Orcon presentation to the

Hon. David Cunliffe

For:
Hon. David Cunliffe,
Minister of IT & Communications,
New Zealand Government

From:
Scott Bartlett,
General Manager – Operations and Regulatory

- Orcon Internet Ltd

Orcon facts

- Number 4 ISP in New Zealand, and largest 100% kiwi owned
- Operating since 1997
- XX dial-up users
- XX broadband users
- 85 staff

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Our vision for broadband in New Zealand

Orcon shares the same vision for broadband in New Zealand as a number of industry players and user groups. We would like to see a true broadband network with unconstrained performance and service levels, which allows service providers to retail quality broadband products at affordable prices.

In order to achieve this vision the market requires competition and market equality for wholesalers, network builders and content providers. At this stage, the primary force holding back this vision is Telecom. If Telecom were providing a true wholesale BitStream product without any imposed limitations, and network builders were provided access to the local loop; it is Orcon's belief New Zealand would be able to catch-up to the rest of the developed world within a relatively short time-frame. The current situation does not permit this to occur.

The guiding vision needs to be world class broadband for kiwis and kiwi businesses. Orcon is committed to being there to provide this service, when, and if the, Government steps in to force Telecom to permit this vision.

The Telecom wholesale environment

The current situation with UBS

As the first ISP to start offering the UBS product, Orcon has always been a strong leader in providing the BitStream product to consumers. Our efforts to assist Telecom in wholesale broadband uptake resulted in us investing $1.3 Million in advertising; a significant investment that has severely inhibited our growth ability in other areas. We are preparing to market the new 3.5M product, and have already had considerable interest from the public since *Xtra* launched its retail offering before any wholesale providers had signed up. We do however have two primary concerns with the offering, and would like the share those with you.

1) Port pricing vs. reference pricing

As per our current arrangements, wholesale port prices are meant to decrease proportionally as Telecoms retail prices alter. So when we saw Telecom reduce the cost of its 256K product to $29.95 (a 25% reduction), we expected to see a 25% reduction in wholesale port prices. This has not happened…

It should also be noted that with Xtra now in the market at $29.95 for a 256/128 product, our ability to compete in any way is severely limited, and will result in abysmal uptake of broadband by wholesale providers. We recognize that the best way to counteract this is through an advertising campaign, however in order to afford the media exposure required to ensure a 1/3 of customers are wholesale, margin needs to be there so we can afford it, this is not the situation.

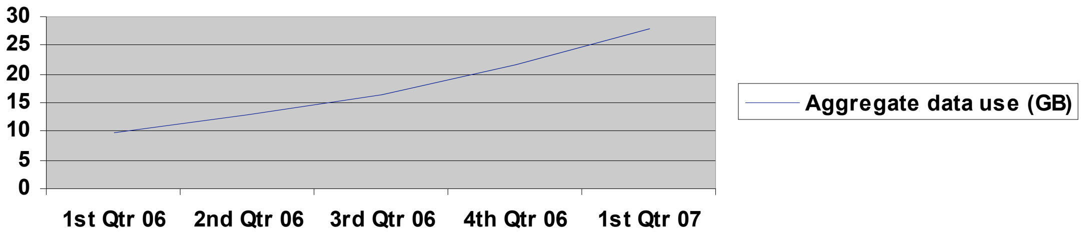
Following on from our comments on margin, the next section will deal with the UBR backhaul costs and how they erode any gains Telecoms proposed pricing gives on the surface.

We are also aware that it incurs Telecom no additional cost to provide the 3584/512 product, but it charges a whopping $55 per wholesale port, as opposed to $30 for the 3584/128 ports.

2) UBR backhaul caps & pricing

Orcon was very concerned to see that the aggregate backhaul data-cap has been lowered to 4GB per user from 10GB per user, with overage charges of $0.50. On our estimated current aggregate usage (Telecom figures of 9.8GB) this represents a cost increase of $3 per user or $XX per month; a significant increase that will hit our bottom line hard. Orcon has built its business model on the 10GB aggregate cap that Telecom put in place 18 months ago. This arbitrary change will result in much lower data caps and higher excess charges on wholesale ISP's plans. This scenario gets worse when we start looking at projected future aggregate usage based on the implementation of the new 3584/128 and 3584/512 products. Based on Xtra's plans and our own experience, we expect to see aggregate UBR usage increase 30% per quarter over the terms of this new deal.

Telecom is again changing the rules to make things harder for ISP's to compete with Xtra. The pricing and UBR changes will now result in Xtra getting a significantly higher market share, as ISP's are now limited in their ability to differentiate and make a margin.



We feel these projections are in keeping with Telecoms thoughts, as Xtra have released both 20GB and 40GB plans into the marketplace.

Our customer base is not the entry level, mum and dad users that Xtra has. As a niche player in the market, our customers tend to be a bit more tech savvy, have a business focus, or have made a data related decision in their purchase. We have also based our business plan moving forward for broadband around having a 10GB aggregate cap, and we suspect that Ihug and CallPlus are in the same situation. Obviously a move away from 10GB towards a model some 60% lower data allowances would have a negative impact on our business model, and result in decreased data caps for consumers. The best example of this is Orcon has been the only ISP in New Zealand providing no data caps or excess charges on 256k broadband plans; we now have no choice but to remove this product.

Based on these projections, and assuming no increase in our own customer base, Orcon would have a monthly UBR cost of over $8.75 per user, or $XX per month at the end of this deal.

Even after we take into consideration the decrease in port prices, the net result is an increase in our current costs, at a time when Xtra enters our pricing point, Ihug and CallPlus are ramping up advertising in the marketplace and our dial-up customer base starts to erode. Unlike Telecom, CallPlus, Telstra-Clear and Ihug; Orcon does not have foreign owners with deep pockets of cash; or the toll revenues to subsidize broadband, the net effect being that smaller providers will go under, limiting the choice for consumers. We are a kiwi owned business that is still operated by its entrepreneurial 29 year old owner.

Investment

It is our intention to invest heavily in the NZ Telecommunications market, given the appropriate environment. This investment will include the following:

- Significant investment in DSLAMS and related LLU technologies. Initially in Auckland, but a nationwide rollout will follow given appropriate customer density (in conjunction with other LLU players). At this stage however, Orcon does not have the required margins on our existing products to afford the capital requirements of installing enough DSLAMS to cover our Auckland customer base.
- On-going investment in the latest SPAM, VIRUS, ADWARE and filtering protection technologies.
- Investment in wireless technologies for the delivery of both data and voice; both WIFI and WiMAX.
- Investment in VoIP hardware and software to lower the cost of calling for the NZ public and businesses.

- Investment in online website business ventures to realize the full potential of broadband in NZ; including media portals, community forums, video delivery, voice services etc.

Opportunities for change

Orcon is encouraged by the Ministers current review of the telecommunications space in New Zealand. Orcon sees a number of different options available to the minister for recommendation to cabinet; please allow us to summarize these in no particular order:

- Local Loop Unbundling
- Legislative changes to permit unconstrained unbundled BitStream
- Forced changes in Telecoms retail product range
- Changes to the telecommunications act to allow the minister to accept or reject parts of a determination
- Naked DSL
- Forced changes to UBS service levels; i.e. SIR, Interleaving, Jitter, Latency etc

Concluding comments

It is during rare times that a kiwi business has to go to its representative minister and ask for assistance in its industry. We accept that there are hard times, and that some businesses are casualties of fierce competition; however given the current market situation in telecommunications and internet service, Orcon felt it had no choice but to raise the issue with the Minister of IT & Communications. We ask that the minister consider improving the industry to allow businesses like Orcon to compete on a level playing field.

Lastly, Orcon would also like to recommend a continued dialogue with the minister's office and the Ministry of Economic Development. This can only help us understand each others positions on regulatory and industry matters.

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