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Mobile Termination Draft Report
Network Access Group
Commerce Commission
PO Box 2351
Wellington

30 November 2004

SUBMISSION ON THE INVESTIGATION INTO REGULATION OF MOBILE TERMINATION (DRAFT REPORT)

Purpose

1. Vector appreciates the opportunity to comment on the Draft Report. The comments contained in this letter are of a general nature rather than addressing matters of detail discussed in the report.
2. As well as Vector's ownership of a communications business (Vector Communications), you will appreciate that Vector monitors regulatory activity across similar or related industries, with a view to better understanding the Commission's regulatory practice and philosophy. As a general comment, Vector notes:
 - it is not always easy to identify consistency in the Commission's work or, where there are differences, clearly understand why they exist and are justified; and
 - there is a feeling amongst interested parties that monitoring the consistency of the Commission's work is largely left to such parties, without evidence that the Commission proactively manages this issue itself.
3. It is with a view to ensuring predictability of regulatory decisions by the Commission that Vector makes this submission. While the Commission no doubt considers consistency and cross-functional issues internally, Vector encourages the Commission to further discuss these in its public reports.

Wealth Transfers and the Long Term Benefits Test

4. Under the approach taken by the Commission in its Draft Report, wealth transfers from producers to consumers are, in essence, treated as a benefit of regulation (under what is referred to as a “consumer welfare approach”). Whilst the Commission provides an estimate of net public benefits of regulation to the New Zealand economy, more emphasis is placed on the consumer welfare approach and the results from that test.

5. Vector questions whether that approach is consistent with the purpose of the relevant part and schedules (Part 2 and Schedules 1 to 3) of Telecommunications Act 2001 (the Act) viz (as set out in section 18 of the Act):

“...The purpose of this Part and Schedules 1 to 3 is to promote competition in telecommunications markets for the **long-term benefit of end-users** of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers...” [emphasis added]

6. In Vector’s view, the reference to long-term benefits makes it clear that the relevant outcomes to be considered are those to the New Zealand economy as a whole. After all, actions (whether regulatory or otherwise) that are detrimental to the NZ economy will have a negative impact on end-users in the long term. Further, and based on reference to Part 4 of the Commerce Act (which (merit aside) specifically requires a net benefit to acquirers test to be applied), if Parliament wanted the Commission to apply a transfer test, the Telecommunications Act would have presumably explicitly required that.

7. In Vector’s view, the approach adopted by the Commission risks imposing regulation where it is not needed and introducing unnecessary compliance costs and uncertainty in a capital intensive industry.

8. Furthermore, regulating as a result of positive value being placed on transferring profits from producers to consumers creates a risk of the Commission’s actions being perceived as regulatory opportunism - i.e. regulating on the basis of observing, *ex post*, that an investment in new technology has been successful. This will likely affect investor expectations for future investments and, therefore, will have a negative effect on dynamic efficiency.

9. Whilst the Commission has been careful to note that it is not presently minded to regulate mobile termination on prospective 3G networks, this informal commitment gives investors little comfort, as the Commission can revisit its view in the future. Further, investors are likely to take more cognisance of actual decisions, not comments related to an uncertain future. Simply saying something will not be done in future counts for little if the actual evidence is doing the

opposite now.¹ If the Commission were to maintain its consumer welfare approach, investors would likely reduce the value they place on any short-term high profits from risky innovations and investments, given these could later be used to justify regulation.

Timing of intervention and the type of industry in question

10. In Vector's view, any decision to regulate must explicitly take into account, *inter alia*:

- when the investment in question was undertaken (recognising that, as for competitive markets, a period of high returns may be appropriate for innovative or risky investments that deliver benefits to consumers);
- the investment cycle of the relevant industry (i.e. the extent and timing of required new/future investment);
- the *ex post* nature of assessments (noting that *ex ante* investment returns are expected to fall within a probability distribution. There must be sufficient probability of high returns to offset the probability of low returns in order to justify the investment: accordingly *ex post* assessments must recognise the *ex ante* investment risks); and
- the maturity of the investment/assets in question (i.e. how long they have been 'in the ground' and the degree of customer connection/density).

11. While these concepts/considerations may be difficult to quantify, they are nonetheless important to consider. Overall, the considerations suggest, in Vector's view, that regulating static, highly connected/utilised assets (e.g. electricity networks (however, even they are susceptible to competition and bypass) and other assets with very strong natural monopoly characteristics) is a very different proposition to regulating assets in a more dynamic environment (such as assets threatened by bypass (either by competing networks or other substitutes)) with scope for increasing service uptake and/or innovation over time (e.g. gas pipelines (given competing energy options and bypass pipelines) and innovative parts of the telecommunications industry).

12. While not intimately familiar with the mobile communications industry, Vector's experience (including as a large and leading user of technological

¹ A similar issue in a different sector is the Government's underwriting of some of the risk associated with the E3P generation investment by Genesis. While the Government has said this is a one-off intervention, having done it once (and therefore demonstrated a willingness to intervene), such "promises" are unlikely to be weighted highly by investors when making decisions.

innovations by the mobile industry) is that it is very dynamic in nature. In relatively short time, new types of networks and technologies have been introduced with significant benefits for commercial and residential users. It is critical for New Zealand's development that similar, if not enhanced, levels of network development continue in the future (e.g. rapid deployment of 3G networks). Further, existing mobile networks are at risk of bypass by new networks, whether of the same cellular/mobile technology, fixed wireless applications or satellite-based communication. New technological developments yet to reach the market (or even be foreseen) further add to the risk of bypass (and, therefore, the risk associated with investments in this field).

13. In this risky and dynamic environment, investor expectations of capital (and a reasonable return) being recovered within relatively short time periods is critical. Without this, existing investments would not have been undertaken, and future investments will not be undertaken. Vector encourages the Commission, including with reference to work in other areas of its responsibility, to further consider the type/maturity/nature of the mobile industry. As a matter of principle, the Commission should, in Vector's view, differentiate between any above-WACC profits being earned as a result of first mover advantage, innovation and high growth in a new or dynamic industry (which will eventually be eroded by competition, bypass or technical/functional obsolescence), from those earned through the use of market power in a market which faces limited competition, with high saturation (i.e. high customer connections or network utilisation) and is unlikely to become more competitive in the medium term.

Treatment of Dynamic Efficiency Effects of Regulation

14. In Chapter 6 of the Draft Report, the Commission identifies and considers the dynamic efficiency effects of control. A number of effects (both positive and negative) are identified and assessed qualitatively. These effects are then considered alongside the quantified net benefit results calculated using the consumer welfare approach.

15. Firstly, as noted above, Vector submits that the appropriate net benefit test in this comparison is the net public benefit test, rather than the consumer welfare approach.

16. Secondly, Vector submits that the Commission should quantify the dynamic efficiency effects of regulation. Admittedly, quantifying dynamic efficiency effects is a difficult task, however, this does not obviate the need to attempt it and use sensitivity analysis to test its robustness and influence on overall results.

17. The Commission has considered, and is considering, dynamic efficiency effects of regulation in a number of other contexts (airports inquiry, electricity lines

businesses, gas inquiry). In the case of the gas inquiry, the Commission modelled dynamic efficiency effects to arrive at quantitative estimates.

18. Vector believes that there is scope for the Commission to quantitatively model dynamic efficiency effects in the current investigation. Such a quantification would provide a better point of comparison than the current qualitative assessment and ensure that the Commission is comparing “apples with apples”.

Closing Comment

19. Vector’s general comments are made with a view to ensuring predictability of regulatory decisions by the Commission over time.

20. At a general level, Vector encourages the Commission to further discuss consistency and cross-functional issues across different industry areas in its public reports. Further, Vector considers the Commission should further consider, in all its work, the type/nature/maturity of the industry in question. Vector’s observation of the mobile industry is that it is very dynamic in nature, thereby making any regulation more risky in the sense of deterring innovations and new investments that New Zealand ideally wants and needs.

21. Should you require any further information, please contact Vector’s Regulatory Manager, Peter Alsop (021 370 869).

Kind regards

A handwritten signature in black ink, appearing to read 'Simon Mackenzie', written in a cursive style.

Simon Mackenzie

Group General Manager Networks