VODAFONE NEW ZEALAND LIMITED SUBMISSION TO THE COMMERCE COMMISSION

Vodafone New Zealand Submission on the Discussion Paper "A Guide to Regulatory Decision Making by the Commerce Commission for the Telecommunications Sector" dated 31 July 2009

2 October 2009

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Executive Summary

1. Vodafone welcomes the opportunity to provide a submission in response to the Discussion Paper "A Guide to Regulatory Decision Making by the Commerce Commission for the Telecommunications Sector" dated 31 July 2009 (the Guide). We note that the Guide is to expand on, and replace, the 2002 "Guide to the Role of the Commerce Commission in making Access Determinations under the Telecommunications Act 2001".

2. The purpose of the Guide is to provide greater clarity on how the Commerce Commission (Commission) discharges its powers and functions under the Act.

3. As both an access provider and an access seeker, Vodafone is particularly encouraged that the Commission has acknowledged the need for regulatory certainty, and incentives to invest and innovate as we go forward.[1] These are critical issues from Vodafone's point of view.

4. Vodafone also recognises the dedication and commitment of the Commission and its staff, and its genuine desire to achieve outcomes for the long-term benefit of consumers. While we may not always agree with the position the Commission takes on all issues, or the processes it follows in making such decisions, we do respect its integrity and value our relationship with it.

5. Vodafone relies on its recent experience in investigations with the Commission, particularly the ongoing Schedule 3 Mobile Termination Access Services (MTAS) Investigation, to provide a context for approaching a number of the matters raised in the Guide. Vodafone has used these experiences to inform and comment on the principles set out in the Guide, and to provide concrete examples to illustrate where Vodafone considers the Commission has adhered to those principles. We have also provided examples where we believe in practice the Commission has departed from or not followed those principles. We hope the Commission appreciates this response, and we encourage the Commission to consider practical application of the principles, with a view to ensuring that the Guide is not simply paying 'lip service' to those well worn phrases that underpin the telecommunications regulatory framework in New Zealand.

6. There is significant value to the Commission and all industry players in investing the time to establish a Guide such as this, since it enables parties to carry out a 'stock take' of the approach of the Commission and to consider the entire telecommunications regulatory framework in a broader sense.

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[1] Commerce Commission, *A Guide to Regulatory Decision Making by the Commerce Commission for the Telecommunications Sector Discussion Paper* 31 July 2009, page 5, paragraph 3.

7. We believe the Commission should be guided in all decisions by the following principles:

- Promotion of regulatory certainty: The Commission acknowledges that undertakings can promote market certainty. Certainty is particularly important for a regulated business: constantly changing regulatory settings can affect investment decisions and harm dynamic efficiency. Vodafone submits that the Guide should make it clear that preference will be accorded to undertakings, and the Commission should actively facilitate the use of undertakings as an alternative to regulation;

- Ensuring operators have incentives to invest and innovate: Vodafone supports a regulatory environment that creates necessary incentives for investment for the long-term benefit of end-users and leads to the creation of new and innovative products. Vodafone welcomes the Commission's statement that it is important to take account of investment incentives facing parties when exercising judgement in determining terms of access to regulated services. Vodafone urges the Commission to keep this objective paramount;

- A preference for commercial solutions to regulation: We welcome the Commission's preference for commercial solutions stated in the Guide. This is aligned with Vodafone's commitment to achieving commercially negotiated solutions in advance of, or in lieu of, regulation, with a view to providing better outcomes both for itself and for consumers than can be achieved under regulation; and

- Fair process: Fair process is essential to an effective regulatory framework. In considering our experience of the Commission's process, we welcome a number of the Commission's approaches, but we also include some process issues that could be improved upon and general recommendations for fair process, in respect of consistent processes, legitimate expectation, natural justice and fair timeframes.

1. Introduction

8. Vodafone welcomes the opportunity to provide a submission in response to the Guide.

9. Our submission is structured to respond to the matters raised in the Guide in the order those matters are addressed in the Guide:

- Section two Sector Overview: we have few comments on this chapter of the Guide which provides an overview of the industry and New Zealand telecommunications markets;

- Section three Legislative Framework: in this section we comment on issues of fair process, providing some areas that the Commission could improve upon, and some general recommendations. We comment on Schedule 3 investigations and undertakings, and suggest that the Commission should emphasise the importance of regulatory certainty to operators in its decision making. We also make general comments on the operational separation of Telecom, enforcement issues, sector monitoring, and other relevant legislation which can impact on telecommunications markets;

- Section four Economic Principles: this section considers the economic principles the Commission sets out at chapter four of the Guide. Vodafone agrees with the Commission's approach that it will give greater weight to the promotion of long term dynamic efficiency over short-term allocative efficiency; and comments on the importance of a regulatory environment which supports investment incentives and innovation; and

- Section five Decision Making: this section considers the factors and considerations the Commission takes into account when making decisions. Vodafone notes the importance of commercial agreements as an alternative to regulation, and provides comments on the Commission's approach to assessment of the potential impact of regulation, noting that there needs to be sizeable net benefits for end users arising out of regulation compared to any counterfactuals (which should include any commercial agreements reached). Vodafone comments on pricing principles and applauds the Commission's acknowledgment that the importance of a robust benchmarking exercise can not be underestimated. Finally, Vodafone provides some high level comments on merits review for the Commission's consideration.

10. Vodafone has provided its views in this submission within the time made available to do so. The fact that Vodafone has remained silent on an issue should not be interpreted as acceptance by Vodafone of the point put forward by the Commission. Vodafone may still hold views on any

matter raised in the Guide which is not specifically addressed in this submission.

2. Sector Overview

11. We note that the Commission appears to be summarising the existing law and industry in chapter two, and provides little analysis or guidance. Accordingly, we have few comments on this chapter of the Guide.

Industry Characteristics (paragraphs 24 – 41)

Sunk investments (paragraphs 26 – 29)

12. We think the use of the word "incumbent" in the context of sunk investments carries with it certain negative implications which are problematic for the Commission in carrying out its role. That a firm has made sunk investments in capital-intensive infrastructure does not necessarily mean such investment will generate excessive profit. Many of our capital investments in the technology and infrastructure necessary to provide services do not generate a normal return. The Commission must therefore take care not to automatically rely on traditional models of natural monopoly that may have applied well for investments made by former government owned and operated utilities when considering issues around investments in new telecommunications technology by private sector investors. In this context, we would be concerned if our investments in 3G and LTE technology are treated in the same way as previous investments made in traditional fixed-line infrastructure simply because we have operated in the market since the late 1990s. Each investment – irrespective of whether it involves large-scale capital intensive investment – must be considered on its own terms.

13. In this context, when does a "new entrant" become an "incumbent"? A risk taking new entrant will not become a rent seeking incumbent overnight. The term "existing operator" is in our view more accurate in this context. With infrastructure investment there may well be a period during which returns are sub-optimal, followed by a period when returns may improve. On average, over the life of the asset, the returns may well be "normal" and acceptable. We think it is important when the Commission is considering the issue of sunk investments that it looks at the whole lifetime of the investment, rather than just the latter periods where returns may be relatively strong.

Economies of scale and scope

14. In addition, the Guide does not in our view put enough weight on scale, which is important in telecommunications and should be recognised as such in the regulatory context. Scale is important when maintaining the right incentives, such as competing to grow market share or

differentiating by targetting niche markets. Removing all advantages of scale could be highly inefficient. An example of this would be regulating the price for the national roaming service at the level of the access provider's average cost across the whole of its network.

Technological Progress (paragraphs 38 – 41)

15. The Commission refers to technological progress and shorter product life spans in the telecommunications industry.

16. We believe the implications of this, in addition to those discussed below, are that Regulators should act with caution when deciding whether to regulate particular services. Given the rapid pace of technological change, there is a greater chance of technological obsolescence, and consequent asset stranding for investors. What may appear like a successful investment yielding economic returns in one period may quickly become a stranded asset in another period.

17. Further, rapid technological change has the potential to quickly change traditional market boundaries. In turn, this has significant implications for appropriate competition and market analysis in the industry. For example, in a converging world, consumers may soon fail to distinguish between fixed and mobile services for their voice calls, emails, text messages or use of the internet. Telecommunications networks are quite different to static networks, such as electricity, where asset lives are extremely long and change is the exception rather than the rule.

Implications for competition and regulation (paragraphs 42– 44)

18. Third party access regulation has typically been focused on bottleneck facilities operating within a vertically integrated supply chain. The principles of regulation in these circumstances are generally well understood. Whether these principles apply equally well in circumstances where there is multiple investments in similar technologies is less clear. For instance, mobile termination is regulated as if it were a bottleneck service despite the fact there are multiple network operators providing this service. In these circumstances, the Commission must pay careful regard to the peculiarities of the specific market it is considering. In the case of mobile termination, this should include having regard to the two-sided nature of the market within which the potentially regulated service is provided, and the way in which this makes analysis of the issues different to a typical natural monopoly/one-way vertical integration problem.

19. As indicated above, however, rapid technological progress also means that telecommunications investments may be relatively risky, as there is always the risk that a technology will be superseded unexpectedly soon. Vodafone is always cognisant of this risk, and in fact we have

invested in some products which were not as popular as was envisaged at the concept stage. The reality is that some products will be more successful than others, and this is something which any investor has to weigh up and plan for. Rapid technological progress and network effects also mean that, as in other high-technology markets, competition may take the form of competition 'for' the market, rather than competition 'in' the market. This does not mean, however, that the market is not competitive. Rather, the implication is that competition needs to be assessed in terms of how the market evolves over time, rather than emphasising any particular point in time. Market power at a given point in time generated by technology choices may only be temporary, and may represent rewards to innovation, rather than a competition problem. We discuss this further below.

New Zealand Telecommunications Markets (paragraphs 46– 53)

20. At paragraph 51, in describing the current state of the industry, the Commission notes that mobile virtual network operators (MVNOs) are present. In our view, the Commission has tended to downplay the significance of MVNOs in its recent work. Vodafone considers that the introduction of MVNOs to the market could have a significant effect on the market, potentially more significant than the entry of 2degrees. The existence of MVNOs acknowledges that it is not efficient to build in all cases. While this section of the Guide appears to be descriptive rather than analytical, the change in mobile competition due to the introduction of MVNOs should be acknowledged.

21. The Commission should consider the concept of "workable competition" in the New Zealand context, and in doing so should be wary of comparing New Zealand too closely with much larger economies. The Commission should not expect to see all the same characteristics in New Zealand as is witnessed overseas. Excluding MVNOs, Australia has three mobile network operators (Telstra, Optus and Vodafone Hutchison), and a population of around 21.9 million. Excluding MVNOs, the United Kingdom (UK) has five mobile network operators (3, O2, Orange, T-Mobile and Vodafone excluding UK01 which uses GSM in London only), and a population of approximately 61 million. We note the trend for consolidation in these countries, given the pending merger of T-Mobile and Orange in the UK which will mean that the UK is soon to have only four mobile network operators and given the recent merger of Vodafone and Hutchison in Australia.

22. We note that in New Zealand, Telecom dominates the fixed-line market to a far greater extent than any party in the mobile market. For example, Chorus has approximately 93% of the New

Zealand fixed line access market.[2] Further, in the Commission's Draft Report of 30 June 2009 on mobile termination access services, it was noted that Telecom is the main supplier of retail fixed to mobile and toll call services, accounting for approximately three quarters of the retail market in 2008.[3]

23. These characteristics must be taken into account in any comparison with other jurisdictions.

[2] Telecom Corporation of New Zealand, *Telecom Corporation of New Zealand Limited Annual Report for the year ended 30 June 2009,* page 18, http://www.annualreport.telecom.co.nz/2009/download/Telecom-Annual-Report-2009.pdf

[3] Commerce Commission, *Draft Report on whether mobile termination access services (incorporating mobile to mobile voice termination, fixed to mobile voice termination and short message service termination) should become designated or specified services* 30 June 2009, page 94, paragraph 339.

3. Legislative Framework

Historical Background, Telecommunications Act 2001 and Telecommunications Amendment Act 2006 (paragraphs 54 to 61)

24. These paragraphs are descriptive and accordingly we have no comments on them.

The Commerce Commission (paragraph 62)

25. Table 1 sets out the Commission's key telecommunications functions. In respect of standard terms determination (STD) development, we have not seen any of the deliverables of 'reports on compliance with both STD terms and with access principles' noted in the Table. For example, we have not seen any proper STD compliance reporting, including in particular any reports on 2degrees' non-compliance with the mobile co-location STD, or reports on compliance for broadband STDs. The closest we have seen is Telecom Wholesale publishing various soft-launch reports. This type of "after the event" reporting should be an important part of the process, and we look forward to receiving compliance reports going forward.

Fair Process (paragraphs 63 – 64)

26. The Commission is required as a matter of law to ensure that its decision-making process is fair and is in accordance with the principles of natural justice protected by s27 of the New Zealand Bill of Rights Act 1990. Fair process obligations, particularly with regard to the nature and extent of consultation, are required by the Telecommunications Act. The Commission has established set procedures, through its previous investigations and regulatory actions, which it has built up and refined over a period of years. The parties taking part in an investigation or other decision-making process have a legitimate expectation that the Commission will follow the same procedure as it has consistently followed previously. As well as the obligation to follow a fair and just process, the Commission has an obligation to ensure that it does not defeat the legitimate expectations of those parties.

We welcome some of the Commission's approaches

27. In relation to process we welcome the following approaches taken by the Commission in the past:

- a good example of proper consultation and consistent process was during the investigation into termination of FTM voice calls on mobile operator networks, from May 2004 to April 2007. The Commission's adherence to fair process (including producing an Issues Paper, a Draft report, a final report and a draft reconsideration report, and receiving submissions and cross-submissions on each of those documents, holding a conference, etc.) allowed for

the issue to be given full and thorough consideration by all relevant stakeholders;

- in our letter to the Commission of 3 April 2009[4], we pointed out a number of deficiencies in the process adopted in the MTAS investigation, which meant the procedure was not in accordance with Schedule 3A of the Act. We were encouraged by the Commission's responsive approach to one of our concerns, relating to allowing parties to amend their undertakings following the draft report, at the time parties make submissions on the draft report.[5] In addition, we welcomed the Commission's decision to allow parties a further opportunity to amend their undertakings following the conference; and
- we welcomed the Commission's decision to hold a separate public session after the conference for the MTAS investigation, in which the Commission gave parties its current thinking on material matters which informed parties' consideration as to whether to revise undertakings.

Process issues that could be improved upon

28. However, Vodafone's experience this year of the process adopted by the Commission in the MTAS investigation, and associated undertakings, raises a number of concerns as to fair process. Vodafone considers improvements should be made to ensure the process is clearer, and set out at the early stages of an investigation so that all parties affected by the process are fully informed, able to prepare for each stage in the process and able to raise any concerns regarding process as early as possible. Where the Commission changes its position on a fundamental issue part way through a process, or towards the end of a decision-making process, this must be signalled to the parties and further consultation is required to allow parties the opportunity to be heard on that issue, regardless of the process followed up to that point.

29. Our main concerns as to process in the MTAS investigation include the following:

    - *Consistency/Legitimate expectation/Natural Justice:* Our concerns have been set out in detail, including in our letter to the Commission of 20 August 2009.[6] As a matter of proper process, the Commission should publish its final views on the key assumptions and the cost-benefit model(s) used in a Schedule 3 Investigation before access providers are given a final opportunity to revise undertakings. Otherwise, undertakings are unlikely to be acceptable

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[4] Vodafone New Zealand Letter to the Commerce Commission *Re Investigation into Mobile Termination Access Services*, 3 April 2009, page 5.

[5] Commerce Commission Letter to Vodafone New Zealand *Re Investigation into Mobile Termination Access Services* 9 April 2009.

[6] Vodafone New Zealand letter to Ross Patterson, Telecommunications Commissioner, 20 August 2009, pages 5-6.

alternatives to proposed regulation, thus defeating the purpose of the undertakings process. While we welcomed the Commission holding a public session to provide its current thinking on material matters, requiring parties to submit final undertakings before releasing the cost-benefit model for all services deprives access providers of the opportunity to be fully informed on the issues raised by the regulation of MTAS and the Commission's view on those issues. Vodafone was disappointed that the only opportunity it had to set out its views in full was through the submissions process which did not allow it to engage the Commission directly or through a two-way dialogue. Such engagement is vital on the extremely complex and important issues which are raised by the MTAS investigation. The Commission has expressly acknowledged, in the TSO context, that direct engagement and interaction at a conference is preferable to written submissions and may be the only way for the Commission to understand the issues.[7]

- *No modelling for mobile to mobile termination and SMS rates:*[8] The Commission has not undertaken cost-benefit analyses for each service it is considering regulating. We have informed the Commission of our view that this failure means that the Commission cannot properly discharge its obligations under section 18(2) of the Telecommunications Act 2001 (Act) and also means that affected parties are deprived of the opportunity to be fully informed and be heard. Without robust cost-benefit modelling:

  (a) the Commission cannot discharge its obligations under section 18 of the Act. It cannot identify, measure or compare the risks and benefits of regulation against the undertakings given by access providers; and

  (b) access providers cannot be fully informed of the basis for the Commission's views nor can they accurately identify the matters they need to address in undertakings and submissions. An example of this in the MTAS investigation is the claim made by certain fixed line providers in relation to pass-through and bundles. None of these claims have been modelled. This undermines the purpose of the undertakings process.

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[7] See Dr Patterson's comments on page 108 of the TSO Mobile Technologies Radio Cap Conference, 11 February 2008.
[8] Ibid.

General recommendations on fair process

30. *Legitimate expectation and consistent process:* We consider that the requirement for consistent processes (which the Commission has acknowledge is needed[9]) is linked to the concept of legitimate expectation. Vodafone submits that the Guide should include a requirement that, wherever possible, the Commission must adopt an approach consistent with the process followed in previous investigations, and where it is necessary to depart from the established process the Commission should provide clear reasons for doing so, and appropriate notice to the parties, who must have the opportunity to respond.

31. *Natural Justice:* The Guide notes that the Commission "usually takes into account natural justice considerations".[10] The Guide should aim for a higher standard for the Commission: there is no reason why the Commission should not always take into account natural justice considerations, as required by law.

32. *Timeframes:* The Commission notes in the Guide that it will "ensure its processes are timely and fair to all parties".[11] Fair process requires fair timeframes. We appreciate that a balance needs to be struck between avoiding lengthy delays and giving the parties a chance to properly consider submissions and provide their own submissions, and that therefore the Commission needs to retain an element of discretion to set timeframes. However, given the potentially significant implications for Vodafone and other operators of the outcomes of the various investigations and determinations and the often complex nature of the information or issues that the parties are dealing with, natural justice considerations are paramount. We note the concern we expressed regarding the original conference for the MTAS investigation being brought forward almost one month, which was not sufficient time in our view to consider the earlier cross submissions and prepare for the conference. An insufficient timeframe not only means that the parties are unable to adequately prepare but that the quality of the information that the Commission receives from the disadvantaged parties is likely to be sub-optimal and this may impact upon the Commission's ultimate decision. A compressed timeframe for submissions and overlapping investigations with deadlines in close proximity seriously stretches resources and risks a sub-optimal submission. This may be all a party can realistically achieve in the timeframe. Such a regulatory process incentivises inefficient heavy investment in resources devoted to regulatory response, something which Vodafone wishes to avoid. No party should be able to achieve better regulatory outcomes for itself merely through heavily resourcing to meet regulatory demands. We ask that the

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[9] Commerce Commission, supra note 1 at page 16, paragraph 64.
[10] Commerce Commission, supra note 1 at page 16, paragraph 64.
[11] Commerce Commission, supra note 1 at page 16, paragraph 63.

Commission gives further consideration to the staggering of deadlines and the need for adequate time for each step taking into account all investigations or regulatory processes faced by operators.

33. It would be helpful if the Guide applied its "standard procedures" to managing consultations on timeframes also, to allow parties to properly and meaningfully participate. Problems experienced by the Commission in bringing together the appropriate Commissioners for a conference should lead to the conference being postponed rather than brought forward to the detriment of interested parties, and ultimately, the Commission.

Schedule 3 Investigations (paragraph 66 – 69)

34. The Commission sets out in the Guide that it may, on its own initiative, or if requested to do so by the Minister, commence an investigation on any proposed alterations to the designated and specified services in Schedule 1. The outcome of an investigation is a recommendation to the Minister. The Commission must make the recommendation that gives best effect, or is likely to give best effect, to the promotion of competition for the long-term benefit of end-users, and must consider the efficiencies that will result or will likely result from the act or omission that is being recommended.[12]

35. Vodafone supports the principle that investigations should be commenced in relation to services which may no longer require regulation. We refer to the Commission's announcement on 25 September 2009 to investigate whether the services Telecom provides to other telecommunications companies to be resold, should be deregulated.[13] There are some services (such as the Wholesale Bitstream Service) for which regulation is no longer essential, and there are other services (such as PSTN resale) for which improved regulation may well be required. In the case of PSTN resale, this service will be the only way that some customers can obtain voice services until 2020.

36. That said, Vodafone is concerned where reviews are contemplated so soon after decisions are made after an initial investigation is completed. This has been particularly concerning in the case of national roaming, where the Commission was contemplating commencing a Schedule 3 Investigation within a month of having completed an investigation into the very same service. Similarly, Vodafone is very concerned that the Commission embarked on its third MTAS investigation a little over a year after the completion of its previous investigation. The outcomes

[12] Commerce Commission, supra note 1 at page 16, paragraphs 66 and 67.

[13] Commerce Commission, *Commerce Commission to investigate resale services* 25 September 2009, http://www.comcom.govt.nz//MediaCentre/MediaReleases/200910/commercecommissiontoinvestigateres.aspx

of these investigations have significant implications for the revenue infrastructure investors can expect to earn from their investments. To the extent such returns on investment are unpredictable, it decreases the appetite for shareholders to make large-scale investments in infrastructure. It is not helpful for investment to have the dampening effect of technological risk added to by regulatory uncertainty. So, while there must always be mechanisms for review available, these reviews should be spaced to occur within a reasonable period well after previous investigations occur.

Reasonable grounds to investigate

37. We welcomed the decision of the Commission on 28 August 2009 to defer the investigation into whether regulation of the national mobile roaming service should be extended to include price. We have expressed our view that Vodafone does not accept there is a direct relationship between roaming and mobile termination costs. In any case, it would be contrary to proper process to commence an investigation on roaming, when the Commission only has a preliminary view on mobile termination costs. Further, there is little, if any, evidence that there is any market failure in relation to roaming which would justify the commencement of an investigation. Given the extensive background on this matter, and the current pending review, we welcome the sensible response of the Commission to defer this investigation. Vodafone does not believe it should drop prices on the basis of preliminary views from the Commission on the cost of mobile termination when this is still the subject of consultation with the industry and any pricing relationship between mobile termination services and national roaming services has yet to be established. We think that national roaming is an example of a service where there are not reasonable grounds to investigate the designation of the service and we were pleased the Commission has taken on board our concerns in this regard.

Have regard to economic policies (section 19A) (paragraph 68)

38. In conducting Schedule 3 investigations, the Commission must have regard to any economic policies of the Government, transmitted in writing to the Commission by the Minister (section 19A(1)). A similar requirement is set out in section 26 of the Commerce Act 1986.

39. We note that, in February 2009, the Government transmitted a Statement of Economic Policy (Statement), providing that decisions concerning regulation of telecommunications services should be consistent with, and take full account of, New Zealand's relevant international commitments as expressed in bilateral and multilateral international instruments in effect in New

Zealand.[14]

40. There has been some debate about what "have regard to" means in this context. We refer to page 63, paragraphs 210 – 214 of Vodafone's Submission of May 2009, and page 123, paragraphs 449-450 of Vodafone's submission of 28 July 2009, for further detail in respect of this terminology, and the Statement.

41. In relation to the steps set out at paragraph 69, we note the Government statement of 17 August 2009, which states that improving the quality of regulation is a priority.[15] The Government commits to only insisting on regulation where it is satisfied that it is required, reasonable and robust. The Government will only accept regulation where it is fully satisfied that the problem cannot be adequately addressed through private arrangements and that all practical options for addressing the problem have been considered. In addition, there will need to be a particularly strong case for making any regulatory proposals that are likely to impair property rights or the incentives on businesses to innovate and invest. We believe the additional step of a robust and thorough regulatory impact statement, is an important one, particularly when dealing with the possibility of regulatory change which will have a significant impact on businesses, such as in the MTAS investigation.

Undertakings (paragraphs 70 – 72)

42. Consistent with the approach set out in the Guide,[16] we agree that undertakings are an important way in which benefits can be provided to end users earlier than regulation and we welcome, and agree with, the Commission's description of the benefits of this mechanism:

- allowing an accelerated take-up of services; and
- delivering benefits to end-users earlier than a regulatory process.

43. In addition, undertakings can contain conditions, and therefore achieve outcomes that regulation cannot, such as retail pass-through commitments. Vodafone provided such commitments in the MTR Deeds.

44. Undertakings have the advantage of ensuring consumers can enjoy the benefits of price reductions sooner rather than later. They can also ensure that the costs of long, drawn-out,

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[14] Commerce Commission, supra note 1 at page 16, paragraph 68.
[15] http://www.treasury.govt.nz/economy/regulation/statement/statement
[16] Commerce Commission, supra note 1 at page 17, paragraphs 70 – 72 and page 38, paragraphs 187 and 188.

regulatory disputes can be avoided if offers are put forward to the satisfaction of the Commission.[17]

45. Although undertakings can, in theory, deliver certainty to service providers by setting prices they will be able to charge in the future, we note that the Telecommunications Act allows for undertakings to be overridden by regulation. This is despite the Act setting a default term for undertakings of five years, which is the period which access providers will be contemplating when considering offering undertakings. We think the fact that undertakings can be over-ridden by regulation part-way through their term undermines any certainty which access providers should be entitled to when offering undertakings.

46. However, since legislative provisions were introduced in 2006 enabling parties to submit undertakings, with the exception of Telecom's operational separation undertakings, the Commission has not yet accepted an undertaking. We urge the Commission to approach undertakings with the significant benefits they provide at front of mind: they should not be considered an inconvenient hurdle that the Commission must "tick off" before imposing regulation.

47. The way in which Vodafone's undertakings have been dealt with through the MTAS process has raised a large degree of uncertainty for Vodafone. This is more of a problem where there are multiple access providers. The issues arising out of having multiple access providers, such as inter-conditionality and reciprocity terms and having different undertakings with different price and non-price terms, have been raised in the MTAS investigation. To the extent possible, a way of dealing with these issues should be addressed in the Guide.

48. Based on recent experience in the MTAS investigation, we are concerned that the Commission may not give enough weight to the benefit of the "accelerated take-up of services". Given the length of time any regulatory process will take, we see this as an important advantage of undertakings over regulation.

49. We believe the Commission should actively facilitate the use of undertakings as an alternative to regulation, and do what it can to ensure that the undertakings process has the best possible chance of success. The way in which the Commission intends to do this should be set out in the Guide.

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[17] Vodafone New Zealand Limited *Submission to the Commerce Commission Telecommunications Act 2001: Submission on Schedule 3 Investigation into Regulation of Mobile to Mobile Termination Issues Paper*, Dated September 2008, pages 11-12, paragraph 32.

50. It would also be useful for the Guide to set out the Commission's approach with respect to any undertakings which are in place but which are not used, or are infrequently used.

51. In a letter to the Commission,[18] we set out our understanding of the MTAS investigation and process in relation to undertakings. We stand by our interpretation of the undertakings process in Schedule 3A as set out in this letter, as being a two step process, summarised below:

- an access provider must first apply to the Commission and the application must meet certain requirements. The Commission then gives public notice of the applications and invites interested parties to make submissions. Before determining the application, the Commission must give the access provider a reasonable opportunity to amend its application in light of those submissions; and

- an access provider may then submit an undertaking following submitting the application. Schedule 3A does not provide time restrictions, only that undertakings may be submitted whilst the Commission is considering proposed regulatory changes and prior to the Commission's final report.

Regulatory Certainty

52. The Commission wishes to promote "regulatory certainty" in telecommunications markets, acknowledges that operators will be looking for regulatory certainty and confirms that undertakings promote market certainty.[19] We are encouraged that the Commission has given this important principle such priority in the Guide. However, we are concerned that the Commission's actions do not always give due consideration to regulatory certainty.

53. Certainty is important for a business so it can invest with confidence around the regulatory settings that will affect its returns on that investment. This is especially important in industries involving large sunk-cost investments, such as telecommunications. This is because these investments rely on many years of expected revenue streams to recover the large amounts invested. If a regulated business experiences constantly changing regulatory settings, and can't have confidence in commercial agreements made, it loses its confidence in making investment decisions for the long-term. This will harm dynamic efficiency and can be to the detriment of the long-term interests of end-users. The process of regulation is undoubtedly uncertain and time

[18] Vodafone New Zealand letter to the Commerce Commission, *Investigation into Mobile Termination Access Services,* 21 November 2008.
[19] Commerce Commission, supra note 1 at page 5 paragraph 3, page 6 paragraph 8, page 17 paragraph 72, and page 38 paragraph 187.

consuming for all involved.

54. Vodafone has recently experienced significant uncertainty in the MTAS investigation. This is a major issue for Vodafone as MTAS revenue comprises a significant proportion of our overall revenue. Uncertainty about regulatory settings for MTAS and the consequential revenue flows impacts all parts of our business, which in turn affects our customers. Combined with the ongoing uncertainty around regulatory settings for national roaming, Vodafone is worried that the Commission does not fully appreciate the need for certainty for infrastructure investors in New Zealand.

55. The fact that the Commission is considering overriding the MTR Deeds has been deeply concerning to Vodafone. In our view, it appears to indicate a lack of attention to certainty concerns by the Commission.

56. In the MTR Deed, Vodafone agreed with the Crown a more immediate decrease in termination revenues in exchange for certainty over rates for a five year period: we agreed to reduce rates earlier than would have been likely under regulation in exchange for certainty over the rates that would be set for some time to come. The actions of the Commission in the MTAS investigation have caused us to question the value of making concessions in commercial negotiations if they are not taken proper account of in Schedule 3 investigations.

57. We recommend that the Guide should make it clear that preference will be accorded to undertakings as an alternative to regulation and go further to state that the Commission will do what it can to accommodate that preference.

Access Determinations (paragraph 73 – 76)

58. We note the availability of the guide to the STD process on the Commission's website, which is useful.

59. Vodafone notes the delays which have occurred in relation to the proposed section 30R review of the set of fixed line STDs. The review was intended to bring the STDs into alignment with each other, and to resolve operational issues that have arisen post implementation. Vodafone would like to see this review completed as soon as possible.

Review of Designated and Specified Services (paragraph 77 – 79)

60. Vodafone considers that the Commission should closely follow the review requirement to consider at five yearly intervals whether there are reasonable grounds for commencing an

investigation into whether services in Schedule 1 should remain regulated. In considering a review, Vodafone considers that the Commission should always have as its main objective, whether regulation (of the designated or specified services) is promoting competition for the long term benefit of end-users. If not, an investigation should be launched into whether the service should remain regulated or, in some cases (such as PSTN resale), be subject to more effective regulation.

Operational Separation of Telecom (paragraph 80- 86)

61. At paragraph 85 the Commission cites the guide to complaints process for breach of the Undertakings (Undertakings Guide). While the Commission states in the Undertakings Guide that a complainant should attempt to resolve the issue using the Independent Oversight Group (IOG) before making a complaint, the Commission makes no mention of what regard it will have to any decision that the IOG has made. The Commission states it will "consider each complaint on a case by case basis". We think it is important that the Commission does not unnecessarily duplicate the activities of the IOG, or render those activities useless.

62. One suggestion for the way the Undertakings Guide could set out a better process around submissions (in relation to any investigation conducted by the Commission), could be that where the matter has been the subject of an IOG decision, parties should be restricted to raising matters in submissions that they have not previously had an opportunity to respond on.

63. Paragraph 86 provides that the undertakings required the formation of the IOG which monitors Telecom's compliance with the undertakings. The first real test of the role of the IOG has been its consideration of Telecom Wholesale's loyalty offers, which demonstrated in our view the required independence from Telecom. We do, however, have two residual concerns:

- while the draft decision was made following a consultative process, we had expected further consultation after the draft decision to only be used to correct factual errors, rather than suggesting changes of substance, as Telecom did; and

- we were disappointed with the inappropriate disclosure of the confidential draft decision. We do not think, however, that this disclosure is justification for doing away with the open consultative process adopted by the IOG in the loyalty offer example. Accordingly, we have proposed to the IOG several options which we think could effectively manage the confidential disclosure of information in future examples.

Accounting separation (paragraph 87 – 90)

64. Vodafone has no particular comments to make on accounting separation.

Telecommunications Service Obligations (paragraph 91 – 94)

65. Part 3 of the Telecommunications Act provides for Ministerial Declarations of Telecommunications Service Obligations (TSO). The Act imposes an obligation on the Commission to calculate annually, the amounts payable by liable persons in relation to a particular TSO, but does not set out the method or formula which the Commission must use in order to calculate the net cost of the particular service. Vodafone considers that the Commission must have regard to its essential task in each annual calculation, which is to determine the unavoidable incremental net cost to an efficient service provider of providing the TSO services. In doing so, the Commission is required by s18 to consider the promotion of competition for the long-term benefit of end-users. Vodafone considers that the Commission has failed in its task to date, which is why it has challenged TSO determinations. It is regrettable that the substantive merit of Vodafone's arguments has been recognised by the High Court (see paragraph 62 of Justice McGechan's judgment dated 18 December 2007) but this has not been addressed by the Commission.

Enforcement (paragraph 95 to 98)

66. As we state above in relation to paragraph 85 of the Guide, we believe the Commission should clarify the weight that it gives to a decision of the IOG which finds that there has been a breach of Telecom's Undertakings. The Commission is empowered to take enforcement action but we appreciate that the Commission may not rely solely on a finding made by the IOG, and may commence its own investigation before taking enforcement action.

Sector Monitoring (paragraph 99 – 100)

67. The monitoring powers provided in Section 9A of the Act are very broad. We believe these broad powers should not be used as a justification for gathering data and general 'fishing expeditions'.

68. Section 9A does not allow 'unbridled power' and this is an issue of concern to Vodafone. Vodafone considers that the Section 9A monitoring power is limited to those markets and services in New Zealand that it is empowered to investigate and/or regulate under the Telecommunications Act.

69. Paragraph 100 provides that the Commission is not required to release all documents it produces or acquires for its sector monitoring and information dissemination function. It is noted that this

allows the Commission to obtain commercially sensitive information without having to publicly release it.

70. In paragraph 103, the Commission highlights the benefits of its new monitoring powers under section 9A, and how these can complement the Commerce Act regime. Vodafone does not consider that the Commission can use the monitoring powers under the Telecommunications Act to "complement" the Commerce Act.

71. We note that at paragraph 145 the Commission refers to "continuous" monitoring, which in Vodafone's view would be unduly burdensome on industry if implemented and probably unnecessary. Vodafone considers that the Commission should clarify whether section 9A allows, in the Commission's view, for continuous monitoring.

72. The Guide should include the criteria the Commission applies in deciding whether or not to release all documents it produces, or acquires, for sector monitoring.

Other relevant Legislation (paragraph 101)

73. The Commerce Act has the potential to impact on competition in telecommunications markets, as we discuss below.

Commerce Act (paragraph 102 – 104)

74. The Telecommunications Discussion Paper released in 2007 in respect of the interrelationship between Part 2 of the Telecommunications Act and the Commerce Act is a useful resource and was a helpful guide for industry. The Telecommunications Act itself sets out in section 15, the only provisions of the Commerce Act which apply to the Commission's powers and duties under the Telecommunications Act.

75. In our submission of July 2009 on the MTAS investigation, we considered the relationship between the role of the Commission under the Commerce Act and the Telecommunications Act in the context of the MTAS investigation, and the allegations made regarding on-net pricing. We noted that the aim of the Commission in the MTAS investigation should be to try to ensure an economically efficient price is being set for MTAS that will enable efficient competition to occur in relevant markets. Once an appropriate price is being set (either via undertakings, commercial deals or regulation), the Commission can then separately determine whether it believes particular on-net pricing practices are anti-competitive at the retail level using its powers under the Commerce Act. It should not attempt to deal with potential anti-competitive conduct by blanket

bans that also rule out other types of activity that might in fact be pro-competitive and perfectly legitimate commercial activities.[20] We therefore welcome the Commission's views in the MTAS investigation that the investigation will not entertain a ban on on-net pricing, as pushed for by some parties.

Radiocommunications Act (paragraphs 105 – 107)

76. We agree that the Radiocommunications Act 1989 has an impact on the telecommunications industry, because wireless has a growing importance in the telecommunications sector.

77. We have seen evidence of this recently, in relation to interference caused to our mobile network, where we were forced to seek urgent relief through the Courts. We acknowledge that regulatory functions with respect to spectrum are held by the Ministry of Economic Development (MED), and we have written separately to the MED who is dealing with the issue. However, we consider the matter relevant to the Commission, as such issues of course impact upon competition in telecommunications markets, particularly when one network is adversely affected, meaning that end-users' use of the service are in turn negatively affected.

78. There remains continued uncertainty in relation to how interference issues are dealt with under the Radiocommunications Act, as there is a lack of clarity regarding the interface between the Radiocommunications Act and the International Radio Regulations (IRR). Essentially the Radiocommunications Act is not able to manage interference issues which arise when two networks with different technologies are implemented between adjacent spectrum managers. The current uncertainty as to how the IRR apply is not helpful, and we hope that progress is made soon around this significant issue.

79. We also make the point that the allocation of management rights to radio spectrum is fundamental to mobile operators, because spectrum is the "lifeblood" of operators. Given the significant amounts invested in their networks, operators need certainty over their spectrum rights, both in relation to current rights and spectrum which they may require in the future, such as for LTE. Operators need to be confident that management rights and spectrum licences are secure and certain, given the essential role they play for operators.

Resource Management Act (paragraph 105 – 107)

80. We feel it would be helpful if the Commission could explain how it believes the Resource

[20] Vodafone New Zealand Limited *Submission to the Commerce Commission Telecommunications Act 2001: Submission on the Schedule 3A undertakings provided on 12 January 2009*, dated 13 February 2009, page 51, paragraph 169.

Management Act 1993 (RMA) has a 'material impact' on competition. We are encouraged that the Commission acknowledges the impact of the RMA, but we would be interested to understand how it believes the RMA is a 'material impact' and whether that impact is on competition.

4. Economic Principles

Competition and economic efficiency (paragraph 112- 119)

81. Vodafone agrees with the Commission's view in the Guide that economic efficiency is generally enhanced by competition.

82. It is appropriate to characterise efficiency in terms of allocative, productive and dynamic efficiencies. We note that allocative and productive efficiency are ex post concepts, that is, these concepts related to welfare generated by historic investments. In contrast, dynamic efficiency is an ex ante concept, that is, it relates to welfare generated from future investments. Since dynamic efficiency is forward-looking, it necessarily involves consideration of uncertainty. This means that dynamic efficiency leads to the *expected* welfare of society being maximised over time, which is not necessarily the same as realised welfare being maximised at every given point in time.

83. We agree with the Commission's basic definition of workable competition[21]. However, workable competition does not mean that every actual or potential competitor has access to exactly the same abilities.[22] As the Commission notes, workable competition will lead to temporary above-normal profits as rewards for risk-taking and innovation. Innovation may lead to a firm having a temporary advantage in terms of information or expertise, for example, that its competitors do not have. Thus we agree with the Commission's description of the incentives and market outcomes under workable competition, but not with the description of the characteristics of workably competitive firms.

Dynamic Efficiency preferred (paragraph 112, 135, etc)

84. Vodafone agrees with the approach the Commission has outlined in paragraph 135 of the Guide that it will give greater weight to the promotion of long-term dynamic efficiency over short-term allocative efficiency, where there is a tension between the two. This is consistent with s18 of the Telecommunications Act.

85. Dynamic efficiency can be harmed when a regulated business witnesses constantly changing regulatory settings, or cannot have confidence in agreements that it has made with other operators or the Crown. The business loses its confidence in making investment decisions for the

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[21] Commerce Commission, supra note 1 at page 24, paragraph 117.
[22] Commerce Commission, supra note 1 at page 24, paragraph 118.

long-term.[23]

86. A key concern for Vodafone is the prospect of regulation being imposed soon after significant investment having been made.

Investment incentives

87. Vodafone welcomes the Commission's statement that it considers it important to take account of the investment incentives facing all parties when exercising its judgement in determining the terms of access to regulated services.[24] Based on the recent experience with the MTAS investigation, however, Vodafone questions the extent to which the objectives are actually applied by the Commission.

88. As a major infrastructure investor in New Zealand, Vodafone supports a regulatory environment that creates the necessary incentives for investment for the long-term benefit of end-users.

89. Substantial investors such as Vodafone need to plan their investments over a number of years. This, coupled with the evolution of technologies, means that Vodafone is often looking five or more years ahead at what it intends to invest in, and to what extent. It is vital when considering such decisions that it is clear what other factors may affect the business case for any particular investment, including the regulatory context. Put simply, a firm will want to (and will need to where shareholders are involved) assure itself that external dependencies which might affect the projected returns are as certain and predictable as possible. Further, once regulatory decisions are made, there must be some commitment to them for a reasonable period of time. Constantly conducting reviews on the same issue – especially so quickly after completion of a previous review – creates significant uncertainty for large-scale infrastructure investors, and diminish confidence in the stability of the regulatory environment here in New Zealand. In the telecommunications industry, any period of less than five years is short, and makes investment decisions difficult. The effect of uncertainty of regulatory context on investment decisions is to make those decisions more conservative at the potential expense of innovation and new technology or services. This harms dynamic efficiency.

90. The reasonable required returns of shareholders cannot be expected to diminish in future. Indeed, with continued unpredictable regulatory intervention, one might expect the investments

[23] Vodafone New Zealand Limited, supra note 20 at page 70, paragraph 249.
[24] Commerce Commission, supra note 1 at page 27, paragraph 134.

to be seen as more risky, therefore requiring higher returns over time, everything else equal.[25]

91. All efficiently incurred costs need to be recovered, including a reasonable return on investment reflecting the risks involved, for a firm to be willing to remain in a market in the long run.[26]

92. For example, in relation to mobile termination rates, the prospect of immediate removal of termination revenues puts at risk investment plans for Vodafone (and we expect Telecom), who had every right to expect termination revenues would be available to them when they invested in their 3G networks due to 5-year MTR Deeds entered into with the Crown in 2007. Large and unexpected swings in mobile termination pricing cause havoc for business plans, which raises uncertainty for mobile operators and consequential detrimental dynamic effects on industry investment and pricing plans and therefore consumers.[27]

93. When contemplating regulation that will impact on market participants' revenue, the Commission should generally consider a phased approach so as to minimise the impact on investment plans for the relevant market. The British regulator OfCom has observed the need to strike a balance in this regard:

> *[*A] balance must be achieved between serving the short term welfare of customers (through lower prices and hence immediate reductions of prices to a level consistent with the underlying costs), and conversely the need for efficient investment incentives for existing and prospective network operators and service providers by allowing a sufficient period of time for operators and customers to adjust to new levels and structures of mobile charges (which benefit consumers in the longer term).[28]

94. In general, it is also important for the Commission to try to distinguish between profits that are being made from risky investments that happened to pay off, versus profits from an enduring bottleneck. As the Commission anticipates at paragraph 117, workable competition will result in firms being rewarded with above-normal profit over the short to medium term. Imposing regulation in response to such profits will clearly harm incentives to invest and dynamic efficiency. It should be recognised that regulation is often done ex post after uncertainty about demand and technology has been resolved, whereas firms have to make investment decisions ahead of those

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[25] Vodafone New Zealand Limited *Submission to the Commerce Commission Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination Access Services Cross Submission* Dated 18 August 2009 page 14, paragraph 44.

[26] Ibid page 45, paragraph 146.

[27] Vodafone New Zealand Limited *Submission to the Commerce Commission Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination Access Services* Dated 28 July 2009 at page 13, paragraph 50.

[28] Ofcom, *Call termination Statement*, 27 March 2007, cited in Vodafone New Zealand Limited *Submission to the Commerce Commission Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination Access Services* Dated 28 July 2009 page 65, paragraph 225.

uncertainties. This means that regulators must be very cautious about the effects of their actions on incentives to invest.

95. One current significant matter of importance to New Zealanders is the Government's objective of ultra-fast broadband. This initiative will require a level of co-operation between the Government and investors not previously contemplated. Vodafone fully supports the Government's vision for ultra-fast broadband for New Zealanders and is prepared to play its part in delivering that vision - in the fixed and mobile broadband space. Regulatory change which has significant impact on parties' revenues will logically have an impact on the extent to which parties can participate in initiatives such as broadband, and the Commission should not ignore this. Our view is that the Commission should be more willing to consider the 'bigger picture' when it is assessing the costs and benefits of proposed regulation.

Innovation

96. As well as incentivising investment in infrastructure, dynamic efficiency benefits end-users in the long-term by encouraging the development of more innovative goods and services. It tends to elicit new and innovative products as competitors seek to differentiate themselves from their rivals in order to attract customers to their business.[29]

97. Evidence that Vodafone's innovation and product development is world leading can be found in the fact that Vodafone New Zealand has the greatest 3G network coverage of any operating company in the Vodafone Group. This development is despite New Zealand having a lower GDP per capita than any of these jurisdictions, and one of the lowest population densities per square kilometre.[30]

98. Vodafone has invested in infrastructure that has enabled a number of highly innovative products to be offered in New Zealand in recent years. For instance, in the last two years, we launched both:

- Home Phone Wireless[31], which enables consumers to make local calls using access to our mobile network; and
- Local Zone[32], which enables consumers to use a single phone as both a mobile phone while they are away from their home and as a home phone when they are at home.

[29] Vodafone New Zealand Limited Submission supra note 20 at page 46, paragraph 142.
[30] Vodafone New Zealand Limited Submission supra note 25 at pages 20 – 21 paragraphs 62 – 63.
[31] See: http://www.vodafone.co.nz/home-phone-and-broadband/home-phone-plus/
[32] See: http://www.vodafone.co.nz/local-zone/

99. Both of these are innovative products that provide greater choice and options for fixed-line and mobile consumers.[33]

100. If regulation that negatively affects revenue is introduced, a variety of responses by operators are likely, including innovative new services not being introduced or being delayed. The larger and more sudden these reductions, the more significant the effects are likely to be.[34]

101. Such outcomes neither promote efficient competition, economically efficient investment nor economic efficiency *per se*.

Long term benefit of end-users: facilities based and access based competition (paragraph 120- 126)

102. We agree with the Commission's approach that economically viable facilities-based competition is usually a more effective form of competition for the long-term benefit of end-users, than access based competition. The benefits of facilities-based competition set out in paragraph 122 are significant. Vodafone has consistently been open and willing to enter into commercial agreements with entrants on roaming, on reasonable terms and conditions, and this will promote further facilities-based competition by allowing entrants to build infrastructure where it is economically viable to do so, and to temporarily use our infrastructure in other areas.

103. In relation to the national roaming service, it is essential that it be priced to maintain the access seeker's incentive to continue to build. The service was only ever intended to be a temporary fix for a new entrant to provide it with nation-wide coverage immediately. If the service is priced close to or at the access provider's overall average cost, then there is little chance that the access seeker will be incentivised to build another site in high-cost areas where cost is above-average. In other words, where costs can differ from one part of the country to another, geographically averaged prices will distort efficient build-buy incentives, and likely lead to inefficiently low facilities based competition in higher cost parts of the country. We note that it has been recently reported that 2degrees has suspended further build of its network.[35]

104. The Commission acknowledges that it will be important that the regulated access price allows for the recovery of efficiently-incurred long-run costs (i.e., including an appropriate risk-adjusted return on capital which, as noted above, is at times higher ex-ante when demand and technology

[33] Vodafone New Zealand Limited Submission supra note 25 at page 33, paragraphs 99-100.
[34] Vodafone New Zealand Limited Submission supra note 27 at page 59, paragraphs 198-199.
[35] Tom Pullar-Strecker, *Maori split on board of 2degrees*, Dominion Post, 28 September 2009.

are uncertain, than it is ex-post when these uncertainties have been resolved).[36]

105. Vodafone considers that striking the right balance is key in terms of the Commission's comment that it considers the impact on and balances the interests of access providers, access seekers and end-users.

[36] Commerce Commission, supra note 1 at page 26 at paragraph 126.

5. Decision Making

Decision making and the Regulatory Process (paragraphs 138 to 144)

106. We agree with the Commission's description in paragraph 138 that regulatory decision making is an evolving process, where regulatory settings are reviewed to ensure they are appropriate and proportionate. Vodafone submits that the dynamic nature of telecommunications technologies should also require the Commission to look forward and anticipate market developments. That said, and as indicated above, the Commission must do so in a way that increases the reliability and predictability of regulatory settings to the greatest extent possible if it is to encourage efficient investment in telecommunications infrastructure in New Zealand. This is especially the case given investments in telecommunications infrastructure are subject to a greater degree of technology risk than is likely in other regulated industries.

107. We refer to our comments on a "workably competitive market" in section four.

108. The way in which the Commission describes the mechanisms to achieve outcomes consistent with a workably competitive market implies that the Commission prefers to incentivise parties to reach commercial agreements as would be expected in a competitive market, 'avoiding the costs of the regulatory process and accelerating the delivery of benefits to end-users', rather than direct regulatory intervention.[37] However, based on our experience, we are not convinced that the Commission does have such a preference or at the least, does not give it much weight.

109. The Commission notes that there is an effective monitoring strategy to collect information on the effectiveness of existing interventions:[38] We think it would be helpful if the Guide could set out what information is collected in this respect.

Monitoring (paragraphs 145 – 149)

110. Vodafone considers that the Commission's monitoring role is an important function as it enables the Commission to bring together all parties' views. As noted above Vodafone considers that further certainty surrounding the Commission's monitoring functions is necessary. Vodafone considers that the monitoring function only relates to the markets and services in New Zealand which the Commission is otherwise empowered to investigate or regulate, and should not be used to supplement the Commerce Act or for a "fishing expedition". The Commission's information gathering powers (such as the use of s98 notices) should only be used for the purposes of

[37] Commerce Commission, supra note 1 at page 29, paragraph 138.
[38] Commerce Commission, supra note 1 at page 29, paragraph 140.

monitoring those markets and services which come within the Commission's jurisdiction under the Telecommunications Act and not for any ulterior purpose. These powers are draconian and should be employed strictly within the clear bounds of the Commission's jurisdiction. Any expansion of the use of such powers risks breaching the New Zealand Bill Of Rights Act 1990.

111. The Commission produces a quarterly monitoring report, a quarterly broadband monitoring report, an annual market monitoring report and special topic reports.[39]

112. In our view the Commission's current broadband performance monitoring is fairly watered down and of limited value to consumers. We think that with the benefit of hindsight, it would have been better for the Commission to have consulted more widely with the industry before making a decision to use the Epitiro tool. We think this tool has significant limitations, which have been outlined by the TCF.

Reasonable grounds for investigation (paragraphs 150 -152)

113. The Commission notes that grounds for proposed alterations to regulated services can arise through the Commission's increased market monitoring activities, and pro-active engagement with stakeholders.[40] It would be helpful if the Commission could elaborate on what it means by pro-active engagement with stakeholders.

Commercial Agreements

114. Vodafone is pleased to see that the Commission has expressed a preference for commercial solutions.[41] Vodafone is strongly supportive of this sentiment. The following paragraphs include discussion of commercial agreements which are addressed in the Guide.[42]

115. Vodafone is committed to finding commercially negotiated solutions in advance of, or in lieu of, regulation that provide better outcomes both for itself and for consumers than can be achieved under regulation.

116. Consistent with the Commission's approach, we believe our past behaviour (especially in relation to our dealings with 2degrees) is testament to this. We have:

- reached commercial agreements with 2degrees on mobile termination on highly favourable

[39] Commerce Commission, supra note 1 at page 29, paragraph 147.
[40] Commerce Commission, supra note 1 at page 29, paragraph 151.
[41] Commerce Commission, supra note 1 at page 29, paragraph 152.
[42] Commerce Commission, supra note 1 at page 31, paragraph 152, and page 45, paragraphs 227 – 231.

terms for 2degrees;

- sold spectrum to 2degrees at heavily discounted rates;
- reached commercial agreement on mobile co-location arrangements which 2degrees has subsequently declined to execute; and
- demonstrated a consistent pattern of being willing to reach commercial agreement on reasonable terms and conditions with regard to national roaming.

117. While the Commission notes here that there is a preference for commercial solutions, we have seen little evidence of this in practice. In the context of the MTAS investigation, use of the undertakings process is the mechanism by which such commercial solutions can be tabled by access providers. As we noted in our submission on the MTAS investigation in February 2009: [43]

> ...the fact that the Commission has continued with an investigation in these circumstances shows the Commission places no weight on commercial deals. It seems there was nothing Vodafone could have done to avoid an investigation in this matter. In turn, this provides no benefit to a party to try to act responsibly and reach reasonable commercial deals in lieu of regulation. This is a pattern we are seeing for other services the Commission is considering regulating, such as national roaming. Rather than potentially resolve a matter, striking a deal with NZC [now known as 2degrees] seems to merely lower the price benchmark below which NZC is able to agitate for regulatory intervention to lower prices further. Vodafone is beginning to question what value it gets from agreeing lower rates for access services with NZC. It does not forestall regulatory investigations – it simply gives ground away in regulatory debates about appropriate prices for these services.
>
> If the Commission continues to ignore commercial deals (especially ones as reasonable as those we agreed with NZC for MTM voice and SMS services), this will depress the incentive regulated entities have to enter commercial deals outside of regulation. Rather than rewarding parties for “good behaviour”, it incentivises them to stop offering ground to access seekers and change their focus to resist regulation wherever possible. This would not be a good outcome for the regulatory environment in New Zealand, and not be in the long-term interests of end-users.

Competition assessment (paragraph 153 – 154)

118. Vodafone agrees with the steps set out in paragraph 153 that (in the absence of undertakings) the Commission must follow, before it comes to a recommendation. If the undertakings process is underway, the Commission must also consider whether competition will be better promoted in the long-term interests of end-users by the acceptance of the undertakings.

[43] Vodafone New Zealand Limited Submission supra note 20 at pages 20- 21, paragraphs 38 -41.

Market Definition (paragraph 155 – 161)

119. While we agree broadly with the Guide's outline of market definition, we think it is important that a market definition is not used as a tool to artificially create "bottlenecks" in order to justify intervention.

120. Vodafone considers the Mergers and Acquisition Guidelines[44] provide a useful guide in respect of market definition for traditional markets. However the Mergers and Acquisition Guidelines do not envisage two-sided markets, and there is a risk that applying traditional market definition to two-sided markets will lead to an incorrect market definition and therefore incorrect competition analysis flowing from such a market definition.

121. In particular, the upstream/downstream dichotomy does not apply to two-sided markets. Rather, firms compete by providing a platform that serves two distinct groups of customers. Traditional market definition in such a situation may lead to defining two distinct markets, one for each consumer group. However, the value of a two-sided platform to consumers on either side of the market comes from the platform's ability to bring consumers together across the two sides and allow them to communicate or interact with each other. This means that demands on the two sides of the market are interdependent and a platform firm will set prices jointly across the two sides of the market, taking account of the fact that the structure of prices across the two sides will affect the platform's profit.

122. The implication is that the correct market definition is of a single two-sided market, rather than two related markets. Competition takes place between platforms and should be assessed at this level of analysis, rather than by considering each side of the market in isolation. Not all telecommunications markets are two-sided, but we believe that two-sided market issues will become increasingly important in telecommunications over time. We would be pleased if the Commission acknowledged the existence of these types of markets and their implications (such as implications for assessing the state of competition), and that regulation on one side of the market will have effects on the other side.

123. We also consider that it would be helpful if the Commission actually set out the test it says that it applies. There was no market definition for national roaming in the last investigation: a particular definition was asserted without analysis.

124. Vodafone agrees that, for the purposes of telecommunications regulation, the relevant markets

[44] Commerce Commission, *Mergers and Acquisitions Guidelines*, page 14, http://www.comcom.govt.nz/Publications/ContentFiles/Documents/MergersandAcquisitionsGuidelines.PDF

will include the wholesale market in which the service is directly supplied, as well as the relevant downstream markets in which the service is used to deliver retail services to end-users. The exception is where, as discussed above, the service provided is a two-sided platform, rather than a traditional wholesale service.

Limited Competition (paragraphs 162 – 166)

125. We agree with the factors the Commission considers in assessing whether competition is limited in a relevant market.

126. The Commission notes that the competition assessment is usually both current and forward looking. Vodafone submits the approach should always be both current and forward looking. We consider that the Commission's approach is too narrowly focussed on current factors, and the Commission needs to balance that with a more forward looking approach. As we explained above, it is necessary to take a dynamic view of competition in telecommunications markets. An example of this is in respect of the co-location investigation: the Commission relied on 2degrees' assertions as to its demand intentions and unfounded claim that the lack of co-location was somehow due to anti-competitive conduct on the part of Vodafone and Telecom. The Commission did not carry out a proper investigation, as to whether the sites were actually required, including a forward-looking assessment, or as to whether there was limited competition. Please see further discussion of this point in section five under the heading "Other Considerations".

127. We note the Commission takes account of the experience of other jurisdictions where the same service has been subject to regulation or the threat of regulation. Vodafone thinks it is important that the Commission take into account which jurisdictions are the appropriate ones to refer to. Even although other jurisdictions may have regulated the same service, characteristics of those countries may make some less useful than others for comparison purposes.

Assessing the potential Impact of regulation (paragraph 167 – 168)

128. Given the importance and significant cost implications of intervention, the Commission needs to be satisfied that, first, competition is limited relative to the standard of workable competition, and then undertake both a qualitative and a quantitative assessment of the extent to which regulation is likely to promote competition for the long-term benefit of end-users.

129. We agree with the balancing exercise the Commission must undertake to weigh the costs and benefits and that the relevant question is: will the benefits of improved competition be

outweighed by the costs created by regulation? However Vodafone submits that this balancing exercise must take place from a properly informed basis and a proper qualitative and quantitative analysis is required before a weighing of the costs and benefits can be undertaken, or a comparison of a factual scenario with relevant counterfactual scenarios.[45]

130. The need to produce actual models to inform the qualitative analysis was demonstrated by the FTM cost-benefit model developed in the MTAS investigation. Vodafone believes that model contains major flaws, and, when those are remedied, the model does not support regulation.[46] Production of the model has enabled it and other operators to identify and address these flaws.

131. In the context of the MTAS investigation, and as noted in our letter to the Commission,[47] the Commission has identified in this context that quantitative analysis is important and informs the qualitative analysis[48]. Vodafone agrees with this. However, the Commission has stated[49] that it is difficult to undertake cost-benefit models for MTM and SMS services. We agree that such modelling is not straightforward, but critically this does not mean it cannot or should not be done. We have argued that it is required and there has certainly been sufficient time for the Commission to undertake this task. We are aware that other regulators have undertaken cost-benefit modelling for MTM.[50]

132. Without quantitative analysis, the Commission has theories, untested and unsupported by empirical data. Proceeding to regulate in the absence of robust analysis puts at risk the very efficiencies which section 18 was designed to protect. The advantage of quantitative analysis is that it provides a rigorous framework for debate to take place. With a quantitative model, it is clear what the key assumptions are and how the conclusions depend on these assumptions. This is very useful for evaluating the views of the Commission and other parties.

133. This issue flows through the following sections on counterfactual and factual scenarios and the benefits and costs of regulation: without proper quantitative analysis, the Commission is limited in its ability to carry out these assessments in a meaningful way. It is important to recognise that regulation will always have negative side-effects. Often these are so small that the economic benefits of regulation outweigh them. However, the Commission must quantify both the positive and negative effects to properly determine whether the benefits of regulation outweigh the

[45] Commerce Commission, supra note 1 at page 35, paragraph 171.
[46] Covec, *MTAS Regulation Quantitative Analysis*, 27 July 2009, paragraph 25.
[47] Vodafone New Zealand letter supra note 6.
[48] Commerce Commission supra note 3 at paragraph 46.
[49] Ibid, paragraph xxiv.
[50] As we are only aware of one jurisdiction, France, where SMS has been regulated, we do not expect that other regulators have considered or undertaken the modelling of SMS.

negative consequences. For example, in the MTAS investigation, the Commission's own analysis showed that the negative impacts on mobile customers and the wealth transfers between mobile and fixed operators are large compared to the welfare gains from regulation.

Counterfactual and factual scenarios (paragraphs 169 – 174)

134. We agree that the Commission, in assessing the likely impact of regulation, should compare:

- relevant counterfactual scenarios, which represent the Commission's view on what is likely to happen in the absence of regulation; and
- a factual scenario, where regulation is implemented.

135. While weight should be given to the counterfactual, special weight should be accorded to commercial solutions reached in the absence of regulation. Paragraph 172 notes that the counterfactual can include continuation of the status quo, but as stated in our previous submissions, Vodafone considers the Commission needs to apply the factual-counterfactual test twice when an undertaking is being considered:

- once when the net benefits of regulation are compared to the net benefits of non-regulation (i.e. relying on commercial agreements and, for MTAS, the MTR deeds); and
- once when the net benefits of regulation are compared to the net benefits of an undertaking.

136. Indeed, the Commission applied the factual-counterfactual test twice in the Schedule 3 Investigation into amending the national roaming service.[51] This included a comparison based on the scenarios of regulation as compared to relying on the commercial agreements.

137. Vodafone reiterates its view set out in earlier submissions that there needs to be sizeable net benefits for end users arising out of regulation compared to the counterfactuals. We note that the difference in net benefits should be "significant"[52], "material"[53] or "substantial"[54] as the Commission has stated in the past. This margin is required because of the risk of regulatory error,

[51] Commerce Commission *Schedule 3 Investigation into amending the roaming service: Final Report*, 10 March 2008, paragraphs 278-280.

[52] Commerce Commission *Schedule 3 Investigation into amending the roaming service: Final Report*, para 265 (10 March 2008); Commerce Commission *Schedule 3 Investigation into regulation of mobile termination: Final Report*, paras 225, 357, 405 (21 April 2006).

[53] Ibid, para 459.

[54] Commerce Commission supra note 52 at paragraph 266 (10 March 2008).

and because of the costs of regulatory intervention, uncertainty and delay.[55]

138. At paragraph 173, the Commission notes that it will consider the impact the amended regulation would have on new entry, and the effect of new entry, and the level of prices, service range and quality, etc. While we agree that the Commission should consider these factors, we note that these factors in and of themselves do not justify the factual scenario of regulation: the test must be whether the regulation will promote competition for the long-term benefit of end-users, and also consider the efficiencies that will result, or are likely to result from competition. The importance of looking forward and producing outcomes consistent with a workably competitive market in considering the factual of regulation, were considered by the Australian Competition Tribunal[56] in *Telstra Corporation Ltd (No 3)* [2007] AcompT3:

> *… we believe it is important not to confuse the objective of promoting competition with the outcome of ensuring the greatest number of competitors. That is, the Act aims to promote competition because of the benefits that result from the* process *of competition, such as lower prices for consumers and the displacement of inefficient suppliers by efficient suppliers. As the Tribunal observed in* Sydney International Airport *(supra) at par [108]:*
>
> > "The Tribunal is concerned with fostering competition in a forward looking way, not furthering a particular type or number of competitors."
>
> *The aim is not to ensure that the greatest number of competitors – irrespective of their level of efficiency – can enter and successfully remain in relevant markets. Rather, it is to ensure the existence of the conditions necessary to promote effective competition.*

Benefits and costs of regulation (paragraphs 175 – 184)

139. We agree with the Commission's approach to considering whether regulation will remove or reduce barriers to entry or expansion however, we do not agree with the Commission placing special weight on 'consumer surplus'.[57] While the Act says 'long-term benefits of end-users', economic efficiency says that producer and consumer surplus should be treated equally. There is a danger that putting more weight on consumer surplus will lead to regulatory decisions that reduce economic welfare overall, even if they increase consumer surplus. Under a consumer surplus test, any reduction in prices is justifiable as this will benefit consumers at the expense of producers (absent a waterbed effect). This is clearly an unsustainable approach devoid of rigour.

[55] Vodafone New Zealand Limited Submission supra note 27 at page 87, paragraph 306.
[56] *Telstra Corporation Ltd (No 3)* [2007] AcompT3 at [95] and [99] – [100].
[57] Commerce Commission supra note 1 at page 36, paragraphs 175 and 177.

140. We welcome the Commission's statements that it takes into account the costs of regulation, which can include detrimental indirect effects of regulation.[58] In the MTAS investigation, Vodafone has pointed out that a sharp and immediate decline in the mobile termination rate is likely to have a detrimental effect on low-spending mobile customers, as operators will find low spending customers less attractive and some may not be attractive at all. This may well result in price increases to those customers.[59] We have also pointed out the potential risk to on-net services which deliver significant value to customers. Vodafone welcomes the Commission's statement that the Commission is taking a wider view of the 'costs of regulation', and bearing in mind alternatives to regulation, when considering the cost implications of regulation.

141. The general point here is that some kinds of regulation, such as termination regulation, affect the incentives of operators to compete for different types of customer, and therefore affect retail prices and the welfare of different consumer groups in different ways. One way to minimise these distortions if regulation is justified is through the use of glide-paths which give operators time to adjust to the changes imposed by regulation and reduce the impacts on consumers.[60]

142. Vodafone agrees that regulation is a costly exercise. Accordingly, it is important that it only be undertaken in circumstances where there is significant market failure that needs correcting, and where the benefits of doing so (net of any regulatory costs) clearly outweigh the detriment to consumer welfare that results from this market failure. [61]

143. In the MTAS investigations, we submitted that the Commission must demonstrate economic benefits of regulation. We submitted that it is not enough for the Commission to devotedly stick to a mantra that price must equal overseas cost model estimates for all possible interconnection services. It must go further and demonstrate how doing so will generate sizeable net economic benefits. Regulation comes at a significant resource cost (and generates significant uncertainty for all business involved) that must be greatly outweighed by a likely net benefit to society.[62]

144. We refer the Commission to our comments on dynamic efficiency in section 4, in response to the similar issues set out in paragraphs 183 and 184 of the Guide.

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[58] Commerce Commission, supra note 1 at page 37, paragraph 180.

[59] Vodafone New Zealand, Submission supra note 27, page 8 -9, paragraphs 27 – 34.

[60] Analysys Mason, *Assessment of the position of the Commerce Commission of New Zealand in determining MTAS prices*, 27 July 2009, page 1.

[61] Vodafone New Zealand Limited Submission supra note 20 at page 53, paragraph 176.

[62] Vodafone New Zealand Limited Submission supra note 27 at page 100, paragraph 365.

Other efficiency considerations (paragraphs 185 – 186)

145. The Commission is required to determine the annual net cost of the TSO and the Act defines the net cost of the TSO with reference to the unavoidable net incremental costs of an efficient service provider.

146. We agree that the use of forward looking costs is regarded as being efficiently incurred costs.

Undertakings (paragraphs 187 – 188)

147. Please see our detailed discussion in section 3 above in respect of undertakings.

148. We agree that there are significant advantages associated with undertakings, including delivering similar outcomes, avoiding direct costs or regulation, timing efficiencies, certainty and earlier delivery of benefits to end-users. We are encouraged that the Commission takes these advantages into account when considering undertakings. However, we believe the Commission needs to give undertakings a fair chance to succeed. The current MTAS investigation has caused Vodafone to query the value of undertakings.

149. The Commission notes that the undertaking process is intended to be efficient and not unduly delay a Schedule 3 Investigation, and while we agree with this in principle, the two processes are interlinked, and the Commission can not expect Vodafone to submit a final undertaking without having first considered the Commission's final views on key assumptions, and the cost benefit model for all services. If this opportunity is not provided, the undertakings process is undermined.

Access Determinations (paragraphs 189 – 192)

150. We agree to the approach to STDs, and the requirement that in making any STD, the Commission must make the recommendation which best gives effect to the purpose set out in section 18 of the Telecommunications Act.[63]

151. The Commission states it will make changes to unanimously agreed Telecommunications Carriers' Forum (TCF) recommendations that have been included in a Standard Terms Proposal (STP), if the Commission considers that best gives effect to section 18.[64] Vodafone considers that TCF decisions should be given 'significant weight', and the Commission should first consult with the TCF, and should avoid making any decisions which override a TCF decision which has unanimous

[63] Commerce Commission, supra note 1 at page 38, paragraph 189 – 190.
[64] Commerce Commission, supra note 1 at page 38, paragraph 191 – 192.

agreement in the industry. This could be seen as undermining the TCF process, the value the industry places in the TCF and the agreements reached by the TCF. It also removes incentives for parties to reach unanimous agreement in TCF working parties. Vodafone suggests that the Guide ought to make clear that this should only be done in exceptional circumstances, and the Commission should be required to provide detailed reasons.

152. We think the process of clarifying existing determinations, with input from the TCF, has worked well to date. The one exception, however, is the recent proposed clarification of the UBA 'early termination charge'. This would far more appropriately be included in a section 30R review. As noted earlier, a section 30R review of the complete set of fixed-line STDs (to bring them into alignment with each other and to solve operational issues), is overdue.

Access Principles (paragraph 193 – 195)

153. Vodafone agrees with the access principles set out in the Guide.

154. The Commission considers it appropriate for standard access principles and limits on those principles to be 'built into' the terms of any STD.[65] However it would be helpful if the Guide could make clear what 'built in' means, such as broadly compliant, or actually incorporated.

Pricing Principles (paragraphs 196 – 200)

155. Vodafone agrees with the general approach to the Initial Pricing Principle (IPP), to apply the plain and ordinary meaning of the IPP within the wider context of section 18 of the Act.

156. We consider the Commission should apply a high degree of caution when using an IPP, as it will necessarily be less accurate than application of a cost model under the FPP.

157. As noted in our submission to the Commission on the Schedule 3A Undertakings, we believe the following approach should be taken:

- first, find the pricing principle that best meets the correctly defined purpose of the Act; and
- second, consider whether prices are presently consistent with that principle.

To carry this out in reverse, by determining the price outcome wanted, and then working backwards to find a pricing principle to support it (as we believe may happen from time to time),

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[65] Commerce Commission, supra note 1 at page 39, paragraph 195.

runs the risk of goal-seeking behaviour.[66]

Benchmarking (paragraphs 201 – 212)

158. Vodafone is in broad agreement with the Commission's approach to benchmarking as outlined in the Guide. It is appropriate to use benchmarking as a "yardstick" to estimate the cost of supplying a regulated service in situations where it is not necessary or desirable (in the interests of setting a price in a timely manner) to develop an actual cost model.

159. However, it has been Vodafone's experience that, in relation to benchmarking in Schedule 3 Investigations in particular, the Commission has not always been consistent with the approach outlined in the Guide.

160. We note that where benchmarking is used to establish a cost-based price, or a likely regulated price in a Schedule 3 investigation, the Commission will usually follow the IPP of "benchmarking against prices for similar services in comparable countries that use a forward-looking cost-based pricing method."[67] This approach was applied, correctly in Vodafone's view, in the Unbundled Copper Local Loop STD.

161. In order to assess the net benefits of regulation, it is crucial that the benchmarking used in the cost-benefit modelling reflects, as accurately as possible, the price that would be arrived at under the IPP. The Commission must conduct its benchmarking in a manner that is consistent with the proposed IPP, and this requires benchmarking against regulated prices, not cost estimates, and taking account of comparability.[68]

162. The importance of comparability is recognised in the Guide at paragraphs 208-209, and we acknowledge that the Commission has used comparability conditions in several benchmarking exercises. The fact that the Commission did not properly do so in the MTAS investigation marked a departure from its own draft pricing principles for the service and previous approaches it has taken to estimate the cost of this and other regulated services in New Zealand.[69]

163. In the last sentence of paragraph 208, the Commission notes "In considering such adjustments, the Commission will take into account the range of such cost drivers for which adjustments to the benchmarks might be made, and bearing in mind the objective of a benchmarking exercise to set

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[66] Vodafone New Zealand Limited Submission supra note 20 at page 29, paragraph 65.
[67] Commerce Commission, supra note 1 at page 40, paragraphs 205-6, and Schedule 1, Telecommunications Act 2001.
[68] Vodafone New Zealand Limited Submission supra note 27 at page 50, paragraph 164.
[69] Vodafone New Zealand *Submission to the Commerce Commission Telecommunications Act 2001: Submission on Schedule 3 Investigation into Regulation of Mobile Termination Access Services*, Dated May 2009, paragraph 154 – 157.

a price in a relatively timely manner". While we acknowledge the objective of a benchmarking exercise is to set a price quickly, this does not suggest that the Commission may avoid a comparability exercise to achieve that objective: the benchmarking exercise must include a comparability assessment having regard to the similarity of the services and other local characteristics that affect costs against the overseas services whose prices are being compared, for the exercise to be meaningful or even lawful.

164. When faced with a relatively small number of jurisdictions with forward-looking cost-based figures to benchmark against, the Commission has previously assessed comparability using a regression-based approach, estimating the relationship between cost drivers and cost-based prices.[70] Similarly, actual cost information may be used where relevant benchmarking information is not available.[71] Vodafone submits that these approaches would provide a sounder evidentiary basis for estimating a likely regulated price in a Schedule 3 investigation.

165. We agree with the Commission that it may be appropriate to use actual cost information when benchmarking is impossible.[72] However, a very high degree of caution should be used, and the costs should not be taken at face value but should be examined to determine if they represent efficient levels of cost.

166. In conclusion, Vodafone is encouraged by the Commission's acknowledgement at paragraph 201 of the Guide that the importance of a robust benchmarking exercise cannot be underestimated. International benchmarking is used to determine prices that have substantial impacts on the revenues and profitability of major businesses that have made substantial investments in infrastructure. It affects the returns on billions of dollars of investment. In these circumstances, the Commission must ensure it takes a rigorous approach to determine what appropriate rates for these services are.

Other considerations (paragraphs 213- 215)

167. The Commission states that, if the value of a quantitative cost-benefit analysis is negative, the Commission still has the discretion to act, if qualitative factors are deemed to be sufficiently important.[73] We consider this discretion should only be applied in exceptional circumstances. It would be helpful if the Commission could set out in the Guide examples of qualitative factors that it considers would justify it to act, in light of a negative quantitative cost benefit analysis. In

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[70] For example, in relation to the UCLL Backhaul STD, discussed at paragraph 211 of the Guide.
[71] For example, in relation to the Sub-loop STD, discussed at paragraph 211 of the Guide.
[72] Commerce Commission, supra note 1 at page 42, paragraph 211.
[73] Commerce Commission, supra note 1 at page 42, paragraph 213.

addition, as discussed above, total welfare (not consumer welfare) is the correct welfare measure to use for quantitative analysis. It is this measure against which any qualitative factors should be compared.

168. In paragraph 215, it is noted that costs and risks need to be factored into an overall assessment of the costs and benefits of regulation. We agree with the considerations listed by the Commission.

169. Vodafone believes that the first consideration “where there is demand for the service for which regulation is being considered” is very important, when considering costs and benefits of regulation. We are not convinced that the Commission has properly considered issues of demand in the past. In respect of mobile co-location, 2degrees asserted there was a demand. The Commission did not challenge this, or conduct its own research to verify the assertion. As a result, operators have spent millions of dollars to allow for regulated co-location: and to date that demand has never materialised. We encourage the Commission to first fully investigate whether something is ‘broken’, before taking action to ‘fix it’ with regulation.

Review considerations (paragraphs 216- 226)

170. Vodafone agrees with the list of factors the Commission will have regard to, in considering whether a designated access service should remain subject to regulation.[74]

171. It would be useful if the Commission could provide in the Guide an example of where it would require regulated access where there is not limited competition.[75] We would expect that this discretion would only be exercised in exceptional cases.

172. Vodafone encourages the Commission to take a pro-active approach to the principles set out in paragraphs 223 and 224, in respect of removal or rollback of unnecessary regulation. Vodafone welcomes the Commission’s statement that it encourages commercial outcomes to the extent possible, while providing a regulatory backstop where negotiation is unlikely to result in access being provided on reasonable terms. Vodafone encourages the Commission to give parties a fair chance to agree commercial outcomes, and have faith in recent regulatory and commercial arrangements that are in place and in progress as a result of its work on FTM termination rates and co-location and national roaming, and allow carriers to focus on implementing those arrangements and on further improving offerings in the marketplace. We suggest that the Commission consult with the parties, and provide detailed reasoning before making assumptions, about whether the negotiations will result in access being provided on reasonable terms.

[74] Commerce Commission, supra note 1 at page 44, paragraph 219.
[75] Commerce Commission, supra note 1 at page 44, paragraph 222.

Commercial Agreements and industry decisions (paragraph 227 – 231)

173. We refer to our discussion of commercial agreements earlier in this section 5.

174. Vodafone (whether in its capacity as access seeker or access provider) takes the obligation in section 22 of the Act to make reasonable attempts to achieve commercial arrangements before turning to the Commission very seriously, and has a strong track record of being willing to reach commercial agreement on reasonable terms and conditions. For example, the national roaming commercial agreement was "negotiated" in context of the Commission's investigation and with Vodafone's voluntary undertakings available to 2degrees.

175. We are encouraged that the Commission will decline an application if there is not enough information to assess whether reasonable attempts have been made to negotiate.[76]

176. Finally, the Commission should be prepared to get involved and negotiate with parties providing undertakings, face to face. It is clear from the Act that the Commission and the party giving the undertaking must reach agreement, and we consider that agreement will require a more conventional negotiation. The best time to conduct this negotiation may be before the draft report has been produced with a further opportunity to submit revised undertakings.[77]

177. Vodafone considers that industry codes are extremely valuable and a great example of reaching commercial outcomes without having to resort to regulation. Vodafone is happy with the TCF and the constructive role it plays in developing such industry codes.

Reviewing the Regulatory Framework over time

178. Vodafone welcomes the Commission adopting forward looking perspectives that encourage investment and innovation in the sector, giving consideration to dynamic efficiency aspects where competition is to be promoted, and taking into account investment incentives for all operators.[78]

Other

179. While the issue of review and appeal of Commission decisions is not addressed in the Guide, Vodafone provides some high level comments on merits review, for the Commission's consideration.

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[76] Commerce Commission, supra note 1 at page 45, paragraph 228.
[77] Vodafone New Zealand Limited Submission supra note 20 at page 17, paragraph 21.
[78] Commerce Commission, supra note 1 at page 45, paragraph 234.

180. Vodafone supports the concept of merits review of Commission decisions by a court or higher regulatory body.[79] The principal objective of merits review is to ensure that the correct or preferable decision is reached. In other words, was the decision the best one that could have been made in the circumstances? Or, in the words of section 52Z(4) of the Commerce Act 1986, is there a "materially better" option? Currently there are few checks and balances on the substance of the Commission's decision-making. Whilst the Commission is obliged to receive submissions, it has wide discretion as to whether it gives submissions any weight. For example, in the MTAS process Vodafone identified that in the Commission's benchmarking the selection of France as a comparator country was plainly not in accordance with the Commission's own selection criteria, since the French cost model was based on some historical accounting approach. The Commission has refused to acknowledge this error in its work and there are no further means of correcting the mistake within the scope of the investigation.

181. The benefits flowing from merits review have been articulated by Professor David Round, a lay member of the New Zealand High Court and a current and former member of several regulatory bodies in Australia, including the Australian Competition Tribunal and the Australian Communications and Media Authority. In summary, merits review:[80]

- promotes transparency, accountability and consistency in regulators' decisions;
- diminishes the likelihood of regulatory error and its consequential private and social costs;
- clarifies the operation of statutes and indicates where amendments may be necessary;
- promotes an environment in which long-term investment decisions can be made with confidence; and
- ensures that the regulatory outcomes are consistent with policy intentions.

182. Professor Round concludes that the availability of merits review is "an essential component of any regulatory best practice package."

183. New Zealand is unusual in not having merits review under the Telecommunications Act,[81] and it

[79] See, for example, Vodafone New Zealand Ltd submission to Ministry of Economic Development on Digital Strategy 2.0, 23 May 2008, paragraph 56, and Vodafone New Zealand Ltd oral submission to Finance and Expenditure Committee on the Telecommunications Amendment Bill 2006.

[80] Professor David Round, "The Merits of Merits Review" [2006] NZLJ 237, 240.

[81] We note that, in contrast, section 52Z of the Commerce Act 1986 provides for merits review in respect of input methodologies determinations, and section 91(1) provides for rights of appeal on the merits of price-quality path determinations and questions of law arising in respect of determinations regarding other regulatory instruments.

is Vodafone's view that we need to be aligned with international best practice in this respect.

184. In the European Union, merits based review is mandated in the telecommunications sector, where appeals have been heard and upheld. In Australia, merits review of ACCC decisions by the Australian Competition Tribunal is available under Parts IIIA (general access regime) and XIC (telecommunications specific access regime) of the Trade Practices Act 1974.

185. The downsides of merits review are often stated as being increased delay and costs. However, these factors can be mitigated or at least minimised if the review process is designed appropriately. For example:

- the Commission's decision could be implemented pending the review process;[82]
- a review would only allow evidence to the appeal body that was submitted to the Commission;[83] and
- the party appealing would bear the costs of the appeal if the appeal were rejected.

[82] As is the case under the section 53 of the Commerce Act 1986 in respect of appeals from determinations on input methodologies.

[83] As is the case under section 52ZA(2) of the Commerce Act 1986.