

**PUBLIC  
VERSION**



## Submission on Revised Undertakings

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16 October 2009

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## 1. Introduction

1.1 2degrees has reviewed the price terms of the undertakings submitted by the incumbents and their accompanying submissions.

1.2 Despite the considerable indulgences granted by the Commission, the clear guidance from the Commission as to its expectations, and the many opportunities for true cost-based undertakings, it is clear that the incumbents are making no serious attempt to offer cost-based prices. In the circumstances we submit that the Commission should grant no further indulgences and must proceed to make its recommendation to the Minister. We see no value in further workshops, submissions, conferences or other delay and submit that, as noted at the conference, the “drop dead date” for revised undertakings passed a considerable period of time ago.

1.3 We offered an undertaking which sought to meet Commission expectations:

- (a) by following Vodafone’s previous non-price terms as much as possible, we sought to neutralise non-price terms issues;
- (b) by having separate undertakings for separate services as the Commission indicated would be helpful, we sought to give flexibility; and
- (c) by offering prices comparable to those in the Commission’s benchmarks (broadly in the order of 85% of the Commission’s benchmarks), we sought to reach a commercial solution.

1.4 By contrast:

- (a) the incumbents’ proposed price terms start at 288% and 231% of the benchmarks for Vodafone (when adjusted for Vodafone’s minute/second proposal) and Telecom respectively, and even in Q4 2014 are 145% and 163% respectively of the voice benchmarks;<sup>1</sup>
- (b) while Telecom has taken a positive step in removing its origination charges and finally adopted the international standard of second plus second billing, its netting-off proposal for text would in our view actually incentivise *higher* retail prices (which Telecom may not have fully appreciated). But as noted its voice rates are too high;
- (c) Telecom (and indeed Vodafone) should have set text termination rates on a (pure) bill and keep basis – the prevention of spam provides no basis for setting prices so manifestly in excess of cost;
- (d) Vodafone continues to game the process by offering more plausible text rates than previously but simultaneously, reversing its previous position and acting inconsistently with the Commission’s guidance,<sup>2</sup> bundling this with implausible voice rates – this is one of many approaches taken by Vodafone indicating that it is not seriously engaging in this process; and
- (e) both Telecom and Vodafone afford themselves generous glide-paths when as outlined in the accompanying document prepared by Dr Haucap (A Short Note on the Philosophy and Economic Rationale Underlying “Glide Paths” for the Regulation of Mobile Termination Rates) *“Neither academic literature nor European practice suggests that glide paths should be used to protect incumbents against competition. Instead, the entire logic behind the use of*

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<sup>1</sup> See 3.1-3.5 below.

<sup>2</sup> Commerce Commission letter to interested parties re request for revised undertakings, 9 September 2009.

*glide paths is to protect and to encourage entrants by granting them higher MTRs than incumbents.*<sup>3</sup>

- 1.5 We entered this process in good faith, and understand why the Commission has granted considerable indulgences on timing and other matters. But we submit that it would have been far more helpful had Vodafone sought to actually estimate the true economic cost of termination rather than in our view seeking to “set up” the Commission on manufactured process issues (borne testament by the numerous threats to challenge the Commission on process grounds and its approach at the undertakings meeting).
- 1.6 The Commission has conducted a comprehensive investigation and undertaken a rigorous benchmarking analysis. It has given all parties numerous opportunities to provide evidence to support their views. It has engaged independent external expert WIK Consult.
- 1.7 As previously noted, the 2000 Ministerial Inquiry into Telecommunications Final Report (**2000 Ministerial Inquiry Report**) noted that a judgement would be required as to where New Zealand sits within the benchmarked countries. *“The inquiry recommends that this judgement be made by the Commissioner on the basis of his/her best estimate of where New Zealand would fall if a full TSLRIC assessment were undertaken.”*<sup>4</sup>
- 1.8 Similarly the Executive has confirmed that *“the Commission is a specialist body, so is best placed to determine technical and factual issues.”*<sup>5</sup> The Court has reinforced this, stating that these kinds of matters are questions *“of fact, and ...for the Commission.”*<sup>6</sup>
- 1.9 Undertakings are designed to reach prices close to economic cost (ie including profit margins) but an extensive process has not resulted in that outcome: the service must now be regulated to ensure competition can flourish in all market segments and to put an end to the relentless gaming by incumbents.

## 2. Purpose of undertakings

- 2.1 As the 2000 Ministerial Inquiry Report made clear, the purpose of regulation is to *“ideally get sufficiently close to the ‘efficient’ price so that both parties accept the determination and decide not to progress to the (longer and more costly) pricing review determination.”*<sup>7</sup> Undertakings as an alternative to regulation must have a similar purpose. We refer the Commission to the Minter Ellison Rudd Watts submission on our behalf regarding agenda item 10 (undertakings process) submitted at the conference. We restate in full the submissions made there, with the exception that we recommend that the Commission only recommend regulation. If accepted by the Minister, we would hope that regulation would encourage cost-based prices to be offered by the incumbents in the near future, not many years out.
- 2.2 In our view, unless there can be a reasonable level of confidence that the undertakings will be close to the TSLRIC price which one would expect under regulation, there is no point delaying regulation.

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<sup>3</sup> Professor Dr Justus Haucap, A Short Note on the Philosophy and Economic Rationale Underlying “Glide Paths” for the Regulation of Mobile Termination Rates, 16 October 2009, para 12.

<sup>4</sup> *Ministerial Inquiry into Telecommunications Final Report* (27 September 2000), <http://www.med.govt.nz/upload/30006/final.pdf>, (2000 Ministerial Inquiry Report) p68.

<sup>5</sup> Select Committee Report on the Telecommunications Amendment Bill 2006, 28 November 2006, p14.

<sup>6</sup> *Vodafone v Telecom*, High Court, Wellington, McGechan J, 18 December 2007, CIV-2007-485-826, paras 59-60.

<sup>7</sup> 2000 Ministerial Inquiry Report, p47.

- 2.3 There is no basis for the approach taken by Vodafone and Telecom to pick numbers that they argue are relatively close to what they consider the benchmarks should be, when in fact they are in excess of 200% of the Commission's actual benchmarks. They then attempt to manipulate the Commission's cost benefit analysis (**CBA**) to suggest that regulation is not required based on their views of the benchmarks. In our view such an approach just makes clear that it is more appropriate to pursue a proper determination of what costs really are. We are quite confident that these would be materially lower than the prices in the undertakings of Telecom and Vodafone.
- 2.4 In support of our view, the Commission has identified benchmarks which are clearly supported by the Commission's cross checks, notwithstanding the fact that those cross checks in our view are conservatively high. They significantly overstate the rate that the incumbents charge themselves, as implied by their retail on-net rates. (We consider that, among other things, the 18% deduction for sale costs is overly generous to incumbents.) In fact, we believe that setting prices at those sorts of levels would risk being in breach of the ECPR pricing principles, explicitly prohibited under the Act.
- 2.5 The WIK-Consult (**WIK**) evidence provided at the conference provides yet further validation for the benchmarking exercise. WIK concluded that voice costs in Australia would be in the order of 6¢ Australian<sup>8</sup>, approximately 7¢ New Zealand, and gave evidence that the New Zealand costs would be lower.<sup>9</sup>
- 2.6 The fact that the incumbents have sought to challenge benchmarking, (missing the point of the exercise) but have still never attempted to estimate the TSLRIC numbers in our view is sufficient evidence that the undertakings cannot be taken seriously, particularly in the context of such overwhelming evidence that their proposed prices are well in excess of cost.
- 2.7 Finally, we re-state our view that we are confident that the TSLRIC rate would be lower still than the Commission's benchmarks (even more so in later years) and do not consider that it can seriously be argued that TSLRIC for mobile termination for the 2010 calendar year can be in the order of 1200% of the cost of termination on Telecom's fixed line PSTN; nor can it seriously be argued that in 5 years time the cost would be 500-700% of the current fixed line PSTN termination cost.

### 3. **General comments on price terms**

#### *Voice rates*

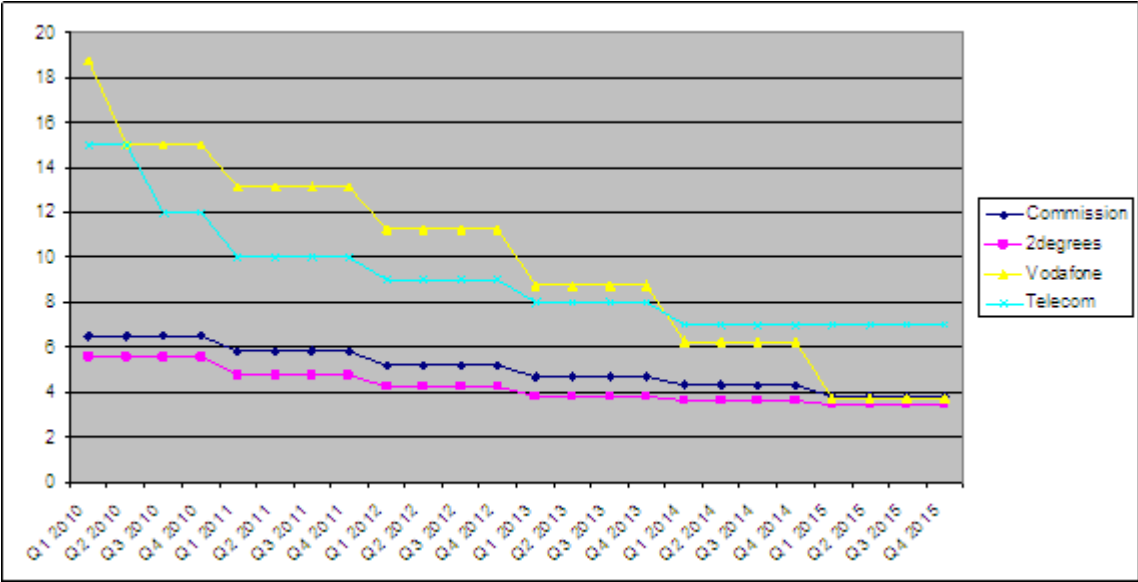
- 3.1 Both parties' voice rates are significantly above cost and ignore the Commission's benchmarks, apart from at the very end of the period, and continue to represent significant barriers to entry, expansion and efficient competition. They ignore the preliminary view expressed by the Commission that the undertakings would need to be near benchmarks to be recommended. Put simply:
- (a) Telecom only want to charge the Commission benchmark for 2009 in 2014 – *five years later*;
  - (b) Vodafone only want to charge the Commission benchmarks for 2009 in 2013 – *four years later*.

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<sup>8</sup> ACCC, *Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011*, March 2009, p14-15.

<sup>9</sup> MTAS Conference Transcript, Day 1, p132.

- 3.2 But the above is generous to Vodafone. Its price terms ignore well-established practice in the rest of the world by continuing to seek to set prices on a minute plus second basis. Even Telecom is no longer proposing to do this now.
- 3.3 The following graph shows the difference between the parties' undertakings.



- 3.4 The graph has been calculated on the following basis:
  - (a) adjustments have been made by quarter to address the mismatch in timing between operators; and
  - (b) Vodafone’s rate is adjusted upwards by 25% to reflect an estimate of the artificial inflation demanded by Vodafone proposing to round up calls less than 1 minute to a full 1 minute charge. (In fact our experience in the past two months has been that this inflates the effective rates by 28%.)
- 3.5 The numbers show that:
  - (a) Vodafone’s proposed voice termination rates effectively start at 288% of the benchmarks and it is only in 2015 (ie in 6 years) that Vodafone’s voice termination price would finally reach the applicable benchmark; and
  - (b) Telecom’s proposed voice termination rates start at 231% of the benchmarks and Telecom’s price would **never** reach the benchmark. In 2015 it would still be 184% of benchmarks for that year.

**SMS rates**

- 3.6 On the face of it the text rates offered by the incumbents look more appealing. At least initially they do not appear to be wildly out of step with the Commission’s benchmarks, although for reasons we will not repeat here, we consider the benchmarks considerably overstate the real cost of text, which is essentially a by-product of providing the voice service.
- 3.7 But for text:
  - (a) Telecom offers what seems to be a well-intentioned netting arrangement, but which would introduce strong incentives on parties to be net receivers of text,

which would likely lead to higher and higher off-net prices as operators compete to be net recipients of texts;

- (b) Vodafone's offer is at first "only" 140% of the benchmark but by 2014 would be 214% of the benchmark.
- 3.8 To expand on our description of Telecom's proposal as "netting", we note that it is not true bill and keep (described in the Act as "pure" Bill and Keep (**BAK**)). A proposal which provides for rates to be imposed when traffic is out of balance is simply a "netting" arrangement and provides for quite different incentives on the parties (as discussed in the separate paper by Dr Eric Ralph and Ms Emma Lanigan). It is not clear to us that the significant difference between netting and BAK was fully appreciated at the conference or in the draft determination. We note also that BAK, as mandated by the Commission in HomeZone, has no bands for out-of-balance traffic. There is no reason for adopting a different approach here.
- 3.9 There are many arguments in favour of BAK for voice and text, including acknowledgment of the benefit to both the calling and called party. But even if one takes a conservative approach (ie when BAK is virtually always regarded as appropriate), BAK is generally viewed as appropriate where the cost of providing the service is very low (especially compared to other transaction costs and/or regulatory costs), and/or traffic is expected to be largely symmetrical. Vodafone and Telecom have fairly strenuously argued that the latter is the case. (And we believe that the cost-benefit is quite clear.) Moreover, in the absence of spam (which is not a legitimate concern), text traffic imbalances could only appear due to high inter-network retail price differentials for off-net texts. But each carrier has complete freedom in their choice of retail rates. On that basis there is no reason for not adopting BAK.
- 3.10 But the problem with the netting proposal is worse than merely ignoring BAK where it is the most obvious solution. In fact, the penal approach adopted by Telecom provides carriers with the incentive to engineer a net inflow of texts, thereby obtaining high per text termination revenues.
- 3.11 A network that chose to set relatively high off-net retail text prices would experience a net inflow of text traffic. Equally, carriers' incentives to cut retail rates are constrained, because cuts will lead to a net outflow of texts, thereby threatening the carrier with punishing per text outpayments. Moreover, given this possibility, no carrier would be prepared to cut retail text rates below \$0.08 (unless its competitor had already done so), since that would result in marginal (retail) revenues exceeding marginal costs. This would largely end competition on off-net retail text prices, and may well lead to those charges rising.
- 3.12 Telecom's netting proposal is seeking to avoid traffic imbalance. But as noted above the only relevant reason for traffic being out of balance is, as we understood was accepted by Vodafone's expert Dr John Small at the conference, consumers responding to retail price signals (namely closed net pricing).<sup>10</sup> Telecom's proposed rates for out of balance traffic means that parties would be incentivised to make sure they were the ones receiving more texts than they sent. Its proposed charges would have exactly the opposite effect of what is intended. It would lead to carriers seeking to create traffic imbalance in its favour, rather than avoiding it. The effect would harm end-users, especially over the longer term.
- 3.13 Oddly, the traffic imbalance that Telecom is trying to avoid would best be achieved under a (pure) BAK regime, as operators compete efficiently and off-net prices come

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<sup>10</sup> MTAS Conference Transcript Day 2, p10, lines 28-31.

down. Traffic symmetry becomes a self fulfilling prophecy under BAK. On that basis there is no reason for not adopting BAK.

3.14 BAK for text would allow far greater certainty for the industry than a prolonged STP, STD and cost modelling process and competition in some segments would be facilitated far sooner as BAK could be adopted quickly and simply.

3.15 Both Telecom and Vodafone have raised the issue of spam as the basis for setting a charge, to somehow disincentivise one-way text traffic. These arguments are not credible:

- (a) Sending spam would be in breach of the Unsolicited Electronic Messages Act;
- (b) Vodafone's own experts, Analysys Mason, have found spam not to be an issue in bill and keep jurisdictions;<sup>11</sup> and
- (c) the undertakings contain explicit provisions enabling the parties to suspend/terminate the service on very broadly defined views of spam – so there is a ready commercial option available rendering the setting of prices above cost unnecessary.

3.16 In conclusion, the proposed numbers may appear superficially appealing for text but:

- (a) Vodafone's text rates:
  - (i) are significantly higher than the benchmarks;
  - (ii) move further away from the benchmarks over time (to over 200% of the benchmarks);
  - (iii) are linked to an especially poor voice termination rate (in what appears to be a cynical reversal of its past approach of separating the undertakings), meaning the Commission could not accept its text rate without also accepting the voice rate. It would seem clear that Vodafone does not want its undertakings to be accepted, but wants to give the appearance of offering more than it really is.
- (b) Telecom's undertaking:
  - (i) suggests Telecom should be commended for its attempt at a BAK arrangement, but on scrutiny its chosen approach (netting) is deeply flawed;
  - (ii) netting should be unnecessary given Telecom's and Vodafone's arguments that traffic should be largely symmetrical. BAK would suffice and would ultimately result in the symmetry they both pronounce through competitive incentives to reduce prices;
  - (iii) actually creates retail incentives to create traffic imbalances through the netting (not BAK) proposal ie by raising off-net retails prices above those of competitors.

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<sup>11</sup> See Analysys Mason, *Case studies of mobile termination regimes in Canada, Hong Kong, Singapore and the USA*, 26 November 2008.

#### 4. Glide paths

4.1 Both parties opt for extraordinarily generous glide-paths for termination on their respective networks. But:

- (a) Glide-paths delay the benefits of regulation and reduce benefits to consumers. “[T]he imposition of a glide-path would amount to a form of compensation to the access provider for the excess profits it is being required to forgo, which would be effectively funded by a levy on access seekers and, ultimately end-users.”<sup>12</sup>
- (b) Contrary to suggestions, Concept Economics noted “as a matter of principle, reducing excessive profit will have no negative impacts on efficient investment. Investments will be undertaken, at least by competitive firms, so long as their expected return exceeds their costs.”<sup>13</sup>
- (c) As explained by Dr Haucap at the conference, the purpose of regulation is to replicate competition. The incumbents would not have a glide-path to respond to competition.<sup>14</sup>
- (d) The delay in implementation of regulation gives operators plenty of time to adjust. The Commission commented in its FTM Final Report (June 2005) that:

*“843. If a mobile operator has a lengthy period of notice of a possible reduction in mobile termination rates, it should be able to avoid suffering an unanticipated shock to its revenue as it would be prudent for it to approach customer acquisition from that date on the basis that mobile termination rates will be reduced to cost.*

*844. The Commission announced it considered there were reasonable grounds to commence an investigation into regulating mobile termination rates on 29 April 2004. That followed moves by other regulators around the world to regulate mobile termination rates. It is unlikely that any determination on mobile termination rates would come into force before late 2005 at the earliest. Mobile operators have therefore had sufficient time to adjust customer acquisition practices to ensure a reduction in termination rates to cost by itself does not cause operators to be stranded with uneconomic customers.*

*845. The Commission therefore considers that a one-off reduction of mobile termination rates (when the possibility has been well signalled) would not impose an unanticipated revenue shock that would significantly disrupt and defer investment, compared to the impact of a phased reduction over a period of years.”<sup>15</sup>*

- (e) As we have previously submitted, arguments about sudden changes are not valid. Our cross submission noted that both Vodafone’s and Telecom’s SEC filings have warned investors of the potential for regulation.<sup>16</sup>

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<sup>12</sup> TelstraClear, Cross-submission on the Commerce Commission Draft Report: Schedule 3 Investigation into Regulation of Mobile Termination (FTM), para 174.

<sup>13</sup> Concept Economics, MTAS Cross-submission, 18 August 2009, section 4.3.7.

<sup>14</sup> MTAS Conference transcript, Day 2, p151-152.

<sup>15</sup> Commerce Commission, Final Report: *Schedule 3 Investigation into Regulation of Mobile Termination* (FTM), 9 June 2005, paras 843-845.

<sup>16</sup> 2degrees, MTAS Cross-submission, 18 August 2009, paras 8.29-8.31.

- (f) There was no detriment when there were significant reductions in fixed PSTN termination in New Zealand and mobile termination in Slovenia. The Concept Economics submission noted that *“In the Slovenian example, the regulator halved the MTR thus allowing a new network to enter successfully where high MTRs had previously been in place. This did not have a negative effect on the market – rather competition flourished.”*<sup>17</sup>

Similarly, Mr McCabe noted at the Conference *“There’s a precedent of course with fixed termination rates where they came down nearly 60% overnight so there’s already precedent here in New Zealand. We haven’t seen any harm either, I don’t think that’s been demonstrated and in some European countries there was a 50% drop in mobile termination rates overnight with no demonstrable harm.”*<sup>18</sup>

- (g) As Dr Haucap’s paper explains, the use of glide paths internationally is generally for new entrants.<sup>19</sup> Further, as Concept Economics noted *“While (some) regulators in countries where there is well-established competition between 3, 4 or 5 competitors find glide paths to be appropriate, in our view this has little relevance to the NZ situation where the benefits of quickly aligning MTRs with cost are not simply pass-through price reductions but of removing entry barriers to enable competition.”*<sup>20</sup>
- (h) As Mr McCabe commented at the conference – a glide-path *“allows incumbents to have a lock in period, so if they know that they have above cost termination rates for another period of time then there are strong incentives for them to put people on to contract, and here contracts are up to 36 months which are exceptional.”*<sup>21</sup> In fact we believe that the proposed price paths give incumbents a unique window to lock in customers. Telecom is trying to secure customers onto its new XT network at the same time as 2degrees is trying to win customers from Telecom. A glide-path would facilitate market foreclosure. For example, it would give Telecom time to change its customers onto 3G handsets, to collect termination revenue from its competitors to subsidise those handset swaps, and to lock in those customers to longer term contracts.
- (i) As noted by TelstraClear during the FTM investigation *“The fact that an immediate reduction in fixed to mobile termination rates would result in a large change simply reflects how excessive fixed to mobile termination rates currently are.”*<sup>22</sup> and *“I think Bruce Parkes [from Telecom] articulated it well, he said we don’t want the regulation. If we’re going to have the regulation, let’s do what we can to delay the effect of regulation and that’s exactly what a glidepath is about, it’s stalling the full effect of the regulation.”*<sup>23</sup>[emphasis added]

## 5. Non-price terms

- 5.1 Given the flaws with the price terms and our view on the undertakings, we make no submission on the non-price terms other than the points we have made above, namely that we consider it disappointing that Vodafone have sought to bundle text and voice rates together.

<sup>17</sup> Concept Economics, MTAS Cross-submission, 18 August 2009, section 4.3.7.

<sup>18</sup> MTAS Conference Transcript, Day 2, p156, lines 10-13.

<sup>19</sup> Professor Dr Justus Haucap, A Short Note on the Philosophy and Economic Rationale Underlying “Glide Paths” for the Regulation of Mobile Termination Rates, 16 October 2009. Also see comments by Mr McCabe at the MTAS Conference Transcript, Day 1, p123, lines 22-25.

<sup>20</sup> Concept Economics, MTAS Cross-submission, 18 August 2009, section 4.3.7.

<sup>21</sup> MTAS Conference, Day 2, p 156, lines 14-17.

<sup>22</sup> FTM Conference Transcript, Day 1, 23 February 2005, p32.

<sup>23</sup> Above, Day 3, 25 February 2005, p406-407.

5.2 If, contrary to our submission, the Commission opts to proceed with the undertakings process, we reserve our right to make detailed submissions on the non-price terms of the undertakings as we would have material comments.

## 6. Other comments on submissions by incumbents

### *Best practice*

6.1 Telecom attempts smear tactics on the Commission's approach arguing that New Zealand lags behind international best practice.<sup>24</sup> That may be correct, but not in the sense that Telecom implies. In many jurisdictions worldwide the regulator would have a direct power to set the termination rate which would lead to far speedier implementation of termination rates and would put a far greater pressure on incumbents to make appropriate commercial offers. That is the backdrop in many of the jurisdictions we have previously commented on. More significant is the fact that mobile termination rates are not regulated in New Zealand when they are in virtually every other OECD country. So New Zealand is very much the "outlier" in regulatory best practice as previously submitted.<sup>25</sup>

6.2 Indeed, if Telecom truly wants regulatory best practice it should be supporting cost based regulation of mobile termination rates (or, as a minimum, match the Commission's benchmarks in its voluntary undertakings).

### *Misleading assertions*

6.3 Telecom's comparison with Australia is incorrect. The AUD9cpm that Telecom refers to is not the cost-based rate required by the New Zealand legislative regime, it is merely an indication given by the ACCC of what it might set when arbitrating an access dispute. Further, this completely ignores the fact that WIK considers costs in New Zealand to be lower than the approximately AUD6cpm that it modelled for Australia.<sup>26</sup>

6.4 Equally, Telecom's submission misses the unique New Zealand need to have cost-based prices to ensure the benefits of competition as required under section 18 of the Act. The full benefits of efficient facilities based competition from a third player will be undermined without cost-based prices.

6.5 Telecom and Vodafone attempt to "manipulate" the CBA. Both parties attempt to do a "mix and match" of assumptions in order to make their reasons for charging above cost more appealing and dilute the case for regulation.<sup>27</sup> This approach is patently self-serving and incorrect. The bottom line is that they are still attempting to charge significantly above cost.

6.6 In a related approach, Vodafone absurdly suggests what it thinks the regulated rate should be, then offers an undertaking to match that.<sup>28</sup> Surprisingly it then results in a graph which makes its undertaking look appealing – but only compared to the rate that it alone thinks is appropriate.

6.7 In a related "loose" approach as to what constitutes fact and expert evidence, Vodafone oddly cites evidence given by their own consultants as being "advice".<sup>29</sup>

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<sup>24</sup> Telecom, Submission accompanying Revised Undertaking, 2 October 2009, para 7.

<sup>25</sup> See 2degrees, Cross-submission on Commerce Commission Draft Report on MTAS, 18 August 2009, paras 11.4-11.12.

<sup>26</sup> MTAS Conference Transcript, Day 1, p132.

<sup>27</sup> See Telecom, Submission Accompanying Revised Undertakings, 2 October 2009, para 11. Vodafone, Covering Submission on Revised Undertakings, 2 October 2009, paras 33-45.

<sup>28</sup> Vodafone, Covering Submission on Revised Undertakings, 2 October 2009, para 30.

<sup>29</sup> Above, para 43.

Similarly, as previously submitted, we would expect Analysys Mason, its expert, being a professional cost modelling organisation, to suggest that cost modelling is a better approach than benchmarking.<sup>30</sup> (We agree where incumbents' undertakings fail to match benchmarks set by the independent expert body.) As previously submitted, Analysys Mason do not appear to have been fully briefed on the New Zealand process. Cost modelling is precisely the approach that we are advocating now that the undertakings process appears to have failed, and no doubt Analysys Mason would be more than prepared to do so.

- 6.8 Vodafone also incorrectly states that 2degrees will be able to stay on the 2degrees/Vodafone agreement "as long as it wants".<sup>31</sup> [

] **[2D/VAPI]**

- 6.9 Telecom makes reference to cost paths and not glide paths<sup>32</sup> and also states that its netting arrangements adopt TSLRIC.<sup>33</sup> These two assertions are confusing and not evidenced. There is no basis or evidence given to suggest that they are offering a cost path, rather than a glide path. Similarly Telecom states that the numbers it includes in its netting arrangement somehow equate to TSLRIC. No evidence is given for this. In fact, Concept Economics has provided evidence that suggests the TSLRIC for texts is virtually zero.

#### *Uncertainty*

- 6.10 As discussed in our commentary on glide paths above, there can be no basis for arguing uncertainty. Both Vodafone and Telecom have it completely within their power to obtain certainty by setting prices based on their actual costs. Benchmarks have been determined and we have offered an undertaking very close to those benchmarks. If Vodafone and Telecom had adopted a similar approach, certainty could be achieved. More importantly, as previously submitted, their regulatory risks have been well foreshadowed to investors and they will be well prepared.

### **7. More detailed comments on Commission process**

- 7.1 As previously submitted, the findings of the 2000 Ministerial Inquiry Report make it clear that the intention of regulation (or indeed the threat of regulation) is to ensure that incumbents are incentivised to charge cost-based prices. However, we recognise that given that any commercial settlement by the incumbents would necessarily be above cost, there would always be a bias in the process that favours the incumbents. Further, there is always the risk that the process could be politicised.
- 7.2 The Commission has followed a robust approach to benchmarking costs. Unsurprisingly the incumbents argue that the estimates are too low. But they have been careful throughout this process to give no real indication as to what they think the real costs of termination are. That is telling.
- 7.3 We consider that the true costs are significantly lower than the Commission's benchmarks indicate and are likely to be close to Fixed Termination costs. But we have nonetheless approximated those benchmarks in our undertaking.

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<sup>30</sup> 2degrees, Cross-submission on Commerce Commission Draft Report on MTAS, 18 August 2009, paras 14.1-14.5.

<sup>31</sup> Vodafone, Covering Submission on Revised Undertakings 2 October 2009, para 17.

<sup>32</sup> Telecom, Submission Accompanying Revised Undertakings, 2 October 2009, para 13.

<sup>33</sup> Above, para 20.

- 7.4 The benchmarking is supported by independent experts WIK. WIK's analysis and commentary at the conference made it clear that WIK considered the Australian cost estimates would be a ceiling for the New Zealand costs.
- 7.5 Furthermore, as we indicated at the conference, we expect costs to drop considerably over coming years due to:
- (a) much greater use of data;
  - (b) further reductions in capital costs; and
  - (c) moves to next generation networks and similar technologies (as alluded to by Telecom in its submissions to the effect that BAK could be appropriate in the future<sup>34</sup>).
- 7.6 As submitted at the conference, the legislature made it quite clear that there was meant to be a "drop dead date" after which undertakings would not be entertained.<sup>35</sup> The undertakings process had been implemented against the backdrop of trying to ensure that there was not gaming of the sort that had occurred previously. It is unsurprising then that the 2000 Ministerial Inquiry Report had rejected undertakings for the very reasons we are seeing now.
- 7.7 The incumbents have been gaming the process and made a number of unjustified attacks on the Commission and/or attempts to prolong the process unnecessarily. This has included:
- (a) Vodafone letter of 21 November 2008 – suggesting the Commission incorrect to impose a 40 day time limit on undertakings;
  - (b) Vodafone letter of 28 November 2008 – requesting Commission to publish project milestones (request granted);
  - (c) Vodafone letter of 19 February 2009 - requesting extension of time for submissions on undertakings (request granted);
  - (d) Vodafone letter of 10 March 2009 – requesting release of Commission's cost-benefit model and other guidance before opportunity for revised undertakings;
  - (e) Vodafone letter of 3 April 2009 – outlining various alleged process failures by the Commission, suggesting Commission incorrect to impose a time limit on revised undertakings, and threatening judicial review;
  - (f) Telecom email of 3 April 2009 – requesting extension for submission of revised undertakings (request granted);
  - (g) Vodafone contact with Commission (referred to in its letter of 14 July 2009) – expressing concern with the conference date being changed and that certain Vodafone representatives might be unable to attend;
  - (h) Vodafone letter of 14 July 2009 – expressing concern again at conference date being changed again and that certain Vodafone representatives might be unable to attend;

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<sup>34</sup> Telecom, Submission on the Schedule 3A Undertakings Received by the Commission, 13 February 2009, para 56.

<sup>35</sup> Minter Ellison Rudd Watts, submission on Agenda Item 10 of MTAS Conference - Undertakings Process, 3 September 2009.

- (i) Vodafone letter of 20 August 2009 – expressing further various concerns about the Commission’s approach;
- (j) Telecom letter of 25 August 2009 – supporting Vodafone’s concerns in its letter of 20 August 2009;
- (k) Vodafone letter of 25 August 2009 – expressing concern for arrangements for the conference;
- (l) Vodafone letter of 25 September 2009 - further concerns around process;
- (m) At the meeting on revised undertakings on 23 September 2009, Vodafone engaging in what appeared to be attempts to create (yet again) judicial review type grounds for appeal (when there are none), opting to bring their litigation solicitors, rather than their usual solicitor who had been present at the original conference. The purpose of the 23 September meeting was to assist the Access Providers in providing revised undertakings. Instead Vodafone took the opportunity to repeatedly cross-examine the Commission on whether it had or had not taken into account certain matters;
- (n) Vodafone in its submission of 2 October 2009 – stated that it plans to “provide a more detailed submission commenting on our undertaking”<sup>36</sup> in its 16 October submissions, clearly misusing the process as other parties will not have had the opportunity to respond on the day specified (today). At best this prolongs the process as other parties may have to further submit on Vodafone’s 2 October undertaking. Cross-submissions (ie the submissions on revised undertakings) allow the opportunity for parties to comment on one another’s submissions in the full context of those submissions, not an opportunity to re-submit on one’s own submission;
- (o) Despite its complaints, Vodafone seems happy to introduce new evidence and submissions when it suits Vodafone or after appropriate processes or deadlines. For example, see the correspondence released only yesterday between the Commission (Commissioner Patterson) and Vodafone (Mr York). The Covec material released yesterday as well, at first blush seems to go well beyond its scope and to introduce new material even though it was meant to simply “clarify” evidence given at the conference. We are perplexed at this given our understanding that the evidence given was meant to respond to an example which itself was meant to be comparable to current market conditions. We considered that to be an unnecessary indulgence to incumbents, to the potential disadvantage of other interested parties;
- (p) Following on from the above, since May last year, Vodafone have been asserting that there are small discrete calling circles in New Zealand.<sup>37</sup> In our view they have not sought to give any real evidence of this until September this year at the Conference and have only provided the actual numbers in October. At the same time, Dr John Small has submitted a paper which purports to “clarify” his comments on the “whiteboard example” at the conference, but which (at least indirectly) relies on Vodafone’s information as to the number of people with on-net bundles.<sup>38</sup> In accordance with the Commission’s indication that it is not conducting a submission process on that submission, we will not make cross-submissions on those numbers. However, we note that in the very short time in which we have had to consider the

<sup>36</sup> Vodafone, Covering submission on Revised Undertakings, 2 October 2009, para 10.

<sup>37</sup> Vodafone Letter, Mobile to Mobile Termination, 29 May 2008.

<sup>38</sup> Covec, comments on the MTAS conference “Whiteboard” examples, 9 October 2009, see for example paras 2 and 20.

information, statements such as “*On-net voice calling plans currently offered are only closed user group plans (not blanket on-net discounts), most mobile subscribers do not in fact use such plans, and the extent of ‘linking’ between calling circles is limited.*”<sup>39</sup> seems to us either plainly incorrect or fundamentally misleading. Perhaps there is some subtlety to what Dr Small considers to be a “blanket on-net discount” that we have not understood, but we do not see how plans like Mega 20, which contain “200 national anytime calling minutes to Vodafone mobiles in NZ” and Free Weekends, with \$10.00 for “TXTs and calls to Vodafone all weekend” should not be classed as offering a “blanket on-net discount”.

7.8 To our mind these faux process issues have been spurious and self-serving attempts to try and create a basis for a judicial review appeal or just frustrate the process. We do not consider that the incumbents’ conduct during this process to be conducive to achieving appropriate outcomes on undertakings and for this reason, and as noted above, urge the Commission to desist this process. We believe that it has granted the incumbents far greater indulgences than the legislature intended when it sought to introduce the undertakings process to avoid exactly the sort of gaming which we are seeing now.

## 8. **Conclusion**

8.1 The incumbents’ undertakings are still well in excess of cost.

8.2 They are still attempting to delay the day when they have to forego their subsidy from new entrants and fixed operators by arguing for glide-paths and gaming the process.

8.3 The only thing that will incentivise them to offer true cost-based rates is regulation.

8.4 The only option now is to designate mobile termination and we urge the Commission to proceed to recommend designation immediately.

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<sup>39</sup> Above, para 2.