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PUBLIC VERSION
BY EMAIL (neville.lord@comcom.govt.nz)

Dear Neville

Cross submission on Vodafone's interconnection application

1. This letter is Vodafone's cross-submission on the Commission's draft determination of 19 June 2006 on our application for interconnection with Telecom's fixed PSTN.
2. We have limited ourselves to comments on Telecom's submission to the Commission of 3 July 2006. We do not repeat arguments in our application or in submissions made subsequent to the Commission's decision to investigate.
3. We also attach a note prepared by Covec that comments on issues relating to the TSO and the impact of the Commission's proposals on Telecom's ability to recover its network costs.
4. As usual we have marked with square brackets and identified as VNZRI the restricted information in this submission. This information relates to the content of commercial agreements between Vodafone and Telecom that we are not at liberty to disclose publicly.
5. We will provide a public version of this cross submission shortly. There is no confidential information in the Covec note.

Summary

6. We make four main points in this cross-submission:
 - Bill and keep is the most efficient pricing principle for local interconnection in the presence of the TSO obligation regardless of the technology used to deliver a local calling service. Bill and keep is not exceptional for local call interconnection, and it will not mean under-recovery of costs by Telecom – indeed, bill and keep will save Telecom the costs of termination on our network for local calls.

- The Commission does not need to be concerned with what happens beyond the point of interconnect. Standard anti-manipulation provisions in the contract plus the NAD rules on geographic structure will help manage any risks of arbitrage.
- A retail price discrimination condition is appropriate to prevent Telecom from using its market power in the local service markets to prevent Vodafone's market entry. Section 30 of the Telecommunications Act 2001 permits, and in this instance obliges, the Commission to impose this type of condition. This is not retail price control.
- The TSO does not justify protecting Telecom from competition. Covec has investigated these issues and concludes that Telecom is unlikely to face higher TSO losses as a result of the Commission's proposals.

7. We address each of these points in turn below.
8. This determination gives the Commission the opportunity to generate real change in markets that have remained stubbornly non-competitive. All that we are asking is for the Commission to enforce standard commercial terms for local interconnection, and prevent Telecom from continuing to restrain nationwide competition from Vodafone in local access and calling.
9. We are encouraged by the Draft Determination. A final determination that is consistent with the terms of the Draft will lead to competitive benefits for all customers.

Bill and keep is the best pricing principle in this case

10. Telecom's submission paints a very bleak, and in our view, over-stated picture for the future of interconnection in New Zealand should the Commission determine bill and keep as the appropriate pricing principle.

There are many reasons to prefer bill and keep

11. The Draft Determination cited numerous reasons why forward-looking cost-based pricing for local service interconnection would not best give effect to the purpose of the Act. These included:
 - Telecom would face higher termination costs that would need to be passed on to its retail customers, impairing Vodafone's ability to attract customers to its local service,
 - Forward-looking cost-based pricing would create incentives that are likely to lead to an imbalance of interconnection traffic, and
 - The parties would have strong incentives to game the pricing structure and target (and possibly cross-subsidise) particular customer groupings, such as those that have large inbound one-way traffic streams.
12. Telecom's submission does not address the efficiency arguments in favour of bill and keep. In our view the Commission is correct to conclude that bill and keep is

preferable to a cost-based regime when other local operators are using bill and keep.

- Requiring Vodafone alone to pay termination charges for local calls would leave us at a competitive disadvantage relative to other carriers.

Bill and keep is not as exceptional as Telecom would have the Commission believe

13. Telecom states that (para 6):

“Bill and keep was originally adopted in New Zealand to address a ... callsink situation created by the requirement that Telecom offer free local calling to residential customers under the TSO”.

14. This is not the full picture. Bill and keep was not adopted in New Zealand solely to address callsink scenarios.

- For example, Vodafone has in the past [] VNZRI
- Similarly, Vodafone currently [] VNZRI

15. The Act specifically recognises bill and keep as an alternative pricing principle, available where the Commission considers that a forward-looking cost-based pricing principle does not give effect to the Act's section 18 objective.

- Parliament chose not to link the use of bill and keep as a pricing principle with the free local calling option in the TSO.
- Bill and keep is not restricted to fixed networks either. Parliament did not link in any way the choice of pricing principle with the access seeker's network technology.

Bill and keep is normal for interconnecting local calling services

16. Bill and keep for calls from fixed to mobile networks on calling-party-pays is unusual. This is partly because local service offered over a cellular network is an innovative service offered so far in just a few countries globally.

17. Such innovation however ought not to change the Commission's standard approach that it is *services*, not *technologies* that are the most appropriate basis for telecommunications regulation.

18. Bill and keep in relation to a local calling service is widespread in the New Zealand market. So using bill and keep for local calling services regardless of the technology used to deliver those services is consistent with a technology-neutral view of regulation.

Bill and keep is unlikely to lead to Telecom under-recovering costs

19. Telecom's submission suggests that the adoption of bill and keep as an interconnection pricing principle could affect Telecom's ability to efficiently recover costs by virtue of a "substantial increase in call traffic" on its network.
20. Covec has considered this issue and finds it difficult to envisage any scenario whereby Vodafone's local service will either significantly increase traffic on Telecom's network or affect Telecom's ability to efficiently recover its costs:
 - As Telecom customers switch to Vodafone's local service, Telecom's subscriber numbers will fall (reducing traffic), and
 - To the extent that Telecom customers elect to call a Vodafone local service number instead of making a Telecom-fixed to Vodafone-mobile call, there will no change in Telecom's fixed local access network traffic (volume neutral).
21. Covec explains that traffic on Telecom's local access network could increase only if Vodafone's local service stimulates greater overall call activity and that this is not offset by lower traffic on Telecom's network due to customers switching to Vodafone's local service.
 - This effect does seem very unlikely, given the scale of the change in volumes required.

Bill and keep will allow Telecom to avoid termination fees

22. Bill and keep is a reciprocal pricing system so both parties receive something valuable in return for the termination of calls. The overall picture of cost and revenue changes needs to be considered when thinking about the efficiency of bill and keep.
 - Even if bill and keep did lead to increased costs for Telecom (which we very much doubt as explained above), the Commission also needs to consider the costs that Telecom avoids as a result of having bill and keep.
23. Vodafone will not have to pay a termination charge on Telecom's network. In return, Telecom does not have to pay a termination charge for calls to Vodafone's network.
 - The current rate for termination on Telecom's fixed network is 1cpm. The equivalent rate for calls to Vodafone's mobile network is around 20 times this level.
 - Vodafone is offering Telecom effectively a zero price for something of significantly greater value, but in response Telecom appears to be suggesting that a zero price is too low.
 - We continue to be surprised by Telecom's reluctance to accept what to us seems like a very attractive offer.

Beyond interconnection, restrictive controls are not necessary

24. Telecom maintains that the Commission ought to be concerned with retail aspects of Vodafone's local service in determining the wholesale fixed-PSTN interconnection relationship between Telecom and Vodafone for local calls.
- Telecom does not address the Commission's statement in paragraph 47 that "the Act neither requires that the Commission determine the characteristics of the access seeker's retail product, nor does it impose requirements of the characteristics of the access seeker's retail product".
 - Nor has Telecom sought to demonstrate the relevance of what Vodafone does with a call beyond the point of interconnection to Telecom's obligation to supply the designated access service.
25. Vodafone encourages the Commission to resist Telecom's suggestion to restrict Vodafone's retail product offering.

- [**] VNZRI**
- Controls continue to be unnecessary and unwarranted, and would only risk restricting Vodafone's flexibility in introducing new retail products in the market and therefore constrain the scope of innovation.
- Our application outlined a "homezone" concept that the Commission could use if the Commission concluded that geographic restrictions on Vodafone's retail service were necessary. However, Vodafone's position remains that such restrictions are inappropriate.

Both anti-manipulation provisions and the Numbering Rules already guard against the arbitrage opportunities Telecom raises

26. Telecom makes much of the perceived arbitrage opportunities that it believes could arise from the Commission's proposed definition of a "local call" for interconnection purposes.
- Telecom states that (paragraph 2, Appendix A) "taken to its extreme, Telecom would not recover its interconnection costs for a potentially wide range of call types".
27. We do not think the issue is anywhere near as serious as Telecom says. This is an old problem, not one created by the Commission's definition of "local call" in the Draft Determination.
28. In addition, it can be dealt with through the existing mechanisms: anti-manipulation provisions in contracts, and the requirements of the Number Administration Deed.
29. We cover each of these points in turn.

Anti-manipulation provisions

30. A number of years ago, Telecom began inserting “anti-manipulation” provisions in its interconnection agreements to deal with arbitrage risks, including with fixed operators. Here is an example from Telecom’s agreement with TelstraClear (Decision 477, Clause 4, Schedule 3):

“4.1 Neither carrier will attempt to artificially manipulate Call presentation information provided to the other carrier so that a Call definition that:

- a. would not otherwise apply but for the artificial manipulation, does (based on the Call presentation information provided to the other party) apply; and/or
- b. would otherwise apply but for the artificial manipulation, does not (based on the Call presentation information provided to the other carrier) apply.

e.g. a “Standard Call” being or appearing to be an “Intra-LICA Call” (or *vice versa*).”

31. The purpose of these anti-manipulation provisions is primarily to prevent an originating carrier presenting a call that would otherwise have been a standard call as a local call when it hands the call over to Telecom.
- Handing over a call as a local call would mean that bill and keep would apply, rather than an approximately 1 cpm termination charge that applies to standard calls.
 - We assume this is the type of arbitrage opportunity that Telecom describes in the Commission-only section of its submissions at paragraphs 26-34 of Appendix A, although of course we have had no opportunity to comment on this information.
32. Vodafone is happy to agree an anti-manipulation provision as we have in our existing NISSA with Telecom that would deal with this risk.

Numbering rules

33. The requirements under the numbering rules that Vodafone’s retail local service have a “geographic structure” should further allay Telecom’s concerns. Vodafone’s retail local service has to have a geographic structure, which we assume would not be the case for the originating carriers in Telecom’s arbitrage examples.

The Commission’s approach to defining local calls (i.e., by reference to local numbers) is the only technology neutral approach

34. Vodafone cannot see a truly technology-neutral approach to defining “local calls” other than what the Commission has adopted in its Draft Determination.
- Any attempt by the Commission to impose, for example, geographic constraints on where a local call can be originated or terminated, will only serve to limit competition between rival technologies.

- There need be no “fixed” equivalent in a mobile network or a broadband wireless network, yet both types of networks are clearly capable of delivering local access and calling services.

Designated designation has nothing to do with defining call types

35. In its submission Telecom misrepresents the significance of the definition and use of “Designated Destination” in interconnection agreements.

- Telecom appears to be suggesting that the use of “Designated Destination” in Telecom’s agreement with TelstraClear (as referred to in Decision 477) somehow provides wider contextual support for the view that what happens beyond the point of interconnection is important.¹

36. In particular, Telecom implies that:

- It is standard interconnection practice to define what happens beyond the point of interconnection, and
- What happens beyond the point of interconnection was important to the rationale behind the Commission’s Decision 477.

37. [

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38.

] VNZRI

Retail price non-discrimination requirement remains necessary and appropriate

39. Telecom’s submission appears to both accept and reject the Commission’s ability to impose a non-discrimination retail pricing condition.

- At paragraph 3(c) Telecom proposes a retail non-price discrimination requirement as one of three solutions.
- Yet at paragraph 10, Telecom repeats its previous submission that the Commission lacks the jurisdiction to impose such a requirement.

40. In our view the position is very simple. The Commission is required in this case to impose a non-discrimination obligation on Telecom to forestall efforts by Telecom to prevent Vodafone from competing with it in local services.

¹ As Telecom points out, the definition of “intra-LICA call” in that agreement was not determined by the Commission, but was agreed between Telecom and TelstraClear.

The Act clearly provides the Commission with jurisdiction to impose a requirement necessary to preserve the value of regulating

41. The Act grants the Commission broad powers in section 30 to impose “terms” and “conditions” and “actions” to supplement the terms on which the service must be supplied under a determination. Section 30 reads:

30 Matters to be included in determination

A determination must include-

- a) The terms on which the service must be supplied; and
 - b) The reasons for the determination; and
 - c) The terms and conditions (if any) on which the determination is made; and
 - d) The actions (if any) that a party to the determination must do or refrain from doing; and
 - e) The expiry date of the determination.
42. Section 30 provides the Commission with jurisdiction to address any practice of an access provider (including those at a retail level) that could substantially impact on the likelihood of the competitive benefits of the determination flowing to end-users. Either section 30(c) or section 30(d) provides the Commission with clear jurisdiction to impose a non-discrimination requirement.
43. The risks to Vodafone of Telecom discriminating between calls to Vodafone local numbers and third party networks are high. The Commission identifies in its Draft Determination the powerful incentives Telecom will have to deter customer switching.

The proposed non-discrimination requirement is consistent with the Commission’s duty to promote competition in telecommunication markets

44. Sections 18 and 19 of the Act provide that the Commission has a duty to make a determination which it considers is likely to best give effect to the section 18 objective of promoting competition for the long-term benefit of end-users.
- A determination with the proposed Telecom pricing requirement would clearly promote competition more than a determination without a pricing requirement.
45. Telecom does not address the Commission’s statement in paragraph 121 that for Vodafone’s service to be an effective substitute for existing local access services, end-users will expect other users to be able to call them at rates comparable to other local calls.
46. Vodafone agrees with the additional observation in the Draft Determination at paragraph 123 that Telecom’s inability to price discriminate as between calls to Vodafone local numbers and other networks will avoid widespread customer confusion and preserve the pro-competitive effects of the Commission’s earlier local and mobile number portability determination.
47. The Commission has previously imposed conditions on retail pricing where necessary to ensure the pro-competitive impact of its rulings at wholesale:

- It prevented donor network operators from charging their customers the per-line setup costs of porting their numbers in its number portability cost allocation determination.
- It required Telecom to ensure that customers switching from a Telecom connection to a TelstraClear bitstream service receive a refund for the any unused portion of the relevant billing period in its draft determination on bitstream access between TelstraClear and Telecom.

What the Commission is proposing is not retail price regulation

48. The non-discrimination requirement is not retail price regulation as Telecom argues. The requirement simply pegs the price to call a Vodafone local number to the price of calls to third party networks, which Telecom remains entirely free to determine.
- The fact that Telecom has committed to free local calling under the TSO Deed for its residential customers is of course an existing constraint on Telecom's ability, but one that was voluntarily agreed to by Telecom with the Crown.
49. Vodafone is not aware of Telecom ever having differentiated its local calling retail prices as between service providers, even for local calls to existing non-fixed PSTN networks such as Woosh.
- While Telecom does discriminate between local calls and fixed-to-mobile calls, this is a function of there being a clear cost difference between the two call types.
 - Vodafone is unable to see why Telecom, faced with no cost differential in originating a call to a Vodafone local number, would wish to differentiate retail prices other than as a means to deter customers from switching to Vodafone's local service.

The Commerce Act provides a means to avoid discrimination but it is extremely inefficient compared with a simple condition set by the Commission

50. Vodafone agrees with Telecom that anti-competitive price discrimination could be pursued by Vodafone under the Commerce Act 1986. But Vodafone's strong preference would be for the Commission to address this issue now in a manner far simpler and more effective than protracted litigation in the Courts.
51. We also agree with CRA that it is not sensible to think in terms of a per-call price squeeze.
- However, the real point is not so much about price squeeze, but rather that Vodafone will not be able to compete effectively if Telecom can charge its customers more for calling Vodafone local customers than for calling local customers of other fixed operators.

The TSO does not provide a rationale for inefficient interconnection regulation

52. Telecom states that Vodafone's local service will mean an increase in the net cost of the TSO, and that it will have dire consequences for the whole of TSO regime.
53. In practice we think that the implications of Vodafone local service for the TSO are very minor, and the TSO funding system was designed to deal with the impacts of increased competition anyway. Below we explain why we think this. We also explain our views on what the Commission should do if it has concerns about the impact of our local service on the TSO.
54. Vodafone's starting assumption is that the TSO should not be used to deter the development of innovative services, or to deny any competitor the opportunity to contest a market with Telecom.
55. Telecom's main concern seems to be that its fixed-to-mobile calls may not be as profitable if some of those calls become local calls to Vodafone's local service customers.
56. We do not think that concerns about a loss of Telecom profitability due to competition provide a rationale to impose an inefficient interconnection solution.
57. In any case, we do not think that Telecom's preferred solution, i.e., cost-based interconnection pricing, will make a significant difference.

The impact on the TSO will only be minor

58. Telecom gives the impression that the impact of Vodafone local service on the TSO will be very significant.
59. In the attached note Covec provides an analysis of what might realistically be considered to be the impact on the TSO from Vodafone's local service.
 - The design of the TSO means that competition for local access from Vodafone is unlikely to change the net cost of the TSO.
 - Telecom may lose profits from the value-added services that it provides to its local access customers if customers substitute fixed-to-Vodafone local calls for fixed-to-Vodafone mobile calls. The TSO methodology can cope with reductions in supplementary revenue, and this is no different from any other increase in competition that affects Telecom's ability to earn supplementary revenues.
 - If Vodafone attracts commercially-non-viable customers from Telecom, the net cost of the TSO may increase or decrease depending on traffic flows. Of course, this would also raise serious questions about whether those customers are actually commercially-non-viable.
 - Overall, Vodafone's local service is unlikely to result in a significant increase in the volume of traffic on Telecom's local network and may well result in a decrease.

60. Telecom has also overstated the importance of the TSO itself. Telecom states at paragraph 6, “in relation to residential fixed local calling, Telecom’s costs are recovered by way of the TSO levy”.
- In fact the TSO levy only applies to Telecom’s commercially non-viable customers as defined in section 84 of the Act.
 - The latest TSO estimates from December 2005 say that only 3% of total fixed line connections, or approximately 54,000 residential customers, are estimated to be commercially non-viable.
 - So for 97% of Telecom’s residential fixed line customers, there is no recovery of costs at all from the TSO levy.
 - Plus Telecom only recovers a contribution towards its net costs from liable persons. In fact it meets most of the costs of commercially non-viable customers itself.
 - On the latest figures, the TSO provides Telecom with revenues of around \$12 million a year compared with local calling revenues of around \$1.1 billion.

The TSO exclusion for local calls to mobiles is unnecessary with bill and keep interconnection

61. Telecom argues at paragraph 10(b) that “the TSO was negotiated between the Crown and Telecom to specifically allow charging for calls to mobile networks. This was anticipated and accepted by the Crown.”
62. The only reason why the TSO needed to exclude calls to mobile networks from the free local calling option is the un-stated assumption that calls from fixed networks to mobile networks would continue to incur the sort of termination charge that was prevalent at the time of the TSO Deed.
- Behind the exception must have been reasoning to the effect that, if Telecom was to face this level of termination charge, then Telecom must have the ability to recover the termination cost through its retail charges.
63. This thinking just is not relevant when the charge for a call to a local number on our network is zero.

The Commission should recommend that issues of TSO neutrality be explored in the current review

64. Bill and keep and the non-discrimination condition remain the most efficient course the Commission can adopt to promote competition in local service markets.
- Vodafone does not accept that the unlikely possibility of a small rise in the net cost of the TSO gives the Commission cause to alter its Draft Determination.

- It would be poor public policy indeed to enshrine inefficiency in interconnection regulation in order to avoid the risk of impact to the TSO net costs. Indeed, one of the major policy thrusts behind the introduction of the TSO was to remove TSO contributions from fixed interconnection prices to avoid just this sort of inefficiency.

65. The TSO is in need of fundamental reform. It would benefit from the removal of obvious technology anomalies (such as the exclusion of local calls terminating on a mobile network where interconnection is free).
66. The Minister of Communications has announced a review of the TSO regime. We encourage the Commission to recommend to the Minister that this review address technology neutrality of the TSO.

Non-price terms

67. Vodafone agrees with the Commission's suggested approach of allowing the parties 30 days within which to negotiate and finalise all outstanding non-price terms. Vodafone also agrees with the Commission's caveat that either party be entitled to revert to the Commission after this period with any issue the parties have been unable to agree upon.
68. We support Telecom's suggested approach to implementation and testing as set out in paragraph 18 of Telecom's submission. Upon Vodafone providing notice to Telecom, the parties will have a maximum of 12 weeks to complete such technical testing and preliminary processes necessary for interconnection.

Conclusion

69. This determination gives the Commission its greatest ever opportunity to promote competition in local access and calling by enforcing standard commercial terms for local interconnection. A final determination consistent with the Draft would have substantial competitive benefits.
70. We encourage the Commission to move swiftly to a determination on Vodafone's application. Like Telecom, we would be more than happy to attend an informal workshop if that would assist the Commission to work through the issues. However, we do not think that local interconnection is nearly as complicated as it is being made out to be.
71. If you have any questions on this submission or require further information, please email me at hayden.glass@vodafone.com or call 021 689 176.

Yours sincerely
Vodafone New Zealand Limited

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