of unbundled copper services were put into the market – UBA, UCLL and SLU (sub loop unbundling) as well as their respective backhaul and co-location services. The development process for an STD was about a year, and we ran parallel processes in order to fast-track their introduction.

At the same time, measures were introduced to level the playing field between Telecom and its unbundled services access seekers, including operational separation undertakings given by, at that time, a still vertically integrated Telecom.

In 2009, 2Degrees entered the mobile market – joining Telecom and Vodafone. The entry of 2Degrees increased the focus on mobile termination rates which led eventually to regulation of Mobile Termination Access Services, as well as putting greater focus on co-location.

### *2011-2015*

In response to the government's desire for New Zealand to have fibre to the home networks, Telecom demerged and Chorus established itself as a separate network wholesaler.

In 2011, a further Telecommunications Amendment Act was passed which put in place the legal mechanisms for the establishment of UFB and RBI.

In the following years, 2012-2016, we see the factors that are shaping the movement with UFB and RBI deployment gaining ground and early uptake becoming apparent.

This change in circumstances had an influence on the existing copper services, as service descriptions and pricing structures were still based around the concept of a vertically integrated Telecom.

This led to our most recent large project which was to set prices for the UCLL and UBA services.

This process had many interested parties, Chorus, naturally, given the portion of Chorus's revenues these services represent. The services are a core input to the services RSPs need to serve consumers, and Government was interested in the impact of pricing on fibre deployment.

Under our regulatory framework, UBA and UCLL services can have their prices set in two ways. The first is to use benchmarking from similar services in relevant overseas jurisdictions. This is called the Initial Pricing Principle. If parties are not happy with those prices they can seek to have pricing based on a full cost model - this is called the Final Pricing Principle. In this case the IPP was not considered appropriate by stakeholders and so we were required to apply the FPP using a methodology called TSLRIC, after receiving applications for a pricing review. This process involved, in a nutshell, developing a model of a Hypothetical Efficient Operator, rolling out a whole new network, using modern equivalent assets.

### **It's worth pausing to consider the sheer scale and complexity of this process.**

The cost modelling process had three key stages:

- First we had to determine the design nature and dimensions of the hypothetical network, including:
  - the location of the customers to be served
  - the network technologies to be modelled, and
  - the location and quantity of assets required.

We then needed to calculate the costs incurred in supplying the UCLL and UBA services based on this network design, to derive a central TSLRIC estimate.

And finally, we then considered whether we were required to adjust our central TSLRIC estimate to best promote competition for the long-term benefit of end-users of telecommunications services - the pivotal purpose statement in the Telecommunications Act.

When we did the modelling we used inputs from **objective** sources where possible:

- we used geospatial specialists to map the optimal path of the network;
- we obtained trenching costs from local civil engineering specialists Beca; and received expert advice from Dr Martin Lally and UK-based consultancy Oxera about the cost of capital for the assets involved; and
- to build the TSLRIC model, we used French specialist, TERA's international engineering and modelling expertise for costing the equipment and combining all the inputs.

The process took approximately 2 years, in which time we received and reviewed about 240 submissions. These submissions contained more than 6,000 pages.

We published two comprehensive drafts. And our UBA and UCLL final determinations, which contain our decisions and reasons, have more than 850 pages.

It was through this FPP process - my first here as a manager - that I came to understand how many competing interests the Commission has to balance, and what it truly means to do economic regulation.

All through this process we were focusing on what it means to make a determination that we consider best promotes competition for the long term benefit of end users. Inherent in this is a need to encourage efficient investment while ensuring that the costs faced by access seekers do not include monopoly profits. Given the complexity of these questions there was plenty of robust debate both internally and externally. I think as an industry we arrived at a good result and the fact that no parties have appealed the decision allows us to move on and look to the future.

With that, I will turn to the year ahead.

We have a significant amount of business as usual work we have to do, for example administering the Telecommunications Development Levy and undertaking our standard market monitoring work, including publishing the annual monitoring report, which tracks the telecommunications market including how we rank against other OECD countries on various metrics. In addition to our BAU, we have four major work streams for the coming months.

#### *The UBA Review of non-price terms*

Moving on from the FPP, we are undertaking a section 30R review of UBA non-price terms. These types of reviews give us the ability to broadly examine any aspect of a standard terms determination or STD – our primary regulatory instrument. As I have said, UBA is the key wholesale service used by RSPs to provide consumer broadband. There are currently approximately 1.2 million UBA connections in New Zealand. The UBA service is delivered over Chorus' copper network.

We first set the terms for access to the UBA service in December 2007, including the service description and technical specifications. Although the UBA STD was updated in November 2011, the technical specifications remained the same as originally determined in 2007.

We consider that there are good reasons to review the non-price terms of the UBA STD now, to ensure they are fit for purpose. In particular:

There have been significant changes affecting the way the UBA service is delivered, such as deployment of new DSL technologies, and increased data consumption by end-users (reflecting modern usage requirements). The service specifications originally set in 2007 have not been revised to reflect these developments.

In addition, with the establishment of Chorus as a separate company, the incentives around the provision of its core UBA service differ from those of Telecom. In response to complaints from access seekers it became apparent that there needs to be a clearer definition around the service specifications.

Doing this will better allow retail providers to make decisions on what services to buy, or build for, and it will allow Chorus to create services that meet more niche requirements - for example end users who need higher grade services for gaming.

To achieve this we have commenced a review of the non-price terms of the service and will be releasing a paper seeking Industry views on this in the coming months.

While the future is fibre - copper based services will continue to play an important role for users for quite some time as a transitional technology, and it is therefore important to make sure this key service is up to date and fit for purpose.

#### *Review of Regulated Services*

We are also conducting a series of slightly different reviews into 13 (of the 16) services we regulate. Each service must be reviewed every five years (from the date of its inclusion in Schedule 1 of the Act) to see if there are reasonable grounds to investigate deregulating any of them.

This type of review differs from the review of UBA I just mentioned, because it focuses on the nature of the service described in Schedule 1 of the Act, which means this type of review goes to the heart of whether a service should be regulated **at all**, rather than specifically examining the way the service is regulated in an STD. So in this context, adding value means not only knowing when to join the party, but also knowing when to leave. This also means that understanding the developments and trends underpinning the telecommunications sector over time is essential for us.

This review is important not only because the law requires it, but because it relates to the principle that *we should not be regulating where markets can function effectively without our intervention*.

#### *Communications*

We are looking to improve the way we communicate with industry and other stakeholders. Communicating the products and findings of the work we undertake is a big part of our role – and an integral tool in fulfilling this role, is our website. So we are looking at revamping the Commission's website, with a view to making the information on it more relevant and accessible to the people and organisations that use it – such as yourselves.

#### *MBIE Review*

Given the pace of change there is an ongoing need to examine whether the tools we have are appropriate to meet the needs of the coming period. The Government recognises this and is currently undertaking a broad review of telecommunications regulatory settings. Many of you will have seen the discussion document issued by MBIE in September last year. This Review is looking at the whole framework for regulating telecommunications in New Zealand, with an eye to potentially changing the legislation to introduce a new framework, if such a change is required.

Given our experience, and the fact that we are the agency responsible for implementing competition regulation in this sector, we see ourselves as able to support MBIE on this review. My aim for this year is to ensure we provide the support to MBIE that is needed to ensure that proposed changes achieve the policy intention and are fit for purpose.

Of particular interest to us is any possible new approaches to the regulation of fixed access networks.

Under the current law the Commission has to find a balance between ensuring access to fixed network infrastructure – essentially Chorus’s legacy network – in terms that avoid excessive profits but encourages access seekers to invest to the deepest level that is appropriate.

MBIE’s view (as expressed in the discussion document) is that, especially given the UFB project and the separation between access network providers and retail service providers, we might see the regulation of those networks as something closer to other utility networks.

This could mean that the way we price services on those networks may be looked at more along the lines of how the Commission looks at gas and electricity networks. Some commentators are of the view that pricing methodologies used in those sectors, once set, may have the potential to create greater certainty for both investors and access seekers.

Given that fibre pricing is only set until 2020 we need to consider as a sector what happens after that period. If the MBIE review results in a fresh approach to regulating fibre we have significant work to do to implement any changes. Whatever form that takes, whether through industry led processes or Commission run processes we have a busy few years ahead.

#### *Conclusion*

My aim today is to have given you a sense of our role and some of the key considerations we have to balance. I’ve set out a summarised history of where we came from, some of the projects for this year and the work we are doing to support the Government to give us the best possible tools for the job that lies ahead.

The deployment of increasingly fast networks whether using fibre, copper, cable or mobile networks is transforming the way we use the internet and the extent to which we rely on it. This, in turn, is transforming how we run our businesses, and how we live our lives.

This new wave of investment will also throw up new regulatory challenges in the years ahead. Getting the right set of regulatory measures in place, will have its part to play in one of the most important industries defining the 21<sup>st</sup> century.

While it is easy to see regulators around the world as the tortoise writing rules for their respective industry of hares it is also important to see that without the robust long term settings in place the industry hares will not have a basis for the further growth and innovation we all expect of them.

The more that we can do cooperatively as an industry to support establishing clear regulatory settings the more resource can be freed up to focus on competition rather than regulation. I am therefore highly supportive of continued dialogue on key issues and can offer an open door to any of you who wish to contribute to that dialogue.

Thank you