



Eric Hertz, CEO

2degrees

Opening Statement

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MTAS Conference

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## INTRODUCTION

### *Overview*

1. Thank you for giving 2degrees Mobile the opportunity to take part in this conference. I am Eric Hertz, Two Degrees Mobile Limited's CEO, and I'm very pleased to be here.
2. I bring to this conversation a number of years of operating experience in the telecommunications industry having had the honour of working in:
  - Both the landline and wireless telecommunications industry for over 33 years.
  - The international mobile wireless industry for 24 of those 33 years through four generations of technology evolution.
  - The telecommunications industry when the United States moved from Monopoly to Duopoly in 1984.
  - The United States twelve years later when the industry moved from duopoly to up to seven wireless licensees per market.
  - In addition, I have been part of senior leadership teams doing business in Austria, Ireland, Iceland, Haiti, Dominican Republic, Cote d'Ivoire, Bolivia, Croatia, Slovenia, and 10 other small and large Latin American markets.
  - An early stage venture-funded company as CEO developing exciting new multi-media services for mobile devices operating on next generation mobile wireless networks.
  - I have a Bachelors of Science degree in Mechanical Engineering and a Masters in Business Administration from the Wharton School at the University of Pennsylvania.
3. My main points for this discussion are:
  - (1) That the incumbents' active, exclusionary, anti-competitive behaviour is a barely concealed abuse of significant market power.
  - (2) That the incumbents' very open and public threats to increase prices or delay innovation and investments are in my opinion a very clear form of bribery directed at the elected officials who need to make important decisions in this process and to confuse potential consumers and their own customers.
  - (3) That there are exciting new services and benefits that consumers of mobile services can expect to see in the future. And that those new benefits will arrive much sooner and at better prices with proper regulation of interconnection/termination pricing. That will provide the foundations for even greater benefits through robust competition in New Zealand.

4. Let me briefly introduce the 2degrees team, express support for the Commission's careful process and make just a few general comments.

### **2degrees**

5. Our company is represented by myself as CEO, Steven Fast, Chief Financial Officer, Bill McCabe, Chief Commercial Officer, and Mike Goss, Chief Technical Officer of 2degrees. In this 2degrees management team alone, we have quite extraordinary and significant relevant international experience, covering different regulatory regimes in Australia, United States, the UK, Ireland, Slovenia, Malaysia, Bahrain, Austria, Switzerland, the Island of Haiti and Dominican Republic, Bolivia as well as 10 other Latin American countries. We look forward to responding to your questions.
6. 2degrees is already a major New Zealand infrastructure player having directly employed or contracted over 1,000 people to date. We have fresh new shareholders' capital of NZ\$ 250 million invested into the New Zealand economy.
7. As you know quite well, this company has been on the scene since February 2001 with Econet and the Maori Community's Te Huarahi Tika and Hautaki Trust. However, our ownership fundamentally changed with additional new money from two new shareholders in 2007 as a very direct consequence of two key regulatory developments:
  - (a) The Commerce Commission's *Review of Cellular Mobile Market Entry Issues* (10 October 2006); and
  - (b) Government action to strengthen New Zealand's weak regulatory environment, which led to the *Telecommunications Amendment Act (No 2) 2006* of 18 December 2006.
8. Our long term Maori investors were joined by more recent shareholders, Trilogy International Partners (52%) & Communications Venture Partners (26%) both of which have separately submitted how the improved regulatory environment influenced their decision to invest in NZ
9. We are supported by our expert economists: Mrs Emma Lanigan; Dr Eric Ralph; and Dr Professor Justus Haucap from Düsseldorf Institute for Competition Economics. They bring considerable international telecommunication regulatory experience, covering the US, EU, Asia, the Middle East, Australia and NZ. They have advised regulators, government agencies, entrants and incumbents, including Telecom Italia, Telstra in Australia, and Telecom New Zealand. Dr Haucap previously worked in New Zealand Treasury, where he covered Telecommunications & Postal Regulation issues. He is current chair of the German Monopolies Commission.
10. Our external counsel are Andy Matthews & Paul Mathewson from Minter Ellison.

***Process – we support the process even when we have different views***

11. We thank the Commission and Staff for their significant and very thorough work to date. The Commission has undertaken a detailed consideration of the issues:
  - This process started in 2006 by the Commission's *Review of Cellular Mobile Market Entry Issues* which indicated an investigation might start if mobile entry occurred.
  - It began formally with the letter to interested parties from Commissioner Patterson on **8 May 2008, a full 16 months ago** and has involved numerous rounds of submissions and cross-submissions.
  - Much of the background and issues were covered in the Fixed-to-Mobile termination process.
12. We completely support this process even though we believe that the length of time required significantly harms us, competition and the consumers. In fact, process delays and time is on my competitors' side. Process delay assists incumbents but harms consumers. We do respectfully acknowledge and fully appreciate that the Commission has erred on the side of caution due to the constant threats, political pressure, and attacks on process by my competitors.
13. I am quite amazed and deeply frustrated by the incumbents' cynical gaming of the regulatory process. But, I am not surprised, since it has been quite effective for them. That must not be permitted to continue. It is time to bring the real sustained benefits that competition offers.
14. My competitors have not even honoured the spirit of this process in that they haven't even tried to address the fundamental question: *What does it cost to terminate calls on their network?* We must ignore their emotion laced, insulting undertakings designed, once again, to delay. We must rapidly move on to objective, rational decision making.

***New Zealand is falling further behind the rest of the world and MUST CATCH UP.***

15. For the broader audience, please don't be fooled. New Zealand is one of a few outliers on telecommunications regulatory issues. Most advanced economies, large and small, have either some form of regulation or very low termination/interconnection rates.
16. Even when the Fletcher Inquiry took place nearly 10 years ago, New Zealand was identified as an outlier. Our lack of regulation has led to consumers missing out significantly. That can be fixed here and now.
17. Excessive mobile termination rates are deeply damaging to the New Zealand consumer, deeply damaging to the health of this important industry and deeply damaging to New Zealand's competitiveness and productivity.

### ***So what do we want?***

18. Let me be quite clear about what we seek here:
- We are not asking for any special favours, just international best practice.
  - We are not asking for a free ride on incumbents' infrastructure.
  - We are renting only where we have yet to build and we fully intend to aggressively build out to eliminate the excessive rent, and further, to upgrade networks if we can be assured of a level playing field on which to compete.
  - We simply want reciprocal interconnection **at cost** that does NOT include monopoly profits gained from providing exclusive bottleneck services.
19. We want this so that we can compete aggressively for customers and so that our customers can call and be called by anyone, anywhere, any time on or from any network. That's called *any-to-any connectivity*. It is, in fact, what the Fletcher Report said was vital nearly ten years ago.
20. The Commission and our experts have clearly highlighted the extremely high levels of on-net calling. That means you're not calling or being called by others on other networks because it's artificially too expensive. In many all too real cases here in New Zealand, I have heard from people who carry multiple phones (fixed and mobile) to avoid these artificially high text and voice calling prices. Amazingly, this is distinctly reminiscent of the telephone industry of the early 1900s when people had multiple phones on their desks or in their homes to connect across town, to different cities, and to longer distance destinations. This problem will persist for as long as there are high on-net vs. off-net, fixed and mobile price differentials.

### ***We support designation of mobile termination access services***

21. Our position is clear:
- (1) Mobile termination is an exclusive bottleneck monopoly service. Entrenched incumbents face no effective constraints and thus have overwhelming incentives to price these services as high as possible, effectively choking new carrier/network-based competition.
  - (2) The entrenched incumbents will never respond to light-handed regulation by offering forward-looking, cost-based prices (LRIC or TSLRIC) or ideally a Bill and Keep interconnect arrangement which would tear down the main barriers to "any-to-any" connectivity.
  - (3) Therefore, mobile termination must be regulated by you.
  - (4) There should be no glide path as there is no justification for protecting incumbent advantages that preclude the benefits of competition.

- (5) There is no credible justification for interconnection/termination pricing that exceeds Total Service Long Run Incremental Costs. Having said that, it is actually true that Bill and Keep arrangements would be would be dramatically better for the consumers of New Zealand.
  - (6) For Short Messaging Text Services we must be on a Bill and Keep basis because real cost is so close to zero that to charge more than that simply keeps networks closed and destroys any-to-any connectivity.
22. The incumbents' undertakings should be rejected. The undertakings are too far removed from demonstrable or relevant costs. Adopting the incumbents' proposals would lock New Zealand into continued high prices when cost based interconnection/termination rates would allow retail pricing to drop and result in significantly increased voice & SMS utilisation and much greater data usage.

### **ISSUE 1: INCUMBENTS' EXCLUSIONARY, ANTI-COMPETITIVE ABUSE OF MARKET POWER.**

#### ***Interconnection is at the heart of Competition in Telecommunications***

23. It is commonly accepted that where incumbents have monopolies there are powerful incentives to charge monopoly prices. The harm of this in telecommunications networks is greater than other industries as it prevents any-to-any connectivity and full utility of services.
24. Incumbents' setting their prices well above cost doesn't just earn them monopoly profits. It chokes off competition downstream. That's not our opinion, that's a fact. That's why mobile termination has been regulated for years in nearly all OECD countries.
25. Termination rates are regulated in the following OECD countries: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, the United States and the United Kingdom.
26. In fact, there are only three OECD countries without regulation - Mexico, the Slovak Republic and New Zealand.
27. Australian termination rates have been regulated since 1997. Australia also has specific competition rules that the ACCC can directly enforce.

#### ***The ability to terminate calls opens up competition***

28. When interconnection/termination prices so manifestly exceed costs there cannot be proper, efficient competition:
- (1) Excessive termination rates set an artificially high floor on the price of off-net calls.
  - (2) They also result in new entrants paying a tax to the incumbents.

29. This is well recognised internationally as we have submitted. In fact, Vodafone actually admits this. In footnote 10 of their 28 July submission they state, in relation to prepaid customers, that:

*“these consumers generate large termination revenues for mobile operators”.*

30. Name me one other business sector where dominant incumbents offer wholesale services to their competitors in such a way as to keep the competitor’s retail prices artificially high and then have the audacity to say they fully deserve to be subsidised by new competitive entrants.

31. So, again, to be clear, we are not asking for a favour. However, it does appear that our competitors are.

32. And when challenged, our competitors have the further temerity to suggest that we are employing “Public Relations” or “Marketing tactics” when we object to paying these monopoly rents. This is clearly absurd and quite revealing of the weakness of their own position. However, it is an insidious and damaging accusation to make to an ill-informed politician, journalist, consumer or business customer.

33. But high termination rates do another insidious thing. They give an artificial basis for charging a user more to call users of other networks. You hear about on-net discounts. They aren’t **discounts**. They are, instead, expensive and artificial **penalties** put in place to call users of other networks.

34. That behaviour is anti-competitive, exclusionary, and an abusive, significant use of the dominant market position they have achieved in over 15 years of business. It results in locking out new competitors in a highly anti-competitive way.

## **ISSUE 2: INCUMBENTS’ THREATS TO INCREASE PRICES OR REDUCE INVESTMENT.**

***Threats to increase prices or reduce investment are false threats, at best.***

35. Threats to increase prices or reduce infrastructure investments are idle threats and irrational. That’s not how markets work.

36. Our competitors seem to use scare tactics. They are effectively saying:

- (1) regulation will mean they have to raise prices;
- (2) regulation will mean that some marginal customers will miss out;
- (3) regulation will mean they invest less over time.

***Only True Monopolists Make Good on Those Types of Threats.***

37. In reality, the only players who can make good on those kinds of threats are monopolists. A monopolist can slow infrastructure investment, stop improving quality and keep prices artificially high. However, a serious competitor is forced to develop new products and improve quality of service to win customers.
38. In fact, we would suggest that our competitors advanced their network investments and lowered prices in anticipation of 2degrees market entry. Their false threats are aimed squarely at derailing this process and an attempt to try to curry favour and sympathy from ill-informed politicians and other key influencers.
39. I would challenge anyone to find one industry where players respond to competition by charging more or innovating less. You will find none that are truly competitive.
40. On the contrary, in North America, we did not see substantial shift to innovative digital telecommunications services until the breakup of the monopoly in 1984, a full 10 years after the technology was available. The monopoly provider delayed innovation until it was broken up and had no choice.
41. Further, North America did not see a dramatic shift in the mobile wireless price-value proposition until the wireless duopoly was broken post-1996. Shortly after the duopoly was broken, US\$40.00 bought consumers about 1000 minutes of voice use as compared to the prior duopoly environment of 100 minutes of use. Today that same US\$40.00 brings unlimited voice services in major urban areas.

***Let's talk about investment threats and bribes.***

42. You hear a lot from the incumbents about how much they are investing, but don't forget that they are able to invest from the profits they make from consumers who are paying too much, not from fresh shareholder capital. Furthermore, investment in mobile services in New Zealand has been among the lowest in the OECD.
43. When the incumbents argue that regulation is a theft of property rights, please don't be fooled. There are no property rights to extraordinary monopoly profits. Those profits have come from the long over-paying and sorely under-served consumers, and from cross-subsidies by competitors, not from aggrieved investors.
44. Our competitors have frequently rolled out arguments that any form of regulation will create uncertainty or threatens their infrastructure investment.
45. These threats of reduced investment are once again simply idle threats and quite obvious scare tactics meant to dissuade ill-advised politicians. They are simply not borne out by the facts. They are also counter-intuitive: ***What rational business person responds to increased competition by investing less, reducing services and slowing innovation?***

46. We've noted in our submissions the following:
- (1) Vodafone's huge investments in the US, India and elsewhere with very low mobile termination rates,
  - (2) Vodafone has sought zero termination rates in Qatar.
  - (3) The NZ Herald article reporting that Vodafone and Telecom New Zealand earned over \$2.4 billion in the last decade in mobile termination payments from landline customers alone, ensuring that incumbent infrastructure has been fully "*paid for*" out of monopoly bottleneck profits earned from New Zealand consumers.
47. Telstra Clear also dismissed these arguments in the fixed to mobile investigation four years ago, commenting that it was:
- "...not aware of any evidence that regulation of 2G or 3G fixed to mobile termination has adversely impacted on 3G mobile network investment. Neither Telecom nor Vodafone has provided any evidence, despite Vodafone operating in a number of markets where such regulation has been introduced. Nor is there any evidence to suggest that 3G mobile investment decisions in New Zealand are being negatively impacted by regulation, or the prospect of regulation..."*
48. The incumbents again are arguing for a *subsidy*, this time from us, their new direct mobile competitor. **So rather than us asking for help, it is the incumbents who want us to help them. And, sadly, it is the consumer that pays unfairly. Arguments about reduced investment simply are not credible.**

### **ISSUE 3: THE COMPETITIVE IMPACT WE'VE HAD AND EXPECT TO HAVE WITH REGULATION.**

#### ***Introduction***

49. Technology and innovation are seen as critical, e.g. the government's current broadband initiative. But we are deprived of the benefits of robust competition in the mobile sector. As the Commission has highlighted, New Zealand has seen limited utilisation and poor service. New Zealand is lacking the technology, product and service innovation that follows robust competition.
50. New Zealand is ready for lower priced voice and SMS services with any-to-any connectivity.
51. In addition, the market is hungry for lower priced mobile internet services. The next generation of mobile phones with advanced capabilities to access web-connected services are now widely available. Video to the phone is now available as are mobile wireless connected eBooks, eCameras, and mobile-connected healthcare devices.

52. We need a New Zealand fix to a New Zealand problem under the New Zealand regulatory regime. That regulatory fix must reflect the fact that:
- (1) The New Zealand market is unique by world standards in relation to the combination of high termination rates and exclusionary off-net pricing, which are in no way based on differences in cost. They are demonstrably discriminatory.
  - (2) As Concept Economics have demonstrated, the market is bifurcating into non-competing “closed” networks, the exact opposite of “any-to-any connectivity”.

### **The Future Market and How It Could Evolve With And Without Competition**

#### ***Future One – No Regulation***

54. As our competitors have correctly observed there have been recent indicators of increased competition. In fact, it is no coincidence that these have occurred on the eve of our entry to the market. It is the very threat of real competition that has led to new innovation. After years of cynical gaming of the entry process, our competitors have been forced to change. Even more robust competition will lead to truly sustained innovation not just a spike or short-term surge.
55. If we are artificially restricted to competing with one hand tied behind our backs due to artificially high interconnection/termination prices, it should not be assumed that this recent surge of competition will fulfil its long term promise.
56. The incumbents argue that excessive interconnection prices and closed net pricing have not prevented competition. Of course it has and will continue to constrain. Many potential customers tell us that they like the 2degrees offer but feel tied to their on-network bundles and moreover fear that a 2degrees mobile would force their friends to pay too much to call them.
57. If there is no regulation of interconnection/termination prices, our real and sustained competitive impact will be highly contained and severely limited:
- (1) Excessive termination rates will set a floor for retail consumer off-net pricing destroying the possibility of any-to-any connectivity,
  - (2) Subsequent traffic imbalances will mean that we will subsidise our competitors, paying them a tax to compete with them.
  - (3) It will be unattractive for our competitors’ customers to call 2degrees customers while the incumbents maintain high off-net price premiums that will destroy the utility of 2degrees services over a very short period of time.
  - (4) So New Zealand would retain the cosy, entrenched duopoly of two increasingly closed networks with 2degrees forced to be a fringe player, at best, as it tries to create a third closed network.

58. Without interconnection/termination regulation there is a real risk that 2degrees would be forced to be, at best, a “tamed, unthreatening dwarf”, of a marginal niche player.
59. At worst, we could suffer the fate of one of our shareholders’ investments in Slovenia where the same conditions forced an expensive exit. Trilogy International was forced to foreclose a US\$200 million investment in Slovenia when high interconnection/termination prices and off-net penalties by the incumbent prevented competition from taking hold. The government failed to exercise its obligation to intercede in an expeditious and timely fashion.
60. We want nothing more than the opportunity to aggressively compete for customers with innovation, quality of service and best value for the dollar. This is what New Zealanders desperately want and richly deserve in these trying economic times.
61. However, when it is so expensive for our customers to call off-net and so expensive for the incumbent’s customers to call ours, it will make it artificially impossible to properly compete.
62. Without regulation we will be marginalised and incapable of attracting the magnitude of new investment dollars needed to bring new next generation web-connected services, new coverage, new innovations and better services at lower prices.

### ***Future Two – Regulation***

63. If there is proper regulation, the incumbents will be forced to set interconnection/termination prices at proper cost based levels.
64. “Any-to-any” connectivity will become real for New Zealanders, 10 years after the Fletcher Report identified it as vital.
65. Proper cost based pricing of interconnection/termination rates will have impacts across the whole of the *telecommunications* market (i.e., not just mobile) rather than just in the small market niche we are in today.
66. In fact, it will have broader impacts across the entire economy as the Commission has pointed out in its *Guide to Regulatory Decision Making by the Commerce Commission for the Telecommunications Sector Discussion Paper 31 July*.
67. Proper cost based pricing of interconnection/termination will force all players to offer better value or lower prices, develop new products, improve quality of service and invest in a sustainable way for the long-term benefit of all segments of New Zealand users.

***To summarize and close.***

68. New Zealand needs the benefits and productivity gains from a healthy, more robust and more competitive telecommunications industry.
69. We simply want the ability to compete unconstrained by damaging monopoly behaviours.
70. We do not expect to receive subsidies from other operators' customers.
71. Nor do we expect to have to subsidize our competitors for the privilege of competing.
72. We expect to pay for access at cost and no more, so that as a competing network we can compete on our innovation and service merits alone.
73. The incumbents have never attempted to properly justify costs – just game the process.
74. Timely regulation is urgently required to allow the seeds of competition to grow and flourish for the benefit of all New Zealanders.