



**TELECOMMUNICATIONS SERVICE OBLIGATIONS REGULATORY
FRAMEWORK**

**MINISTRY OF ECONOMIC DEVELOPMENT DISCUSSION DOCUMENT DATED
AUGUST 2007**

SUBMISSION IN RESPONSE FROM TUANZ

Introduction

Before answering the list of questions in the Discussion Draft TUANZ wishes to make two introductory comments:

1 We Are Not Happy With the Process

TUANZ welcomes the release of the Discussion Document and the opportunity to comment. For many years we have been urging a comprehensive review of the TSO. While the concept of universal service for voice traffic is well justified and common practice world-wide, New Zealand's TSO in its current form has for many years been stifling the development of new technology, reducing incentives to invest, and producing perverse anti-competitive unintended consequences.

The Paper comes at a time of wide reaching change in the sector including the regulatory environment. TUANZ is deeply concerned that the government is calling for submissions on this critically-important issue at a time when so many fundamental elements of the telecommunications framework are under review concurrently. Given that this Paper was announced by the Minister as far back as May 2006, we are disappointed that it contains very little analysis of options, but merely a compilation of information that was already available from other sources.

Given the scale of the issues, we would have expected the government to obtain the necessary resources to compile the paper in a more comprehensive and timely manner, followed it with a comprehensive discussion process to ensure a common perception of the scope and issues, and then allowed those with specific interests adequate time to assimilate the issues and respond. As it stands, we are concerned that key interested parties – ourselves included – will respond with submissions of lower quality than these issues deserve.

2 Core Principles Guiding Our Submission

TUANZ notes the following core principles underlying our Submission:

- This Discussion Document concerns the TSO, which deals with the supply of voice services in a “last resort” scenario to end users. It should not be confused as an answer to other critical telecommunications issues that are being dealt with through other investigations.
- TUANZ is extremely supportive of the widespread availability and uptake of broadband across New Zealand. However, this issue should be dealt with separately to the TSO through such initiatives as the Digital Strategy. Adapting the TSO to encompass broadband would dilute the focus on the core issue of voice traffic, and could even place rural voice services at risk.
- Likewise, TUANZ has a strong desire to see incentives provided for emergence of new service suppliers and new technologies including MUSH networks, local wireless networks, satellite, and fixed/mobile substitution. But again incentives for emergence of these should be addressed in other places. Contestability of the TSO is essential, but at this time should be confined to services that have proven, robust technical and commercial platforms. A “service of last resort” is not the mechanism to use to encourage start-up businesses, nor to provide an artificial boost to technologies that have yet to be fully proven under high-volume conditions.

The TSO Framework

3a How important is the KSO/TSO framework as a component of the overall regulatory regime of New Zealand for telecommunications services?

Enforced universal service in some form remains essential to provide certainty of access to more remote customers, and will do so until such time as market conditions and technology developments result in residential customers having access to voice services on an affordable basis without subsidy. However, the Kiwi Share and TSO mechanisms have not done the job. They have slowed the evolution of competition while producing perverse and costly side effects – such as the requirement for Telecom’s competitors to subsidise Telecom’s provision of fixed line services to customers that they could themselves offer over a wireless service on an unsubsidised basis. They have also slowed the substitution of fixed line calls with mobile calls by artificially depressing the price of fixed line calls to those customers whose needs could be met far more cost-effectively by the use of mobile phones.

TUANZ supports the concept of a “last resort” cross subsidised voice service for users who might not otherwise have access to a voice line service. This is standard practice globally, and justified on the grounds of public safety. However, the existing TSO has not been reviewed properly since its inception and has been allowed to become an expensive and distortionary anachronism in the current environment.

3b How effective has the TSO framework been in achieving the government’s telecommunications objective of ensuring the delivery of cost efficient, timely, and innovative telecommunications services on an ongoing, fair and equitable basis to all existing and potential users?

The TSO is effective in delivering services that are timely, but very ineffective in delivering services that are cost efficient, innovative, fair or equitable.

- A TSO that requires Telecom's competitors to subsidise it to deliver loss-making services that they themselves could deliver at a profit is clearly not "cost efficient."
- A TSO that subsidises loss making services on dilapidated fixed lines, therefore making it harder or impossible for wireless or satellite operators to compete, is not "innovative."
- A TSO that has low income earners who happen to live in urban areas paying a surcharge to subsidise high income earners who happen to live in rural areas is clearly not "fair" or "equitable."

3c Would other policy mechanisms be more appropriate than TSO instruments to achieving the government's telecommunications objective going forward?

In the medium or long term, TUANZ believes the best way to deal with the issue is through the welfare system. This could be phased in at some point by allowing charges gradually to reflect regional variations in the cost of supplying the services, and providing for those customers who find themselves disadvantaged to apply for a subsidy via the welfare system.

However, we recognise that this would be premature at present and any such transition would take time to achieve. For that reason we have answered the remainder of these questions on the presumption that an ongoing cross subsidy within the telecommunications industry will remain a necessity for the immediate future.

3d What are the strengths and weaknesses of the TSO framework?

TUANZ believes the TSO in its current form is a voice-age policy which has very few, if any, strengths in an Internet era.

Weaknesses include:

- Distortion of investment signals
- Anti-competitive transfer of funds from new entrants to the incumbent
- Lack of a regular, transparent review process
- Excessive administrative costs
- Retrospective calculation, leaving large contingent liabilities on the balance sheets of all service providers
- Perverse transfer from poor to rich in some cases, as noted above

Purpose and Market Impact of the Local Service TSO

4a How does the Local Service TSO contribute to advancing the interests of telecommunications users?

It advances the interests of Telecom's customers whose services are categorised as "commercially non viable" by protecting them from the real cost of service provision whether or not they can afford it.

It advantages all other telecommunications users by maximising the number of New Zealanders who subscribe to fixed line telephones, though at the cost of possibly deterring some users from the use of alternative means of communication such as mobile phones.

4b Would the universal availability and affordability of local residential telephone service for households be better achieved another way?

Yes – over time the burden should be transferred to the welfare system as set out above. This would avoid the perverse transfer of wealth from poor to rich, and ensure far greater transparency of the real social costs of the subsidy.

4b What should be the focus of the Local Service TSO going forward?

Technological neutrality, service provider neutrality, economic efficiency, and administrative efficiency.

Availability of Service

5a Does the Local Service TSO effectively address gaps in the commercial market for the availability of telephone service?

Yes, the gaps in the market are effectively addressed but at the cost of considerable economic inefficiency.

5b Should the Local Service TSO requirements for service availability be retained?

Yes, but subject to a radical restructuring including contestability of service provision to ensure technological neutrality and economic efficiency.

5c Should geographic coverage requirements for the supply of TSO local service be extended to cover areas currently outside the TSO and why?

We see no reason to extend the current geographic coverage.

5d Should the existing service performance measures be expanded, including down to geographic regional level, to better ensure reliability of telephone service? If so, what measures are recommended and why?

If the provision of TSO services become contestable as recommended in our Submission, then service levels will need to be reviewed to encompass technologies other than fixed line. Each service provider should be subject to an individual set of performance measures.

5e Are there service measures which would better represent the aspects of service performance which are of most importance to users?

Within the confines of the current TSO we see no reason to change.

5f Should penalty performance rebates apply for non-compliance by the Local Service TSO Provider?

As with any other service contract there should be penalties for non-compliance.

5g Should there be reporting on the quality and capacity of network capabilities for supplying TSO local service?

Yes

5h Should information about TSO local telephone service supplied in commercially non-viable areas be made publicly available by the TSO provider as part of its TSO requirements? If so, why?

Yes – because (1) alternative potential service providers need this information in order to compete for services, and (2) the public has a right to know what it is paying for.

5i Should the gateway devices installed in customer's homes to support the supply of telephone service be required to have battery back-up? If so, why, and should there be a requirement that battery back-up last for a specified period?

Consumer education about the merits of battery backup should be mandatory and implemented jointly by government and the industry. However the final decision is a matter of consumer choice - just as with smoke alarms, or with alarm clocks that may, or may not, have battery backup. If service providers were required to provide battery backup the logical next question would be whether there should be regular inspections to ensure consumers were changing their batteries regularly – there must come a point where responsibility rests with the individual.

5j Should a requirement for battery back-up only apply for residential customers living in areas outside mobile cellular phone coverage?

n/a

5k Should battery back-up requirements be equally applicable across all providers (TSO and non-TSO) of telephone access services and if so, should any requirements be prescribed by regulation?

n/a

5l Should dial-up internet access be discontinued for TSO local service if a bitstream equivalent (i.e. NGN version) is supplied as a replacement?

Yes – the TSO is a service of last resort for voice calling and should not become “gold plated.”

5m Do you have any concerns about aspects of Telecom's planned NGN local service?

No comment.

6a Should the status quo prevail for setting the TSO charge compensating the Local Service TSO Provider for meeting TSO requirements?

Contestability will reduce greatly the net cost to the community of the TSO, so that the cost and complexity of the present calculation would become less justifiable. A simpler formula, that provides liable parties with certainty in advance, should be developed. This is an important topic on its own - the time allowed for submissions and the lack of detailed analysis in the Discussion Document does not allow us to comment more fully at this time.

6b If the TSO charge is to remain an unspecified amount, should the prescribed methodology for calculating the TSO charge be changed?

Yes – as above.

6c Should a specified amount TSO charge be applied for the Local Service TSO?

Unable to comment at this time - see above.

6d How should any such “specified amount” TSO charge be structured? Should there be fixed charge and variable charge components?

Unable to comment at this time - see above.

6e Should a TSO Charge of specified amount be linked to the Communications Producer Price Index (PPI) as a proxy cost standard for the telecommunications industry?

If it is deemed desirable for the sake of administrative efficiency to index an annual TSO charge, this should be measured against the cost of telecommunications inputs which more accurately reflect the underlying cost of providing the services.

6f Should the TSO Charge for Local Service be abolished?

Unable to comment at this time - see above.

6g What importance do you place on the merits and risks outlined for abolishing the TSO charge?

Unable to comment at this time - see above.

6h What importance do you place on the merits and risks outlined above for contestability in compensating the Local Service TSO Provider?

TUANZ strongly supports contestability as a means to reduce some of the perverse anti-competitive side-effects of the TSO, and for the reasons set out in para 142 of the Discussion Document.

We believe the risks identified in para 143 can be managed as follows:

- Possible lack of bidder interest – by careful management of the contestability process
- Business failure by a new entrant - through a rigorous qualifying process for bidders consistent with the “provider of last resort” objective of the TSO
- Cost of a contestability scheme – becomes immaterial compared to the economic inefficiencies of the status quo, and offset by the saving in current mathematical work by the Commerce Commission
- Lost economies of scale – manageable by prudent division of the geographic areas put out for tender
- Asset stranding risk – up to each service provider to assess

TUANZ strongly believes the industry should be deeply engaged in developing the detail of a contestability process. We would urge that government request the Telecommunications Carriers Forum (TCF), under supervision of the Commerce Commission and with involvement by other interested parties, to develop an industry position paper on these options.

6i Do you agree that contestability can only be expected to bring net benefits in areas which are commercially non-viable?

Contestability will bring benefits most in areas that are commercially non viable in their entirety, and least in areas where a handful of customers are non viable in areas that in total are profitable. This is the kind of issue that, with the details of non-viable customers made public, the TCF would be well placed to report on.

6j What form of contestability would best achieve the service objectives

Unable to comment at this time - see above.

6k How should investment be linked to compensation of the TSO Provider for local telephone service?

The effect of any TSO subsidy is to convert non-viable customers into profitable ones. In principle this should give service providers the incentive to invest in the appropriate regions, as if they do not they will run the risk of losing this profitable business when tenders roll over. The reason Telecom has not invested adequately in rural areas in the past is that the non-contestable nature of the TSO has effectively guaranteed it a subsidised monopoly in these areas. Contestability, with a periodical need to re-tender, will expose it or any other TSO provider to the possibility of competition and force it to keep its technology up to date accordingly.

6l What TSO requirements should be added to prevent the deferral of investment for capability renewal by the Local service TSO provider?

None - see 6k.

6m Should a special fund be established for capability renewal of the networks supplying TSO local service?

No – see 6k.

6n Who (e.g. a corporate trustee) should be responsible for such a fund? Should it operate on an 'escrow' basis?

n/a

7a Should eligibility for TSO local telephone service be confined to purely residential use?

No – the TSO should also encompass voice services for business users or joint business/residential users – the provider of last resort test should apply without distinction.

7b What are the merits of establishing a 'hybrid telephone service option' for home business use where a business is co-sited with a household in residential premises?

Unable to comment at this time - see above.

7c Should the incremental revenue for such a new TSO local service be channelled into investment in rural network infrastructure?

No – see 6k.

7d What are the merits of applying such an option to all home business premises as opposed to confining the application to only those home business premises located in a rural area as defined by Statistics New Zealand rural definition?

No – see 6k.

7e Should the CPI price cap be retained for commercially non-viable areas?

TUANZ strongly opposes retaining the CPI-based price cap in anything like its current form. As the Discussion Document observes, this quirk of the TSO has allowed Telecom to increase its prices each year by around 25% more than its costs. Based on Telecom's "Homeline" price of \$43.60/month (\$523.20/year) this has the effect of a transfer of \$130.80 annually each by several million users to Telecom, over and above its reasonable costs.

The question of what Telecom should be allowed to charge in areas where it has a monopoly service, and how this might be enforced, should be referred to the Commerce Commission for investigation and recommendation.

7f Should the CPI price cap be retained for commercially viable areas where there is not yet full and effective competition?

See answer to 7e

7g Should the price cap for commercially viable areas be removed where there is full competition?

See answer to 7e

7h Should the retail charge for residential local telephone service continue to be capped through the Local service TSO deed?

See answer to 7e

7i Should retail prices be controlled outside the TSO framework through regulations made under the Telecommunication Act?

In general TUANZ does not support the concept of price control unless there is clear justification. However, such an option could be considered if prices over time, as identified in the Commerce Commission's regular monitoring, were to give cause for concern.

7j Should another policy mechanism be used to cap the price of residential telephone service?

See answer to 7i.

7k Do you agree with the factors listed for setting the retail price cap for local service? What is missing? What weight should be given to each?

See answer to 7i

7l Does the option of free local calling for residential customers present difficulties for development and growth of the broadband market?

If so, the issue will diminish over time as the incremental benefits of broadband over dial-up become more apparent to customers.

7m Should retail line rentals for local telephone service be aligned with the degree of geographic de-averaging applied for pricing regulated wholesale services?

No. The broadband market is outside the scope of the TSO. TUANZ supports the rationale of the Commerce Commission in de-averaging the prices for regulated wholesale services, but the same issues do not apply to the voice market.

7n Should prices for local telephone service supplied in rural areas be rebalanced (to align prices closer to cost) more aggressively than the rate of CPI change?

Unable to answer in the time available.

7o How should any detrimental impact on the consumer affordability of local service due to price de-averaging be addressed?

n/a

7p Should the upfront charges for establishing telephone access connections be covered by the TSO requirements?

No – the TSO mechanism over time should be reduced and not increased. Generally upfront charges should be covered by property developers as is the case with other utility services.

8a Should the gatekeeper role be performed by a government or non-government organisation and why?

TUANZ has no evidence to support a change at this time and recommends that in view of the magnitude of other changes in the industry the status quo be left in place for the moment.

8b Should the gatekeeper role continue to be performed under the Local Service TSO or be a new TSO instrument?

n/a

8c Should all providers of telephone service in New Zealand be required to establish and maintain capability to identify caller location for emergency calls sourced by their subscribers?

If “all providers of telephone service” includes mobile providers, then clearly they neither do nor can.

As mobile calls overtake fixed calls to emergency services, TUANZ believes the issue of CLI is a matter of public education rather than regulation. The public should be advised that when they call emergency services, whether on a fixed line or a mobile, they should always give their current location.

8d How should requirements for call information be phased in? Should they apply equally to both legacy telephone networks and next generation telephone networks?

n/a

8e Should the cost for establishing and maintaining call information capability for public telephone networks in New Zealand be borne by the carriers operating those networks?

n/a

8f How should minimum standards be set for the supply of call information? By invoking reserve regulation making powers and/or by an industry code of practice?

n/a

8g Should requirements for the quality and reliability of emergency call services be prescribed to apply uniformly across the telecommunications industry (TSO service and non-TSO service)?

Supply of backup power should not be the responsibility of the industry. Service providers should be subject to a minimum set of customer information standards when converting customers to IP phones, specifically covering the desirability of backup power and the need to give location details when calling emergency services. Placing responsibility on service providers would not be effective – although they could conceivably be required to provide battery backup facilities they could hardly be charged with ensuring customers were keeping batteries charged.

8h Should the requirements for conveyance of emergency calls be prescribed through regulations under the Telecommunications Act, through an enforceable industry code of practice, or a combination of both?

TUANZ strongly prefers a voluntary code made by the TCF with government monitoring.

8i Should all telephone service providers in New Zealand (including those facilitating telephone calling through Internet access) be required to offer their subscribers the ability to make emergency calls?

Yes.

8j Should access lines be kept in an active state after service is relinquished to enable lifeline calls to be made?

No, not by regulation although if service providers choose to do this on a case by case basis that should be encouraged. Regulating this would introduce huge distortions and inefficiency for the sake of a very small proportion of the population, and potentially lead to calls for the boundaries of “lifeline calls” to expand. If service is relinquished for any reason and the subscriber is left with no other means of calling for help, this should be a matter for the welfare system to address.

8k Should the supply of such lifeline connection be compulsory for all operators of public fixed telephone networks, irrespective of whether telephone access is by an analogue line or a VoIP bitstream on a digital line?

n/a

8l Should this requirement be applicable to only cable (wire or fibre) fixed lines that reticulate dwellings and premises?

n/a

9a Taking into account likely broadband user requirements in 3-5 years time, what do you consider will be the key broadband applications (e.g. email, web browsing etc) for businesses and households?

TUANZ supports ubiquitous availability of broadband services as fast as possible, but does not support the TSO as a means to deliver these. Therefore we are not answering the questions in this section.

9b To what extent do you consider that the market will meet the broadband needs of rural users (including availability and affordability) in the next five years?

See answer to 9a

9c Do you consider there is a case for subsidy mechanisms to fund upgrading of rural broadband infrastructure, and if so, what mechanisms should or should not be considered, and why?

See answer to 9a

9d What role do you think the TSO framework should have in accelerating the uptake of broadband access for New Zealand homes?

None. The TSO is about a voice service provider of last resort. Broadband issues should be dealt with through different policies including an actively promoted and supported Digital Strategy.

9e How are these rules above for considering a broadband USO relevant to New Zealand?

See answer to 9a

9f Are there other factors that need to be considered for a Broadband TSO?

See answer to 9a

9g Should for the TSO Provider for any broadband TSO be selected on a contestable basis?

See answer to 9a

9h Do you agree with these suggested guiding principles?

See answer to 9a

9i Are there other factors which need to be consideration in shaping TSO requirements?

See answer to 9a

10a Should the Commerce Commission retain responsibility for calculating the TSO charges for TSO instruments containing charging rates of specified amount?

TUANZ supports the Commerce Commission as the correct body to administer matters related to the TSO and make calculations of this kind.

10b What type of organisations should be considered to perform such a role going forward?

Commerce Commission.

10c Should responsibility for making TSO determinations which calculate TSO charges of specified amount be separated from the Commerce Commission?

No.

10d Should responsibility for allocating TSO charges over the industry be separated from the Commerce Commission?

No.

10e Does a trust fund arrangement have merit? Who would be appropriate to operate such a trust fund?

No.

10f Should an interim TSO levy be applied for compensating TSO Providers in advance of reconciliation and final payments?

See answer to 6a.

10g Should such an interim payment arrangement for TSO levies be on a similar basis to the industry levy for recovering the Commerce Commission telecommunications regulatory cost?

n/a

10h Should a standard practice apply for extending the duration of TSO instruments?

Contestability should be subject to a review cycle based on recommendations from the TCF (see answer to 6h. Any new TSO instrument should be subject to frequent reviews.

10i Should TSO instruments automatically expire after a specific period?

They should not necessarily expire, but should be subject to review with a defined periodicity.

10j How frequently should TSO instruments be reviewed?

More frequently than every five years, but less frequently than every two years.

10k Should a single organisational unit of Telecom have accountability for all TSO functions?

Unable to comment due to the time available.

10l How should responsibility for the various TSO functions identified be allocated across the Telecom Group?

Unable to comment due to the time available.

10m How should costs and revenues for TSO service requirements, which Telecom fulfils as TSO Provider, be allocated across the Telecom Group?

Unable to comment due to the time available.

10n How should the cost of TSO levies paid by the Telecom Group be allocated across Telecom business units?

Unable to comment due to the time available.

10o Should provision be made in the TSO regulatory framework for establishing a "Standard TSO Instrument" to save multiple determinations against the same general TSO terms and conditions

Unable to comment due to the time available.

Ernie Newman
Chief Executive
14 October 2007