

27 July 2009

By email: mark.berry@comcom.govt.nz

Dr Mark Berry
Chair
Commerce Commission
PO Box 2351
Wellington 6140

Mobile Termination Investigation

Dear Commissioner:

Trilogy International Partners (“Trilogy”) was established in November 2005 by John Stanton, Theresa Gillespie, and Brad Horwitz, each of whom has more than two decades of experience in launching and leading cellular communications companies in the United States and throughout the world. Trilogy’s founders previously served as founders and/or senior executives of VoiceStream PCS (acquired by Deutsche Telekom in 2000 and known today in the U.S. as T-Mobile), Western Wireless Corporation (“WWC”) – a publicly-traded mobile cellular company that they led for over a decade – and its subsidiary, Western Wireless International (“WWI”), which owned and managed a portfolio comprised of wireless businesses in eleven developed and developing countries, including Austria, Ireland, Bolivia, Latvia, Croatia, Georgia, Haiti, Iceland, Slovenia, Ghana and the Ivory Coast. WWC was sold to ALLTEL Corporation, a U.S. regional landline and wireless company based in Little Rock, Arkansas, in August 2005. The company owns and operates mobile phone networks in 4 countries.

Trilogy International Partners has been following the progress of the evolving NZ regulatory environment since 2002. Encouraged by the 2006 mobile market review and recent developments that have realigned the NZ telecommunications environment with international best practice Trilogy has chosen to increase its ownership stake in Two Degrees Mobile Limited to 52%. Two Degrees Mobile Limited has to date invested \$250 million of fresh equity to build the third mobile network in New Zealand and plans to launch services to the public during August.

The Trilogy executive team has substantial experience in the deployment and operation of mobile phone networks and has experienced of the anti-competitive effects that excessive mobile termination rates combined with on-net / off-net retail pricing differentials have on mobile markets. Trilogy knows well that they inhibit the ability of network operators to compete efficiently for customers.

We detail below the experiences of Western Wireless International in Slovenia during the period 2001 to 2005 which resulted in the foreclosure of its mobile investment 'Vega' early in 2006. The Commerce Commission will note there are many structural similarities between the situation in Slovenia and those currently in place in New Zealand.

Background:

Western Wireless International (WWI) through its subsidiary Western Wireless International d.o.o., entered the Slovenian mobile communications market in 2001, offering 1800 MHz GSM mobile communications services under the brand name "VEGA". WWI was one of the largest international investors in Slovenia at the time, and the only multinational company to invest more than \$200 million in the period 2001 to 2005.

After four years of operations, WWI attracted less than 2% market share, with the incumbent Mobitel retaining over three-quarters of the market. Another operator, Simobil, an affiliate of Vodafone had been unable to muster more than a 21% market share despite an earlier entry date (1999) and aggressive marketing with Vodafone's strong international brand name. Indeed Mobitel lost the least amount of market share among all incumbent operators in the EU member states as measured in the first four years after competition first appeared in a given market. Notably, Mobitel in Q1 2009 still retains one of the highest market shares of any mobile operator in the EU at 60%.¹

Mobitel's ability to retain overwhelming market share resulted largely from its anti-competitive cross-subsidisation of on-net calls by its high charges for off-net calls. For Mobitel subscribers on the carrier's four most popular calling plans, making a peak-period call to a WWI customer cost between 2 and 8 times more than a call to another Mobitel customer.² The large cost differential discouraged Slovenians from signing up with WWI, as they knew that Mobitel subscribers – ie most of the country's wireless users, will be reluctant to call them due to the higher cost that would be incurred.

In a 2004 paper on Slovenian telecommunications reform ("Reform White Paper"), faculty at the University of Ljubjana's School of Economics agreed that the large price difference between on-net and off-net calling was one of the main causes of concentration in the mobile services market.³ The authors explained that on-net calls were being subsidised by high off-net charges.

WWI filed a formal complaint in April 2003 under Slovenia's Telecommunications Act and Mobitel's pattern of anti-competitive behaviour was repeatedly brought to the attention of Slovenia's national telecommunications regulatory authority and national competition authority and the relevant government ministries but no concrete action was taken to curb such behaviour. As a result, WWI ceased all investments and ceased to

¹ European Commission Information Society: 14th Report on the Implementation of the Telecommunications Regulatory Package - 2008

² WWI notes that this much higher cost cannot be attributed to WWI's mobile termination rates for calls originating on Mobitel's network.

³ N. Hrovatin et al., Liberalisation and (De)Regulation of Slovenian Telecommunications Markets (2004) at 6, 18 ("[F]or the user, the network that has the most users has the greatest value;" "In our opinion, the reasons for the concentrated market structure in the mobile telephony market lie in the late granting of GSM licenses to competing firms and the high price difference between on-net and off-net prices."

trade in Slovenia on 31 May 2006 transferring 30,000 customers and all structural assets to both Simobil and Mobitel and transferring the license to Tus Mobil.

As U.S. Commerce Secretary Donald Evans stated in a letter to Slovenia's Prime Minister, "The difficulty being experienced by Western Wireless International / VEGA with Slovenia's regulatory system sends a negative message to potential investors and may adversely impact future U.S. investment in Slovenia."⁴

Slovenia's mobile market remains one of the least competitive in Europe even today and although two new mobile networks re-entered the market in the fourth quarter 2007, and first quarter 2008 respectively, the incumbent's market share remains high at 60%.

Pricing:

VEGA believed that Mobitel had structured its tariffs to ensure that its installed base of customers did not migrate to other mobile operators. By structuring the tariffs to provide a significant on-net / off-net retail price differential, Mobitel was both ensuring that communities of users using Mobitel's services did not migrate to other mobile operators and that such users encouraged other members of their 'community' using another network to migrate back to Mobitel. The strategy was aimed at ensuring that competitor networks became extremely unattractive both for Mobitel customers to call, as the retail price was so high (between 2 and 8 times higher than on-net calls), and unattractive to subscribe to as few if any calls would be received from the incumbent's customers. As customers expect to be able to both make and receive calls when they choose a mobile provider, the full utility of mobile service was not being enjoyed as calls were no longer received. We note that in some countries on-net / off-net retail price differentials are either banned or actively discouraged by the regulator.

Calling behaviour was evidenced in the on-net / off-net call balances of Vega customers. As a direct result of the retail structure employed by the incumbent, the proportion of minutes being sent by Vega's postpaid customers to the incumbents exceeded 155% of the traffic returned (ie from incumbent operator to Vega customers). Not only was there a huge imbalance of mobile termination payments but the total cross network traffic was a tiny proportion of what might be expected in a fully functioning market. The proportion of total off-net traffic from Vega was just 42% with a customer base of 2%. In a functioning market, with a 2% subscriber base we should expect it to have been above 95%. Put another way, the on-net calling amounted to nearly 60% when, based on the number of subscribers, it should have been less than 5%.

A tacit agreement exists between mobile users that they will call each other a roughly equal number of times. Customers value receiving calls as much as making them (there are of course an equal number of call minutes made as received across telecommunications in total). Vega's customers were frustrated as they received so few calls from incumbent customers (due to the retail price differential), the tacit agreements broke down and calling between networks almost disappeared.

⁴ Letter from Donald Evans, U.S. Commerce Secretary, to Anton Rop, Slovenian Prime Minister, Sept. 14, 2004.

Mobitel's retail tariff structures amounted to the exclusionary exploitation of the network effects that it enjoyed as the operator with the largest 'network' of users. Its tariffs were discriminatory, provided cross-subsidy of on-net calls by off-net calls (and terminated calls) and entailed predatory on-net pricing. Mobitel's pricing strategy was designed to preserve its massively dominant market share. We note that in the New Zealand prepaid student community, Vodafone's dominance of the Auckland market (97%) and Telecom's dominance of the Dunedin market (89%)⁵ is even higher than Mobitel's dominance of the Slovenian market (at 78%) and that the on-net / off-net retail pricing differentials in New Zealand can be far higher than in Slovenia (up to 40 times higher for texting⁶) and an unknown but almost certainly high ratio for nominated on-net numbers on both New Zealand incumbents.

The proportion of on-net traffic reported in the Phoenix report (88-97%)⁷ gives Trilogy International utmost cause for concern. It would seem that competition in the New Zealand market is in a far worse state than that experienced in Slovenia, and that there is virtually no cross network traffic in certain segments of the market. The dominance of incumbent operators is almost absolute by city and although the excessive Mobile Termination Rates in New Zealand is of critical concern and currently the subject of a substantial (and long) investigation as they are now universally recognized as responsible for distorting competition in favour of large mobile networks, Trilogy International is equally concerned about the retail price differentials between on-net and off-net calls employed by incumbents which must have been directly responsible for the near complete breakdown of any competition between the operators in respective cities.

Conclusions and recommendations:

The New Zealand mobile market bears many similarities to the Slovenian market where the dominant incumbent Mobitel's on-net / off-net pricing policy formed part of an exclusionary strategy by creating a significant barrier to effective entry and expansion, a distortion of calling patterns by maintaining a powerful deterrent to Mobitel customers calling customers of its competitors and a strong disincentive to churn in a saturated market.

We request that the New Zealand Commerce Commission and government take appropriate and proportionate measures to restore the market to an appropriate competitive equilibrium for the benefit of New Zealand consumers, namely to;

1. Require incumbents to have no retail differential between on-net and off-net pricing unless supported by evidence demonstrating that proposed differentials reflected cost differences.
2. Require incumbent networks to set on-net prices at a level that exceed twice (as 2 call legs are involved) its mobile termination rates plus retail costs, which would aid in both (a) providing incentives for incumbents to voluntarily lower mobile termination rates; and (b) reduce the likelihood of anticompetitive pricing.

⁵ Phoenix Research: http://www.phoenix.co.nz/about/Student_mob.pdf

⁶ Vodafone text 2000 offer includes 2000 on-net texts for \$10 (0.5c per text), cross net texts cost 20c.

⁷ See 5 above

3. Take fast and decisive action to ensure that mobile termination rates are lowered to cost-reflective rates to prevent the market distortions and harm to competition that result from above cost mobile termination rates.

I will next be in New Zealand for the launch of 2degrees mobile services in August and would be happy to discuss this matter and the potential harm to investment, competition and consumers with you on request.

Yours sincerely

Stewart Sherriff
Senior Vice President and Chief Technical Officer, Trilogy International Partners
Deputy Chairman of Two Degrees Mobile Limited

cc

- Shane Kinley, Commerce Commission. shane.kinley@comcom.govt.nz
- Bruce Parkes, Ministry of Economic Development. bruce.parkes@med.govt.nz
- Thomas Walsh, First Secretary – Economic Section, Embassy of the United States of America, 29 Fitzherbert Terrace, Thorndon, Wellington. Walshtj@state.gov
- Janet Coulthart, Commercial Specialist, U.S. Commercial Service, Embassy of the United States of America, 29 Fitzherbert Terrace, Thorndon, Wellington. janet.coulthart@mail.doc.gov