

26 June 2006

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Commerce Commission
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**BY EMAIL
PUBLIC VERSION**

Dear Kate

Submission on draft report on extension of regulated services

1. This letter is Vodafone's submission on the Commission's draft report on its investigation into whether to extend the regulation of services in the Telecommunications Act.
2. This is the Public version of our submission.
 - We are requesting Commission-only protection for the information in this submission marked in square brackets and labelled '**VFNZCOI**'. This information relates to the current commercial arrangements that we have or are negotiating with other carriers that our confidentiality agreements oblige us not to disclose.
 - As usual, we have marked all restricted information in square brackets and labelled it '**VFNZRI**'.

Summary

3. We support extension of regulation of number portability and interconnection with Telecom's fixed PSTN.
 - It would be destabilising for the industry number portability project if regulation were left to expire four months before the service is due to be launched.
 - There are compelling market failure grounds for continuing to regulate interconnection with Telecom's PSTN.
4. We continue to argue that there is no evidence of a market failure in the case of co-location, and no need to regulate it.
 - We have strong incentives to negotiate co-location arrangements. Co-location saves us money. Vodafone is currently the biggest access seeker of co-location.
 - The best evidence for this point of view is the large number of agreements with most of the existing operators that we already have for co-location, about 40 of which are not with Telecom. The process for co-location is well

established, the pricing for co-location is very reasonable, we offer the same terms to all comers (although pricing does change over time, of course).

5. We also argue that regulation of roaming is unnecessary, given existing commercial arrangements, and the obvious incentives on the existing operators to negotiate reasonable terms with entrants.
- We would prefer to negotiate a reasonable deal with a credible new entrant. Refusing to negotiate a roaming deal will cost us wholesale revenue, since we will not get any roaming traffic on our network. And it will not help protect our retail business if the entrant joins the market anyway either by building a network or by roaming on Telecom's network.
 - If we were to refuse to offer roaming to a genuine entrant or to only offer roaming at a very high price, this would encourage a new entrant to build a more extensive network. Clearly we would prefer to set a reasonable price for roaming in order to get an entrant's traffic on our network, rather than encourage a more extensive competing network build.
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6. In our view the Commission has not done enough to demonstrate that extending these regulations will promote competition.
- The Commission needs to define a counterfactual in each case, i.e., state what it thinks would happen if regulation were allowed to lapse, and compare that with what it thinks would happen if regulation were continued.
 - The Commission also needs to do a more thorough investigation of actual competitive conditions in the relevant markets before it can conclude that further regulation is required.
 - For example, the Commission needs to explain why regulation of roaming is needed if [
] VFNZCOI, and why regulation of co-location is required if the existing terms have generated around 100 existing agreements with Telecom, Woosh, BCL, Police, TV3 and others.

Regulation of number portability should be extended

7. The Commission's argument for extending regulation of number portability is, in effect, that number portability is an important boost for competition.
- We agree that number portability can help reduce switching costs and lead to greater competition between operators.

8. But this is not a sufficient reason to recommend the extension of regulation unless number portability would not be introduced if the regulation were to be allowed to lapse.
 - The Commission needs to consider the question of what would happen if regulation was not extended in its review.
9. Vodafone is strongly committed to the introduction of mobile number portability by 1 April 2007. Allowing the regulation to lapse on 19 December would be unwise. That would introduce uncertainty into the process at a time when what the industry needs is stable rules.

Regulation of fixed interconnection should be extended

10. We agree that regulation of interconnection with Telecom's fixed PSTN should be extended. This is a standard situation of mandating access to a network bottleneck that has some natural monopoly characteristics.
 - While there is developing competition for Telecom's local access services (including Vodafone's local service) we do not expect this to substantially impact on Telecom's market power in the next six months.
 - Removal of fixed PSTN interconnection regulation before we have started services would jeopardise competition. It would allow Telecom to continue to refuse interconnection with our competing service.
11. While we agree with the Commission's conclusions, we do not agree with its analysis. In particular, we think the Commission has defined its interconnection markets too narrowly.
 - As we argued extensively in the case of mobile termination, there is a two-sided market for termination and origination on telecommunications networks.
 - The Commission needs to rethink its market definition and do some analysis of the two-sided market. To define an operator-specific market for termination alone is inconsistent with both commonsense and with commercial reality. The Commission has recognised that operators compete for termination revenues by competing to attract retail customers.¹
 - In practice, we do not think that market definition makes a great deal of difference in this case. Regardless of how the market is defined, Telecom will have the majority of the market share by customers and revenue.
 - Telecom continues to have strong incentives to foreclose competition by competitors that are forced to seek access to its customers in order to provide services.

¹ In para 173 of its Final Reconsideration Report on the regulation of MTRs the Commission says "Mobile termination is a revenue stream attached to each mobile subscriber (by generating wholesale revenues on incoming calls to that subscriber). Mobile operators compete for this revenue stream by competing for mobile subscribers."

12. Again, the Commission needs to define what it thinks would happen if regulation of fixed PSTN interconnection were allowed to lapse in December, and compare that with what would happen if regulation were extended.

Co-location regulation does not need to be extended

13. We think that extension of co-location regulation is unnecessary. This is because co-location works without regulation. There is no need for ongoing Commission intervention. On each occasion that a new entrant has entered the market, reciprocal agreements have been forthcoming in a short timeframe, such as with Woosh in recent times.

The Commission's views on market definition and state of competition need some refinement

14. The Commission has defined a market for co-location only on cellular operators' towers. This is too narrow a market.
 - In fact we co-locate 40 sites with organisations other than Telecom. This indicates that there is competition between site owners for co-location business.
 - There is effectively an almost limitless number of buildings that can host radio equipment, especially in urban areas. Thirty percent of our sites are on top of buildings, and fifteen percent are micro sites in lampposts and traffic lights. Anyone can co-site on these or adjacent structures (normally subject to a simple technical check that their equipment will not interfere with ours).
 - So an entrant will face a choice whether to put its radio equipment on top of an existing building or lamppost, or whether to seek co-location on an existing mast, assuming there is one nearby. If a hypothetical mast monopolist were to raise its prices for co-location, an entrant would respond by placing its radio equipment on the nearby building or lamppost. The obvious conclusion is that we compete with building owners and lamppost owners for co-location business in areas where we have towers near to buildings or lamp posts.
 - In any case, we have no incentive to set an unreasonable price for co-locating because, as we explain further below, co-locating with another operator saves us money.
15. The Commission suggests that existing operators have already taken all the "most optimal" sites. This misunderstands how network building actually works.
 - There are no "most optimal" sites that can be monopolised. In practice, network building is an exercise in compromise, where Vodafone effectively takes the path of least resistance between numerous demands to try to put together a network that meets our customers' needs. We have to take account of the physical landscape, our existing network, what sites area available, the attitudes of landlords, the rules of councils, lwi considerations, interference (including from our own network), and community concerns that sometimes arise in relation to particular sites.

- In practice, for example, we have a site on a lamppost on Fanshawe St right outside Vodafone's offices in Auckland. There are eight other lampposts within 20 metres of our site on which a new entrant could install radio equipment. There is nothing to say that our choice is the "most optimal" in any sense. The fact that there is a Telecom microcell on another lamppost within 40 metres of our microcell is compelling evidence that none of these sites are "most optimal".
- We are still building our 3G radio network. We plan to put up several hundred sites over the next few years. Unfortunately there is no way that we can co-locate all these sites with our existing 2G equipment due to landlord resistance, RMA issues, network design concerns and so on. We are in a similar position to a new entrant when it comes to site acquisition for many of the sites for our 3G network.

Co-location would work just fine even without regulation

16. The Commission does not consider what would happen if co-location regulation were allowed to lapse. We think that even without regulation there would be no competition problem. Our pricing for co-location is low, we do not discriminate between access seekers, and the standard form agreement and normal process work just fine.
17. The co-location code is shortly to be finalised. The process would have been a lot quicker if such a substantial amount of time at the working party meetings was not devoted to management of Econet's endless tirades against the code, the TCF, other telecommunications operators and the regulatory regime in general.
18. Econet's ongoing campaign to present co-location as a significant competition issue is both misguided and unhelpful, particularly when it refuses to meet to discuss issues directly but prefers to engage through the media.

We want as much co-location as possible

19. Vodafone wants as much co-location as we can get. It saves us money. We want to share our network costs as much as possible. Vodafone is New Zealand's largest current access seeker for co-location with several hundred sites to be built in the next 12 months.
20. Co-location means savings in both operating and capital costs. As sketched out in the table below, based on standard terms, co-location can save half the capital and up to 40% of the operating costs for both parties relative to the costs of two sites.
 - We offer and seek access for either half the capital cost or a fair market operating cost.
 - Most operating costs are shared evenly, and some (e.g., power) are paid separately.
 - Not one application has ever been rejected or blocked on the basis of pricing.

Table 1: Savings for each party associated with two standard co-location options for a standard metrosite build

Item	Option 1	Option 2	Self build
Capital excluding radio equipment	137,500	0	275,000
Capital charge at 13%		17,875	
Shared operating costs	8,250	8,250	16,500
Non-shared operating costs	4,000	4,000	4,000
Total annual operating cost	12,250	30,125	21,500
Total capital cost	137,500	0	275,000

Co-location is only part of a network build

21. Co-location is a useful way for network operators to reduce their costs. But it is not a substitute for building a network. We have approximately 100 sites co-located out of a total of around 1200.
22. As we explained above, 45% of our sites on our buildings or in other structures that we do not own. Another 5% are collocated on infrastructure that we don't own. This leaves around 50%, or about 625 sites that are capable of supporting co-location.
 - Of the 625 possible sites for co-location, 30% are in urban areas and 70% in rural areas.
 - We estimate that at least half of these sites would require additional investment to support co-location, usually either a new mast or a new foundation and a new mast.
 - In addition, landlord, resource and building consent are needed.
23. Often we can not co-locate new equipment on our own sites because of issues with landlord or resource consent. For example, we had planned to co-locate [] VFNZRI of our 3G sites on our existing 2G infrastructure, but we were only able to co-locate [] VFNZRI of sites due to planning and landlord constraints. This means that we co-located about [] VFNZRI sites, and were unable to co-locate a further [] VFNZRI that we expected to co-locate when we first planned our 3G network.
24. The savings from co-location are not insubstantial, but they are small in the context of the overall business case for new entry.
 - Covec modelling of the likely costs of entry for a 3G operator suggests that co-location would save an entrant around \$5 million in annualised capital costs and \$1.1 million in annual operating costs in the first year of network rollout. These savings are obtainable at a cost of \$1.9 million in co-location rentals.
 - These savings are equivalent to the revenue from about 8,200 customers or 0.2% of the market (assuming an ARPU of just over \$500).

- What this means is that co-location will affect network rollout at the margins, but it is unlikely to be a make or break part of the business case for a new mobile entrant.

Co-location requires site-by-site consideration

25. Site-by-site consideration is required because the unique characteristics of each site determine whether co-location can be accommodated or not. The structure has to be able to hold the equipment requested, the landlord must be willing, and the relevant resource consent must be complied with, as well as the basics of power and interference.
- We are not unique in requiring site-by-site consideration. Oftel recognised that co-location is a site-specific service.² We do not require site-by-site consideration in order to delay entry or to put hurdles in the way of Econet. We require the same process of every applicant for co-location.

Extending regulation of co-location is unlikely to make a difference

26. In practice, the current regulation of co-location makes little difference to our business. Co-location will continue to operate commercially regardless of whether co-location continues to be regulated or not.
27. But the question for the Commission is whether continuing to regulate co-location will promote competition. The Commission needs to explain what it thinks will happen if co-location is no longer regulated and compare what would happen if regulation were extended.
- We are of the view that regulation makes little difference to our behaviour. Therefore it can be allowed to lapse without any impact on market outcomes.
28. We will be discussing these issues in our interview on the Commission's investigations into whether further mobile regulation is required. We hope that the Commission will take into account information received in that process in its extension review as a matter of course.

Roaming regulation does not need to be extended

29. We think that roaming regulation is unnecessary. We are happy to negotiate roaming arrangements on reasonable terms without regulatory intervention. [

] **VFNZCOI** There is no need to extend the existing regulation.

Market definition is too narrow

² "Oftel did not set charges for those ancillary services that are either bespoke or whose characteristics are subject to significant variation from one location to another (e.g., co-location)", <http://www.ofcom.org.uk/consult/condocs/rwlam/statement/rwlam161204.pdf> para 1.15.

30. The Commission defines separate markets for roaming on GSM and CDMA networks on the basis that an entrant faces costs in switching between technologies once its network is launched. Of course, an entrant will face costs in switching between technologies, but this does not mean that there are separate markets.
31. The entrant knows that it will face costs in switching from GSM to CDMA roaming in the future, and so the entrant will naturally push for a long-term contract at the outset with rights of renewal.
- This is consistent with our experience of negotiating roaming arrangements and similar to contracting arrangements for any other long-held, specific asset. [

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- The long-term nature of the deal does not prevent an efficient contract, nor does it allow the host network to rip the roaming network operator off.
32. What the long-term contract does mean is that an entrant can seek bids from both CDMA and GSM operators in deciding which technology to choose.
33. For example, we understand that Hutchinson considered bids from both GSM operators and the CDMA operator in Australia before agreeing to roam on Telstra's CDMA network (as part of a wider network sharing deal).
- Clearly roaming on GSM networks competes with roaming on CDMA networks.
34. The Commission's market definition also focuses very narrowly on roaming. In practice, an entrant has a range of inter-related choices including (roughly in order of reducing capital requirements and therefore risk):
- building a stand-alone network,
 - co-location of some sites,
 - sharing the network build with another operator,
 - building some network and roaming outside of coverage,
 - wholesaling minutes on another operator's network, or
 - resale of another operator's retail products.
35. All of these entry options are related.
- Roaming and network building are substitutes, so a higher roaming price will induce network building.
 - Sharing of network assets and network building are also substitutes so a lower co-location price will deter network building and encourage sharing.

- Wholesale entry and network entry are also substitutes, so a lower wholesale price or a generous discount for resale will affect the incentives for network entry.

36. The Commission should take a broader view of the wholesale market, one in which all of these network entry strategies are options for an entrant, and where the terms set for any of these options affect an entrant's choices of strategy.

Strong incentives to negotiate with an entrant who intends to build

37. We would prefer to negotiate a reasonable deal with a credible new entrant. Refusing to negotiate a roaming deal will cost us wholesale revenue. This could happen because:

- Without roaming on our network, an entrant may choose to roam on Telecom's network, or
- Without roaming on our network, an entrant may choose to build a more extensive network than it would otherwise.

38. Either way, we will lose retail revenues as the entrant competes with us in the retail market. If we agree to a roaming arrangement, we at least get some roaming revenues that will help to offset the retail losses.

Strong incentives to set a reasonable price

39. Setting a high roaming price encourages network building by an entrant, so obviously we would prefer to set a reasonable price for roaming so as not to encourage an extensive network build.

40. In addition, more traffic on our network lowers our average costs, so there is a cost benefit to us from hosting a roaming network operator. This incentive is stronger the more customers the roaming network takes from Telecom.

Our prices for roaming are reasonable

41. [

] **VFNZCOI**

42. We are in the process of revising our standard roaming pricing [**VFNZCOI.**

- There seem to be very few published international benchmarks for roaming prices. We are not aware of a regulatory decision that sets roaming prices anywhere in the world.
- Our first year rate is roughly equivalent to [**VFNZCOI**, which is the rate we understand was agreed in Ireland.
- Our rates are per-leg, per-minute prices. Each operator is responsible for its own interconnect arrangements.

- For example, if a customer of another network operator were to receive a call from a Telecom landline customer while roaming on our network, that other operator would receive its standard mobile termination fee from Telecom and pay us the rate below.

The Commission needs to look at what difference this regulation actually makes

43. It makes little difference whether roaming is specified or not. We are happy to offer roaming at attractive prices to genuine entrants.
44. However, regulation, and particularly uncertainty about regulation, does have an impact on commercial negotiations.

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- One impact of a Commission investigation into roaming pricing will be to discourage new entrants from negotiating roaming agreements, since there will be the near-term prospect of regulation that might reduce the price.
45. The Commission's analysis does not consider what would happen in the wholesale market and in the retail mobile market if specification of roaming was allowed to lapse.
 - If the Commission does not explore what would happen in the wholesale market in the absence of regulation, it is impossible for the Commission to draw any conclusions about the impact of roaming regulation on wholesale offerings.
 - Equally, without looking at any features of the retail market (like prices, products, market shares, or churn), it is impossible for the Commission to conclude that the current roaming regulation actually benefits consumers.
 46. Specifically, we suggest that the Commission construct a simple business case for a roaming entrant and see whether this regulation makes any difference to the chances of entry.
 - In our view, if regulation does not measurably increase the chances of new mobile entry, it does not generate any benefits at all for consumers.
 - We think that the current regulation of roaming does not measurably increase the chances of new mobile entry. There is therefore no purpose in extending this regulation.

Conclusion

47. It is not clear that the Commission has considered our previous submissions on these topics. It would be most helpful if the Commission could summarise the views of submitters on each issue in the body of its submission, and then provide the Commission's view after that summary.
 - This was the Commission's standard practice in the MTR investigation.

- It helps us to avoid repeating ourselves because we are not sure whether the Commission has considered our previous submissions on an issue.
48. If you have any questions, or would like further information about the issues raised in this submission, please email hayden.glass@vodafone.com or call 021 689 176.

Yours sincerely

Vodafone New Zealand Limited

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Public Policy