



GOVERNMENT & INDUSTRY RELATIONS

Telecom New Zealand Limited

Level 2, North Tower, Telecom House
68-86 Jervois Quay, PO Box 570, Wellington
Telephone: (04) 498 5573
Facsimile: (04) 473 9190
Email: bruce.parkes@telecom.co.nz

3 July 2006

Douglas Webb
Telecommunications Commissioner
Commerce Commission
PO Box 2351
WELLINGTON

Dear Douglas

VODAFONE'S APPLICATION FOR DETERMINATION FOR INTERCONNECTION WITH TELECOM'S FIXED PSTN: SUBMISSIONS ON DRAFT REPORT

1. The Commission's draft determination of Vodafone's application for interconnection with Telecom's fixed PSTN opens up new opportunities for access and calling in New Zealand. With the increase in fixed and mobile convergence internationally, Telecom accepts (and has always accepted) the Commission's conclusion that Vodafone must be able to interconnect with Telecom's fixed PSTN for the purpose of offering its proposed service.
2. The key questions have been what the terms and interconnection charge should be, and how parties can recover their costs. Telecom believes that the question of interconnection charging and cost recovery can be answered in a way that allows Vodafone to offer a viable service while maintaining the integrity of the interconnection regime in New Zealand.
3. Telecom proposes three solutions as workable alternatives for the Commission to consider in determining the appropriate pricing construct:
 - (a) TSLRIC termination payments, with the ability to charge at retail;
 - (b) Bill and keep interconnection, with the ability to charge at retail, with a clear definition of what happens beyond the point of interconnection; or
 - (c) Bill and keep interconnection, a non-discrimination of retail charging requirement, with a clear definition of what happens beyond the point of interconnection.

TSLRIC

4. As a starting assumption, TSLRIC termination is the appropriate interconnection charging mechanism, to allow parties to recover their costs from an access seeker. Telecom's preference for interconnection charging is TSLRIC interconnection, as this fits with the underlying rationale for interconnection in New Zealand. TSLRIC interconnection also makes the question of how Vodafone's service is defined beyond the point of interconnection less important.

5. However, when coupled with an inability to charge at retail, TSLRIC termination creates a potential callsink scenario. Such a scenario would become unworkable from an interconnection perspective, and the potential cost impact would mean that it was not in the best interests of end-users.

Bill and keep

6. Bill and keep was originally adopted in New Zealand to address a similar callsink situation created by the requirement that Telecom offer free local calling to residential customers under the TSO. The implicit assumption underlying bill and keep is that there will be no interconnection charge levied between providers, and that providers will recover their costs from end-users of the service. In relation to residential fixed local calling, Telecom's costs are recovered by way of the TSO levy, and has in part been factored into the price-capped line rental set by the TSO.
7. The draft determination proposes that bill and keep should apply for interconnection between Telecom's fixed PSTN and local numbers allocated to Vodafone's mobile network. It is also proposed that Telecom would not be able to discriminate between calls to Vodafone's proposed service and local calls to fixed networks when setting its retail prices. These parameters, coupled with the TSO, mean that Telecom would not be able to recover its costs for calls from its residential customers to Vodafone's proposed service either through call charges or increased subscription prices.
8. Telecom understands the Commission's desire to facilitate Vodafone's entry into the local calling market, and does not object to Vodafone entering the market. However, entry should not be promoted at Telecom's own cost – which includes both incremental and common costs due to the TSO limitations. The Commission has not limited Vodafone's ability to recover its costs from offering its local service, and neither should it limit Telecom's ability to recover its costs. If the scope of bill and keep is extended with no mechanism for a party to recover its costs at retail, the interconnection regime in New Zealand will become unworkable.
9. If the Commission's preference is for bill and keep, Telecom believes that the best way forward is to allow parties to recover their costs through retail charges, and allow normal competitive pressures determine what those retail charges should be. Those competitive pressures will be enhanced by Vodafone's entry into the market and, if Vodafone's assumptions are correct, its service will be competing directly with other local access and calling products. Vodafone can offer a viable service without the Commission constraining Telecom's ability to recover its costs. Any concerns as to potential price squeezes can be addressed through the application of the Commerce Act.
10. Principled and economic arguments aside, there are also two issues raised previously by Telecom that the Commission is yet to address in relation to the proposed limitation on Telecom's retail charging:
 - (a) The Telecommunications Act only allows the Commission to determine wholesale prices, and not retail prices; and
 - (b) 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. The Commission's decision displaces that decision.
11. The Commission has suggested that Vodafone would be subjected to a price squeeze were it to pay termination fees in the face of Telecom offering free residential calling at retail. Telecom disagrees with this conclusion for a number of reasons: Vodafone need not necessarily match Telecom's offer of free local calls and (unlike Telecom) is not constrained from charging; not every call need be profitable at the margin; Vodafone's service is different to Telecom's and could attract a premium due to additional

flexibility (indeed this has been signalled in a recent article in The Dominion Post)¹. CRA expands on these issues in the attached paper.

12. Where this brings us to is that, while Telecom's preference is TSLRIC interconnection, if the Commission opts for bill and keep, Telecom should be entitled to recover its costs and the only options for doing so is at retail.
13. If the Commission is minded to determine bill and keep, what happens beyond the point of interconnection becomes critical.
14. To maintain a workable interconnection regime which strikes a commercial balance between services subject to bill and keep and others subject to cost-based pricing, it will be important for the Commission to clearly define Vodafone's service as one that is genuinely local in nature – including a clearly defined HomeZone and "local call". The success of the existing interconnection regime relies on a clear delineation between call categories to which particular interconnection regimes apply (e.g. local calls vs toll bypass).
15. At present, Vodafone's service is only defined by reference to its use of local numbers which creates a risk that bill and keep will be extended to categories of calls that were not intended fall within bill and keep, and will create incentives for carriers to characterise as many calls as possible as (free) "local calls". Taken to its extreme, the absence of any limitation on the scope of the Commission's determination would mean no interconnection or residential retail revenue for Telecom, which is clearly not in the interests of end-users, and not what we understand the Commission to intend. Telecom's views on the potential impact of such an extension are elaborated in the attached summary of the thoughts of the Telecom Wholesale Services team.
16. While Telecom believes that it should be able to recover its costs in some way, if the Commission determines bill and keep, and limits Telecom's ability to recover its costs through retail charging, it becomes even more critical that the Commission clearly define and limit what happens beyond the point of interconnection.

Non-price terms

17. Telecom agrees with the Commission that the parties should be left to negotiate the detailed non-price terms. However, if the Commission determines bill and keep, guidance from the Commission on the appropriate HomeZone (required by Vodafone's proposed non-price terms) and what constitutes a "local call" for Vodafone's purposes will greatly assist those negotiations.

Implementation

18. On the issue of implementation, the Commission proposes that the parties begin testing within 30 days of the final determination. It is not clear whether Vodafone is ready to test or launch its service immediately, and there may be technical issues yet to be resolved. For this reason, Telecom suggests that any implementation timeframes start from the date on which Vodafone notifies that its service is technically ready for testing and provides Telecom with the relevant number ranges. Telecom has also investigated its likely implementation timeframes, and estimates that it requires at least 12 weeks from the time of notification until the service is ready for full launch from Telecom's network end (i.e. 3 weeks

¹ <http://www.stuff.co.nz/stuff/0,2106,3705622a13,00.html>, hard copy also attached..

longer than estimated by the Commission). The change required to Telecom's network is labour intensive and requires any new number range to be mapped into every switch.

19. To assist with the Commission's consideration of the matters raised in this letter, I attach two documents:

(a) Appendix A summarises Telecom Wholesale Services' views on the interconnection regime in New Zealand and the potential wholesale business impacts of the Commission's draft determination; and

(b) Appendix B is a report from CRA setting out the economic rationale of: bill and keep; the issue of price squeeze; and the TSO cost recovery; and

20. Given the complexity of the issues involved, if it would assist the Commission work through the issues, Telecom would be happy to attend an informal workshop.

Yours sincerely



Bruce Parkes
General Manager, Government & Industry Relations