

30 September 2005

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BY EMAIL

Dear Kate

Regulated services extension review: Comments on Commission's preliminary view on decision to investigate and procedural issues

1. The Commission asked for comments on its preliminary views on the extension review in a letter dated 15 September.

Summary of views

2. Overall Vodafone is comfortable with the process the Commission proposes. It would be helpful to us if the Commission could provide some more clarity on the question of thresholds, and on the basic administrative issues of timeframes, processes and issues to be considered when it releases its final decisions to investigate. We would like the Commission to reconsider the appropriateness of changing processes during the investigation should the Act change.
3. We also take this opportunity to express a view on the substantive points of which services we think should and should not be extended. I appreciate that this has not been sought at this point, but it should be helpful in terms of explaining Vodafone's interests in the process and starting to outline our key arguments.
4. Of the services that are regulated in the Act at present, Vodafone is only directly interested in national roaming, cell-site co-location and number portability.
 - We think the facts do not justify an investigation into whether to extend the existing regulation of cell-site co-location or national roaming.
 - On the other hand, we think it is important that the Commission does extend regulation of number portability, at least until some time after the service has been successfully launched in April 2007.

Process issues

5. We agree with the Commission that the thresholds for a decision to recommend an extension and a decision to recommend changes to the content of an existing regulated service should be different.
6. It is obvious from the Act that the threshold for a decision to investigate is different from the threshold for a decision to recommend amendment, extension or addition or deletion of a regulated service in Schedule One of the Act. The Act sets out two legal tests, the first applying when the Commission is deciding whether to investigate and the second when the Commission is deciding whether to make a recommendation. No distinction is made on the basis of the type of recommendation.
7. While the legal test is the same, we believe the practical threshold required to satisfy the legal test varies according to the nature of the recommendation. This is because the consequences of a potential recommendation vary. For example, where a technical amendment to a service specification is being considered, the implications could be quite narrow. However where a range of amendments is proposed, or in the case of the introduction of a new service, the potential impacts on competition are far greater. In these cases, we think the Commission will likely need to conduct a broader analysis in order to satisfy the section 18 requirement.
8. It would be useful if the Commission could explain how it sees the different thresholds in more detail in its final decisions to investigate.
9. We see potentially four different decisions for the purposes of considering thresholds. Broadly speaking we think that the threshold gets higher as you move from top to bottom of this list:
 - Deciding whether to investigate extension or regulation of a new service,
 - Deciding whether to extend the regulation of an existing service,
 - Deciding whether to recommend changes to a service specification, and
 - Deciding whether to recommend regulation of an entirely new service, or recommend that a specified service become designated.
10. We also think that the Commission should generally err on the side of not regulating. The default position should be to let regulation lapse, rather than to continue it just in case it might be useful.

Thresholds for deciding whether to investigate extension (or further regulation)

11. The relevant decision in this particular case is whether to investigate extension or not. Clause 1 of Schedule 3 of the Act states that the Commission must be satisfied that there are “reasonable grounds” to investigate whether to extend a service.
12. We agree with the Commission’s implicit statement that this is a relatively easy threshold to meet, but we think that the Commission is doing everyone a disservice by setting the bar too low.

13. The Commission says that it would be enough to form a view that there are reasonable grounds to investigate:
 - if someone has applied for the service, or
 - if a potential cellular network provider has recently expressed concerns about the service in question.
14. We are comfortable with the first criterion. If someone has applied for a service (and by definition been unable to negotiate a commercial agreement) then this forms reasonable grounds to at least investigate whether extension is warranted.
15. On the second criterion, we think that the Commission needs to undertake further analysis. We do not see how it can avoid assessing the reasonableness of the concerns expressed and whether they have some basis in fact in order to be satisfied that there are reasonable grounds to investigate extension.
16. For example, we do not think that Econet's public complaints about access to co-location have any merit. As we explain below, if Econet is serious about co-location or roaming, we are more than happy to negotiate reasonable commercial arrangements with them, as we have with others. It seems unwise to us to decide to investigate extension of regulation on the basis of perceptions of barriers to entry that do not exist in fact.

Investigating changes to service specifications

17. As we said in our previous letter on the extension review process, we support a parallel process for considering minor changes to a service specification at the same time as the extension review.
18. It would be most helpful if the Commission could indicate its thinking on whether it intends to look at the conditions around regulation of national roaming at the same time as the extension review.
19. National roaming is the service that most interests Vodafone where there might be arguments about changes to the service specification. A weakening of the thresholds and rollout provisions for an access seeker is obviously an issue of great importance to Vodafone.

Grandfathering and retrospective effect

20. It would be surprising if the Commission decided to apply new principles or a new process to the existing investigations were the legislation to change while the extension reviews were underway. In paragraph 5 of your letter you say that this could happen. To us it seems like it is standard regulatory practice to determine existing investigations under the law that applied when those investigations began.
21. We will certainly encourage the Ministry and the Parliament to state clearly how they intend existing investigations to be affected by changes to the Act. This may avoid the need for the Commission to consider this issue further.

Other issues

22. The Commission has suggested starting the review with the most complex and controversial services.
23. It would be helpful if the Commission could clearly state which it considers to be the complex and controversial services and how the staging will work. It is obvious that these extension reviews are a major undertaking for both operators and the Commission. We would appreciate it if the Commission could provide as much timetabling information as possible at the earliest possible opportunity.

Substantive issues

24. As mentioned above, of the existing regulated services, we care most about the regulation of cell-site co-location, national roaming and number portability. We take a more indirect interest in regulation of fixed networks.

Local and mobile number portability

25. We think that the Commission should recommend extension of the regulation of number portability for a further two years.
26. It would be risky to allow the regulation of number portability to lapse just before the service is due to launch. To recommend it not be extended the Commission would need to be certain that regulation is no longer necessary to ensure number portability is launched as agreed by industry.
27. In practice, we think regulation will play a useful backstop role for some time after the launch of the service. Things have changed dramatically since the Act was passed, and the introduction of portability now seems inevitable. But we do not see any practical gain from removing the regulation relative to the risks associated with its removal.

Cell-site co-location

28. We think that extension of the regulation of cell-site co-location is unnecessary. Of course, having the regulation on the books does not really affect anything, since no one has applied for access to the regulated service and, as far as we can see, no one is likely to apply any time soon. Nevertheless, if the general principle is that regulation should be removed unless good grounds can be found for its extension, then cell-site co-location is a regulation whose time to expire has come.
29. We can see why in theory the idea of regulating cell-site co-location is appealing to the Commission. It can see a highly concentrated mobile market, with apparently high retail prices, where mandated access to an apparent bottleneck facility (cell-sites) could speed access into the market by new cellphone operators. It can also see potential incentives for existing cell-site operators to restrict access to the potential new entrants in order to slow their entry.
30. This attractive theoretical picture breaks down in practice. As we have said to the Commission before, what we actually see is a much more complicated picture. We don't see established entrants using their theoretical market power to keep others out. This kind of perspective is a far too theoretical lens through which to examine co-location.

31. In fact, Vodafone is the largest access seeker of co-location. We support co-location, whether with our competitors or with other firms. It can reduce the costs of running our network. This is the basis for our engagement with the code on co-location in the TCF.
32. Moreover, there are multiple firms with towers on which radio equipment can be sited. Since co-location can reduce costs, we would expect firms to have an interest in providing co-location to others. In fact, we would expect firms to actually compete with each other for co-location business.
33. To understand our view, it is important to be aware that Vodafone does not own any of its sites. We have around 950 landlords, to whom we pay many millions a year in rental payments. In addition there are payments for site maintenance and EME and OSH monitoring that add to the costs.
34. All these costs are reduced if we co-locate (either putting our radio equipment on someone else's tower or vice-versa). So there are very good commercial reasons for Vodafone to want to co-locate with other networks where it is feasible to do so.
35. Unfortunately, co-location just isn't practical on most sites. Vodafone has more than 1,000 2G and 3G cellsites. But only around 30% of these sites are large monopoles or large lattice towers. Most of the remainder are sites built on buildings (predominantly in the urban areas), and smaller microcells that are attached to buildings or traffic lights. The trend is towards capacity infill, rather than coverage expansion, so new cellsites are likely to be smaller rather than larger.
36. Co-location is, however, widespread for those sites where it is possible. Vodafone currently has around 100 co-located sites with the Police and other carriers. More than sixty sites are co-located with Telecom. Approximately 80% of Vodafone applications to other carriers are successful. This is in keeping with the usual application success rate across the industry.
37. One of the biggest obstacles to co-location is the attitude of landlords. Obviously, within legal limits, they are free to do as they wish with their land. And we find that approaches vary widely from landlord to landlord and therefore from site to site.
38. Challenges to successful co-location can also arise from different interpretations of the Resource Management Act requirements by local authorities who determine the consents for sites. Companies will usually do what they can to avoid selecting a site which would have to be "notified" because such a site costs around \$100,000 to obtain approval for – as opposed to around \$10,000 for a non-notified site.
39. The requirements of the Building Act and the absolute requirement for the site to be technically suitable also impose constraints. It is possible that additional equipment could create a situation where the entire structure would need to be swapped out. This could render the speed to market and cost benefit of co-locating redundant.

40. In summary, securing site-owner agreement to co-locate is often as much of a burden as meeting RMA and other legislative requirements.
41. The importance of site-specific factors also explains why we have argued for a site-by-site consideration of co-location in the TCF process. We support the idea of blanket applications for co-location that cover a number of sites, but the application process would need to deal with the individual characteristics of each site separately.
42. Recently TUANZ ran an article in its TUANZ Topics magazine on co-location, suggesting that further regulation of co-location was required in order to boost the opportunities for new entrant cellular networks.¹
43. This article included a picture of a hill just south of Auckland that has three cell-sites on it as evidence for its view that co-location was not working commercially and that further regulation was required. Unfortunately, while this makes for a interesting photo, it doesn't stack up in practice. On that particular hill, Vodafone was very keen to pursue co-location with Telecom. Neither Telecom nor Vodafone were approached by Counties Power (the owner of the third site) to co-locate.² Unfortunately the landlord who owns that hill had other ideas, presumably to do with the relative virtues of three rental payments rather than just one.
44. We have just one further point to make on co-location, and it concerns Econet. The Commission will be aware, of course, that Econet has publicly expressed its concerns about the market for cellsite co-location.
45. In our view Econet has unrealistic expectations of the extent to which co-location can help with its market entry plans. Econet has publicly stated that it should be able to co-locate half of the cell-sites that it needs to build a network.³ As we noted above, only around 30% of our sites (and actually only 10-15% of our urban sites) are even capable of supporting co-location. Cell-site co-location can only be a small part of the network build of any entrant.
46. Of course, we are happy to agree reasonable arrangements for co-location with any commercial partner, including Econet, just like the agreements that we have already made with other carriers.
47. As the Commission is no doubt aware, Econet is presently contributing to the co-location code as a guest of the TCF.
48. In summary, there are three factors at work in arranging co-location:
 - Agreements between an access seeker and an access provider
 - The regulatory environment outside of the Telecommunications Act – This includes national legislation like the RMA, the Building Act, the Electricity

¹ 'A lender and a borrower be', Greg Adams, TUANZ Topics, August/September 2005, page 10. Available at <http://www.tuanz.org.nz/tuanz/index.cfm?9CD728E0-E018-8BD1-32A1-B79F9B36D2D7>

² The article mistakenly identifies this third tower as belonging to Woosh.

³ 'Co-location issue still bugging industry', Richard Wood, Telecommunications Review, August 2005, page 14.

Act, the Radiocommunications Act, and the Health and Safety in Employment Act, as well as local Council policies and by-laws in each area.

- Commercial decisions made by landlords.
49. Regulation of co-location can influence only the first of these three factors. In our view there is sufficient evidence that co-location works commercially for regulation to be considered unnecessary:
- No one has ever applied to the Commission for access to the regulated co-location service,
 - For all serious applicants, commercial processes seem to be working just fine, and
 - There are good reasons to think that any genuine new entrant would be able to successfully negotiate co-location even without a regulatory backstop. Woosh is a good example of just such a new entrant.
50. Together these factors lead us to think that there is no need to continue to regulate cell-site co-location.

National roaming

51. We also think that extension of the national roaming regulation is unnecessary. As with co-location, no one has applied for access to the regulated service and, as far as we can see, no one is likely to apply any time soon. The regulation remains as a backstop that seems destined never to be used.
52. This is another situation where the Commission could easily take a theoretical view in favour of regulation. It is easy to characterise this as an access seeker/access provider situation, where we have incentives to control access to our network to protect our retail business. Econet is, of course, fond of calling Vodafone a “GSM monopolist”.
53. But this is nothing more than convenient rhetoric. In practice it is not as simple as that.
54. In fact, once it is clear that an entrant has a credible entry strategy and does actually intend to build, we clearly want them on our network rather than building their own. This is for at least two reasons:
- The additional traffic on our network helps to reduce our average costs (given economies of scale in sites and in transmission), and
 - Joint use of one network reduces the negative impact on both firms that could result from an oversupply of capacity in the market. This is a particularly significant issue in New Zealand where fixed costs are likely to be a high proportion of total costs.
55. This incentive to accommodate new entrants is one very good reason why the regulation of national roaming does not make sense. The regulation effectively requires an access seeker to be genuine, i.e., they need to have spectrum, capital and a credible network build plan. But if an entrant is genuine, our

incentive is obviously to make a wholesale deal, a network sharing deal to share capital costs, or a roaming deal to reduce the extent of underutilised capacity.

56. TelstraClear has many possible mobile options. Dr Freeth has recently suggested that they could include a TelstraClear network, a wholesale deal, or continuation of the existing resale arrangements.⁴ To that list we might add network sharing.
57. But whatever path it follows, it seems obvious to us that if TelstraClear does build a network, it will have strong incentives to offer wholesale access to others (including possibly Econet) in order to make use of spare capacity on the network.
58. So in our view regulation of national roaming is at best pointless. If that were where the issue ended, then we could leave the regulation as it is and no harm would be done. But in fact, we think that there is some harm caused by regulation of national roaming.
59. Our chief concern is that it alters firms' incentives to negotiate commercial arrangements. Obviously if new entrants can get a better price from the Commission than they can negotiate from Vodafone, then all the better for their profitability.
60. The problem is that it is difficult for the Commission to distinguish between a legitimate entrant being excluded by a selfish existing operator and an opportunistic new entrant gaming the regulatory process in order to take advantage of a cheap regulated price.
61. One further point, if the Commission were minded to investigate extension, it might also want to look at the conditions in the service specification. Specifically it might want to consider the implications of the view that Telecom's 1xRTT network is 3G for the purposes of the definition under the Act. If Telecom's 027 network is 3G (and, as you know, we think there is a credible argument that it is) then the regulation of national roaming in the Act is a rather asymmetric regulation of Vodafone.
62. In summary
 - We think that regulation of national roaming does not help the competitive situation in the New Zealand mobile market, and that there is no purpose in investigating extension of the regulation. No one has ever applied for the service, it seems that no one ever will, and existing operators face strong commercial incentives to make national roaming agreements with credible entrants.
 - If the Commission is keen to investigate extension of national roaming regulation, it would be useful to look at the conditions around the service specification and whether the regulation should apply to Telecom's CDMA network.

⁴ 'Telstra narrows focus to lift sales', Marta Steeman, Dominion Post, September 27 2005.

Conclusion

63. I would be more than happy to expand on any of these points, or to discuss them further with the Commission in person. Please drop me a line to tom.chignell@vodafone.com or on 021 639 977 if you wish to take up this invitation.

Yours sincerely
Vodafone New Zealand Limited

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