



Kordia Group Submission to Ministry of Economic Development

Discussion Document

Telecommunications Service Obligations Regulatory Framework

August 2007

15 October 2007

Introduction

1. Kordia Group Limited (*Kordia*) thanks the Ministry of Economic Development (*Ministry*) for its invitation to provide submissions on the key questions raised in the Telecommunications Service Obligations Regulatory Framework (Discussion Document).

2. Kordia's contact person for the purpose of this submission is:

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3. The KSO/TSO framework has been a part of the NZ regulatory environment for the last 17 years and it is therefore timely that it is reviewed. The review of the TSO regulatory framework is however an important and complex exercise and should include appropriate cost benefit analysis of the many options that are available, including whether the framework needs to be expanded to address broadband uptake concerns.

4. Kordia considers that the matters contained in the Discussion Document are varied and complex and deserve appropriate time for consideration and we are therefore concerned with the limited time that the industry was given to respond. We also note that it is likely that the Ministry will receive a range of options to consider in the submissions, which will require careful analysis.

5. The TSO matters under review have significant impact on investment and competition. To assist the discussion and debate, Kordia commissioned Covec Ltd to write a paper, "Response to TSO Discussion Paper 15 October 2007" (*"the Covec paper"*) which is provided separately. This paper addresses some of the issues raised by the Ministry's Discussion Document and provides more detailed consideration of the key matters from an economics perspective.
6. Kordia supports and endorses the content in the TCF submission on the TSO regulatory framework discussion document. TCF members are in alignment on a number of key areas and the track record of the TCF in developing industry solutions bodes well for the TCF being the body to provide advice to the Minister and the Ministry on many of the issues in the Discussion Document.
7. Kordia's responses use the numbering of the relevant key questions as set out in the Discussion Document. References to paragraphs (para or paras) refer to the Discussion Document unless explicitly stated otherwise.

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?*
8. Kordia considers that the potential distortionary effects of the KSO/TSO framework as regards to investment incentives and competition make the KSO/TSO framework a very important component of the overall regulatory regime for telecommunications services. As such any review needs to be mindful of the impacts of the

TSO on the market and balance the potentially competing objectives of affordability and availability.

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?

9. Kordia notes that OECD reports clearly indicate that New Zealand has continued to under-perform in the provision of telecommunications and in developing a progressive approach to investment in infrastructure. This would suggest that the KSO/TSO framework may have failed to meet *some* of the government's objectives, in particular around the timely introduction of innovative telecommunications services. This again highlights the potentially competing nature of some of the objectives e.g. affordability and availability.

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

10. Kordia considers that there are more effective policy mechanisms to drive investment and to address affordability and some of these are outlined in the Covec paper.

11. In particular Kordia considers that with regard to the *availability* objective the government should look at how best to stimulate infrastructure investment via regulatory certainty, and ensure that national and local initiatives are co-ordinated to provide appropriate incentives for investment (and not provide disincentives). This area is explored in more detail in the Covec paper.

12. The government should also consider the role that the Resource Management Act and in particular the use of National Environmental Standards can have in investment in new telecommunications infrastructure.
13. Kordia also considers that the question of *affordability* for basic telecommunications services would be better addressed through the mechanisms of the welfare system, as is the case for example with health services via the community services card. This area is explored in more detail in the Covec paper (see pages 11-14).

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

14. The strengths of the current TSO are largely historic as they relate to the provision of basic voice services.
15. Weaknesses include its potential disincentive to investment and impact on competition, lack of transparency, retrospective nature leading to uncertainty and lack of targeting to those that can truly not afford the services.

Purpose and Market Impact of the Local Service TSO

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

16. Kordia considers that the local service TSO advances the interests of those consumers that are commercially non-viable, as they are avoiding paying what it really costs to provide the service. Kordia also considers that it is useful to have a minimum standard for the basic telephony service, but that the interests of consumers would be better advanced if this was technology and service provider neutral.

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

17. Kordia considers that there are better mechanisms for addressing the social policy objectives of availability and affordability, as highlighted in the Covec paper, in particular the introduction of the welfare system as the means for addressing affordability and the removal of the disincentive to invest provided by the price cap.

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

18. The future focus should be technology and provider neutral and confined to the minimum voice standards of service. It should enable contestability of service supply and be subject to regular review. The framework should be designed to ensure that it does not hinder investment and competition.

Availability of Service

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

19. The Local Service TSO addresses gaps in the commercial supply of basic telephony services. The issue is with the *effectiveness* and the *cost* of it as a mechanism and the changes suggested in this submission are intended to address the gaps in the performance of the TSO.

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

20. Yes. Kordia considers that the current Local Service TSO needs to be amended to recognise the changes that have occurred in the last 17

years. A key area, given the deployment of competing infrastructure, is the introduction of contestability of service provider and technology.

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

21. Kordia considers that a redrafted TSO for basic voice service should apply across NZ and be technology and service provider neutral.

Service Performance

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?

22. Kordia considers that the TCF is the best forum for the development of new technical standards.

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

23. These should be considered as part of the TCF review.

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

24. These should be considered as part of the TCF review.

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

25. These should be considered as part of the TCF review.

Service Reporting

- 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?*
26. Kordia supports the concerns expressed at para 108 where the Ministry notes that there is market concern over the lack of transparency of information about TSO service demand.
27. Kordia also believes that it is appropriate to request that Telecom become more accountable as to how that money is applied.
28. Kordia agrees with the position expressed at paras 107 and 108 that the public information which is subject to a high level of aggregation is not helpful in enabling the market to assess the viability of deploying infrastructure in "so called commercially non-viable areas". Further, Kordia agrees that greater transparency would provide better information for informed debate and increase opportunity to assess potential entry thus reducing the long term need of regulation in those areas.

Convergence and Transitioning of NGN

- 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?*
29. No it should not be required. Battery backups are only useful if they are maintained appropriately, which is the responsibility of the consumer. Today consumers choose cordless phones which will not

operate in a power failure. Consumer education is the way to deal with what to expect in case of a power failure..

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

30. Not applicable.

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?

31. Not applicable

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?

32. Yes as the TSO should be about basic voice services

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

33. Kordia has no comment at this time and considers the TCF the most appropriate industry body to work through the Next Generation Access local service implication.

TSO Charge of Unspecified Amount

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

34. Kordia considers that there needs to be further analysis of the Commercially Non Viable Customers and consideration of how they can be served by alternative technologies and suppliers.
35. Kordia also considers that there needs to be consideration of alternative options for funding a TSO. In particular the government should consider alternatives to the current industry taxation model, for example use of general taxation. Kordia refers the Ministry to the useful discussion at pages 14-16 of the Covec paper.
- 6b If the TSO charge is to remain an unspecified amount, should the prescribed methodology for calculating the TSO charge be changed?*
36. Yes as it should consider the outcomes of the contestability mechanism.

Uncontested TSO Charge of Specific Amount

- 6c Should a specified amount TSO charge be applied for the Local Service TSO?*
37. As above.
- 6d How should any such "specified amount" TSO charge be structured? Should there be fixed charge and variable charge components?*
38. No Comment.
- 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?*
39. Kordia considers that any adjustment should be cost based.

TSO Provider Bearing All TSO Cost – No TSO Charge

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

40. Kordia considers that the merits of continuing with a TSO charge and its final form will become apparent after the contestability work has been undertaken. It may become apparent that there are very few consumers left who are not covered by alternative service providers for voice service.

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

41. Kordia considers that when considering the merits and the risks, consideration has to be given to the effects on infrastructure investment and competition.

Contested TSO Charge of Specified Amount

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

42. Kordia strongly supports the notion of contestability for TSO subsidy funding outlined at para 142. Enabling contestability simply promotes ensuring that the TSO funding would be applied to the entity that is best able to utilise it for the greatest net benefit. The process of tendering would seem to be produce the most informed result, ensuring that this subsidy is not merely applied to Telecom who previously held an uncontested monopoly on this access (refer to para 133). Any contestability for the TSO should be subject to re tender after a reasonable period of time – e.g. five years to ensure that efficiencies were maintained.

43. This approach is consistent with a general regulatory persuasion to produce a technologically forward thinking approach. Kordia supports bullet point one at para 142 which describes the increased efficiency through the deployment of technology solutions with higher productivity than the Telecom wireline network.
44. Covec notes in its paper that the timing of the contestability process is important as we are about to see new market entry (see page 17).
45. Contestability should also reduce the cost of the TSO and therefore the imposition on funding provider, be it the industry or the government via general taxation.
- 6i Do you agree that contestability can only be expected to bring net benefits in areas which are commercially non-viable?*
46. No as benefits from contestability may go wider than areas which are commercially non viable e.g. new service provision in adjacent commercially viable areas.
47. Kordia submits that this is also an area that the TCF is able to report back on.
- 6j What form of contestability would best achieve the service objectives?*
48. Kordia supports a geographically based tender approach versus an auction as the tender process may be simpler. An auction process similar to the spectrum auction process with multiple rounds could also be used to aggregate areas.

Linking Compensation and Investment

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

49. Kordia agrees with the concerns expressed at para 144. The current lack of accountability and management of the TSO charge compensation arrangement enables exposure to investment avoidance.

50. Kordia considers that contestability for the TSO, with a requirement for re-tendering after a reasonable period of time – e.g. five years - will provide an incentive to invest.

51. Kordia also considers that the risks identified by the Ministry at para 143 can be managed via a carefully constructed tendering process which need not cost as much as the estimated costs of the Commerce Commission in undertaking the TSO calculations.

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

52. Contestability for the TSO, with a re-tendering process at regular intervals, will ensure that commercial competitive pressure is applied to the current service provider regarding the need to invest.

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

53. No.

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

54. Not applicable.

Eligibility for Service

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

55. Kordia submits that it is inappropriate for telecommunication service providers who contribute to the TSO fund to subsidise business telecommunication operations as this was not the intention of the TSO when it was originally established.

56. Kordia concurs with the sentiments expressed in para 157 by rural communities and submits that these areas could be more efficiently serviced by other methods than the current fixed telephone network service.

57. Home based business rentals are not only subsidised by the TSO contributions but also by the Government through the tax deductibility of it as an expense by Inland Revenue. This is a negative aspect of the TSO framework which should be amended.

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?*

58. The implementation of this aspect is not without numerous compliance difficulties and this should be considered after the contestability work has been undertaken.

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

59. No. Investment in rural network infrastructure will be driven via a contestability model, with appropriate review and re-tendering.

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?

60. It may be appropriate to distinguish home businesses from home businesses operating in a rural area, but this is an area that should only be considered after clarification of any amendments to the TSO framework that may already address this issue using another method.

Price Cap

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

61. No. As observed by the Ministry at paras 163-164, the CPI price cap has allowed Telecom to increase its prices every year and at a rate arguably higher than actual costs increases. This is a perverse outcome, contrary to the intention to enable re balancing of prices.

62. The CPI price cap also acts as a potential disincentive to investment in rural areas, where the costs to supply the service are greater than in urban areas. The outcome of the CPI cap is that prices do not align with cost, despite the annual increases.

63. Once the CPI price cap is removed, pricing will be set by market forces as has been seen in areas where Telecom faces competition today. The

Commerce Commission is also available to investigate pricing matters referred to it in areas where Telecom faces limited or no competition.

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

64. No. Kordia considers that the price cap should be removed to allow the market to set prices and for prices to rebalance to reflect the cost of supply.

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

65. Yes.

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

66. No. As discussed above Kordia's view is that the market should determine prices. The Commerce Commission is also available to investigate pricing matters referred to it in areas where Telecom faces limited or no competition.

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

67. No. Kordia considers that the Commerce Commission's processes are sufficient.

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

68. No. Kordia considers that the Commerce Commission's processes are sufficient.

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?

69. No. Kordia considers that the Commerce Commission's processes are sufficient.

Free Local Calling

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

70. Kordia considers that free local calling and the consequent impact on the dial up market is merely one factor in the development and growth of the broadband market. This effect will dissipate once the benefits of broadband become apparent to customers.

Price Rebalancing, De-averaging and Wholesale Services

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

71. Kordia supports the de-averaging of prices in the wholesale market to align with costs.

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?

72. Kordia supports the rebalancing of prices to better align with costs. The need or degree of this should be apparent after the tendering exercise is undertaken.

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

73. Kordia supports the use of the welfare system as the means to address issues of consumer affordability. Kordia refers the Ministry to the discussion of the impact in the Covec paper.

Upfront Subscription Charges

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

74. Kordia considers the upfront charge is currently a mechanism which has the potential for double cost recovery. Kordia supports transparency of the charging which is applied to consumers to ensure that the rental charge does not contain elements of the installation charge.

TSO Provider Gatekeeper Role

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

75. This is an area that could be addressed by a TCF review.

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

76. This is an area that could be addressed by a TCF review.

Emergency Call Information

77. Kordia considers that the following questions raised by the Ministry are best dealt with through the existing TCF Emergency Services Calling Working Party and public education programmes.
- 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?*
- 8d How should requirements for call information be phased in? Should they apply equally to both legacy telephone networks and next generation telephone networks?*
- 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?*
- 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?*

Availability of Emergency Call Service

- 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)?*
78. Kordia considers that there should be a minimum set of standards and that these should be developed by the TCF as part of the TCF Emergency Services Calling Working Party.

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?*

79. Kordia supports the TCF being the appropriate body to develop a code of practice.

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?*

80. Yes.

Lifeline Access

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

81. Kordia supports a non-regulated approach to this as it is an option that service providers have available to them. Consumers also have the alternative of mobile and wireless voice services as an alternative to the fixed access line.

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?*

82. Not it should be a matter of operator choice.

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

83. Not applicable.

Availability and Adoption of Rural Broadband

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?*

84. Kordia considers that key broadband applications and demand will develop in New Zealand in line with overseas experience and forecasts.

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?*

85. The market is best served by investment in future infrastructure which has lower maintenance costs such as terrestrial radio based services. As this infrastructure is put in place the expectation is that time and technology advancements will reduce the marginal costs of providing this service to rural users.

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?*

86. Kordia considers that this is a separate discussion from that of the TSO. In our view before considering the question of subsidies the Ministry has to look out over the next 3-5 years and consider future investment and whether there is any market failure. There should therefore be further work from the Ministry in analysing the investment that is to come via the LLU policy change, the availability

of spectrum at 3.5GHz for community initiatives, and the auctioning of spectrum at 2.3GHz and 2,5GHz which could be used for WiMAX services. This should occur before the Ministry considers the use of subsidies.

TSO Role in Improving Broadband Connectivity

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

87. Kordia does not consider that the TSO is the framework for accelerating the uptake of broadband services as it considers the TSO should be confined to basic voice services. The government has other mechanisms for addressing broadband access uptake as outlined in its digital strategy.

88. Kordia is also concerned with the potential for distortionary effects from the creation of a broadband TSO and notes the concerns that Covec raises in its paper around the introduction of broadband TSO (see the discussion at pages 19-27).

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

89. These appear sensible.

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

90. The government needs to consider the potential distortionary impact on investment, funding alternatives for the TSO, and use of the welfare system to address issues of affordability.

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

91. Should the government decide that a broadband TSO was required then Kordia supports the position that the broadband TSO Provider status must be selected on a contestable basis. Kordia reiterates arguments expressed at the response to question 6h above, that contestability will be fundamental to ensuring that consumers have access to services from the most efficient provider not merely the provider who was the historical incumbent. This is particularly relevant in the case of wireless technology as new entrants should be encouraged to make entry if they have a case for being the best most efficient service provider.

Design Principles for TSO Instruments

9h Do you agree with these suggested guiding principles?

92. No comment.

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

93. No comment.

Responsibility for TSO Change Determination

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

94. Kordia supports the Commerce Commission in this role.

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

95. Kordia supports the Commerce Commission in this role.

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

96. No.

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

97. No.

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

98. No comment.

Payment of TSO Levies by Liable Persons

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

99. Kordia considers that there needs to be certainty for both the provider and the Liable Persons as to the amount of the applicable levy. Accordingly any interim arrangement needs to take account of the need for this.

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?*

100. Kordia supports the view that interim payments could occur on a similar basis.

Extension, Expiry and Review of TSO Instruments

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

101. As stated above contestability of services should be subject to review and re-tendering.

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

102. TSO instruments should not automatically expire but be subject to review periods where expiry can only result when, and if, a suitable replacement instrument is established or until the market can efficiently self regulate.

10j *How frequently should TSO instruments be reviewed?*

103. Kordia suggests an initial period of 5 years, and notes that this is a matter the TCF should consider and report back on.

Accountability for Local Service TSO Compliance

104. Kordia considers that these matters should be considered after the review of the Telecom response to the Ministry's proposed operational separation model.

Standard TSO Instruments

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?*

105. Kordia concurs with the view expressed in para 259 that it would be desirable that particular TSO service requirements are met through appointing multiple TSO providers, each assigned a particular geographic territory. However, a standard TSO instrument is administratively tidy and it should be able to be adjusted with the consent of both the Crown and the provider where a commercial justification can be made for departure in the terms and conditions.

ENDS