

19 July 2004

The Telecommunications Commissioner
The Commerce Commission
P O Box 2351
Wellington

Attention : Douglas Webb

Dear Sir,

RE: Submission – Investigation into Regulation of Mobile Termination

WorldxChange has prepared this brief response to the Commission's request for submissions on the possibility of regulating mobile services.

Responses to questions:

Question 2

Do respondents have any comments on the legal framework as set out by the Commission?

- We agree in principle with the outlined legal framework and have no further comments at this stage.

Question 3

Do respondents have any concerns with the Commission's proposed decision making framework?

- We have no concerns about the proposed decision-making framework.

Question 4.1

(a) Has the Commission correctly defined the relevant wholesale and retail markets for its Schedule 3 investigation?

- Yes but additional markets should also be included (see 4(d)).

(b) Is there any evidence that there is not a distinct market for the termination of mobile calls?

- No.

(c) Is call transport a relevant upstream market the Commission needs to consider for the purposes of this investigation?

- Yes. The Commission must also consider that the identified hop-on charge of 1.13 cents/minute is only relevant for a Tier 1 carrier. The rest of the market pays anywhere between this local interconnect rate and 7 cents/minute if no local POI exists between the mobile provider and the access seeker.

(d) Are there any other mobile markets that respondents consider the Commission should be considering as part of its investigation?

- Yes. We believe that in addition to the relevant defined markets, the Commission should also include Mobile to Toll Free services in the Schedule 3 investigation.

(e) When end-users select a mobile calling plan, is there any evidence that they consider the cost to other people of calling them from a fixed line or another mobile phone?

- As we are not a mobile provider we cannot comment based upon direct customer feedback but the generally accepted view is that mobile users do not consider the cost impact on people who call their mobile.

Question 4.2

(a) What evidence is there that mobile termination charges are above cost?

- Both Telecom and Vodafone have retail “on-net” rates for mobile-to-mobile users of around half what non-mobile carriers have to pay for the mobile-only component of fixed-to-mobile calls. This appears to clearly demonstrate that the cost to competitors of fixed-to-mobile calls of around \$0.30 per minute is well above the true cost of providing the service.

(b) Do charges well above cost indicate that the relevant markets for mobile termination are not competitive?

- Yes, we believe that it does exactly that because of the duopolistic market that exists in New Zealand.

(c) Is there any other evidence that competition in this market is limited? For example, is there evidence that the likely access providers are achieving excess returns.

- WorldxChange buys mobile termination minutes to 187 different countries around the world and by analysing our buy prices across all carriers that we interconnect with it is clear that more than 130 of these destinations that are in countries with true mobile competition are below the rates charged by both Telecom and Vodafone for domestic mobile terminations. Translated this means that it is cheaper to get a call from a fixed line user in Auckland to 70% of all mobile phone networks overseas than it is to get from a fixed line in Auckland to an Auckland mobile phone user. This would suggest excessive returns if the costs of running a mobile network in NZ was on a par with running similar networks overseas.
- It is also worth noting that the retail rates for calls to NZ mobiles that originate on fixed lines in Australia are below those offered to NZ fixed line users that could indicate that both mobile carriers offer lower rates to offshore carriers than onshore carriers (source AAPT web site).

(d) How should the cost of mobile termination on NZ mobile networks best be estimated?

- The cost of mobile termination (and origination in the case of mobile-to-0800) should be determined via a cost-plus model in a similar fashion to how the interconnect rate was determined.

(e) How relevant are overseas cost studies?

- We believe that the recent ACCC investigations and subsequent ruling in Australia would be a starting point as Vodafone has a similar mobile network in both countries. Other jurisdictions may also be relevant (ie Europe)

(f) What is the best way to benchmark them with New Zealand?

- Start with the Australian model

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

- If it is assumed that all mobile networks of a similar nature cost about same to operate around the world then we see no evidence that Telecom and Vodafone should have a higher cost structure than corresponding overseas networks.

(h) Is it valid to take half the amount being charged for a mobile-to-mobile call to estimate the portion that recovers the mobile termination charge?

- This question appears to be a mistake as the one below makes more sense.

(h) Is it valid to then take half the lowest average mobile-to-mobile calling cost as an estimate of the upper bound of mobile termination cost?

- Yes.

(i) How important is a detailed calculation of the cost of mobile termination in New Zealand when considering the need for regulation?

- We believe that it is not necessary to undertake a detailed cost calculation as there is clear evidence in both carriers' rate sheets that mobile termination is provided above true cost. We would also expect that the Commission has historical evidence gleaned from investigations into other industries that define the difference between fair margin and predatory pricing. Any such benchmarks may be useful in this situation.

Question 4.3

(a) How do respondents view the retail fixed-to-mobile market?

- The domestic fixed-to-mobile market is simply an unregulated duopoly. The difference between what Telecom and Vodafone each charge other carriers for access to their respective networks is almost identical (ie within a cent). Both networks have completely different architectures, use completely different technology (ie CDMA versus GSM) and yet the underlying cost models of both carriers have somehow arrived at almost the same per minute rate that each access seeker must pay to terminate mobile calls. This situation looks very similar to when the oil companies "set" prices at the pumps.

(b) What evidence is there that competition in this market is limited?

- Competition is limited because there are only two mobile service providers that share the entire market almost 50-50 and charge extremely high rates by world carrier standards in order to access their respective networks.

(c) Has pre-selection had an impact on competition in this market?

- Preselection has decreased Telecom's fixed line revenue but has also increased the corresponding revenue streams as well as the profits that both Telecom Mobile and Vodafone now reap. The prolific take up rate of mobile phone users in New Zealand means that all access seekers have to offer a mobile preselection service to their customers in order to remain vaguely competitive. The actual preselection process is not without its own problems as the methodology is archaic and prone to numerous errors that translate into customer service issues.
- Whilst fixed-to-mobile preselection now allows access seekers such as ourselves to provide a seamless service to fixed line users, in order to compete for business customers we end up retailing the service for almost no margin. The fixed component of the call costs us between 1.13 cents (local interconnect rate where we have a POI) and up to 7 cents (national transport rate where no POI exists). The mobile component is around 30 cents.
- Therefore, the total average cost to us as a non-mobile carrier is around 35 cents per minute, which is slightly more than the retail rate available to some Telecom commercial customers for the same service.

(d) How would a reduction in mobile termination rates be likely to affect this market?

- If the mobile termination cost were to be reduced, we ourselves would be in a better position to reduce the corresponding retail rate to our customers and be able to provide a more competitive product. The market would self-level around a new retail cost structure and the consumer would be better off regardless of which carrier he/she elected to use for fixed-to-mobile services because there would be more competition.
- This is exactly what happened in 1996 when WorldxChange reduced the retail rate to call the UK and USA from \$1.80 to \$0.65 cents. All carriers in this market at the time (including Telecom) also reduced their rates to around this level almost overnight. Today the market average to call these destinations is around 15-25 cents per minute.

(e) Why has the residential retail cost of fixed-to-mobile calls charged by Telecom and TelstraClear remained at 71 cpm since these calls were first offered?

- Both carriers have established residential retail bases and to reduce their respective retail rates would simply erode established margins for both carriers. WorldxChange has the next largest residential retail tolls base and whilst our cost structure to provide the same mobile service is higher than both of these carriers, we have elected to offer a lower retail rate in order to attract customers. However, this does not reflect true competition in the market because by world standards even our retail rate is higher than it should be if a true cost-based model were to be applied to a regulated mobile rate.

(f) *Since residential customers can obtain retail rates up to 42 percent cheaper than the standard 71 cpm rate charged by Telecom and TelstraClear, why don't more residential customers switch to providers offering a substantially cheaper service?*

- Whilst fixed-to-mobile calls can be cheaper if a customer elects to sign up with a smaller carrier, these calls only make up part of a residential customer's telecommunications requirements. Line rental, enhanced voice services, dialup/DSL internet services and other bundled services (ie Sky TV, Calling Cards etc) remain in the realm of the larger carriers only.
- Consumers are unaware of the alternatives because margins are at a level where Tier Two carriers cannot afford advertising and consumer awareness programs.
- It remains to be seen whether the new Telecom WSA and UBS offerings will provide a commercially viable model that will allow carriers such as WorldxChange to step up and compete on a more level playing field with enhanced product offerings that will translate into being able to grow our customer base faster.

Question 4.4

(a) *How do respondents view the retail mobile-to-mobile market?*

- This market is out of the reach to all carriers other than Telecom and Vodafone for obvious reasons.

(b) *What evidence is there that competition in this market is limited?*

- We do not believe that there is direct limited competition in the mobile-to-mobile market as both carriers have roughly half of the market each.

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

- We believe that if both carriers were to implement a "bill and keep" model for all inter-network mobile traffic then both carriers would be well positioned to offer their own customers who call from one network to the other better retail rates. The existing negotiated mobile termination rate is also an indirect barrier to all other access seekers.

(d) *How would regulation affect the trend towards substitution of fixed line services with mobile services?*

- Regulating mobile-to-mobile rates and forcing them lower combined with the advances toward 3G-style mobile services should increase the rate at which retail fixed line users move towards a mobile-only solution.

Question 5.1

(a) *What do respondents think is the likely counter-factual?*

- We agree with the Commission's preliminary view of the counterfactual except for the possible constraint relating to Wi-Max.

(b) *How do respondents expect relevant telecommunications markets to evolve in New Zealand over the next few years?*

- We believe that New Zealand will not see a third mobile (ie not fixed) wireless network of any kind that uses any technology that also provides truly national coverage and can also offer fully convergent IP services over such a network. The closest that will happen will be certain niche-market cherry-picking city/regional initiatives that will require the installation of fixed radios that have a relatively high CPE cost putting them out of the reach of most residential New Zealanders.
- In saying that, if the Commission was to regulate mobile termination to a point that New Zealand become attractive to a potential third player, then end-users would possibly benefit from the additional competition.

(c) *Are there new technologies likely to compete with mobile termination?*

- While Wi-Max is one of the wireless technologies that will compete with 3G services on paper, it is far from a reality in the New Zealand market place. Globally, the first Wi-Max networks will not start coming on line until late 2005 and simply having this technology is only the start of the problem.
- The prohibitive cost of rolling out yet another nationwide wireless alternative to CDMA/GSM mobile networks is a major hurdle. BCL, Woosh and Wired Country have all attempted partial regional rollouts of wireless networks using various existing technologies over the past two years and publicly disclosed figures would point to a combined NZ \$150 million spent so far by these three companies yet none of these players have their own VoiP services up and running to date.
- BCL uses traditional voice channels instead of VoiP and the CPE is expensive, Woosh is yet to prove that voice will actually work over their network, and Wired Country relies on other carriers to provide the VoiP services. The taxpayer funds one, one is funded via venture capital and one is funded by a community trust. None of these networks are either owned or operated by any actual carrier in this marketplace which would seem to suggest that within a full-service carrier, the business case required for even regional rollouts is hard to justify.
- Therefore, in order for truly seamless, carrier-grade, VoiP services to be rolled out nationally to all end-users over newer wireless technologies such as Wi-Max, a fully IP-convergent carrier that is a well-funded and not looking for a positive return on investment for a number of years would have to undertake such a project. We simply do not see any existing carrier stepping up or any new player entering the market to achieve such a goal as the return on investment for a country with our geography and population would be almost non-existent.

(d) *If there are no new technologies likely to compete with mobile termination, what incentive will there be for mobile network operators to significantly reduce mobile termination charges?*

- Because of the above scenario, we believe that there is no incentive for the two existing mobile carriers to reduce their termination rates unless forced to do so by the regulator. Convergent fixed & mobile voice services that are available overseas will not be implemented in New Zealand unless either, or both, mobile providers elect to do so at their own pace because of the lack of any additional competition.

(e) *What incentive will there be for fixed network operators to significantly reduce retail fixed-to-mobile prices?*

- There is no incentive for fixed operators to significantly reduce their fixed-to-mobile rates either. Telecom and TelstraClear will not proactively put existing margins at risk and the rest of us cannot reduce our rates any further without making the fixed-to-mobile parts of our respective businesses commercially non-viable. WorldxChange has in the past presented new convergent service opportunities that would be possible with a better mobile interconnect rate to both mobile providers and the responses were that these opportunities would not be considered unless mobile termination was regulated.

Question 5.2

(a) *What do respondents think is the likely factual?*

- We agree with the Commission's preliminary view of the factual.

(b) *If the mobile termination rate was reduced significantly, why wouldn't this decrease be passed through by retailers of fixed-to-mobile calls?*

- Since 1996, when WorldxChange began operation in New Zealand, we have maintained a policy of reducing our retail rates as our costs were decreased. We see this continuing as we go forward so if there were a significant reduction in our domestic fixed-to-mobile costs we would logically reduce our retail offerings as long as they remained commercially viable and also possibly introduce convergent fixed and mobile offerings.

(c) *How long is any pass-through likely to take?*

- At WorldxChange, we evaluate our retail residential offerings approximately every three months and our commercial offerings every month. We will also react to any major change in a competitor's offering if it is viable to do so. Without committing to an actual timeframe, we may be positioned to reduce our fixed-to-mobile offerings almost immediately depending upon the level of cost reduction.

(d) Why haven't recent reductions in mobile termination rates been passed through to retail fixed-to-mobile prices?

- In WorldxChange's case, our mobile buy rate has not changed by more than a cent in the past three years yet we have reduced our retail rates significantly so this is not true of our company. In fact, soon after the Commission determined a lower interconnect rate, we reduced our retail rates accordingly so we anticipate doing the same again if mobile termination was to be regulated.
- An educated guess as to why other carriers have not moved their retail rate is the level of pure margin associated with retaining a high retail rate whilst the cost was reduced.

(e) Would it be feasible for the Commission to include a term in any mobile termination determination that the reduction in price be passed through to end-users?

- We would need to better understand the Commission's actual legislative powers to mandate such a term before commenting further or actually agreeing with this concept. In addition, any formula used to arrive at a mandated retail rate and/or reduction of existing rates would need to be robust, transparent and not prejudice any carrier more than any other carrier if it were to be implemented.
- The market has already proven that a lower regulated cost will force retail rates down and if the Commission were to fix the retail rate in this case then product creativity would be stifled.

(f) Are there other actions that could be taken to encourage reductions in mobile termination rates to be passed through to end-users?

- Unless fixed-to-mobile and mobile-to-0800 costs are regulated with a price determined by the Commission, we see no other avenue to encourage a change from the status quo.

(g) Would reductions in mobile termination rates lead to an increase in mobile subscription charges?

- Either of the mobile operators would be in the best position to answer this question as it pertains to market research that they may or may not have undertaken already but a general observation is that as the cost to call a mobile phone reduces, more fixed line users would be encouraged to also have a mobile phone.

Question 6.1

(a) Are high charges for mobile termination being used to subsidise other parts of the mobile business in a way that increases subscription.

- We cannot answer definitively but would expect cross-subsidisation of 3G network rollouts and other mobile services to be a natural result of the margin made by both carriers on their existing mobile termination minutes.

(b) If so, where are the subsidies being directed and what evidence is there of these subsidies?

- As we have no visibility of the internal operations of either mobile carrier, we cannot answer this question.

(c) Is particularly high advertising spend an indication of a subsidy?

- It could be an indication.

(d) To what extent is Ramsey pricing used in setting mobile calling prices in New Zealand?

- We are in no position to answer this question

(e) Are mobile operators in New Zealand earning economic profits?

- As a general comment, we believe that they are.

(f) What is the best measure of the profitability of mobile networks?

- Benchmark against similar networks and duopolistic environments around the world

(g) What is considered to be a reasonable WACC for a mobile network?

- Again, benchmarking against similar networks and then modelling for the New Zealand environment would be a start.

Question 6.2

What efficiencies and inefficiencies do respondents consider would result from the regulation of mobile termination?

- By regulating mobile termination, no end-users will be worse off unless the regulated price ends up higher than what access seekers have to pay now. However, we expect that both Telecom and Vodafone will argue that if the price is regulated downwards then future investment in their respective networks will be affected etc. We do not see issues of quality as being valid arguments against regulation.

Question 6.3

What technical and practical considerations do respondents think the Commission needs to consider?

- We believe that any technical and practical considerations would be minimal as this is purely a pricing issue that has no impact on either carrier's mobile network other than a simple rate change in both billing systems. We see the exercise of regulating mobile termination as a subset of the process used to determine local interconnect rates.

Question 6.4

(a) How do respondents think that existing regulatory decisions are likely to impact on market evolution and the need for mobile regulation?

- The Commission has already determined fixed-to-fixed interconnection pricing and terms so we see this investigation resulting in a regulated fixed-to-mobile determination along the same lines. None of the existing regulatory decisions have negated the requirement to regulate fixed-to-mobile costs and existing market forces will not allow for better commercial terms related to mobile termination to be forthcoming from either mobile carrier.

(b) Do respondents have views at this stage on whether any mobile termination regulation should be temporary or permanent?

- Our preference is that mobile termination regulation be permanent but a similar time-period to that dictated in the interconnect decision would be sufficient to allow the resultant impact of price reductions to be analysed and reset if required.

Question 6.5

(a) What are respondent's views on the need for a full cost benefit analysis?

- We do not believe that a full cost-benefit analysis is required to regulate the price of mobile termination as the underlying issues to consider appear to be a lot simpler than the issues around the local interconnect decision (ie two mobile carriers with 50% market share each and similar sell prices to other carriers). Any full cost-benefit analysis would drag out the process unnecessarily.

(b) What are the direct costs and the opportunity costs of regulating mobile termination?

- We will leave this one for the Commission's economists to answer.

Question 6.6

(a) Has the Commission identified the right categories of costs and benefits?

- We believe that the identified cost and benefit categories are correct

(b) What other costs and benefits should the Commission consider in a quantitative analysis of mobile termination regulation?

- We have no other categories to add.

(c) How should network externalities be handled?

- We believe that network externalities should be excluded from the CBA.

Question 7.1

(a) How should the mobile termination service be described?

- Termination of voice calls on any mobile network technologies (2G, 2.5G, 3G and other)

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

- Yes

(c) Would the costs of call termination on a 3G network be likely to be similar to those of a 2G network? If not, why not?

- True costs would probably be different depending on how both Telecom and Vodafone amortise their respective networks. However, we believe the Commission would need to determine a single average cost per minute applied across all platforms.

Question 7.2

(a) What evidence is there that a one-off reduction in mobile termination rates is less desirable than a phased reduction over several years?

- Only Telecom and Vodafone would argue for a phased approach. As an access-seeker, we see no evidence that a one-off reduction is less desirable than a phased approach. The significantly high margins pretty much speak for themselves and the mobile termination rates should be reduced to a more realistic final cost-based level as soon as possible.

(b) Could a staged rate reduction be managed given the current wording of the Act?

- We believe that the Act does not allow for a staged reduction of cost in any regulated service.

(c) If a reduction in mobile termination rates is to be phased in over time, over what period should it be phased in?

- We believe that the Commission should not be considering any phased approach as the Act precludes this from happening.

(d) What mechanism should be used for such a reduction?

- Our understanding is that no such mechanism exists under the Act. The closest is the ability to reset the price at the expiry of a timed determination but this requires a final price to be determined in the first place.

Question 7.3

(a) What is an appropriate interim pricing principle?

- If an interim pricing principle was required, it could use benchmarking against the lowest mobile-to-mobile rates.

(b) Is benchmarking appropriate?

- No

(c) Could cost proxies be used?

- Yes

(d) Is an interim pricing principle needed at all or could the price just be specified?

- We believe that the Commission could probably just specify the final price

(e) How could an interim pricing principle incorporate a staged reduction over time, if that is desired?

- We do not believe that staged reduction is the way forward.

Question 7.4

(a) What is an appropriate final pricing principle?

- International studies and source data from Telecom and Vodafone should be used.

(b) Is it necessary to require TSLRIC pricing?

- No

(c) Should TSLRIC pricing be delayed for several years?

- If TSLRIC was ever to be used then it should be delayed as long as possible due to the likely prohibitive costs and time involved.

(d) *Could the application of a final pricing principle be delayed for several years? If so, how?*

- No

(e) *How could the final pricing principle incorporate a staged reduction over time, if that is desired?*

- We do not believe that it can.

Question 7.5

What conditions do respondents consider should be included in the service specification (if any) and why?

- Mobile origination calls to services/numbers billed to customer by fixed line carriers should also be included (ie 0800 Toll Free & 50XY services). Currently these costs are the same as mobile termination charges.

Question 7.6

Do respondents have any views on the wording of the other parts of a service specification for mobile termination and whether any new parts are needed?

- The service description should also specify direct E1 SS7 interconnect links only (not ISDN) with flexibility to add full IP via Ethernet/ATM handoff at some future date. Billing increment should be 60+1 second with no ANI charge as per the local interconnect determination.
- No charge for any successful call under two seconds.
- Consideration should also be given to other relevant specifications that are of a similar nature in the local interconnect determination

As with previous submissions, the Director's of WorldxChange are available for discussion and further comment on the issue of mobile termination regulation.

Regards,

Paul Clarkin
Director, Operations & Carrier
WorldxChange Communications Limited