



**NEW ZEALAND INSTITUTE FOR THE STUDY
OF COMPETITION AND REGULATION**

BROADBAND REGULATION AND GOVERNMENT INVESTMENT IN ULTRAFAST FIBRE BROADBAND NETWORKS: Evidence from New Zealand

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NEW ZEALAND: A MARKET TO WATCH?

Government-subsidised 'nationwide' FTTH network

- 75% of residences to have access to 100Mbps by 2018

Delivered by Public-Private Partnerships (PPPs)

- Government funds \$1.5b of \$4 to \$6 billion project
- 'capital recycling' model

Criterion for participating:

- full structural separation of network and retail operations
- including copper network if incumbent is a partner



EARLY SUCCESS?

“One of the rewarding things about our UFB programme has been the high levels of international praise for how our roll-out is progressing, particularly compared to some of the other international programmes”

Communications Minister Amy Adams, 8 August 2013

- 20% of network built
- but less than 3% uptake by premises passed
- “by comparison, in Singapore uptake was about 2 per cent when 20 per cent of the network was built and in the UK, uptake was about 3 per cent when 24 per cent of the network was built”



WHAT MS ADAMS DIDN'T SAY

An industry in near complete disarray

- impasse as draft regulatory decision on future copper access price (proposed 30% decrease for unbundled bitstream) threatens business case for fibre investment
- collapse in the share price of (separated) copper incumbent Chorus
- international capital flight from Chorus (from 70% to around 40% of shareholding in less than five months)
- threatened government override of regulatory decision
- consumer (and voter) backlash at denial of (possible) lower copper prices if government intervention occurs



HOW DID THIS COME ABOUT?

2008 election

- Government fibre investment a key plank of (then) opposition policy

Rationale for government intervention

- ‘missing market’ for investment?
 - 2007 NGN undertaking between Chorus and Government
 - all communities with 500 or more lines would have access to 20Mbps by December 2011
- keeping up with the neighbours?
 - 2007 Australian election – incoming government pledged substantial investment in telecommunications



‘JUST BUILD THE NETWORK’

No clear competition policy intention articulated for building fibre network

- to accelerate infrastructure competition?
- to accelerate substitution of copper with fibre access?

No coherent regulatory framework to govern industry

- Telecommunications Commission to regulate copper network to promote competition on copper (with no reference to Fibre market developments)
- Crown Fibre Holdings to use contractual undertakings with fibre partners to regulate fibre market



REGULATORY SILOS: FIBRE

“Crown Fibre Holdings monitors compliance with the terms of the Ultra-Fast Broadband Initiative while the network is being built. This includes oversight of price caps, products, network construction and operation (especially quality assurance testing), as well as the Government’s investment in shares, financial instruments and governance.”

» <http://www.crownfibre.govt.nz/publications/regulatory/>

“The Commerce Commission monitors and enforces the deeds of undertakings made by the government’s Ultra-Fast Broadband partners, as well as other aspects of the Telecommunications Act 2001”

» Ibid



REGULATORY SILOS: COPPER

“We have no statutory role in promoting or protecting fibre,” says Gale. “Our task in this larger project is just to fix the price of copper-based services. Retail service providers will then compete on whatever network they find most profitable.”

Telecommunications Commissioner

- » <http://computerworld.co.nz/news.nsf/news/new-wholesale-price-for-access-to-copper-network>



LETTING THE PPP CONTRACTS

Bid prices based on equalised copper and fibre prices for equivalent services when bids called in early 2010

Non-Chorus bidders

- no existing market participant apart from the incumbent bid
- price bid unequivocally subsidised network build cost only

Chorus

- bid price will include compensation for regulatory takings for forced early closure of copper network as a consequence of government fibre investment, plus build costs
- will differ depending upon how much of the addressable market Chorus expects to get contracts for

‘AND BUILD IT AS CHEAPLY AS POSSIBLE’

Chorus had absolute cost advantage (FTTx network)

Crown Fibre let contracts in two stages to ensure Chorus ‘sharpened its pencil’

- substantial share of contracts (18%) let pre-emptively early to non-Chorus bidder to signal willingness to strand Chorus FTTx investments if tendered price not ‘right’
- but led to incoherent competitive outcome, e.g.
 - Chorus got contract for fibre in Auckland (population 1.5 million) => no infrastructure competition between copper and fibre
 - WEL networks got contract for Hawera (population 11,500) => inevitable indefinite copper-fibre infrastructure competition
 - Chorus did NOT get the contract for Christchurch => post-earthquake rebuild has Chorus reinstating copper connections

THE COMPETITIVE REALITY

At least 6 different market structures

- areas where government fibre will not be deployed (30% of market) – copper must endure indefinitely
 - with and without other effectively competitive infrastructure (satellite, LTE, etc)
- fibre areas (70% of market)
 - Chorus supplies copper and fibre => short term infrastructure competition, cut rapid substitution and decommissioning copper (70% of the fibre market, 50% of broadband market)
 - Chorus supplies copper and competitor supplies fibre => enduring infrastructure competition
- both of above, with and without infrastructure competition (cable, rival fibre, LTE etc)



REGULATORY RIGIDITY

Changes to Regulatory framework enacted June 2011

- sole change to address structural separation
 - new pricing method needed for retail-minus priced products
- one single nationwide price for all Chorus copper connections

No change made to govern either

- inevitable infrastructure competition
 - in the interim in the areas where Chorus provides both networks
 - in the long run, where Chorus copper competes with non-Chorus fibre
- incentives for ongoing ‘ladder of investment’ in the 30% of the market where fibre would not be deployed



ONE COPPER PRICE TO RULE THEM ALL?

Which of the six markets is the single price set to calibrate?

- one single nationwide copper price will be ‘wrong’ for at least 5 of the 6 markets

December 3 2012

- Commission proposes internationally-benchmarked copper access price
 - 30% lower than 2010 prices used when setting fibre bids
 - unilateral breach of good faith w.r.t. PPP contracts
 - will delay fibre uptake rate => non-Chorus firms will not meet rollout targets as capital will not ‘recycle’ as fast as expected
 - devalues Chorus’ compensation for ‘regulatory takings’



GOVERNMENT BREACHED PPP TERMS

Chorus, other investors legitimately believed the government would not allow copper prices to deviate from early 2010 levels

Regulator's actions have led to government breaching PPP agreements

Government could have intervened immediately

- threatened, but no action until February 8 2013
- ‘action’ turned out to be ‘inaction’
 - a regulatory review, which was not begun until August 2013
- result was collapse in Chorus share price, foreign capital flight
 - investing in NZ ‘too hard/too risky’
 - Government ‘can’t be trusted’



PROPOSED 'REVIEW SOLUTION'

Set (single, nationwide) copper price using 2010 fibre bid price as the cost of an equivalent modern network as per TSLRIC

But which fibre price?

Chorus price (including compensation for early closure)?

- 'wrong' price for non-Chorus fibre areas (too high)

Non-Chorus price

- 'wrong' price for Chorus fibre areas (too low)

Any fibre price

- 'wrong' for non-fibre areas as crowds out entrant copper investment incentives



WHAT CAN BE DONE NOW?

More patching of 'bad existing regulation' not an option

- must start with a clean slate
- governing today's markets, not yesterday's or 'tomorrow's'
- but forward-looking so adaptable to changing circumstances

Separate geographic markets regulated according to current competitive realities

- incentives to achieve government policy objectives can be calibrated differently for different competitive environments

Government buyout of all private investments so taxpayers, not investors, bear risks of (poor) government policy-making (the 'Australian' solution)???

WHAT CAN EUROPE LEARN?

State Aid rules make an NZ-type outcome less likely

- but any state subsidy alters incentives

Any State investment must be addressing a specific market ‘problem’

- clarity of objective, ensuring consistency of competitive interaction and policy objectives are non-negotiable’
 - investing just to ‘get a fibre network’ is not sufficient

When regulating for infrastructure competition

- separate geographic markets are unavoidable if appropriate incentives are to be applied across all networks and all operators



WHAT CAN EUROPE LEARN (cont)?

Path dependency influences regulatory frameworks

- risk of ‘frame blindness’ must be overcome

Regulators are ultimate custodians of sector strategy

- may be strongly influenced by integrated incumbent firms
- structural separation disincentivises sector participants from taking responsibility for sector strategy
 - missing market for co-ordination
 - increases responsibility for regulators, policy-makers for determining direction

Beware of doing deals with governments!



THANK YOU



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