

Commerce Commission

Mobile Termination Access Services - *Undertakings*

Submission from NZ Communications Limited

13 February 2009

INTRODUCTION

This investigation is timely. On 12 February 2009 NZ Communications Limited (**NZ Comms**) attended a conference in Brussels, Belgium - *The Second Annual Mobile Termination Rates Forum - Creating a Balanced Regulatory Environment*. With presentations from leading thinkers involved in the lively European debate (including influential academics, senior representations from the European Commission, several National regulators the ERG consumer groups and the individual operators), the key “take-aways” were:

1. High termination rates distorts markets where they are set above costs.
2. There is wide agreement that mobile termination rates are above cost and must come down to cost.
3. Disagreement exists over what cost is and how it should be calculated, and the timeframe in which it should be imposed.

A Strategic Director at British Telecom, Geoff Richardson, fresh from what he describes as their so-called “successful” appeal in the UK, described high mobile termination as: “a *blindingly obvious problem*” and “a *barely constrained exploitation of monopoly power*”. He stated that “*deeply damaging and unfair excessive MTRs (i) distort competition (ii) penalise fixed phone users and networks and (iii) divert funds away from more socially valuable uses.*”

On winning the appeal he commented it was “*intense and demanding requiring 2.5 metres of written economic and legal arguments*” and referred to the “*glacial flow from 22 months into a four year control period without final resolution*”. He described it as “*very expensive*” estimating the cost of the appeal “*so far*” being “*at least 30 million Euros to date and deeply frustrating*”, commenting that he believes that they received a 20% cost reduction in rates but that rates were still 60% above cost. He praised ARCEP and the European Commission for their insight and encouraged OFCOM to do likewise when it conducts its Mobile Sector Assessment in 2009.

CONTENT OF SUBMISSION

This submission focuses on Mobile to Mobile (**MTM**), particularly on the inadequacy of the mobile termination rates (**MTRs**, also known as wholesale prices or access prices) offered by the incumbents. While there are some specific comments on the non-price terms of the proposed undertaking these are initial reactions of NZ Comms commercial managers, and are not intended to be comprehensive.

CONFIDENTIALITY

Confidentiality is sought for the information contained in (ie [] under the Telecommunications Act 2001 and the Official Information Act 1982.

OVERVIEW OF COMMENTS ON THE UNDERTAKINGS

New Zealand consumers will benefit from a Bill and Keep (**BAK**) arrangement for mobile to mobile termination (**MTM**) because this will lower prices and maintain investment pressure on infrastructure upgrades. BAK prevents many of the distortions, delays and ongoing regulatory costs that otherwise can be expected to occur (including rent-seeking behaviour and gaming).

NZ Comms' proposed undertaking, which followed BAK, was supported by a report from independent economists, Concept Economics,¹ which itself referred to respected economic literature favouring BAK. Concept concluded that BAK was pro-competitive and "*would promote efficient entry and competitive expansion, and hence competition*".²

The long-term benefit to end-users may be significantly harmed by another protracted regulatory process as a consequence of the incumbent mobile network operators (Telecom and Vodafone, the **incumbents**) making no real efforts to tailor undertakings to the problems described by the Commerce Commission (**Commission**) in its Issues Paper³ and subsequent "*Reasons for Commerce Commission decision to investigate mobile termination access services*".⁴ Particularly when there is such urgency to resolve the issues given the risk of adverse impacts on investment and competition should there not be timely resolution of the issues.

Neither incumbent sought to address the statutory test and identify how their proposal would further that test by remedying the harm resulting from excessive MTRs. Rather, the thrust of their submissions seems to be incorrectly claiming that this is the third inquiry of its kind (when there has been no MTM inquiry) and to suggest that there should be no inquiry into broader issues (such as MTM) simply because there was a settlement on Fixed to Mobile (**FTM**) to avoid regulation (even though undertakings were not available under the legislation at that time).⁵ Media reports suggest that they have successfully muddied the waters with comments on the deeds and an inaccurate portrayal of offshore experiences.⁶

The incumbents have offered no credible solution to address the issues and the competitive distortions associated with excessive MTRs and incorrectly suggested that their approach and proposed rates are consistent with international experience. Their focus has been dominated by complaints about the FTM investigation, largely ignoring the scope of this investigation which includes MTM voice, MTM SMS and on-net / off-net pricing differentials (**closed network pricing**).

The principal concern must be the access prices themselves. This is a simple case of access prices being set so high as to prevent competition (exacerbated by closed net pricing) and ensuring a continued but unjustified subsidy to incumbents from fixed line operators and new mobile entrants (should they emerge).

This is the first inquiry of its kind and is long overdue. There is a real problem. Regulation – or meaningful price undertakings - will enhance competition with consequent consumer benefits. As things stand, the high termination rates offered in the incumbents' undertakings mean there is a poor counterfactual (the circumstance in the absence of regulation), so the case for regulation is even stronger.

¹ Dated 22 December 2008 entitled "Report – Bill and Keep in this Mobile Termination Option Most in the Long-Term Interests of End-Users" (**Concept Undertaking Report**).

² Concept Undertaking Report, p1.

³ "Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination - Issues "Paper" 8 August 2008.

⁴ Dated 6 November 2008, reference 13.6/J10310.

⁵ They ignore the fact that the undertakings regime was only enacted on 18 December 2006 in the Telecommunications Amendment Act (No 2) 2006, *well after* the Commission's "*Mobile Termination Reconsideration Final Report*" released on 21 April 2006. The political settlement *must* be viewed in that context.

⁶ Refer para 4.26 and para 4.27 below.

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1. RECAP ON THE ISSUES

1.1 The incumbents' undertakings (discussed in section 2 below) make it clear they are not seeking to remedy market failures. Rather, their submissions and approach obfuscate the real issues and prepare for a protracted debate, the effects of which will further postpone investment in infrastructure.

1.2 Accordingly NZ Comms reiterates some key points from its September 2008 Submission:

- (a) The mobile market is not competitive, but is in fact a cosy duopoly. Returns are high, penetration is high, but utilisation is low and prices are high. There are many significant barriers to entry that an entrant such as NZ Comms faces. As the Commission has noted, comparable countries tend to have four or more operators.⁷
- (b) Clearly the incumbents want to maintain their high profits. They have every incentive to make access expensive, to delay matters and have no real incentives to agree commercially useful terms (vividly illustrated by the five year colocation debate). Indeed the reverse is true – it is not in their interests to facilitate new entry – that would be inconsistent with their profit-maximising purpose. In fact, to do otherwise would breach fiduciary duties to shareholders.
- (c) These incentives are well-recognised:

“...terminating operators have incentives to raise rivals’ costs by setting termination prices at a level that impedes their ability to compete in downstream retail markets.”⁸

Conversely:

“...low termination rates facilitate low retail call charges and higher consumption.”⁹

- (d) In contrast to the incumbents, NZ Comms' commercial goals are not just consistent with the Telecommunications Act 2001 (**Act**) but promote its purpose. NZ Comms want to enter the market so that there is a third mobile infrastructure competitor. The relevant purpose in the Act is promoting competition, which is exactly what NZ Comms wants – to compete.
- (e) NZ Comms is making a significant investment in new infrastructure, which can be expected to result in true, dynamic, facilities-based competition and deep price competition (as opposed to the inherent limitations of potential competition through wholesale (reseller) arrangements). And – contrary to “threats” by incumbents – logic dictates that competition enhances the need to invest, not the opposite.
- (f) NZ Comms notes that a review of all the major capital investment decisions in telecommunications in New Zealand in the last seven years implies a strong correlation of Capex (capital expenditure) announcements in response to an

⁷ The Commission's Issues Paper notes that 2007 OECD figures showed that “New Zealand and Slovakia were the only countries among 30 member countries with two mobile network operators. The other 28 jurisdictions have three or more...” (para 45). The Commission goes on to note that benchmarking against “close” or “comparable” jurisdictions “supports this finding. That is, there are two mobile operators in the New Zealand market, whereas comparable countries tend to have 4 or more operators competing for the customers.” (p 46).

⁸ As noted in EC Draft Commission Staff Working Document Explanatory Note – Accompanying document to the Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, 2008, at p6.

⁹ Above, p7.

actual (or potential) competitors or an actual (or potential) changing regulatory setting. For example:

- (i) Telecom New Zealand announced a 3G upgrade of its network in May 2007 after Econet rebranded to NZ Comms and commenced deployment of its network.
 - (ii) Vodafone threatened to stop all further 3G construction in the 2007 Schedule 3 inquiry into Roaming and Colocation.¹⁰
 - (iii) Vodafone expanded its 900mhz 3G deployment once Telecom announced its 850-mhz upgrade, in response to the NZ Comms construction progress.
- (g) NZ Comms has made significant investment in New Zealand in order to enter the market and has plans for significant capital expenditure, contingent on appropriate regulation. The initial investment was made as a direct result of the perceived effectiveness of the Telecommunications Amendment Act 2006 and the conclusions made in the October 2006 Mobile Market review.¹¹
- (h) But efficient competitive entry will only occur if appropriate regulatory action is taken consistent with international norms, while reflecting the New Zealand market and regulatory framework. New Zealand likely has this “one shot” to develop competition and the consequent benefits. If NZ Comms does not succeed, no one else will likely enter.
- (i) It is clear that regulatory intervention is required. As noted by *Albon and York*, mobile network operators:
- “...have market power in mobile termination that manifests itself in prices for termination well in excess of costs of production. This market failure results in an efficiency cost that gives rise to a **prima facie case for intervention in the form of regulated reduction of the termination charge to cost...**”¹²*
(emphasis added)
- (j) The incumbents’ wholesale access prices and closed net prices constitute clear abuses of market power. Their retail pricing policies foreclose market access in an anti-competitive way. The Act provides a framework to address this anti-competitive conduct, and it must be utilised.¹³
- (k) NZ Comms is not asking for any regulatory indulgence. NZ Comms simply seeks the usual competition law (antitrust)/regulatory protections to restrain the otherwise unfettered abuse of the incumbents’ monopolies over termination on their networks. As the Commission knows there are acknowledged and consistent regulatory responses to these well-documented problems, which have yet to be adopted in New Zealand for the unique situation whereby one

¹⁰ Pullar-Strecker, T., 5 September 2007, “Vodafone my pull plug on expansion”, *The Dominion Post*.

¹¹ Prior to these developments an international investor road show delivered feedback that until the regulatory environment improved no investment would be forthcoming. NZ Comms is happy to provide further details.

¹² Albon and York, (2006) “Mobile termination: Market power, externalities and their policy implications” *Telecommunications Policy*, 30, 368-384, at p382.

¹³ NZ Comms agrees with the Commission’s conclusion in the Issues Paper that mobile termination on the incumbents’ networks constitutes a *bottleneck* and shares the Commission’s concerns about the incumbents’ market power in call termination (including prices significantly above cost, strategic price discrimination, actual/constructive refusal of access and bundling).

mobile operator appears to have 60 – 70 % (if not more) market share by traffic.¹⁴

- 1.3 Consistent with York's comment above, regulators worldwide are drastically reducing MTRs. Viviane Reding, EU Telecoms Commissioner said she wanted termination rates to be lowered by "up to 70 per cent over the next three years"¹⁵ and as noted in the Issues Paper to between 1 and 2 €cpm by 2012.¹⁶ The incumbents' proposals do not come close to international benchmarks, let alone trends.
- 1.4 In fact the need for regulation is much greater in New Zealand than elsewhere in any event. The *tariff mediated network externality* (ie the artificial network effect from closed net pricing) is amplified when there are asymmetric market shares and concentrated markets. New Zealand is unique in this regard; both effects are exaggerated, creating an even higher artificial entry/expansion barrier. Competition should take place at the retail level, it should not be prevented by anti-competitive conduct at the wholesale level.
- 1.5 As the Commission noted in the PSTN Determination,¹⁷ new entry:
- "...will result in consumers having greater choice of local access providers, which will, in turn, encourage local access providers to deliver product innovation and reduced prices. Such increased competition would be in the long term benefit of end users and is likely to give best effect to the purpose set out in section 18..."*
- 1.6 Other empirical studies confirm this. For example, the entry of a third mobile entrant in Portugal led to very substantial price drops which in turn led to industry-wide price reductions. Both effects were directly attributable to competition.¹⁸
- 1.7 The Concept Economics Undertaking report concluded:
- "We find that BAK is an extremely simple and low cost mechanism well suited to MTM calling in New Zealand. It requires no billing and related costs. It imposes minimal upfront and ongoing direct and indirect regulatory costs. It is pro-competitive, being unlikely to distort efficient entry or competitive expansion. Rather, it will promote efficient entry and competitive expansion, and hence competition. It is considered likely to result in outcomes that would be similar to those that would arise under more complex pricing approaches, but be substantially less costly and would be more efficient overall."¹⁹*
- 1.8 As discussed in paragraphs 4.18 – 4.20 below and in Appendix C, there is considerable New Zealand precedent for BAK. Most notably, when Vodafone argued the virtues of BAK when it sought access to Telecom's PSTN (which it obtained on the basis of BAK **and** non-discriminatory pricing).²⁰ Vodafone still benefits from BAK.

¹⁴ In March 2008 the Commission reported that as at March 2007 Vodafone had just over 50% of *mobile subscribers* and as at December 2007 had around a 60% market share by *call volume*. (Source: The Commission's 2007 Telecommunications Market Monitoring Report, dated 31 March 2008.) Subsequently an independent analyst reported that Vodafone had a 72.7% *market share by call volume* as at June 2008. (Source: Greg Main CFA, Director, Equity Research, First NZ Capital – discussed in paragraphs 5.2 and 5.22 below).

¹⁵ As quoted in the *Financial Times*, 27 June 2008 <http://www.ft.com/cms/s/0/734832d0-43e7-11dd-842e-0000779fd2ac.html>.

¹⁶ Issues Paper, para 78.

¹⁷ *Final Determination on the application for determination for 'Interconnection with Telecom's fixed PSTN'*, 28 September 2006 (**PSTN Determination**), para 154 http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/InterconnectionDeterminations/InterconnectionDeterminations/ContentFiles/Documents/500941_6.pdf.

¹⁸ Abrantes-Metz, R.M. and P.Pereira (2007) "The Impact of Entry on Prices and Costs" <http://ssrn.com/abstract=1013619>.

¹⁹ <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/Investigations/MobiletoMobileTermination/ContentFiles/Documents/NZC%20Bill%20and%20Keep%20Paper.pdf>.

²⁰ See, footnote 14.

- 1.9 Other options all have shortcomings which BAK does not. NZ Comms notes that it could seek asymmetric access prices (and indeed reserves its right to do so), which would enable it to recover its higher costs at the wholesale level. If the incumbents continue with their current stance, it may be worth considering as an alternative, but it can lead to an entrenchment of the network effect. The ERG confirmed that 25 countries surveyed allowed asymmetric pricing as at January 2007.²¹
- 1.10 As earlier submitted,²² the “next best” option would be marginal cost (MC) based pricing, discounted to avoid double mark-ups and reflect the benefit received by the called party and their network. Failing that the next best is Long Run Incremental Cost (LRIC), again discounted to off-set double mark-ups. Both cases would require careful estimation of the appropriate cost (a costly and contentious process).
- 1.11 The incumbents’ undertakings are immaterial. They do not come close to any meaningful measure of cost. More importantly they do not fulfil the requirements of the Act. They set a poor counterfactual, and confirm the need for regulation.

²¹ The European Regulator’s Group (ERG) Common Position on Symmetry of Fixed Call Termination Rates and Mobile Call Termination Rates, 28 February 2008., (ERG (07) 83 final 080312) http://www.erg.eu.int/doc/publications/erg_07_83_mtr_ftr_cp_12_03_08.pdf, p74.

²² NZ Comms Issues Paper Main Submission, September 2008. See, for example, paragraphs 5.5, 5.29-5.39.

2. THE UNDERTAKINGS' PRICE TERMS AND THE EXISTING AGREEMENTS

Telecom's undertaking

- 2.1 Telecom's undertaking and Annexures total 78 pages. This comprises a 3 page undertaking and 75 page Annexure 1 – Mobile Termination Terms, itself comprising Schedule 1 (Contact Details); Schedule 2 (Standard Terms for Carriers); Schedule 3 (Services covered by this Undertaking); Schedule 4 (Charges); Schedule 5 (LICAs); Appendix A (Text message services); and Appendix B (Form of Deed Acceptance).
- 2.2 NZ Comms comments on certain key price terms of the undertaking and existing commercial agreements below.
- 2.3 Price terms are contained in Clauses 3 (Charges payable to Telecom) and 4 (Charges payable to the Access Seeker) of Schedule 4 (Charges) of Annexure 1.
- 2.4 The charges for calls (which are reciprocal and symmetric, subject to the point in paragraph 2.9 below) are as follows:

| Period | Per minute charge payable by Access Seeker cents / minute | Per minute charge payable by Telecom cents / minute |
|------------------|--|--|
| To 31 March 2009 | 16.0c | 16.0c |
| To 31 March 2010 | 15.0c | 15.0c |
| To 31 March 2011 | 14.0c | 14.0c |
| To 31 March 2012 | 12.0c | 12.0c |
| To 31 March 2013 | 11.0c | 11.0c |
| To 31 March 2014 | 10.0c | 10.0c |

- 2.5 Importantly for Mobile Calls, Telecom's undertaking provides that charges apply on a **first minute** then per second basis; *"that charge is payable for the first minute of the duration of the call and per-second charge of 1/60th"* for each second after that, except for calls with less than 2 second duration (clause 2.2). As noted in the letter from NZ Comms to the (then) Minister of Communications dated 31 July 2008, NZ Comms estimates that per minute charging provides an artificial inflation of up to 50% above the headline rate as up to 70% of calls are of less than one minute duration. Per minute rounding is discussed further in section 4 below.
- 2.6 The prices for text messages are:
- (a) 3.5c for each Chargeable Access Seeker Text message (clause 3.1(j)); and
 - (b) 3.5c for each Chargeable Telecom Text message (clause 4.1(g)).
- 2.7 No explanation is given for choosing 3.5c.
- 2.8 Clause 4.2 (p54) provides:

"Where a Chargeable Telecom Mobile Call (other than a Call to which paragraph bii of the definition of "Mobile Call" applies) originates at a Telecom Local Number that is allocated to a LICA in a LICA Group where such LICA Group does not contain a Telecom Handover Point, the charge payable by Telecom under clause 4.1a will be reduced by an amount that is equal to 3.5 cents per minute of Call duration."

- 2.9 In other words, if the Access Seeker does not interconnect to all of Telecom's 24 major LICAs, Telecom pays the Access Seeker 3.5c less per minute for every call that originates in a LICA where the Access Seeker does not interconnect with Telecom. NZ Comms is not aware of any international precedent for such a provision, which

effectively dictates the network requirements of the new entrant and creates a price asymmetry in favour of the incumbent operator. NZ Comms also notes that the marginal cost of carrying a call to a point of interconnection is close (if not equal) to zero. There is no justification given for the 3.5c “deduction”. NZ Comms also contrasts this with an existing commercial agreement with a local provider under which it is able to deliver calls to the United Kingdom for 2.1c per minute and is also aware that lower rates than this may be available.

- 2.10 Other charges (set out in clause 3.1(b) – (j) and 4.1 (a) – (g) are reciprocal **except**:
- (a) Telecom grants itself the ability to charge reasonable establishment fees (clause 3.1(b)) – there is no matching ability of the Access Seeker to do this; and
 - (b) Telecom specifies an ability to charge other reasonable charges (clause 3.1(b)) - there is no matching ability of the Access Seeker to do this.
- 2.11 The above clauses raise questions as to why the provisions are not reciprocal, and exactly what would be considered to be “*reasonable*” fees and charges. (Since Telecom efficiently incurs establishment costs then, so would any interconnecting carrier.) As a minimum, establishment fees should be cost based.
- 2.12 NZ Comms notes that the Telecom Undertaking does not address pass-through. This appears unusual given the pass-through commitments given in the FTM deed and the fact that Vodafone’s FTM undertaking (but not its other undertaking) require pass through.

Vodafone’s three undertakings

- 2.13 Vodafone’s undertakings comprise:
- (a) Draft Undertaking to the Commerce Commission [for] the Vodafone FTM Call Termination Service (15 pages);
 - (b) Draft Undertaking to the Commerce Commission [for] the Vodafone MTM Call Termination Service (14 pages);
 - (c) Draft Undertaking to the Commerce Commission [for] Vodafone Text Message Termination Service Undertaking (23 pages); and
 - (d) Draft Undertaking for the Vodafone Mobile Termination Access Service – Schedule 3 - Terms and Conditions (78 pages).
- 2.14 Vodafone’s prices are:

| Period | FTM cents / minute | MTM cents / minute | Text Termination cents |
|------------------|-------------------------------|-------------------------------|---------------------------------------|
| To 31 March 2010 | N/A | 15.0c | 9.5c |
| To 31 March 2011 | N/A | 14.4c | 8.9c |
| To 31 March 2012 | N/A | 14.0c | 8.3c |
| To 31 March 2013 | 13.0c | 13.0c | 7.7c |
| To 31 March 2014 | 12.0c | 12.0c | 7.3c |
| To expiry date | 11.0c | 11.0c | 7.0c |

- 2.15 Sources of Vodafone’s Prices are as follows:

- (a) FTM: per Schedule 2 of (a) above. See also:
- (i) Note 2 provides that *“The Chargeable FTM Call rate applies on a minute plus second basis”* with calls less than one minute *“being rounded up to one minute”*.
 - (ii) Note 3 provides that *“The charge for each Chargeable FTM call is rounded up to the next whole cent”*.
 - (iii) Note 4 provides that *“Chargeable FTM calls of more than two seconds will be charged for the full period of the call”*.
 - (iv) Note: *“N/A”* in the table above means not available under the undertaking. Clause 1.62 (Services Commencement Date of the Terms and Conditions (per 2.10 (d) above) provides that the commencement date is *“no earlier than.....1 April 2012”*.
- (b) MTM: per Schedule 2 of (b) above. Like FTM, Notes 2, 3 and 4 also provide for per minute charging, whole cent rounding and charges for all calls exceeding 2 seconds in respect of MTM. As noted above and discussed in more detail in paragraphs 4.33-4.41 below, per minute charging significantly inflates the headline rate as a large number of calls are of less than 1 minute duration. Rounding the charge of **all** calls up to the next whole cent also further inflates the charge payable to Vodafone.
- (c) Text: per Schedule 2 (Pricing) of (c) above.

2.16 In respect of the Terms and Conditions accompanying the undertakings: Subschedule 3A, Part A, Interpretation, Defined Terms, *Access Seeker Mobile Number* and *Vodafone Mobile Number* respectively (in clause 1.7 and 1.78 respectively) provide:

“1.7 Access Seeker Mobile Number means:

1.7.1 *any number in any number ranges for 02X non-geographic service numbers:*

(a) that may be allocated to the Access Seeker from time to time; or

(b) that has been allocated to a Third Party Reseller that is used on the Access Seeker Network, until such time as the Access Seeker notifies Vodafone that any such 02X numbers allocated to the Third Party Reseller should not be Access Seeker Mobile Numbers, that is not identified by reference to the Ported Number Register as a number ported out of the Access Seeker Network; and

1.7.2 *any Mobile Number (as that term is defined in the Network Terms) that is identified by reference to the Ported Number Register as a number ported to the Access Seeker Network in accordance with the LMNP Determination,*

but excluding any mobile number allocated or ported to the Access Seeker that is used on the Vodafone Network in accordance with an agreement between the parties, and provided that any mobile number of a subscriber of a cellular mobile network outside New Zealand who is roaming on a cellular mobile network in New Zealand operated by the Access Seeker shall be deemed to be an Access Seeker Mobile Number for the purposes of this Undertaking.”

“1.78 Vodafone Mobile Number means:

1.78.1 any number in the 021 number ranges or any other number ranges for 02X non-geographic service numbers:

- (a) that may be allocated to Vodafone from time to time; or*
- (b) that has been allocated to a Third Party Reseller that is used on the Vodafone Network, until such time as Vodafone notifies the Access Seeker that any such 02X numbers allocated to the Third Party Reseller should not be Vodafone Mobile Numbers,*

that is not identified by reference to the Ported Number Register as a number ported out of the Vodafone Network;

1.78.2 any Mobile Number (as that term is defined in the Network Terms) that is identified by reference to the Ported Number Register as a number ported to the Vodafone Network in accordance with the LMNP Determination; and

1.78.3 any mobile number allocated or ported to the Access Seeker that is used on the Vodafone Network in accordance with an agreement between the parties,

provided that any mobile number of a subscriber of a cellular mobile network outside New Zealand who is roaming on a cellular mobile network in New Zealand operated by Vodafone shall be deemed to be a Vodafone Mobile Number for the purposes of this Undertaking.”

2.17 The effect of these definitions would be that NZ Comms’ customers roaming on the Vodafone network are treated as Vodafone Mobile Numbers for the purposes of interconnection. This would mean that Vodafone would not have to pay NZ Comms interconnect charges for calls from Vodafone to NZ Comms’ customers roaming on the Vodafone network. It may also be possible that Vodafone could claim NZ Comms needs to pay a roaming charge plus an interconnect charge for all calls delivered to NZ Comms “roamers”, thus radically altering the terms of the National Roaming Agreement.

2.18 While clauses 3.2 (Pass-through by Access Seeker of reductions in the price of the FTM Call Termination Service) and 3.4 (Pass-through by Vodafone of reductions in the price of the FTM Call Termination Service) of the Vodafone FTM undertaking deal with pass through, NZ Comms notes that the MTM and Text Undertakings have no provisions for pass-through.

NZ Comms’ Undertaking

2.19 NZ Comms considers that while all commercial terms are important, the access price is by far the most significant.

2.20 For that reason – and given that NZ Comms is likely to be the only mobile entrant – it proposed an undertaking under which existing commercial agreements with the incumbents were retained and amended only to provide for a revised access price. (This is despite the fact that the terms of these agreements were essentially “dictated” by the incumbents given the significant imbalance in bargaining power.)

2.21 NZ Comms’ undertaking is 14 pages long. NZ Comms’ undertaking applies (clauses 4.2 and 5.2) to:

- (a) mobile voice calls;

- (b) text messages;
- (c) multi-media messages; and
- (d) video telephony calls.

2.22 The pricing is “Bill and Keep” (clauses 4.3 (b) (Pricing) and 5.3 (b) (Pricing)). This is defined in the undertaking as:

“Bill and Keep or Net Payment Zero means the method of pricing where neither of two interconnecting network operators (in this Undertaking NZ Comms and Vodafone, or NZ Comms and Telecom, as the context requires) charges the other for terminating Mobile-to-Mobile Events [ie interconnecting (cross network) traffic for the services listed in [2.17] above.] originating on the other party’s network. Each network operator provides and receives consideration through the reciprocal interconnection and conveyance services. Each network operator recovers from its own end users the cost of both originating Mobile-to-Mobile Events that it delivers to the other network and terminating Mobile-to-Mobile Events that it receives from the other network.”

2.23 In other words the price for wholesale access is zero cents.

2.24 The undertaking prohibits price discrimination (clauses 4.3(c) (Retail Pricing) and 5.3(c) (Retail Pricing)). By way of example, clause 4.3 (c) provides:

*“Retail pricing: Vodafone and NZ Comms will not impose any charge on their retail customers that would discriminate between Vodafone-NZ Comms Mobile-to-Mobile Events and Mobile to Mobile Events which originate and terminate on their respective mobile telecommunications networks (for the purpose of this clause ... **On-net Mobile-to-Mobile Events**). This requirement applies to retail bundle and usage based charges.*

For the avoidance of doubt, the purpose of this sub-clause... is to ensure that Vodafone and NZ Comms mobile retail customers do not face price differentials when communicating with customers on the other party’s mobile networks (often described as the “tariff mediated network externality”), consistent with the Commerce Commission’s “Final Determination on the application for determination for ‘Interconnection with Telecom’s fixed PSTN’” dated 28 September 2006. By way of example, tariffs such as Vodafone’s “Best Mates” (TM) or Vodafone’s “text 2000” (where customers can make up to 2000 texts to any other Vodafone customer) would not discriminate between termination on the Vodafone mobile telecommunications network and termination on the NZ Comms mobile telecommunications network (ie the price would be the same to the Vodafone customer).”

Existing Commercial Agreements

Telecom’s terms

2.25 Under the existing “Telecom Wholesale Interconnection Agreement” entered into by NZ Comms and Telecom dated 5 October 2007, the per minute charges payable are as follows (clause 4 (Charges payable to Telecom) of Schedule 4 - Charges):

| Period | Charge |
|---------------------|--------|
| | [] |
| To 31 March 2008 | [] |
| To 31 March 2009 | [] |
| To 31 March 2010 | [] |
| To 31 March 2011 | [] |
| After 31 March 2011 | [] |

2.26 The charges are payable []

2.27 The Text price []

Vodafone’s terms

2.28 Under clause 4.1 (Price of Vodafone Network Interconnection Services), Vodafone specifies its fees as follows:

| Type of Chargeable NZC Call | Chargeable NZC Call Rate [] |
|---|---------------------------------|
| Chargeable NZC Standard calls | [] |
| Chargeable NZC National calls | [] |
| Chargeable NZC Mobile calls to 31 March 2009 | [] |
| Chargeable NZC Mobile calls to 31 March 2010 | [] |
| Chargeable NZC Mobile calls to 31 March 2011 | [] |
| Chargeable NZC Mobile calls to 31 March 2012 | [] |
| Chargeable NZC MTM calls to 31 March 2012 | [] |

2.29 Note 2 specifies that:[]

2.30 Note 3 specifies that:[]

2.31 NZ Comms notes that its current commercial agreement with Vodafone, provides for []

2.32 The tables below set out the [] terms for MTM Voice and SMS (respectively):

Summary of MTM Termination Costs – Voice – Current commercial Agreement
Vodafone

| | Amount Payable by Vodafone to NZ Comms [] | Amount Payable by NZ Comms to Vodafone [] |
|--------------------------|---|---|
| Year to 31 March 2009 | [] | [] |
| Year to 31 March 2010 | [] | [] |
| Year to 31 March 2011 | [] | [] |
| Year to 31 March 2012 | [] | [] |
| [] | [] | [] |

Summary of MTM Termination Costs – Text – Current commercial Agreement
Vodafone

| | Amount Payable by Vodafone to NZ Comms [] | Amount Payable by NZ Comms to Vodafone [] |
|--------------------------|---|---|
| Year to 31 March 2009 | [] | [] |
| Year to 31 March 2010 | [] | [] |
| Year to 31 March 2011 | [] | [] |
| Year to 31 March 2012 | [] | [] |

Comparing the undertakings and existing agreements

- 2.33 The following table sets out a comparison of the MTM voice termination costs payable by NZ Comms under the existing commercial agreements with Vodafone and Telecom as compared to the proposed undertakings:

Summary of MTM Termination Costs Under Current Commercial Agreements and Proposed Undertakings – **Telecom**

| | Voice | | Text | |
|--------------------------|---|--|---|---|
| | Amount payable [] under current commercial agreement [] | Amount payable by either party under Telecom undertaking (cents per min) | Amount payable [] under current commercial agreement [] | Amount payable by either party under Telecom undertaking (per text) |
| Year to 31 March 2009 | [] | 16.0c | [] | 3.5c |
| Year to 31 March 2010 | [] | 15.0c | [] | 3.5c |
| Year to 31 March 2011 | [] | 14.0c | [] | 3.5c |
| Year to 31 March 2012 | [] | 12.0c | [] | 3.5c |
| Year to 31 March 2013 | [] | 11.0c | [] | 3.5c |
| Year to 31 March 2014 | [] | 10.0c | [] | 3.5c |
| [] | [] | first minute, then per second | [] | |

Summary of MTM Termination Costs Under Current Commercial Agreements and Proposed Undertakings – **Vodafone**

| | Voice | | | Text | | |
|---------------------------|---|--|---|---|--|--|
| | Amount Payable by Vodafone to NZ Comms under current commercial agreement [] | Amount Payable by NZ Comms to Vodafone under current commercial agreement [] | Amount payable by either party under proposed Vodafone undertaking (cents per min) | Amount Payable by Vodafone to NZ Comms under current commercial agreement [] | Amount Payable by NZ Comms to Vodafone under current commercial agreement [] | Amount payable by either party under proposed Vodafone undertaking (per text) |
| Year to 31 March 2009 | [] | [] | | [] | [] | |
| Year to 31 March 2010 | [] | [] | 15.0c | [] | [] | 9.5c |
| Year to 31 March 2011 | [] | [] | 14.4c | [] | [] | 8.9c |
| Year to 31 March 2012 | [] | [] | 14.0c | [] | [] | 8.3c |
| Year to 31 March 2013 | [] | [] | 13.0c | [] | [] | 7.7c |
| Year to 31 March 2014 | [] | [] | 12.0c | [] | [] | 7.3c |
| 1 April 2014 to Expiry | [] | [] | 11.0c | [] | [] | 7.0c |
| [] | [] | [] | first minute, then per second | [] | [] | |

3. THE STATUTORY TEST

The overall policy of the regulatory regime is to promote competition

3.1 As noted in NZ Comms' September 2008 submission, the purpose of Part 2 (Designated services and Specified services) and Schedules 1 to 3 of the Act are to:

*"... **promote competition** in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by **regulating** ... the supply of certain telecommunications services between service providers."*²³ (emphasis added)

3.2 In making that determination:

"...the efficiencies that will result, or will be likely to result, from that act or omission must be considered".²⁴

3.3 More generally the purpose of the Act *"is to regulate the supply of telecommunications services"* (emphasis added). This regulation acknowledges *market failure* in the provision of telecommunications services flowing from supply and demand peculiarities in telecommunications.

3.4 NZ Comms also noted that excessive MTRs have a number of effects. In particular:

- (a) They exacerbate incentives for large networks to set high on-net/off-net price differentials (**closed net pricing**). This creates a barrier to new entrants by reducing their flow of inbound calls, making the larger incumbents even more attractive to consumers and creating a significant barrier to entry and/or expansion for smaller networks.
- (b) They inhibit new entrants from offering competitive tariffs. If entrants offer low off-net prices (necessary to compete with closed net pricing), they then make losses, whereas the large network makes profits. Indeed, the large traffic imbalances lead to significant financial transfers from small to large players.²⁵
- (c) They also allow incumbent carriers to coordinate on inefficiently high, but profitable retail prices.²⁶

3.5 NZ Comms' submission also noted that the duopoly nature of New Zealand's mobile communications market exhibits many of the harms associated with monopoly (especially when for so long there has been a monopoly in GSM technology), which would be substantially reduced through efficient competitive entry.

3.6 The issues can be clouded by a lack of transparency about costs and profits. It is commonly accepted that Vodafone New Zealand is hugely profitable. In April 2004 National Business Review (**NBR**) quoted Arun Sarin (then worldwide CEO) as

²³ Section 18(1) of the Act.

²⁴ Section 18(2) of the Act.

²⁵ See the literature cited in Concept Economic's earlier report, and also Stennek, J. and T. Tangerås (2008) "Intense Network Competition" <http://ssrn.com/abstract=1303638>, hereafter ST-2008a.

²⁶ The literature on this point has varied, but a wide range of recent papers, which essentially generalise earlier papers, including papers with contrary results now support this conclusion. Note in particular, Poletti, S. and J. Wright (2004) "Network interconnection with participation constraints" *Information Economics and Policy* 15(3): 347-373; Dessein, W. (2004) "Network competition with heterogeneous customers and calling patterns" *Information Economics and Policy* 15(3): 323-345; Hoffer, F. (2006) "Mobile termination and collusion, revisited" <http://ssrn.com/abstract=925801>; Armstrong, M. and J. Wright (2007), "Mobile call termination" <http://ssrn.com/abstract=1014322>; Tangerås, T. (2007) "On the Profit Neutrality of Access Charges in Network Competition" <http://ssrn.com/abstract=1147676>; and Stennek, J. and T. Tangerås (2008) "Competition vs. Regulation in Mobile Telecommunications" <http://ssrn.com/abstract=1147677>, hereafter ST-2008b.

commenting: “New Zealand contributes far more than what the ordinary numbers might suggest it punches above its weight.”

- 3.7 Market monitoring submissions by the industry participants indicate that there is a industry wide concern that while Telecom is subject to strict accounting separation, Vodafone remains an undisclosed secret enterprise to the industry. Vodafone has no regulatory accounting standards to meet. As a consequence much of the debate on whether to regulate or not could be greatly assisted (if not determined) by a simple accounting review of the companies structure, cost base, international operating benchmarks and the real level of profitability.

Neither of the incumbents’ undertakings meets the statutory test

- 3.8 Neither incumbent has addressed the flaws in the market discussed above (and elsewhere) or specified how their undertakings will address these harms.
- 3.9 Instead, they focus on the FTM deeds (discussed below) and comment on offshore experience (also discussed below). Yet while offshore regulatory experiences can be informative **if properly interpreted**, ultimately we are looking at the New Zealand market and our regulatory test. To our knowledge, no international comparisons in the developed world truly reflect the unique situation in New Zealand.
- 3.10 This investigation must be directed at ensuring a New Zealand solution to local conditions and problems, which will necessarily differ to other markets.

The problem remains excessive access prices and closed net pricing

- 3.11 As noted, NZ Comms’ principal concern is with pricing. In particular:
- (a) Current and proposed *access pricing* which are at levels *only possible* as a result of the incumbents’ substantial market power (**SMP**) (regardless of how the relevant market is defined) and which have the purpose of restricting market entry, preventing or deterring competitive conduct or eliminating a person from a market.²⁷
 - (b) Retail pricing which again would not be possible absent SMP. Applying an appropriate counterfactual test, incumbents would not, among other things, penalise offnet pricing in a way that creates artificial network effects (thereby creating significant barriers to new entry and expansion).
- 3.12 NZ Comms has real concerns about much other conduct by the incumbents relating to price and non-price matters. Those are beyond the scope of this submission. But we consider it important to bear in mind that the specific conduct being examined (access pricing and closed net pricing) in our view remains in breach of the Commerce Act 1986 (**CA**). NZ Comms remain perplexed at the incumbents’ approach and can only assume that they have taken the view that appropriate regulatory action will not be taken.

NZ Comms’ undertaking addresses the market problem efficiently & effectively

- 3.13 NZ Comms’ proposed undertaking focuses on the principal concern – price - by simply amending existing interconnection agreements, thereby avoiding the need to renegotiate / regulate non-price terms.

²⁷ In other words conduct which ought properly to be regarded as a breach of s36 of the Commerce Act. The existing interconnection agreements by virtue of their price and non-price terms ought similarly to be regarded as likely to substantially lessen competition in relevant mobile telephony market/s compared with a non-abusive counterfactual prices.

- 3.14 By definition the non-price aspects of the NZ Comms approach must be acceptable to Telecom and Vodafone because the NZ Comms undertaking simply adopts those non-price terms *imposed* on NZ Comms by Telecom and Vodafone, notwithstanding the fact that it considers some of those terms unduly onerous or one-sided.
- 3.15 NZ Comms' undertaking constitutes a total of 14 pages providing a sound solution to the major competition problem of mobile to mobile termination rates as well as closed net retail pricing. It:
- (a) is pro-competitive;
 - (b) is consistent with deregulation (ie no future regulation is required) – this would be similar to Hong Kong, which has adopted a regime that allows operators to negotiate prices, but if they fail to do so then BAK is the fallback;
 - (c) avoids the call termination monopoly bottleneck problem;
 - (d) mitigates the risk of regulator “getting it wrong”;
 - (e) facilitates low retail rates and greater usage through fair competition;
 - (f) is simple to implement, and avoids ongoing regulatory and compliance costs;
 - (g) encourages efficiency and investment;
 - (h) is consistent with the local land-line adoption of BAK (as sought and obtained by Vodafone);
 - (i) is in-line with emerging international best practice; and
 - (j) draws on existing agreements, is simple to implement, and has wide economic and competitive benefits.

The incumbents' undertakings could frustrate the regulatory process

- 3.16 By contrast, Telecom and Vodafone's undertakings cover over 200 pages between them of dense legal text.
- 3.17 It is self-evident that new entry will expose the incumbent duopoly to greater competitive pressures. It is in the incumbents' interests to make their undertakings as complicated as possible and to draw out the process (by endlessly debating the undertakings for as long as possible). It is clear from Vodafone's approach to date (eg its request to extend the timeframe etc)²⁸ that it plans to ensure that the process “drags on”. (By the same token irrelevant or incorrect / confusing points have been made by the incumbents. NZ Comms has chosen not to respond to all these points in detail.)
- 3.18 NZ Comms considers that the debate should not be allowed to be drawn out on the minute detail of either of these undertakings – and that the Commission should bear in mind it would be in the incumbents' interests to have that happen.
- 3.19 The key issue is price. Changes can be made to existing interconnect agreements to adjust price simply and easily.

²⁸ See, for example, its various letters to the Commission on this process.

There are many broader benefits of efficient market entry

- 3.20 Facilitating efficient mobile entry and competition has many benefits which will no doubt be reviewed in detail later in the process. But it is intuitive that facilitating efficient entry will, among other things:
- (a) result in a vibrant competitive mobile sector, ie enhance dynamic competition;
 - (b) result in lower prices, greater usage – get people talking and doing business;
 - (c) increase the productivity of the New Zealand business sector, including the nation’s effectiveness as an international competitor, ultimately increasing the well-being of all New Zealanders;
 - (d) end monopoly rents and consequently lower New Zealand financial transfers of those rents overseas;
 - (e) lead to greater investment in the sector;
 - (f) improve opportunities for skilled workers;
 - (g) improve opportunities for entrepreneurs and innovators; and
 - (h) will increase employment in New Zealand.

Global financial crisis accentuates the need for significantly reduced MTRs

- 3.21 Vodafone’s submission plays on the global financial crisis and the importance of maintaining investor certainty rather than overturning the existing (FTM only) deed. This is a rather peculiar claim only made explicable by its self-serving nature. Maintaining the present duopoly will harm: (1) investment, by preventing the substantial investments NZ Comms will make, and the investments Telecom and Vodafone will make in response, and (2) the efficient operation of the New Zealand economy. (We noted examples of links between competitors and investment in paragraph 1.2 (f) above.)
- 3.22 Moreover, ensuring the New Zealand mobile market is efficient will have a far greater beneficial impact, in the short and long term, on the New Zealand economy, than continued protection of the present inefficient duopoly. As a consequence, given the present crisis, it is all the more important that an appropriate regulatory framework be put in place. These benefits include a short run employment and expenditure boost, and long run productivity and income boosts. Maintaining the status quo would mean forgoing these benefits.
- 3.23 In addition, it is worth pointing out that Vodafone claims traffic is and will be generally balanced.²⁹ If true, then reducing MTM rates or introducing BAK should not change the net flow of payments between networks, and hence, such a change should not impact on investor returns (in this respect).³⁰ That lays bare Vodafone’s real concern, namely that entry by a third player will reduce retail prices, because it will increase competition, and that this would harm Vodafone and its investors because it would lose monopoly rents.

²⁹ See, for example, Vodafone’s letter of 29 May 2008 to Dr Ross Patterson, Telecommunications Commissioner which states that “Market Share Should Not Generate Traffic Imbalances ...” (heading after paragraph 36) and that any asymmetry flowing from “*different retail pricing opportunities ... would be expected to be fairly short-term in nature ...*” (para 44).

³⁰ This is confirmed in the literature. See, for example, ST-2008b, p19.

- 3.24 Finally on this point, NZ Comms, as a startup, bears substantially greater risks than the incumbents, and all the more so in a recession, but stands ready to make substantial investments contingent on gaining the right to compete on a level playing field. This makes it clear that Vodafone's claim, that the present economic situation calls for maintenance of a cosy environment for its (and Telecom's) investors, is not necessary for its survival, or even capacity to thrive, let alone about what is best for New Zealand. Rather, it merely states a preference for a comfortable life, un-harassed by competition. Moreover, it is not credible for Vodafone to claim it would invest more if its protected position was maintained, than if it faced aggressive competition from a new entrant.

4. PROCESS

4.1 NZ Comms comments on process and related issues in this section 4 under the following headings:

- (a) timing concerns / urgency;
- (b) debate on “cost”;
- (c) mischaracterisation of this investigation;
- (d) irrelevant comments on pass through; and
- (e) per minute rounding.

Timing concerns / urgency

4.2 This process began with a Letter to Interested Parties on 8 May 2008. On the current timetable, the final report will be delivered to the Minister on 27 November 2009. Assuming that timetable is met, it will be a considerable period of time until a determination is made and (it is hoped) an appropriate regulatory regime brought to bear.

4.3 The complexity of the incumbents’ undertakings contributes to this – yet as noted, the principal issue is price. This can be fixed by adopting BAK, but whatever the pricing solution, non-price terms could be set as per the existing agreements, greatly simplifying the matters to be resolved. The reductions in both the direct regulatory costs incurred and the costs of delay are efficiencies that should be considered under the Act.

4.4 NZ Comms notes that if the Commission were minded to follow the new non-price terms approach, then it should surely work to a single uniform undertaking for both incumbents.

4.5 New Zealand may have “one shot” at entry – if NZ Comms does not succeed due to a failure to impose an appropriate regulatory regime (or undertaking) in a timely manner, this would deter any subsequent new entry as prospective investors would know that the regulatory regime did not live up to its promise.

Debate on “cost”

4.6 As earlier submitted, and is abundantly obvious in submissions around the world, there will always be arguments about the relevant cost, including allocation, detriments etc and cost of regulation. A cost-based focus could also lead to a focus on static, rather than dynamic efficiencies (at the extreme it could favour a regulated monopolist which is inconsistent with the underlying assumption of the Act).

4.7 Given the incumbents’ undertakings are, in effect, not materially different from the status quo, it is important to contrast them with BAK. But the questions must be:

- (a) Does BAK facilitate efficient entry?
- (b) Does BAK have long term benefits to consumers?

4.8 The answer is “yes” to both questions - BAK is the quickest, most efficient means of removing the market distortions.

- 4.9 BAK, which implies a zero termination charge, will be efficient in the New Zealand context for three reasons:
- (a) Compared with seeking to identify the optimal rate, BAK has low direct regulatory costs.
 - (b) It results in a price that is close to the unknown optimal price, so such a price is unlikely to distort outcomes materially relative to a regulated outcome, if it would result in any relative distortion at all (since the regulatory process will not identify the ideal rate, but rather merely an estimate of it).
 - (c) Compared with setting a price, BAK has lower set-up and ongoing operations costs.
- 4.10 As a result, BAK is likely to be welfare superior to regulating optimal termination charges. In particular, the efficiency cost of the small difference between zero and the optimal termination charge is unlikely to exceed the costs of attempting to, but still not correctly, identifying the optimal termination charge, and the implementation and ongoing costs of billing processes. These points are now explained in somewhat more detail.
- 4.11 Regulatory proceedings are clearly expensive, and introduce costs of delay in establishing the regulated rates.³¹ These costs must be weighed against the potential benefits obtained from the proceedings, presumably (but not necessarily) a more accurate estimate of the efficient termination charge than, in this case, the zero termination charge implied by BAK.
- 4.12 Moreover, even with careful formal (and costly) inquiries as to the efficient termination rate, the optimal rate is unlikely to be identified. Rather, the rate chosen will be the regulator's best estimate. Thus, any efficiency costs that would be incurred due to choosing a zero rate must be discounted by the efficiency costs that would be incurred under regulation (because the optimal rate will not be chosen through formal regulatory inquiry).
- 4.13 Yet, a zero termination charge may well be a good approximation for the efficient charge. The economic literature is almost uniformly consistent in finding that in a world with no transactions costs, and where mobile penetration is relatively high, that the efficient termination charge would reflect marginal cost, or be less than that (for example, reflecting the calling externality or the need to avoid double-marginalisation). The marginal resource cost of carrying an additional mobile minute, or for that matter ten or one hundred mobile minutes, is very close to zero. Taking account of the call externality and/or problems of double-marginalisation raises the possibility that a negative termination charge may be efficient. In any case, the academic literature suggests that BAK can lead to efficient prices in any case, so long as competing networks are close substitutes, and interconnection is required, access prices are symmetric and closed network pricing is ruled out.³²
- 4.14 While, we are not aware of any economic models that show that setting termination charges to long run *average* incremental cost (LRAIC) is efficient, even this number may well be tiny. In the US, LRAIC (called TELRIC) estimates for local switching

³¹ ST-2008b, p5: "A recent Swedish official report (SOU, 2006) describes excessive bureaucratic complications. Companies and regulators often have divergent views of most issues... Legal proceedings are known to drag on for years. In addition, companies have great difficulties in predicting the eventual decisions by regulatory agencies and courts. The official report speculated that this legal uncertainty reduces investments and limits the supply of services to consumers. This conclusion is supported in a report to the European Commission (London Economics, 2006) comparing investment in electronic communications throughout the EU. It concludes that regulatory uncertainty is sometimes detrimental to higher levels of investment."

³² ST-2008b, pp6, 19.

appear to run from USD0.00004-USD0.0061 (averaging USD0.00058) and for transport from USD0.00010-USD0.00727 (averaging USD0.00057).³³ Moreover, the FCC has set a rate of USD0.0007 as their benchmark TELRIC estimate.³⁴ Indeed, rates elsewhere are virtually only set at levels materially higher than the FCC benchmark rates when the regulator has included a range of costs that do not typically vary with call minutes, but which are shared in the supply of call minutes, that is, when they have added a cost contribution to LRAIC.

- 4.15 Finally, imposing non-zero termination rates requires setting up billing processes and ongoing bill procedures that are also costly. Such costs are avoided under BAK.
- 4.16 In summary, given the unknown efficient termination price is likely close to zero, the costs of regulation, including delay, on-going dispute and regulatory error, are high, and that there are costs of billing, then it is likely BAK is in practice more efficient than regulating to determine and impose a so-called “optimal” rate.

If Vodafone’s submissions about cross-network traffic are correct, adopt BAK

- 4.17 For completeness NZ Comms notes that given that, with regard to MTM pricing, seeing as Vodafone says that traffic is generally balanced, reducing MTM rates or introducing BAK should not change the net flow of payments between networks, and hence, this should not impact on investor returns. That lays bare Vodafone’s real concern, that entry by a third player will reduce retail prices, because it will increase competition. That would harm Vodafone if it was earning monopoly rents, or was inefficient or both.

BAK has precedent in New Zealand

- 4.18 BAK is not a new concept in New Zealand. For example it has previously been used by:
- Telecom/Telstra Clear for Fixed line & Local calls,³⁵
 - Telecom/Vodafone for MMS traffic;³⁶
 - Telecom/Vodafone for MTM calls;³⁷
 - Vodafone/“Another fixed carrier”, apparently for Fixed Line calls³⁸.
- 4.19 Most significantly, Vodafone sought – and obtained – BAK pricing when it introduced its fixed line service using Telecom’s Fixed PSTN. So BAK is being used at Vodafone’s request. At Vodafone’s request the Commission also prohibited Telecom from price discrimination (namely charging more for calls termination on Vodafone’s

³³ High-Cost Universal Service Support, Federal-State Joint Board on Universal Service, Lifeline and Link Up, Universal Service Contribution Methodology, Numbering Resource Optimization, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Developing a Unified Intercarrier Compensation Regime, Intercarrier Compensation for ISP-Bound Traffic, IP-Enabled Services, WC Docket Nos 05-337, 03-109, 06-122, 04-36, CC Docket Nos 96-45, 99-200, 96-98, 01-92, 99-68, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 5 November 2008, page A-114, para 254.

³⁴ Strictly, this was the rate for ISP-bound traffic, but in choosing to apply this rate a local exchange carrier has to offer the same rate on a reciprocal basis to all competitive local exchange carriers and mobile carriers terminating local calls on its network. The result has been widespread use of the rate for terminating fixed calls on mobile networks. This is a benchmark rate because the FCC allows any party to seek a higher rate through a process wherein the TELRIC cost of termination is established to be higher. Few if any mobile carriers have sought to avail themselves of this option. *Ibid*, paragraph 12 and also footnote 77, for a short summary. The original decision was Intercarrier Compensation for ISP-Bound Traffic, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9171–72, (2001) (ISP Remand Order).

³⁵ Referred to by NZCC at para 74 of “Homezone” Final Determination, 28 Sept 2006.

³⁶ Per para 83, Homezone Determination, referring to/ quoting Vodafone submission.

³⁷ Para 83, Homezone Determination, referring to Vodafone submission noting Telecom and Vodafone had “in the past” interconnected MTM calls on BAK basis.

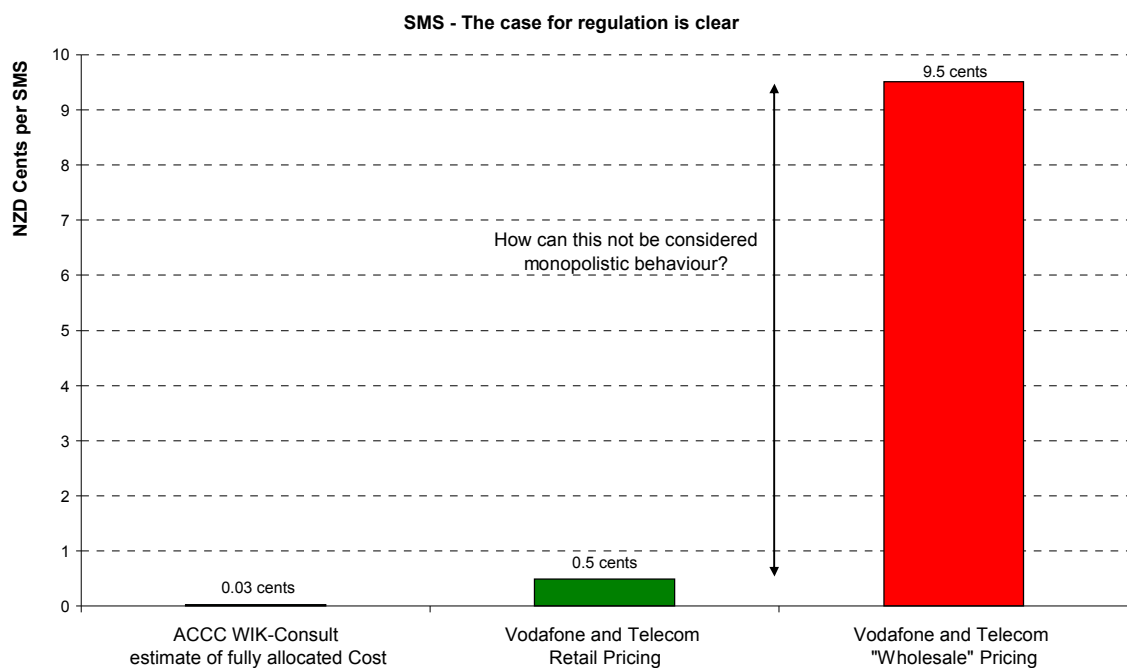
³⁸ Para 84, Homezone Determination:” In its Application, Vodafone notes that it had agreed with another fixed carrier to exchange traffic with the proposed local access service on a bill and keep basis.”

network; directly analogous to closed-net pricing). Fixed line prices have actually come down much further in New Zealand as a result of Vodafone’s successful entry.

- 4.20 Further, BAK is already employed by Vodafone for its on-net calls. Vodafone does not receive a terminating fee for calls that are made from one of their customers to another person on its network and they recover the full cost from the originating customer – even though these calls are often charged at heavily discounted rates.
- 4.21 Finally on this point, we return to the statutory test and the purpose of this Investigation. Regulating MTRs should focus on removing the distortions under the status quo, and the issue is whether the undertakings do anything to fix that – which they patently do not. BAK does.

The different approach to “costs” for internal and external purposes

- 4.22 But it is worth highlighting the discriminatory nature of the incumbent’s pricing. In Australia, WIK estimated A0.03c “per leg” was the fully allocated cost of text termination. Vodafone sells text messaging for as low as NZ0.25c “per leg” (including GST). This makes it essentially impossible to explain how, in the absence of substantial market power, a wholesale rate can be set at 9.5 cents. Indeed, a wholesale price that exceeds a retail price by up to over 40 times is not readily explained by ordinary profit-maximisation. Rather, the only plausible way such prices could maximise Telecom and Vodafone’s profits is if they prevent entry thereby protecting existing margins. As highlighted in NZ Comms’ September 2008 Submission, the wholesale / retail differentials do not “stack up” and can only result from an abuse of market power (conduct not addressed by the undertakings).



- 4.23 Vodafone offers 2000 on-net texts for \$10. The same number of off-net texts would cost the customer \$400. This pricing differential goes to the core of the problem. The fact that off-net texts are charged at such a premium effectively means that almost no cross network traffic exists for some customer types. The result may be that if NZ Comms were to attract a customer to their offering, they would be unlikely to receive calls / texts simply because it imposes a huge burden on customers of other networks. The utility of mobile (in practice being able to receive calls as well as make them) is

seriously diminished and customers would ultimately leave NZ Comms and re-join the large network. This problem was the sole reason for Vega foreclosing its Slovenian investment of USD200m. New entry in Slovenia was delayed by many years as a result.

- 4.24 In fact, the problem in Slovenia was less pronounced as incumbent off-net pricing was “only” between 2 and 14 times higher than on-net pricing. *The New Zealand market has prices up to forty times higher.* If the New Zealand regulatory regime cannot manage distortions of this magnitude, which threaten the viability of any efficient entrant, then there may not be another investor likely to enter the New Zealand market without substantial regulatory reform.

Mischaracterisation of this investigation

- 4.25 NZ Comms wishes to record its concern that this inquiry has been mischaracterised, which has in turn been misreported by the media.

- 4.26 In short, contrary to submissions:

- (a) This is not the third inquiry of its type:

- Telecom (Para 2) inaccurately says there have been “*previous mobile termination investigations*”. There has been only one Schedule 3 Investigation into mobile termination – and it only concerned FTM.
- Telecom (Para 24) also says “*The current Schedule 3 investigation is the third of its kind in a five year period.*” This is misleading – there has been no previous MTM investigation of any sort, ever.
- More significantly, this Investigation also covers MTM voice, MTM SMS and closed network pricing.

- (b) FTM deals do not negate the need for an inquiry.

- As noted, the FTM deals must be seen “in context” – the Commission investigation and recommendation occurred before the undertakings regime was implemented (and the usual decision-making minister was conflicted from making the determination).

- (c) As a related point there is reference to Vodafone and Telecom having engaged with the MED on that process. It is unclear, which (if any) interested parties were engaged (and to what degree) in that process.

- 4.27 So as a result of these submissions there has been confusion about this process. This can be seen from reports in the media. For example:

- (a) “*Telecom appears to be playing hardball with the Commerce Commission in its investigation of **mobile termination rates – a price to end a call from a fixed landline to a mobile phone***”.³⁹ (emphasis added)

- (b) “*It is the commission’s **third** attempt to regulate the mobile termination wholesale charge which makes up part of the price fixed line callers pay when they phone mobile numbers*”.⁴⁰ (emphasis added)

³⁹ Keown, J., 29 January 2009, “Telecom bids to keep mobile savings” *The Independent*, p4.

⁴⁰ Drinnan, J., January 27 2009, “Telco’s fight Commission charges plans”, *New Zealand Herald*.

- (c) “Vodafone and Telecom argue that the voluntary agreement and its undertakings are guaranteed to be passed on to consumers and that has contributed to a fall in the charges to retail customers. Formal regulation would be limited to the wholesale sector and there would be no guarantee that it would be “passed through” to consumers”.⁴¹ (emphasis added)
- (d) “Today, the ComCom has announced a **third investigation** into whether mobile termination rates and national roaming charges should be regulated”.⁴² (emphasis added)

4.28 Finally NZ Comms is surprised that Telecom (at para 31) suggests that its undertaking is more favorable than a Schedule 3 process. This is obviously incorrect. As noted they have a duty to profit-maximize and are not offering favours. Yet conversely, NZ Comms and the end-users’ interests are closely aligned – it has no customers and will readily accept lower wholesale / retail prices to get them.

Irrelevant comments on pass through

- 4.29 The incumbents spend much time arguing about pass-through. NZ Comms reiterates that the question, when looking at MTM, is not whether a regulated duopoly will pass through reduced wholesale termination costs to end users, but that significantly reduced termination costs will facilitate new entry and increased competition. It is increased competition which will result in lower prices, as opposed to any pass through obligation.
- 4.30 The extent of any reduction in mobile retail prices will depend on the type of regulatory intervention. If regulation of MTRs were to lead to only a small MTR reduction (as proposed by the incumbents’ undertakings) then effective pass-through would be less than would occur if regulation led to significant MTR reductions that did result in efficient competitive entry.
- 4.31 A substantial reduction in the MTRs will encourage entry, and that entry (eg NZ Comms) would intensify competition in the retail mobile market leading to better outcomes to all mobile consumers (and the broader economy), including price reductions, as previously evidenced by Concept Economics.
- 4.32 The likelihood of price reductions following new entry was also acknowledged by the Commission in the *PSTN Determination* in Vodafone’s favour (which also adopts BAK and non-discriminatory retail pricing).

Per minute rounding

- 4.33 Putting aside other concerns about international comparisons (discussed below), NZ Comms wishes to repeat a concern previously highlighted with Telecom and the Commission.
- 4.34 Telecom purports to make international comparisons and seeks to favourably compare itself with international benchmarks. Yet Telecom **consistently – and despite having the error pointed out to it – fails to adjust its comparisons to reflect the fact that Telecom requires first minute rounding charges whereas standard international practice is per second rounding**. This materially skews international comparisons in its favour.

⁴¹ See above.

⁴² Keall, C., 6 November 2008, “Tuanz: Don’t let Telecom and Vodafone off the hook again”, *The National Business Review*.

4.35 As noted in NZ Comms' letter of 19 August 2008 to Telecom, NZ Comms had

"...outlined...concerns that first minute rounding charges are unprecedented in any interconnect arrangements globally and have the impact of artificially inflating the wholesale price (perhaps by up to 50%). First minute rounding also creates distortions at the retail level limiting the ability of operators to compete and innovate or price".

4.36 In response (contrary to claims in current submissions) Telecom suggests (Letter of 25 August 2008) that the FTM deed rate provide a "reasonable glide path down to a rate which we consider reflects the cost of mobile termination". Yet even **today** regulators around the world say current benchmarks are out of date, let alone in years to come.

4.37 The same (25 August 2008) letter states that other terms (ie including per minute billing) are "consistent with industry practice and NZ market pricing". Either this is one and the same category or Telecom is wrong as industry practice worldwide is clearly not per minute pricing. Equally, how can a monopolist/duopolist discuss industry practice when **it** decides what the practice will be? As noted in NZ Comms' letter of 16 September 2008 to Telecom, that response does not adequately address the issue:

"First minute rounding may be the way things have been done in New Zealand until now but that does not justify retaining it when we consider the distortions it creates on retail competition, the stifling effect on service providers to innovate on packages, the artificial inflation of prices, the arbitrage opportunities and the fact that in the absence of SLAs on service quality, a wholesale provider has positive incentives to offer poor network quality (as it increases the inflation effect)."

4.38 The continued requirement of the incumbents in their undertakings for per minute billing is hugely significant and of continuing concern of NZ Comms. As noted in NZ Comms' letter of 17 September 2008 to Osmond Borthwick, Director, Telecommunications Branch:

"In response to your specific questions, NZC has contacted approximately 40 Operators in 15 Countries. We have received 16 responses and the table below summaries the results.

| Country | Wholesale Charging Increment | |
|----------------|------------------------------|------------------|
| | Mobile Termination | National Roaming |
| Austria | Per second | Per second |
| Australia | Per second | Per second |
| Belgium | Per second | N/A |
| Denmark | Per second | Per second |
| France | Per second | Per second |
| Germany | Per second | No info |
| Ireland | Per second | Per second |
| Israel | Per second from 1/1/09 | N/A |
| Italy | Per second | Per second |
| Netherlands | Per second | N/A |
| Poland | Per second | Per second |
| Sweden | Per second | Per second |
| United Kingdom | Per second | Per second |

With the single exception of Israel, all operators in all countries have confirmed that per second billing is the norm for both mobile termination rates and for national roaming agreements.

In Israel the current mobile termination charging structure is similar to New Zealand. However, this will change to charging on a per second basis as of 1st January 2009...

4.39 As also noted in that letter NZ Comms confirmed:

“... we know that MTRs in the EU have come down by 20% in the 18 months from January 2007 so even if it were established that MT was the appropriate benchmark, the prices today would be much lower and the prices going forward would be lower still.

The impact of per second billing clearly needs to be addressed. As I have argued before, the New Zealand practice of round up wholesale prices to the first minute introduces a number of distortions, opportunities for arbitrage, stifles the ability of service providers to compete on retail prices, relies on network quality of terminating networks and is not the norm in the rest of the world.”

4.40 Notwithstanding unequivocal international precedent, on 25 September 2008 Telecom advised NZ Comms:

“We do not consider there is a compelling reason to move to....per second billing”

4.41 This is a response only possible from a monopolist/duopolist.

5. OFFSHORE EXPERIENCES AND BENCHMARKING

Introduction

- 5.1 NZ Comms considers that attempting to use international MTR rates as benchmarks for MTM pricing is unreliable and counter-productive given the diversity of international regulatory practice, the historical nature of the MTRs and the many other difficulties inherent in benchmarking exercises. Such difficulties include selecting meaningful calling profiles to calculate a headline rate (for example, to average rates that differ across networks, by time-of-day, and by charging unit) and identifying an appropriate exchange rate.
- 5.2 More generally, when examining approaches taken by regulators abroad and views expressed by them it is important to recognise the context in which those decisions are made. The New Zealand market currently has limited competition between only two facilities-based players, one of which has a technically superior network which strengthens its market power. This contrasts starkly with the situation faced by regulators in benchmark countries – NZ Comms is not aware of comparable benchmarks with GSM operators who reportedly have as high as 72.7% market share by traffic. (Source: an independent analyst report that Vodafone had a 72.7% *market share by call volume* as at June 2008;⁴³ Commission figures to December 2007 put this at around 60%.⁴⁴) The heavily concentrated market in New Zealand has led to high barriers to entry expansion due to the combination of high MTRs and strong on-net retail discounting causing a closed network effect.
- 5.3 There are tremendous efficiency gains in New Zealand to be achieved through introducing BAK or dramatically reducing MTRs below those in the Telecom and Vodafone Undertakings. Doing so would permit effective entry, which would reduce current deadweight loss, strengthen incentives for productive efficiency, and substantially increase dynamic efficiency through competition and innovation.
- 5.4 That a regulator of a much more competitive market containing three, four or even five established network players considers, for example, there is no need to reduce charges, or that only modest reductions are required, has no applicability to the peculiarities of the New Zealand market. What the Commerce Commission needs to consider is the impact on the real level of payments from NZ Comms to Vodafone due to the level of entrenchment at a high penetration rate.
- 5.5 In what follows, NZ Comms comments in detail on claims made by Telecom in relation to international benchmarking, and shows that its analysis is misleading. NZ Comms also make some remarks on recent publications by the ACCC and the UK Competition Commission on MTRs, and highlights the strong downward trend in EU rates.

⁴³ Greg Main CFA, Director, Equity Research, First NZ Capital, calculations based on data available from http://www.vodafone.com/start/investor_relations/financial_reports/previous_results_announcements.html and Telecom Quarterly result releases.

⁴⁴ In March 2008 the Commission reported that as at March 2007 Vodafone had just over 50% of *mobile subscribers* and as at December 2007 had around a 60% market share by *call volume*. (Source: The Commission's 2007 Telecommunications Market Monitoring Report, dated 31 March 2008, see <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/MonitoringandReporting/ContentFiles/Documents/2007%20Telecommunications%20Market%20Monitoring%20Report0.pdf>).

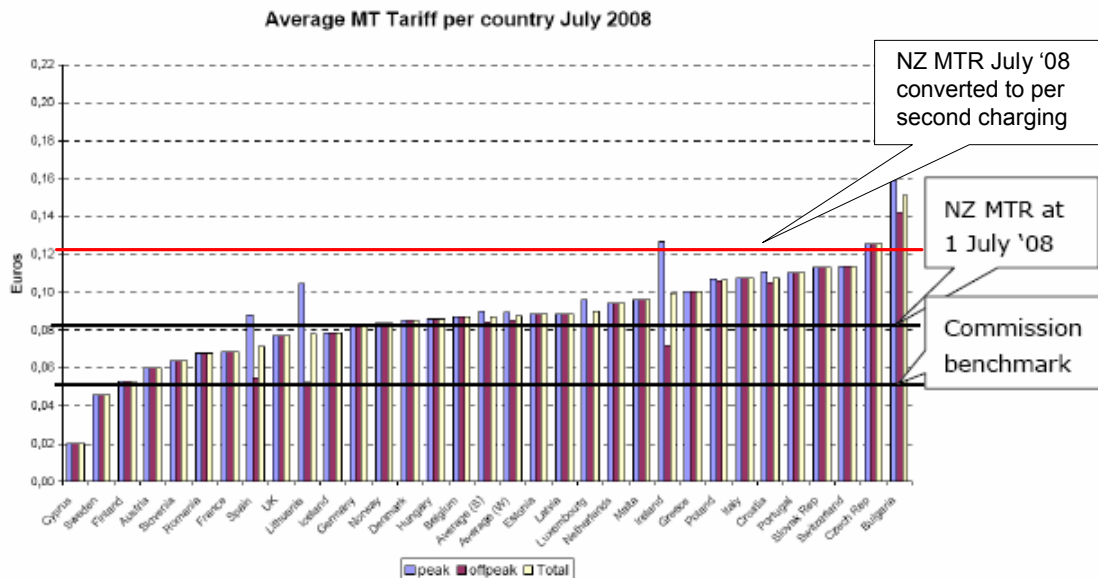
Comments on the Telecom's claims regarding international comparisons

- 5.6 Telecom (para 9) claims that the rates in the MTR deed “*compare favourably with the rates reported by the ERG*”. NZ Comms considers that the Telecom comparisons are misleading.
- 5.7 A first and crucial flaw is that Telecom compares the New Zealand rates which are billed on a one minute plus one second basis⁴⁵ with rates in other countries that are billed on a per second basis. The result is that the Telecom comparison is simply incorrect because it is not comparing like with like. This materially affects the results of the international comparison, such that the Telecom comparison wildly understates the effective rate paid in New Zealand. That per minute pricing can dramatically increase the effective price paid per second was demonstrated by the Commission in the Issues Paper, where it found, for example, that calls having duration of 10 seconds or less were effectively charged a rate of at around \$1 per minute or more. The ACCC has also explicitly recognized the price inflation that results from using increments that are larger than 1 second.⁴⁶
- 5.8 To demonstrate the effect of rounding, consider the following example:
- Assume that the number of seconds rounded up is randomly distributed across calls that have duration of 1 minute or less.
 - This means that a call with 1 second duration will have 59 seconds rounded up, a call with 2 seconds duration will have 58 seconds rounded, up and so on.
 - The average number of seconds rounded up for calls of duration less than a minute would therefore be 30 seconds (ie, $(59 + 58 + 57 + \dots + 3 + 2 + 1)/59$). In reality, there are likely to be a high number of very short-held calls - for example, due to voice message services and calls that have poor call quality so that the caller soon disconnects and redials again later. This means that the average number of seconds rounded up for sub-minute calls would substantially exceed 30.
 - If 50% to 75% of FTM and off-net MTM calls have a duration of less than 1 minute, then the average across all FTM and off-net calls will be 15 seconds to 22.5 seconds.
- 5.9 In the above example, if FTM and off-net MTM calls have a duration of around 2 minutes, then one minute + one second rounding implies a 12.5% to 18.8% higher price as compared with per second rounding. In fact, the price inflationary effect will be much higher because of the prevalence of very short-held calls (as noted above). NZ Comms understands that the true impact on price may be closer to 50%.
- 5.10 Applying a 50% uplift factor to the New Zealand rates so as to be able to make a meaningful comparison with the EU rates collected by the ERG shows the MTR Deed rate to be significantly in excess of the rates applicable in all Western Europe, and in Eastern Europe cheaper only than the rates in the Czech Republic and Bulgaria (both of which will be subject to significant cuts in the near future - see para 5.18 below).

⁴⁵ That is, calls with duration less than one minute are rounded up to one minute.

⁴⁶ Telstra, as of 1 November 2008, commenced billing FTM calls in 30 second increments thereby raising the effective price paid for FTM calls significantly. “ACCC Draft Pricing Principles Determination November 2008, p18.

- 5.11 **Figure 1: ERG chart contained in TNZ submission – with NZ MTR rate converted from 1 minute rounding to per second charging**



- 5.12 A second substantial problem with the Telecom analysis is that it is comparing international benchmarks based on historic data with future proposed New Zealand prices. It is inappropriate to compare past benchmarks with current rates as by definition the historic benchmarks are out of date. The error is compounded by not offering that (already out of date) price until a future point.
- 5.13 In any event the ERG's data that Telecom relies on is already 7 months old and has been overtaken by developments that we detail below. Telecom makes the claim that *"the latest available evidence confirms the pricing in the MTR Deed is robust."* However, it is clear that many of the EU rates it presents have been superseded by regulators' decisions to cut rates significantly. More generally, Telecom misses the point expressed in the NZ Comms Submissions and Concept Economics Reports that there is a growing trend in the EU to reduce rates as a result of the view expressed by the EC.
- 5.14 A further difficulty with the Telecom discussion of international rates is its claim that *"...the rates in [its] MTR Deed lie within a range of forward looking cost based rates reported by the European Regulators Group (ERG)".*⁴⁷ Telecom fails to provide a reference for this comment. The ERG's July 2008 MTR Snapshot referred to by Telecom,⁴⁸ contains no evidence to support Telecom's claim that the European countries MTRs are either purely cost based or forward looking.

Benchmarking and recent pricing developments

- 5.15 The vast variation in MTRs internationally makes benchmarking for the purposes of determining a reliable estimate of cost, a dubious if not impossible exercise. Within the EU alone individual network MTRs vary from 2€¢pm up to 16€¢pm but, recently most regulators have concluded that significant reductions to existing MTRs are needed.⁴⁹ As a result, international benchmarking provides little guidance to

⁴⁷ Telecom Submission Accompanying Proposed Undertaking 12 January 2009 para 9.

⁴⁸ <http://www.erg.eu/template20.jsp?categoryId=260345&contentId=544607>.

⁴⁹ In the last month, the French regulator concluded that the long-term MTR should be 70-85% below current charges. The Italian regulator has found that MTRs should fall by more than half over the next three years. These recent decisions follow public statements made by the European Commission (EC) that MTRs in the EU are unacceptably high and should be reduced by around 70%.

determining MTRs. Moreover, regulated MTRs are in a significant state of flux in most locations. In virtually all such cases, they are subject to substantial and ongoing regulatory reductions. Consequently, benchmarking against present MTRs would not result in MTRs that reflect most regulators' desired price levels, but would significantly exceed them due to the historic nature of present MTRs.

- 5.16 The average mobile terminating charge in Europe is set to be reduced significantly over the next two to three years. The European Commission is currently pursuing a policy of both price reduction and price standardisation. It has indicated that it expects this process to reduce mobile retail charges by around 70%, which, according to its reasoning, implies a reduction in the terminating rate of a similar magnitude.⁵⁰ Indeed, the Commission has indicated that it considers a cost orientated terminating rate to be between 1€¢pm and 2€¢pm.⁵¹
- 5.17 While the Recommendation has yet to be adopted, the European Commission is making its policy felt in other areas. Most notably, the European Commission recently wrote to the Bulgarian regulator requesting that the rates be reduced substantially.⁵² Similarly, the Commission recently threatened the German regulator with infringement proceedings for not notifying it of that country's terminating charges.⁵³ Lastly, it is regular practice for that Commission to now use the Article 7 notification practice to reiterate its policy that MTRs be substantially reduced.
- 5.18 Irrespective of this process, most Member States are already cutting their MTRs. In the last four years, rates have fallen by almost 40% on average due to the glide paths imposed by most regulators.⁵⁴ The continued use of glide paths will mean that rates will continue to fall – with the ERG estimating that this will equate to a fall of around 1.7€¢pm in the latter half of 2009, down from 8.7€¢pm in July 2008.⁵⁵ Some specific examples include:
- (a) In 2008, the French regulator decided that that Orange France and SFR, which currently charge 6.5€¢pm, will apply a maximum call termination rate of 4.5€¢pm from 1 July 2009 and 3€¢pm between 1 July 2010 the end of 2010.⁵⁶ In praising this decision, the European Commission encouraged ARCEP to continue cutting rates to a level of between 1€¢pm and 2€¢pm by 2011.⁵⁷
 - (b) In the United Kingdom, the recent decision of the Competition Commission will see rates drop to 4pence per minute (**ppm**) for the GSM operators by 2010/11 from prevailing levels of around 6ppm. For H3G, the 3G-only player, prices will be cut from 8.9ppm to 4.4ppm.
 - (c) In Germany, it is widely anticipated that the regulator will cut prices (to be announced on 12 February 2009).
 - (d) In Italy, Wind, Tim and Vodafone will be permitted to charge 5.3€¢pm in 2011 (a reduction from 8.85€¢pm for Vodafone and TIM and 9.51€¢pm for Wind. By

⁵⁰ "Lower charges, greater consistency, more competition: Commission consults on bringing down mobile phone tariffs in Europe", IP/08/1016, 26 June 2008.

⁵¹ "Commission welcomes French regulator's move to introduce competitive mobile termination tariffs", IP/08/1810, 27 November 2008.

⁵² The Bulgarian terminating rate is currently 15.09c, with the Bulgarian regulator planning to reduce it to 7.6c by 2010. This level is already being undercut by a number of EU states, and is only slightly below the prevailing average of 8.7-9.0c.

⁵³ "Commission Continues MTR Campaign", *BMI Industry Insights*, 4 December 2008.

⁵⁴ IRG/ERG Response to Public Consultation on Termination Rates, September 2008, ERG (08) 31 rev1.

⁵⁵ "EU telecoms watchdogs to study call pricing change", *Reuters*, 17 October 2008.

⁵⁶ "SFR seeks to fight mobile termination rate cuts in court", *DMEurope*, 6 February 2009.

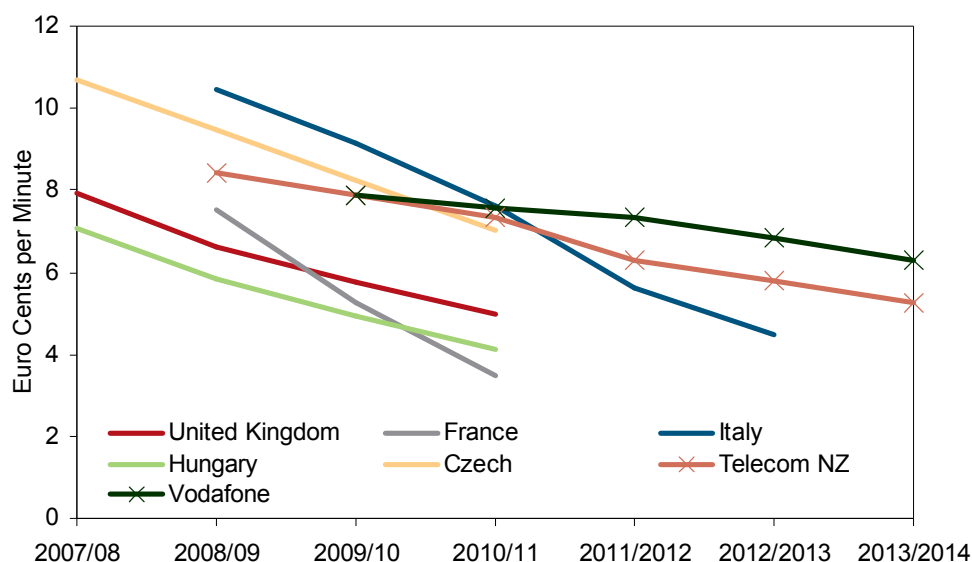
⁵⁷ "Commission welcomes French regulator's move to introduce competitive mobile termination tariffs", IP/08/1810, 27 November 2008.

2012, the Italian regulator intends to have complete price symmetry at 4.5€¢pm or lower.⁵⁸

- (e) In Spain, the regulator has indicated that it will reduce prices every six months, but that it is currently reviewing the glide path.⁵⁹
- (f) In Hungary, the regulator will reduce prices from an average of 20.34 HUF (approx 6.9€¢pm) to a uniform price of 11.86 HUF (approx 4.1€¢pm) by the end of 2010.⁶⁰
- (g) In the Czech Republic, the price will be uniformly reduced from 2.99 koruna (approx 10.6€¢pm) to 1.96 koruna (approx 7€¢pm) by 1 January 2010.
- (h) In Poland, the mobile terminating charge will be reduced to 0.17 zlotys (approx 3.7€¢pm) by mid-2009, with the regulator indicating that it was likely to impose further cuts in 2010. The Polish regulator has raised the possibility of reducing the terminating charge to zero.⁶¹
- (i) In Bulgaria, the regulator has issued a draft decision to reduce the peak rate to 7.6€¢pm per minute from the current rate of 15€¢pm. The European Commission has recently encouraged the Bulgarian regulator to consider even deeper cuts.⁶²

5.19 Figure 2 below illustrates graphically a number of downward sloping glidepaths that have been adopted. Aside from the many other problems associated with benchmarking, to focus solely on historic rates in MTR benchmarking seems non-sensical and will not produce dependable estimates of costs.

5.20 **Figure 2: Selected MTR cost-reductions in Europe and New Zealand, 2007-2014**



⁵⁸ "Italian regulator proposes further MTR reductions", *Agence Europe*, 19 November 2009.

⁵⁹ "CMT approves fixed, mobile call termination rules", *DMEurope*, 2 January 2009.

⁶⁰ "NHH reduces mobile termination charges from 1 January", *DMEurope*, 8 January 2009.

⁶¹ "Lower Mobile Termination Rates Come Into Effect in Poland" *Global Insight*, 13 January 2009.

⁶² "Europe Calls on Bulgaria to Lower its Mobile Termination Rates" *Cellular News*, 31 January 2009. Available at: <http://www.cellular-news.com/story/35747.php>.

Comparing like-with-like

- 5.21 Telecom expresses the view that when drawing conclusions on international comparisons, it is important to compare like services. This general view is indeed correct - as discussed above in the context of rounding. The specific example that Telecom focuses on is the difference in the FTM service provided by it, as compared with mobile network internationally. That is, that Telecom performs the function of carrying the FTM call from the POI to the MSC. NZ Comms considers it important to highlight that this issue does not affect international comparisons of Telecom's MTM rate – the Telecom MTM service is identical to that of carriers in other countries.

Peculiarities of the New Zealand market

- 5.22 An important feature of the New Zealand mobile market is its high degree of concentration. In particular, Vodafone reportedly has 60 - 70% market share by *call volume, possibly more*.⁶³
- 5.23 As was shown NZ Comms' earlier submissions, high termination charges coupled with closed network pricing create traffic imbalances between larger incumbents and smaller entrants. In particular, the larger incumbents create higher volumes of internal traffic, and to match the incumbents' "on-net" prices, smaller entrants must offer discounted calls to the subscribers that go beyond their small "on-net" customer base. The result is to push up outbound traffic relative to the larger networks, creating a net outflow of termination charges from the smaller and toward the larger carriers.
- 5.24 This capacity for an incumbent carrier to put such pricing pressure on an entrant is more than proportionately increased as the incumbent carrier's market share rises. To see this, consider a network of 100 subscribers, where, if all calls are priced equally, each subscriber has the same probability of calling any other subscriber in a given period. Assume this probability is ten percent, so, with equal prices, each subscriber on average makes 10 calls in any given period.
- 5.25 Now, allow that for a given set of closed network prices on a particular network, subscribers' probability of calling any other subscriber on that network is ten percent higher than it otherwise would be. Thus, if a network has 50 of the 100 subscribers, then each of those subscribers will make 5 more on-net calls than they would make if all calls were priced at the off-net rate. That amounts to 250 more calls. If, instead, a network has 70 of the 100 customers (a 40% increase on the network with 50% of all customers), then they will each make 7 more calls, for a total of 490 more calls, or an increase in on-net calling of 96%.
- 5.26 A smaller network's capacity to offer comparable rates to its subscribers is harmed more than proportionately not merely as the larger network rises, but because this generally implies its own network is smaller. Thus, it must not only offer discounts equivalent to the off-net discounts of the larger network, but in so doing, it must generate substantially more off-bound traffic that has a low retail price, but which incurs a high termination charge. In short, as the size and share of the incumbent's closed network rises, its capacity to harm the entrant rises much more rapidly.

The ACCC Draft Report

- 5.27 The ACCC released a draft report on MTR pricing late last year.⁶⁴ Telecom and Vodafone both make references to views expressed by the ACCC in that report.

⁶³ As noted in paragraphs 1.2(k) and 5.22 above, the Commission's 2007 Market Monitoring report dated 31 March 2008 reported that as at December 2007 Vodafone had around a 60% market share by call volume and a subsequently independent analyst reported that Vodafone had a 72.7% market share by call volume as at June 2008.

- 5.28 Telecom states that the ACCC comments favourably on the New Zealand deeds experience (para29) *“as an experience that Australia **should** consider in preference to regulation”*. In fact the ACCC merely comment that this *“may also be appropriate”*. It is important to note that the ACCC makes no further comment on the deeds in New Zealand and the comment is in the context about lack of pass through (FTM), rather than the more general use of deeds to replace MTR regulation.
- 5.29 More generally, in considering the implications of views expressed by the ACCC on MTR pricing mechanisms and the level of rates it is important to bear in mind that the ACCC faces quite a different competitive context from that faced by the NZCC. In Australia even the newest network has now been in operation for 6 years, and, unlike in New Zealand, there is no new entrant planning to deploy a network. Further, as mentioned earlier in this submission, because the market is less concentrated than in New Zealand, the barriers to entry and expansion posed by the network effects that come from on-net discounting are much weaker than in New Zealand. If the ACCC were faced with a situation where the mobile market concentration was as high as it is in New Zealand and there was a new player waiting to enter whose very entry was at least partially hinging on the mobile-to-mobile termination charge, it may well have come to quite a different view on the appropriate rate.
- 5.30 One issue raised by the ACCC is that there has been a lack of pass-through of mobile termination charges to fixed-to-mobile retail calls. As a result, the ACCC considered that this limited the benefits of reducing mobile termination charges and this appears to have been an important factor in its draft decision to leave the MTR unchanged. In the New Zealand context there are substantial benefits to be achieved through reducing at least the MTM termination charge given that this will directly affect the potential for full-scale entry and competition from a third network.
- 5.31 A further point to note in relation to the ACCC’s report is that it is currently a draft and has been subject to feedback from some parties that is particularly critical of the lack of transparency and logic in the ACCC’s determination of the appropriate price. In particular, there has been concern expressed that the ACCC adds an apparently arbitrary mark-up of 50% to the TSLRIC+ estimate calculated by WIK, the ACCC’s consultants. The inconsistency in the ACCC’s approach to setting access prices has also been highlighted. This all suggests Australia may not be a best practice reference point, especially on mobile termination, since this decision is sharply inconsistent with many of their past and concurrent access pricing decisions. In any event, the ACCC appears not to regard its own decisions as precedent, noting that *“[t]he ACCC has previously indicated that it will consider the appropriate pricing approach on case-by-case basis”*.⁶⁵

The UK Competition Commission

- 5.32 The UK Competition Commission recently released its findings with respect to the BT and H3G appeals from the Ofcom decision. It is worth noting that this complex decision was restricted by a number of admissibility issues, and was not a policy review of the system of call charging in the UK. In fact, the Commission left open the possibility that an alternative system may prove more desirable in the future. For example, it stated that:

⁶⁴ ACCC, *Draft MTAS Pricing Principles Determination*, November 2008.

⁶⁵ November, 2008, *ACCC Draft MTAS Pricing Principles Determination.*, p12.

*“We have had regard to the Admissibility Ruling and have confined our considerations accordingly. We note, as did the Tribunal, that **there may well be very powerful arguments in favour of a radically different way of approaching the question of MCT rates.** However, in so far as they do not fall within the scope of H3G’s appeal we could not and have not considered them”.*⁶⁶ (emphasis added)

- 5.33 We note therefore, that as with the ACCC’s decision mentioned above, there are complications in simply applying a regulatory decision from abroad to the New Zealand situation. NZ Comms considers that lengthy and ultimately fruitless study of international comparisons simply serves the interests of the incumbents by lengthening the time taken to review the current arrangements, and distracting from the clear market power of the New Zealand incumbents.

⁶⁶ Para 14.18, Reference under section 193 of the Communications Act 2003, Hutchison 3G UK Limited v Office of Communications, Case 1083/3/3/07, British Telecommunications plc v Office of Communications, Case 1085/3/3/07: Mobile phone wholesale voice termination charges, http://www.catribunal.org.uk/files/CC_Determination_1083_H3G_1085_BT_220109.pdf.

6. MAIN COMMENTS ON NON-PRICE TERMS OF THE UNDERTAKINGS

- 6.1 NZ Comms does not have the time or the incumbents' resources to review and comment in detail on the non-price terms of the undertakings. Nor does it consider that there is any need to do so given that it has already agreed to non-price terms set by Vodafone and Telecom. (Further, as noted, this investigation should not get distracted overly on non-price terms when the price terms are so critically important.)
- 6.2 Accordingly, while it makes only some high level comments on non-price terms, it should not be taken to agree that the terms are acceptable and reserves its right to comment further on them.
- 6.3 However NZ Comms notes that if full terms (ie non-price) terms are to be "re-written", then the terms should be uniform. In other words if the non-price interconnection terms are to be renegotiated in a regulatory setting there should be one (not two) sets of standard terms, drafted in a way that does not favour the incumbents.

Telecom

- 6.4 Clause 1.1 (Definitions & Interpretations) of Schedule 2 (Standard Terms for Carriers) defines "*Fixed Network*" and "*Originating End-User's Building*" and "*Mobile Calls*" as follows:

"Fixed Network" means a carrier's Network that is directly connected to each Originating End User's Building by means of a wireline connection or a fixed wireless receiver that is attached to the Originating End User's Building, but excludes any Network that provides cellular, mobile radio, paging or other like services."

"Originating End User's Building" means the building or other physical premises that is directly connected to the originating carrier's Fixed Network and that contains the Originator's telephone or terminal."

"Mobile Call" means a Call, other than a Call prefaced by a Toll-Free Number:

- a. for which a Mobile Number in a carrier's (the first carrier's) mobile Network is provided as the called party number; and
- b. where the ultimate source of the end-to-end call is either:
 - i. a Local Number allocated to an Originator in the other carrier's Fixed Network; or
 - ii. a Local Number allocated to an Originator in the first carrier's Fixed Network where the end-to-end call is prefixed by a Toll Access Code or where 02 Non-Code Access has been applied. In this case, the terminating end of this end-to-end call (i.e. the Call delivered from the other carrier's Network) will be a Mobile Call; or
 - iii. a Mobile Number allocated to a telephone or device in the other carrier's mobile Network."

- 6.5 The definition of *Fixed Network* and *Mobile Call* will severely restrict an Access Seeker's ability to offer wireless "*Homezone*" type services in the retail market as they appear to exclude calls originating on a "*virtual*" fixed network. Further, Telecom's definition is at odds with the spirit of Commission's Determination on VF / TEL on Local Interconnection of 28 September 2006.
- 6.6 The Commission Determined that:

“A local voice call is a voice call where the number from which the call originates and the number of the intended recipient of the call are local numbers that have been allocated to the same LICA.

It is not necessary to further define the features of a local voice call beyond the link to a local number. In particular, the interconnection service should not be defined with reference to the characteristics of the proposed Vodafone retail services.

The Commission is not required to consider what happens to a local call from a Telecom customer to a Vodafone local number after the call has been handed over to Vodafone.”

6.7 Telecom have inserted the following clause

“Where a Chargeable Telecom Mobile Call (other than a Call to which paragraph bii of the definition of “Mobile Call” applies) originates at a Telecom Local Number that is allocated to a LICA in a LICA Group where such LICA Group does not contain a Telecom Handover Point, the charge payable by Telecom under clause 4.1a will be reduced by an amount that is equal to 3.5 cents per minute of Call duration.”

6.8 The effect of this clause is that an Access Seeker must interconnect with Telecom in all of Telecoms 24 Major LICAs, otherwise Telecom will receive an asymmetric (in Telecoms favour) interconnection rate.

6.9 The idea that an established incumbent can receive an higher asymmetric termination rate than an Access Seeker is bizarre and inconsistent with the purpose of the Act.

Vodafone

6.10 The major issue with Vodafone’s undertakings is that the definition of “Access Seeker Mobile Number” and “Vodafone Mobile Number” means that our customers roaming on the Vodafone network are treated as Vodafone Mobile Numbers for the purposes of interconnection. This means Vodafone wouldn’t have to pay NZ Comms interconnect charges for calls from Vodafone to our roaming customers. Its also possible that Vodafone could claim NZ Comms need to pay a roaming charge plus an interconnect charge for all calls delivered to NZ Comms roamers.

6.11 As noted in section 2 above the definitions of :

- (a) Access Seeker Mobile Number *“exclude[es] any mobile number allocated or ported to the Access Seeker that is **used on the Vodafone Network in accordance with an agreement between the parties,**”*; and
- (b) Vodafone Mobile Number includes *“any mobile number allocated or ported to the Access Seeker that is used on the Vodafone Network in accordance with an agreement between the **parties**”*.

6.12 The effect of the above definitions is that:

- (a) Vodafone would not have to pay NZ Comms a termination charge when a Vodafone customer calls an NZ Comms customer who is roaming on the Vodafone network;
- (b) Indeed, Vodafone could charge NZ Comms a termination charge for **all calls** received by NZC customers whilst nationally roaming on the Vodafone network (in addition to roaming charges).

- 6.13 It is difficult to view this as anything other than a cynical attempt to manipulate this process.
- 6.14 A secondary issue is that their powers to terminate are far too broad. Particularly in relation to the text message service. As an example, Vodafone can terminate if:
- (a) NZ Comms contacts their customers (even if that contact is solicited); or
 - (b) one of NZ Comms's business subscribers contact that businesses customer and that customer happens to also be a Vodafone customer (even if that contact is solicited).

And once terminated, the Access Seeker has no rights to become an Access Seeker again for at least 6 months. The effect of a 6 month interconnection suspension would be to permanently foreclose an Access Seeker from the market.

7. SUMMARY

7.1 The incumbents' undertakings and submissions do not advance this Investigation.

7.2 The commercial terms do not address the wholesale and closed net pricing problems. Among other things:

- (a) the prices are well in excess of costs and do not reflect the significant worldwide downward movements in regulated MTRs;
- (b) proposed wholesale prices are much higher than they appear due to the incumbents' first minute charging, which is without international precedent (other countries charge on a per second basis) – not only does this artificially inflate the charge, but it stifles retail innovation;
- (c) Vodafone's proposal to round each bill up to the nearest whole cent further increases the effective charge;
- (d) Telecom seeks asymmetry in its favour by 3.5cpm reduction in some circumstances, again we believe this is unique by world standards;
- (e) Vodafone appears to be attempting to rewrite the terms of the National Roaming Agreement through their voluntary undertaking;
- (f) neither incumbent addresses their high on-net/off-net prices differentials; and
- (g) nor do they address the fact that they charge wholesale customers more than retail customers.

7.3 The incumbents' submissions:

- (a) misreport internationally accepted norms;
- (b) do not adjust international comparisons for the "first minute" rounding, which understates their true charges; and
- (c) misleadingly describe this investigation as the third of its type and/or incorrectly imply the issues have previously been reviewed by the Commission.

7.4 Both of the incumbents' undertakings fail to address the problems associated with excessive MTRs or provide proposals that would facilitate efficient market entry.

SCHEDULE A - COMMENTS ON TELECOM'S UNDERTAKING

NZ Comms has conducted an initial commercial, but not legal, review. We reserve the right to comment further should that be necessary, and are happy to discuss with the Commission.

TELECOM MTAS

ANNEXURE 1 – MOBILE TERMINATION TERMS

Schedule 2

| Page | Clause | Issue | Comment |
|------|---|--|--|
| 4 | 1.1 <i>Calling Charge & Network Numbering (CC & NN) document</i> | This document is referred to numerous times but it has not been supplied by Telecom. Also, there is nothing within the Undertaking that prevents Telecom from unilaterally changing this document. | Telecom should supply document. Insert a clause requiring that changes to the CC & NN are to be agreed in writing between the parties and that written agreement shall expressly refer to this clause. |
| 6 | 1.1 <i>Fixed Network</i> | Definition is too narrow. It prevents a Carrier from providing a Homezone type solution using a mobile handset. | This definition of fixed network will severely restrict an Access Seekers ability to offer wireless "Homezone" type services in the retail market. |
| 6 | 1.1 <i>Interface Specification</i> | Both a. and b. enable Telecom to make changes which are "accepted" by the Access Seeker. This is too uncertain. | Amend both a. and b. to: <u>"...that Telecom and the Access Seeker agree in writing. Such agreement shall expressly refer to this clause."</u> Delete: <i>"and any changes made by Telecom to that document which are accepted by the Access Seeker."</i> |
| 7 | 1.1 <i>Local Calling Area</i> | Refers to clause 17.4 We would delete this clause. | Delete: <i>"...under clause 17.4..."</i> |
| 7 | 1.1 <i>Local Number</i> | Includes Telecom payphones. Telecom already charges a higher rate for calls to 0800 numbers originating from Payphones (19.9c). | Delete: <i>"including such numbers that are allocated to Telecom payphones."</i> |
| 8 | 1.1 <i>Mobile Call</i> | (b)(i) and (b)(ii) refer to "Originator". Too narrow. This will limit the type of retail services that an Access Seeker can offer. | Delete "Originator" and replace with <i>"telephone or device"</i> . |
| 8 | 1.1 <i>Mobile Number</i> | Includes Telecom payphones. Telecom already charges a higher rate for calls to 0800 numbers originating from Payphones (19.9c). | Delete: <i>"including such numbers that are allocated to Telecom payphones."</i> |
| 9 | 1.1 <i>Originating End User's Building</i> | Definition is too restrictive. It prevents a Carrier from providing a "Homezone" type solution using a mobile handset. | We would delete entire concept. |

| Page | Clause | Issue | Comment |
|------|---------------------|--|---|
| 12 | 2.2(a) | Credit rating is too low (barely above junk bond status). Increase. | Increase requirement to: A2 Moodys A S&P A- AM Best |
| 13 | 2.2(b) | Three months gross is too high, especially since Telecom can terminate within 1½ months. | Reduce to 1 month. |
| 22 | 10.10 | Requires clarification. If the Access Seeker is required to install separate physical links for each service, then their costs are unnecessarily increased. | Add at end: <i>"As clarification, a distinct route may include logically distinct routes over the same physical circuit."</i> |
| 26 | 17.4 | Access Seeker must match their free local calling areas to Telecoms network. This is unnecessarily restrictive on the retail offerings that a carrier can make. | Delete. |
| 26 | 17.5 | 20 Working Days notice removes competitive surprise. | Delete. |
| 28 | 18.5(b) | Provides an extensive "out clause" for sharing confidential information with sales and marketing staff. | Consider deleting or restrictive. |
| 29 | 19.5(d) | Telecom may refuse to supply CLI for Payphones. | Delete. |
| 31 | 21.5(f) | Unfair clause. Carriers are not punished for "small" billing errors, only ones >5%. A 5% miscalculation on an invoice is significant. | Delete (f)(ii). Delete "by more than 5%" from (f)(iii). |
| 31 | 21.8 | A 6 month time period to raise an invoice dispute – this is an inordinately long time. | Reduce period. |
| 32 | 21.11 | 6-month time period to raise an invoice. This is an inordinately long time. It would be very difficult for a carrier to on-bill their customers 6-months later. | Reduce period. |
| 32 | 21.10 and 21.13 | The penalty interest rate is very high (Bill Rate + 10%). | Reduce. |
| 35 | 22.12 | Note –Vodafone needs a similar clause in their Undertaking. Vodafone currently has a mandatory 6-month stand-down period after suspension, this would kill an operator. | |
| 38 | 26.2(c) | \$1,000,000 is inadequate. | Increase. |
| 39 | 26.6(a) and 26.6(b) | Liability is limited to revenue of carrier with lower total revenue. This particularly doesn't work for a new entrant Access Seeker as they do not have any revenue so Telecom has no liability for direct losses and refusing to make services available. | Insert: <i>"of the <u>infringing carrier</u>"</i> Delete: <i>"with the lower total revenue in New Zealand during that period".</i> |

| Page | Clause | Issue | Comment |
|------|--------------------------|--|---|
| 41 | 26.11(a) and 26.11(b) | Same issue as 26.6. | Insert: “of the <i>infringing carrier</i> ” Delete: “with the lower total revenue in New Zealand during that period” |
| 42 | 27.1(c) | Refers to making the undertaking “ <i>impracticable</i> ”. | Replace “ <i>impracticable</i> ” with “ <i>impossible</i> ”? |

Schedule 3

| Page | Clause | Issue | Comment |
|------|--------|---|----------------|
| 49 | 5 | This clause potential restricts ability to make retail offerings. | Delete clause. |

Schedule 4

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 52 | 2.2 | Minute + Second rounding. | Amend to per second. |
| 52 | 3.1(a) | Note – pricing is high & well above cost. | Covered elsewhere in submission. |
| 52 | 3.1(b) | Telecom can charge new entrants its establishment costs. There is no corresponding ability in undertaking for access seeker to charge Telecom for their reasonable costs. | Delete or amend so reciprocal. |
| 53 | 3.1(j) | 3.5 cents per message. | Pricing is high and well above cost. BAK. |
| 53 | 4.1(a) | Charges are reciprocal. If not BAK, then asymmetric. | |
| 54 | 4.1(g) | Charges are reciprocal. If not BAK, then asymmetric. | |
| 54 | 4.2 | Telecom is forcing an Access Seeker to build POIs in all of Telecoms 24 Major LICAs or else accept a lower termination rate. | Delete. This clause is unprecedented and would severely penalise a new entrant during their build process. Also, it would encourage inefficient building to match the Telecom network. |

Appendix A – Text Message Service

| Page | Clause | Issue | Comment |
|------|--------------------------------------|---|---|
| 59 | 1.1 <i>Text Message</i> (c) | Unable to transit for other parties. | Delete. This clause forces third parties to interconnect directly with Telecom. This unnecessarily restricts the wholesale market. |
| 59 | 1.1 <i>Text Message</i> (c)(i) | Prevents Access Seeker customers from interfacing their SIM card with their computer. This is unnecessarily restrictive and would be difficult to police. | Delete: “(except where that Mobile phone or handset is used as a computer server or is in some way an intermediary device connected to a computer server)” |
| 63 | 6 | Note – Vodafone should have | |

| Page | Clause | Issue | Comment |
|-------|---------------|--|--|
| | | something similar in their Undertaking instead of all of their other restrictions. | |
| 65 | 12.1 | Businesses cannot web-to-text their customers. | Delete: “(but not customers)” Insert: “or customers” |
| 65 | 12.2(a) | Businesses cannot web-to-text their customers. | Insert: “or customers” |
| 65 | 12.3(a) | Very low limit of 30 messages per day. | Increase. |
| 67 | 15.2(a)(i) | Who decides if equipment is “illegal”? | Delete: “or illegal” |
| 67 | 15.2(a)(v) | This limit of 500 messages applies to a group of subscribers. It is very low. | Delete entire clause. |
| 67 | 15.2(a)(vii) | Gives Telecom the right to terminate if Access Seeker customers are not using service within Access Seeker guidelines. | Delete. Access Seeker should manage their own customers. |
| 67 | 15.2(a)(viii) | Insert unsolicited text. | Insert: “is sending <u>unsolicited</u> Text Messages...” |
| 67 | 15.2(a)(ix) | Insert unsolicited text. | Insert: “uses the Text Message Service to <u>make unsolicited</u> contact...” |
| 68 | 15.2(e) | 30 SMS limit is external low. Also, note that this limit does not apply to an individual subscriber but rather it applies to a group of subscribers. | Delete. |
| 68 | 15.2(f) | Telecom can add additional restrictions by giving 24-hours notice to the Access Seeker. | Delete. Far too much uncertainty. This clause could easily be abused. |
| 68 | 15.3 | Telecom can suspend the service if an Access Seeker’s customers receive too many text messages. | Delete entire clause. This severely restricts an Access Seeker’s customers e.g. a radio station or TV program running a promotion (text this number to enter) would breach this clause. This clause appears to be a thinly disguised attempt to maintain the Premium SMS market. |
| 68 | 15.3(b) | Telecom can add additional restrictions by giving 24-hours notice to the Access Seeker. | Delete. Far too much uncertainty. This clause could easily be abused. |
| 68-69 | 15.4 | Telecom can reduce the text message limits by giving 24-hours notice to the Access Seeker. | Delete. Far too much uncertainty. This clause could easily be abused. |
| 69 | 15.5 | Telecom can reduce the text message limits by giving 24-hours notice to the Access Seeker. | Delete. Far too much uncertainty. This clause could easily be abused. |
| 69 | 15.6 | This clause refers to clauses 15.4 | Delete. Clause is now redundant. |

| Page | Clause | Issue | Comment |
|------|---------|--|---|
| | | and 15.5 which would be deleted. | |
| 69 | 15.7(b) | Refers to <i>Standard Terms for Carriers</i> . | Document isn't supplied. Supply the document and include a clause that it can only be changed by written agreement between the parties. |
| 69 | 15.9 | No time period for consultation – it could be 5-minutes. | Include 10-working days minimum consultation period. |
| 70 | 15.11 | Refers to <i>Standard Terms for Carriers</i> . | Supply document. Insert a clause requiring that changes are to be agreed in writing between the parties and that written agreement shall expressly refer to this clause. |
| 71 | 16.5 | Vodafone needs this clause in their Undertaking. | Insert. |

SCHEDULE B - COMMENTS ON VODAFONE'S UNDERTAKINGS

NZ Comms has conducted an initial commercial, but not legal, review. We reserve the right to comment further should that be necessary, and are happy to discuss with the Commission.

FTM VOICE SERVICE

Schedule 1

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 5 | (a) | This clause includes reference to "Vodafone Mobile Number". The effect of this clause is that Access Seeker would be liable for Interconnection payments when terminating to its roamers. | Note. This is dealt with by addressing definition of Access Seeker Mobile Number and Vodafone Mobile Number in Schedule 3. |
| 5 | (c) | As above. | As above. |

Schedule 2

| Page | Clause | Issue | Comment |
|------|--------|---------------------------------------|---------------------------------|
| 6 | 1 | [] | Note. |
| 6 | Note 2 | Minute plus second. | Amend to " <i>per second</i> ". |
| 6 | Note 3 | Each call rounded up to nearest cent. | Reduce to a certain fraction. |

Schedule 4

| Page | Clause | Issue | Comment |
|------|--------------------------|--|--|
| 9 | FTM Call (b)(i) to (iii) | The effect of this means that the Undertaking does not include transit or international traffic. | Delete. This severely restricts the wholesale market. |
| 9 | FTM Call (c) | Vodafone Mobile Number. | Recurring issue with definition. |
| 12 | 3.5(e) | Only applies to Vodafone, not Access Seeker. | Asymmetric in Vodafone's favour. Amend to include Clauses 3.2 and 3.3 as well. |

Schedule 5

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 14 | 7 | Requirement to offer Vodafone termination at same terms and pricing if requested. | Delete. This removes the Access Seeker's ability to seek asymmetric rates. |

Subschedule 3A Part A

| Page | Clause | Issue | Comment |
|------|--------|---|---|
| 2 | 1.7 | Definition means that NZC National Roamers on the VF network are not counted as "Access Seeker Mobile Numbers". | Delete " <i>but excluding any mobile number allocated or ported to the Access Seeker that is used on the Vodafone Network in accordance with an agreement between the</i> |

| Page | Clause | Issue | Comment |
|------|--------|--|---|
| | | | <i>parties, and</i> Issue covered in more detail in main submission. |
| 4 | 1.18.3 | Undertaking is a public document yet Vodafone is listing it in definition of confidential information. | Delete, <i>"including the terms and conditions of this Undertaking"</i> . |
| 7 | 1.55 | Operational Procedures can be amended. Presumably unilaterally by Vodafone. | Insert <i>"as amended from time to time <u>by written agreement between the parties</u>"</i> . |
| 7 | 1.56 | Everything is <i>"in Vodafone's reasonable opinion"</i> . | For Clauses 1.56.1 thru to 1.56.4 delete all references to <i>"in Vodafone's reasonable opinion"</i> . |
| 11 | 1.78.3 | Definition means that NZC National Roamers on the VF network are not counted as "Vodafone Mobile Numbers". | Delete 1.78.3 The effect of this clause is that NZC roamers are treated as Vodafone numbers for interconnection purposes. <i>This leads to <u>perverse</u> outcomes which are covered in more detail in main submission.</i> |

Part B

| Page | Clause | Issue | Comment |
|------|---------------------------|--|---|
| 12 | 2.3.1 (b) to (d) | Vodafone is not required to provide Interconnection until these extras are agreed. | This creates uncertainty for Access Seekers and is potentially open to abuse. |
| 16 | 2.23.1 | Credit rating is too low (barely above junk bond status). Increase. | Increase requirement to: A2 Moodys A S&P A- AM Best |
| 16 | 2.23.2 (f), (g), (i), (j) | Three months gross is too high. Especially since they can terminate much earlier. | Reduce. |

Part D

| Page | Clause | Issue | Comment |
|------|--------|---|---|
| 20 | 5.2.4 | Definition of Force Majeure includes power failure. | Very broad definition of Force Majeure. |
| 21 | 5.2.12 | Definition of Force Majeure includes industrial action. | As above. |
| 20 | 6.1 | Threshold for early termination has been set very low. | This is a particularly big issue for an Access Seeker as once terminated, there is a mandatory 6 month stand-down period. |

Part E

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 34 | 13.3.2 | Cannot use a transit route that uses SIM boxes. | Delete. An Access Seeker cannot be held responsible for actions of |

| | | | |
|--|--|--|--|
| | | | third parties. This is a fundamental obligation that gives Vodafone rights to terminate. |
|--|--|--|--|

Part F

| Page | Clause | Issue | Comment |
|------|---------|--|---|
| 38 | 18.1 | The quality of billing information Vodafone is obligated to provide is poor. | An Access Seeker needs good quality billing information so that they can accurately reconcile their records and bill their customers appropriately. |
| 40 | 18.10.7 | Unfair clause. | Delete 18.10.7 (b). Delete from 18.10.7 (c) "by more than 5%". |
| 42 | 18.16 | Vodafone can bill 12-months in arrears. This is an inordinately long time. It will be very difficult for a carrier to on-bill their customers 12-months later. | Unacceptably long. Reduce. |

Subschedule 3B

| Page | Clause | Issue | Comment |
|------|--------|--|---|
| 60 | 3.3 | This appears to have been a two-way clause that Vodafone have amended and made one-way. | Amend to: "Neither party shall undertake flood-call testing without obtaining the prior written consent of the other party. The other party is not to withhold consent unreasonably." |
| 63 | 4.5 | Whose forecast prevails? In the past, Vodafone has refused to stand-up interconnection capacity. | Insert new clause requiring Vodafone to make available forecasted interconnect capacity. Insert similar clause to 16.5 (P71) of Telecom Undertaking. |

Subschedule 3D

| Page | Clause | Issue | Comment |
|------|--------|--|--|
| 70 | 2.1.2 | Dictates how Access Seeker hands over calls to third parties. | Delete. The relationship between an Access Seeker and a third party is outside scope of this agreement. |
| 71 | 3.1.1 | Clause requires clear identification of international traffic. VF may use this to enable differential (higher) charging. | Delete. Vodafone (and Telecom) charge higher rates for terminating calls that originate internationally rather than locally. There is no cost-basis reason for this. |

**Text Message Service
Schedule 1**

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 5 | (b)(i) | This clause includes reference to "Vodafone Mobile Number". The effect of this clause is that NZC would be liable for Interconnection | Note. This is dealt with by addressing definition of Access Seeker Mobile Number and Vodafone Mobile Number in |

| | | | |
|--|--|---|-------------|
| | | payments when terminating to our roamers. | Schedule 3. |
|--|--|---|-------------|

Schedule 2

| Page | Clause | Issue | Comment |
|------|--------|------------|---------|
| 6 | 1 | [] | Note. |

Schedule 4

| Page | Clause | Issue | Comment |
|-------|-----------------------------|---|---|
| 9 | 1 – Text Message definition | Places severe limitations on what qualifies as a Text Message and therefore what is subject to this Undertaking. | Delete (b) and (c). |
| 10 | 5.1(b) | Not allowed to transit for third parties. | Delete. Restricts the wholesale market. |
| 11 | 5.2(a) | Not allowed to use internet for SMS. | Delete. Limits ability to compete in retail market. |
| 13 | 5.9(b) | Not allowed to transit via third parties. | Delete. Restricts the wholesale market. Access Seeker should be allowed to least cost route. |
| 14-18 | 6.1 to 6.5 | This whole section needs revision. The threshold for suspension is too low. | Low thresholds for suspension are particularly a big issue in the Vodafone Undertaking because Vodafone have inserted a mandatory 6 month stand-down period after any suspension. |
| 15 | 6.2(b)(i) | “illegal” – not defined. What does this mean? | Delete “illegal”. |
| 16 | 6.2(b)(viii) | Vodafone can terminate if the Access Seeker customer is not using the Access Seekers service within the Access Seekers guidelines. | Delete. Let the Access Seeker deal with their own customers. |
| 16 | 6.2(b)(ix) | Vodafone can terminate if an Access Seekers customer is generating SMS via a method that Vodafone doesn't pre-approve of. | Delete. This is unnecessarily restrictive. How an Access Seekers customer generates a message should be irrelevant to Vodafone. |
| 16 | 6.2(b)(x) | Vodafone can terminate if an Access Seeker contacts their customers. | Delete. |
| 17 | 6.4(b) | If Vodafone terminates they do not have to do so “ <i>to the minimum extent practicable</i> ”. | Delete. Any termination should be limited as much as possible. |
| 18 | 6.5 | “ <i>Clause 6.2 of Subschedules 3A to Schedule 3 shall also take effect on termination of the Text Message Service</i> ”. The effect of this is a minimum 6-mth shutdown of the SMS termination service. | Delete. This is a unprecedented clause. Once suspended, this clause is highly likely to permanently foreclose an Access Seeker from the market. Insert a clause similar to 22.12 (P35) of Telecom Undertaking. |
| 20 | 8.3 | Vodafone can require Access Seeker to identify different SMS types. Silent on who bears cost of this. | Insert clause that Vodafone will pay Access Seekers reasonable costs of doing this. |

Schedule 5

| Page | Clause | Issue | Comment |
|------|--------|---|---|
| 22 | 7 | Requirement to offer Vodafone termination at same terms and pricing if requested. | Delete. This removes the Access Seekers ability to seek asymmetric rates. |

MTM Voice Service**Preliminary**

| Page | Clause | Issue | Comment |
|------|--------|---|---|
| 3 | 2(b) | Refers to FTM Call Termination Service. | Possible typo. Does Vodafone mean MTM Call Termination Service? |

Schedule 1

| Page | Clause | Issue | Comment |
|------|--------|---|--|
| 5 | (a) | This clause includes reference to "Vodafone Mobile Number". The effect of this clause is that NZC would be liable for Interconnection payments when terminating to our roamers. | Note. This is dealt with by addressing definition of Access Seeker Mobile Number and Vodafone Mobile Number in Schedule 3. |
| 5 | (c) | As above. | As above. |

Schedule 2

| Page | Clause | Issue | Comment |
|------|--------|---------------------------------------|--|
| 6 | 1 | [] | Note. |
| 6 | Note 2 | Minute plus second. | Amend to " <i>per second</i> ". |
| 6 | Note 3 | Each call rounded up to nearest cent. | Amend to a certain fraction of a cent. |

Schedule 4

| Page | Clause | Issue | Comment |
|------|----------|--|---|
| 10 | 1(b)(ii) | Access Seeker Mobile Number. | Recurring issue to do with definition. |
| 10 | 1(c) | Vodafone Mobile Number. | Recurring issue to do with definition. |
| 11 | 4 | Call must originate on our network, therefore no ability to transit for third parties. | Delete. This severely restricts the wholesale market. |

Schedule 5

| Page | Clause | Issue | Comment |
|------|--------|---|---|
| 13 | 7 | Requirement to offer VF termination at same terms and pricing if requested. | Delete. This removes the Access Seekers ability to seek asymmetric rates. |

SCHEDULE C – VODAFONE’S PAST SUPPORT FOR BAK

The Commission’s PSTN Determination⁶⁷

1. The Commission’s *PSTN Determination*, including the incumbents’ submissions, provide a compelling basis for adopting BAK.
2. As noted in NZ Comms’ September 2008 Submission *PSTN Determination* makes it clear that:
 - (a) Vodafone thought BAK had real advantages and its use should not be treated as an exception.
 - (b) Telecom’s experts also favoured BAK in earlier submissions, but tried to limit its application in later submissions.
 - (c) The Commission noted commentary accepting that BAK approximated the large fixed costs and very small marginal costs of (in that case) local calls.
 - (d) Vodafone’s experts thought it inappropriate to treat BAK as a price less than actual cost.
 - (e) The Commission noted that BAK:
 - avoided the MC (marginal cost) disadvantage Vodafone faced (as the new entrant);
 - this enabled more effective competition;
 - removed incentives to game the regime or target customer groups, and encouraged efficient termination costs through retail charges;
 - enhanced dynamic competition.
 - (f) The Commission also prohibited Telecom from price discrimination (namely charging more for calls terminating on Vodafone’s network).
3. NZ Comms has found it difficult to reconcile the prices offered in the undertakings with Vodafone’s unequivocal support for BAK when seeking access to Telecom’s PSTN. However, Vodafone clearly does favour BAK as the following discussion highlights.

Vodafone’s position - use of BAK most appropriate

4. The Commission summarised from Vodafone’s submission as follows:

“Vodafone submits that termination costs on its network are significantly higher than termination costs on Telecom’s fixed PSTN. Accordingly, the adoption of cost-based termination pricing would result in the payment by Telecom to Vodafone of net interconnection charges. Telecom would then pass that cost on to its retail customers, which would retard competition by discouraging Telecom customers from making calls to Vodafone local numbers.”⁶⁸

5. Clearly NZ Comms faces the exact same situation as Vodafone in that case.

⁶⁷ PSTN Determination, 28 September 2006.

⁶⁸ Above, para 78.

6. Accordingly:

“Vodafone argues that forward-looking cost-based pricing will not give best effect to the purpose set out in section 18, and that bill and keep pricing is preferable. Vodafone submits that⁶⁹

“...the ability for callers to ring a Vodafone local number at the price of a local call is likely to be important to the success of our local service initiative.”

Vodafone does not consider that the use of bill and keep in Decision 477 was an “exception” and notes that in the past Vodafone and Telecom had interconnected mobile-to-mobile calls on a bill and keep basis and that Vodafone and Telecom currently use bill and keep to exchange MMS traffic on their mobile networks.”⁷⁰

7. Similarly BAK here would be the preferred option and the ability for existing mobile users (ie on incumbents’ networks) at the same price they make calls on those networks will be important to the success of NZ Comms. BAK has been adopted, regulated or agreed previously.

Telecom’s experts’ comments on BAK

8. The Commission commented:

*“During the consultation stage preceding Decision 477, Charles River Associates (“CRA”)⁷¹ submitted on behalf of Telecom that a forward-looking cost-based methodology was appropriate for many call-types, but that pure bill and keep was preferable for local calls. **CRA argued that pure bill and keep leads to greater compatibility of incentives between interconnecting parties, which enhances dynamic efficiency.** In particular, CRA argued that under pure bill and keep each carrier is required to **bear its own costs for reciprocal traffic exchange, thus providing incentives to minimise costs.** CRA also cited simplicity and avoidance of the risk of gaming or arbitrage as examples of the benefits of bill and keep pricing for the interconnection of local calls.*

CRA’s submission in response to the draft determination for this Application states that some of their previous comments on bill and keep only apply to voice and data calls and not calls to mobile networks.”⁷² (emphasis added)

9. NZ Comms agrees with Telecom’s experts that pure BAK enhances dynamic efficiency and provides incentives to minimise costs. It sees no objective basis for distinguishing MTM.
10. The Commission noted that the use of forward-looking cost-based pricing *“incurs administrative costs due to the billing and recovery of Interconnection charges. ...[It]...would also incur the regulatory cost of the Commission having to undertake benchmarking or TSLRIC modelling to determine the interconnection.”⁷³*
11. The Commission noted that Telecom had *“initially argued that balanced traffic is a pre-requisite for adopting bill and keep pricing, but later argued that in New Zealand,*

⁶⁹ Above, Vodafone Submission on Commission decision to investigate local service application for April 2006, para 37, at footnote 25.

⁷⁰ Above, para 83.

⁷¹ Above, CRA, *Interconnection Pricing*, 7 June 2002, p9, at para 85, footnote 29.

⁷² Above, CRA, *Economic Advice on Aspects of Vodafone’s Application for Interconnection with Telecom’s Fixed PSTN*, 3 July 2006, p4, at para 86, footnote 30.

⁷³ Above, para 93.

bill and keep was only introduced “to deal with the specific internet call sinks (asymmetric traffic) problem” ...”⁷⁴ But the Commission then went on to note that, when it issued a paper prepared by Frontier Economics suggesting that out of balance traffic could be priced at its forward looking common cost:⁷⁵

“TelstraClear and Telecom responded with a common view that pure bill and keep should be used for all local call traffic (i.e. that pure bill and keep should not be limited to addressing the call sink situations, but extended to all local calls)...

*...While there is no reason to believe that local voice traffic between Vodafone and Telecom customers would intrinsically be materially out of balance, **forward-looking cost-based pricing could result in the introduction of retail plans that game the interconnection payments.** By changing customer call behaviour and/or attracting certain customer calling profiles, such plans could lead to an imbalance of interconnection traffic. **Hence the pricing method can itself influence whether or not traffic is in balance.**”⁷⁶
(Emphasis added)*

12. This last comment is important and the root cause of much of the current problem. Closed net pricing artificially changes calling patterns, anti-competitively creating barriers to entry and expansion.

Commission comments

13. But the debate about costs is arguably academic given they are so low or that there is a “barter” or equivalent exchange (namely network interconnection). As the Commission noted: “*Bill and keep has been described as a pricing regime in which each carrier bears its fixed costs for interconnection, and the payment for out of balance termination is set as zero. In this sense, **the prices that are set under bill and keep approximate those that are incurred by carriers** – large fixed costs and very small marginal costs for both origination and termination of local calls.*”⁷⁷ (emphasis added)
14. The Commission commented that Telecom’s experts, CRA had earlier submitted that:

“...like in barter, the absence of an explicit price does “not mean the price is zero” and that bill and keep did provide a price:”⁷⁸

“In neither case (hybrid bill and keep or pure bill and keep), however is the price of interconnection (as opposed to the net payment) set to zero.”

In the earlier paper CRA argued that “it is inappropriate to assume that bill and keep prices interconnection at less than its true cost” or that bill and keep sets prices “below cost”.⁷⁹

However, CRA’s current submission argues that some of their previous comments on bill and keep only applied to “voice and data interconnection”

⁷⁴ Above, para 94.

⁷⁵ Above, para 95.

⁷⁶ Above, para 98.

⁷⁷ Above, CRA, Comments on the Draft Access Determination: Interconnection Pricing, 9 September 2002, pp4-6; at para 113, footnote 36.

⁷⁸ Above, CRA, Interconnection Pricing, 7 June 2002, pp7,16, at para 116, footnote 39.

⁷⁹ Above, p7 at para 117, footnote 40.

and “not mobile networks”, the implication being that these earlier comments applied to interconnection between two fixed PSTNs”.⁸⁰

15. NZ Comms requests that the Commission review its comments in that decision, summarised in Section 6 of NZ Comms’ September 2008 Submission. NZ Comms ends this Submission with two useful quotes.

16. First, Commission’s comment:

*“Since calls are exchanged without payment under pure bill and keep this **avoids the problem of Vodafone having a marginal or per call cost disadvantage relative to Telecom and TelstraClear** for determination of local voice calls on Telecom’s fixed PSTN. Equivalence of **input prices allows Vodafone to compete more effectively** for residential customers who want uncapped or a large number of free local call minutes.*

*As pure bill and keep removes the potential for the Parties to generate a positive net flow of interconnection payments, **it removes the incentives for the Parties to game by targeting customers who are net receivers of local voice calls.** Pure bill and keep **removes the inefficient cross-subsidies** that such gaming would create.*

*As pure bill and keep applies to both Parties it is effective at resolving the price determination on both networks, **hence removing a barrier to launching the new competing service.** In the absence of any term requiring the access seeking to provide termination under its network on comparable terms to what it pays the excess provider for termination, pure bill and keep addresses any potential terminating monopoly problem.*

***CRA⁸¹ previously submitted the pure bill and keep reduces ongoing regulatory and administrative costs.** Pure bill and keep does not require the Commission to undertake benchmarking or TSLRIC modelling to determine the interconnection rates.*

The Parties agree that termination on Vodafone’s network would cost more than termination on Telecom’s fixed PSTN.

***Vodafone may choose to recover its higher termination costs through its retail charges, such as fixed monthly subscriptions. In that event, Vodafone’s higher termination costs will be recovered from its retail customers and not from Telecom**”.*⁸² (emphasis added)

17. Second, the conclusion that the Vodafone service:

*“...will result in consumers having greater choice of local access providers, which will, in turn, encourage local access providers to deliver product innovation and reduced prices. Such increased competition would be in the long term benefit of end users and is likely to best give effect to the purpose set out in section 18. Telecom as an integrated provider with its own mobile network is capable of responding to the competitive challenges that the proposed Vodafone service may present”.*⁸³

18. Clearly it would be inconsistent to not adopt BAK and non-discrimination here.

⁸⁰ Above, CRA *Economic Advice on Aspects of Vodafone’s Application for Interconnection with Telecom’s Fixed PSTN*, 3 July 2006, p4, at para 118, footnote 41. This comment was made with reference to the paper by Quigley and Vogelsang *Interconnection Pricing: bill and keep Compared to TSLRIC*, CRA Report for Telecom New Zealand, 7 April 2003.

⁸¹ Above, CRA, *Interconnection Pricing*, p9, at para 125, footnote 43.

⁸² Above, paras 122-127.

⁸³ Above, para 154.