



Telecom New Zealand Limited

Cross-Submission in respect of the

**Commerce Commission's Draft Reconsideration
Report for its Schedule 3 Investigation into
Regulation of Mobile Termination**

Public Version

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A EXECUTIVE SUMMARY

- 1 These cross-submissions respond to submissions made by Vodafone, TelstraClear, Ihug and TUANZ in respect of the Commission's Draft Mobile Termination Reconsideration Report, dated December 2005 ("**Draft Reconsideration Report**"). Telecom also responds to the Commission's letter of 14 February 2006.
- 2 Telecom submits that there is nothing in submissions made by other parties that adds weight to the Commission's case for regulation and, in fact, the submissions generally support Telecom's view that regulation of mobile termination rates is unwarranted.

Pass-through requirement

- 3 Telecom maintains that the Commission does not have jurisdiction to regulate retail prices.
- 4 However, without prejudice to this view, Telecom submits that:
 - If the Commission is minded to include a pass-through consideration in its final report, it must first provide the parties with an opportunity to comment on its rationale for including a pass-through requirement, as well as its view on how the pass-through requirement will be applied. To date the Commission has provided insufficient information to allow parties to comment meaningfully on the proposal, and has failed to meet its obligation to adequately consult; and
 - There is no justification for including a pass-through consideration (or, as proposed by Vodafone an enforceable pass-through requirement). A pass-through obligation (in any form) would be contrary to international precedent, potentially dampen the competitive process in the retail market, be contrary to the Act, and be contrary to the Commission's own data showing that pass-through will occur anyway.

The cost of termination in New Zealand

- 5 TelstraClear has submitted that the Commission's benchmarked rate of 15cpm for mobile termination is too high.
- 6 Telecom submits that TelstraClear's rationale for arguing that 15cpm is too high is unfounded:

- TelstraClear has no evidence of the cost of providing mobile termination services in New Zealand; and
- Their rationale, the assertion that mobile termination rates will decline over the next five years, is incorrect.

The commercial offers

- 7 TelstraClear has submitted that the Commission is correct to implement a regulated solution in preference to the commercial offers made by Telecom and Vodafone. Telecom disagrees with TelstraClear's rationale:
- While there may be compliance costs with implementing the commercial offer, there will also be compliance costs involved with implementing any regulated outcome;
 - It is incorrect that a regulated outcome will be more immediate – the commercial offer has seen a reduction in mobile termination rates from September 2005, with a further reduction occurring in April 2006. There are still a number of steps in the process that must occur before a regulated rate could be finally determined;
 - It is not clear whether a regulated outcome will result in rates lower than the commercial rates that have been offered; and
 - Once errors in the Commission's cost benefit analysis are corrected, it shows a clear benefit to end-users from the commercial offers, and a detriment to end-users resulting from regulation.

Quantitative analysis of the impact of regulation

- 8 Both Telecom and Vodafone have identified a number of issues with the Commission's CBA.
- 9 Both parties agree that there are two critical assumptions that require significant modification: the rate at which mobile operators will recover the lost mobile termination revenue; and the inconsistent fixed-to-mobile pass-through assumptions between the factual and counterfactual.
- 10 Telecom reiterates that these issues, as well as those highlighted previously by Telecom must be addressed by the Commission. Further, the Commission must consult on any changes to the CBA to avoid the risk of any further errors.

Dynamic Efficiency

- 11 TelstraClear asserts that investment in New Zealand will not be impacted by a decision to regulate. However, TelstraClear fails to acknowledge the impact on the economy of a slow-down or complete halt in mobile termination investment and innovation in New Zealand which is likely to result from regulation of new and future technologies.
- 12 Further, TelstraClear has recently confirmed that it does not intend to invest in a mobile network in New Zealand. Despite this, it submits that the Commission's proposal to regulate 3G and future technologies will not have a detrimental impact on dynamic efficiency.
- 13 The Commission cannot ignore the evidence of the existing mobile operators in New Zealand about the detrimental impact of regulating 3G and future technologies.

Service description- pricing principles

- 14 Vodafone has demonstrated a number of the complexities involved with calculating a cost-based estimate of the mobile termination rate. Telecom submits that this is in part perpetuated by the Commission's proposed pricing principles, which do not allow the Commission the flexibility to address market developments as they arise, and which potentially create distortions.
- 15 If the Commission is minded to regulate, Telecom notes that the issues could be overcome by adopting pricing principles that are in line with the pricing principles for the fixed interconnection services in the Act – which give the Commission the option to select a single cost measure.

Telecom's EVA

- 16 As a final point, Telecom notes that in its submissions in response to the Commission's Draft Report, dated 30 November 2005, Telecom submitted Economic Value Added (EVA) results for Telecom's mobile business, to demonstrate that its mobile business was not in fact earning monopoly rents. The EVA model these results were based on was developed at a time when Telecom's mobile business was largely separated out in the Telecom Group and when divestiture of the mobile business was being considered. For this reason, the model was developed to be comprehensive and robust. However, to test and confirm the robustness of the model, Telecom engaged Professor Trow from Victoria University of Wellington to review the EVA, with his review also provided to the Commission on 30 November 2004.

- 17 The results of the EVA model clearly demonstrated that Telecom's mobile business was not earning monopoly rents. [

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- 18 These results provide robust market evidence which calls into question many of the conclusions reached by the Commission, both in its June 2005 Final Report and the Draft Reconsideration Report. In particular, the evidence supports Telecom's submissions as to the competitiveness of the mobile services market and the extent of the pass-through that could be expected as a result of the waterbed effect.
- 19 Given its materiality to these and other issues relevant to the Commission's weighting of the costs and benefits of the proposed regulation, Telecom remains concerned that the Commission failed to consider this evidence in its June 2005 final report, and again in its Draft Reconsideration report. Telecom submits that the EVA is important evidence that the Commission must take into account if it is to make an informed decision.

Previous submissions and process

- 20 Telecom notes that it has limited these cross-submissions to responding to submissions made by other parties, and the Commission's letter of 14 February 2006. However, Telecom reiterates its previous submissions made in respect of the Commission's Final Decision of June 2005, submissions to the Minister, and Submissions in respect of the Draft Reconsideration Report.
- 21 It is clear that there are a number of issues that are still be resolved, and Telecom submits that these issues are best addressed at a conference, with clarification of outstanding matters from the Commission given in advance.

B LEGAL FRAMEWORK

Retail prices are not regulated under the Act

- 22 As noted in its Submissions of 7 February 2006, Telecom is firmly of the view that the Commission has no jurisdiction to regulate retail prices under the Telecommunications Act 2001 ("Act"). Section 18 is plain in this regard: the Commission can only regulate services and prices between service providers i.e. at the wholesale level.
- 23 Without prejudice to its view that a pass-through consideration is *ultra vires* the Act, Telecom responds to the Commission's letter of 14 February 2006, and comments on whether pass-through (as proposed by Vodafone or the Commission) is justified.

Further information on the proposal is required

- 24 As the Commission had not provided any rationale for the inclusion of the new consideration, nor had it provided any explanation of how it would apply the consideration, Telecom sought clarification from the Commission in order that it could comment.
- 25 The Commission responded to Telecom's inquires by letter dated 14 February 2006 stating that:
- It was not necessary or desirable to impose a mandatory pass through;
 - It should be able to have regard to how an access seeker would make use of a reduction in mobile termination rates; and
 - It had not considered what weight it would give to a commitment from an access seeker regarding how it would use the benefits of a reduced mobile termination rate.
- 26 The Commission's vague response raises significant concerns. The Commission has provided no rationale for including the additional consideration, and in fact has given no consideration as to what type of commitment it expects access seekers to provide, or how a commitment will impact on its decision-making. Not only does this mean that parties cannot comment on the Commission's rationale, or on the substantive issue of including such a commitment in the regulation itself, but it also demonstrates that the Commission has given no consideration as to whether the proposed consideration will be in the long-term interests of end-users.

- 27 In order to respond meaningfully, parties need the Commission to outline how the proposed pass-through consideration will be treated as relevant by the Commission, as well as how a pass-through commitment might affect the Commission's consideration of an application. If the Commission does not provide this information, it will not have met the standard for consultation established in *Wellington International Airport v Air New Zealand* [1993] 1 NZLR 671.

Pass-through consideration/requirement not justified

- 28 Vodafone goes further than the Commission appears to intend its pass-through consideration to apply and submits that the Commission should impose an "enforcement clause" to guarantee pass through of reductions in mobile termination rates into retail fixed-to-mobile prices.
- 29 Telecom submits that requiring pass-through (in either the form proposed by Vodafone or the Commission) is not justified, and notes that a pass-through condition:
- Is contrary to international precedent;
 - Will dampen the competitive process in the retail fixed-to-mobile market by limiting the way in which parties compete at retail. This would not be in the long-term interests of end-users, and would therefore not meet the purpose of the Act;
 - Is unnecessary as a high rate of pass through occurs in the retail fixed-to-mobile markets anyway, as evidenced by the Commission's own data; and
 - Risks unintended effects.

Decision of the ACCC

- 30 To date in Australia, the ACCC has agreed that it is not necessary or appropriate to require a pass through commitment from access seekers. In its Draft Report on Vodafone's Mobile Termination Access Service ("MTAS") Undertaking, dated December 2005, the Commission concluded the following in determining that Vodafone's pass-through safeguard should not be accepted:
- It is likely that pass-through will occur, and is likely to increase over time as a result of a reduction in the MTAS rate alone;
 - Given the nature of the market within which fixed-to-mobile services are provided, the extent of pass-through is not the only

measure of the extent to which a lower price for the MTAS promotes competition in the market or the long-term interests of end-users generally; and

- A reduction in the MTAS rate alone may put in place the pre-conditions for improved competition and efficient use of and investment in infrastructure, which may result in improvements in the quality of services provided or reductions in the price of other services provided in the bundle of pre-selected fixed line services.

31 Telecom supports the ACCC's reasons for rejecting a pass-through requirement to date, and considers that the ACCC's reasoning is equally relevant in the New Zealand context in this case.

Reduction of competition in the retail market

32 There is a real risk that a pass-through requirement (in any form) will dampen the competitive process in the retail fixed-to-mobile market by limiting the way parties compete.

33 While Telecom's commercial offer committed to pass-through the reduction of mobile termination rates to fixed-to-mobile callers, there are a number of ways that a reduction in termination rates may be used to benefit end-users. For example, a reduction in mobile termination rates could be used by service providers to:

- Invest in new infrastructure;
- Improve the range and quality of services offered; or
- Reduce the prices of other products.

34 Telecom submits that it would be inappropriate to direct that reductions in mobile termination rates be passed-through in any one way, as there is a significant risk that competition in retail will be reduced to the detriment of end-users. This would be contrary to the purpose of the Act.

Pass through occurs anyway

35 The Commission's own evidence proposes that a high level of pass-through occurs currently, without an imposed pass-through requirement.

For example, the Commission has already estimated a minimum pass-through rate of 75% will occur in this market over the next five years. And this high rate is based on a conservative scenario of regulation not improving competition in the fixed-to-mobile and toll calling market¹.

- 36 Further, if the Commission is correct that regulation of mobile termination will promote competition, which, it appears to assume, will only manifest in retail price reductions, 100% pass through will occur without any pass-through consideration or obligation being required².
- 37 These factors suggest that any enforcement mechanism would only have the marginal effects of potentially increasing pass through from 75 to 100%. These marginal benefits must be compared with the significant legal and policy issues associated with introducing an enforcement mechanism.

A proper CBA would need to be undertaken

- 38 Even if the Commission does not accept Telecom's view that an enforcement mechanism cannot be introduced, it is critical that the Commission assesses the costs and benefits of introducing this new regulatory mechanism before deciding to impose such a requirement. The potential marginal benefit of increasing pass through from 75% to 100% would need to be assessed and compared with the potentially large detriments.

¹ Paragraph 89, Draft Reconsideration Report, 23 December 2005.

² Repeating this view should not be seen as an endorsement of the view by Telecom. Telecom is still firmly of the belief that regulation of mobile termination will not promote competition in the fixed-to-mobile and tolls market and thus pass through will not increase to 100% in the factual over the CBA study period.

C THE COST OF TERMINATION IN NEW ZEALAND

- 39 Both Vodafone and TelstraClear have made submissions on the Commission's estimates of the current cost of mobile termination and trends in this cost over the next five years.
- 40 N/e/r/a, on behalf of Vodafone, estimated that the costs of 2G mobile termination in New Zealand range between 13.2cpm – 27.4cpm, with a midpoint of 20.3cpm.
- 41 In contrast to this view, TelstraClear submits that 12.98cpm is a more accurate estimate of the cost of producing mobile termination services in New Zealand in 2005/06. However, TelstraClear's view is not based on any evidence or understanding of the cost of operating mobile networks in New Zealand. Nor has TelstraClear commissioned any studies which attempt to estimate the costs incurred by Telecom and Vodafone. Accordingly, Telecom submits that TelstraClear's submissions should be given little or no weight by the Commission.
- 42 Without prejudice to Telecom's view that the Commission should rely on evidence from operators of mobile networks in New Zealand, Telecom addresses each of the arguments made by TelstraClear in support of their view that the mobile termination rate should be lower than 15cpm for 2005/06.
- 43 Firstly, TelstraClear submits that the Commission should select a mobile termination rate that is above the 75th percentile of overseas benchmarked mobile termination cost estimates³. Further, TelstraClear submits that the Commission did not realise that it was in fact setting a rate significantly below of the 75th percentile⁴.
- 44 Telecom notes that the Commission did in fact acknowledge that 15cpm was below the 75th percentile⁵. As the Commission has noted, there are several sources of mobile termination cost estimates. The Commission's Final Report took into account numerous other estimates, including an

³ As set out in Table 2, Draft Reconsideration Report, 23 December 2005.

⁴ Paragraph 26, TelstraClear Submissions, 7 February 2006.

⁵ Paragraphs 105, Draft Reconsideration Report, 23 December 2005, and paragraph 521, Final Report, June 2005.

Ovum survey of regulatory cost models of mobile termination, which suggested that 17cpm was a more appropriate rate⁶.

- 45 Further, as Vodafone notes in its submissions of 7 February 2006, there is much debate about the appropriate cost estimate for producing mobile termination in New Zealand-specific circumstances. Telecom has also noted that 15cpm is simply an estimate, and that the real cost of mobile termination in New Zealand will not be known until a proper costing exercise is done in New Zealand⁷.
- 46 Secondly, TelstraClear submits that the 15cpm estimate should be reduced on the basis that the Commission's estimate is based on data that is at least a year old, and on the basis that the Commission has assumed that mobile termination costs are trending down annually⁸.
- 47 Telecom strongly disagrees with TelstraClear's reasoning on the basis that, as previously submitted, the Commission's assumption of rapidly declining mobile termination rates over the next five years is incorrect. In its submissions on the Draft Reconsideration Report, Telecom highlighted the extensive problems with the Commission's new assumption that mobile termination costs will trend down to 12cpm by 2010/11⁹. In summary:
- The Commission has based its assumption on three cost profiles (set out in Table 5 of its Draft Reconsideration Report), and there are significant problems with each profile;
 - The first profile is based on the declining trend in mobile termination rates seen in the Telecom and Vodafone commercial offers. This trend bears no relevance to the reduction predicted by the Commission, as the commercial offers decline from a much higher base.
 - The second profile is based on modelling by Ofcom. The Commission has not shown that the costs of mobile termination in the United Kingdom are similar to New Zealand. Even if the costs were similar, an extrapolation of the Ofcom predictions shows a

⁶ Paragraph 389, Draft Mobile Termination Report, x date 2005

⁷ Paragraph 75, Telecom Submissions on the Draft Reconsideration Report, 7 February 2006.

⁸ Paragraph 26(b), TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

⁹ Paragraphs 76-98, Telecom Submissions on the Draft Reconsideration Report, 7 February 2006.

rate of 13.7cpm in 2010/11 - which is significantly higher than the 12cpm forecast by the Commission.

- The third profile is based on inaccurate forecasts of the decline in mobile production unit costs in New Zealand as the Commission has significantly over-estimated the predicted growth in the use of mobile minutes by New Zealand customers in the future. Further, its forecast of the rate of capital investment by Telecom and Vodafone (\$34m per annum) has no basis in fact.
- The Commission's hypothesis that declining mobile equipment costs and economies of scope will contribute to declining unit costs of mobile production in New Zealand is incorrect. It is not at all clear that demand for new 3G mobile services will drive economies of scope within the next five years. Further, a careful analysis of mobile equipment costs must be undertaken before any conclusions can be made about the trends in the next five years.

48 TelstraClear also notes that the use of a Purchasing-Power-Parity (PPP) conversion rate would lower the 15cpm estimate¹⁰. However, Telecom submits that the use of a ten-year rolling average exchange rate is appropriate and is standard practice in Commission proceedings.

49 Telecom submits that these factors, as well as the issues raised in its previous submissions, demonstrates that there is no analytical grounding for determining a mobile termination cost estimate lower than 15cpm.

¹⁰ Paragraph 26(c), TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

D THE COMMERCIAL OFFERS

- 50 TelstraClear has submitted that the Commission is correct to implement a regulated solution in preference to the commercial offers made by Telecom and Vodafone to reduce mobile termination rates. However, TelstraClear's submissions¹¹ do not make a good case as to why a regulated solution is preferable to the Commission accepting Telecom and Vodafone's commercial offers.
- 51 TelstraClear submits that there would be significant compliance costs associated with monitoring implementation of commercial offers¹². However, TelstraClear ignores the fact that there are significant compliance costs associated with regulation too. Accordingly, the attractiveness of the commercial offers vis-à-vis a regulated solution cannot be assessed by considering compliance costs.
- 52 TelstraClear also submits that end-users are likely to benefit more from regulation as the reduction in termination rates will be both "lower and more immediate"¹³.
- 53 The claim that a regulated outcome will have a more immediate effect is not credible. Regulatory proceedings take time, as they often require consideration of complex issues. With regards to the current proceedings, it will take some time for the Commission to issue a final reconsideration report, for the matter to be considered by the Minister, and then, if regulation is recommended, it will take time for an application to be made and the determination process to be concluded. For this reason, Telecom considers that the Commission has been too optimistic in building its CBA with a starting date for regulation of June 2006.
- 54 By way of contrast, Telecom implemented the first stage of its commercial offer in September 2005, with the second reduction in the mobile termination rate occurring in April 2006 if regulation does not proceed. This is by far a more immediate effect than the alternative of regulation.
- 55 While it will not be clear whether regulation will provide lower termination rates than the commercial offers until after a TSLRIC model

¹¹ Paragraphs 16 – 22, TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

¹² Paragraph 17, TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

¹³ Paragraph 18, TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

of termination in New Zealand has been built, lower mobile termination rates in themselves does not make a case of choosing regulation in preference to the Telecom and Vodafone commercial offer.

- 56 Both Telecom and Vodafone have submitted that a proper cost benefit analysis that takes account of the commercial offers vis-à-vis regulation, shows a clear benefit to end-users from the commercial offers, and a detriment from regulation.
- 57 Finally, TelstraClear submits that regulation is preferable because it addresses the “asymmetric bargaining problem” between fixed operators and mobile operators. However, this view is too simplistic. It is critical that there is a careful analysis of the costs and benefits of regulation.
- 58 Telecom submits that TelstraClear’s submissions on the commercial offers made by Telecom and Vodafone do not establish that regulation should be preferred over the commercial offers. The commercial offers made by Telecom and Vodafone will produce a robust and credible outcome that is in the long-term interests of end-users in New Zealand. By contrast, the Commission’s CBA shows a case for regulation that is, at best, shaky. As Telecom submitted in response to the Draft Reconsideration Report, if any of the more egregious assumptions used by the Commission in the CBA are changed, the CBA confirms that New Zealand consumers will in fact be harmed by regulation.

D QUANTITATIVE ANALYSIS OF THE IMPACT OF REGULATION

- 59 Vodafone has made extensive submissions on the potential impact of regulation of mobile termination rates in New Zealand and, in particular, the Commission's quantitative analysis (or CBA).
- 60 It is critical that the Commission carries out an accurate and robust CBA if the Commission is to recommend regulation of mobile termination rates in New Zealand as the CBA provides a robust framework within which the costs and benefits of regulation can rationally be measured and compared. The potential for the CBA to swing the case either for or against regulation means that the Commission must be certain of the accuracy of its assumptions and modelling techniques used.
- 61 Both Telecom and Vodafone agree that the Commission's CBA does not meet the necessary standard and, if a number of assumptions are corrected, in fact shows a detriment to end-users if regulation is introduced.
- 62 Telecom and Vodafone have both identified two critical assumptions in the Commission's CBA that require significant modification:
- The rate at which mobile operators will recover lost mobile termination revenue is far too low (i.e. the 'waterbed effect' is under-estimated); and
 - The fixed-to-mobile pass through assumptions under both the counterfactual and factual scenarios are both inconsistent and incorrect.

The waterbed effect will be larger than the Commission has modelled

- 63 Telecom and Vodafone have both submitted that the Commission has erred significantly in estimating that the mobile operators will recover lost mobile termination revenue at a rate of only 50%.
- 64 As both operators have noted, 50% pass through is the minimum possible in any market, and represents the pass through rate of a market supplied by a single firm monopolist¹⁴. Yet the mobile market, with two players, is significantly more competitive than that dominated by a single firm supplier.

¹⁴ Paragraph 47, Vodafone Submissions, 7 February 2006 and paragraph 121, Telecom Submissions, 7 February 2006.

- 65 Telecom reiterates its view, supported by Vodafone, that the Commission must revise upwards its pass through assumption, on the basis that the mobile operators will recover lost mobile termination revenue at a significantly greater rate than 50%.
- 66 Telecom continues to believe that a mobile pass through rate of 65% is appropriate.

Vodafone agrees that FTM pass through is inaccurately modelled in the factual and counterfactual

- 67 Telecom agrees with Vodafone that the Commission is being inconsistent in its fixed-to-mobile pass through assumptions:
- The Commission is being unduly pessimistic about pass through under the counterfactual (i.e. if the commercial offers are accepted). In effect, the Commission is assuming that competing fixed operators will be happy to give market share to Telecom if there is no mobile termination revenue. This is inconsistent with eight years of the Commission's own evidence on fixed-to-mobile pass through; and
 - The Commission is unduly optimistic about pass through rates under regulation – predicting the emergence of theoretically perfect competition within five years of regulation¹⁵.
- 68 Telecom refers the Commission to its Submissions of 7 February 2006 for further details on how it should modify the fixed-to-mobile pass through rates to improve the accuracy of the CBA¹⁶.

Allowing for the indirect costs of regulation

- 69 Vodafone notes that the Commission has made no allowance for the risk of being wrong on the cost of mobile termination or any of its other assumptions¹⁷.
- 70 Telecom agrees that it is important for the CBA to be adjusted to include an allowance for indirect costs. As Vodafone correctly highlights, the Commission did not previously make an allowance for indirect costs on

¹⁵ Paragraph 45, Vodafone Submissions, 7 February 2006.

¹⁶ See paragraphs 99 – 117, Telecom Submissions, 7 February 2006.

¹⁷ Paragraph 45, Vodafone Submissions, 7 February 2006.

the basis that 3G was not regulated. Now that 3G is to be regulated, the Commission must build this allowance into the CBA.

G DYNAMIC EFFICIENCY

- 71 Both Telecom and Vodafone have highlighted the high risk of a detrimental impact on future mobile investment posed by the Commission's proposal to regulate 3G – and future generations – of mobile voice services. Both have noted the uncertainty that exists with respect to take-up and revenue potential of new data services, and the consequent importance of voice revenues to mobile operators' investment paths. The Commission cannot continue to ignore this evidence.
- 72 Telecom and Vodafone are currently the only two mobile companies prepared to take the large commercial risks involved in innovating and providing mobile services to New Zealanders.
- 73 TelstraClear has recently confirmed that it does not intend to invest in a mobile network in New Zealand. Despite this, TelstraClear submits that the Commission's proposal to regulate 3G voice services will not have a detrimental impact on dynamic efficiency.
- 74 If the Commission is incorrect in its assumption that regulation of 3G and future technologies will not impact on dynamic efficiency, this will result in large detriments to New Zealand society. Given the high stakes involved, Telecom considers that the Commission must take account of the view of mobile operators, which are based on real experience in the market and decisions to invest.
- 75 TelstraClear has not provided any credible rationale for its view that investment in New Zealand will not be impacted by a decision to regulate, and fails to acknowledge the impact to the economy of any slow down or complete halt of mobile network investment and innovation in New Zealand.
- 76 TelstraClear's key contention appears to be that a "bottleneck facility exists no matter what technology is used". It reasons that this means regulation should cover all generations of mobile networks¹⁸. However, this view of regulation is simplistic. As the Commission itself has recognised, even finding the existence of a "bottleneck" mobile termination facility does not automatically warrant regulation¹⁹.

¹⁸ Paragraph 13, TelstraClear Submission on the Draft Reconsideration Report, 7 February 2006

¹⁹ Telecom continues to dispute the market definition proposed by the Commission of a "single market for mobile termination on each mobile network".

- 77 Rather, a careful analysis of the costs and benefits of regulation must be performed before a case for regulation can be made. One of the significant costs is the detriment to future investment, in both further 3G network upgrades and future generations of mobile network technology.
- 78 Telecom submits that TelstraClear's view that future investment in 3G is unlikely to be deterred by the regulation of 3G voice services is incorrect, and appears to be based on the erroneous reasoning that 3G rollouts are driven by the requirement to provide data services, and these services will not be regulated. TelstraClear concludes that, on this basis, the case for any remaining "incremental" investment in 3G networks will not be harmed by the regulation of 3G voice²⁰.
- 79 TelstraClear's argument risks hiding the basic economics lying behind any new investment: any business case for future investment must show that the total revenue generated will, at a minimum, recover the total costs of the investment. Given that total revenue is undeniably driven down by the regulation of mobile termination rates, the case for future "incremental" investment in 3G is compromised.
- 80 This is not a cross-subsidisation argument (as characterised by TelstraClear in its 7 February submissions at paragraph 14). Telecom has previously documented the fact that its mobile termination revenue does not cross-subsidise the incremental costs of its mobile handsets and connections²¹. It is undeniable that once mobile termination revenue is reduced through regulation, there is a lower expected pay-off from each mobile customer. This, necessarily, will make future investment decisions less attractive.
- 81 Telecom reiterates its previous submissions that, if the Commission is minded to regulate, it must not regulate 3G (or future) voice termination services. If it does regulate 3G and future technology, this risks:
- Making mobile operators' investments in 3G technology uneconomic;
 - Removing the business case for further incremental investment in 3G; and

²⁰ Paragraph 14, TelstraClear Submissions on the Draft Reconsideration Report, 7 February 2006.

²¹ Footnote 25, Telecom Submissions on the Final Report, 30 November 2004.

- Slowing or curtailing investment in future generations of mobile network technology.

H SERVICE DESCRIPTION

Pricing Principles

- 82 In Section VII of its submission, Vodafone presents an analysis that demonstrates some of the complexities of calculating a cost-based estimate of the mobile termination. While the issues that Vodafone raise relate to the Commission's analysis of cost-based prices for mobile termination set in other regulatory jurisdictions, the issues raised by Vodafone are also relevant to any subsequent implementation of the proposed designation.
- 83 For example, Vodafone notes the complexities of calculating a unit average cost in the case where customers transition from a 2G to 3G network over time, and the costs of 2G and 3G services are changing. As a result, there is uncertainty in any forward looking estimate of costs. This analysis is consistent with Telecom's view that, looking forward, there is uncertainty in the timing of the introduction of new technical capabilities for the delivery of current and new services; there is uncertainty regarding the customer uptake of new services and substitution with existing services; and, these issues are made more acute in the mobile market due to rapid developments in technology.
- 84 Given these uncertainties, Telecom submits that the proposed designation does not give the Commission the necessary ability to address developments in the mobile market. The Draft Reconsideration Report's recommended designation, of the termination on a cellular telephone network of voice calls originating on a fixed telephone network, includes the initial pricing principle:
- Benchmarking against the price of terminating a voice call on a cellular network in comparable countries where the price calculation is based on a forward-looking cost-based pricing method.
- 85 The recommended final pricing principle is simply stated as *TSLRIC*.
- 86 The proposed designation appears to be far more limited than the designation for fixed interconnection. Telecom is concerned that the proposed mobile termination designation differs from the fixed interconnection designation, and therefore it is unclear whether the proposed pricing principles give the Commission discretion to address market developments as they arise.
- 87 The fact that the proposed pricing principles for mobile termination is more parsimonious than the pricing principles for fixed line services in the Act seems peculiar given the rapid and significant changes in the

mobile market. In particular, Telecom notes the proposed service description differs from the fixed interconnection service descriptions in the Act in that it does not give the Commission an option to select a single cost measure to avoid the need to undertake unnecessary duplicative modelling exercises which expend valuable time and resources for little incremental benefit, and significant distortions that would flow from an asymmetry of regulated rates. We would, for example, be strongly opposed to a situation where the industry was required to develop, consider and argue about multiple mobile TSLRIC models.

- 88 In order to address these concerns, Telecom submits that the following pricing principle would be more appropriate:

Initial pricing principle

Either –

- a) The price determined by the Commission (if any) for interconnection with a mobile network that corresponds most closely in nature to the access provider's network; or
- b) Benchmarking against the price of terminating a voice call on a cellular network in comparable countries where the price calculation is based on a forward-looking cost-based pricing method.

Final pricing principle

Either –

- a) The price determined by the Commission (if any) for interconnection with a mobile network that corresponds most closely in nature to the access provider's network; or
- b) TSLRIC.

- 89 Furthermore, Telecom submits that the Commission should carry out a consultation process on the implementation of the TSLRIC methodology for the termination of voice calls on a mobile network, prior to an application. This consultation process should cover the same issues addressed by the Commission's consultation on the implementation of TSLRIC for the termination of voice calls on a fixed network. A consultation process specific to mobile termination is needed given the obvious technology and market differences between fixed and mobile networks, and the dynamics of the mobile market which have been extensively traversed throughout the mobile termination investigation.