

ECONET WIRELESS NEW ZEALAND LTD

CLOSING COMMENTS

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COMCOM MOBILE TERMINATION CONFERENCE

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Econet has found the conference very useful and we hope that we have been able to contribute to the debate despite the fact that the bulk of our comments are limited to our opening and closing addresses. However we feel we have an important contribution to make given our role in the industry and our experience in operating GSM networks in other countries.

Summary position

I'd like to reiterate Econet's summary position: the Commission is right in analyzing the market as being ready for an adjustment, given the exorbitant prices paid by New Zealand consumers relative to their OECD counterparts. However, it would be a mistake to prefer direct price regulation over the encouragement of new entry and the promotion of real competition at the retail level. We are

concerned that the regulation of fixed to mobile termination rates would have the effect of reducing incentives to enter, and entrenching the structure that exists today which has been so harmful to the interests of end users. Across the spectrum of discussion topics in this conference, the positions that have been taken have been set against a background of the current market structure where no real competition exists. If that dynamic were to change, we believe the discussion would have proceeded quite differently, and the Commission would be less disposed towards direct price regulation.

Retail prices and the waterbed effect

We are not convinced by the arguments of Telecom and Vodafone that retail prices will automatically rise should the Commission decide to regulate. It seems to us intuitively that there would be no justification for them to raise prices given that New Zealand prices are currently amongst the highest in the OECD. However, even if prices were to be increased, the only reason they would be able to do so is because there is no effective price competition in the market. In a competitive market, the clawback gains would be subject to competitive pricing pressure and therefore would not lead to an overall rise in retail prices.

As Professor Hausman pointed out, the arguments around retail prices seem to be based on a fallacious argument that there is a current level of profitability that must be maintained. Therefore, the argument goes, if revenue is artificially reduced, the operators will have to increase the price of their services to claw back their former level of profitability. However, as Professor Hausman said, operators have an incentive simply to maximize their profits, taking into account all of the market conditions that exist at the time. It does not matter what the former price point was – the issue is what present conditions will allow. Telecom and Vodafone tell us that prices will increase as a result

of the regulation. As we've said, we are skeptical about how this can be justified. But even if they are right, that could only happen in the current uncompetitive market. In a competitive market, market conditions would impose a constraint on the pricing levels which the operators could achieve.

At the end of the day, the issue is the number of players in the market, not the mobile termination rate. After all, the current high retail prices – which is the evil the Commission is attempting to address - are simply the natural consequence of a lack of effective competition.

NZ operating costs

We understand that Vodafone was to present information to you today during the closed session refuting our arguments on Wednesday about the lower cost structure in New Zealand versus other markets. We were not present at the closed sessions, but we would like to reiterate our views on the lower cost structures here in New Zealand. The basis of our view is our experience in operating GSM networks in other countries and our analysis of the market to date as a prospective new entrant. This information can be made available to the Commission if it is interested.

We believe that a GSM operator in New Zealand has a cheaper cost structure than in most OECD countries because of:

- The low cost of distribution in New Zealand, caused by minimal competition in distribution channels (ie, minimal or no retained ARPU is payable to retail channels)

- The absolute quantum of spectrum Vodafone has relative to its international operators (Vodafone has 25 + 25 Mhz of GSM spectrum in New Zealand, while the normal international level is 7.5 + 7.5 MHz for a subscriber base many times greater than that in New Zealand). This means that each base station can carry higher capacity, and therefore fewer base stations need to be built.
- GSM handset subsidies are unnecessary in New Zealand because there is little retail competition between the incumbents and on the whole, GSM handsets are much cheaper than CDMA handsets. In the UK, handsets will be provided for free to customers on a contract plan. The same handsets in New Zealand can cost NZ \$800 - \$1000. The customer then has to pay some the highest calling charges in the world for the privilege of being on GSM.
- It has been suggested that New Zealand operators incur higher capital costs because New Zealand has unique geographical conditions and low population density. But infrastructure is supplied on the basis of capacity, not coverage – therefore, on a per customer basis, their costs should not be materially higher than their OECD counterparts.

In addition, GSM subscriber acquisition costs are significantly lower across the service provision chain than CDMA costs. As Professor Hausman pointed out, CDMA operators must pay a circa 4.5% fee to Qualcomm for every CDMA handset it buys; while no such fee exists for GSM handsets. This means a direct hit to Telecom's bottom line. It also means that Vodafone can price its

GSM phones at CDMA prices – possibly the only GSM operator in the OECD which has this opportunity. Indeed, we believe that Telecom mobile is actually making very little money, and that market prices are being driven by Vodafone.

Vodafone's lower cost structures will exist with or without the regulation of fixed to mobile termination rates. And it is these cost structures which determine overall price levels and provides Vodafone's key strategic advantage over Telecom.

In summary, the market is uncompetitive and needs to change. And the fact that operating a network in New Zealand is cheap relative to OECD means that price comparisons with OECD countries are relevant and should be considered in analyzing the issue. But the way to address the issue is through competition, not through direct price regulation of fixed to mobile termination rates.

Fixed to mobile substitution

When discussing Vodafone's incentives to keep mobile termination rates high (since Vodafone is a net receiver of termination revenues), there seemed to be some confusion on the Commission's part. The idea was that Vodafone also has an incentive to reduce mobile termination rates so that their customers can receive more calls and Vodafone more termination revenue.

The single biggest revenue opportunity facing mobile operators today is fixed to mobile substitution, where calls that would historically been made over the fixed network are transferred onto the mobile network. Put another way, fixed to mobile calls become mobile to mobile calls.



If a mobile operator can keep termination rates artificially high, then this gives them a competitive pricing advantage over the fixed line operator. This artificial competitive advantage can then be used to transfer dominance in the mobile voice market into dominance of what was once the fixed-voice market.

The result of this is that the mobile operator who competes against the fixed line operator has an enormous interest in keeping mobile termination rates high.

The suggestion that Vodafone may consider dropping their mobile termination rates so that they were in line with fixed termination rates is a difficult argument to make. Mobile termination rates are circa 30 cents, whereas fixed line termination rates are circa 1.4 cents.

A profit maximizing firm will not reduce their mobile termination rate by 29 cents to pursue increased termination traffic – they will instead keep termination rates high and accept lower termination traffic and increased outgoing traffic.

Vodafone to Vodafone calls obviously incur no termination costs. However, there is no requirement to reduce retail prices for this type of call. Therefore, with market share at around 65% and rising, Vodafone stands to gain substantially from high mobile termination rates as the probability increases that each call made will be a Vodafone to Vodafone call, for which no termination rate is payable. In this way, a ‘closed network’ develops which is hugely compelling given the size of the fixed to mobile substitution opportunity. Therefore the dominant GSM operator has every incentive to keep mobile termination rates high, and there is no countervailing incentive to reduce them.

Regulation of 3G

We'd like to reiterate our position that no distinction should be made between 2G and 3G regulation. Networks in New Zealand have gone through transitions from AMPS, D-AMPS, CDMA, 1XRTT, and EVDO, and GSM, WAP and GPRS. 3G is just another evolution.

Vodafone has accepted that 3G is a more efficient technology for handling voice, but they believe that the upfront costs mitigate against the overall efficiency of 3G. However, the regulation in question is TSLRIC, which by definition is a long-run cost measure. Therefore, their suggestion that short-term considerations mean that 3G is less efficient under a regulated scenario is questionable.

Further, if one compares the publicly stated investment figures to publicly stated profitability, one can see the actual size of investment relative to the size of the business. 3G is not the end of the road for infrastructure investment: 4G, 5G and 6G will follow, and each stage will require investment, just as the upgrades in the past have done. We agree with Telstra-Clear's analysis that each upgrade has to stand on its own in terms of cost-benefit. What is happening in 3G is not a special case in the history of New Zealand cellular, and it should not be treated differently from any other technology.

Summary

In closing, we'd like to reiterate that OECD style regulation provides an incentive to invest for new entrants. It is this investment, not incumbent investment, that needs to be promoted. Mobile termination rates may well need to change down the track – but this is not how successful OECD



regulatory systems have worked. Without exception, they have ensured GSM competition as a first step. Many years later, they have regulated mobile termination rates. Regulating the price now is the wrong way around.

We would like to close with the acknowledgement from the group CEO of Vodafone PLC Arun Sarin when he was quoted in the National Business Review of NZ on the 8th April 2004 as saying that the New Zealand operations punches well above what the financial numbers would suggest, and that “If I could take the New Zealand company and scale it to the rest of the world, I could retire early and say my job is done”. This is the power of GSM: Vodafone stands out in New Zealand because it is unopposed in GSM.

In summary, therefore, we believe that the key to reducing prices is new entry in GSM, not the direct regulation of termination rates.

Thank you for your time and consideration.