



**TelstraClear Limited**

**Comments on Submissions by Telecom New Zealand Limited and  
Vodafone New Zealand Limited on the Commerce Commission's  
Reconsideration Draft Report on the Schedule 3 Investigation into  
Regulation of Mobile Termination**

**21 February 2006**

**PUBLIC VERSION**

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## **2. EXECUTIVE SUMMARY**

### **2.1 Introduction – the context for regulation**

1. TelstraClear continues to consider that the termination of Fixed-to-Mobile (FTM) voice calls on any network technology should be regulated, as the Commission’s Reconsideration Draft Report recommends.
2. Telecom and Vodafone (and their consultants) seek to challenge some of the assumptions behind the Commission’s Cost Benefit Analysis (CBA). However, in our view the case for designating the mobile termination service is clear:
  - (a) New Zealand Mobile Termination Rates (MTRs) have been and remain significantly above cost estimates.
  - (b) New Zealand retail FTM prices are high, and regulating MTRs should promote competition in this market to the benefit of end-users.
  - (c) New Zealand retail mobile prices are very high and the pricing “waterbed”, with MTRs on the one hand and retail mobile prices on the other, does not appear as finely balanced as Vodafone contends.

### **2.2 The case for a regulatory backdrop to commercial negotiations**

3. Both Vodafone and Telecom argue that commercial offers are preferable to regulation and that there is a risk that the Commission has incorrectly estimated the cost of mobile termination.
4. However, if the Commission recommends designation of the FTM voice termination service this does not:
  - (a) preclude reasonable commercial offers from being made and accepted; nor
  - (b) set the regulated price.
5. TelstraClear continues to believe that regulation is needed to address the asymmetric bargaining power that exists where there is a terminating network monopoly problem, as has been done in the case of fixed termination.

### **2.3 Cost Benefit Analysis Issues**

6. Both Vodafone and Telecom (and their consultants) claim that there are a number of issues with the Commission’s CBA. The key issues identified concern the Commission’s assumptions regarding:

- (a) the waterbed effect;
  - (b) FTM passthrough;
  - (c) mobile termination cost estimates and assumed cost reductions; and
  - (d) indirect costs.
7. TelstraClear and its consultants; Marsden Jacob Associates (**MJA**) and Network Strategies, consider that the assumptions made by the Commission in the CBA are reasonable, if not overly conservative. In TelstraClear's view, the case for regulating both 2G and 3G FTM voice termination has been made out and, if anything, is understated.

#### **2.4 No need to include proposed retail market consideration**

8. Vodafone argues that FTM passthrough must be rigorously enforced and should be a condition of MTR regulation. Telecom disagrees.
9. TelstraClear agrees with Telecom that a FTM passthrough safeguard is not needed and amounts to retail market regulation.
10. The usual and, in our view, correct approach is to regulate to address the wholesale market impediments to competition and then let retail market competition play out. As Telecom notes, the proposed retail market consideration is inconsistent with the Telecommunications Act 2001 (the **Act**) and with the equivalent fixed termination regulation.
11. TelstraClear considers that a retail market consideration or condition would distort the retail market, as it would be likely to constrain the ways in which an access seeker seeks to pass through the benefits of reduced wholesale rates into the wider retail FTM and tolls market. Lower MTRs may result in other benefits, such as improvements in the quality of services provided or reductions in tolls prices, as well as FTM price reductions. The exact mix of benefits should be determined by competition.

#### **2.5 Regulation should not be technology-specific**

12. Both Vodafone and Telecom argue that 3G MTRs should not be regulated and that regulating 3G will harm investment. Vodafone also argue that if 3G is regulated, a higher regulated price should be assumed to reflect higher costs.
13. TelstraClear fully supports the Commission's proposed service-based regulation and the removal of the previously proposed technology-based

distinction. As stated in previous submissions, we do not consider that a network-protocol based distinction between regulated and unregulated services is appropriate or workable.

14. The bottleneck nature of the FTM voice termination service exists regardless of what technology is used within the network to deliver calls. Further, the key drivers for 3G mobile investments are mobile network cost reductions and/or new data services. TelstraClear does not consider that either of these drivers justifies excessive prices being charged to fixed voice consumers.
15. Further, as the specified pricing principle is based on a forward-looking cost-based approach, there is no case for a higher regulated rate to be assumed to reflect 2G to 3G migration.

## **2.6 The Legal Framework**

16. Vodafone and Telecom both raise a number of concerns with the Commission's legal framework. These issues have largely been raised and debated previously, but include concerns regarding the Commission's proposed approach concerning:
  - (a) market definition;
  - (b) wealth transfers;
  - (c) the promotion of competition;
  - (d) regulating 3G;
  - (e) a new consideration regarding FTM passthrough; and
  - (f) the onus and standard of proof.
17. TelstraClear agrees with Telecom that the proposed passthrough consideration is inconsistent with the Act. However, TelstraClear does not consider that any of the other matters raised justify a variation to the Commission's recommendations proposed in its Reconsideration Draft Report.

### 3. INTRODUCTION

18. TelstraClear remains of the view that the Commerce Commission's Reconsideration Draft Report recommendations should be confirmed, with the exception of the proposed passthrough consideration.
19. In TelstraClear's view, nothing in Telecom's response to the Reconsideration Draft Report (**Telecom's Response**) or Vodafone's response to the Reconsideration Draft Report (**Vodafone's Response**) justifies a departure from the key recommendations of the Commission's Reconsideration Draft Report, except concerning the proposed passthrough consideration.
20. TelstraClear's comments in this submission are structured as follows:
  - (a) **Part 4** outlines the context for regulation;
  - (b) **Part 5** discusses why regulation is needed as a backdrop to commercial negotiation;
  - (c) **Part 6** examines comments on the Commission's revised CBA;
  - (d) **Part 7** explains why a retail market consideration is not required;
  - (e) **Part 8** considers why regulation should be technology-neutral as recommended;
  - (f) **Part 9** discusses issues raised relating to the legal framework for decision-making;
  - (g) **Part 10** concludes TelstraClear's comments on the submissions on the Reconsideration Draft Report;
  - (h) **Annex 1** is an economic opinion by MJA concerning comments on the Commission's CBA; and
  - (i) **Annex 2** is a report by Network Strategies largely looking at the NERA report and the arguments for adjusted benchmarks to estimate the cost of regulation.
21. TelstraClear's cross-submission is public. There is no restricted version, with the exception of Annex 1 – the MJA report.

#### 4. THE CONTEXT FOR REGULATION

- *New Zealand MTRs have been and remain significantly above cost estimates.*
- *Retail FTM prices in New Zealand are high when compared internationally, and regulating MTRs should promote competition in the retail FTM and tolls market to the long-term benefit of end-users.*
- *Retail mobile prices in New Zealand are very high when compared internationally.*

##### 4.1 New Zealand Mobile Termination Rates have been and remain significantly above cost estimates

22. Vodafone's Response provides a comparison of MTRs in 24 countries across Europe, Japan and Australasia in which Vodafone operates. This data is used to argue that "New Zealand's MTRs are at about the world average" and "are not high".<sup>1</sup>
23. In fact, as the Commission's benchmarking analysis demonstrates, New Zealand's MTRs are most certainly high and have been and remain significantly above cost, even based on the Commission's conservative cost estimate of 15cpm.
24. The Vodafone data does not refute this since:
- (a) as Network Strategies notes,<sup>2</sup> very few of the countries identified in Vodafone's Response have cost-based termination rates;
  - (b) the data provided does not reflect recent regulatory decisions likely to lead to reductions in MTRs in countries like Australia in order to better reflect cost;<sup>3</sup>
  - (c) the average Vodafone quotes is inflated by the very high rates in just three countries (Greece, Romania and Switzerland); and

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<sup>1</sup> Vodafone's Response, paragraphs 30 and 32 and figures 2 and 3.

<sup>2</sup> Network Strategies report, pages 25-26.

<sup>3</sup> In fact, the ACCC recently issued a Draft Decision rejecting Vodafone's mobile terminating access service (MTAS) undertaking (December, 2005), as the ACCC was not satisfied that the rates proposed were "reasonable".

- (d) even on the data Vodafone provides, New Zealand MTRs are the 7<sup>th</sup> most expensive out of the 24 countries identified.

#### 4.2 Retail Fixed-to-Mobile Prices are high when compared internationally

25. Vodafone's response seeks to highlight the connection between MTRs and retail mobile prices.<sup>4</sup> TelstraClear's views on the strength of this "waterbed" connection are set out in part 6.2 of this response and MJA's report at Annex 1, however we consider that it is also important to highlight the connection between MTRs and retail FTM prices.

26. The Ministry of Economic Development's (MED's) recent benchmarking report<sup>5</sup> demonstrated that the average price of FTM calling is significantly higher in New Zealand than the OECD average. Relative pricing would need to reduce by approximately:

- (a) 50% for residential end-users; and
- (b) 20% for business end-users;

to rank in the top half of the OECD.

27. The above data alone calls into question Telecom's contention that the retail market for tolls and FTM calls is already competitive.<sup>6</sup>

28. As set out in previous submissions, TelstraClear considers that current MTRs represent a significant barrier to entry into or expansion in the FTM and tolls market. Currently, Telecom is able to compete in the provision of FTM calls from a lower cost base than fixed only competitors. Regulating MTRs will address this cost asymmetry and better align costs and prices, which is likely to result in increased competition in the retail FTM and tolls market and, amongst other benefits, lower retail FTM prices, especially for residential end-users.

29. We agree with the Commission that:<sup>7</sup>

*"under regulation, fixed-to-mobile providers will obtain the mobile*

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<sup>4</sup> See paragraphs 38-42 of Vodafone's response, for example.

<sup>5</sup> <http://www.med.govt.nz/upload/23954/2005.pdf>.

<sup>6</sup> Telecom's Response, paragraph 3.

<sup>7</sup> Paragraph 236, Reconsideration Draft Report.

*termination service at a price intended to emulate the price that would be available in an effectively competitive wholesale market. Accordingly, competition can be relied on to constrain downstream retail prices...”.*

#### **4.3 Retail Mobile Prices are very high when compared internationally**

30. Vodafone’s Response claims that its “*retail mobile prices are average and text prices are very low*”.<sup>8</sup> This claim is not supported by the MED benchmarking report based on February 2005 data, nor by the ARGO report commissioned by the Commission last year, nor by the November 2005 Teligen data Vodafone quotes.

31. The MED report concluded that New Zealand’s:<sup>9</sup>

*“comparative cellular pricing performance ranked in the bottom quartile of OECD performance.”*

32. Further, the ARGO report commissioned by the Commission in May 2005 reached a similar conclusion:<sup>10</sup>

*“using updated tariff sets for February 2005, New Zealand ranks out of 30 OECD countries:*

- *23<sup>rd</sup> for the low user basket of services*
- *29<sup>th</sup> for the medium user basket*
- *30<sup>th</sup> for the high user basket*
- *30<sup>th</sup> if the three baskets are weighted equally*

*... when actual data from New Zealand is used, despite improvements for both low and medium user baskets, New Zealand remains at the bottom of the OECD rankings for a combined basket.*

*We believe that this indicates that regardless of how a user basket is defined, what year’s data is examined or how currencies are converted, New Zealand’s mobile tariffs remain some of the highest in the OECD.”*

33. As Network Strategies points out,<sup>11</sup> while the most recent Teligen study (November 2005) that Vodafone quotes has found improvements in New

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<sup>8</sup> Vodafone’s Response, paragraphs 33 to 37.

<sup>9</sup> <http://www.med.govt.nz/upload/23954/2005.pdf>.

<sup>10</sup> Report on the Competitiveness of New Zealand Mobile Services by: Argo Telecom Management Consultants B.V., 27 May 2005.

<sup>11</sup> Network Strategies Report, page 26.

Zealand's rankings, these improvements have only altered New Zealand's ranking by three or four places. New Zealand retail mobile prices are still ranked in the bottom quartile of OECD performance.

34. Further, Network Strategies also points out that Vodafone's argument that the Teligen figures are not the true picture, since they leave out promotions and multi-connection plans and do not reflect New Zealand usage patterns, do not withstand scrutiny. These factors are true for all countries.
35. Hence, it is not correct that New Zealand's mobile prices are "average". We also do not consider that Vodafone's Response demonstrates that costs are higher in New Zealand (this is discussed in detail in part 6.4 and the Network Strategies report at Annex 2). In TelstraClear's view, the data does not support Vodafone's contention that a cut in MTRs would leave it with little "room to move" on retail rates - the waterbed does not appear to be as tightly balanced as Vodafone suggests.
36. The above price data alone also calls into question Telecom's contention that the retail mobile market is competitive.<sup>12</sup>

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<sup>12</sup> Telecom's Response, paragraph 3.

## 5. REGULATION IS REQUIRED AS A NECESSARY BACKDROP TO COMMERCIAL NEGOTIATIONS

- *The FTM voice termination service should be designated (like fixed termination) to address asymmetric bargaining power between access seekers and providers.*
- *Regulation does not in itself set a price nor preclude reasonable commercial offers.*

### 5.1 Fixed-to-Mobile voice termination should be designated to address asymmetric bargaining power

37. Vodafone argues that its offer to “voluntarily cut MTRs” is preferable to regulation.<sup>13</sup> Telecom similarly argues that the commercial proposals from Vodafone and Telecom will produce “a robust credible outcome that benefits consumers”.<sup>14</sup> TelstraClear disagrees.
38. In its previous reports, the Commission concluded that there were no adequate substitutes for termination on a particular mobile network and in this report the Commission again concludes that: “*there is limited competition in the markets for mobile termination services on each mobile network.*”<sup>15</sup>
39. The Commission’s conclusions highlight the fact that FTM termination represents a terminating network monopoly problem, effectively an access bottleneck. This fact means that access seekers have little real bargaining power in negotiating termination rates with access providers. These are the exact same circumstances that led to the designation of the fixed PSTN interconnection service. Commercial offers are not, in these circumstances, a “robust and credible” solution.
40. In this instance, commercial offers have not arisen from the effective functioning of a competitive wholesale market. Rather, the offers have been made due to the threat of regulation and represent more gradual and reduced benefits to end-users than regulation would.
41. TelstraClear considers that a regulated solution is most likely to best serve the

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<sup>13</sup> Vodafone’s Response, paragraph 6.  
<sup>14</sup> Telecom’s Response, paragraph 3.  
<sup>15</sup> Reconsideration Draft Report, paragraph 5.

long-term interests of end-users.

## **5.2 Regulation does not in itself set a price nor preclude reasonable commercial offers**

42. Vodafone's Response contends that the regulated rate proposed by the Commission is too low.<sup>16</sup> In fact, the Commission is not setting the regulated rate at this stage in the process.
43. By designating a FTM voice termination service, the Government would not be setting a price for the mobile termination service. The regulation of the service merely sets the regulatory backdrop against which commercial negotiations occur.
44. As submitted previously, when regulation is in place there will be every incentive and no constraint on the mobile operators voluntarily offering to reduce termination rates. If mobile operators fail to reduce prices to efficient levels, then and only then will an access seeker be able to request that the Commission step in and determine a price.
45. At the time that the Commission comes to make a price determination for mobile termination (assuming the service is regulated, and agreement cannot be reached between an access seeker and access provider) the Commission would (based on past practice) undertake a rigorous benchmarking exercise.
46. However, as we have previously argued and note in relation to the NERA report, care needs to be given to ensuring that the benchmarking exercise does not become as complicated and time-consuming as a TSLRIC price determination under the final pricing principle. This would negate the benefits of having an initial pricing principle (which allows an access price to be determined relatively quickly) and a final pricing principle (to ensure that the access price will be robust, if necessary).
47. Ultimately, if the price determined under the initial pricing principle is deficient the access provider and/or access seeker can seek a price determination under the final pricing principle (and this can be backdated to the time at which the initial price was set).
48. Further, if the service is designated, at no time would an access provider be

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<sup>16</sup> Vodafone's Response, for example, paragraph 3.

prevented from making a reasonable commercial offer.

## 6. RESPONSE TO COMMENTS ON THE COMMISSION'S REVISED COST BENEFIT ANALYSIS

*There is a strong Consumer Welfare case for regulation:*

- *The assumed “waterbed effect” is, if anything, overstated.*
- *The fixed-to-mobile passthrough assumptions are reasonable*
- *The assumed mobile termination cost estimates are reasonable and, if anything, overstated*
- *There is no need for an additional “margin of error” or “indirect cost” assumption on top of already conservative assumptions.*

### 6.1 There is a strong Consumer Welfare case for regulation

49. TelstraClear commissioned MJA to consider the CBA-related submissions contained in Telecom's and Vodafone's (along with Covec's) Responses to the Reconsideration Draft Report. MJA's report is annexed to this cross-submission as Annex 1.
50. MJA considered that only one minor change to the Commission's revised CBA was justified by the submissions of Telecom, Vodafone and Covec, and this adjustment only impacts on the Total Welfare results, which have not been relied on by the Commission in making its recommendations.
51. MJA concluded that in both the linear and CED models, the net benefit of regulating FTM termination is positive. Table 1 below compares MJA's (amended) estimate of the net benefits of designation against the Commission's estimated benefits and Covec's estimated detriments:

Table 1: Comparison

	<i>Commission</i>	<i>Covec</i>	<i>Amended</i>
Consumer Welfare – Linear	\$72.1m	–\$115.4m	\$72.1m
– CED	\$54.8m	–\$149.6m	\$54.8m
Total Surplus – Linear	\$10.4m	–\$105.5m	\$9.1m
– CED	\$1.4m	–\$131.6m	\$0.1m

52. In fact, MJA conclude that:<sup>17</sup>

*“we believe the Commission has been too conservative in its assumptions and hence that the case for designation of mobile termination is stronger than currently indicated by the Commission’s analysis.”*

53. MJA’s comments regarding the key specific concerns raised by Telecom, Vodafone and Covec are summarised in more detail below.

## **6.2 The assumed “waterbed effect” is, if anything, overstated**

54. Vodafone (along with its consultants’ Covec) submits that the Commission’s waterbed calculations understate the losses to mobile consumers.<sup>18</sup> Telecom also questions the Commission’s proposed waterbed assumption of 50% with reference to the previous submissions of Professor Hausman.<sup>19</sup>

55. Vodafone, Covec and Telecom’s arguments are addressed in the report prepared by MJA. MJA points out that neither Telecom nor Vodafone provide any material new information regarding the Commission’s waterbed effect assumption, which is unchanged from the Commission’s 9 June 2005 Final Report (**Final Report**). MJA state that:<sup>20</sup>

<sup>17</sup> MJA Report, Annex 1, paragraphs 7 to 8 and Table 1.

<sup>18</sup> Vodafone’s Response, paragraphs 46 to 48 and Covec report.

<sup>19</sup> Telecom Response, paragraphs 118 to 128.

<sup>20</sup> MJA Report, Annex 1, Page 2.

*“None of the arguments provided by Vodafone (and Covec) and Telecom give us reason to revise our position on the extent of the waterbed effect. In our view, the Commission assumption of a “50%” waterbed likely results in an overstatement of detriments. As we have stated in previous reports to the Commission, any justification of a waterbed hinges critically on the reactions of Telecom because of its integrated nature. While we are not able to quantify the exact extent of the waterbed effect, we do not believe this effect could reasonably be quantified to be more than 25%. Indeed, we are not convinced that a waterbed effect would even be material in New Zealand and it may even be appropriate to exclude it altogether.”*

### **6.3 The Fixed-to-Mobile passthrough assumptions are reasonable**

56. Telecom and Vodafone argue, along with Covec, that both the counterfactual and factual FTM passthrough rates assumed by the Commission are inappropriate.<sup>21</sup>
57. These arguments are also covered in the MJA report at Annex 1. In this regard, MJA concludes that:

*“In our opinion, no evidence or arguments have been presented that demonstrates that there should be a material change to the Commission’s assumptions.”*

### **6.4 The assumed Mobile Termination cost estimates are reasonable and, if anything, overstated**

58. Vodafone argues, with the assistance of its consultants NERA, that the Commission’s CBA understates the costs of providing mobile termination in New Zealand. In particular, Vodafone argues that:<sup>22</sup>
- (a) 2G costs are likely to be higher in New Zealand than in the UK; and
  - (b) 3G costs could vary dramatically based on different demand profiles.
59. Telecom also submits that the Commission’s assumption that the cost of mobile termination is likely to decline from 15cpm to 12cpm over the period of

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<sup>21</sup> Vodafone’s Response, paragraphs 49 to 53 and Covec. Telecom’s Response, paragraphs 99 to 117.

<sup>22</sup> Vodafone’s Response, Part VII and NERA.

the CBA is incorrect.<sup>23</sup>

60. TelstraClear asked Network Strategies to consider the evidence presented by Vodafone and NERA that New Zealand mobile termination costs are likely to be high in comparison to other countries. Network Strategies' report on Vodafone's and NERA's criticisms of the Commission's use of benchmarking is attached to this cross-submission as Annex 2.
61. Further, both Network Strategies and MJA have considered Telecom's argument that it is incorrect for the Commission to assume a decline in the mobile termination cost estimate to 12cpm.
62. Network Strategies has concluded that no conclusive data was provided in support of Vodafone's claims that a cost-based mobile termination rate in New Zealand would fall outside the range of the Commission's sample benchmarks, nor that New Zealand is a high cost country.<sup>24</sup> Network Strategies went on to conclude that NERA's attempt to adjust the UK cost data for New Zealand is flawed since:<sup>25</sup>

*“with so many key factors within the UK data not being adequately amended to capture New Zealand characteristics, the results obtained from NERA's methodology are misleading and should not be used as an estimate of the likely cost-based mobile termination rate for New Zealand.”*

63. Network Strategies refers to the ACCC's position on adjusting for factors which drive differences between MTR cost estimates between jurisdictions, summarising it as follows:<sup>26</sup>
  - (a) adjustments should be comprehensive or they should not be attempted;
  - (b) an approach that only makes partial adjustments could lead to misleading results; and
  - (c) information pertaining to cost drivers could be better used in a bottom-up costing model than in adjusting benchmarks.

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<sup>23</sup> Telecom's Response, paragraphs 71 to 98.

<sup>24</sup> Network Strategies, Annex 2, page 35.

<sup>25</sup> Ibid, page ii.

<sup>26</sup> Ibid, pages 33 to 34.

64. Further, both Network Strategies and MJA conclude that it is reasonable to assume that unit costs will decline. MJA states that a 3cpm decline is a reasonable estimate. Network Strategies agrees that a constant mobile termination rate assumption is difficult to support, given the expected trends in demand and costs. In Network Strategies view, it is reasonable to assume that:

- (a) traffic on the network will increase – via a combination of growth in subscribers and changes in calling behaviour;
- (b) technology costs will decrease;
- (c) productivity will improve; and
- (d) transmission costs will fall.

All these factors are likely to lead to a reduction in the cost of mobile termination over time.

65. Further, TelstraClear believes that the starting baseline cost-based termination rate estimate used in the Commission’s factual scenario of 15cpm is in fact too conservative (high), as a rate above the 75<sup>th</sup> percentile was chosen and the benchmarked cost-estimates are not all current.<sup>27</sup> Therefore, TelstraClear believes that there is a considerable margin before the Commission’s unit cost assumptions would alter the case for regulation.

66. MJA also addresses Vodafone’s (and Covec’s) argument relating to 3G demand profiles - that there is ongoing migration of traffic from 2G to 3G during the period covered by the Commission’s investigation and that this migration will affect the cost of mobile termination in New Zealand. MJA points out that issues of migration are irrelevant to the extent that the Commission has specified the appropriate benchmark for mobile termination costs on the basis of TSLRIC (or a forward-looking cost-based pricing method):<sup>28</sup>

*“Although traffic over time will migrate from Vodafone’s 2G network to its 3G network, this is, irrelevant for the efficient forward-looking cost standard TSLRIC. TSLRIC is the cost of building a network today looking forward using best in use technology. Hence, even if half of Vodafone’s*

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<sup>27</sup> TelstraClear submission on Reconsideration Draft Report, paragraphs 26 to 27.  
<sup>28</sup> MJA Report, Annex 1, page 3.

*subscribers were using 3G technology and the other half 2G, the choice to be made within the TSLRIC standard is to build a network that could efficiently cater for that traffic. That could be 2G, 3G or even a hybrid solution, but would not include any migration costs.”*

**6.5 An additional “margin of error” or “indirect cost” assumption is unreasonable on top of already conservative assumptions**

67. Covec argues that some account must be taken of indirect costs because of the uncertainties in the MTR estimate and suggests that 10% of estimated benefits is reasonable.<sup>29</sup>
68. TelstraClear considers that an indirect cost allowance is inappropriate given that the Commission’s assumptions in the CBA are already (overly) conservative and since the Commission is not setting the regulated rate at this point in time. As we pointed out in our submission on the Reconsideration Draft Report, the 15cpm cost assumption is already high. MJA also agrees that there is no justification for an indirect cost allowance.<sup>30</sup>

*“Covec seems to forget that the Commission already conservatively has chosen to use the 75<sup>th</sup> percentile as a starting point for their termination cost estimate. In fact, the 15 cpm estimate is above the 75<sup>th</sup> percentile benchmarked cost estimate. It is therefore, in our opinion, wholly inappropriate to include any allowance for indirect costs. And even if there was, no justification is provided for the 10% suggested by Covec, which simply seems to be an arbitrary chosen number.”*

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<sup>29</sup> Vodafone’s Response, paragraph 58 and Covec.

<sup>30</sup> MJA Report, Annex 1, paragraph 50.

## 7. A RETAIL MARKET CONSIDERATION IS NOT REQUIRED

- *Regulating the wholesale market is the appropriate way to intervene.*
- *A retail market consideration would be difficult to implement and could distort retail competition.*

### 7.1 Regulating the wholesale market is the appropriate way to intervene

69. Vodafone argues in its response that FTM passthrough must be rigorously enforced.<sup>31</sup> Telecom submits that any commitment proposed by an access seeker as to how it will use any benefits from reduced MTRs does not seem relevant to achieving cost-based termination rates, either on the basis of a TSLRIC methodology or benchmarking.<sup>32</sup>

70. TelstraClear agrees with Telecom that a specific condition or consideration requiring commitments as to outcomes in the retail market in order for an access seeker to be able to seek a regulated cost-based wholesale price is unnecessary and is inconsistent with the approach taken to equivalent fixed PSTN termination regulation.

71. As submitted previously, TelstraClear believes that regulation should focus on addressing economic bottlenecks upstream and then let downstream competition play out.<sup>33</sup> We agree with the Commission's view in the Reconsideration Draft Report that:

*“competition can be relied on to constrain downstream retail prices and measures to achieve pre-determined retail outcomes are unnecessary.”*

72. TelstraClear's concerns with the legality of the proposed passthrough consideration are set out in part 9.5.

### 7.2 A retail market consideration would be difficult to implement and could distort retail competition

73. Telecom points out that *“it is not clear how such a [passthrough] commitment*

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<sup>31</sup> Vodafone's Response, paragraphs 59 to 71.

<sup>32</sup> Telecom's Response, paragraphs 137 to 140.

<sup>33</sup> TelstraClear submission on the Reconsideration Draft Report, see section 7.

*would be relevant to the Commission’s consideration, and how the Commission would consider such a commitment.”*<sup>34</sup> TelstraClear agrees that it is uncertain how the proposed consideration of an access seeker “commitment” would be implemented. Further, if this will require specific details of future retail market activity to be supplied this could act to distort downstream competition.

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<sup>34</sup> Telecom’s Response, paragraph 142.

## 8. REGULATION SHOULD BE TECHNOLOGY-NEUTRAL

- *Regulation should be service-based.*
- *Dynamic efficiency considerations do not justify excluding 3G call termination from regulation.*

### 8.1 Regulation should be service-based

74. Vodafone submits that there is no justification for regulation of its new 3G network.<sup>35</sup> As TelstraClear has previously submitted, we consider that there is every justification for regulating FTM voice call termination across all network technologies. The bottleneck nature of the FTM voice termination service exists regardless of what technology is used within the network to deliver it.

75. TelstraClear fully supports the Commission's views in the Reconsideration Draft Report that:<sup>36</sup>

*“Unless there is something specific about 3G technology that undermines the market power identified in respect of termination services, the regulatory decision should be indifferent as to the type of technology used to deliver termination services.”*

76. As with other designated services under Schedule 1 of the Act, it is the FTM termination service that is being designated, not the network used to deliver it. Further, a network-protocol defined service is likely to prove difficult to regulate effectively, as carriers and customers have no way of knowing when a voice call is on “2G” or “3G” or swaps during the course of a call.

### 8.2 Dynamic efficiency considerations do not justify excluding 3G call termination from regulation

77. Telecom<sup>37</sup> and Vodafone<sup>38</sup> both argue that regulating 3G technology will risk curtailing future investment. Vodafone further submits that its 3G rollout is not complete and is risky due to uncertain revenues and demand.

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<sup>35</sup> Vodafone's Response, see paragraph 3 for example.

<sup>36</sup> Reconsideration Draft Report, paragraph 187.

<sup>37</sup> Telecom's Response, paragraphs 53 to 64.

<sup>38</sup> Vodafone's Response, section VIII.

78. As submitted previously, TelstraClear does not consider that the regulation of FTM voice call termination, without excluding 3G call termination, poses a material threat to future investment or dynamic efficiency since:

- (a) The market power concerns in relation to the termination of voice services exist with regard to the provision of voice services on all mobile network platforms, be they 2G or 3G;
- (b) The termination of voice calls on mobile network platforms is a mature service that should be regulated irrespective of the underlying network technology – 3G voice termination is not an entirely new service in the traditional sense because it is a (perfect) substitute for 2G voice termination;
- (c) While a few years ago it may have been possible to argue that there was uncertainty around 3G investment and innovation, 3G is now being deployed worldwide, as the Commission acknowledge - it is a tested technology and widely recognised as the natural (if not only) migration path for mobile operators. Hence, any uncertainty has been reduced;
- (d) In our view, Vodafone overstates the issue of demand and revenue uncertainty. Mobile operators are migrating their customer base – it is not a question of finding a whole lot of new customers. Mobile operators know the demand profiles of their existing customers and can structure investments based on knowledge from their 2G operations;
- (e) There is no evidence to suggest that 3G mobile investment decisions to date have been negatively impacted by regulation (or the prospect of regulation) of mobile termination in New Zealand or any other jurisdictions;
- (f) Providing Telecom and Vodafone with a guaranteed source of economic profits from 3G mobile voice termination will weaken the disciplines on Telecom and Vodafone to invest efficiently; and
- (g) The consistent application of principles of efficient investment requires that any new services enabled by 3G should not be dependent on supra-normal profits derived from voice, regardless of the technology platform. For an existing 2G mobile operator to advocate higher 3G voice termination rates in order to justify its continued 3G network investment is no different (and therefore no more justifiable) than

advocating unregulated 2G voice termination rates in order to justify a 3G network upgrade investment.

79. TelstraClear agrees with the Commission that *“the estimated benefit of regulating mobile termination rates given by the CBA outweighs any residual dynamic efficiency detriment from regulating 3G voice call termination.”*
80. Specifically, Vodafone argues that:<sup>39</sup>
- (a) Its 3G coverage is not yet complete;
  - (b) New 3G data services (HSPDA) are not fully delivered; and
  - (c) It will take time to migrate customers over to 3G.
81. In TelstraClear’s view, none of the above three points justifies a departure from the Commission’s recommendation to regulate all FTM voice call termination since:
- (a) 3G, excluding new data services or economies of scope, is largely about reducing network costs. Therefore, MTRs estimated on the basis of 2G costs should still encourage efficient investment in lower cost network technology where it makes economic sense;
  - (b) it is not efficient for excessive voice termination charges levied on fixed consumers to fund risky investments in new data services offered to mobile consumers. This is likely to harm allocative efficiency and lead to inefficient over-investment in network and equipment used to provide mobile data services and inefficient under-investment in network and equipment used to provide voice services to fixed consumers; and
  - (c) the proposed regulation is on the basis of TSLRIC, estimated initially by benchmarking of forward-looking cost-based estimates. As MJA notes, TSLRIC does not allow for recovery of migration costs, but reflects the cost of building a network today looking forward using best in use technology. Therefore, the fact that Vodafone has chosen to invest in a new technology platform to reduce network costs and deliver new

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<sup>39</sup> *ibid.*

non-voice services does not justify a regulation holiday or above cost prices for traditional voice services.

82. TelstraClear considers that excluding 3G from regulation and permitting unregulated above cost MTRs to be charged would create an artificial distortion in the market. Failing to regulate all mobile termination at cost would amount to asymmetric regulation. For reasons of certainty and consistency, we consider that the Commission should recommend regulation of the FTM voice call termination in the same way as PSTN fixed termination - regardless of network technology - as the Reconsideration Draft Report proposes.

## 9. THE LEGAL FRAMEWORK

- *The Commission’s market definition approach is not inconsistent.*
- *The Consumer Welfare test is the correct test to apply in considering whether to recommend regulation of mobile termination services.*
- *Regulation of mobile termination rates will promote competition.*
- *The Commission’s approach to regulating 3G is not unreasonable.*
- *The addition of a retail passthrough consideration to the proposed service description is ultra vires.*
- *The appropriate test under the Telecommunications Act is equal to or less than the “balance of probabilities test”.*

### 9.1 The Commission’s market definition approach is not inconsistent

83. TelstraClear concurs with the Commission’s assessment that there are separate national wholesale markets (for Telecom and Vodafone, respectively) for mobile termination services in New Zealand. Vodafone claims that the Commission’s assessment is founded on an error of law, and cites the Commission’s modelling of waterbed effects and its recent Decision 561 (*Fairfax New Zealand Limited and Times Media Group Limited*) as evidence of an inconsistency in approach. In TelstraClear’s view, Vodafone’s submission is erroneous and unfounded.

84. In Decision 561 (in a section partially quoted by Vodafone), the Commission noted at paragraph 54:

*“The Commission does not consider that a two-sided market analysis requires departure from the Commission’s Mergers and Acquisitions Guidelines. In cases where the two-sided market theory applies, neither “side” of the two-sided market can be analysed in isolation from the other. That is, regard must be had to competitive conditions, barriers to entry, pricing, output and quality decisions, etc. on both sides of a two-sided market”.*

85. While accepting that the two-sides of the market were interlinked, the Commission concluded that there were *separate* product markets for print advertising and news and information provision. The Commission noted at

paragraph 55 that:

*“The sides of the platform operate in distinct markets. While community newspapers are a platform, the sides of the platform exhibit different, though linked, competitive dynamics”.*

86. There is no inconsistency between the Commission’s approach in Decision 561 and its approach in the Reconsideration Draft Report. The Final Report states categorically at paragraph 96 that:

*“...the Commission has not assumed that “the other side of the two-sided market” will necessarily remain constant under the regulatory factual. In other words, the Commission has considered the likely impact of regulating mobile termination rates on subscription services. This is in recognition of the relationship between termination services and retail mobile services. However, this does not require the definition of a single, conglomerate mobile services market. It does require analysis of the relationship between termination services and retail services (such as subscription services), which the Commission has undertaken”.*

87. This approach is consistent with the approach outlined in Decision 561. Indeed, Vodafone’s reference to the Commission’s modelling of the waterbed effect is further evidence of the extent to which the Commission has conducted a full analysis examining the full range of impacts arising from regulation.

## **9.2 The consumer welfare test is the correct test to apply**

88. TelstraClear agrees with the Commission’s view that it should apply a consumer welfare test in considering whether to recommend regulation of mobile termination services.<sup>40</sup>
89. Telecom continues to suggest that the decision of the High Court in *Air New Zealand & others v Commerce Commission & Others* (Auckland High Court, Rodney Hansen and Kerrin Vautier, 17 September 2004) supports the proposition that section 18 of the Telecommunications Act requires the Commission to adopt a total surplus standard. In TelstraClear’s view, this suggestion is erroneous; *Air New Zealand* stands for no such proposition.

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<sup>40</sup> See TelstraClear submission, 30 November 2004, Appendix B.

90. In *Air New Zealand*, the High Court was determining whether or not by enacting section 1A of the Commerce Act, Parliament intended to repeal the existing interpretation of the statutory tests in section 61 and 67. Those tests focus respectively on:

*“...a benefit to the public which would outweigh the lessening in competition”, and*

*“...such a benefit to the public that it should be permitted”.*

91. New Zealand’s courts have interpreted a public benefit test as requiring the Commission to assess net benefits based on a total surplus standard where wealth transfers are neutral. In *Air New Zealand*, the High Court ruled that it was not Parliament’s intention to overturn this established interpretation of these two sections by such an obtuse method as enacting section 1A.
92. TelstraClear accepts the validity of the High Court’s conclusion regarding the interrelationship between sections 1A and 61 and 66. Section 1A is a general provision. It cannot override the specific “*benefit to the public*” test in section 61 of the Act for the purpose of Part V of the Act: *McCosh’s application* [1958] NZLR 731 at 734; *Allison v Kealy* [1968] NZLR 958 at 965/6.
93. However, the interpretation of *a benefit to the public test* does not inform the question as to how section 18 of the Telecommunications Act should be interpreted. Section 18 of the Telecommunications Act is focused on the long-term benefit of end-users of telecommunications services, not the public. The Commission’s CBA correctly focuses on the benefit of regulation to end-users.

### **9.3 Regulation on Mobile Termination Rates will promote competition**

94. In TelstraClear’s view, regulation of both Telecom and Vodafone’s MTRs will undoubtedly promote competition. That competition will be for the benefit of end-users. Increased competition will result from reducing barriers to entry and by aligning wholesale MTR prices more closely with the cost of providing those services.
95. Vodafone’s submission that regulating Vodafone’s MTR will not promote competition is unfounded. Vodafone argue that regulation of its MTR will: cause its subscription prices to increase; reinforce Telecom’s dominant market position; and amount to price control because Vodafone is not vertically integrated.
96. Wholesale prices that are aligned to costs will promote greater competition in

downstream retail markets. This occurs not only by reducing any price asymmetry enjoyed by a vertically integrated operator but also through the normal mechanics of markets. As the Commission notes:<sup>41</sup>

*“under regulation, fixed-to-mobile providers will obtain the mobile termination service at a price intended to emulate the price that would be available in an effectively competitive wholesale market.”*

97. Prices that are aligned to costs reflect a more efficient and competitive outcome. In the FTM and tolls market, a reduction in MTRs will manifest itself in a reduction in FTM and/or tolls prices as operators react in a normal profit maximising way to lower MTRs and, hence, lower marginal costs. This will intensify competitive pressure in the FTM and tolls market.

#### **9.4 The Commission’s approach to regulating 3G is not unreasonable**

98. Vodafone criticises the Commission for relying on “scant public information” on the extent of Vodafone’s 3G network rollout in proposing the regulation of 3G.<sup>42</sup> It concludes that the Commission’s approach to regulation of its 3G network is unreasonable and unjustifiable when the Commission lacks any reliable evidence of its rollout, its expectations for demand, or its costs.<sup>43</sup>

99. TelstraClear contends that this conclusion is not sustainable:

- (a) As to evidence of expectation for demand: this is an irrelevant consideration. As stated above, the pattern of migration of customers from 2G to 3G is not relevant to a forward-looking cost-based cost estimate. Further, the Commission carefully considered and concluded in its Reconsideration Draft Report that the primary drivers of the examples of 3G investments made and proposed in New Zealand to date, are the search for competitive advantage through functionality and technological differentiation.<sup>44</sup>
- (b) As to costs, the Commission relied on public data and information published by the ACCC. Vodafone has not provided any concrete evidence on costs to refute this information. In the circumstances, the

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<sup>41</sup> Reconsideration Draft Report, paragraph 236.

<sup>42</sup> Vodafone’s Response, paragraph 164.

<sup>43</sup> Ibid, paragraph 173.

<sup>44</sup> Reconsideration Draft Report, paragraph 193.

Commission is entitled to rely on the information to hand, and to draw inferences that any evidence which Vodafone could have produced, would not have assisted their case.<sup>45</sup>

100. In the circumstances, it cannot be said that the Commission has acted unreasonably, irrationally or unfairly by failing in its Draft Report, to take account of relevant considerations, or that it has applied the wrong test or taken irrelevant considerations into account.
101. Now that Vodafone has provided details of progress with its 3G network rollout in its submission, the Commission can take account of this information in its final deliberations.

**9.5 The proposed consideration regarding Fixed-to-Mobile passthrough is ultra vires**

102. TelstraClear shares Telecom's concerns<sup>46</sup> with the additional matter to be considered regarding application of section 18 in the proposed service description in the Reconsideration Draft Report. The Commission appears to be seeking to regulate retail prices through the "back door" by encouraging access seekers to give a pass through commitment.
103. The Commission has no jurisdiction power to regulate retail prices under the Act. TelstraClear refers to the following provisions of the Act:
  - (a) Section 18(1) states that the purpose of the Act is to be achieved by "*regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers*". The term "service provider" is defined in section 5 to mean "a provider of telecommunications services." The Act does not contemplate the regulation of the supply of services to end-users. Rather it presumes that regulation of supply terms between services providers will lead to the promotion of competition for the long-term benefit of end-users. As was noted by the Supreme Court of the United States in *Gonzales v Oregon* (2006) 546 US 1 at 20:

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<sup>45</sup> See TelstraClear Mobile Termination Cross-submission, 23 December 2004, paragraphs 47 to 48.

<sup>46</sup> Telecom's Response, paragraphs 37 to 40 and 141 to 143.

*“The idea that Congress gave the Attorney General such broad and unusual authority through an implicit delegation ...is not sustainable. “Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions – it does not, one might say, hide elephants in mouseholes.” Whitman v American Trucking Association 531 US 457, 468 (2001); see FDA v Brown & Williamson Tobacco Corp., 529 US 120, 160 (2000)(“We are confident that Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion”).”*

- (b) Section 20 provides access seekers and access providers with a right to apply to the Commission for a determination of the terms of supply of designated or specified services. It is clear from the definitions of access seekers and access providers in parts 2 and 3 of Schedule 1 and the nature of the designated and specified services governed by those Schedules, that the determination process is limited to setting the terms for the supply of services between service providers; and
  - (c) End-users at the retail level have no standing to be heard in any determination application. Nor do they have rights of appeal. Only access seekers and access providers have such standing.
104. Accordingly, TelstraClear considers that the addition of such a consideration to the proposed service description is ultra vires. Should the Commission decline an application for a determination due to the absence of what it considers to be a satisfactory commitment from the access seeker related to retail market activities, it will have taken into account an irrelevant consideration and its decision will be open to challenge.
105. Furthermore, there are insurmountable practical problems with such a commitment being effectively imposed on access seekers. For example:
- (a) How will such commitments be policed and enforced?
  - (b) How will the value of such commitments be measured or compared with the commitments given by other access seekers?
  - (c) What weight will be given to such commitments relative to the relative competitiveness of prices charged by access seekers to end-users? For example, if Access Seeker X charges lower prices to end-users for FTM services, should it be required to give an equivalent commitment to

price reductions to Access Seeker Y who charges higher FTM prices to end-users?

- (d) How will the Commission measure how such commitments will promote competition for the long-term benefits of end-users? In particular, how will the Commission determine what price reduction is appropriate for a given access seeker, having regard to what is likely to be a range of retail prices across a range of customers? What other criteria will it apply in assessing what level of commitment is appropriate?
- (e) What opportunity will be given to access seekers to challenge the Commission's assessment of these issues?

106. As outlined in part 7, such commitments are not required. TelstraClear considers that market forces at the retail level should be allowed to drive retail prices. The Act is founded upon a fundamental premise that by imposing cost based prices for the supply of upstream services through regulation, the Commission will promote competition in downstream retail markets. This in turn will impose downward pressure on retail prices charged to end-users. The Commission has never suggested that there is a need for such commitments to be given by access seekers in connection with other designated services.

#### **9.6 The “balance of probabilities” or less is the appropriate test under the Act**

- 107. TelstraClear adheres to the view that the appropriate test under the Telecommunications Act is equal to or less than the “balance of probabilities test”.<sup>47</sup>
- 108. Telecom selectively and incompletely cites United Kingdom and Irish authorities which are, contrary to the impression Telecom gives, clear authority for the balance of probabilities test.<sup>48</sup>
- 109. In *Hutchison 3G (UK) Limited v The Office of Communications*<sup>49</sup>, the UK Competition Appeal Tribunal concluded that while there has to be proper

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<sup>47</sup> See TelstraClear Submission, 30 November 2004, paragraph 16b and appendix A and Cross Submission, 23 December 2004, paragraphs 43 to 53.

<sup>48</sup> Telecom's Response, paragraph 6.

<sup>49</sup> *Hutchinson 3G (UK) Ltd v Office of Communications* [2005] CAT 39

evidence, “it does not have to achieve some high degree of weight.”<sup>50</sup>

110. In citing the decision of the European Court of Justice (ECJ) in regard to prediction of future behaviour as to market power in a merger case<sup>51</sup>, the Tribunal cautioned that the facts were “*somewhat specialised, and required more prediction of future behaviour than will be necessary in many merger contexts*”.<sup>52</sup>
111. For the sake of completeness we cite the UK Competition Appeal Tribunal’s conclusions on this point below.

*...[the ECJ’s remarks] sound a warning about the need to carry out proper assessments, and they provide for an understandable degree of caution where what is required is an assessment as to future conduct, as opposed to an evaluation of past conduct, but **they do not flag a particularly high degree of probability**. ... .the real position is that the evidence must be carefully looked at, and properly assessed.”<sup>53</sup> [our emphasis]*

*“The case demonstrates ... that theory and surmise is not enough. One must look to see how things operate in practice, and prove whatever has to be proved to an appropriate level of proof. It points out the need to be particularly careful in relation to that when one is considering future conduct.”<sup>54</sup>*

112. The Tribunal then cited with approval, the decision of the Irish Electronic Appeals Panel (ECAP) in an appeal brought by another Hutchison group company<sup>55</sup>. ECAP also considered the ECJ case, citing the following principles from that case as relevant in so far as it discusses the difficulties of a prospective analysis:

*“A prospective analysis of the kind necessary in merger control must be carried out with great care since it does not entail the examination of past events – for which often many items of evidence are available which makes*

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<sup>50</sup> ibid at paragraph 34.

<sup>51</sup> Commission v Tetra Lava Case C-12/03, 15 February 2005

<sup>52</sup> op cit at paragraph 31.

<sup>53</sup> ibid

<sup>54</sup> ibid at paragraph 32.

<sup>55</sup> Hutchinson 3G (Ireland) Ltd v Commission for Communication Regulation [2005] ECAP 2004/01

*it possible to understand the causes – or of current events, but rather a prediction of events which are more or less likely to occur in the future...”.<sup>56</sup>*

113. The Tribunal noted with approval, ECAP’s conclusions:

***“This does not mean that because there is ex ante analysis that the Respondent [i.e. the regulator] has to meet a higher standard of proof. The standard is whether, on the balance of probabilities an undertaking has significant market power. Rather the Panel is merely asserting the common sense proposition that when one is making a finding of significant market power on the basis of a prospective analysis (as opposed to an ex post analysis) then it is necessary that this analysis be sufficiently rigorous and thorough so that a clear link can be drawn between existing circumstances and likely future behaviour. To put it another way, because the likelihood of error is greater in a prospective analysis, the prospective analysis must be proportionately more rigorous to account for this possibility.”<sup>57</sup> [our emphasis]***

114. Telecom cites the same cases as authority for the proposition that *“it would be an inappropriate focus for a regulator to proceed with an exercise ‘with an eye to the remedy it wishes to impose’”<sup>58</sup>*. We do not disagree. However, again, it is important to consider the citation in its entirety. The Tribunal was emphasising that the exercise of determining significant market power cannot be carried out lightly as it has serious consequences:

*“But it remains the same exercise, and would be the same whether or not there is an obligation to impose a remedy if [significant market power] is found. The regulator cannot be expected to carry out the exercise ...with an eye to the remedy it wishes to impose, or whether it wishes to impose one, if it finds it. All that needs to be acknowledged is that the exercise is a serious one with potentially serious consequences.”<sup>59</sup>*

115. Its main point is that:

*“The exercise that has to be done in any given case is dependent on the facts of that case. In some cases a “thorough economic analysis” may be*

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<sup>56</sup> Commission v Tetra, paragraph 42.

<sup>57</sup> Hutchinson 3G (Ireland) Ltd v Commission for Communication Regulation, paragraph 4.23.

<sup>58</sup> Telecom’s Response, paragraph 8

<sup>59</sup> Hutchinson 3G (UK) Ltd v Office of Communications , paragraph 28.

*required; in others a differently described exercise will be required. One cannot specify more in advance, and one is not required to do so by the obvious proposition that regulation is a serious matter.”<sup>60</sup>*

116. TelstraClear submits that the Commission has satisfied this test, in carrying out the requisite examination of the relevant factors; it has not merely proceeded “*with an eye to the remedy it wishes to impose*” as intimated by Telecom.

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<sup>60</sup> *ibid*

## 10. CONCLUSION

117. TelstraClear remains of the view that the Commerce Commission's Reconsideration Draft Report recommendations should be confirmed, with the exception of the proposed passthrough consideration.
118. This investigation has now been going for over 18 months and the issues involved have been debated extensively over that time. TelstraClear does not consider that any of the concerns Vodafone, Telecom or their consultants raise with the Commission's CBA alter the fact that the case for regulating FTM voice call termination is clear and, if anything, understated by the Commission's CBA. Contrary to Vodafone's (and NERA's) submissions:
- (a) MTRs have been and remain significantly above cost – this position is unchanged by the recent commercial offers; and
  - (b) FTM retail prices are high and the key impediment to competition is high MTRs – aligning these with costs with promote competition in the retail FTM and tolls market to the long-term benefit of end-users.
119. Further, TelstraClear disagrees with Vodafone and Telecom that the recent commercial offers are preferable to regulation – these offer more gradual and lesser reductions in MTRs and therefore more gradual and lesser benefits to consumers. As the ACCC has done, the Commission should reject these offers and recommend that the FTM voice call termination service be designated. In doing so, the Commission will not be setting the price for MTR nor will regulation preclude the making of reasonable commercial offers.
120. In our view, the Commission should also maintain its recommendation that regulation be technologically neutral. There is little evidence that this will result in material dynamic efficiency detriments – efficient investment should not require funding from supra-normal profits on other services – and any detriments are outweighed by the expected consumer benefits.
121. However, TelstraClear agrees with Telecom that a FTM passthrough safeguard is not needed and amounts to retail market regulation. In our view, the Commission should follow the approach envisaged by the Act and followed for equivalent fixed termination regulation and regulate to address the wholesale market impediments to competition and then let retail market competition play out. TelstraClear considers that a retail market consideration or condition would distort the retail market, as it would be likely to constrain the ways in which an access seeker seeks to pass-through the benefits of reduced wholesale rates into the wider retail FTM and tolls market.

**ANNEX 1: MARSDEN JACOB ASSOCIATES ECONOMIC REPORT**

## ANNEX 2: NETWORK STRATEGIES REPORT