



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

28 July 2009

**Public Version
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Table of Contents

1.	Introduction	2
2.	Pricing Methodology	2
3.	IPP principle doesn't reflect Commission's intended approach	4
4.	Use of the Vodafone/2degrees ICA as counterfactual	5
5.	The purpose of this investigation	7
6.	Standing back	7
7.	A different approach to the IPP?	9
8.	Other issues	10

1. Introduction

- 1.1 Woosh and Kordia generally welcome the draft Report and support many of the draft recommendations.
- 1.2 In this submission we focus on some key issues. We rely also on our submissions at all stages of the investigation, from when the Commission considered whether to launch an investigation, and including submissions on draft undertakings.

2. Pricing Methodology

BAK

- 2.1 We welcome the Commission's addition of BAK as an option in the pricing principles for the reasons outlined in our earlier submissions. We consider that the issue should be addressed immediately, so that there is an immediate move to BAK, so long as both FTM and MTM are covered. However, if that is not to happen, we firmly support the addition of BAK as an option.

TSLRIC or LRIC

- 2.2 With virtually no analysis, the draft Report opts for TSLRIC as the pricing model. The discussion is limited to a few short paragraphs (Paras 428-439) and a brief reference to the desirability of having consistency with the existing TSLRIC regime for PSTN interconnection (Para 427). Broadly the conclusion that TSLRIC is appropriate is taken as read, without analysis.
- 2.3 We appreciate that this is a draft report, which is part of an ongoing process. Therefore it is understandable why there are important omissions in this section of the draft report, at this stage in the process:
- (a) This section of the report refers, at Para 434, only to a May 2009 EU staff working paper on termination rates (i.e. a paper of relatively limited significance). Yet, in that same month, the EU produced its final report: the highly significant *Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*. There is no reference to this paper, which bears closely on this issue, well beyond the EU staff working paper.
 - (b) The new Commission Recommendation is picked up when a related but different topic is handled (at Para 473) but not in this section.

- 2.4 We make this point to illustrate that there is substantially more work to be done by the Commission on what is a critical topic for the Final Report: the choice of pricing model for the FPP.

The EU LRIC Recommendation

- 2.5 The Commission Recommendation requires EU national regulatory authorities to have the utmost regard to its recommendation that termination rates are set on a LRIC basis.
- 2.6 LRIC, as applied by the EU, is sometimes called Long Run Marginal Cost (LRMC) or “pure” LRIC. In this submission, to avoid confusion in terminology, we use TSLRIC as applied in New Zealand and LRIC as applied by the EU.
- 2.7 In contrast with our TSLRIC, LRIC includes no allowance for recovery of common (and fixed) costs. There will be a substantial difference between the rates produced by LRIC and TSLRIC.
- 2.8 We consider that the FPP should be LRIC not TSLRIC. The choice has been very carefully considered and consulted upon in Europe. New Zealand would be out of line with this international best practice. This is particularly important in this challenged market where, as noted below, even rates such as 7.2 cpm will not stop New Zealand’s market failure in the mobile and fixed markets, and in relation to NGN.

Ofcom and LRIC

- 2.9 Ofcom, also in May 2009, published its *Wholesale Mobile Voice Call Termination – Preliminary Consultation*. In that report, Ofcom dealt with LRIC compared to other cost models such as our TSLRIC, in relation to the UK market where there are substantially less mobile market problems than in New Zealand. Ofcom noted:

6.114 LRMC [that is, the LRIC model recommended by the EU in May 2009] may be an appropriate methodology to set termination rates for a number of reasons.

6.114.1 Common costs would no longer be recovered from the regulated termination service but would instead be recovered from retail services

6.114.2 It would most likely lead to a reduction, if not elimination, of the on/off-net differential in mobile call charges, addressing any potential concerns about competitive distortions between mobile operators arising from this issue.

6.114.3 A reduction in mobile termination rates would reduce the absolute difference between fixed and mobile termination rates. This would be more consistent with the anticipated general direction of travel over the longer term, and provide industry greater flexibility to adapt to ongoing market developments (e.g., fixed / mobile convergence).

6.114.4 It would also remove potential concerns about competitive distortions between fixed and mobile operators that are related to common cost recovery.

6.114.5 And finally, as termination charges feed into retail call charges, we would expect lower termination rates to lead to increased operators' retail pricing flexibility, ultimately benefiting consumers. [Highlighting added]

Consistency with fixed line price regulation?

- 2.10 Although primarily dealing with BAK versus cost-based pricing, Para 426 of the Commission's draft report appears to point to the use of TSLRIC, on the basis that there is consistency with the PSTN interconnection pricing methodology.
- 2.11 The reality is that there is a large difference between fixed line and mobile termination rates, when underlying cost is not far removed from each other. Consistency of model needs to be considered in light of what is actually happening in reality. In our view the approach should not be to have TSLRIC for mobile, to be consistent with fixed line, but for mobile to have consistency with the latest international best practice: the EU's LRIC.
- 2.12 Fixed line can be transitioned to LRIC when and if appropriate. We note in particular that the transition from PSTN Interconnection to IP Interconnection requires the pricing model to be revisited anyway in the short term. Change to mobile pricing methodology should therefore not be held back.
- 2.13 By having "consistency" here, which in practice is not really consistency, means that New Zealand does not have consistency with leading thinking in Europe.
- 2.14 There is little analysis of this issue in the report, and we consider this should be the subject of close review leading up to the final report.

3. IPP principle doesn't reflect Commission's intended approach

- 3.1 We are very pleased that the Commission has accepted our submission that benchmarking should be based on underlying cost assessments by regulators, where available, in preference to regulated prices which overlay those cost assessments. This reflects our view that benchmarking must always "skate to the puck" and not be an end in itself. That "puck" is an estimate of TSLRIC (assuming that is the model). In the past, the Commission has even gone to the extent of unpicking a TSLRIC price and reverse-engineering that back to "benchmarking" (when the opposite should happen).
- 3.2 The Commission has noted its preliminary view:¹

"..it is appropriate to benchmark against cost modelled rather than regulated rates..."
- 3.3 So for example, it has relied, correctly, on WIK's modelling for ACCC instead of the ultimate regulated price. That is understandable because ACCC acknowledged that the WIK model, with adjustment, is in fact the price based on TSLRIC+. To benchmark correctly to New Zealand, the increment added by ACCC, beyond TSLRIC+, should be removed (as New Zealand's pricing is limited to the NZ equivalent of Australia's TSLRIC+).
- 3.4 However the intended, and correct, approach is not yet accurately recorded in the proposed IPP principle.² This refers to "benchmarking against MTAS prices

¹ Para 482, Draft MTAS Report.

in comparable countries...”. Assuming “MTAS” is defined as the services themselves, this means that the focus is the regulated price and not the underlying cost assessment. Applied strictly, and assuming the same benchmarks are used as were applied in the draft report’s benchmarking, the rate would be significantly higher than 7.2cpm.

- 3.5 Benchmarking under the proposed IPP principle would enable the Commission to make some adjustments to the regulated prices when inputting them into the modelling. However, there is likely to be a judicially reviewable position if the Commission does what it currently intends: focuses on underlying cost models ahead of price. Disaffected access providers could have actionable grounds for complaint. The focus on underlying cost models should be explicit.
- 3.6 We propose that the draft is amended by the Commission to make it sufficiently flexible (as well as directed at underlying cost models) to accommodate the Commission’s intention. This can be done by amending the draft and/or by the way in which MTAS (or similar expression) is defined.

4. Use of the Vodafone/2degrees ICA as counterfactual

- 4.1 Neither this nor any other private agreement should be used as a counterfactual. Only publically available material should be used.
- 4.2 The Commission gives no reason for this approach,³ nor for its departure from its seemingly opposite conclusion – following our submissions – in the roaming investigation. There the Commission stated (in a report quoted in the MTAS draft report):⁴

While the Commission welcomes the conclusion of a commercial roaming agreement between Vodafone and NZC, it has significant concerns with the current state of the mobile market that suggest there may be a case to commence a national roaming investigation. **These concerns are:**

- **the bilateral nature of current commercial roaming agreements, which may not be available to future potential access seekers wishing to enter the mobile market;**
- questions as to whether the prices contained in current commercial roaming agreements align with the costs of providing the service,⁵ and the impact that pricing above cost will have on the ability of new entrants in the mobile market to compete with the on-net pricing plans offered by the incumbents;⁶
- questions regarding whether current commercial roaming agreements will facilitate efficient network expansion, leading to increased facilities-based competition; and

² Para (lvi) Draft MTAS Report.

³ Para 82, Draft MTAS Report.

⁴ Para 10, Commission’s Notice to Parties in the roaming investigation (30 March 2009).

- the inability of potential entrants to the market to negotiate competitive agreements in a timely manner, including roaming and interconnection arrangements. [highlighting added]
- 4.3 A particular problem of using ICAs as counterfactuals is that, unlike a draft undertaking or a reference offer, they are not public. They do not allow parties, other than the parties to the agreement, to check and submit on the counterfactual. At present there is a dispute as to whether ICAs in this context should attract RI or COI status. Either way, the ability for parties to submit on them is constrained, and non-existent if the ICA is treated as COI.
- 4.4 As we note below, just as important is that, as the ICAs attract RI or COI, the service providers (who are not party to the ICA) do not know about any of the terms of the ICAs when it comes to negotiating their own ICAs.
- 4.5 Our own situation illustrates this well. What is at stake is whether or not the Commission will recommend regulation. That is the purpose of the counterfactual analysis. If the Commission, based on that assessment, decides not to regulate in view of the terms of the ICA, the very problem identified in the first bullet point above arises:
- These concerns [include] the bilateral nature of current commercial roaming agreements, which may not be available to future potential access seekers wishing to enter the mobile market;
- 4.6 It appears that the ICA will be part of the counterfactual for the FTM assessment. This of course is an immediate issue for us and other fixed line operators. Based on an ICA we will not see, decisions are being made as to whether to recommend regulation of FTM rates.
- 4.7 Just as importantly, if the decision is made not to regulate, and we then seek to negotiate FTM terms, we have no idea what has been agreed by the parties to the ICA used in the counterfactual. We could end up far worse off than the position if there was regulation.
- 4.8 As WiMAX spectrum holders, we may later seek roaming and MTM MTRs. If there is no regulation, as the private ICA is such that regulation is not justified, our position is likely to be untenable. We face negotiating with incumbents (with considerable negotiating strength and information asymmetry in their favour) without knowing what the counterfactual ICA contains. It is decidedly possible if not likely that we end up negotiating a worse ICA than the counterfactual ICA.
- 4.9 The counterfactual may well have the flaws identified in the Commission's bullet points above: certainly that would be a common experience. This is an impossible position, which is self-evident, as listed by the Commission itself.
- 4.10 Further, ICAs are complex price and non-price agreements, which often involve lateral and wider commercial elements, reflecting the wider commercial relationship carriers have between each other. Therefore they are generally inappropriate for use as counterfactuals.
- 4.11 If the counterfactual ICA path is to be pursued, there will usually be many more than one ICA that are at stake, as our solicitor's letter to the Commission of 27 July notes.

- 4.12 Use of private agreements in a merger and clearance situation may be suitable in view of the, largely, one-to-one situation. Here, the investigation is about industry-wide regulation.
- 4.13 From a policy and broader perspective this is an unsatisfactory approach to take.
- 4.14 We are very concerned at this departure, without reasons, from the apparent position in the roaming investigation, given these grounds for concern. If there is to be a departure from the position so recently reached in the roaming investigation, reasons for doing so should be stated by the Commission.
- 4.15 However we remain of the view that ICAs and similar documents should be disclosed for their evidential value in investigations, again for the reasons noted in the letter of 27 July.

5. The purpose of this investigation

- 5.1 Although the approach has become clearer over the years, there is still frequent confusion over the role of a benchmarked price in investigations such as this. It has nothing to do with setting the price itself (leaving aside undertakings for the moment). The investigation is about whether to recommend regulation and what the terms of that regulation should be, including the pricing methodology. A benchmarked price is calculated solely for the counterfactual analysis, to determine if there should be regulation. If there is to be regulation, a key issue is the *methodology* for calculating price on a subsequent STP or application for determination. The STP or application for determination of course happens only after, and if, the Minister accepts there should be regulation.
- 5.2 Recent events show how easy it is for this limited investigation process to be elevated to a view that price is being set now.

Draft undertakings

- 5.3 However, in deciding whether a draft undertaking is acceptable, presumably the Commission would consider the price derived for the counterfactual.
- 5.4 The undertakings are a considerable distance from the benchmarked pricing. For this reason only, we will not submit on the benchmarked pricing, except as to (a) the underlying methodology (proposed to be TSLRIC and BAK) and (b) the unsatisfactory use of an ICA as a counterfactual.
- 5.5 However, we would reconsider that when and if a draft undertaking and the benchmark prices converge (an unlikely scenario).
- 5.6 At that point, we would submit that the benchmark price is too high to be used for a number of reasons.

6. Standing back

- 6.1 It helps to look at the situation in the round. Standing back,, if FTM and MTM rates land at anywhere near 7 cpm, New Zealand will continue to have the same dysfunctional mobile market, and this will increasingly extend to the fixed market and the NGN, for the reasons we have noted in earlier submissions. For example, 7 cpm will perpetuate the on-net problem. This negatively impacts not

- 6.2 As is well known, *ex post* remedies under the Commerce Act are ineffective in dealing with the issues. The only hope is action under the Telecommunications Act.
- 6.3 The Commission, under that Act, has wide powers to recommend regulation which can make all the difference between success and failure. This includes conditions that extend beyond setting price. The Commission can even cap retail prices in a determination, as it did at the request of Vodafone in the Homezone determination under Section 30.
- 6.4 That is something that the Commission can do at the determination phase, as Section 30 does not apply to investigations. However, such ancillary conditions are also available to the Commission under Section 66 and Schedule 3. Problems will not be solved by regulating price only (absent BAK for both FTM and MTM although even then issue may remain). To require such ancillary conditions fulfils the Section 18 drivers: *“The purpose of this Part and Schedules 1 to 3 is to promote competition in telecommunications markets for the long-term benefit of endusers”*.
- 6.5 There is something wrong when the regulatory regime can allow perpetuation of the recognised problems of on-net pricing and similar issues, when one of the two carriers benefiting from this perpetuation can seek and obtain a determination that stops the same type of behaviour. In the conceptually indistinguishable area of Homezone connection, the Commission said in granting Vodafone’s request for both BAK and retail price control (the latter under Section 30):⁷
- If Telecom can require callers to Vodafone local numbers to pay higher rates than callers to other local numbers, there could be a significant disincentive to take up Vodafone’s local service. Hobbling Vodafone’s local service before it begins is unlikely to promote competition for the long-term benefit of end-users.”
- 6.6 Something is wrong if the same problems, but on a much larger scale, cannot also be fixed by the Commission in relation to the mobile market.
- 6.7 We have submitted on this in earlier submissions, but these submissions have not had a response from the Commission.
- 6.8 The Commission has an opportunity to deal with these matters. Tinkering with price only will not solve the problems, despite the ambitions noted in the draft report. Wider and more laterally based solutions need to be used, and they are available.
- 6.9 We would welcome the opportunity to provide concrete proposals. We ask the Commission to deal with this request and this issue. Without even getting recognition of our submissions on this, or having them dealt with in the material, there seems little point in putting up specific proposals that could help the Commission achieve its objectives (in fulfilment of the Section 18 purposes).

⁷ Para 43, Commission’s Vodafone Homezone determination.

7. A different approach to the IPP?

- 7.1 This section addresses the problematic time as between acceptance of a recommendation to regulate, and the determination of a new price (a period of around a year). We suggest ways to overcome the serious timing problems. It is important to take into account that we are suggesting a solution, which has imperfections, for a short period which otherwise has much greater imperfections. A “mini” counterfactual analysis, which has no implications beyond that short period, demonstrates the value of an IPP that is either BAK or at 7.2cpm.
- 7.2 The Act is sufficiently flexible to allow this approach.
- 7.3 To demonstrate, assume that the FPP will be, as currently proposed, the TSLRIC/BAK combination.
- 7.4 It does not follow that the IPP must reflect the same model (i.e. forward looking cost benchmarks/BAK). We suggest that FTM and MTM rates (it must be both) go to BAK only for the IPP, with the TSLRIC/BAK option applying for the FPP. (We add an option below of using 7.2cpm assuming a TSLRIC model).
- 7.5 When doing the counterfactual, the Commission has rightly looked at the reality: that new regulated prices will not apply until early 2011. The Commission’s assessment reflects timing factors and the welfare impact of that (i.e. the analysis deals only with the period from early 2011 and not before).
- 7.6 Significantly, with the currently proposed IPP, this means that the FTM rates in the Ministerial undertakings will remain, at around double the benchmarked rate of 7.2cpm, until early 2011. From the draft Report, it is evident that this is a serious market failure problem during this period, at a critical time.
- 7.7 However, if the IPP is BAK, then assuming Ministerial acceptance of the Commission’s recommendation at the end of this year, BAK instead of double-benchmarked rates apply for the first year. Parties can quickly instigate the final pricing review if they wish, to get a TSLRIC/BAK determination on an FPP basis. We are only talking about addressing a short time period in this manner.
- 7.8 Vodafone and Telecom should have no valid objection to this. After all, they have both pushed for, and got, BAK, in circumstances where traffic flows are asymmetric (local PSTN interconnection in the case of Telecom and Homezone in the case of Vodafone). It is of particular concern that they argue so strongly against BAK given that situation (let alone Vodafone’s position outside New Zealand).
- 7.9 The state of market failure is such that the balance of risk and benefit between the two approaches (no change in double-benchmarked rates until early 2011 as against BAK now) indicates that a BAK approach is to be favoured for this one year period. Further, this is at this critical time for the market.
- 7.10 Double-benchmarked rates seem much worse for the market than the opposite. It is important that, more than the draft report does in some parts, the Commission considers and recognizes the downside of being too conservative (i.e. by having rates that are too low). The overall circumstances in the market indicate that the risk of rates that are too high is far greater than the risk of rates that are too low. And here we are addressing a period of only a year.

Alternatively, an IPP at 7.2cpm

- 7.11 Alternatively, for the purposes of the one year, the Commission can make the IPP rate 7.2cpm. Again, balancing factors, that is better than perpetuating double-benchmarked rates. The Commission's analysis on the present round (for the counterfactual) is not as robust as it would be on a determination. But it is strong enough for the purposes of a one year period (and can be made more robust by more analysis at this point if necessary).
- 7.12 Without seeking out solutions such as this, market failure is real, not just in the mobile sector but also in fixed line, and, perhaps most significantly for NGN, as we noted in earlier submissions.

8. Other issues

- 8.1 In relation to the following matters, we rely on our earlier submissions, and also adopt the CallPlus submissions on these points dated 28 July 2009 (numbers in brackets cross-reference Para Nos in the CallPlus submission):
- (a) Second + Second v Minute + Second((3.1);
 - (b) Internationally originated and VoIP calls (3.2);
 - (c) Mobile to Toll-Free (3.4);
 - (d) Transit traffic (3.5);
 - (e) Handover deductions (3.6); and
 - (f) Reciprocal Interconnection Set-up costs and links (3.7).

For further information please contact:

Susie Stone, Kordia Group Limited (021 899 202)
susie.stone@kordia.co.nz

Rod Inglis, Woosh Limited (021 978 602)
rodinglis@woosh.com