



**CROSS-SUBMISSIONS TO THE COMMERCE COMMISSION IN RELATION TO MTAS  
SCHEDULE 3 DRAFT REPORT**

**18 August 2009**

**Public Version  
(There is a Restricted Version)**

## Table of Contents

1.	Executive Summary	2
2.	On/Off net pricing: the August 2009 submissions on restricted data	5
3.	Firm action needed	5
4.	No differentiation between FTM and MTM rates	6
5.	Setting the MTR rates and the rates for the counterfactual	7
6.	Incentives to invest	9
7.	Glidepaths	10
8.	Telecom's Undertaking is for more than 9 cpm (Aust)	11
9.	Call set up costs – second/minute + second	11
10.	Internationally originated calls to NZ mobiles	16
	Appendix - Case Study on CallPlus	23

### 1. Executive Summary

#### **Our starting point: new information confirms the severity of market failure**

- 1.1 We start our submission with one of the most significant developments in this investigation: the data made available by Telecom and Vodafone in answer to the questionnaire. The data and its analysis show the severity of the market failure, which impacts beyond mobile services, through to fixed line and NGN investment.

#### **Strong measures required: regulating the termination rate is not enough**

- 1.2 The severity of the problem calls for strong measures. Regulating the termination rate, critical though it is, only tinkers with the problem. Without more (such as a margin squeeze imputation test to deal with on/off net pricing), the severe problems will remain.

#### **The risk of under-regulation considerably exceeds the risk of over-regulation**

- 1.3 Incumbents note that regulators should be conservative as to the level of regulatory intrusion (such as in relation to rates and glide paths) in view of the potential negative impact on networks and consumers.
- 1.4 What firmly emerges is that these statements come from the perspective of the negative impact on incumbents.
- 1.5 Little account is taken of the negative impacts of reduced regulation on other stakeholders.
- 1.6 However, in this market, with its severe failure, the risk of overly intrusive regulation (from an incumbent's perspective) is much less than the risk of inadequate regulation.
- 1.7 The severe market failure calls for robust regulation, and for the Commission to take into account the adverse impacts if this does not happen. In doing so, it can balance the benefits of robust regulation against the impact on incumbents. However, the negative impacts on incumbents should be considered only insofar as those impacts in turn demonstrably negatively impact end users.

### **Outcomes**

- 1.8 The severity of the problems drives a need for outcomes such as: lower MTRs; use of median or lower quartile cost benchmarks (not top quartile); shorter glidepaths; second + second, regulation on internationally originating calls, quicker methods to get to a reasonable initial price (as we suggested in our submission on the draft Report); restraints on on/off net pricing etc).

### **The severity of the problems should dominate the approach**

- 1.9 The problems caused by high rates and on-net/off-net pricing (and other strategies) in our view should dominate the approach that the Commission takes on all issues related to this investigation.

### **Cost based benchmarking**

- 1.10 We firmly support the use of cost benchmarks by the Commission, and we summarise why. We also suggest a solution, designed to allay incumbents' concerns, which retains cost benchmarks while allowing use of other benchmark data such as prices. We note again that it is the draft IPP that needs to change, not the currently-used methodology.

### **Pricing methodologies**

- 1.11 We consider that the Commission should be doing a review of the pricing options similar to that being undertaken by Ofcom. The period under review for regulation runs to 2016. It is better to get this important issue right now: delay can be minimised by tight timetables. The severity of the market problems make this even more necessary. We still support the EU LRIC model, and note that 2degrees' proposal that all fixed and mobile calls terminate at 1 cpm – which we support also – is an implementation of Ofcom's mandated reciprocity option.

### **Dynamic efficiencies and incentives to invest**

- 1.12 Telecom and Vodafone – correctly – refer to dynamic efficiencies and incentives to invest as factors to be considered.
- 1.13 Their perspective seems to be, however, their own incentives to invest or, at best, incentives to invest in mobile networks generally.
- 1.14 This is an issue that extends well beyond mobile networks. Mobile termination has substantial effects on investment in fixed services and in investment in the NGN. It is recognised for example that high termination rates are holding back NGN investment.
- 1.15 We illustrate the wider effects using both (a) a case study on CallPlus and (b) the WiMAX spectrum that each of us holds and can use to create facilities-based competition, depending on termination rates.

### **Telecom's 9 cpm (Aust) draft undertaking**

- 1.16 Telecom's offer of the "same" (10.6 cpm (NZ)) is not the same. The offer is based on minute + second pricing. Telecom overlooks the –correct – requirement in the draft report to adjust for sub-60 second calls. This makes a substantial difference.

### Minute + second

- 1.17 Vodafone provides a number of reasons for retention of minute + second. We deal with those reasons.
- 1.18 But the real issue is clear and simple. For the factual (on the investigation) and for the initial price (under the IPP), the approach is **benchmarking**. All or most of the countries being benchmarked use second + second. To benchmark correctly, New Zealand must apply second + second too, both for the factual and for the IPP. The granularity of set up costs is immaterial. It only becomes relevant on a final pricing review under the FPP (that is not an issue until after an Initial pricing determination.)
- 1.19 This international outlier of a debate (resolved years ago elsewhere) seems endless and costly. Costly for providers, the stretched resources of the Commission (which has more important things to do), for consumers presented with limited competition due to the minute-minimum, and for certainty going forward.
- 1.20 Rather than leaving open the issue to deal with on the determination, the issue can be closed out in the definition of the service.

### International origination of traffic

- 1.21 This also comes down to a benchmarking issue. The countries being benchmarked do not differentiate internationally originated (IO) traffic from domestically originated (DO) traffic. Therefore, on a benchmark basis, IO termination on mobile networks should be regulated and priced as termination of DO traffic is priced. Additionally, benchmarked countries generally are GATS signatories which further indicates this approach is correct.
- 1.22 There is a very small incremental cost of IO traffic compared to DO. But this is a level of granularity that is not relevant until a final pricing review.
- 1.23 We provide a detailed analysis and conclude that the GATS instruments require:
- (a) Non-discriminatory supply of IO and DO termination services by NZ mobile providers (i.e. the terms and conditions must be the same or similar);
  - (b) Supply of IO termination services at cost-oriented rates.
  - (c) Governments must ensure that this happens, and the Commission must have regard to those GATS obligations, under Section 19A of the Telecommunications Act.
- 1.24 Using CallPlus as a case study we also show that regulation of IO termination rates encourages NZ facilities-based competition beyond mobile services and fosters wholesale and retail competition for the benefit of NZ end users. Therefore there are New Zealand public welfare benefits (and NZ wealth transfer) even if it is relevant that some benefits from reduced termination rates go offshore.

### Overview of submissions

- 1.25 As well as cross-submitting on the submissions regarding the draft report, this submission deals with the submissions on the restricted data in the

## **2. On/Off net pricing: the August 2009 submissions on restricted data**

- 2.1 We start our submission with one of the most significant developments in this investigation: the data made available by Telecom and Vodafone in answer to the questionnaire; the conclusions reached in the 11 August Concept Economics report; and the 12 August Wigley submission on our behalf. The data shows the severity of the market failure. We deal below, and in the Appendix, with the impact of this problem, beyond mobile services, into fixed line, NGN and international markets.
- 2.2 Our comments in this submission, where they deal with that RI data and the RI submissions on that data, are of necessity made by our nominated counsel, as only he has seen the material.
- 2.3 On that basis we draw the Commission's particular attention to the RI section of the Concept Economics August 2009 report, in addition to the Wigley submission. The severity of the situation is clearly demonstrated in ways that cannot be repeated outside an RI context. Concept's worked up example appears to be a valuable approach, and variations can be modelled and developed by the Commission (this can include modelling based on information not available to our counsel).
- 2.4 The severity of the problem calls for strong measures. This firmly confirms the need for the action sought by us in this and earlier submissions (and the action sought by 2degrees).
- 2.5 This includes the submissions made in our counsel's submission of 12 August 2009, such as a margin squeeze imputation test, and review of termination rates at the level being undertaken by Ofcom (we return to that below).
- 2.6 As we have noted, regulating the termination rate only tinkers with the problem. Without more (such as an imputation test), the severe problems will remain.
- 2.7 The Trilogy submission on the draft report, outlining what happened in Slovenia, illustrates the severity of the problems here.

## **3. Firm action needed**

- 3.1 Incumbents note that regulators should be conservative as to the level of regulatory intrusion (such as in relation to rates and glide paths) in view of the potential negative impact on networks and consumers.
- 3.2 What firmly emerges is that these statements come from the perspective of the negative impact on incumbents, and so they support outcomes such as higher MTRs, longer glide paths, and so on.

- 3.3 No account is taken of the negative impacts of reduced regulation on other stakeholders. Little or no reason is given for this seemingly automatic assumption that excessive regulation is damaging and so regulators should be “conservative” (that is, “conservative” in favour of incumbents).
- 3.4 However, in this market, with its severe failure, the risk of overly intrusive regulation (from an incumbent’s perspective) is much less than the risk of inadequate regulation. We support the 2degrees submission (on the draft report) that there is a tendency to ignore the risks of under-regulation, leading wrongly to outcomes such as higher MTRs, long glide paths, etc.
- 3.5 The severe market failure calls for robust regulation, and for the Commission to take into account the adverse impacts if this does not happen. In doing so, it can balance the benefits of robust regulation against the impact on incumbents. However, importantly, the negative impacts on incumbents should be considered only insofar as those impacts in turn negatively impact end users. Impact on end users must be clearly demonstrated given the severity of the position. No longer should there be a pre-disposition in this specific area to a “conservative” approach. Nor should a “conservative” approach be justified by only limited reasoning. If this involves a move away from what regulators have done elsewhere, the circumstances in New Zealand call for it.
- 3.6 Among other things, the problems shown in the RI data and the submissions on that data show that the Commission should lean toward significantly stronger regulation which has a quicker impact. This drives a need for outcomes such as:
- (a) lower MTRs;
  - (b) use of median or lower quartile cost benchmarks (not top quartile); shorter glidepaths;
  - (c) second + second;
  - (d) regulation on internationally originating calls;
  - (e) quicker methods to get to a reasonable initial price (as we suggested in our submission on the draft report); and
  - (f) restraints on on/off net pricing etc.

#### **4. No differentiation between FTM and MTM rates**

- 4.1 We support Telecom’s submission that FTM and MTM rates need to be linked,<sup>1</sup> for the reasons they give, and for reasons we have already submitted.
- 4.2 Parity between FTM and MTM means also parity of all relevant terms. For example, there would be no parity if FTM is minute + second and MTM is second + second.

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<sup>1</sup> Para 76, Telecom submissions on draft report dated 28 July 2009.

## 5. Setting the MTR rates and the rates for the counterfactual

### Using cost data for the counterfactual and the IPP

- 5.1 Telecom note that the draft IPP requires benchmarking against price, so the use of cost models is not appropriate for the factual assessment (as price not cost is the basis for the IPP).
- 5.2 As we noted in our submissions on the draft report, the draft IPP does not accurately reflect the – in our view, correct – current approach by the Commission to use cost benchmarks. So it is the draft IPP to be remedied rather than the other way around.
- 5.3 It is also said that use of cost models is wrong anyway, and that regulators typically determine a price that is higher than the cost model.
- 5.4 We do not agree, for reasons we have outlined in the submission on the draft report, and in particular in earlier submissions.
- 5.5 In particular, the object of the exercise is now correctly articulated and implemented by the Commission. In calculating the factual for the investigation, and the initial price on a determination, the objective is, by timely and cost-effective means, to estimate what the regulated price would be as a final price under the FPP. This also requires projecting forward to what the estimate would be for the final price under the FPP at the relevant times (in this instance, up to 2016). The projection is not toward a benchmarked price but toward an estimate of the FPP (the benchmarking is just a step in the process). Therefore, existing data, and trends, are used to deduce this.
- 5.6 We have described this as “skating to the puck”. The need to do this is, as we described in earlier submissions, particularly acute for MTRs, given the rapid downward trend in rates by substantial margins, and the large difference between price and underlying cost. Therefore, the use of historical benchmarks must be applied with care, and adjusted to meet forward looking estimates. Simply using historical benchmarks does not achieve the objective and clearly creates major distortions.
- 5.7 Regulators often do not articulate why they have chosen to depart from a costs model, or if they do, they do so in a broad brush way (as ACCC did in its 2009 MTAS decision, uplifting the MTR with a broad explanation confined to a single sentence).
- 5.8 In 2004, ACCC accepted the TSLRIC<sup>2</sup> calculation by WIK, but, again briefly, choose, with little reason (a sentence or two) to uplift the rate beyond the accepted TSLRIC figure. Australia is illuminating for New Zealand because, if a cost model such as TSLRIC is adopted for the NZ FPP (as currently proposed), the Commission does not have the discretion to uplift price for other reasons. The price must be TSLRIC: it cannot be “TSLRIC plus something else”. However, ACCC does have the discretion to go beyond TSLRIC.
- 5.9 Therefore the WIK estimate of TSLRIC, accepted by ACCC in 2004, is the accurate benchmark, not the price itself. The price includes elements that cannot apply here. To confine benchmarking to the price instead of the underlying cost would have the Commission applying the wrong benchmark.

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<sup>2</sup> Called TSLRIC+ in Australia which is equivalent to NZ's TSLRIC.

- 5.10 Having noted this, we accept that the Commission should be able to use benchmarking information such as costs models and prices, and not be limited to either. Additionally, there is some flexibility at present, and this can be made explicit. But there is not enough flexibility to allow significant use of cost models.
- 5.11 Such an approach will ensure the objective noted above is achieved (to estimate, in cost effective and timely manner, what the FPP will be). We suggest that the draft IPP is amended to allow for this flexibility. Additionally the implicit objective could be overtly stated. This can be economically stated in a sentence or two.
- 5.12 Of particular significance now, is that the NZ market conditions, noted above, call for such a robust approach. What other regulators may have considered appropriate in the past will not solve the severe market failure in New Zealand. We welcome the Commission's use of cost models as benchmarks in that context. Such steps will help remove the market failure.

#### **Fuller review of options for price methodologies**

- 5.13 In our submission on the draft report and the submission (dated 12 August) on our behalf as to the RI information, we noted:
- (a) Ofcom is conducting a thorough review of mobile pricing methodologies, addressing 6 options:
    - (i) No regulation;
    - (ii) The equivalent of our TSLRIC;
    - (iii) The equivalent of the EU's LRIC;
    - (iv) BAK;
    - (v) Mandated reciprocity; or
    - (vi) Capacity based charging.
  - (b) the draft report, when dealing with the pricing model, did not address the Ofcom review, these options or the EU LRIC option (although the WIK report touches on LRIC). The draft report quickly went to the TSLRIC/BAK option based on short reasoning (other than more detail in relation to BAK);
  - (c) we supported the EU LRIC approach, noting we would be out of step with latest practice if this was not applied; and
  - (d) the position is severe in New Zealand, as confirmed by the RI data, and the Wigley submission is that options other than the TSLRIC/BAK should be considered.
- 5.14 Having seen the 11 August 2009 Concept report, the severity of the situation is clearer and our views and submission are clearer.
- 5.15 The period under review for regulation is up to 2016 (the normal 5 year period starting in 2011). Decisions are being made now for a long period. We firmly submit that the Commission should consider options in more detail, as Ofcom is doing. Time lost now in doing so (although the Ofcom and other reports

- 5.16 We consider that it is particularly significant that AnalysysMason support such a review. Having identified trends such as fixed-mobile convergence, and IP-based technology, AnalysysMason note in their mobile services report to Ofcom, appended to the latter's report, *Wholesale mobile voice call termination*:<sup>3</sup>

Therefore, Ofcom is rightly investigating the question of what interconnection charging regime is most appropriate for telecommunications services going forward.

- 5.17 We note that there is no such observation in the AnalysysMason report prepared for Vodafone. What is left out of the report commissioned by Vodafone is telling. The AnalysysMason report is narrow in scope. The absence of dealing with this issue may reflect the constraints on their terms of reference from Vodafone. Given the strong attack on the Commission by AnalysysMason, a company which notes its high international reputation and experience, there is concern about the limited scope of the report prepared for Vodafone.
- 5.18 Finally, we note that 2degrees, in its submission on the draft report, proposes fixed and mobile termination rates should all be 1 cpm.
- 5.19 This is the application of the one of the options that Ofcom is seriously considering: mandated reciprocity. We support 2degrees in relation to this option, believing it to deliver strong end user benefits.
- 5.20 This highlights to us that the options raised by Ofcom should be seriously considered by the Commission.

## **6. Incentives to invest**

- 6.1 Telecom and Vodafone – correctly – refer to dynamic efficiencies and incentives to invest as factors to be considered.
- 6.2 Their perspective seems to be, however, based on their own incentives to invest or, at best, incentives to invest in mobile networks generally.
- 6.3 This is an issue that extends well beyond mobile networks. We return to that below.
- 6.4 We deal first with the immediate impacts on mobile networks. The recent RI data, and the August 2009 submissions on it (noted at Para 2 above) demonstrate the severity of the market failure and therefore the reduced incentives to invest on the part of new entrants. This problem is so clear, and the adverse impacts on dynamic efficiency so clear, that the Commission can readily conclude that dynamic efficiency is best served by the more robust regulation that we are seeking. The Commission already has sufficient information to make an assessment on this aspect, which is generally seen as an issue that is driven more by qualitative rather than quantitative considerations.
- 6.5 That position becomes clearer as we move away from the direct impact on mobile networks to the wider telecommunications markets.

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<sup>3</sup> Annex 8.1 to that report.

### **WiMAX, nomadic and wireless services**

- 6.6 First, we are examples of potential providers that cross-over between the fixed and mobile worlds. All of us hold spectrum suitable for WiMAX and other applications, which can be used for nomadic and, increasingly as the technology evolves, mobile services.
- 6.7 Much of the focus in the other parties' submissions is upon 2degrees. But this overlooks the following matters:
- (a) the period under review for regulation is until 2016 (that is, the standard 5 years commencing, as the Commission estimates, in 2011). In assessing the approach, the Commission should have regard to that timeframe;
  - (b) we and others are potential new entrants in the period up to 2016 (the Vodafone submission that there are no barriers to entry as 2 degrees has entered the market is flawed for that reason alone, plus others);
  - (c) we are significantly less likely to enter the market (nomadic and/or mobile) if there is insufficient regulation of the MNO's termination monopoly and on/off net pricing; and
  - (d) that would diminish our incentives to invest and in turn diminish facilities-based competition.

### **Impact on Fixed line and NGN**

- 6.8 What is now apparent however is the negative impact of high MTRs (and related mobile market failures such as on/off net pricing) on dynamic efficiencies, and incentives to invest, in the fixed and NGN environments.
- 6.9 In their major report for the EU, The Future of IP Interconnection, WIK-Consult concluded that high mobile termination rates in a CPNP world, stand in the way of evolution to, and investment in, NGN. For example, at Page XI of the report:<sup>4</sup>

If [mobile] termination fees were to remain at current levels, we anticipate that many mobile operators and some fixed operators might choose not to evolve their networks to IP based interconnection. They might perceive the migration as an unacceptable regulatory risk. Alternatively, they might choose an IP interconnection strategy that attempts to lock in the current inefficient arrangements [CPNP], or a modernized version of them, rather than enabling IP-based interconnection arrangements to evolve in a healthy and natural way. These concerns suggest that waiting for the migration to IP based NGNs to implement changes might be a self-defeating strategy.

### **The CallPlus example**

- 6.10 The case study on CallPlus in the Appendix is an example of the way in which mobile termination rates have an impact beyond mobile services.

## **7. Glidepaths**

- 7.1 Due to the severity of the market failure, we consider that the Commission should take steps now to truncate (or signal truncation of) transition to lower

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<sup>4</sup> See also the ERG November 2008 Report on IP Interconnection.

rates, rather than leaving this to the determination phase. This will help access providers too. The gap between (a) the report and the Minister's decision and (b) the decision on the determination, allows most of a year to enable them to plan for change.

## **8. Telecom's Undertaking is for more than 9 cpm (Aust)**

- 8.1 Telecom bases its draft undertaking on ACCC's decision to regulate at A 9 cpm. They propose a rate of NZ10.6cpm.
- 8.2 However, the pricing model in the undertaking is minute + second.<sup>5</sup> The Commission in its draft report clearly signalled that a minute + second approach would require an adjustment to the rate, for the counterfactual.
- 8.3 There appears to be an oversight by Telecom in not dealing with that matter raised by the Commission, in its submission as to the undertaking.
- 8.4 Once the adjustment is made, Telecom could no longer say that it is simply applying the Australian rate (which is second + second and therefore different).
- 8.5 Each of us provided data about sub-60 second FTM phone calls in earlier submissions, and CallPlus updated this in its submission on the draft report. The CallPlus data indicates that the increased cost of termination would be at least [%]CPRI; VRI. This makes a significant difference to the adjusted rate to be applied in the counterfactual.
- 8.6 We note that the adjustment would be for "at least" this amount. That is because, as we have submitted early on in this MTR process, we expect that similar data from other providers (particularly Telecom) would demonstrate the adjustment would be materially larger. We repeat our submission that the Commission should obtain that data from other providers; from our experience it is readily available.
- 8.7 Of course any other price based on minute + second (such as the rates in the undertakings to the Minister; another draft undertaking; a minute + second ICA rate, etc) needs to be adjusted in this way.

## **9. Call set up costs – second/minute + second**

### **Overview**

- 9.1 In this section we respond to Vodafone's submissions.<sup>6</sup>
- 9.2 In over 10 pages, Vodafone seek to justify retention of the minute-minimum approach. They raise a variety of points that are flawed, often based on supposition, miss the point as to the objective of this investigation and the IPP determination, and ultimately show that minute + second does not reflect call set up cost.
- 9.3 We demonstrate this below by dealing with each of their points. In doing so, and in demonstrating that Vodafone's arguments are not sustainable, we show they support the following conclusions:

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<sup>5</sup> Clause 2.2 draft Telecom Undertaking 28 July 2009.

<sup>6</sup> Para 414-437 Vodafone submissions on draft report dated 28 July 2009

- (a) Vodafone's arguments about call set up cost are for the FPP stage on a final pricing review. It would be incorrect to apply them at the counterfactual and the IPP stages (that is, the investigation and the subsequent determination), even if their points are valid;
- (b) the real relevant issue for this investigation is:
  - (i) getting a price for the factual in this Schedule 3 investigation phase; and
  - (ii) the clearly separate –but overlapping - issue of subsequently determining the price during the IPP determination phase (assuming a cost-based IPP is implemented);
- (c) for both of those phases (factual for the investigation and initial price for the IPP determination), the approach, to get to the relevant figure (the factual and the initial price respectively), is to use **benchmarks** from other countries;
- (d) nearly all those benchmarks (whether in or out of the benchmarks currently used by the Commission in its draft report) are second + second with no flag fall charge;<sup>7</sup>
- (e) as they are second + second, the factual (and the initial price under the IPP) should be second + second. There is no unique New Zealand reason to have a different regime, so moving from second + second would be erroneous;
- (f) there may be further submissions on our behalf on this issue in submissions on the confidentially-available ICAs, due on 20 August. If for example, the ICAs show a trend to second + second for MTM termination, it is essential that FTM is also second + second. We agree with Telecom's submission, on the draft report, that MTM and FTM MTRs must be linked;<sup>8</sup>
- (g) including a minute-minimum artificially increases the price relative to the benchmarks. This in turn would require an artificial drop in the price in both the factual and the IPP, to achieve benchmarked parity, as the Commission has pointed out in the draft report. That is an artificial workaround, for which there is no need or any justification. (Further, minute-minimum constrains competitive options in the retail market place);
- (h) if a party is concerned that the benchmarked initial price is too high under the IPP, as second + second does not recover costs, it can seek final pricing under the FPP. Most importantly, this is when the detail about actual call set up and other cost becomes relevant. Not before. The investigation and the IPP are deliberately designed to avoid having to analyse detail such as specific set up costs;
- (i) this international outlier of a debate (resolved years ago elsewhere) seems endless and costly. Costly for providers, the stretched resources of the Commission (which has more important things to do), for

<sup>7</sup> So far as we are aware, second + second without flag fall is the approach taken in all other major countries being compared with New Zealand, except, perhaps Spain, and, as to Norway, the unconfirmed possibility that their second + second model has a small flag fall charge. Most recently, in 2009 the ACCC reaffirmed the long standing second +second model without flag fall. For further details see the Letter from Bill McCabe to Osmond Borthwick dated 17 September 2008, lodged in relation to national roaming.

<sup>8</sup> Para 76. Telecom notes "they have to be to avoid arbitrage between the two rates".

consumers presented with limited competition due to the minute-minimum, and for certainty going forward; and

- (j) rather than leaving open the issue to deal with on the determination (with the welcome indication that second + second is the Commission's preference), the issue can be closed out in the definition of the service (as a condition under Section 66). For the reasons outlined in this submission, second + second, applying the benchmark approach, is inevitable and therefore should be decided now. This will also assist the access providers by giving them certainty on this issue sooner rather than later, including more certainty in potential negotiations with the Minister, similar to the negotiations that led to the current undertakings to the Minister.

- 9.4 Our submission now deals with the Vodafone submissions on the Commission's draft Report.

#### **Incorrect use of the minute-minimum model to reflect underlying cost**

- 9.5 Vodafone seeks to justify the minute-minimum model based on the underlying cost of call set up.<sup>9</sup> Apart from general assertion and supposition, it provides no quantifiable link between that minute-minimum and underlying cost. That is not surprising. Self-evidently, this "minute" approach is a blunt and arbitrary instrument as a reflection of the complexities of cost.
- 9.6 Further, the minute-minimum model was never developed to reflect the specific cost. It would be a remarkable coincidence if the minute-minimum price, developed without direct regard to actual call set up costs, equated or even came near to the cost of call set up.
- 9.7 Both points throw into doubt the validity of the minute-minimum model. In particular it would be erroneous, applying the international benchmarks, to add the minute-minimum model, when it is not part of those benchmarks (they are almost universally second + second models with no flag fall).
- 9.8 The above conclusions can be concluded, even before Vodafone's submissions on particular points are addressed.

#### **Use by Vodafone of Telecom's data**

- 9.9 Vodafone makes a distinction between "network time" and "conversation time".<sup>10</sup> Network time is the time from the caller pushing the green "send" button to the end of the connection. Conversation time is the time a caller and receiver are connecting to each other.<sup>11</sup>
- 9.10 Calls are billed based on conversation time not network time.
- 9.11 Vodafone relies heavily on the following statement from Telecom's 6 May 2009 submission:<sup>12</sup>

Under the current charging structure, Telecom charges for 1055 seconds for every 1000 seconds of mobile network time used. If

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<sup>9</sup> See for example Para 437 Vodafone 28 July 2009 Submission on MTAS Draft Report.

<sup>10</sup> Para 421 Vodafone 28 July 2009 Submission on MTAS Draft Report.

<sup>11</sup> Absent calls which are disconnected within 2 seconds.

<sup>12</sup> Para 56 Telecom 6 May 2009 MTAS submission; Paras 423, 433 and 436 Vodafone 28 July 2009 Submission on MTAS Draft Report.

successful calls (greater than 2.0 seconds) were charged on a second+second basis and ring time was excluded then Telecom would be charging for 856 seconds for every 1000 seconds of mobile network time used. This shows that the current model is a better reflection of the structure of costs than a pure second+second model.

9.12 This is said by Vodafone to justify the minute-plus model as Telecom charges for 1055 seconds for every 1000 seconds of “network time” (as the 1000 and the 1055 are nearly equal).<sup>13</sup>

9.13 However the reverse is the case. Both Vodafone and Telecom charge, based on “conversation time” not “network time”. We understand the benchmarked pricing is also charged on “conversation time”.<sup>14</sup> Assuming Telecom’s figures to be accurate:

- (a) Telecom should be charging based on the 856 seconds (the “conversation time” billed in the benchmarked countries); and
- (b) Telecom is overcharging, relative to benchmarks, 23.2% (based on the difference between the 1055 and the 856 seconds).

9.14 In this regard we note also the CallPlus submission on the draft report<sup>15</sup> that the increased cost of termination due to calls ending within the 60 second minute-minimum period is, for Vodafone [%]CPRI; VRI and for Telecom [%]CPRI; VRI. To the same effect is the data in the CallPlus submissions and the Woosh/Kordia/Orcon submissions, both of 5 September 2008.

9.15 If for some reason, 23% of the charge for a minute (the minimum-minute) is said to represent call set up costs, then on current rates (around 15 cpm) that would be around 3.5 cents for call set up (assuming the Commission’s draft factual of 7.2cpm), this would be around 1.7 cents.

9.16 Vodafone draw a parallel with PSTN termination rates of minute + second. That rate is 1 cpm.<sup>16</sup> This indicates PSTN call set up costs are a small proportion of that one cent. It could never seriously be contended that comparable mobile call set up costs comprise a significant proportion of the initial-minute mobile termination rates, whether around 15cpm as at present or 7.2cpm in the Commission’s draft factual. We expect such costs to be close to PSTN call set up costs. However, as we note above, this is an issue for the final pricing review, not for the investigation or the determination of the initial price.

9.17 Our submission so far assumes that the Commission applies the TSLRIC approach. If instead it applies, as we are submitting, the EU’s LRIC methodology, then the call set up cost is at or close to zero.

9.18 Vodafone also uses the differential between the billing of conversational and network minutes when it, so it says, “suggests”<sup>17</sup> that regulators increase the rate as against underlying cost models, to cater for that differential. We are not

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<sup>13</sup> Para 433 Vodafone 28 July 2009 Submission on MTAS Draft Report.

<sup>14</sup> That point is implicitly accepted at Para 426 of the Vodafone 28 July 2009 Submission on MTAS Draft Report, as Vodafone assume in that paragraph that benchmarked pricing is billed on conversation not network minutes.

<sup>15</sup> At Para 3.2 and Appendix A of that Submission.

<sup>16</sup> BAK for local calling.

<sup>17</sup> Para 426 Vodafone submission on Draft Report dated 28 July 2009.

aware of any regulator attributing uplift to this factor, and the suggestion clearly draws a distant and unsustainable inference.

#### **Retail pricing for mobile termination**

- 9.19 Vodafone notes that New Zealand retail pricing for mobile termination revolves around minute + second.<sup>18</sup>
- 9.20 However, In New Zealand, underlying termination rates drive retail pricing, and in ways which reduce competitive options (i.e. no lessons can be drawn, as to wholesale rates, from the retail plans, save for the important point that minute + second reduces competitive options in the retail market).

#### **Vodafone's "Factors to Consider"**

- 9.21 At Paras 430 to 433, Vodafone raise factors to consider without seeking to quantify or identify the magnitude of the factors. However the detail discussed around (a) designing a "green fields" model to reflect actual cost and (b) issues as to disruption and costs for customers and network operators, is not relevant to:
- (a) the factual for the investigation; or
  - (b) the interim price, under the IPP, on a determination.
- 9.22 That material is for the final pricing review under the FPP. This is irrelevant for current purposes. The information is sketchy in any event.

#### **Termination rates other than mobile**

- 9.23 Vodafone argue that PSTN and mobile rates are converging such that mobile rates will drop, thereby increasing the conversation minutes relative to network minutes. For reasons that are hard to follow, it is said that minute + second rates will thereby converge with second + second rates.<sup>19</sup> Whatever the reasoning, the reality is that mobile termination rates, would, if TSLRIC-based benchmarking is applied, appear set to vary from PSTN termination rates by a considerable margin.
- 9.24 Similarly, the fact that operators face other origination and termination costs does not appear to be material, if only because mobile termination rates would substantially exceed PSTN and other termination cost.<sup>20</sup> It also cannot be concluded, from PSTN minute + second termination rates (at 1 cpm where BAK does not apply) that there will be no pass-through of reduced cost due to second + second MTRs.
- 9.25 But in any event, these issues do not impact the issue for the Commission: benchmarking for the factual and the initial price on the IPP determination.

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<sup>18</sup> Paras 428 and 429 Vodafone submission on Draft Report dated 28 July 2009.

<sup>19</sup> Para 434 Vodafone submission on Draft Report dated 28 July 2009.

<sup>20</sup> Para 435 Vodafone submission on Draft Report dated 28 July 2009.

## 10. Internationally originated calls to NZ mobiles

### Introduction

10.1 In this section we respond to Vodafone's submission that internationally originated (IO) calls should not be regulated.<sup>21</sup>

### Scope of the investigation

10.2 We agree with Vodafone that:<sup>22</sup>

- (a) there are two categories of call:
  - (i) calls to MSRN ranges (i.e. calls to visiting international roamers); and
  - (ii) international direct dial (IDD) calls, where an international A-party dials a New Zealand mobile number. (This is the same type of call as a call to a mobile number where the A-party is New Zealand based, which is an FTM MTAS service: the call is handed over to the terminating MNO at the New Zealand-based point of interconnection); and
- (b) these two categories need to be treated separately.

10.3 The first category (calls to visiting international roamers) is out of scope for this investigation, as it was for the ACCC MTAS review. Therefore, it is not necessary to consider Paras 454-457 of the Vodafone submission.

### Benchmarking

10.4 As with call set up costs, all of Vodafone's submissions are answered by the nature of the current investigation. It is to determine the position, including the including the wording of the IPP, based on the international **benchmarks**.

10.5 We are not aware of any country, against which New Zealand is being benchmarked, (whether inside or outside the 9 countries used in the draft Report), where:

- (a) internationally originated calls to mobile networks are priced any differently than domestically originated calls to the same network; and
- (b) the prospect of differential pricing of internationally (IO) and domestically (DO) originating calls has been an issue of recent times.

10.6 Like call set up costs, Vodafone is running an international outlier of an argument, which has been resolved elsewhere a long time ago.

10.7 The Commission should apply the benchmarks and approach potential regulation, in the same way as other benchmarked countries (treat IO and DO mobile termination the same).

10.8 A recent example is Australia. Although the service there is called the Domestic MTAS service, it in fact applies equally to IO calls where the call is handed over in Australia to the terminating MNO.

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<sup>21</sup> Paras 442-463 Vodafone submission on Draft Report dated 28 July 2009.

<sup>22</sup> Para 452-457 Vodafone submission on Draft Report dated 28 July 2009.

- 10.9 Termination of IO traffic on New Zealand fixed line networks is at the same price as fixed line DO termination. We cannot understand how it can be contended that mobile termination should be any different.
- 10.10 Particularly significant is that many of the benchmarked countries are GATS signatories, and they handle internationally originating calls the same way as domestic calls. For New Zealand to do otherwise would be out of step with its fellow GATS signatories. That is a consideration as the Commission has regard to the Ministerial Statement.

#### **Additional costs for IO calls**

- 10.11 We agree with Vodafone's submission that IO calls require more national transit on the terminating MNO's network than DO calls.<sup>23</sup> Calls arriving at the Auckland MSC are transported throughout the country, whereas DO calls go to one of three MSCs (Wellington, Auckland or Christchurch) and often terminate closer to the area where they were handed over.
- 10.12 However, we note:
- (a) relative to mobile termination rates, this cost is very small (assuming a TSLRIC approach: if the EU's LRIC approach applies, it is close to nil or nil);
  - (b) calls arrive at Auckland, which is the most densely populated area, reducing the additional transit significantly (that MSC covers the area down to Taupo so a large proportion of calls are handed over with no incremental transit);
  - (c) a country the size of Australia has found no need to have differential rates for IO and DO call termination, and that is the case even after a full costs review similar to an FPP review. So why does NZ need a different rate?;
  - (d) to differentiate on this basis is to depart from GATS obligations;
  - (e) most importantly, as noted above, this is a benchmarking exercise and the international benchmarks do not differentiate IO and DO calls;
  - (f) we estimate the cost of backhauling traffic nationally would be no more than 0.1-0.2 cents per minute (assuming the EU LRIC model is not applied). Furthermore this only affects some calls and relates only to the cost of transit between main centres Auckland to Wellington, and Auckland to Christchurch. These are large (and therefore cheaper circuits. (Once the call reaches Wellington or Christchurch, the circuits used are the same as DO calls) ; and
  - (g) any cost will be marginal relative to termination rates, regulated or not.
- 10.13 Implicitly, Vodafone agrees with us that additional national transit charges should not be paid. Vodafone does not accept Telecom's position with respect to fixed line operators facing a transit cost of taking a call from, for example, a fixed line in Dunedin to the Christchurch MSC. Yet, by the same logic, that call is more likely to terminate closer to Dunedin than Christchurch. In similar

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<sup>23</sup> Para 453 Vodafone submission on Draft Report dated 28 July 2009.

circumstances, it is arguing it should not have to pay for incremental cost of national transit.

## GATS

### Introduction

10.14 Vodafone argues that GATS does not support regulation of IO termination, nor pricing of IO termination at or near DO termination rates. We do not agree. There are substantial errors in Vodafone's interpretation and application of GATS. It is necessary to deal with those errors in some detail.

### Summary as to GATS

10.15 The GATS instruments require:

- (a) non-discriminatory supply of IO and DO termination services by NZ mobile providers (i.e. the terms and conditions must be the same or similar);
- (b) supply of IO termination services at cost-oriented rates; and
- (c) governments must ensure that this happens, and the Commission must have regard to those GATS obligations, under Section 19A of the Telecommunications Act.

### Vodafone's approach

10.16 Vodafone incorrectly outlines the effect of GATS as to termination of IO calls to NZ mobiles, relative to DO calls to NZ mobiles. In doing so, Vodafone has confused provisions in GATS, and not referred to the relevant requirements. It is therefore necessary to clarify the various applicable instruments within GATS, and then deal with Vodafone's submissions.

### Overview of the GATS telecommunications instruments

10.17 There is no single document, under the General Agreement on Trade in Services, (GATS), that deals with telecommunications. There are three key documents related to the main GATS document, as follows:<sup>24</sup>

- (a) under the GATS, there is the *Annex on Telecommunications*, often known as the Basic Telecommunication Agreement;<sup>25</sup>
- (b) an instrument with binding effect is the *Reference Paper on Regulatory Principles*: this supplements the Annex on Telecommunications;<sup>26</sup> and
- (c) each State makes specific commitments to GATS, by lodging, with WTO, its *Schedules of Specific Commitments*. These qualify and describe the way in which the State applies GATS. New Zealand has lodged a

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<sup>24</sup> For useful summaries, see (a) the WTO summary on Telecommunications services at [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/telecom\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm) and (b) <http://www.ispa.org.za/regcom/advisories/advisory6.shtml>.

<sup>25</sup> A copy is at [http://www.wto.org/english/tratop\\_e/serv\\_e/12-tel\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/12-tel_e.htm). This is implemented by the Fourth Protocol, a copy of which is at [http://www.wto.org/english/tratop\\_e/serv\\_e/4prote\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/4prote_e.htm).

<sup>26</sup> A copy is at [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/tel23\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm).

Schedule of Specific Commitments with 2 Supplements. The First Supplement is relevant to telecommunications.<sup>27</sup>

- 10.18 A Member (that is, a State) has, contrary to Vodafone's submission,<sup>28</sup> obligations beyond duties to other Members. It also has obligations to individual suppliers as well.

#### **Commitments in the Annex on Telecommunications**

- 10.19 For example, under the Annex on Telecommunications, the State (New Zealand in this instance) must, as the draft report notes, provide reasonable and non-discriminatory access to mobile termination services. "Non-discriminatory" in this context is stated to include providing "terms and conditions no less favourable than those accorded to any other user of like public telecommunications transport networks or services under like circumstances". This includes provision of mobile termination services.<sup>29</sup>
- 10.20 Contrary to Vodafone's submission, this commitment, which is the commitment referred to in the draft report, is not subject to New Zealand's competition policy. The "essential facilities" exception, referred to below, and in Vodafone's submissions at Para 450, does not apply to the requirements in the Annex on Telecommunications.

#### **Reference Paper on Regulatory Principles**

- 10.21 This is binding on New Zealand, as it is incorporated in the text of the 1st Supplement to New Zealand's Schedule of Specific Commitments.
- 10.22 There is the alteration, which Vodafone notes, to the application of the Reference Paper to New Zealand. The definition of "essential facilities" is qualified<sup>30</sup> to apply "only to the extent consistent with New Zealand's competition policy regime, which regulates the activities of "dominant suppliers"".
- 10.23 However, this qualification does not affect the relevant obligations under the Reference Paper.
- 10.24 In particular, "essential facilities", and therefore the qualification of "essential facilities", do not limit the Interconnection obligation in Clause 2. Under Clause 2.1, mobile termination services (both IO and DO) are services covered by the interconnection obligation. For this obligation to apply, the service provider must be a "major supplier" as defined in the Reference Paper. A terminating mobile operator (particularly as it has a termination monopoly or is otherwise dominant in relevant markets) is a "major supplier" as it has "the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market....as a result of ....use of its position in the market".<sup>31</sup>
- 10.25 This means that under Clause 2.2, terminating mobile operators in New Zealand must provide:

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<sup>27</sup> These schedules are available at [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/telecom\\_commit\\_exempt\\_list\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_commit_exempt_list_e.htm) and then select the relevant Schedule and the First Supplement: [GATS/SC/62/Suppl.1](#).

<sup>29</sup> Clause 5 of the Annex on telecommunications (quoted at footnote 433 of the Commission's draft report). Clause 5 refers to networks and services, as defined in Clause 3, which includes mobile termination. The Annex at footnote 1 describes "non-discriminatory" consistently with the position outlined above. The explanation of "non-discriminatory" is at Note 1 in the Annex.

<sup>30</sup> At Footnote 2 in the 1<sup>st</sup> Supplement to the Schedule.

<sup>31</sup> Limb (a) of the definition, referring to "essential services" does not apply to Limb (b).

- (a) IO termination “under non-discriminatory terms, conditions,....and rates and of a quality no less favourable than that provided for ,”like services of non-affiliated service providers...”; and
- (b) IO termination “....on.....cost oriented rates that are transparent [and] reasonable, having regard to economic feasibility....”.

10.26 Additionally, the exception to “essential facilities” does not limit the anti-competition prevention obligations in Clause 1 (which includes restraint on anti-competitive cross-subsidisation).

#### **The role of the Commission**

10.27 In making its recommendation, the Commission must have regard to the statement of economic policy in relation to GATS. For the reasons outlined in this submission, it can and should implement the requirements of GATS while still complying with the sections 18 and 19 requirements. Additionally, where there is discretion or doubt, the Commission should apply the GATS instruments in favour of the same or similar treatment of IO calls. For example, as the benchmarks from GATS countries are the same for DO and IO calls, it would be consistent with the sections 18-19A to have the same rate here for DO and IO calls.

10.28 For example, IO and DO calls, just like other countries with GATS obligations, should simply be treated in the same way, as part of the same service (and not seek to distinguish it as Vodafone seeks to do). They are in fact nearly identical services with the very small difference that one involves more national transit than the other. But this is a level of granularity at this benchmark stage, and there may well be other countervailing cost savings, or other factors, which, in the round, indicate that other countries correctly treat them as the same from a pricing perspective.

#### **Long term benefit of end users of services in New Zealand**

10.29 Vodafone contends that, as benefits flow out of the country (particularly to the overseas carrier and/or its customer), there is insufficient benefit to end users in New Zealand, and the service should not be regulated.

10.30 As noted above, we do not consider IO calls should be treated separately from DO calls, in line with other countries.

10.31 However, if it is to be treated separately, there are factors beyond some of the termination rate reductions going to offshore providers and/or their calling customers.

10.32 To deal with the position raised by Vodafone’s submission, it is important to be clear about the nature of the service under review. MTAS is a service that carries traffic (whether IO or DO) from a New Zealand-based MSC to a New Zealand-based mobile end user.

10.33 Vodafone chooses to use the example of a call from a US mobile customer of AT&T to a New Zealand mobile customer, for which the charge is US\$3.75 per minute.<sup>32</sup>

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<sup>32</sup> Para 460, Vodafone submission on Draft Report dated 28 July 2009.

- 10.34 The end to end service will be provided via inputs from multiple carriers, of which one input is the termination input between the NZ MSC and the mobile call receiver.
- 10.35 Carriers are able to compete for that traffic, frequently providing a service that bundles in the input which carries traffic from the MSC to the mobile call receiver.
- 10.36 Vodafone, for some reason, has used as its single example (to demonstrate that there would be no pass through, for example), one of the most expensive calls (US mobile to US mobile at \$US3.75 per minute). However most IO calls, including from fixed line, will be far cheaper than this outlier. Competition, such as from calling cards, results in carriers having much lower prices and therefore lower margins. Generally, those services will reflect the cost of the inputs, and are more likely to do so in overseas markets where, typically, competition is stronger. It can be expected therefore that a reduction in one of the inputs - termination within New Zealand - will be reflected in the international carriers' pricing over time.
- 10.37 Vodafone submits that New Zealand is such a small part of the market that a drop in termination rates will not be passed through to A-Party customers.<sup>33</sup> However:
- (a) carriers work out their pricing for each destination individually, taking into account the cost of the inputs into the service. Over time, the retail price changes to reflect the cost of supplying the service;
  - (b) many calls are much cheaper than the outlier example given by Vodafone, meaning that international competition will drive reduced prices;
  - (c) this is a two sided market with the New Zealand market. New Zealand call receivers benefit from reduced overseas prices (New Zealanders will receive more calls, including, for example, more business calls which in turn generate New Zealand economic benefits); and
  - (d) Vodafone's submission that regulation of termination of IO calls does not benefit New Zealand end users, overlooks the structure of the international telecommunications markets, the benefits for New Zealand end users of competition between carriers in providing IO services, the role of termination within the wider array of services offered by providers, and the current and potential role of New Zealand carriers in providing international services. We use CallPlus as a case study to demonstrate this.
- 10.38 The CallPlus case study is in the Appendix.

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<sup>33</sup> Para 460-461 Vodafone submission on Draft Report dated 28 July 2009.

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## Appendix - Case Study on CallPlus

### Overview

1. Vodafone submits that regulation of termination of IO calls will not benefit New Zealand end users. Therefore the MNOs' termination monopoly should be unconstrained. In response to Vodafone's submission, it is necessary to deal with wider benefits of IO termination rate regulation. In this case study we demonstrate that regulating IO termination rates:
  - (a) facilitate significantly greater competition in New Zealand wholesale and retail telecommunications markets;
  - (b) removes barriers to entry and expansion;
  - (c) aid the development of facilities-based competition;
  - (d) are in the interests of the New Zealand market, in the wider context of telecommunications services, particularly as (i) services and relationships between New Zealand and overseas carriers are interwoven, and (ii) the ability to develop stronger competition depends on a range of services being available at competitive rates, this being adversely affected by unconstrained mobile termination rates for inbound IO calls; and
  - (e) benefits New Zealand providers (wealth transfers between New Zealand providers – in addition to public welfare - is an appropriate consideration as the Commission decides whether to recommend regulation).

### **CallPlus: from reseller to carrier with switches and a domestic and international network**

2. CallPlus' business has evolved from a straight reseller to a much larger and multi-faceted business. CallPlus started to build out its network, from 1999, with points of presence both domestically and, later, internationally. A robust regulatory framework is essential to enable it to grow and build infrastructure, and provide greater competition in the wholesale and retail markets.
3. Nationally, CallPlus has built out to the 24 points of interconnect offered by Telecom. This network and infrastructure offers significant savings in the cost that CallPlus incurs in transiting calls.
4. In addition CallPlus has established off-shore Points of Presence (POPs), along with international backhaul arrangements, in order to establish direct interconnections with a number of overseas carriers. This is designed to:
  - (f) reduce the cost to CallPlus of using a carrier, such as Telecom, to terminate calls originating in New Zealand and terminating overseas by doing this directly;
  - (g) enable CP to offer New Zealand termination services to domestic and overseas carriers in competition to Telecom, Vodafone and others; and
  - (h) achieve economies of scale on its network.

5. This has enabled CallPlus to build its wholesale business in competition with Telecom and others. A significant portion ([ ]%CPRI) of CallPlus' network minutes are from wholesale traffic.
6. As is outlined below, being able to provide a range of services (for example, both fixed and mobile termination) is key to CallPlus' ability to develop and offer wholesale services.
7. When CallPlus enters an agreement with an overseas carrier to terminate traffic in New Zealand, the following applies:
  - (i) almost invariably CallPlus will terminate both fixed and mobile traffic for that carrier;
  - (j) CallPlus buys the termination service from each of Vodafone and Telecom to carry the IO traffic from the New Zealand based MSC to the MNO's end user;
  - (k) that IO MTAS service is of course unregulated, and Telecom and Vodafone each have termination monopolies: currently Telecom charges 24cpm to terminate and Vodafone charges 15cpm. With number portability, CallPlus is unable to accurately pass through this differential cost in the price it charges overseas carriers as they do not know whether calls terminate on Vodafone or Telecoms network. Number ranges – 021 and 027 – are an increasingly poor approximation. CallPlus carries the risk arising out the price differential;
  - (l) the call termination (i.e. between the New Zealand MSC and the end user) is only one wholesale input into the overall service provided by CallPlus. For example, CallPlus supplies services by which traffic is carried from another country to fixed and mobile end users in New Zealand. MTAS (between the New Zealand MSC and the New Zealand end user) is an input it buys to be able to provide the end to end service;
  - (m) the unrestrained termination pricing impacts the price at which CallPlus can offer the end to end service;
  - (n) Vodafone and Telecom can undercut CallPlus in the market for services to offshore carriers, by reason of their ability to rely on their termination monopoly and the fact that the wholesale rate CallPlus must pay substantially exceeds cost (we have seen instances where we would not be able to compete for this reason);
  - (o) because of this, CallPlus is constrained in its ability to provide services to overseas carriers; and
  - (p) this reduces competition and creates barriers to entry and expansion.

### **Reduce the cost of outbound termination for calls originating in New Zealand**

8. One of the main reasons for investment in establishing overseas points of presence and direct interconnects with international carriers is to achieve significant savings on the cost of terminating international calls (that is, calls originating in New Zealand and terminating overseas).

9. CallPlus also competes in the domestic wholesale market and provides an out-bound international termination service to a number of tier 2 operators.
10. CallPlus achieves significant savings through the lower cost of sending calls to overseas destinations, as a result of not having to pay Telecom to carry and terminate this traffic. Callplus estimates that it saves  $\square\%$ CPRI by using its network and relationships, compared with carrying the same traffic via Telecom.
11. As a result CallPlus has a substantial wholesale business in competition with Telecom and other providers. New Zealanders benefit from the wholesale competition as a result of CallPlus, and its wholesale customers, being able to offer lower international calling rates to their retail customers.
12. However in order to offer this service CallPlus needs to be able to:
  - (q) offer inbound and outbound services (both fixed and mobile) to the overseas carrier:
    - (i) typically, as Telecom note in their submission of the 6th May 2009 Para 71, these deals are bilateral and involve traffic both outwards and inwards. Clearly it is inefficient (to both CallPlus and the overseas carrier) to create direct interconnects for traffic in only one direction; and
    - (ii) furthermore overseas carriers seek to establish direct interconnects with carriers that can offer a single point for termination for different types of calls across all domestic networks (fixed, mobile, etc). In order to compete in the international wholesale market, a carrier, such as CallPlus, needs to offer fixed services and mobile termination services for all networks. It is inefficient for an international carrier to establish links with a domestic carrier that is restricted in the type of service and/or network on which it can offer to terminate calls. In fact with the advent of fixed and mobile number portability it is impossible for an overseas carrier to selectively route traffic destined for a particular network.; and
  - (r) in addition, CallPlus needs to recover the costs of an overseas POP and international backhaul arrangements. These costs need to be recovered from the revenues and saving generated by the traffic flowing in both directions. Inbound New Zealand mobile termination is a significant component of this recovery given the higher cost and margin of these calls when compared to fixed traffic.
13. To be restrained from competing for internationally originating mobile termination, in view of unconstrained and high termination rates (such as Telecom's of 24 cpm compared to the undertakings rate of 15cpm which itself exceeds cost) would create a significant barrier to establishing international direct interconnects and PoPs. There would be flow-on effects which would be detrimental to domestic competition, both retail and wholesale, and the long term best interests of New Zealanders.
14. In the body of this submission it is noted that termination rate problems have implications well beyond mobile services. This case study and CallPlus' position is an example of mobile termination rates having implications beyond mobile services.

### **Reduce the cost of termination of domestic calls**

15. CallPlus' ability to compete therefore depends on offering a range of services, often as part of a package of services such as fixed and mobile inbound termination. Facing unconstrained high prices in one area (FTM MTRs) adversely impacts the overall business and the ability to grow scale and develop facilities-based competition.
16. As noted above, CallPlus offers a wholesale service, in competition to Vodafone, Telecom and others, to other tier 2 carriers.
17. New Zealanders benefit from the competition, which results in lower national calling costs. By way of example, see the recent comment from Woosh (press release 30th July 2009):

Woosh Head of Sales and Marketing, Gerome Garthwaite, says the company's recent partnership with Telecom Wholesale to sell fixed line home phone and broadband and a wholesale agreement with CallPlus which allows it to offer industry leading calling rates means it can include free, unlimited dial up into its latest product offering.

18. However in order to cover the costs in establishing and operating the POPs, backhaul, co-location and interconnect links to all carriers, CallPlus sources traffic not only domestically, from its retail and wholesale customers, but also from international wholesale customers. This traffic is all handed over to Vodafone and Telecom in an identical manner, over the same links as domestically originated traffic.
19. Vodafone acknowledges the significance of internationally originated calls (Para 451 and 459 - 28th July 2009 Submission) as a type of call on their network.
20. To be precluded from competing for internationally originated mobile termination would create a significant barrier to a competitor establishing a national network and be detrimental to domestic competition, retail and wholesale, and the long term best interests of New Zealanders.

### **CallPlus is a New Zealand based and owned company**

21. Significantly, it is CallPlus, a 100% New Zealand owned company, based in New Zealand, that pays the termination charges to Telecom and Vodafone. The MTAS service is an input into the international services provided by CallPlus. CallPlus has the ICA agreements with Vodafone and Telecom, and CallPlus pays the charges. These are New Zealand domestic relationships and transactions, just as the traffic carried by the service is from one point in New Zealand to another.
22. While the New Zealand end user benefits, the Commission can and does take into account wealth transfers between New Zealand carriers.