

NZ COMMUNICATIONS LIMITED



**Submissions to the Commerce Commission
in relation to the commencement of an investigation into the
regulation of mobile to mobile termination charges**

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EXECUTIVE SUMMARY

NZ Communications Ltd (“NZCL”) submits that reasonable grounds do exist to investigate whether mobile to mobile termination charges should be regulated under Schedule 1 of the Act, on the basis that:

- (a) there is an absence of effective competition in the New Zealand mobile communications market;
- (b) it is in the long-term interests of end-users of telecommunications in NZ that there are new entrants to the mobile market;
- (c) the high mobile to mobile termination rates on offer from Vodafone and Telecom NZ are significantly above cost and present major barriers to entry for new entrants to the market; and
- (d) high mobile to mobile termination enables other behaviours detrimental to competition, such as closed network pricing, bundling, pocket pricing & on net fixed price calling plans
- (e) appropriate regulation of the mobile to mobile termination market has been shown to assist in resolving these issues in other jurisdictions.

SUBMISSIONS

A. Background

- A.1. NZCL is building the third mobile telecommunications network in New Zealand, it has an obligation to build over 1300 cell sites and cover 65% of the New Zealand population in order to qualify for the national roaming service.
- A.2. As the new entrant in the New Zealand mobile telecommunications market ('Market'), one of the major barriers to entry that NZCL faces is the high mobile to mobile termination rates on offer from the incumbent carriers, Telecom NZ and Vodafone.
- A.3. The submissions outlined here show why, in order to promote competition in the Market, NZCL believe that the Commission should commence an investigation into whether or not Schedule 1 of the Act should be amended.
- A.4. In particular, it is submitted that reasonable grounds exist for the Commission to investigate the regulation of mobile to mobile termination charges
- A.5. If the Commission undertakes such an investigation or issues an Issues Paper, NZCL would, at that time, seek to make detailed submissions on the benefits and suitability of appropriate cost models and remedies to the problems and barriers that exist.

Termination rates are a barrier to entry.

Closed network pricing is also a barrier to entry

B. Investigation by the Commission

The Commission's Power

- B.1. As identified in the Commission's letters, to commence an investigation, the Commission needs only to be satisfied that reasonable grounds exist for it to do so.
- B.2. NZCL submits that reasonable grounds do indeed exist to commence an investigation of whether mobile to mobile termination pricing should be regulated.

Reasonable grounds currently exist.

Legislative Backing for the Promotion of Competition

- B.3. The purpose of Part 2 of the Act (designated services and specified services) and Schedules 1 to 3 of the Act is described in sub-section 18(1) of the Act as:

"to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers."

- B.4. Under sub-section 18(2), the Commission must also have regard to the efficiencies that will result or be likely to result from any act or omission, such as designating a service.

The Commission must promote competition in its decision making.

High termination rates have a similar theme to competition as a practical extension of the Baumol-Willig rule which was banned by the Telecommunications Act 2001

B.5. The application of the Baumol –Willig rule was specifically identified as having no application to any initial or final pricing principals. However the impact of high mobile to mobile termination charges is effectively the same as endorsing or adopting the Baumol – Willig principles. This is because a new entrant is being asked to pay a significantly higher rate than cost for termination, which is, in effect, a contribution to a loss of monopoly rent by the terminating carrier.

Reasonable Grounds

B.6. In NZCL’s submission reasonable grounds exist now and warrant the Commission commencing an investigation into mobile to mobile termination pricing, namely that:

- (a) the Market, as it is presently composed, is not competitive;
- (b) Competition will be improved; it is in the long-term interests of end-users of telecommunications in NZ if the market is regulated to enable new entrants to the Market that are able to compete on fair terms; and
- (c) There are currently significant barriers to entry for new entrants to the Market;

These Submissions

B.7. The purpose of these submissions is to provide evidence to the Commission to demonstrate that reasonable grounds exist now to warrant an investigation into mobile to mobile termination rates.

The Market currently lacks competition.

C. The Market is not Competitive

C.1. The Commission has already undertaken a number of reviews of the Market in the last 2 years¹. Additionally in its “*Statement of Intent*” for 2007-2010, the Commission noted that:

“While the high penetration level will present challenges to new entrants, the Commission considers that there will be major benefits for end users from such entry”

The market is saturated

C.2. As the Commission observed in its 31 March 2008 Report², there are already more mobile phone subscribers than there are people. Further the 2006 evidence showed that approximately 50% of the existing population with access to a mobile phone in fact had 2 handsets. This is inherently inefficient.

C.3. NZCL contends that the reason for this is that subscribers take advantage of cheaper on net pricing with each carrier. In its October 2006 Report the Commission noted³ that the incumbents have already admitted that “*closed network pricing*” was common and not outlawed in other jurisdictions The Commission went on to observe that:

¹ Commerce Commission, ‘A Review of Cellular Mobile Market Entry Issues’, New Zealand, 10 October 2006 and Commerce Commission, ‘2007 Telecommunications Market Monitoring Report’, 31 March 2008

² At paragraph 81.

³ At paragraph 70

“...closed network pricing may be a barrier to entry in the event of unbalanced and unregulated above-cost mobile to mobile termination rates.”⁴

- C.4. NZCL argues that high mobile to mobile termination rates, with associated low on net pricing further entrench the non competitive Market as budget orientated consumers will select a network on the basis of who else is on that network and not on the basis of pricing, handset availability or the network coverage in their district. As a consequence of this is as noted above, many customers will elect to carry 2 handsets.

D. Competition will be Improved

Competition

- D.1. The Commission’s own reports and mission statements referred to above make it clear that there is likely to be a significant benefit to end users from a new entrant in the mobile market. Specifically, it has observed:

“Notwithstanding these indicators of competition between Telecom and Vodafone ... there are features of the mobile market that suggest that competition in this market is limited.”⁵

And...

“New Zealand is unusual amongst OECD countries in having only two competing mobile networks. Most countries have at least three networks, with some having four or more.”⁶

- D.2. The Commission has further expressed the view that competition in the Market is limited:

“The Commission considers that the fact that there are only two mobile networks operating in New Zealand and each uses different technology (so users generally have to buy a new handset to change networks) limits the intensity of competition in the mobile market.”⁷

- D.3. Accordingly it is submitted that the benefit of improved competition through the addition of a new carrier is consistent with the purposes of the Act and justifies the commencement of an investigation into methods by which that can be achieved.

- D.4. Competition will be improved not just in the mobile calling business but in all voice businesses including the land line. The Fixed line business in NZ has not benefited from aggressive “fixed to mobile substitution” like it has in more competitive mobile markets, as a consequence of a more competitive mobile market , land line pricing will also fall. This is because at 100% penetration one of the few sources for growth is the land line business

New entrants to the Market will benefit end-users.

⁴ At paragraph 74

⁵ 10 October 2006 Review at page 3.

⁶ 10 October 2006 Review at (iii) in the Introduction.

⁷ 31 March 2008 Report at para 103.

High mobile to mobile termination charges are a barrier to entry.

E. Difficulties for New Entrants to the Market

E.1. The barrier to entry posed by high mobile to mobile termination rates has been recognised by the Commission, which recently observed:

“The entry of a third operator into the market ...should help to increase competition for the benefit of end-users. However, if mobile-to-mobile termination rates for both voice calls and text messages are set significantly above cost, this would reduce the ability of a new entrant to compete effectively in the market.”⁸

E.2. The difficulties for new entrants are increased by the saturated nature of the Market in New Zealand, with penetration at over 100 per cent. This presents particular difficulties for a new entrant to attract customers that would not be faced by a new entrant to a market with a lower degree of penetration.

E.3. If market penetration were below 100%, a new entrant could target customers who did not yet own a mobile phone. In a saturated market, however, it is necessary to attract customers away from the incumbent networks.

E.4. Since the incumbent networks are likely to offer mobile termination rates significantly higher than their interconnection costs, as concluded by the Commission’s investigation into the mobile market in October 2006, a new entrant in a saturated market will struggle to attract customers away from the incumbent networks.

E.5. The following two facts combine to create difficulties for a new entrant to the Market:

(a) The first customers of a new entrant will have a disproportionate amount of their calls terminate “off-net” onto the incumbent networks, rather than “on-net” on its own network. The new entrant therefore must make higher payments for mobile termination to the incumbent networks than it will receive from the incumbent networks.

(b) To attract customers from the incumbent networks, the new entrant must offer lower off-net rates for customers making calls terminating on the incumbent networks which serves to amplify the payment disparities.

New entrants face higher costs and lower revenues as a consequence of the current termination situation.

E.6. A new entrant is therefore faced with higher costs and lower revenues than the incumbent networks. This difficulty has been recognised by the Commission, which has stated:

“High mobile termination rates are therefore a particular concern for new entrants, who have no established community of users, because they find it difficult to attract customers from existing networks which offer low on-net rates. New entrants need to be able to offer similarly low off-net rates, which high termination rates make uneconomic, to entice new customers.”⁹

The result of imposing mobile to mobile wholesale termination rates significantly above cost is to ensure that new entrants make unjustifiably high out-payments to incumbent networks for significant period of time while it

⁸ 31 March 2008 Report at para 105.

⁹ March 2008 Report at para 99.

A solution to the mobile to mobile termination should have the effect of limiting other problems such closed network pricing, pocket pricing and on net -fixed price calling

gains market share. These out-payments effectively subsidise and pay for the incumbents' closed network pricing plans. This creates an unfair barrier to entry for new networks.

- E.7. As noted in part C above, the high cost of mobile to mobile termination rates has led to a growth in the number of customers with two handsets. This proliferation of two handset customers is a direct result of closed network pricing and shows the inefficiency of a market with high mobile to mobile termination rates. It seems unlikely that even the most budget conscious of consumer will carry three handsets once NCZL enters the Market.¹⁰
- E.8. Where mobile to mobile termination rates are significantly above cost, as is the case in the New Zealand Market, the effect is for the new entrant to make excessive out-payments to the incumbents as a cost of entry. Capital that could otherwise be invested in developing its business is being transferred to incumbent networks constituting a transfer of a monopoly rent, a concept similar to the *Baumol- Willog rule* (see B.5 above).
- E.9. A further problem emerges when the mobile to mobile termination rates are significantly above cost, namely the incumbent carriers are able to adopt other pricing behaviours that are detrimental to a competitive retail market. The types of behaviours that are seen include closed network pricing, pocket pricing, bundling and fixed on net price calling.
- E.10. To lessen the burden on new entrants to foreign markets, various regulatory models have been adopted. Imposition of cost based pricing has generally been made on networks with Significant Market Power in their jurisdiction. New entrants' costs (on a per minute basis) tend to be significantly higher than those of incumbent networks who tend to have recovered their network costs from termination fees in a matter of a few years. Asymmetric pricing of mobile to mobile termination charges has been applied by the regulators of those markets, enabling the new entrants to charge higher mobile termination rates than the incumbent networks.
- E.11. The effect of asymmetric pricing of mobile termination charges is to decrease costs and increase revenues for a new entrant, enabling it to continue to offer its customers lower prices and establish itself in the Market.
- E.12. There are high barriers to entry these give the Commission reasonable grounds commence an investigation into methods by which those barriers can be removed.

¹⁰ IDC, 'New Zealand Mobile Market Passes 100% Penetration', Press Release, 3 August 2007, <http://www.idc.com/getdoc.jsp?containerId=prNZ20810307>, last accessed 29 April 2008.

CONCLUSION

In summary

The barriers are:

1. High termination rates
2. Closed network prices
3. Fixed price calling numbers on network
4. Asymmetric traffic patterns
5. 100% penetration
6. aggressive bundling propositions
7. significant level of dual handset ownership

The Evidence of a lack of competition are:

1. Expensive consumer pricing
2. No real pricing competition
3. Limited traffic flows between networks
4. Proliferation of dual handset customers
5. No new entrants have successfully been able to commence business

The Market is not competitive and end users would benefit from the introduction of new entrants to the Market.

High mobile to mobile termination charges are a significant barrier to entry for new entrants to the Market.

Regulation of mobile to mobile termination charges in foreign markets has been demonstrated to foster competition.

Reasonable grounds exist for the Commission to commence an investigation into the regulation of mobile to mobile termination charges.

Profile of “NZCL” NZ Communications Limited

NZ Communications is a mobile telecommunications company. The company owns several blocks of spectrum which it is developing into a mobile phone network to compete on a like for like basis with Vodafone NZ and Telecom NZ. NZCL was formed as a response to the New Zealand Government passing the 2006 Telecommunications Amendment Act, to stimulate more competition. The company’s objective is to build a new NZ institution to own and operate a nationwide mobile phone network.

NZCL is owned and controlled by two private equity companies who specialise in investing and building mobile phone networks. General Enterprise Management (GEMS) and Communication Venture Partners (CVP) have built and invested in over 20 networks over the last ten years. They have injected cash and a management team into the company. The Maori-controlled Hautaki Trust owns 20% of the company. The Chairman of NZCL is Bill Osborne, CEO of Quotable NZ, ex All Black, Board member of SPARC, Positively Wellington Business and the NZ Maori Rugby Union Board.

NZCL has announced plans to commence business in NZ using Huawei Technologies as its technology partner. Huawei Technologies have supplied equipment on 32 GSM/WCDMA networks worldwide and are the fastest growing network equipment supplier in the world. They are on track to supply 20% of all new mobile phone networks by 2010.

NZCL is headquartered in Auckland with offices in Wellington and Christchurch. The company is in the process of deploying an initial 840 cell sites to cover 60% of the NZ population. The company currently employs 58 people and 20 consultants. It is in negotiations for multiple co-location sites with Telecom and has filed XX RMA applications for cell site tower erection in Auckland, Wellington and Christchurch.

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