



Econet Wireless New Zealand

Cross-submissions commenting on other parties' submissions

23 December 2004

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2 Summary

It is Econet's position that a structural problem exists in the New Zealand mobile communications market, due to the fact that there is no same technology competition. Econet believes that the reason the New Zealand consumer pays too much is that the two incumbents respond rationally to market conditions: because there is a duopoly, they behave like duopolists. This behaviour is best characterised by lots of marketing, but little or no competition as to price. The result is that New Zealand consumers have not enjoyed the same benefits of GSM technology as their international peers. In economic terms, the difference between New Zealand and its peers is that in other international markets, GSM operators must set prices according to their competitors who have similar cost structures to themselves. In New Zealand, Vodafone can afford to set its prices not according to a similarly geared GSM network, but according to an inefficient, uncompetitive incumbent who has invested in AMPS, TDMA, CDMA, and 1X technologies – all of which involve higher cost structures because they are non-standard technologies across the world.

Econet believes the voluminous submissions of the incumbents pose a risk of obfuscating the Commerce Commission's enquiry, by complicating what should be a relatively simple issue. Accordingly, Econet has made brief comments on the Vodafone NZ, Telecom NZ, TelstraClear and New Zealand Business Roundtable statements.

3 Econet Wireless comments on Vodafone NZ submission

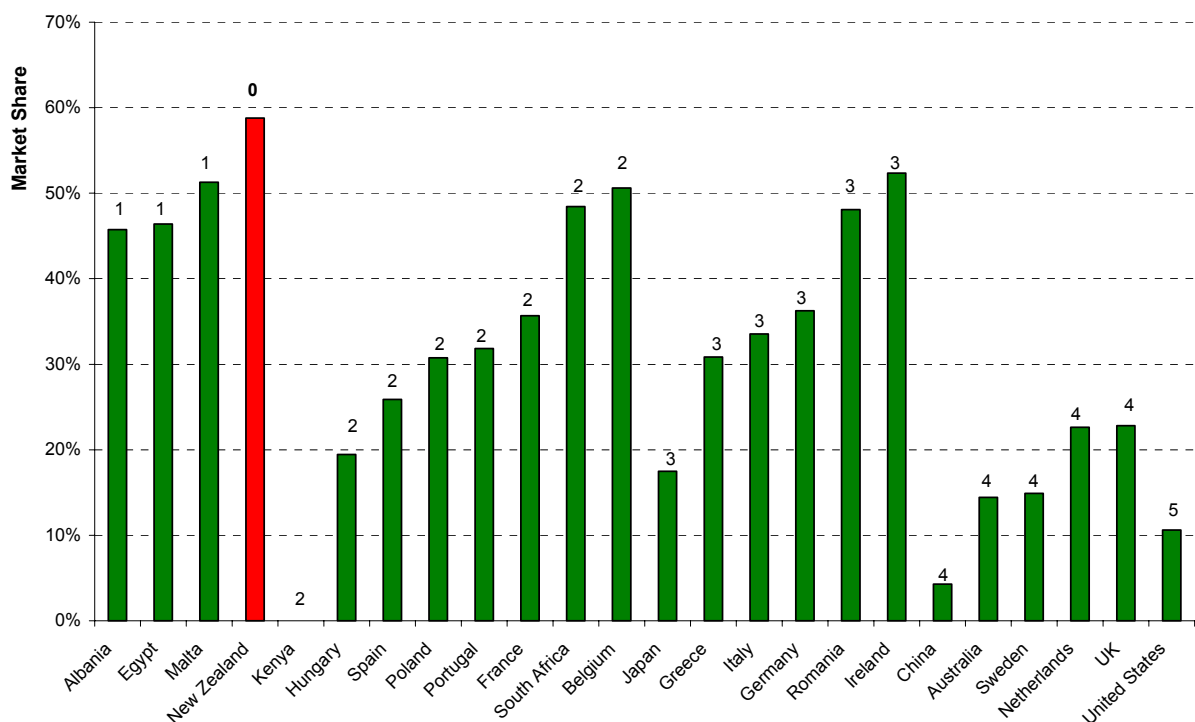
“Globally, the New Zealand business is seen as a centre of excellence and is a business that is noted for its innovative flair.”¹

We agree. Vodafone holds an exalted position in both the New Zealand telecommunications market, and within the Vodafone Group itself. It is a star performer in the Vodafone Group, the largest and most dominant telecommunications group in the world. This stellar performance is mainly due to the fact that it is the only company in that group (other than Fiji, where Vodafone has a monopoly) to have NO competition at a GSM level. How could it not be a star performer?

Econet believes that the Commerce Commission must clearly understand the enormous economies of scale that come from running a GSM network as opposed to CDMA. GSM technology was specifically introduced by equipment suppliers with the intention that networks would run in competition with each other. That is why SIM cards were developed. In the early 1990s, it was envisaged most markets would have two, three, or four networks at the same technology platform to create real competition. GSM was always going to be a business that provided the customer with huge economies of scale as billions of people adopted the technology if there were three or more operators.

In this regard, the encouragement of the New Zealand government of the day for Telecom to invest in CDMA technology, and Telecom’s compliance, was perhaps the single biggest wrong turn in New Zealand telecommunications in the last two decades. The results have been disastrous for Telecom Mobile, and disastrous for New Zealand mobile telecommunications users. It has allowed Vodafone to strengthen its economies of scale in terms of handsets, roaming, service delivery, and subscriber acquisition cost, and left Telecom stranded as a player backing a marginalized technology, with all of the cost implications that go along with it.

Vodafone Market Share and Number of GSM/3G Competitors in each Country



¹ Vodafone New Zealand, *Submission to the Commerce Commission on mobile termination Issues Paper*, public version, 19 July 2004, page 8.

“The New Zealand market has unique characteristics such as sparse population, challenging terrain and a low population.”²

We disagree. New Zealand has a population and terrain similar to that of Norway, Sweden, Denmark, and Switzerland – locations where more competition and lower prices exist. The key difference between New Zealand and these markets is that New Zealand has a GSM monopoly, allowing Vodafone to maintain high prices, whereas in other markets Vodafone faces competition from companies with similar cost bases, which means prices come down. Every market has its geographical challenges, and mobile networks are generally sold by equipment suppliers on the basis of how many customers are on the network and the capacity of the network. As a consequence, it is no more expensive to build in New Zealand on a per capita basis than in any similar country. Indeed, Vodafone tends to use its dominant position in the global marketplace very aggressively when negotiating supply agreements, and therefore tends to enjoy far lower costs from equipment suppliers than its local competitors.

“If it will not promote competition in any telecommunications markets, then the Commission must recommend that there be no regulation.”³

The word “regulation” in New Zealand is consistently used by the incumbents to demonise the process of creating competition. The word “regulation” in New Zealand is too often used to present a type of “bring-back Muldoon” mentality, whereas in fact the regulatory process is a process designed to create competition through the encouragement of infrastructure investment. This is its usual meaning, and its usual effect, in international markets. Econet’s view is that fixed-to-mobile regulation must be considered with a series of other methods to create a competition path at the operator level, not specifically to adjust prices.

“Question 4.2(c) – Is there any other evidence that competition in this market is limited? For example, is there evidence that the likely access providers are achieving excess returns?”⁴

Econet’s view is that Vodafone is achieving excess returns. As an operator of five GSM networks, Econet knows from its own experience that GSM is a cheaper technology to run and provide handsets for than CDMA, TDMA, and 1X. Econet believes that the profitability of Vodafone NZ before inter-company payments, before parent company royalties, and before inter-company software costs, is excessive. Econet estimates Vodafone’s free cash flow in New Zealand to be approximately NZ\$600 million. There is little, if any, transparency in Vodafone NZ’s financial statements, other than statutory numbers, because all disclosure is merged with its data from Australia, Japan, and Fiji.

“Question 4.2(g) – What evidence is there that New Zealand mobile networks have a higher cost structure than overseas networks?”

- *“size of the mobile market in New Zealand versus other countries;*
- *“size of the carriers in New Zealand versus other countries and therefore the relative level of economies of scale and scope; and,*
- *“population density and geographic and environmental differences which introduce greater costs associated with coverage.”⁵*

The issue is not whether New Zealand has a higher overall cost structure than overseas networks. The issue is that within the New Zealand market itself, the two incumbents have vastly different cost structures. It is this that leads to the lack of competition.

Put simply, Econet believes that:

- A CDMA business has a materially higher cost structure than a GSM business.
- Telecom, using CDMA, cannot lower its prices because its cost structure is too high.

² Ibid, page 14.

³ Ibid, page 16.

⁴ Ibid, page 31.

⁵ Ibid, page 33.

- Vodafone, using GSM, has no incentive to lower its prices because Telecom cannot lower its prices.

On the question as to whether New Zealand has a high cost structure for GSM networks than other countries, the answer is no. Networks are sold by equipment suppliers on the basis of capacity, not coverage. That is, the costs depend on how many users you have. In addition, the GSM operator in New Zealand is a member of the world's largest telecommunications group, and therefore can assert significant pricing pressure on equipment suppliers.

Normally, a network incurs big distribution costs because of the competition and distribution on the high street, where several GSM networks are competing amongst each other. This means that the distribution outlet can capture anything up to 25% of retained airtime spent in return for offering the operator an attractive distribution footprint. This is best characterized by some of the European markets in which four GSM operators would all compete at the high street level, leading to greater service, along with greater cost for the operator to provide that service. New Zealand, however, has been characterized by a monopoly provider of GSM services, and as a consequence, there has been very low distribution costs associated with distributing a product which has become a modern day necessity.

Question 4.4(c) – How would a reduction in mobile termination rates be likely to affect this market?

“The mobiles market in New Zealand is different to the United Kingdom for various reasons ... Vodafone expects that the waterbed effect discussed in the United Kingdom will be modified in New Zealand as a result of the integrated status of Telecom.”⁶

We agree that the New Zealand cell phone market is substantially different to the United Kingdom market. New Zealand has only one GSM network, which is by far the world's preferred technology. The United Kingdom has four GSM networks and four Mobile Virtual Network Operators (“MVNO”). The United Kingdom has cheaper handsets at the retail level and substantially cheaper airtime rates. The United Kingdom has higher distribution margins and has substantially higher usage and adoption of mobile technology as a consequence of lower price and increased usage. Specifically, fixed-to-mobile substitution is more advanced. There is a strict regime on number portability and co-location which has benefited consumers because competition has been created at the network level.

“Question 4.4(d) – How would regulation affect the trend towards substitution of fixed line services with mobile services?”

“As explained above in our answer to question 4.4(c), regulation of mobile termination services would most likely lead to an increase in either or both of mobile outgoing call prices and subscription prices. This will delay, and probably halt, the trend towards fixed to mobile substitution.”⁷

We agree that regulation of mobile termination rates would slow the development of fixed-to-mobile substitution, but not for the reasons that Vodafone sets out. It would slow fixed-to-mobile substitution because a high termination rate increases fixed line calling costs. Therefore, a lower termination rate would reduce fixed line charges, encouraging customers to retain their fixed line connections.

Econet believes that it is in Vodafone's interest to have a continued high fixed-to-mobile termination rate, not just to earn revenue, but to benefit from an additional incentive in marketing a closed mobile network solution. A “closed network group” is a situation where an operator will charge very little, or nothing, for users to call other users within a community – say, a common place of employment. If termination rates are high, then there is considerable competitive advantage in offering this service. But if they are low, the advantage reduces.

“Question 5.2(g) – Would reductions in mobile termination rates lead to an increase in mobile subscription charges?”

⁶ Ibid, pages 38-39.

⁷ Ibid, page 39.

“Vodafone does not earn economic profits. Vodafone is investing hundreds of millions of dollars in a new 3G network with the result that our fixed costs are reaching a cyclical high point relative to variable costs.”⁸

We disagree. We believe Vodafone does earn economic profits before inter-company adjustments. In addition, we believe that Vodafone is only investing a fraction of its free cash flow in 3G equipment, which is going to roll out much more slowly than its European counterparts.

Econet invites the Commission to reflect about the small context of the 3G investment, which is small in comparison with the real level of profitability and minute in comparison with other 3G rollouts. The slow adjustment from 2G to 3G networks represents a steady, normal replacement of capital equipment in the normal case of any business, very similar to a company updating its fleet of trucks or printing presses. To suggest that the 3G investment is massive in terms of the overall cost structure of the business is misleading, since the major costs of any network construction are initial site acquisition, construction and subscriber acquisition, and these barriers have already been overcome. In addition, 3G capital equipment costs have halved in recent years and 3G handset costs have come down approximately 70%. The ACCC’s decision to regulate 3G voice services reflects the fact that most operators are seeking to migrate their 2G business to a 3G business; and really there is little difference in the business model of a 2G operator to 3G.

“Question 6.1(e) – Are mobile operators in New Zealand earning economic profits?”

“No, Vodafone does not earn economic profits over the life of its capital assets. Across the business, Vodafone made losses during the early years of its entry into the New Zealand market. Given the heavy capital investment by Vodafone its returns in recent years cannot be characterised as ‘supernormal profits’.”⁹

Without access to the management accounts of Vodafone, we are unable to prove whether Vodafone is earning economic profits. However, based on its understanding of operating GSM networks, handset costs, New Zealand distribution costs, and network airtime costs, Econet believes that Vodafone earns significant economic profits. Please see our comments above in relation to the fact that the major structural costs of the Vodafone business have already been recovered long ago. .

“Question 6.1(f) – What is the best measure of the profitability of mobile networks?”

“First, providing mobile service is a highly capital intensive business. Moreover, many of the relevant assets are not particularly long-lived, at least relative to fixed-line assets. Vodafone invites the Commission to reflect on these questions about profitability in the context of Vodafone’s investment of hundreds of millions of dollars in a new 3G network.

“If this capital spend could be avoided, Vodafone would not be undertaking it. The 3G network is being built because of competitive pressure: if we do not build this network, someone else will, and they will then be able to take our customers.”¹⁰

Providing mobile service is undoubtedly a capital intensive business, more specifically competing in the mobile business as a new entrant. However, the biggest cost is not capital cost, it is subscriber acquisition cost.

We repeat our comments in relation to the real cost of the 3G investment in the context of Vodafone’s overall profitability: these are normal costs relating to technology upgrades that any operator must bear, and do not significantly impact on overall profitability.

⁸ Ibid, page 46.

⁹ Ibid, page 48.

¹⁰ Ibid, page 48.

“Question 7.1(b) – Should the description apply to voice calls terminated on any cellular mobile network regardless of what generation technology it is?”

“Vodafone is strongly of the opinion that any regulation of 3G voice call termination services would be extremely premature at this point.

“Vodafone considers that the ACCC’s decision to regulate 3G voice services was unnecessarily heavy-handed and premature in this regard.

“While the threat of regulation of 3G voice call termination services will not change Vodafone’s decision to deploy a 3G network, it will negatively impact Vodafone’s investment ‘at the margin’, by impacting the pace and altering the scope of Vodafone’s roll-out.”¹¹

We disagree. Econet believes that it is imperative that any regulation focuses on where the action is, not where it is not. It is not premature or irrelevant to preclude 3G voice termination in any regulation it intends to introduce. 3G is no fundamentally no different from 2G. Indeed, it is being marketed as an upgrade to an existing product, which is exactly what it is. Again, the costs are not significant over the life of the business and considering the levels of profitability being achieved. Any regulation that does not take 3G into account risks regulating an irrelevant technology, whilst ignoring the real market that needs to be addressed.

“2. We do not think that there are any issues with the current structure or level or MTR prices that are serious enough to require regulation at this time—MTRs are not high by world standards, they have fallen, they are expected to fall further, and market developments, especially our efforts to drive fixed-to-mobile substitution, mean that MTRs are becoming less important over time.”¹²

We disagree. As mobile markets approach saturation (mobile penetration is circa 80% of population) and growth of new mobile subscribers decreases, mobile operators are looking to increase call minutes and revenue per subscriber as a way to increase total revenue. One of the largest revenue opportunities facing mobile operators today is fixed-to-mobile substitution. In marketing fixed-to-mobile substitution, it is in Vodafone’s interest to keep MTRs high, as this keeps retail prices for calls from the fixed network to the mobile network high, thus giving Vodafone a competitive pricing advantage over their fixed network competitors. Therefore, contrary to Vodafone’s submission, Econet believes that Vodafone’s efforts to drive fixed-to-mobile substitution makes MTRs more important.

“3. The Commission must also continue to recommend exclusion of 3G and mobile-to-mobile termination from the ambit of control.”¹³

We disagree. Econet does not believe the Commission should concern itself about whether an operator is using 2G or 3G. When or if Vodafone operates a 3G network, that network will share many elements of the existing 2G network, e.g. sites, housings, transmission networks, etc.

In fact, the cost of terminating voice calls on a 3G network is expected to be materially cheaper (up to 20%) than terminating voice calls on a 2G network because 3G uses a more efficient, packet-switched, method of handling calls rather than the traditional, circuit-switched, 2G method.

“5. We understand the reasons why the Commission has embarked on this investigation. The Commission is concerned about the overall intensity of competition in retail markets for calls from fixed line to mobile phones and for toll calls, and about the influence that the only integrated fixed and mobile firm has in those markets.”¹⁴

We disagree. Vodafone is the dominant player in the mobile market and they have enormous market power to dictate MTRs. If MTRs remain at their current level, Vodafone will have a competitive price advantage, enabling them to transfer this market’s dominance to the market for fixed voice. Econet

¹¹ Ibid, pages 54-56.

¹² Vodafone New Zealand, *Submission to the Commerce Commission on mobile termination Draft Report*, public version, 30 November 2004, page 2.

¹³ Ibid, page 2.

¹⁴ Ibid, page 3.

notes that the “only integrated fixed and mobile phone” Vodafone refers to is in actual fact one of the original complainants to the Commission.

“11. The MED’s report on the OECD data is not a reliable indicator of the state of competition in the New Zealand mobile market as the data is outdated and incomplete.”¹⁵

We disagree. The MED report is a very good “report card” on the state of competition in New Zealand. In 2001, an Econet study suggested New Zealand consumers were paying as much as 2.45x OECD average for mobile calls. The MED report confirms that New Zealand consumers are still paying more than their OECD counterparts 4 years later. Of course Vodafone is critical of the report – the report is critical of its pricing.

“23. But if the Commission does decide to regulate, then Vodafone argues that there should be a staged reduction in prices (consistent with overseas and previous Commission practice) and that passthrough of price reductions by fixed-line operators should be a condition of access to regulated lower prices.”¹⁶

We disagree. If the Commission finds that MTR are too high, Econet believes the Commission should immediately right the wrong. By allowing a glidepath, the Commission is allowing Vodafone to continue to extract supernormal profits from their mobile market dominance. A glidepath will also assist Vodafone to transfer their mobile market dominance into the fixed voice market because it will enable them to maintain their pricing advantage for calls to mobiles over the fixed line operators.

“24. Vodafone relies on 3G not being regulated. We say the market for 3G services is too immature for regulation to be assessed at present.”¹⁷

We disagree. It is not surprising that Vodafone does not want 3G to be regulated, since Vodafone is very well placed to transfer its 2G dominance into the 3G arena. However, Econet believes that the Commission must take a principled approach to regulation. If regulation works, why should it not be implemented on Day 1? The sorry history of competition in New Zealand telecommunications is littered with the excuses of incumbents arguing that a problem must first be proven beyond doubt before regulation can be introduced. This has been accepted by government who perceives that “regulation” is a dirty word, rather than a proven means to introduce competition into a market that government itself has created. This argument has been used to justify a 10 year fiasco over number portability, and a seriously compromised legislative regime in relation to national roaming and other regulatory measures. If the Commission considers that regulation works as a principle, it should proceed and not be compromised by incumbents’ arguments about markets being not ready, which usually simply amount to a plea to maintain existing dominance.

As far as 3G versus 2G is concerned, a minute of voice on a mobile network is simply a minute of voice. Whether the terminating operator uses GSM or 3G is of no consequence. Econet believes that MTR regulation should apply to all calls terminating on mobile networks regardless of the technology platform. It would be wrong for the regulator to be influenced by the argument that the 3G market is immature: these arguments merely exacerbate the problem and postpone the remedy.

“38. The barriers to entry are not high for a serious entrant – We accept that to build a new national mobile network any new entrant is going to need to commit a lot of money and ensure that it has national coverage. But in our view entry is easier now than it was when Telecom, BellSouth and Vodafone entered the market: the regulatory environment is currently tilted towards promoting entry through the existing regulation of 2G national roaming and co-location. And there are alternative strategies that a new entrant could adopt to reduce the risks and costs of entry.”¹⁸

¹⁵ Ibid, page 4.

¹⁶ Ibid, page 5.

¹⁷ Ibid, page 5.

¹⁸ Ibid, page 14.

We disagree. Entry could not possibly have ever been easier than when Vodafone entered the market. BellSouth had installed its basic infrastructure and gone through the necessary pain to break into the market. Penetration of mobile phones was at less than 20%, and GSM was exploding around the world as one of the most profitable and successful technologies the world has ever seen. Vodafone had a monopoly in GSM, while Telecom was deciding to back an American standard which was fast becoming irrelevant to the majority of the world's mobile users. Penetration in New Zealand quickly rose to circa 75%, allowing enormous profits to be made by the duopoly participants.

In contrast, the regulatory environment today in New Zealand is seriously in trouble: there is still no number portability after a situation which can only be described as an embarrassing fiasco, in which incumbents have successfully held out for over ten years under the banner of "self-regulation". The provisions concerning national roaming and cellsite co-location are dangerously ineffective since they do not deal with the fundamental issue of price. The efforts of new entrants to rely on these provisions have proven their ineffectiveness. The incumbent networks, particularly Vodafone, have had ten years to build a fortress position in the marketplace on the back of an unregulated duopoly, in a market where the absence of regulation is an international oddity.

Given the stunning success that Vodafone has enjoyed as a result of the timing of its entry, contrasted with the failure of any new company to enter the mobile market over the last 10 years, it is extremely misleading to suggest that entry is easier today than when it entered the market.

"99. In our view the Commission is part way there. It sees the evidence of competition and contestability, but it does not reach the appropriate final conclusions. It has been seduced by simple arguments based on unreliable OECD comparisons. It has not done quite enough to explore the reality of competitive conditions."¹⁹

We disagree. Econet believes that the arguments based on OECD comparisons are valid and the suggestion by Vodafone that more work needs to be done is merely delaying the inevitable introduction of a more competitive regulatory environment in which Vodafone's economic profits would be reduced.

"Prices are falling, new services are being introduced, and customer switching keeps us on our toes"²⁰

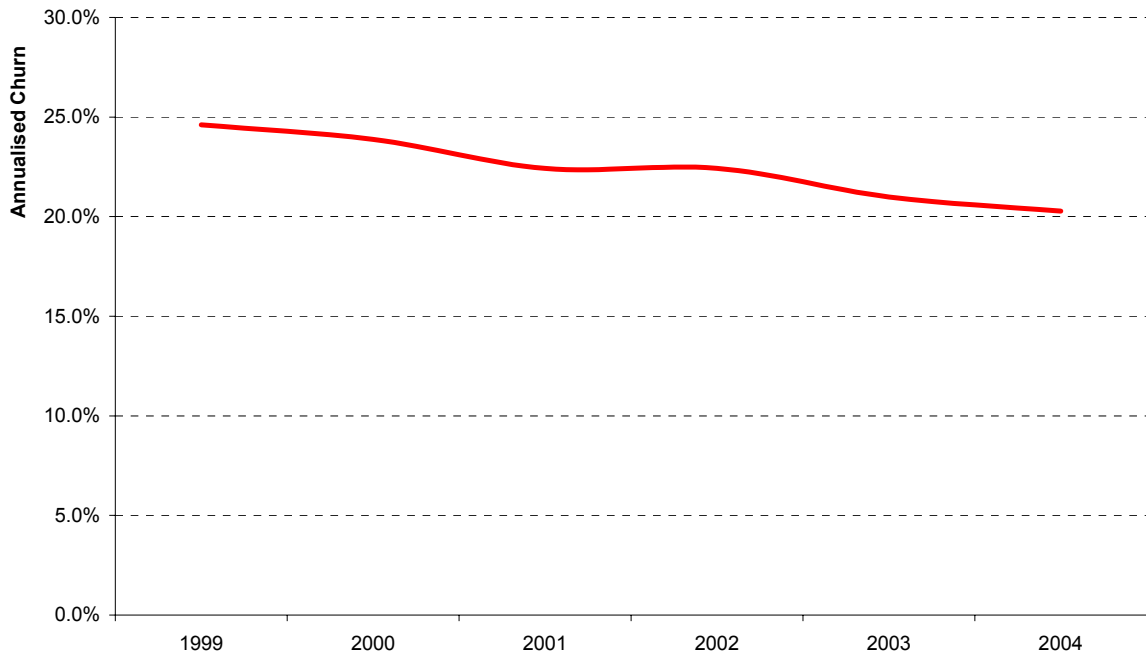
Econet believes that customer switching in New Zealand is extremely low because there is no same technology network switching available. Any customer must change handsets to switch. New Zealand is characterized by 3-year lock-ins and relationships in which customers cannot use the same handset on both networks. Churn is nowhere near the international norms for a competitive OECD market.

Churn has been dropping in New Zealand for the past 6-years, with most analysts forecasting that churn will continue to fall. During the same period, churn in the international arena has been increasing as competition has heated up in global markets.

¹⁹ Ibid, page 24.

²⁰ Ibid, page 25.

Annualised Churn in New Zealand



Data Source: Merrill Lynch, Global Wireless Matrix 2Q04, 29 September 2004

“104. Unfortunately no one produces reliable data for New Zealand at present. The OECD figures are not especially useful (as we explain below) because they are not up to date, they exclude a lot of relevant data, and they seem to systematically overstate usage. We understand that the MED is working on a new benchmarking approach. We have asked to be involved in its development.”²¹

We agree that no one produces reliable data for New Zealand. However, much of the problem is because Vodafone does not publish full financial results for its New Zealand operations. Vodafone seems to have a closed-door policy to all Australasian financial analysts and produces no detailed data other than brief filing notes for the company’s office. Vodafone’s PLC disclosure only accounts for Japan , Australia, Fiji, and New Zealand combined. Vodafone’s PLC also provides no relevant data for New Zealand.

“105. Even in the absence of reliable benchmarking data, there is good evidence easily available of competition. This includes price competition on calls and texts (contrary to the views of the Commission in para 273), rivalry through new products, services and special offers, and ongoing customer switching between the networks.”²²

Of course there is evidence of *some* competition. But the question is whether the competition that exists is as vigorous as it should be given OECD norms. Econet believes that there is no material competition at the price level on airtime, international roaming, handsets for pre-paid users, GPS data, and rural roaming services. Certainly no competition exists at a GSM level, which is the overwhelmingly accepted international standard. Customer churn is way behind other countries, and we challenge Vodafone to graph the percentage of customer switching in New Zealand with the rest of its 30 networks.

“106. There have been recent cuts in retail prices:

²¹ Ibid, page 25.

²² Ibid, page 25.

- *“Vodafone introduced the Motormouth plan for prepay and consumer customers in August 2004. This plan eliminates the distinction between peak and off-peak pricing by lowering calling rates during the day to 49 cpm. It is designed for prepay or consumer customers who make most of their calls to other Vodafone mobiles or to landlines in New Zealand. The 49 cpm rate also includes calls to Australia, Canada, Ireland, UK and the USA. Table 9 compares Motormouth pricing with pricing on other Vodafone plans.”²³*

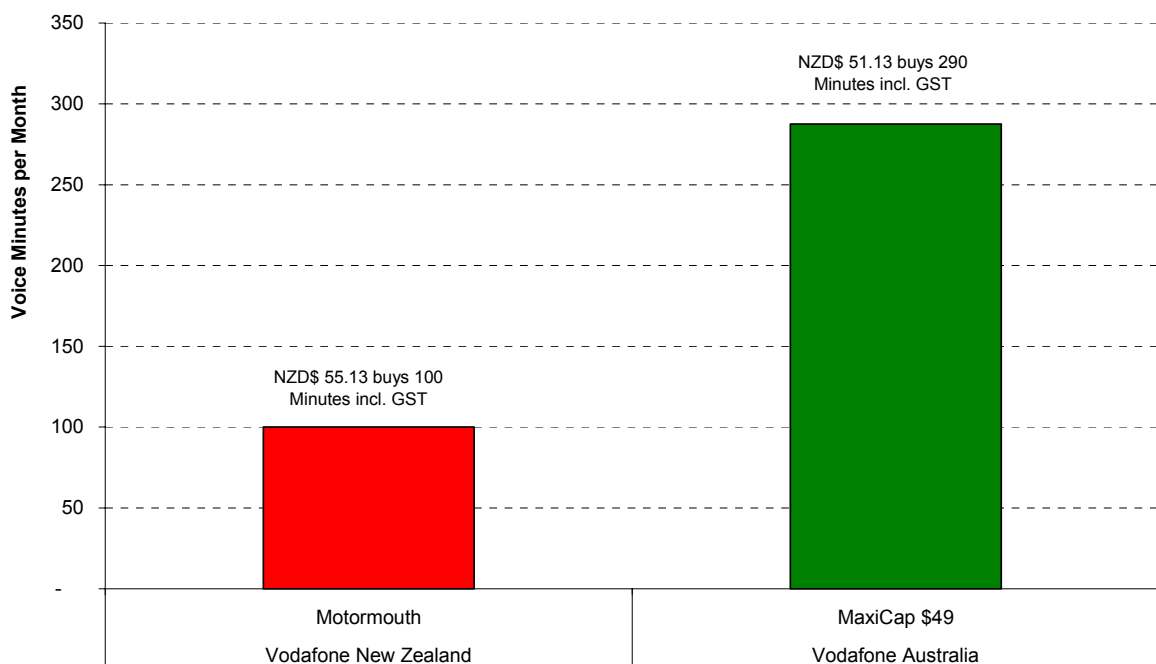
100 Minutes of Motormouth Voice will cost a New Zealand Consumer NZD \$55.13 including GST. This same amount of money, converted for exchange rates, buys an Australian Vodafone Consumer over 290 Minutes of Voice.

Even after Vodafone NZ’s recent price reductions, Australian Prepay customers still get a 290% better deal than their New Zealand counterparts. It is cheaper for a Vodafone Australia customer to call a Vodafone NZ customer than it is for a Vodafone NZ customer to call another Vodafone NZ customer!

Vodafone Australia’s standard rate to call New Zealand is AUD \$3.00 for 10-minutes, equating to AUD \$0.30 per minute. This compares against Vodafone NZ’s much touted Motormouth plan which charges NZD \$0.49 per minute.

In Australia, Vodafone competes with 2 other GSM providers and an MVNO. In New Zealand, Vodafone is the only GSM provider.

Number of Prepay Minutes NZD\$ 55.13 buys from Vodafone



Assumes each call is a standard call to a landline or mobile and is 1-minute in duration. In Australia the customer can call any other mobile network. In New Zealand calls to other mobile networks is charged at 2.84x the standard rate. NZD-AUD FOREX rate: 0.9299.

- *“Vodafone introduced the Mobilise plans for business customers at the same time, meaning price cuts for these customer. Table 10 details the changes.”²⁴*

A New Zealand business on a Mobilise 200 plan will pay NZD \$106.88 including GST for 200 Minutes of Voice. This same amount of money, converted for exchange rates, buys an Australian Vodafone business customer over 650 Minutes of Voice.

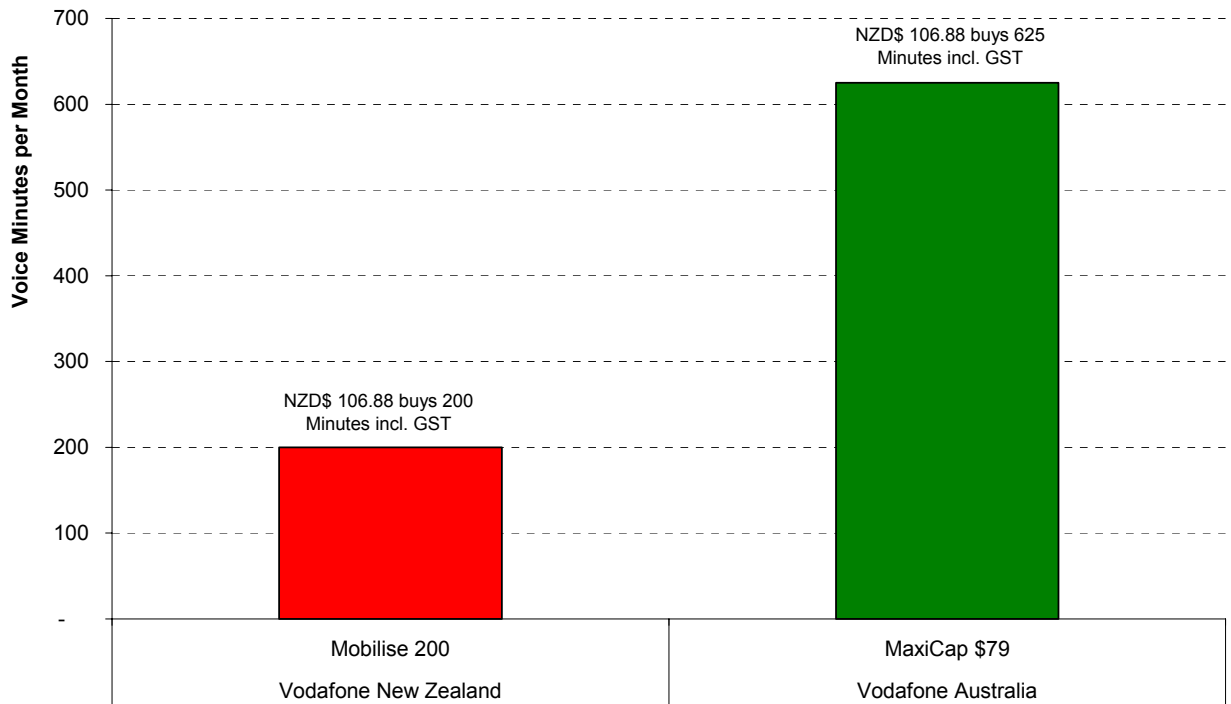
²³ Ibid, page 25.

²⁴ Ibid, page 25.

Even after Vodafone NZ's recent price reductions, Australian business customers of Vodafone still get a 325% better deal than New Zealand businesses.

In Australia, Vodafone competes with 2 other GSM providers. In New Zealand, Vodafone is the only GSM provider.

Number of Business Minutes NZD\$ 106.88 buys from Vodafone



Assumes each call is a standard call to a landline or mobile and is 1-minute in duration. NZD-AUD FOREX rate: 0.9299.

- “Very recently Vodafone launched talkZone Zero, specifically for businesses that make more than one third of their calls within a calling group. The plan enables users to call mobiles within their group for no charge apart from the monthly access charge. Before talkZone Zero, such calls would have cost 15 cpm for users of a talkZone plan. Customers may also add other frequently called landline or Vodafone mobiles to the free calling plan for an additional fee.”²⁵*

This is a short-term offer and does not represent any long-term reduction in prices. The offer is only available until 30 June 2005. From 1 July 2005, all calls to “Frequently Called Numbers” will be charged at 15cpm + GST.

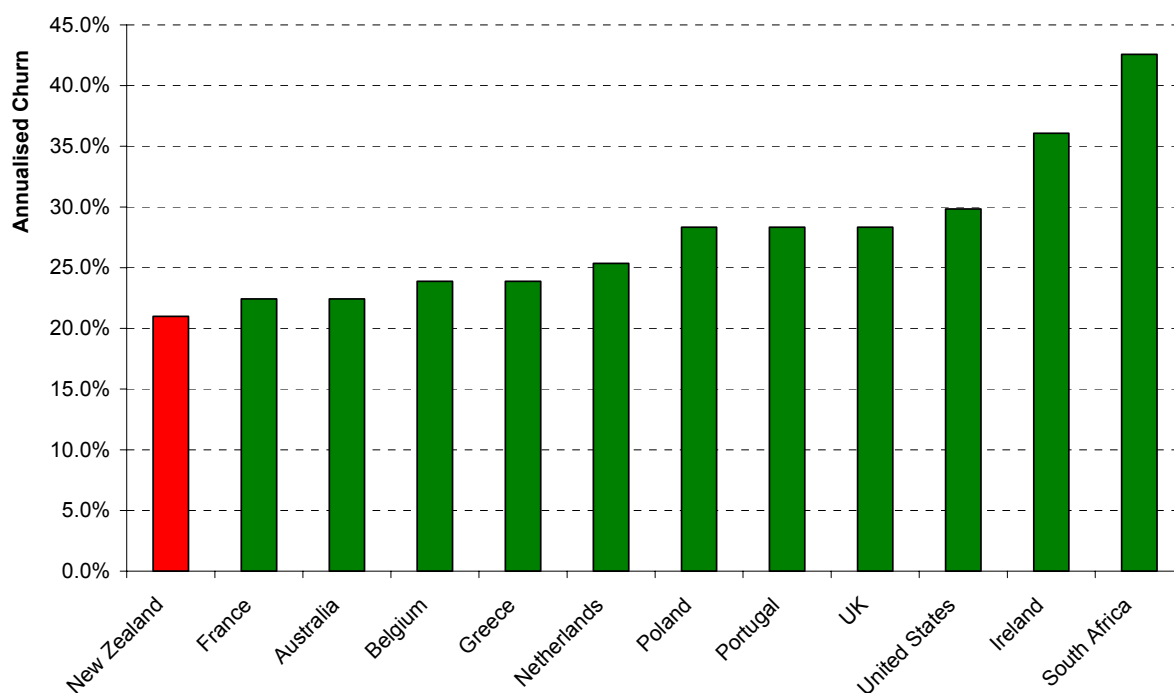
“111. Churn statistics provide a measure of the extent of customer disconnections. Our churn data counts the number of disconnections from our network each month and expresses them as a proportion of the average customer base in that month.”²⁶

Below is a chart comparing churn in New Zealand to churn in other Vodafone countries. This chart was compiled using data from Vodafone PLC 2004 Annual Report and data from Merrill Lynch.

²⁵ Ibid, page 26.

²⁶ Ibid, page 26.

Churn Comparison with other Vodafone Countries



Data Source: Merrill Lynch, Global Wireless Matrix 2Q04, 29 September 2004

“116. Even Ernie Newman, the Chief Executive of TUANZ, whose complaints sparked the current MTR investigation, recognises that the mobile market is working for consumers.

‘[Our early adoption of 3G is] a sign that we do have a very dynamic and quite competitive mobile industry here in New Zealand.’²⁷

We refer the Commerce Commission to TUANZ’s own study of expensive airtime in New Zealand. We observe that 3G at the W-CDMA level is only coming to New Zealand in June of 2005, when it has been introduced in late 2003 in many European countries.

“The OECD evidence is not reliable as an indicator of domestic competitive conditions

“117. The Commission points to an MED report on recent OECD price comparisons as evidence that there is limited competition in the mobile services market (paras 256 and 260). This is because:

- *“the report shows that New Zealand’s mobile calling prices are some of the highest in the OECD (para 28, and*
- *“ the Commission assumes that costs of operations in New Zealand are likely to be no higher than costs in other OECD countries because it has had no evidence to the contrary (para 303).”²⁸*

We disagree. We believe that the OECD evidence is reliable and that the MED report is credible.

“120. The MED’s OECD comparisons use data from February 2004. They have been superseded by movements in the market, as outlined above.

- *“The Motormouth plan for prepay and consumer customers generates a price cut of 23% for the OECD low user using the OECD’s methodology.*
- *“The Mobilise plans for business customers means a price cut of 13% for the OECD high user.*

²⁷ Ibid, page 27.

²⁸ Ibid, page 27.

- *“The OECD data also excludes Telecom’s \$10 txt promotion, and Telecom’s responses to our price cuts.”*²⁹

Econet has compared Vodafone NZ’s Motormouth and Mobilise Plans with offers available to Australian Vodafone customers. The fact is Australian Vodafone customers get a circa 300% better deal than their New Zealand counterparts.

“The Commission needs to do more to look at the costs of mobile operations”³⁰

We agree . We suggest that the Commerce Commission commence an audit of all direct costs associated with the New Zealand GSM network and calculate what the specified wholesaling price of that network airtime is. It should look specifically at direct costs and indirect costs, focusing in on competitive pricing in billing systems, software management, royalty payments, branding support, and inter-company value transfers. It should also look at the treatment of spectrum valuation and contrast and compare capital equipment costs and opex costs with third-party companies.

*“140. In summary, there is good reason to expect that the unit cost of mobile service in New Zealand is higher than in other OECD countries, and certainly higher than in Australia, even only considering some of the factors that might drive cost differences.”*³¹

We disagree. There is a wealth of factors to suggest that unit costs are lower in New Zealand than in other countries. However, even if unit costs are higher in New Zealand, the real issue is the difference between the cost structures of the two incumbent operators. Telecom, with a higher cost structure, cannot reduce its prices; while Vodafone, with a lower cost structure, has no incentive to reduce its prices. The result is that Vodafone is enormously profitable and by far the dominant mobile player; while New Zealand consumers pay prices that are far too high.

If Vodafone feels that there is good reason that the unit of cost of mobile service in New Zealand is higher than other OECD countries, Econet believes it should disclose its full financial details for its New Zealand operation in comparison with other OECD Vodafone operations.

*“147. In our view entry into the New Zealand mobile market is relatively easy. The regulatory environment here is friendly to new entrants. Spectrum is cheap by comparison with other countries (and held by two firms that have chosen not to enter the market at this point). Number portability is on its way (although we note that churn levels already seem high). National roaming and cell-site co-location are already regulated.”*³²

We disagree. It defies belief that Vodafone can hold the view that entry is relatively easy, given the repeated failure of companies to enter the mobile market over the years that Vodafone has operated in New Zealand, even in this new era of regulation. Vodafone is well aware that the current national roaming and cellsite co-location provisions do not guarantee entry into the marketplace and in fact feature key omissions which favour the incumbent positions and thereby minimise the likelihood of new entry. Number portability has been “on its way” for over 10 years – a period during which BellSouth as a new entrant was extremely vocal about number portability, while Vodafone as an incumbent now seems fairly ambivalent by comparison. It is true that spectrum *is* cheap – however the price of spectrum is determined by an open market process of auction, in which purchasers decide what the opportunity is worth. Failure after failure at a new entrant level has made many investors wary of participating in the New Zealand mobile market. It speaks volumes that spectrum is cheap in New Zealand, because it indicates the risk a purchaser must take as to whether it will ever receive a return on its investment. It is public knowledge that both companies which hold spectrum and have chosen not to enter the market have negotiated with Vodafone over key aspects of new entry strategy before their decision not to enter.

²⁹ Ibid, page 28.

³⁰ Ibid, page 29.

³¹ Ibid, page 31.

³² Ibid, page 32.

Vodafone must also be well aware that the business case for a new entrant is difficult, given the significant market power of the GSM monopoly network, which has approximately 64% market share with no market for national roaming (only the monopoly network to negotiate with), along with industry cell-site co-location self-regulation protocols which essentially re-enforce the access providers' right to negotiate on their own terms.

*"150. The high costs of building a mobile network are not a barrier to entry. What matters for a commercial entry decision is the expected return on investment rather than the size of the investment. Capital is not scarce. There are poor investments and good investments, but there is no shortage of capital for investment. In any case, no one can seriously argue that Telstra is capital constrained. Admittedly, the position of Econet Wireless is rather less clear, although the Hautaki Trust, its partner, was given a 5% discount on the price of its 3G spectrum."*³³

We agree that what matters is the quality of the investment, and not the size of it. In this light, the fact that even Telstra, who should be able to afford a very large investment, seems to be wary of investing in New Zealand, says everything about the state of play in New Zealand mobile telecommunications, and says everything about the quality of the investment case Telstra faces given the existing market structure.

The cost of building a mobile network in the major cities in New Zealand is not a large number. Nevertheless, Econet can confirm from its own experience that market structure and the strength of the regulatory system is a paramount concern for capital investors considering an investment in a new entrant. The failure of new entry in the post-regulation era is an enormously negative commentary on the existing market structure and on the effectiveness of the current Telecommunications Act.

*"152. Likewise, the requirement for national coverage does not strike us as a barrier to entry. BellSouth and later Vodafone built their networks after Telecom had already built its network. They did not have national coverage from day one. And they did not have the benefit of regulated national roaming, cell-site co-location, the prospect of number portability, or regulated fixed termination rates to lower their costs. Nor did they have an industry specific regulator that they could petition to investigate any constraints on competition in the market."*³⁴

To suggest that the conditions of Vodafone's market entry compares with today's shows a lack of understanding about the real issues that are driving regulation and competition in today's market. The market that Vodafone entered was fundamentally different from the market of today. Penetration was less than 20%, whereas today it is over 70%. GSM had not yet exploded across the world. A GSM monopoly had not yet been formed, and an unregulated duopoly had not yet had the opportunity to forestall any new entry into the marketplace for a decade – an unprecedented event in a developed market. Vodafone's views of the supposed benefits of cell-site co-location and national roaming are at odds with its experience in negotiating those very issues: no new entry has yet taken place, despite the fact that new entrants have negotiated with Vodafone on cell-site co-location and national roaming while these provisions have been in place.

*"160. Of course, we accept that it is expensive, difficult, and risky to enter the mobile market in New Zealand. But those expenses, difficulties and risks were taken by Telecom, BellSouth and Vodafone. In our view the Commission should focus on changes to the costs and risks of entry over time rather than on whether a particular line of business is expensive to enter or not. Seen in this light, we think that barriers to entry are actually falling over time."*³⁵

For the reasons stated above, we disagree that the same expenses, difficulties and risks were taken by Telecom, BellSouth and Vodafone. Certainly, Telecom had absolutely no risk competitive risk whatsoever when it entered the mobile phone market. BellSouth and Vodafone entered at a time when GSM had not taken off in this part of the world, and the New Zealand mobile market was more or less a greenfields operations. This is fundamentally different from the reality of today's market, where many third entrants have failed so far, some before they have even got to first base.

³³ Ibid, page 32.

³⁴ Ibid, page 33.

³⁵ Ibid, page 34.

We also disagree that the barriers to entry are falling. It is obvious that Vodafone will increase its subscriber acquisitions costs should a new entrant enter the market, making it financially more attractive for customers to join its network and placing pressure on new entrants' costs structures.

In 2005, network coverage will also create a barrier to entry. Specifically there is only one GSM network, which means there is only one player for a new entrant to negotiate a roaming arrangement with.

*"162. Econet Wireless recently announced that it would not enter until more had been done to lower the costs of entry through the introduction of number portability and more generous terms for access seekers to cell-site co-location. It makes no sense for a business to invest substantial capital if it believes it may be able to persuade a regulator to grant it lower-cost entry at the expense of the competitor."*³⁶

Any regulatory environment is subject to change: Vodafone itself states its annual report that regulatory environments may change from time to time. It would be foolish for an investor seeking to invest substantial capital to rely on an assumption that it is able to convince a regulator that it should have incrementally better terms. It is not a matter of "gaming" the regulatory process so as to secure a better deal. The challenge is to arrive at a threshold at which entry becomes acceptable. In this environment, a new entrant investor's decision is binary: it can only invest if conditions are appropriate.

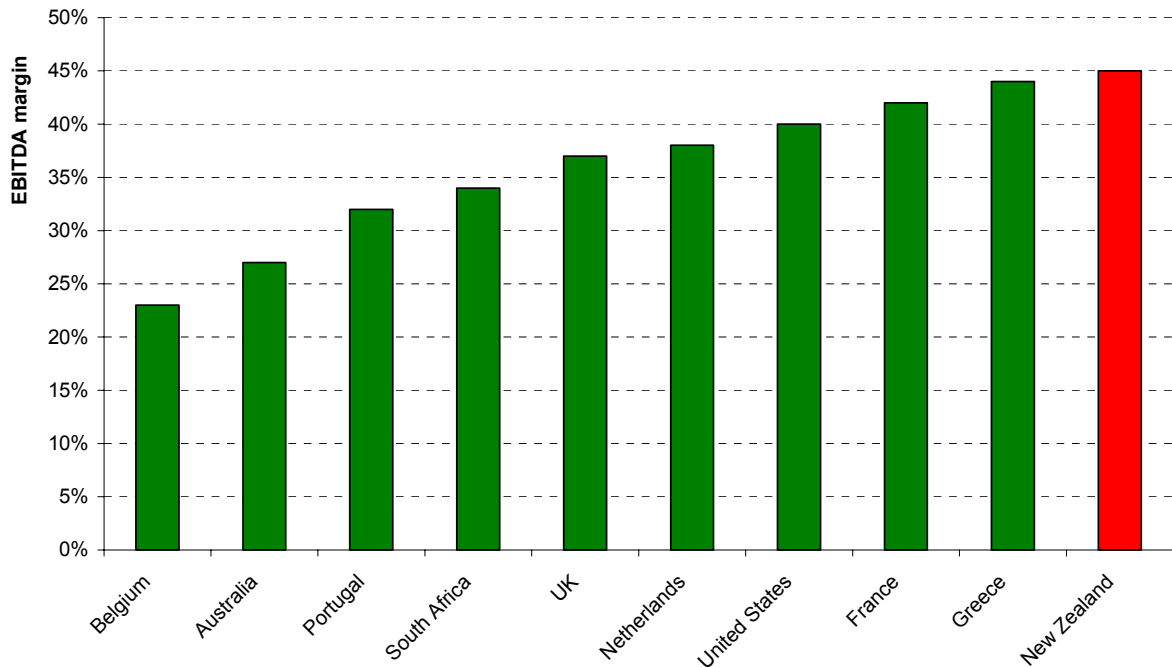
*"163. For the avoidance of doubt, we point out that we do not consider that the absence of some regulatory advantage for new entrants counts as a barrier to entry."*³⁷

We disagree. Barriers to entry naturally exist when a duopoly has been created and allowed to continue for a decade. The government *created* this duopoly, and it should be open to the government to manage the results of its decision. Regulatory 'advantage' in a New Zealand context is nothing more than the introduction of international standards for the proper management of mobile telecommunications markets. Vodafone, as the world's only true global mobile telecommunications group, should be more aware than anybody of the fact that regulation is absolutely normal in international telecommunications markets: New Zealand stands alone in the developed world as a duopoly, with a GSM monopoly, marked by very little, if any, effective regulation.

³⁶ Ibid, page 34.

³⁷ Ibid, page 34.

EBITDA margin Comparison with other Vodafone Countries



Data Source: Merrill Lynch, Global Wireless Matrix 2Q04, 29 September 2004

“We suggest the Commission should formally consider evidence on profitability”³⁸

We agree. A financial model should be built of Vodafone New Zealand, tabling third-party costs and referencing its profitability relative to its pre-royalty, pre-inter-company cost adjustments.

“204. Even if our returns were significantly higher than our WACC for a sustained period, that in itself would not be evidence of monopoly pricing. It might simply be that we have a superior customer mix, or a superior level of efficiency. In other words, an alternative explanation is that we are constrained by competition but just better at our job than other firms. Both of these advantages are contestable, so any excess returns that are generated through these means would not be an indicator that a firm had a dominant position in the market.”³⁹

We disagree. We believe that if Vodafone returns were significantly higher than their WACC, then it is definite evidence of monopoly pricing. We believe current returns are 4x or 5x higher than the WACC before inter-company royalty payments and software adjustments based on normal operating costs with a GSM network. There are over 400 GSM networks globally and costs are easily mapped and compared. GSM, as the preferred technology internationally, is genuinely cheaper to operate than the Telecom technology of TDMA, CDMA, AMPS, and 1X.

One simply needs to contrast the difference between Vodafone Australia, Vodafone PLC UK, and Vodafone NZ. Vodafone Australia competes with three other voice networks: one GSM, one GSM / CDMA, one 3G, and two MVNOs. Airtime is cheaper, handsets are cheaper, value is better, and profitability is lower.

“253. The Commission can only recommend regulation if it considers that the regulation proposed best promotes competition for the long-term benefit of end-users. In our view, MTR regulation is unlikely to promote competition overall.”⁴⁰

³⁸ Ibid, page 41.

³⁹ Ibid, page 41.

⁴⁰ Ibid, page 49.

We agree. Whatever the decision of the Commission on MTR, it will not make the structural difference necessary to encourage and allow new entry.

“348. Vodafone is concerned about the use of overseas benchmarks, and especially that the benchmarks used are relevant or appropriately adjusted to ensure they take account of differences from the New Zealand mobile market.”⁴¹

Econet has the view that overseas benchmarks are absolutely reasonable to use in New Zealand. This is particularly so because there is very little detailed information about Vodafone NZ’s financial structure or cost structure. Econet respects the right of Vodafone to conduct its activities confidentially; however it also respects the right of the New Zealand consumer to understand why their prices are so high.

“352. A similar point applies for every other country in the Commission’s comparison group: they all have significantly higher populations and their population densities differ from New Zealand. And the size of their markets mean that economies of scale and scope are likely to be much greater there than in New Zealand.”⁴²

We disagree. Vodafone globally can afford to be very aggressive on its suppliers in driving economies of scale and scope. Vodafone’s equipment supply relies on a global pricing book, not a country-by-country one. Vodafone is the largest and most dominant mobile telecommunications group in the world, and its New Zealand operations are celebrated as profitable success story. We are sceptical that Vodafone has material costs in New Zealand which are materially higher than in other markets, such that it makes a material difference to the cost of producing airtime.

⁴¹ Ibid, page 68.

⁴² Ibid, page 68.

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“11.3 The interdependency of mobile service pricing means regulatory intervention will result in subscribers dropping off (or not joining) the mobile network. This will have adverse consequences for all customers. The subscribers will no longer have access to a mobile phone. Similarly, those wishing to call them will no longer be able to do so. Moreover, all those customers (subscribers and callers) will no longer be making a contribution to mobile operators’ fixed costs—meaning prices for remaining subscribers could be expected to rise further;”⁴³

We disagree with both Vodafone and Telecom’s assertions that regulation will lead to rising retail tariffs. Regulation of MTR should result in lower fixed line and mobile tariffs, as well as increased traffic as an increase of mobile-to-land line revenue.

“11.5 There is vigorous competition in the mobile services market. The real and effective competition is for subscribers, as this drives all revenue streams, and Telecom and Vodafone compete hard on price and non-price attributes. It would be an affront to common sense to suggest Telecom or Vodafone are in a less than competitive market or otherwise able to earn economic rents.”⁴⁴

We disagree. While there is clearly competition for customers in terms of brand awareness and text, Telecom and Vodafone clearly do not compete hard on price. In the New Zealand market, one player has 64% market share by revenue and captures up to 85% of all new additions.

Further we believe that Vodafone earns economic rents in New Zealand cellular. It is important to note that Telecom earns considerably less EBIT per customer because Telecom has antiquated technology, a four network history, and does not benefit from the economies of scale of GSM technology or W-CDMA technology.

“14. The fact that the Australian and UK regulators have got their market definition wrong is no reason to perpetuate the same error here.”⁴⁵

We disagree. The level of competition and number of players in Australia and UK, and the price Australian and UK customers pay for their calls relative to New Zealand customers, speaks for itself.

“72. This section examines the level of competition between mobile operators in New Zealand. It demonstrates that the level of rivalry between Telecom and Vodafone is intense; that mobile competition is workable and effective; and that consumer welfare is unambiguously and quickly improving.”⁴⁶

We disagree. We believe that the mobile services market is not highly competitive because there is no same technology platform in New Zealand. Barriers to entry remain high and customer costs for mobile phone usage remain excessive. This is demonstrated by:

- 1) high prices;
- 2) low levels of churn; and
- 3) lack of new entry.

We believe that consumer welfare is not improving as fast as equipment costs and handset costs are dropping, and that the MED’s observation that the New Zealand consumer is paying 153% more than the top 20 OECD countries is correct.

“76. Telecom submits that it is entirely inappropriate to infer from this that there is any lack of domestic competition. The OECD study says nothing about the relative cost of providing mobile

⁴³ Ibid, page 5.

⁴⁴ Ibid, page 5.

⁴⁵ Ibid, page 6.

⁴⁶ Ibid, page 18.

*services in different countries, and the methodology used to arrive at a single 'price' for all countries means the final number (and ranking) must be treated with considerable scepticism.*⁴⁷

We believe it is entirely appropriate to assume there is lack of domestic competition.

*"79. This rivalry is delivering an ever expanding set of services which are highly valued by (and thus benefit) end users."*⁴⁸

We disagree. It is the nature of mobile telecommunications markets to provide an expanding set of services. However it is beyond dispute that the level of competition in providing these services in New Zealand is way behind the level of competition in markets which have traditionally had an active regulator to encourage competition. In contrast to their European and Australian peers, New Zealand customers cannot move from one network to another without investing in a handset change or a number change, and new entrants must negotiate with one provider for national roaming in an environment where price and contract term are not subject to regulatory oversight. This has a fundamental effect on the competitive environment, and therefore on the services and prices which are available to consumers.

*"123. There is no competition problem to fix, and regulation can be expected to distort, rather than promote, competitive market outcomes."*⁴⁹

We disagree. There is no competition at same technology level, and no market to engender a roaming solution for a new entrant. We believe that regulation is required to remove the distortions created by the government's failure to act in the same manner as their OECD peers with respect to normal market regulation.

⁴⁷ Ibid, pages 18-19.

⁴⁸ Ibid, page 19.

⁴⁹ Ibid, page 30.

5 Econet Wireless comments on TelstraClear submission

“11. We also believe that it would prove difficult to distinguish 2G- and 3G-directed voice traffic, both conceptually and in practice. The challenge of devising a service description capable of distinguishing 3G from non-3G networks would be compounded by the practical difficulty of separately identifying and characterising relevant network elements.”⁵⁰

We agree.

“55. However, TelstraClear strongly disagrees with the Commission’s view that there would be a material risk to dynamic efficiency from regulating mobile termination on 3G networks; and considers that 3G mobile network platforms should not be exempted from the scope of mobile voice termination regulation in New Zealand ”⁵¹

We agree.

*“56.
“c. There is no evidence to suggest that 3G mobile investment decisions have been negatively impacted by regulation (o the prospect of regulation) of mobile termination in New Zealand or any other jurisdictions; and
“d. Providing Telecom and Vodafone with a guaranteed source of economic profits from 3G mobile termination will weaken the disciplines on Telecom and Vodafone to invest efficiently.”⁵²*

We agree.

“57. The Draft Report proposes not to regulate mobile voice calls terminating on 3G networks because of concerns that the imposition of 3G regulation would create an unacceptably high risk that Telecom and Vodafone would delay or restrict their planned investments in these networks.

“58. In our view these concerns are unfounded. We believe that in arriving at this conclusion, the Draft Report has greatly overestimated the costs and risk levels faced by existing mobile network operators when investing in 3G infrastructure, which differ both in magnitude and character from those faced by greenfields operators. In contrast to new operators, the 3G investments of Vodafone and Telecom:

- “a. are relatively low cost, being incremental to, and leveraging heavily, their existing 2G network assests and operational capabilities; and*
- “b. are relatively low risk, as they constitute a migration path for their large, highly profitable 2G customer bases, and are demand-driven.”⁵³*

We agree.

“59. For incumbent mobile operators, the deployment of 3G network equipment over existing 2G network infrastructure and operations is appropriately characterised as a network upgrade – albeit a significant one – and is treated as such by the operators themselves. As with other network upgrades, the deployment of 3G network equipment is scheduled and costed well in advance, supersedes written-down equipment, and enhances operating efficiencies in relation to the carriage of its legacy traffic.”⁵⁴

We agree. The move to 3G is in the nature of a normal technology upgrade – it is not a fundamental shift in the marketplace. Further, it is nowhere near as expensive as is commonly imagined.

⁵⁰ TelstraClear, *Submission to the Commerce Commission on mobile termination Draft Report*, public version, 30 November 2004, page 6.

⁵¹ Ibid, page 22.

⁵² Ibid, page 23.

⁵³ Ibid, page 23.

⁵⁴ Ibid, pages 23-24.

“60. Clearly, 3G network infrastructure offers enhanced functionality compared to 2G networks (primarily by enabling the carriage of higher data volumes at much faster speeds); and the primary utility in deploying 3G network infrastructure is to expand the addressable market for mobile services to include forms of broadband-dependent content and carriage services. However, this neither contradicts nor negates the fact that, for existing mobile operators, these investments also form part of the continual upgrade process inherent to all technology-based industries, the risks of which are minimised to the extent that they protect and support existing revenue streams.”⁵⁵

We agree. The major investment costs are cell sites and customer acquisition, and competition’s reaction.

“61. For existing operators, this ‘upgrade’ character of 3G network investments – which renders them less costly, risky or exceptional – is a key reason why decisions about these investments are very unlikely to be affected by the imposition of regulation in relation to legacy services carried over them.”⁵⁶

We agree. We believe that any difference in regulatory position between 2G and 3G for the incumbent networks will mean they will merely transfer their duopoly from 2G to 3G and no competition will start.

“62. Vodafone and Telecom both announced their 3G investment plans after the prospect of regulation was raised. Vodafone confirmed its commitment to invest in a 3G mobile network on 10 May 2004 by announcing its partnership with Nokia across New Zealand and Australia; well after the release of the ACCC’s draft MTAS decision. Further, Telecom NZ announced on 25 June 2004 its intension to spend \$40M on 3G network rollouts based on EV-DO technology. EV-DO does not support voice; rather, the investment was aimed at fast internet and data services. This was post the release of the Issues Paper on 21 June 2004.”⁵⁷

We agree. This is why 3G regulatory symmetry must be adopted.

“63. The Telecom and Vodafone 3G investments leverage heavily their existing network assets and operational capabilities, to such an extent that, for the purposes of this inquiry, they are appropriately characterised as upgrades to their existing 2G networks rather than as separate networks in their own right.”⁵⁸

We agree.

“64. That the move to 3G is an incremental development in Telecom’s and Vodafone’s mobile networks is well articulated in Telecom’s submission on the Issues Paper. Telecom’s submission illustrates the series of incremental developments in Vodafone’s and Telecom’s cellular networks over the past five years. 3G is simply the latest step to be made. This is depicted in Table 7.1.2 below.”⁵⁹

We agree.

“65. While the relationship between each operator’s respective 2G and 3G network architectures differ (as a result of Telecom and Vodafone deploying different technologies in their 2G and 3G networks), both operators are able to exploit substantial economies of scope between their 2G and 3G networks, as the 3G networks will be able to utilise the existing investments in:

“a. radio towers;

“b. cell site facilities;

“c. transmission linking infrastructure; and

“d. exchange and collocation facilities;

⁵⁵ Ibid, page 24.

⁵⁶ Ibid, page 24.

⁵⁷ Ibid, page 24.

⁵⁸ Ibid, page 24.

⁵⁹ Ibid, page 24.

ulising [sic] these existing investments represents a significant cost saving over the costs faced by a greenfields 3G network operator. In addition to these cost savings, many of the Resource Management Act issues faced by a new entrant 3G operator have already been dealt with by existing operators.”⁶⁰

We agree. This explains why 3G roaming must be implemented by the Commerce Commission and helps to explain why the co-location protocol developed by the TCF will be a failure in terms of introducing competition.

“66. Furthermore, Telecom’s ability to re-use spectrum already being used to deliver its existing 2G service constitutes a major windfall saving compared not only to greenfields operators, but also to many other existing 2G operators making 3G investments in other countries.”⁶¹

We agree.

“67. Although TelstraClear does not have access to precise cost information, it is apparent that, absent spectrum charges, the costs of upgrading an existing 2G network to 3G capability are small in comparison to those involved in building the existing 2G network. The costs of 3G equipment deployments are incremental to those already incurred in the original network deployment.”⁶²

We agree.

“68. In addition, 3G network equipment is designed to either enhance or replace the equivalent 2G equipment, such that the 3G network will be capable of assuming all the functions of the 2G network and ultimately supersede it entirely. Carriers with heavy traffic volumes (such as Telecom and Vodafone) will also realise lower operating costs upon migration to the new platform.”⁶³

We agree. Econet’s capital equipment numbers on a 3G upgrade from 2G is less than 10% of total construction cost.

*“69. In fact, Telecom’s ‘T3G’ 3G network leverages so heavily on its existing infrastructure that T3G subscribers’ voice traffic will be carried over exactly the same voice platform as is currently used by Telecom’s 2G CDMA subscribers. As Telecom’s media release, launching T3G, states: ‘...all T3G connections will use the underlying CDMA voice network for ordinary calling... “We’re simply getting more out of the same basic infrastructure,” [Telecom head of mobile Kevin Kenrick] said. ...Over the next 100 days, Telecom will continue to launch a range of new T3G services that will enable New Zealanders to take full advantage of **the upgraded 027 mobile network.**’ [emphasis added]”⁶⁴*

We agree. We believe it is important for the Commerce Commission to understand this issue.

“70. For all of these reasons, Telecom’s and Vodafone’s 3G investments represent upgrades to their existing networks rather than wholly new networks. We therefore find problematic the Commission’s premise that: ‘...by drawing a clear line between the regulation of existing and 3G networks, it has demonstrated that it will give proper weight to the dynamic efficiency effects of regulation of new technologies.’”⁶⁵

We agree. In a two operator market with a GSM monopoly, to give a regulatory concession for 3G services would further entrench the dominant player.

“71. As in the case with other participants in technology-driven industry sectors, existing mobile operators are driven by market opportunity and competitive pressure to continually upgrade and

⁶⁰ Ibid, page 25.

⁶¹ Ibid, page 25.

⁶² Ibid, page 25.

⁶³ Ibid, page 26.

⁶⁴ Ibid, page 26.

⁶⁵ Ibid, page 26.

*enhance their networks. This is a perennial process inherent to the business and operating environments of these types of companies.*⁶⁶

We agree.

“72. As a result, and in accordance with prudent operational practice, the relevant components of existing 2G networks (that is, those parts due to be replaced by 3G network equipment) will have been subject to depreciation schedules commensurate with their predicted economic lives and written down accordingly. At the same time, the investments in the 3G components designed to replace them will have been planned, costed and scheduled well in advance.”⁶⁷

We agree.

*“8.1.3 For existing mobile network operators, the risks of 3G investments are greatly minimised
“73. We note the Draft Report’s concern that:
‘...if mobile network operators are unable to anticipate an economic return on efficient investment over the life of the investment, it is likely that such investment would not be undertaken, even though the technological and competitive pressures to innovate will be strong regardless of whether regulation is introduced.’”⁶⁸*

We agree. Ironically, New Zealand is already on course to be the world’s most profitable W-CDMA 3G market.

“74. However, overseas evidence suggests that voice and SMS traffic will likely comprise a significant proportion of 3G revenues over the near to medium term. Both Telecom and Vodafone carry high volumes of highly profitable voice and SMS traffic over their existing 2G networks. Because voice revenues have well-established demand and pricing characteristics, and SMS revenues are enjoying very strong growth despite static prices, such carriers will be able to coordinate the migration of this traffic (and attendant revenues) onto their 3G network platforms more or less in accordance with their respective preferred timetables.”⁶⁹

We agree.

*“75. Telecom is currently in the process of doing exactly this in relation to the migration of voice traffic from its 025 TDMA network to its 027 CDMA network. Telecom’s 2004 Annual Report states:
‘Telecom’s marketing emphasis is geared towards growing usage of the CDMA network, which offers greater functionality and high speed data capability. This has resulted in a migration of the customer base from TDMA to CDMA. TDMA customer numbers and revenues have declined markedly since the launch of CDMA and this is expected to continue, with revenues expected to fall to marginal levels towards the end of 2007. Due to the decline in the TDMA customer base...the present value of the net cash flows that the TDMA network is expected to generate no longer support its carrying value. Accordingly an impairment charge of \$100 million (\$74 million net of tax) has been recognised at 30 June 2004 to write the network down to its assessed value of \$49 million.’”⁷⁰*

*“8.1.4 Existing evidence does not support Commission’s concerns
“77. We have been unable to find any evidence of Telecom or Vodafone having either modified, or considering modifying, their 3G investment strategies in response to the prospect of regulation.”⁷¹*

We agree.

⁶⁶ Ibid, page 26.

⁶⁷ Ibid, page 26.

⁶⁸ Ibid, page 26.

⁶⁹ Ibid, page 27.

⁷⁰ Ibid, page 27.

⁷¹ Ibid, page 27.

*“78. The Draft Report observes that Telecom’s 3G investment decision proceeded indifferently to the announcement of the mobile termination investigation. We also note recent media statements regarding Telecom’s ambitious network rollout plans, with further deployments being demand-driven: ‘High-speed mobile services are available in Auckland, Wellington and Christchurch, with Telecom extending coverage to places such as Taupo, Coromandel and Queenstown by Christmas. **Further expansion would reflect customer demand.**’ [emphasis added]”⁷²*

We agree.

“79. The initial timing and scope of the deployment does not appear to have been affected by the present inquiry (and it can be assumed that Telecom would have informed the Commission had this been the case). Similarly, we find no evidence to infer anything other than that the timing and scale of further deployments would be similarly unaffected by the actual or possible imposition of regulation.”⁷³

“80. Although Vodafone has presently made only limited announcements regarding the planned scope of its 3G investments in New Zealand, we consider it instructive to examine Vodafone’s global investments in 3G networks.”⁷⁴

We agree. Our view is that Vodafone NZ’s relatively slow 3G rollout is due to the fact that there is no competition or threat of competition in W-CDMA.

*“82. The Vodafone Group’s 2004 Annual Report contains the following comments:
‘The group has secured 3G licenses in all of the jurisdictions in which it operates...and in which such licenses have been awarded to date.
‘Cumulative expenditure on 3G license was GBP14.4 billion at 31 March 2004...
‘Vodafone expects to participate in additional licence allocation procedures in other jurisdictions in which it operates.
‘The construction of 3G network infrastructure has continued throughout the 2004 financial year, with tangible capital expenditures on 3G network infrastructure amounting to approximately (GBP) 1.5 billion during the financial year. The Group presently expects capitalised tangible fixed asset addition to be around (GBP) 5.0 billion in the 2005 financial year, 35 of which is expected to be in respect of 3G network infrastructure.’”⁷⁵*

Econet would like to focus the attention of the Commerce Commission in the contrasting environment the other Vodafone companies operate in.

“86. Accordingly, we are unable to find any evidence supporting Vodafone’s contention that the timing and scale of its planned 3G investments in New Zealand would be affected by the imposition of mobile voice termination regulation. Rather, we find significant evidence to the contrary: namely, that Vodafone’s 3G investment plans anywhere in the world appear to be indifferent to the actual or possible imposition of regulation.”⁷⁶

We agree.

“87. We also note that the Vodafone submission discusses the decision of the UK regulator, Ofcom, not to extend the application of mobile termination regulation to 3G networks.”⁷⁷

“89. Ofcom commented that due to the newness of [Hutchison’s] 3’s service, together with the fact that it had captured only 0.75% market share, ex ante regulation was not justified. Ofcom’s reasoning

⁷² Ibid, page 27.

⁷³ Ibid, page 28.

⁷⁴ Ibid, page 28.

⁷⁵ Ibid, page 28.

⁷⁶ Ibid, page 29.

⁷⁷ Ibid, page 29.

infers that its decision not to regulate 3 was based primarily on its status as a new operator and the limited size of its subscriber base relative to the wider mobile sector. This conclusion is reinforced by Ofcom's preparedness to regulate 3 as its traffic levels grow (if Ofcom considers that 3's charges remain above costs). To this end, Ofcom has required 3 to report quarterly on its 2G and 3G voice revenues and traffic volumes, stating:

*'it is possible that during the period of the next formal review of mobile voice termination markets, 3G voice call termination may establish itself to such an extent that Ofcom may need to consider its position'.*⁷⁸

We agree. We point out the regulatory regime applying to Hutchison UK's 5th network framework:

- Mandatory wholesale roaming;
- Number portability; and
- Wholesale co-location

*"91. Furthermore, the UK situation is readily distinguishable from the New Zealand environment, as its regulatory regime sets out ex ante regulatory measures and the market review process allows the remedies to be revisited relatively frequently. Also, in New Zealand both existing operators enjoy high market shares, which are readily capable of being migrated to a new 3G network platform."*⁷⁹

We agree.

*"92. We also believe that the imposition of differential regulation would impede the Commission's ability to regulate the designated service effectively."*⁸⁰

We agree.

*"93. The following section of this submission describes difficulties in clearly and robustly distinguishing between 2G and 3G networks, particularly where 3G infrastructure is being deployed as an overlay on an existing 2G digital mobile network. While this inability to clearly demarcate between technologies and platforms gives rise to difficulties in developing sufficiently robust service descriptions, it additionally provides encouragement and opportunity for existing 2G mobile network operators to engage in regulatory gaming in order to avoid the scope of any service designation."*⁸¹

We agree.

*"94. Because 3G network deployment by an existing network operator bears the character of a network upgrade and the ongoing need for this, the Commission's adoption of technology specific regulation and service descriptions would give rise to **perennial** problems with characterisation and competitive equality."*⁸²

*"97. As discussed above, 3G investments by existing 2G digital mobile network operators are incremental and have the character of network upgrades. While these investments, to varying degrees, may involve significant capital outlays, these costs are factored into carriers' long-term business and operational plans; with the risk levels normally associated with these types of investments greatly minimised as a result of these operators' ability to migrate high volume, high margin voice revenues onto these platforms in accordance with predictable and internal timetables."*⁸³

We agree. Transferring a 2G business to a 3G business presents a low risk of churn, particularly given the overriding New Zealand market dynamic of a duopoly.

⁷⁸ Ibid, page 30.

⁷⁹ Ibid, page 30.

⁸⁰ Ibid, page 30.

⁸¹ Ibid, page 30.

⁸² Ibid, page 30.

⁸³ Ibid, page 32.

“98. We have been unable to find any evidence of either Telecom or Vodafone modifying their 3G business plans in response to the actual or possible imposition of mobile voice termination regulation on their investments. We believe that the regulation of voice termination on their investments. We believe that the regulation of voice termination on 3G networks would not deter the existing investment plans of either Vodafone or Telecom. We therefore believe that the Draft Report significantly overstates the risk that regulation of mobile voice termination could affect efficient investment in 3G infrastructure; and accordingly, significantly overestimates the resulting negative dynamic efficiencies. In our view, this potential negative efficiency should be discounted entirely, or at the most, accorded very little weight.”⁸⁴

We agree.

“99. We also noted that difficulties with distinguishing between 2G and 3G networks will create ongoing difficulties with effectively regulating the designated service, thereby significantly increasing both direct and indirect costs attributable to the counterfactual.”⁸⁵

We agree.

“100. Against this, we refer to our review of the Draft Report’s findings regarding the net benefits arising from the regulation of mobile termination services (see section 6 of this submission), which concludes that there are substantial net benefits from designating mobile termination. The result of this review is that any negative dynamic efficiencies face a much higher threshold in order to offset the combined quantified consumer surplus plus positive dynamic efficiency effects.”⁸⁶

We agree.

“101. Accordingly, we consider that the regulation of mobile voice termination services should be imposed on all mobile networks, including 3G networks.”⁸⁷

We agree.

“Question 7.1: (e) Should 3G networks be described more precisely in the service description, and if so, how should 3G networks be described?”⁸⁸

“109. There is no suitably robust and durable generic description of 3G networks that would enable them to be readily distinguished from all forms of 2G networks. This is due both to the incremental nature of user functionality enhancement involved in the progression from 2G to 3G networks, as well as the fact of differing 3G technology platforms and upgrade paths from existing forms of 2G platforms.”⁸⁹

We agree.

“110. When combined with the existence of an array of 2G (including 2G+) and 3G technology platforms (with attendant variety of possible comparisons and upgrade paths), this renders the task of developing a robust 2G-specific service description an extremely difficult one. Such distinctions as may currently exist cannot be regarded as static: technological progress is effecting improvements to all forms of network and customer equipment, and equipment vendors are continuing to invest aggressively across all platforms, including advanced 2G platforms.”⁹⁰

We agree.

⁸⁴ Ibid, page 32.

⁸⁵ Ibid, page 32.

⁸⁶ Ibid, page 32.

⁸⁷ Ibid, page 32.

⁸⁸ Ibid, page 34.

⁸⁹ Ibid, page 34.

⁹⁰ Ibid, page 34.

“112. 3G technology platforms enable the carriage of both existing and new call products. Existing call products include voice, SMS, images and other forms of digital media; whereas new products include various multimedia applications, for example video clips. These new products, which can be distinguished by their high data volumes, are supported by 3G (and, to some extent, by 2G+) networks primarily because of the higher bandwidth capabilities of these networks. From an end-user perspective, the key difference between 2G, 2G+ and 3G networks is the progressive ability to transfer larger amounts of data files, and at higher speeds.”⁹¹

We agree.

“113. Current descriptions of 3G networks and technologies appear to be driven primarily by vendor-mobile operator and mobile operator-consumer marketing. Because of the availability of various technology platforms, these descriptions differ, though (as per the discussion above) a common element is the greater bandwidth capability enabling new forms of service functionality.”⁹²

We agree.

“114. The most commonly agreed, technology-neutral definition of a 3G network platform is its ability to support circuit-switched and packet-switched access at speeds of at least 144 kbps for vehicular/mobile users, 384 kbps for pedestrian users and 2mbps for stationery users.”⁹³

We agree.

⁹¹ Ibid, page 35.

⁹² Ibid, page 35.

⁹³ Ibid, page 35.

6 Econet Wireless comments on New Zealand Business Roundtable Submission

*"We regard the Commerce Commission's determination to interpret the Telecommunications Act as requiring it to weight distributional issues as a serious impediment to dynamic efficiency and to the integrity of competition policy generally. In our view, this is a major policy issue that needs to be resolved."*⁹⁴

We disagree. Telecom's business, and indeed the entire telecommunications market, was created and structured by government; around the world, spectrum is a scarce asset owned by governments, and is subject to national monopolistic tendencies in the absence of some kind of regulation.

*"We commend the Draft Report for judging that the costs of imposing price control regulation on 3G investments would likely exceed any benefits. However, in our view its belief that these costs will be reduced materially by its proposal not to regulate 3G immediately is unfounded. The general hostility of the Draft Report to investors in infrastructure (see section 4 of this submission for a long list of examples) virtually guarantees a general expectation on the part of investors that the Commission will regulate 3G at a later date."*⁹⁵

We disagree. We believe NZBR has failed to understand the fact that only a small difference exists between 2G and 3G.

*"We submit that the Final Report should rule out price regulation on the grounds that the case for it is far too inconclusive and it is not possible now to regulate non-3G without creating serious doubts in investors' minds about the future regulation of 3G. We also submit that it needs to pay greater attention to the possibility that the Kiwi share could be distorting the market for mobile services and that it should comment on the case for abolishing or substantially modifying the Kiwi share obligation."*⁹⁶

We agree that the Kiwi share has created market distortions.

*"The economic arguments appear to underestimate supply and demand substitution effects for two reasons: (i) they overlook the importance for competition of the subset of users who are price sensitive and have choices; and (ii) they incorrectly assert that callers have "no choice" but to make a mobile call to contact a mobile subscriber."*⁹⁷

We disagree. It is difficult to see what alternatives are available to mobile telephony. It is indisputably a necessity of modern living.

*"We commend the Draft Report for being seriously concerned about the cost of discouraging investment in 3G, but suggest that it fails to appreciate the importance of providing credible signals to investors in 3G that they will be permitted to retain excess profits from those investments if they are successful (in order to offset the risk of failure). As noted in section 4, the cumulative effect of the Draft Report's arguments and presumptions is hostile towards investors in infrastructure."*⁹⁸

"1.1 This submission on the Commerce Commission's Draft Report on its Schedule 3 Investigation into Regulation of Mobile Termination under the Telecommunications Act 2001 (Draft Report) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests. We believe that all our members are users of mobile telecommunication services; some are in competition with each other

⁹⁴ Ibid, page iii.

⁹⁵ Ibid, page iii.

⁹⁶ Ibid, page iii.

⁹⁷ Ibid, page iv.

⁹⁸ Ibid, page vi.

*as suppliers. We take the view that public policy should not be focused on benefiting either consumers or suppliers and instead should aim to maximise the overall gain to both groups. This objective is commonly expressed as maximising the sum of producer and consumer surplus.*⁹⁹

“2.7 A presumption against intrusive state regulation of competitive markets places the burden of proof on any proposal that a market is sufficiently uncompetitive to justify intrusive regulation. In our view, the burden of proof should be particularly high in an area like mobile telephony where competition between infrastructure suppliers is manifestly intense.”¹⁰⁰

We disagree. We invite NZBR to independently assess Vodafone NZ profits relative to its OECD peer groups.

“2.8 Mobile telephony is a dynamic technology. Major advances can require large, risky, irreversible investments in licenses and infrastructure. It is hard to think of a greater deterrent to such investments than the threat that the state will expropriate the returns from those investments by (arbitrarily) weighting end-user interests ahead of investor interests.”¹⁰¹

We disagree. Regulation is a standard feature of every OECD telecommunications regime, and is justified on the basis that government has never been separate from the creation, development and structural management of the market. Vodafone PLC and Telecom shareholders’ reports routinely make investors aware of the fact that the regulatory environment could change: it is a normal part of any international mobile telephony business.

“4.1 We doubt that the Commission is fully aware of the negative signals it is giving investors about the worth of investing in the future of dynamic technologies in network industries. There are many reasons why infrastructure investors in mobile technology are likely to interpret the Draft Report as a disincentive to such investments. These include:

- *“its insistence that the legislation is biased against investors – that it favours wealth transfers from investors to consumers;*
- *“its failure to establish any principle that might limit the Commission’s discretion to act arbitrarily in determining how heavily to weight consumer interests relative to producer interests;*
- *“its failure to acknowledge that tolerance of excess ex post returns is essential as a balance against the likelihood of ex post losses;*
- *“its apparent view that anything less than the ideal of ‘full’ competition is limited competition;*
- *“its apparent view that a finding of limited competition is tantamount to proving that excess profits exist in reality;”¹⁰²*

We disagree that regulation provides a disincentive to investment. Econet has perhaps more experience than any other player in the market in dealing with investors for a new entrant to provide competition. Without exception in our experience, a stronger regulatory system would mean more likelihood of infrastructure investment, not less.

⁹⁹ Ibid, page 1.

¹⁰⁰ Ibid, page 5.

¹⁰¹ Ibid, pages 5-6.

¹⁰² Ibid, page 25.

7 Concluding Remarks

Econet's overall position is that mobile termination rates are a small piece of the jigsaw, and not material in attracting the new entry that is required to structurally shift the competition dynamics of the New Zealand marketplace. Accordingly, whether or not mobile termination rates are specifically regulated:

1. There is no real competition in the New Zealand mobile market.
2. There is no same technology competition in New Zealand and this is required to enable switching between networks and real competition.
3. Vodafone earns economic profits in New Zealand.
4. Without
 - Designated pricing and long term 2G and 3G roaming;
 - Spectrum prices on co-location;
 - Number portability; and
 - A clearer position on competitive reaction through the use of competition policy,

the New Zealand consumer will continue to pay too much for essential mobile communications infrastructure.

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