



Internet New Zealand (Inc)

Submission to the Ministry of Economic Development

on the

Proposals for Rural Broadband and TSO Reform and
Funding Telecommunications Development

30 October 2009
Public Version (there is no confidential version)

A. Introduction

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. This submission is in response to the two Proposals for Comment issued by the Ministry of Economic Development that called for submissions by 30 October 2009:
 - a. Rural Broadband Initiative (hereinafter the RBI or RBI paper)
 - b. TSO Reform and Funding Telecommunications Development (hereinafter the TSO paper)
3. This single submission deals with both Proposals for Comment because they are so closely intertwined.
4. The next section of this submission deals with the broad policy issues raised by the discussion documents. The following section responds to the specific questions asked in the RBI paper. The penultimate section responds to the specific questions asked in the TSO paper.
5. InternetNZ is always available to provide more detailed information to policymakers should that prove useful.

B. General Policy Issues

Overarching points

6. Taken together, the Proposals for Comment lead to the following key points:
 - a. Retention of a Universal Service Obligation on Telecom through the TSO, to provide voice landline and emergency calling access in rural areas.
 - b. The end of any cost-sharing for the expense of Telecom providing services required by the TSO.
 - c. A diversion of the former TSO levy for a period to fund investments in rural broadband infrastructure.
 - d. The rollout of new broadband (focused primarily on fibre optic network access for schools and the associated backhaul infrastructure) to rural areas.
7. The effects of the suggestions in these Proposals for Comment are broadly as follows.
8. Instead of receiving approximately \$24m per annum from other service providers to provide TSO services, Telecom will likely instead

have to pay approximately \$35m per annum in levies for the RBI which it may or may not win tenders to provide.

9. If Telecom wins no tenders as part of the RBI, the net effect on its bottom line would be likely to be a negative change of around \$60m per annum. Once the RBI is complete the levy falls to a level that funds relay and emergency service access, but Telecom remains obliged to provide the TSO services.
10. The effect on other liable persons is a modest decline in their levies, which will go to the RBI instead of Telecom as TSO provider. As for Telecom, once the rural broadband initiative is complete the levy falls to a level that funds relay and emergency service access. Other liable persons are therefore better off.
11. The effect on communities in rural areas – the “last 16%” – is that they will gain access to fibre infrastructure at rural schools, which can be leveraged as appropriate to provide higher-speed community-wide broadband services.
12. The effect on New Zealand, assuming that predicted benefits of broadband on productivity and economic development and growth are accurate, is a net increase in the country’s overall economic welfare.
13. The effect on the Government is a higher overall level of tax income due to higher economic output.

Is the proposed investment in rural infrastructure a good idea?

14. Yes. Since sponsoring an LGNZ Forum on rural broadband in February 2008, InternetNZ has advocated for the need to roll out high-speed broadband services to rural communities. While the provisioning cost per person is higher than in urban areas, the potential economic gains may also be larger depending on the extent to which the rural sector can improve its output and productivity through access to high-speed broadband.
15. More broadly, the provision of high-speed backhaul infrastructure is a step towards InternetNZ’s long term goal of fibre to the premises everywhere that people want it.

Is the contestable nature of the proposed Rural Investment Initiative a good idea?

16. Yes. Contestable tendering should lead to the best “bang for buck” in obtaining the maximum possible infrastructure for the least possible cost. As long as the requirements imposed on providers are open-access compliant and give any provider access to the infrastructure needed to connect a given school end-point to the core of the

network, InternetNZ supports a contestable approach. Further comments on this appear below in specific responses to the RBI paper.

Should the TSO requirements on Telecom be retained?

17. InternetNZ has not traditionally engaged in the debate about voice service availability through the PSTN, which the TSO is primarily concerned with. We note with some disappointment that the Government has sought no input as to whether basic broadband services should become part of the TSO.

Is the logic behind the decision not to fund the TSO obligations sound?

18. The Government has set out its view that the cost of the TSO should be determined across the entire network; that Telecom should simply cross-subsidise loss-making PSTN services in rural areas from gains made in the profit-making urban areas. Telecom would only receive TSO compensation if the entire cost of providing voice service across the country exceeded the revenue gained.
19. Such a scenario is very difficult to imagine. Given the gap shown in the cost index for telecommunications compared with the CPI; the level of competition Telecom faces in fixed line voice services in many urban areas; and the relatively low need for new investment to maintain voice services in urban areas, the Government has essentially decided to convert the TSO obligation for uneconomic customers into an unfunded obligation to provide universal service.
20. This is not an approach InternetNZ has advocated for in the past. Our submissions to the previous TSO review in October 2007¹ noted the possibility of an unfunded universal service obligation but did not recommend it, or recommend against it.
21. We do note however that there is a similar obligation imposed on BT in the UK, where the national averaging and coverage requirements have been a feature of the market for some time.
22. We also note various commentaries over the years in New Zealand that point to Telecom spending considerably less on maintenance and development of services in TSO areas than it has received by way of TSO revenue.
23. The Government appears willing to allow Telecom to continue to increase its TSO service prices by the CPI, and to treat the wedge between that index's growth and that of the PPI communications index as revenue space to fund the cost of the TSO service in uneconomic areas.

¹ <http://www.internetnz.net.nz/issues/submissions/archive/2007/tso171007/view>

24. It is not clear from the information presented by Government what the total gain to Telecom has been from the abovementioned wedge, and what proportion of that gain to-date and in future is expected to be diverted to funding the USO. The Government could usefully obtain, and publish for consultation, more detailed analysis of this issue.
25. InternetNZ submits that if the Government did obtain further analysis of this issue and found that the gain was considerably larger than the cost, it could consider a change to the price cap regime for the TSO services. It is not clear why rates of price increase far in excess of the trends in general communications prices should be allowed and indeed encouraged by the Government at the expense of consumers if this is not required for reasons of service viability, investment in infrastructure, or any other purposes.

Should TSO liable persons be paying for the Rural Broadband Initiative through the new Telecommunications Development Levy (TDL)?

26. The Government's proposal to introduce a replacement Telecommunications Development Levy, to spend a significant portion of it on the Rural Broadband Initiative, and to lower the levy over time, is a benefit to TSO liable persons (in the sense that compared with the status quo, they will be levied less - at first marginally less, and later substantially less).
27. However, it does not follow that the TDL is an appropriate way to fund investment in infrastructure. The Government has not set out the case as to why it believes that the customers of liable persons are the appropriate financing base for rural broadband investment.
28. Indeed there is a simple issue of relativity in the sense that urban consumers will gain the benefit from \$1.35bn of public investment. The remaining 16% of consumers in rural areas only receive \$48m of public funds. This is a substantially lower per-capita investment than urban consumers, and the logic for this difference is not clear.
29. Therefore on the principles listed in paragraph 55 it is difficult to understand why Government funding from general taxation is not the obvious preferred mechanism. InternetNZ would prefer that this system of funding rural broadband investment was adopted, consistent with previous arguments we have made to Government for an integrated rural broadband strategy.
30. InternetNZ is well aware of the current economic situation facing New Zealand and the effects this is having on tax revenue. The budget deficits the country faces, while not particularly large in a relative sense compared with some other developed countries, are a major turnaround from earlier large budget surpluses. The

Government has been clear it regards reductions of the Budget deficit as an important policy priority in the medium term.

31. Given this overriding policy priority, InternetNZ can understand the desire of the Government to finance increased investment in rural broadband through the use of an existing non-government revenue stream (currently TSO levies, to be replaced by the TDL).
32. In summary, while InternetNZ would prefer direct Government funding, and regards the TDL mechanism as a second-best alternative, the imperative is to proceed with the Rural Broadband Initiative.

Does the definition of a TSO liable person need to change?

33. Given the new Telecommunications Development Levy, the question arises as to whether there should be an expansion of the current definition of who a TSO liable person is. A wide range of parties will benefit from expanded access to rural broadband, beyond the providers of telecommunications services. If an industry levy is the preferred approach to funding the investment in rural infrastructure, the question of where the boundary around the “industry” is drawn will be asked.
34. In an ideal world a levy would target all those who would gain benefits from the application of the levy, to keep it at the lowest per-unit level. However, the broader the application of the levy the higher the administrative and other costs attached to it. Further mitigation is provided by the relatively short time period for which the levy will be applied at a significant level. This is another area where the pragmatic compromise outlined by the Government’s Proposal is more acceptable than it may otherwise have been.

C. Specific Comments on the “Proposal for Comment: TSO Reform and Funding Telecommunications Development” paper

35. This section of the submission responds to the specific questions asked by the Government in the TSO paper.

Q. Are there any aspects of these objectives which should not be retained?

36. InternetNZ has no concerns with the objectives as stated.
37. InternetNZ notes that the requirement to be able to make 111 calls should be considered in the context of the increasing availability of cellular phones for making such calls and the increasing usage of

rechargeable portable phones and VoIP-based PSTN substitute services, which are vulnerable to power outage.

38. Bullet point 4, given the discussion at paragraph 26, would appear to be out of alignment with bullet point 2. Specifically, if a service is available in rural areas at a price and quality comparable to local service available in urban areas then it should perhaps only be increasing in price along the lines of the Producer Price Index for Communications rather than the CPI.

Q. Do you consider the current TSO methodology for calculating TSO charges for local service over-compensates Telecom?

39. InternetNZ does accept the logic of taking a national approach to the aggregation of profitable and unprofitable customers, which indicates the aggregate answer is “yes”.
40. The description in paragraph 37 of the TSO paper indicates that there are “large surpluses” being made in telephony that are not being used to offset the cost of unprofitable customers.
41. The use of CPI as described in paragraph 26 of the TSO paper (as the price cap for local service under the TSO) indicates there have been increasing surpluses, supporting the Government’s argument that Telecom should meet the costs of uneconomic customers internally.

Q. Do you consider public disclosure by Telecom at a customer cluster level to be adequate?

42. We are supportive of greater transparency than currently exists so that a fuller understanding of unprofitable areas is possible. We do accept that this may only be relevant when a cost determination is requested, given that in the absence of such a determination there is less interest on the part of the industry as a whole to determine which customers Telecom or the Commission regard as uneconomic.

Q. Do you consider the proposed new TSO determination process is feasible?

43. Yes. Given that the proposed new TSO charge methodology (paragraphs 43-46 of the paper) is unlikely to lead to any TSO charge arising, the process set out in paragraphs 47-53 is feasible.

Q. Is the process outlined for applying the new industry levy feasible?

44. Yes, the process outlined in paragraph 73 for applying the new industry levy is feasible.

D. Specific Comments on the “Proposal for Comment: Rural Broadband Initiative” paper.

45. InternetNZ endorses the broad intent of the Government’s proposal to roll improved fibre backhaul capacity to rural settlements, and sees the focus on school connectivity as a useful reference point for structuring a rollout that brings services to communities outside the footprint of either the Ultra-Fast Broadband Investment Initiative, or of Telecom’s cabinetisation programme.
46. For InternetNZ, a key concern is to ensure that the investment made is truly open access.
47. Critical to that open access is to ensure that a range of service providers have access to direct fibre optic glass from each end point (at a school, presumably) to a relevant regional point of interconnection which is competitively viable for service providers.
48. We would regard it as a failure of the Initiative if the investment only provided, for example, clear glass paths from a school to a local exchange point where only one provider was available for national backhaul connectivity.
49. This is a significant issue because delivering this form of open access will presumably require either successful negotiation with existing infrastructure owners to provide dark fibre access on their networks to competing service providers, or overbuild of other networks funded by this initiative.
50. Given the lack of competitive infrastructure in rural regions, existing infrastructure owners will be in a strong bargaining position regarding access to their networks.
51. It is important that this be factored into the tendering process. Given the largest source of funds for the Initiative is an industry levy, InternetNZ would be concerned if there was any slippage of the amount proposed for investment from the levy (currently \$252m) or in the areas to be covered as set out in the Proposal.
52. On other issues, InternetNZ endorses the proposal in paragraph 55 to make some funds available on a contestable basis for community initiatives that might serve to improve last mile access, or aggregate community demand for broadband services.
53. The tendering process should place serious weight on spillover benefits from the proposed investment, so as to maximise the community benefits from the funds being invested.
54. As part of the spillover criteria, InternetNZ believes that proposals which offer expanded fibre to the premises connectivity beyond the

school should be preferred to those which (by way of example) increase the speed of copper-based services.

E. Conclusion

55. InternetNZ thanks the Government for the chance to contribute its advice and suggestions on the two Proposals.
56. InternetNZ is available to offer more detail or to meet with officials to explain the rationale behind the comments made in this submission.

With many thanks for your consideration,

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jordan Carter', with a horizontal line extending to the right.

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