



BROADBAND INVESTMENT FUNDS: DRAFT
CRITERIA AND PROPOSED PROCESS FOR
CONSULTATION

JUNE 2008



SUBMITTER'S DETAILS

Name: Susie Stone

Position: General Manager Strategic Development

Organisation: Kordia Group

Email address: susie.stone@kordia.co.nz

Postal address: PO BOX 2495 Auckland



Table of Contents

1.0 Executive Summary4
2.0 Question Response Form5

1.0 EXECUTIVE SUMMARY – QUESTION RESPONSE FORM

Kordia welcomes the BIF funding initiative, and proposes some additions in this submission, including:

- We firmly support the demand-side initiatives noted in the Paper, and would encourage Government to extend those initiatives, including into the private sector.
- Kordia also submits that Government should undertake a detailed analysis of supply and demand, rather than leaving that to the providers, to the degree proposed.
- The issues noted above are on the critical path and should take priority over the next few months. Government can achieve strong and early gains in this way.
- The timelines (such as for providing an expression of interest and then down-selection of providers) are too tight given the need in our view to do detailed analysis of supply and demand, and therefore create substantial risk of reduced or fatal BIF outcomes. The exception is the possibility, if probity requirements permit it, of fast-tracking approval of any well-understood and developed projects in the next few months.
- BIF is a lever which will have considerable impact in the market, with a risk of sub-optimal outcomes. Use of that lever should carefully take into account competition and investment objectives, and the criteria amended explicitly to require consideration of the wider economic goals, epitomised in the long term interests of the end user.
- The Rural funding for each project should not be capped, and the criteria should not be ranked in order of priority. If they are to be ranked, priority should be on long term not short term benefits.

2.0 Question Response Form

Questions on Urban Criteria

1. *Will the proposed timeframes provide Applicants with sufficient time to fully complete the application requirements?*

More time is needed

The proposed timeframes are insufficient by a substantial margin. At the end of this answer, we suggest an approach to optimise success of the BIF, over coming months.

The EoI proposal¹ requires, among other things:

- Likely levels of co-investment and support from local authorities and/or local providers.
- Projected demand scenarios and anticipated levels of usage (although these will be at preliminary level, this is a large and critical task, as we note below).
- An estimate of likely total project cost and funding sought.

Even on a no-commitment basis, where parties are providing indicative information, a one month time frame does not appear to be viable (and may well be met with requests for the sort of time extension the Australian Government has had to grant in the Australian Broadband Network RFP).

Rather than suggesting extending the period of the EoI phase, we have suggested below that the next few months focus should be on what we consider is the critical path: the demand-side and building information on both the supply and demand sides.

The time lines are also challenging in relation to the full application stage. Although the timeframes are longer, the complexity, multi-party issues, and the relativity between various projects, make the timetables at this stage difficult to achieve as well.

Early progress is desirable but not at the expense of poor or even fatal BIF outcomes.

Fast-track particular projects?

Phased funding over three years is anticipated. It is possible that one or more significant projects could move quickly through the selection process, possibly bypassing EoI. Assuming Government guidelines – such as those of the Auditor-General – can be met; Kordia is not opposed to fast tracking suitable projects. It would encourage this in appropriate circumstances (and if its concerns about demand side considerations are met).

It would be better to focus on getting a clearly meritorious project up and running in the next few months, where that can be “fast tracked”, rather than seeking to down-select to several proponents in October following the EoI round.

More information needed, and demand-side considerations

¹ MED paper page 15.

Kordia warmly welcomes Government's decision to focus on demand-side initiatives, particularly as set out under the heading, *Demand Aggregation*, at Page 6 of the BIF paper. We consider that even more development, analysis and, depending on that analysis, funding of demand-side initiatives, is important to achieve Government's policy objectives. This includes developing gap analyses to match demand, supply, and the needs of the economy. We suggest below that the focus in the first few months revolve around this aspect rather than getting the EOI decisions made by October, as that will produce the best outcomes. Getting the demand-side analysis and a gap analysis, underway is, we suggest, on the critical path ahead of the EOI.

The BIF initiative, including the RFP for suppliers and other Government policy material, should explicitly deal with these issues in more detail.

Seeking, by October, to down-select suppliers at the EOI stage is a target that we consider is not achievable without severe or fatal project risk. One reason is that decisions on funding of suppliers should not be made without a comprehensive understanding of the demand-side issues. That is – correctly – necessary for the EOI stage. So, this is not an issue that can be deferred. The requirement on suppliers to provide demand-side information in their proposals is not sufficient to meet strong BIF outcomes, as we outline below.

The strength, for Government, of demand side considerations is illustrated by the OECD's April 2008 report, *Developments in Fibre Technologies and Investment*:

For instance in Canada there is an idea to use broadband networks to achieve energy efficiency gains. The benefits from the projected energy efficiency might be enough to finance the network. Similar ideas have been voiced by local governments and housing corporations when investing in new networks. The benefits from having the elderly live at home a year longer, or to be able to monitor remotely patients who would otherwise be hospitalised might be enough to finance the network. To develop these ideas in practice is often hard, because the benefits and savings often materialise over years, whereas the investment is up front. However, the ideas do show that networks are platforms on which new applications and services can be built that offer higher benefits than are visible from just looking at the business model of the network.²

From the BIF paper, it is apparent that Government is already working on some of these issues (such as in the health sector). We expect that the Ministry is already addressing other demand-side issues, ranging from gap analysis (determining the match between available supply and demand) through to possible initiatives beyond the ones noted in the BIF paper. That might include, for example, support for ICT cluster development, which, in appropriate cases, would pull demand and meet wider objectives (such as the needs of regional economies). We suggest this approach is optimally developed and made publicly available.

Suppliers, when proposing at EOI and full application stage, are being asked to identify demand for their proposed services. We consider that this is insufficient for five main reasons:

1. Suppliers and other proponents, even the larger ones with substantial networks and information, cannot, from their own resources, adequately provide sufficient information on demand considerations and the match with supply (particularly when the wider issues identified in the next answer are taken into account).
2. It is more efficient, and enables a coordinated approach by Government, for the Ministry to develop comprehensive material to enable matching of demand and supply. As the highly regarded Connect Kentucky initiative shows, this does not have to be an unduly costly or time consuming process. As in Kentucky, outcomes for the economy can be well in excess of cost

² OECD report page 32

and time incurred. It is clear that New Zealand is already making real progress down this path. For example, there is the continued enhancement of SSC's GIS mapping project.

3. Taking into account the range of larger and smaller proposers, ultimately it will be less costly, in terms of time and money, for a well developed centralised resource to be provided.
4. Benefits of a centralised gap analysis extend beyond the BIF initiative.
5. There is a lot at stake. As well as the substantial spend on BIF, there are considerable risks for the economy in getting the decisions wrong. In answer to Urban Question 2, we note the criticality of the BIF investment meeting the twin – and related – objectives of fostering competition and encouraging investment. This is challenging. Well informed decision-making is important.

Recommendation: Government announces and implements a more comprehensive package on demand-side initiatives, beyond the work it is already doing. This could include, as well as the already announced public sector initiatives (and further announcements foreshadowed in the BIF paper), comprehensive analysis of (and implementation of, as appropriate):

1. Current and forecast infrastructure, gaps in the networks, and demand for services relative to that infrastructure.
2. In addition to public sector demand-side initiatives, private sector and economy-wide initiatives as well.

2. Are any amendments needed to the draft criteria to improve the outcome of the Urban Fund?

We consider that it is important to address the full intended proposal (much of which is foreshadowed in the *Broadband Investment Fund: Draft Criteria and Proposed Process* document ("the BIF Paper"). The weighted criteria are only part of the proposal.

Therefore, for example, we note that, in answering Urban Question 1, we have made a recommendation as to further demand and supply information, and supply side initiatives. We have a particular concern that the evaluation of proposals should explicitly take account of the related objectives of promoting competition and incentivising investment. This would drive consideration of proposals within a wider context.

Recommendation: We recommend that Government amends Para 6.2 of the BIF Paper by, for matters relevant to demonstration of a Project's benefits:

Adding: "*Promotion of competition, and incentives to invest, for the long-term benefit of end users.*"

Amending 6.2(d) to read: "*the degree to which the Network may impact on other infrastructure and services over that infrastructure*"

Government has a lever which can be expected to have considerable impact on the market. If the lever is used sub-optimally, it could have significant negative impacts on the economy. If the criteria are not carefully drafted, Government may have no choice but to make sub-optimal funding decisions.

This risk is recognised in Treasury's Memorandum of 29 February to the Minister of Finance. For example:

Treasury's view is that Telecom's commitment under operational separation to roll out faster Broadband to at least 80% of the population, along with the competitive response, as Treasury indicated by Vector's recent announcement of 300km of fibre in Auckland, means that Crown investment in urban fibre is not only unnecessary but will displace private sector investment.

Government is proposing to spend \$230M on urban infrastructure, the initial departmental recommendation having been \$75M.

While Treasury's views are said to be contentious, they highlight, along with the substantial proposed spend, the risk of significantly negative outcomes for the economy. The criteria should explicitly ensure that proposals are evaluated within a wider economic context.

The sector has seen major change this year, particularly with operational separation, LLU, and Telecom's cabinetisation. There has not been the opportunity to see whether these changes enable the urban challenges to be resolved commercially. That implies that there should be especial care when funding decisions are made that might impact on these developments. Obviously there is the risk that investment incentives will be unduly chilled, there will be stranded assets, and that competition, rather than being enhanced, will reduce.

An explicit LTBE objective is therefore important. It is not enough to have only the less directed criteria, such as (from Para 6):

- the provision of significant community benefits (which has overlaps with the LTBE objective);
- the degree to which the proposed network does not unnecessarily duplicate similar infrastructure; and
- the degree to which the proposed network can support a number of access technologies (this is wide enough to encourage provision of wider facilities based competition (for example, the new network could provide backhaul for MSANs and wireless base stations))

There should be specific and careful consideration of the impact of funded projects on current and proposed infrastructure and services (not just duplication of "similar infrastructure"). Hence the second suggested change.

To take a practical example, a fibre network could be funded which would also be suitable for a SME customer serviced by a DSL LLU provider, even though the new network is targeted at larger organisations. The LLU provider faces a subsidised competitor in the addressable market. If this is not handled carefully, investment incentive is chilled, there is the stranded asset risk for suppliers, and end-users ultimately do not get the competition from which they would benefit.

Treatment of NGN access is a major challenge throughout the world, and BIF funding is one facet. The issues in this funding environment are similar to issues of concern to regulators. On 25 June 2008, the European Regulators Group-via its incoming Chair- summarised the issues for NGN access, which apply equally to Government's use of funding levers in this situation:

- [European regulators are] committed to setting the right framework and rules to open options to LLU operators and avoid stranded investment at the MDF (neutral to business models and in line with the ladder of investment approach) and maintain [the] level of infrastructure competition reached with LLU.

- There is no contradiction between infrastructure and service competition, but the balance has to be reviewed in an NGA environment as economics of scale change...
- Ensure current state of competition is maintained in an NGA environment by adapting the regulation to deal with technological change while incentivising efficient investment in new infrastructure and avoid leveraging of SMP.

Recommendation: Amend the Section C definition of "Passive Infrastructure" to encompass high speed radio links

The BIF Paper envisages that there may be funded solutions other than fibre-based. The criteria should allow for this.

3. Should successful Applicants be prevented from offering Application Services across the supported broadband infrastructure?

No. Ideally, the open access nature of the projects would exclude suppliers also offering retail services. However, it is too restrictive to have funding limited to applicants who only wholesale and do not offer retail services across the funded infrastructure. "Open access" will need to be carefully established and controlled in those circumstances.

4. The draft urban criteria include absolute criteria and weighted criteria. Are there any absolute criteria that you consider are too onerous and should instead be classed as percentage weighted criteria?

No.

5. Do you agree with the percentage weightings in the urban criteria?

Yes.

6. What do you consider to be an appropriate level of applicant assistance (eg: a list of relevant experts, funding, case management)?

No. See in particular the answer to Urban Question 1 in relation to the need for more information.

7. Does the proposed timing raise any issues for your planning processes?

Yes. See the answer to question 1 above.

Questions on Rural Criteria

1. Do you agree with the proposed outcome of the Rural Fund?

Yes assuming that the criteria take into account the LTBE and investment issues identified in answering Urban Question 2.

2. Do you consider that there should be a secondary outcome that relates to improving rural voice services?

We recognise the challenges in meshing provision of improved rural voice services with this broadband initiative. However voice services should not be a "secondary outcome" or part of the evaluation criteria for funding of rural broadband services. This is a TSO issue.

3. Given the significant cost increases to deploy high-speed broadband in rural and remote areas and the better potential coverage that may be provided at a lower cost but also at lower speeds (including potentially by wireless rather than fibre) should the rural criteria be set at a lower speed than urban?

Yes.

4. Do you think that mobile/wireless solutions would provide the required level of broadband service?

Yes, in the right circumstances. All potential solutions should be available for consideration.

5. Do you agree that rural applicants should be required to offer open access to their infrastructure, bearer and/or application services?

Yes.

6. The rural criteria do not specify percentage weightings but rather are ranked in order of priority. This has been proposed in order to retain the greater level of flexibility that is required in rural areas. Do you consider that percentage weightings should be specified at the expense of flexibility?

Kordia agrees that there should not be percentage weightings for rural areas in view of the need for a greater level of flexibility.

However, ranking the rural criteria in order of priority has the effect of setting weightings, by a different path. This raises two concerns:

1. The level of flexibility should be such that there should be no order of priority. It is not necessary or desirable to prioritise the rural criteria.
2. The proposed choice of ranking creates the wrong incentives and the wrong outcomes. If the priority is to be retained, the order of priority should be changed. To illustrate the problem, C1 to C3 have higher priority than C4 to C6. This means that what appear to be the most important criteria (the long term criteria, focussed on community benefits) rank behind (a) short term priorities (eg; C2: ability to complete project build on time within budget, etc) and (b) the level of funding). More significant, in particular, is C4: the extent of estimated community benefits. Long-term benefits are significantly more important than completion of the project build on time and within budget.

As identified in answer to Urban Question 2, the criteria for Rural should include the LTBE and investment objectives.

7. Consideration is being given to limiting interim seed funding for a rural project to a maximum of \$500,000, with a proviso that neighbouring communities would be permitted to apply for a greater funding amount where a combined solution leads to a lower overall cost per new broadband access connection. Do you agree with this approach?

Limiting funding to \$500,000 could mean that otherwise excellent projects do not meet the requirements. Consistent with the flexible approach to rural funding, it is suggested that this cap is deleted. All reasonable options for rural should be considered to increase the prospect of successful



outcomes. It is generally recognised that NGN Access is about scale, and that will also apply, although to a lesser extent, rurally as well.

8. What do you consider to be an appropriate level of applicant assistance (eg: list of relevant experts, funding, case management)?

See in particular the answer to Urban Question 1 in relation to the need for more information.

9. Will the proposed timeline provide applicants with sufficient time to fully complete the application requirements?

No, for the reasons identified in answering Urban Question 1.

10. Does the proposed timing raise any issues for your planning processes?

Yes, for the reasons identified in answering Urban Question 1.

ENDS