



Internet New Zealand (Inc)

Submission to the Ministry of Economic Development

on the

New Zealand Government
Broadband Investment Initiative

27 April 2009

Public Version (there is no confidential version)

1. Executive Summary

1.1 The main points InternetNZ makes in this submission are:

- (a) InternetNZ supports the Government's Broadband Investment Initiative including the regional framework and co-investment model.
- (b) Implementation detail should be released as soon as possible to allow for public feedback. Proper consultation or comment periods should also be included in the proposal's timetable, to improve the prospects of a successful rollout
- (c) InternetNZ supports Open Access being a fundamental aspect of the new network's business arrangements. Open Access will also need to be clearly defined.
- (d) Price regulation will be required at the outset to increase regulatory certainty and avoid delays for when SMP develops. An appropriate body should also be appointed for technical standards-setting.
- (e) InternetNZ has a strong preference for point-to-point network architecture. LFCs should be able to provide wholesale services, particularly if PON network architectures are chosen.
- (f) InternetNZ would like to see a stronger separation between LFCs and vertically integrated incumbents.

2. Introduction

- 2.1 The mission of InternetNZ (Internet New Zealand Inc) is to protect and promote the Internet for New Zealand. We advocate the ongoing development of an open and uncaptureable Internet, available to all New Zealanders. The Society is non-partisan and is an advocate for Internet, and related telecommunications, public and technical policy issues on behalf of the Internet Community in New Zealand - both users and the Industry as a whole.
- 2.2 InternetNZ supports the Government's Broadband Investment Initiative and welcomes a commitment to the roll-out of the fibre-optic network infrastructure that is vital to New Zealand's future.
- 2.3 This brief submission highlights some key policy considerations and then provides comment in respect of each of the sections in the Cabinet paper, as sought. Residual other items are in the last section.

3. The Government's approach is to be welcomed

- 3.1 InternetNZ supports the broad approach of regionally-based Local Fibre Companies that have a mandate to roll out dark fibre (with some wholesale services also made available), part funded by a Crown investment.
- 3.2 The success or otherwise of this approach to broadband rollout depends on the implementation detail that is yet to be released. **InternetNZ recommends proper consultation or comment periods being included in the proposal's timetable, to improve the prospects of a successful rollout.**
- 3.3 Noting the 75% coverage target, InternetNZ restates its view that eventually, fibre broadband networks will need to extend to all New Zealand settlements. The Government should commence policy work on opportunities to leverage Government expenditure on telecommunications services and on the provision of public services, into further commercial or government-funded investment in such infrastructure in the rest of New Zealand.

4. Specific Feedback

A. Objective and principles

- 4.1 InternetNZ supports the broad set of principles set out in the Cabinet paper.
- 4.2 Compared with the Prime Minister's earlier statement of principles, the "open access" principle is no longer present in the list. InternetNZ reiterates its support for open access being a fundamental aspect of the new network's business arrangements.

B. How the Government will achieve this objective

- 4.3 The Government's rationale for investing (to accelerate rollout which would otherwise occur too slowly under fully commercial conditions) is appropriate.
- 4.4 The regional framework and co-investment model set out in the paper are supported by InternetNZ. The approach is consistent with that proposed by Network Strategies in the research we commissioned from them last year, and allows for the widest possible range of

parties to participate in the rollout, including those with longer investment time horizons and thus lower cost of capital than conventional telecommunications companies.

- 4.5 The possibility of some wholesale bitstream services being provided by LFCs is supported. The emerging consensus in European regulatory environments is that both active and passive service provision by network owners is likely to maximise competition at the retail level, leading to the lowest possible prices and highest quality services.
- 4.6 InternetNZ believes that initial price regulation (as mentioned in para 36) is in fact required. Further feedback on this is provided below.
- 4.7 The institutional set-up with CFIC at the centre and LFCs operating regional networks is reasonable. The Cabinet paper may underplay the resources required by CFIC, which will have to be a hands-on investor, especially during the start-up phase.
- 4.8 The note in para 47 regarding common technical and commercial standards needs to be more clearly set out. An appropriate, technically competent body of experts, including user and operator points of view, should develop the standards and they should be enforced uniformly on all networks.
- 4.9 In particular a clear definition of “open access” will need to be defined and imposed on the LFCs. The term is used differently by different people and only a robust and enforced definition can deliver the Government’s objectives of a network that serves as an input to the industry. Establishing the meaning of this term and other technical requirements early in the rollout of the new framework will simplify later negotiations with providers and avoid unnecessary complications later in the process.
- 4.10 Some of the issues that will arise in such a discussion, including the implications of IP interconnection arrangements on the new network, including commercial issues, cannot be dealt with by existing standards setting organisations, such as the Telecommunications Carriers’ Forum, due to restrictions in other areas of law e.g. the Commerce Act. So it is critical that the Government propose an appropriate standards-setting body and consult on its proposal at the earliest possible opportunity.

C. Crown-owned holding company – “Crown Fibre Investment Co”

- 4.11 InternetNZ supports the broad scheme set out in the paper.
- 4.12 Government may wish to impose a further task on the CFIC, to be able to invest if required in national or regional backhaul networks to connect the LFC networks to each other or to national points of aggregation. This would avoid any possibility of the networks being held hostage by providers of such backhaul, or isolated where backhaul connectivity cannot match the demand created by the new networks.

D. Eligibility of private sector partners

- 4.13 The “no majority control” requirement set out in para 56 of the paper does not preclude vertically integrated incumbents exercising other forms of control. For example, a retail provider which owned a majority stake in an LFC could enjoy a strong monopsony relationship with the LFC, influencing it through commercial pressures. It could also make future investment decisions in a manner which gave it a measure of control. Both situations are independent of Board membership.

- 4.14 InternetNZ supports a stronger separation between LFCs and vertically integrated incumbents. With the exception of allowing some wholesale provision by LFCs, the stronger the separation is between the infrastructure owners and retail service providers, the greater the incentives for strong competition at the retail level. We urge the Government to consider strengthening the requirements for arms-length treatment by investors with retail operations.

E. Local Fibre Cos

- 4.15 InternetNZ supports the broad framework for Local Fibre Companies, including the possibility of fewer than 25 such companies being formed.
- 4.16 As mentioned above, it is important to allow LFC provision of some wholesale services. This may be particularly relevant if PON network architectures are chosen, to allow greater competition to develop in retail markets than would otherwise be the case.
- 4.17 InternetNZ would favour LFCs being required, on an open access basis, to make their duct or aerial infrastructure available to others who wish to lay fibre where this is suitable.

F. Profit allocation

- 4.18 The matters set out in para 69 do need to be determined, but InternetNZ would be concerned if stop-loss provisions were included (understanding these to be Crown guarantees of maximum exposure for commercial partners).

G. Selection process and criteria

- 4.19 While the broad scheme set out in this section seems suitable, further detail would be welcomed as to how the CFIC will compare bids that are not easily commensurable (e.g. a commercial bid by a telco investor compared with a local body bid). Without further specific detail it is difficult to judge the adequacy of the criteria. InternetNZ also notes that priing is not discussed, yet is integral to achieving the Government's take-up objectives.
- 4.20 InternetNZ strongly supports criterion d) in para 78, and has a strong preference for point-to-point network architecture as the most flexible and competition-enhancing architecture that could be selected. PON architectures should only be accepted if they provide acceptable levels of virtual unbundling, so as to maximise competition.
- 4.21 Guidance in the selection criteria as to the weights that different criteria enjoy and how they will be assessed would increase the transparency of the selection process.

H. Shareholders agreement

- 4.22 InternetNZ has no specific feedback on this section of the paper.

I. Pricing and regulatory matters

- 4.23 A range of scenarios are apparent where price regulation may be necessary. These include, for example, where the LFC networks take over delivering most services from other networks (i.e. the Telecom copper network is taken out of service); or where other network owners are significant co-investors in LFCs (therefore having incentives to maximise prices on both networks).

- 4.24 Implementing price regulation (on a cost basis) from the beginning will increase the regulatory certainty faced by investors, instead of leaving the question to uncertain and lengthy regulatory proceedings at a later date. Due to the market structure being established by the Government's intervention (LFCs providing network infrastructure, with other parties providing services over this infrastructure), LFCs will inevitably enjoy significant market power over the infrastructure in the same way that electricity lines companies do through their provision of electricity lines networks (in both cases, a de facto monopoly is the most likely outcome for the large majority of households).
- 4.25 Up-front regulation would also avoid the inevitable problem that when SMP does develop in the LFCs' networks and regulation is deemed necessary, the regulatory process will take a long period of time, to the detriment of consumers in the interim.
- 4.26 The paper mentions Commerce Act remedies which may assist. Unfortunately such competition law remedies are even slower than Telecommunications Act remedies and are not an appropriate way to manage the implementation of this new infrastructure in a pro-competitive manner.
- 4.27 InternetNZ suggests that the Government have the Commerce Commission commence a Schedule 3 investigation into the services the LFCs will operate. The Commission could then use the processes already established in the Telecommunications Act to develop a cost model. This procedure would require amendments to the Act to allow for regulation of a prospective service; currently the regulatory framework set out in the Act is aimed only at the regulation of existing services.
- 4.28 InternetNZ understands that this approach is consistent with the Australian Government's approach to developing a new regulatory framework for its new broadband network as recently announced.
- 4.29 Finally, InternetNZ had made extensive submissions in favour of robust information disclosure requirements being applied to Telecom as a complement to its operational separation. Robust information disclosure requirements should be required of the LFCs, incorporated in the Shareholder Agreement, to assist with the development of an open and competitive market.

J. Demand-side initiatives

- 4.30 Demand-side initiatives are an essential component to building the business case for the LFC investments the Government is proposing.
- 4.31 Some of the demand-side initiatives proposed in last year's Digital Strategy may be useful for improving the business case, where funds can be found to support them.
- 4.32 The difficulties of government-wide procurement are a key problem for demand-side progress from the Government's point of view. The desire for agencies to maintain autonomy in their choices of service provider conflicts with the Government's interest in making the new fibre networks economically viable. Ministers should consider what can be done in procurement to improve the viability of the rollout.
- 4.33 Those initiatives mentioned in the paper give assurance that consideration is being given to these issues, and InternetNZ will provide further suggestions on request.

K. Timetable

- 4.34 The implementation detail that the Cabinet paper refers to will have a significant bearing on the workability of the proposal. Current timetables for the implementation of the proposal do not include any public consultation on this implementation detail.
- 4.35 InternetNZ strongly recommends that the Government release this detail as early as possible, to allow for considered public feedback. Any other approach increases the risks to the proposal succeeding.
- 4.36 There appears to be an inconsistency between the paper's text and the timetable, with earlier references to a three-month RFP process not flowing into the timetable. This should be made consistent at three months.

L. Complementary measures

- 4.37 In respect of the environmental and access issues set out in para 97 of the proposal, subparagraphs a-c, InternetNZ supports the use of codes of practice to achieve desired outcomes, as opposed to regulatory or legislative amendments. LGNZ's Broadband Friendly Protocols are a useful framework for improving the performance of local government in lowering the cost of, and barriers to, the rollout. MED are aware of the Protocols' progress and should work with LGNZ and others to discern what suggestions require further Government policy work or legislation to smooth the rollout of the new infrastructure.
- 4.38 In this context InternetNZ notes the recommendations in a report by Dr Murray Milner to Treasury dated from February this year, which recommended uniform policies on aerial plant deployment, best practice guidelines for the same, as well as a pilot of micro-trenching funded by central government, if this has not already been done.
- 4.39 InternetNZ also notes that para 97 of the proposal does not explicitly include providing access to existing telecommunications access network infrastructure – ducting and other facilities operated by Telecom and others. The proposal should be changed to require such access. The reasons for the omission of such a requirement are not clear: the costs of the rollout of the new network could be reduced by making all relevant infrastructure available on the same basis, instead of restricting access to electricity network infrastructure. As this would presumably occur on a cost basis, and only where facilities had spare capacity, it is not clear there is any particular risk or penalty imposed on existing providers by mandating access to such facilities.
- 4.40 Government should also consider the need to update the Building Act to require new premises to include at a minimum standard, internal conduit that is capable of being used for fibre/Ethernet connections within the premises. It could also consider right of access issues to commercial premises for network providers – currently there is no automatic right of access even when a provider has a customer in the building.

M. Risks

- 4.41 The paper's coverage of the risks inherent in the proposal is up front and very welcome. InternetNZ does not disagree with any of the analysis presented.
- 4.42 Para 107 discusses the risk of overbuild. The proposal's focus on rolling out infrastructure in the first instance to MUSH-type institutions makes overbuild a likely prospect. The competitive response from existing fibre providers would likely make the economic viability of the LFCs more questionable than would otherwise be the case. Examination of these

issues and the consequences both for existing providers and the LFCs themselves could be dealt with as part of the Commerce Commission regulatory proceedings.

- 4.43 Some degree of overbuild could be seen as an advantage for the new network, to improve network resilience and redundancy, as well as increasing the options available to wholesale and retail providers. This does not suggest that widespread overbuild is desirable but does accept that some degree of overbuild is likely and not always problematic.
- 4.44 One risk inherent in the proposal is that of the roll-out target not being met, given the global financial crisis and its impact on the availability of capital for investors in network infrastructure, combined with the scale of investment the Crown is proposing. If it becomes clear that coverage cannot be met through this proposal, then the Government will need to consider further investment at some time in the future.

N. Other

- 4.45 There are no other issues arising from the paper that InternetNZ wishes to raise with the Ministry or the Government at this time.

5. Conclusion

- 5.1 InternetNZ reiterates its support for the Government's objectives and the broad outline presented in the proposal.
- 5.2 InternetNZ reiterates that the keys to success or failure of the proposal lie in the implementation detail, which has not been released. Proper consultation with interested parties should be included in the timetable to maximise the chances of the proposal fulfilling the Government's objectives.

Thank you for the opportunity to make this submission. InternetNZ is always available to provide further responses or information, should this be helpful.

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