

**VODAFONE NEW ZEALAND LIMITED SUBMISSION TO
THE COMMERCE COMMISSION**



**Telecommunication Act 2001: Schedule 3 Investigation into
Regulation of Mobile Termination Access Services**

16 October 2009

[PUBLIC VERSION]

CONFIDENTIALITY

Confidentiality is sought for that information included in square brackets in the confidential version of this submission and designated as VNZAPI (Vodafone - designated Additional Protection Information) or VNZRI (Vodafone – designated Restricted Information) pursuant to the Commission’s confidentiality order dated 6 November 2008.

We are providing you with this information on a strictly confidential basis. The information is highly confidential and commercially sensitive to Vodafone because it is not generally known to our competitors. If this information were to be made available, it would unreasonably prejudice the commercial position of Vodafone. This highly sensitive pricing information must be protected from disclosure to protect Vodafone’s commercial position.

Accordingly, for the reasons set out above, this information should not be made available pursuant to any request made under the Official Information Act 1982.

Should the Commission decide to make the information available following a request, despite the reasons set out above, please provide Vodafone with not less than three working days notice so that it has the opportunity to seek to protect its position.

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Executive Summary

1. Vodafone welcomes the opportunity to comment on the revised undertakings provided to the Commerce Commission by Telecom, 2degrees and itself as part of its Schedule 3 Investigation into mobile termination access services (**MTAS**).

The Vodafone undertaking responds to key Commission signals

2. The questions of what are appropriate prices for mobile termination, and whether the MTAS should be formally regulated, have been the subject of significant disputation over a long period of time. The Commission first began investigating mobile termination rates in 2004, and has twice made recommendations to the Minister of Communications on this issue.
3. We have not always agreed with all of the Commission's views on mobile termination. However, we have regularly sought to find innovative solutions to deal with its concerns:
 - in 2007, we voluntarily provided a court-enforceable deed of undertaking in favour of the Crown whereby we agreed to immediately drop our mobile termination rates from existing prices of 20 cpm to 17 cpm, with further reductions to 14 cpm by 1 April 2012. We also ensured all of these reductions would be passed-through, in full, by Telecom and ourselves. The agreement is referred to as the MTR Deed. At the time, the Commission was indicating the benchmark cost of mobile termination was 15 cpm, and likely to trend down to 12 cpm by 2011¹;
 - in 2008, the Commission had changed its view on appropriate benchmark costs, and published an indicative cost of 10.76 cpm². In response to concerns at the time about the ability of 2degrees to enter and survive in the market, we reached a commercial agreement under the encouraging eye of the Minister. The details of that agreement are confidential, but involve an [

] VNZAPI.

4. Our pattern of behaviour has been consistent. While we strongly disagree with the cost estimates published by the Commission, we regularly seek to find commercial solutions that deliver better outcomes for consumers than would be achieved under the Commission's proposed regulatory interventions.

¹ Commerce Commission, *Schedule 3 Investigation into Regulation of Mobile Termination – Reconsideration Final Report*, 21 April 2006, at para [101].

² Commerce Commission, *Schedule 3 Investigation into Regulation of Mobile Termination – Issues Paper*, 8 August 2008, at paras [76]–[77].

5. Unfortunately, the Commission's views on benchmark cost estimates have not been consistent. Since 2007, it has changed its benchmarking methodology on two occasions. As a result, its cost estimates have significantly changed on two occasions. Earlier this year, it released new costs estimates setting out rates of 7.16 cpm for voice (trending down to 3.8 cpm by 2015), and 0.95 cpt for SMS (trending down to 0.5 cpt by 2015)³. It has also effectively recently indicated at the MTAS conference that the price of mobile termination should not lie above 41 per cent of average on-net retail prices for voice and SMS services.
6. Our revised undertakings respond to important signals from the Commission in its Draft Report, the MTAS conference and a subsequent public session held to discuss the investigation on 23 September 2009. In this regard, our undertaking offers:
 - an immediate 87.4 per cent reduction in the price of SMS termination on 1 April 2010 to 1.2 cpt. This rate is consistent with our estimates of 41 per cent of the average on-net retail price for SMS, and not significantly different to the Commission's most recent publications on the benchmark cost of SMS termination. By being available well in advance of when reductions would be possible under regulation, consumer welfare will be enhanced by accepting this undertaking rather than proceeding with regulation. On reasonable assumptions and basic consumer welfare calculations, we estimate that consumers will be better off by between \$14.7 and \$38.6 million if our undertaking in relation to SMS termination is accepted as compared to regulation; and
 - an 80 per cent reduction in the price of voice termination to 3 cpm by 2015 so that our voice termination rates are marginally **below** those set out in the Commission's most recent estimate of voice termination costs for 2015.⁴
7. The only significant difference between the voice termination rates contained in our undertaking and the cost estimates set out in the Commission's Draft Report is the glide path of rate reductions we have included in our undertaking. Glide paths of price reductions are consistent with international best practice regulation in most overseas jurisdictions, and recognise the significant disruption to investors' business plans that can be caused by large reductions in mobile termination rates. The rate reductions contained in our undertaking will reduce our revenue by more than \$450 million over the next five years compared to existing rates. The impact of these reductions on the ability for us to recoup the costs of our

³ See Commerce Commission, *MTAS Draft Report*, at Table 4 on p. 14.

⁴ In its Draft Report, the Commission's cost benchmark for 2015 was 3.8 cpm. If our rate of 3 cpm is converted to a second plus second equivalent, the rate in our undertaking would equal 3.69 cpm, assuming a mark-up of 23 per cent consistent with the comments of Mr Walmsley at the MTAS Conference. See: Mobile Termination Access Service Conference Transcript (Day One), 2 September 2009 at p. 171 - 172.

investments in network infrastructure cannot be over-stated. \$450 million is almost our entire expenditure on our 3G network, and almost double the total investment made by 2degrees in its recently launched mobile network.

8. Massive reductions in termination rates also change retail pricing incentives for mobile operators. They do so in two ways. First, they lead mobile operators to need to find other ways to recover lost revenues in order for them to recover the costs of their investments. Second, they make consumers who receive more calls and SMSs than they make relatively less attractive subscribers to have on a mobile network. This is because mobile operators receive less revenue for calls and texts made to these customers, but still incur all the costs of providing services to them. Typically low-spend pre-pay customers are the ones who receive more calls than they make – they make less calls because they have to be more careful with the money they spend. We expect massive reductions in termination rates will lead to less attractive offers for these types of consumers than would otherwise have been the case. This is inevitable once we head down the path of lower termination rates. With a glide path, however, these changes can be managed over a more gradual timeframe, rather than overnight.
9. Overseas regulators recognise these effects and that is why it is international best practice to have glide paths when regulated prices are set. Glide paths have been (or are) being used in a number of leading countries, including Australia, the UK, Ireland, France, the Netherlands, Spain and Hungary⁵.

The 2degrees and Telecom undertakings should not be accepted

10. On 2 October 2009, 2degrees and Telecom also submitted revised undertakings to the Commission. We believe the Commission should recommend that both be rejected, and that it should encourage both 2degrees and Telecom to re-submit undertakings more closely aligned with that submitted by Vodafone.
11. The undertakings provided by 2degrees have two major limitations. First, 2degrees offers to provide SMS termination on a pure bill and keep (BAK) basis. This means that mobile operators would pay nothing to send SMS traffic to each other's network. The problem with this is that there would be no limit to the amount of traffic network operators could send to each other's networks for free. This provides warped incentives for mobile operators to find products they can sell that bombard their competitors' networks with traffic at no cost to themselves. Doing so enables them to earn revenue from the services they sell, but not have

⁵ See Analysys Mason, *Assessment of the position of the Commerce Commission of New Zealand in determining MTAS prices*, 27 July 2009, at pps. 12 – 13.

to contribute to the cost faced by other mobile operators who ensure SMSs get through to their customers. It also raises the risk of SMS spam, which is currently a significant problem for email traffic where pure BAK arrangement exist.

12. While some mobile operators agree to some form of BAK for SMS termination, commercial best practice places limits on the extent to which carriers can send traffic to each other's networks for free. Unlimited BAK of the type proposed by 2degrees is naïve and carries too much risk that another operator would try to take advantage of the arrangement. Pure BAK is also not consistent with international best practice – indeed, in the developed world only France regulates SMS termination rates, and it applies a rate of between 3 and 3.5 euro (or 6 to 7 NZ⁶) cpt.
13. Second, the voice rates contained in the 2degrees undertaking offer no glide path and drop rates immediately to a cost estimate of voice termination from Australia of 6.54 NZcpm. The problem with the rate chosen by 2degrees is that the cost estimate in Australia has been discredited by the Australian telecommunications regulator. As indicated in previous submissions, the Australian Competition and Consumer Commission⁷ has noted:

... that the WIK model provides an estimate of TSLRIC+ of supplying the MTAS somewhat lower than that achievable in reality.

14. Rather than use the cost estimate that 2degrees relies upon when regulating voice termination rates in Australia, the ACCC instead set a higher rate of 9 AU cpm (or 11.07 NZ cpm using current exchange rates⁸). It is noteworthy that 2degrees [**VNZAPI** under the terms of its interconnection agreement with us.
15. We believe it would be reckless for the Commission to endorse an undertaking that relies on such poorly based evidence and does not contain a glide path consistent with international best practice.
16. With respect to the Telecom undertaking, Vodafone also has two key concerns. With respect to SMS termination, Telecom has proposed a form of hybrid BAK. Under this arrangement, traffic would be exchanged between two mobile networks for free, provided that one network did not send greater than 7 per cent more traffic to the other network than it received in return. Beyond this level of “out of balance” traffic, penalty rates would apply of either 3 or 8

⁶ Using the spot exchange rate on 15 October 2009 of 1 euro dollar to 2.00 New Zealand dollars at <http://www.xe.com/ucc/convert.cgi?Amount=1&From=EUR&To=NZD&image.x=37&image.y=12>

⁷ See ACCC, *Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011*, March 2009, at p. 18.

⁸ Using the spot exchange rate on 15 October 2009 of 1 Australian dollar to 1.23 New Zealand dollars at <http://www.xe.com/ucc/convert.cgi?Amount=1&From=EUR&To=NZD&image.x=37&image.y=12>

cpm, depending on the extent of out of balance traffic. While such an arrangement is more consistent with commercial practice around BAK interconnection arrangements; provides protections against SMS spam; and should ensure one party does not abuse the ability to send traffic to another carrier for free, the schedule of rates proposed by Telecom would add considerable complexity to interconnection billing arrangements. It also introduces considerable risk and uncertainty as to the likely price a mobile operator will pay to interconnect with another mobile operator, which may inhibit the willingness of mobile operators to develop innovative retail pricing offers for SMS services. We believe a simple, low, flat rate structure like the one set out in our undertaking will be less costly to implement and is more likely to guarantee outcomes that will promote the long-term interests of consumers.

17. With regard to voice termination rates, Telecom's undertaking has the benefit of containing a glide path of rate reductions. We believe, however, that the glide path is too steep in its early years, and too shallow in the later years of the undertaking. We believe the rapid early reductions defeat the purpose of having a set of steady rate reductions over time to manage the detrimental impacts of sudden reductions in voice termination rates. Further, the end point in the Telecom undertaking is substantially above that contained in the Vodafone and 2degrees undertakings such that Telecom would be able to charge significantly more than its rivals if all three undertakings were accepted together.

The Commission should hold a workshop to attain alignment of MTAS undertakings

18. During the MTAS public session on 23 September 2009, the Commission indicated that a workshop will occur if at least one undertaking is capable of being recommended for acceptance.⁹
19. We believe the undertaking provided by Vodafone gets the balance right between:
 - ensuring substantial reductions in MTAS rates;
 - providing a reasonable glide path towards costs for voice termination rates; and
 - ensuring 2degrees will not have to pay more for mobile termination than 41 per cent of the average on-net retail price for relevant retail services.
20. Our undertaking should be accepted on this basis. Doing so, however, would mean the Commission has three main options with respect to the undertakings provided by Telecom

⁹ Commerce Commission, *MTAS Investigation Public Meeting re Clarification of Matters for Submission of Revised Undertakings*, 23 September 2009 page 13

and 2degrees. It could either:

- also recommend acceptance of one or both of the other undertakings from Telecom and 2degrees, in their present form;
- recommend the Minister reject the undertakings of Telecom and 2degrees and that the service should be designated; or
- encourage Telecom and 2degrees to submit revised undertakings more consistent with that put forward by Vodafone.

21. Following the first option would be undesirable because it would mean different operators were charging vastly different rates for the same service. This is unlikely to create a level playing field in the mobile industry where parties were left to compete on their merits. We think this option should be avoided.
22. Pursuing the second option would leave Vodafone exposed to greatly reduced rates during 2010 while potentially both of Telecom and 2degrees being free to charge whatever rates they wanted to each other and to fixed-line operators. This too would distort competition in the industry and should not be allowed to occur.
23. We believe the third option would be the best option for the Commission to pursue. To achieve this, we believe the Commission should proceed to hold the industry workshop it indicated it would at the MTAS public session. Our submission provides suggestions on how this workshop could be managed.

Let's turn our attention to policy matters that will have a significant impact on consumer welfare

24. In conclusion, the Commission has been provided with three undertakings that show all mobile operators are prepared to make considerable reductions in mobile termination rates. We believe our undertaking gets the balance right, and that Telecom and 2degrees should be encouraged to move to rates consistent with those set out in our undertaking. It provides for 87.4 per cent reductions in SMS termination rates and 80 per cent reductions in voice termination rates.
25. The Commission should take the opportunity before it to try to seek greater alignment in the industry to deliver immediate, substantial, certain and responsible reductions in mobile termination rates. The alternative is for the Commission to recommend designation and spend much of the next year (and possibly more) presiding over industry disputation and uncertainty to fine-tune mobile termination rates.
26. We believe the industry – and consumers in general – would benefit more if the Commission

recommended accepting the substantial reductions on offer in our undertaking and leaving parties to compete on their merits. While we could all spend much of the next two years quibbling over the precise cost of SMS and voice termination in New Zealand, the rates contained in our undertaking already give the Commission most of what it believes should occur without the need to resort to formal regulation of the service.

27. It is now time to finally put this issue to bed and allow the industry to get on with competing to provide services to consumers; and allowing policy makers and regulators to devote more attention to considering other important policy issues such as the appropriate arrangements for investment in ultra fast broadband networks in New Zealand. This will have a greater impact on consumer welfare than tinkering with theoretical cost models to fine-tune mobile termination rates for the next few years.

1. Introduction

28. Vodafone welcomes the opportunity to comment on the revised undertakings provided to the Commerce Commission by Telecom, 2degrees and itself as part of its Schedule 3 Investigation into mobile termination access services (**MTAS**).

29. In order to assist the Commission in its consideration of these undertakings, our submission is structured so that it:

- provides comments on the undertakings made by Vodafone, Telecom and 2degrees (collectively “the parties”) in relation to SMS termination;
- provides comments on the undertakings made by Vodafone, Telecom and 2degrees (collectively “the parties”) in relation to voice termination; and
- discusses issues associated with the compatibility of the three different sets of undertakings.

30. It also contains appendices that provide additional information on:

- competition for A2P services under pure BAK arrangements;
- welfare estimations of Vodafone’s undertakings in relation to SMS termination as compared to regulation at the rates contained in the Commission’s Draft Report; and
- non-price terms and conditions contained in the undertakings provided by the parties.

31. In providing these submissions, Vodafone has not sought to re-agitate other issues previously discussed in its submissions to this investigation. The fact that we have remained silent on an issue should not be taken as acceptance by Vodafone of any particular point.

2. SMS termination

32. In the revised undertakings provided by Vodafone, Telecom and 2degrees, three very different offers have been made in relation to SMS termination:

- Vodafone has offered a simple 1.2 cpt rate for SMS termination;
- 2degrees has offered pure bill and keep (BAK); and
- Telecom has offered a hybrid BAK arrangement, whereby traffic within certain limits would be charged at a zero rate, but charges of 3 cpt and 8 cpt would be levied depending on the extent to which traffic flows between interconnecting operators slip out of balance.

33. The diversity of offerings put forward suggests there is not widespread industry alignment on what pricing approach is most preferred for SMS termination, as might otherwise have been thought to be the case.

34. Each of these offers would, if accepted, represent a dramatic shift from existing SMS termination arrangements. While each has its own appeal, Vodafone strongly believes the option presented in its undertaking is the one most likely to be in the long-term interests of end-users of telecommunications services. In this regard:

- pure BAK is not consistent with international commercial or regulatory best practice. It is also not likely to be in the long-term interests of end-users, as it will make it free for a mobile operator to send traffic to another network. In turn, this will distort incentives such that mobile operators will be rewarded if they can develop (and sell) products that generate revenue, but which involve pushing more of the cost of providing the services onto its rival mobile operators who would terminate traffic for it. This is especially the case for application to person (A2P) traffic. If the Commission has concerns created by the incentives generated by above-cost pricing of SMS termination, it should also have concerns about the detrimental incentives that would be created by below-cost pricing of SMS termination. In particular, we believe pure BAK creates incentives that will distort competition in favour of smaller network operators against larger operators. Pure BAK increases the risk of (and costs of seeking to prevent) SMS spam. For these and other reasons set out below, we do not believe the Commission should accept the pure BAK undertaking submitted by 2degrees. It is also not an undertaking that we would sign up to, and so in that sense would be ineffective in governing rates set between our two networks;

- to protect against abuse of BAK arrangements, it is commercial best practice to include terms and conditions that deal with circumstances where traffic flows consistently and materially shift out of balance. To its credit, Telecom has tried to reflect this in its undertaking. However, we believe moving to these forms of hybrid BAK arrangements will likely add significant complexity to SMS termination arrangements. It is also not clear to us that the particular limits suggested by Telecom are likely to generate significant benefits for consumers relative to existing market arrangements. We do accept, however, that Telecom's undertakings in relation to SMS termination are more likely to be in the long-term interests of end-users than the arrangements contained in 2degrees' undertaking;
- by offering an immediate 87.4 per cent reduction in the price of SMS termination on 1 April 2010, our undertaking ensures rates are able to quickly fall to levels close to the Commission's benchmark estimates of the costs of SMS termination in its Draft Report. Our proposed SMS termination rate is also consistent with our estimate of 41 per cent of average on-net retail SMS prices. This is consistent with requirements set out by Commissioner Mazzoleni at the MTAS conference. Setting a low, but non-zero, SMS termination rate should help to protect against the potential for abuse that would exist under pure BAK arrangements; do much to prevent SMS spam; and avoid the complexity surrounding a hybrid BAK arrangement of the type proposed by Telecom in its undertaking.

35. Overall, an undertaking containing pure BAK should not be accepted by the Commission if it is properly carrying out its statutory obligations. We believe our simple low flat rate option is preferable and should be accepted by the Commission in lieu of designation of the service.

36. This part of our submission is structured so that we first set out our concerns with the pure BAK option contained in 2degrees' undertaking. We then provide some high level comments on the undertaking in relation to SMS provided by Telecom, before concluding with some comments on why the Commission should accept the terms in our undertaking in relation to SMS termination.

2degrees' undertakings in relation to SMS

37. 2degrees' undertaking in relation to SMS termination involves the price of SMS termination being set on a pure BAK basis. That is, mobile operators would not pay to terminate SMS traffic on each others' networks, irrespective of the amount of traffic they send each other. In support of the pure BAK arrangements set out in its undertaking, 2degrees argues that:

- SMS termination costs are close to zero;

- the risk of SMS spam would be low under its undertaking, as there are adequate protections against SMS spam in the draft undertakings offered by Vodafone and Telecom and the Unsolicited Electronic Messages Act (**UEMA**);
- there was agreement at the MTAS conference that BAK for text would not lead to distortions; and
- Vodafone and Telecom have used a variant of BAK for SMS termination as recently as 2001.

38. In response, Vodafone notes that pure BAK:

- is inconsistent with international best commercial and regulatory practice;
- was not accepted as being free of distortions at the MTAS Conference, as 2degrees suggests. Further, there was not industry agreement at the MTAS conference that pure BAK would be optimal for SMS termination;
- will distort mobile operators' retail pricing incentives in order to take advantage of the ability to develop products that involve their rivals incurring costs that they do not need to pay for. In turn, this will both distort competition between different sized network operators and economic efficiency;
- will increase the risk of SMS spam. Further, the protections afforded by the draft Vodafone and Telecom undertakings and the UEMA are unlikely to be effective in deterring SMS spam; and
- was not applied to SMS termination in our agreements with Telecom in 2001. Instead, a hybrid form of BAK was trialled, but eventually abandoned due to persistent out of balance traffic between our networks.

39. For all of these reasons, we do not believe that pure BAK should be accepted in any undertaking setting out terms and conditions for SMS termination. Accordingly, we believe the Commission should reject the SMS termination undertaking provided by 2degrees.

40. Our reasons in support of this conclusion are set out in more detail below.

International commercial and regulatory best practice does not involve setting SMS termination rates on a BAK basis

41. As noted by the Commission at the MTAS public meeting on 23 September 2009¹⁰, clause 4 of Schedule 3A of the Telecommunications Act (the Act) indicates that the Commission may not recommend an undertaking for acceptance unless it complies with the standard access principles in Schedule 1 of the Act. In this regard, Access Principle 2 requires any undertakings received to be consistent with international best practice. The Commission has also previously stated that it is appropriate for the standard access principles to be built into the terms of any standard terms determination (STD)¹¹. An example of this is in the Mobile Co-location STD¹².
42. In the first instance, BAK is not consistent with regulatory best practice overseas. Indeed, as we have noted many times throughout this investigation, SMS termination is rarely regulated overseas. The only developed country that we are aware of that regulates SMS termination is France. Further, when regulating SMS termination, the French regulator – ARCEP – sets an SMS termination rate of 3 to 3.5 euro (or 6 to 7 NZ¹³) cpt. Hence, it is certainly not international best practice for SMS termination to be regulated on a BAK basis.
43. That said, Vodafone does acknowledge that in some instances, mobile operators have *commercially agreed* to provide SMS termination to each other on a BAK basis. As noted by 2degrees throughout this investigation, international SMS termination arrangements are sometimes provided on a BAK basis. This is not, however, the same as saying that overseas regulators force pure BAK on interconnecting operators. For instance, while mobile operators may choose to interconnect on a BAK basis in the United States, it is not our understanding that United States regulators have imposed this arrangement on mobile operators. As indicated by Mr Partridge at the MTAS conference¹⁴:

There's a difference between that, a mandatory arrangement, and a commercially entered into arrangement where parties have the protection of being able to revert to a paid settlement arrangement. So what actually exists in the US, my understanding is that there is a fixed and mobile termination rate which is around US 55 (sic) cents per

¹⁰ See Commerce Commission, *MTAS Investigation Public Meeting Re Clarification of Matters for Submission of revised Undertakings*, 23 September 2009, at p. 11.

¹¹ See Commerce Commission, *A Guide to Regulatory Decision Making by the Commerce Commission for the telecommunications Sector*, 31 July 2009, at para [195].

¹² Mobile Co-location General Terms, clause 2.3.

¹³ Using the spot exchange rate on 15 October 2009 of 1 euro dollar to 2.00 New Zealand dollars at <http://www.xe.com/ucc/convert.cgi?Amount=1&From=EUR&To=NZD&image.x=37&image.y=12>

¹⁴ See Mobile Termination Access Service Conference Transcript (Day One), 2 September 2009 at p. 107.

minute, and that parties are free to enter into a bill and keep arrangement if they wish. And if they don't wish to then those cost base rates apply. So I guess it's up to individual operators, and where individual operators have that freedom to unwind those bill and keep arrangements ...

44. Further, while some form of BAK is often commercially agreed between interconnecting mobile operators, this is not the same thing as saying mobile operators agree to provide SMS termination on a **pure** BAK basis.
45. Where mobile operators agree to terminate SMS traffic for each other on a BAK basis, they will generally ensure protections exist in their commercial agreements so that either party has the option to move to a paid basis under certain circumstances. This is necessary to protect parties against situations where traffic flows may slip greatly out of balance, and one party may end up terminating substantially more traffic (at its own cost) for its competitor than its competitor terminates for it.
46. Put simply, terminating traffic comes at a cost. While the cost may be relatively low on a per unit basis, there is still cost involved. This is especially the case for A2P services where one party may send out a bulk message to a number of mobile phone subscribers on a given network. While the originating operator may incur little costs in sending the message, other carriers may incur significant costs if they have large market share and terminate the vast bulk of these messages.
47. In principle, mobile operators expect person to person (P2P) SMS traffic to be largely in balance between network operators – the nature of SMS communications means that when one person sends a text to someone, they normally receive a text in response around [] **VNZRI** of the time¹⁵. For P2P traffic, therefore, BAK can be a convenient arrangement as traffic flows between networks are expected to be in balance. As indicated in previous submissions to this investigation, this has traditionally been our experience in our interconnection arrangements with Telecom in New Zealand. This principle is widely recognised and is also the main reason why regulators overseas have not seen it necessary to regulate SMS termination payments between interconnecting operators.
48. For A2P traffic, however, there is a great risk that one mobile operator could end up incurring significant costs to facilitate the provision of services by another operator. If interconnection agreements involve BAK arrangements, then the operator terminating large amounts of SMS for its interconnecting partner will not be compensated for this cost. As indicated below, this can place a large operator at a competitive disadvantage to smaller operators.

¹⁵ See Vodafone Submission to Draft Report, 28 July 2009, at para [381] on p. 105.

49. To protect against the risk of persistent out of balance traffic flows where one party ends up terminating substantially more traffic for its interconnecting partner than it terminates for it, commercial BAK agreements will usually involve the option to move to paid arrangements where necessary. For instance, during the MTAS conference, Mr Partridge noted that¹⁶:

But certainly if we see any commercial spam or A to P, which is application to person SMS, then we look to move the arrangements to a paid arrangements

50. At the MTAS conference, Mr Partridge also described the interconnection arrangements that apply for SMS hubbing with Sybase 365 – an international SMS hubbing organisation that both 2degrees and Vodafone interconnect with. As indicated by Mr Partridge at the MTAS conference¹⁷:

... we have two connections to Sybase 365; one is for the rest of world excluding USA traffic and all of the SMS on that connection is paid; and the other connection is for SMS to +1, which is American, and Canadian, and Caribbean countries. And that is bill and keep but with some limited thresholds and those thresholds are 5% or 25,000 SMS per month. If it exceeds either of those then it moves to a paid arrangement for all SMS.

51. In short, pure BAK carries unacceptable risk of exposure to a persistent pattern of out of balance traffic. For this reason, it is not commercial or regulatory best practice to have pure BAK arrangements overseas. There are good reasons for this that should not be ignored by the Commission.
52. Vodafone strongly encourages the Commission to reject any undertaking that contains pure BAK arrangements - either for voice or SMS services.

Pure BAK was not widely accepted as an appropriate pricing principle for SMS termination at the MTAS conference

53. In its submission provided with its revised undertaking, 2degrees argues that¹⁸:

It appears to have been accepted by many at the conference that this approach (ie BAK for text) would not lead to distortions.

¹⁶ See Mobile Termination Access Service Conference Transcript (Day One), 2 September 2009 at p. 108.

¹⁷ MTAS Conference, *op. cit.*, at p. 109.

¹⁸ 2degrees, *Undertakings Submission*, 2 October 2009, at para [8] on p. 6.

54. The Commission also seems to believe that there was widespread agreement at the MTAS conference that BAK would be appropriate for SMS termination. In this regard, the Commission noted at the MTAS public session on 23 September 2009 that¹⁹:

... the majority of views expressed at the Conference supported TSLRIC pricing for voice and some form of a bill and keep approach for SMS.

55. Vodafone believes it is important to make some qualifications about this statement. In the first instance, Vodafone believes the “industry” in this instance should be the three mobile operators who supply and acquire SMS termination to and from each other – i.e. Vodafone, Telecom and 2degrees. While 2degrees has consistently supported BAK arrangements for SMS termination, we do not believe it is clear that Vodafone and Telecom agree that this pricing approach is appropriate for SMS termination. Importantly, while Telecom has provided an undertaking that provides a hybrid form of BAK, it does not appear to have indicated at any point that it would favour a move to pure BAK, as 2degrees would prefer. With regard to BAK, Telecom representatives made a number of comments at the MTAS conference that suggested it is not in favour of a move to pure BAK. For instance, Mr Wesley-Smith noted²⁰:

... it's [BAK] a fairly extreme position to adopt and it's a fairly good distance away from where we are at today. So I'd be pretty nervous about a sudden shift from today's world to bill and keep or bill and keep for one service on the platform and not for the other.

And

... if we were to go to bill and keep tomorrow, and not knowing what we don't know, having some kind of threshold at which point LRIC or TSLRIC pricing kicks in would be a sensible thing. So I'm not sure if I've misunderstood what Bill [McCabe of 2degrees] was saying, but it seems we've got a fundamentally different understanding of bill and keep.

56. Vodafone believes it is important there is no confusion on this issue. While Telecom may be prepared to move to some form of hybrid bill and keep arrangement (such as that set out in its undertaking), it does not appear to be suggesting that a move to pure BAK (of the type 2degrees is offering in its undertaking) is appropriate.
57. For the avoidance of any doubt, Vodafone does not believe it would be appropriate to move to a pure BAK system for SMS termination. It does not appear Telecom would favour this either. Of the three industry mobile phone operators in New Zealand, only 2degrees appears

¹⁹ See Commerce Commission, *supra* note 8, at p. 6.

²⁰ MTAS Conference, *op. cit.*, at pps. 105 and 110.

to be in favour of pure BAK arrangements for SMS termination.

Pure BAK will distort competition and economic efficiency

- 58. BAK deviates from cost based pricing and will lead to inefficient decisions by carriers because of the incentives that it creates. Short-run incentives for profit-maximisation are determined in part by costs and revenues at the margin, and the termination rate is the marginal cost of off-net traffic. Thus, the termination rate affects retail prices even if net traffic flows between networks are balanced and there are no net termination payments. In other words, BAK will not generate the same incentives and market outcomes as a cost-based termination rate, even if the net termination payment is zero in both cases.²¹
- 59. Since BAK results in a cost faced by the originating network for off-net traffic that is less than the actual cost incurred by the carrier that terminates the traffic for it, BAK will generate distorted incentives and economic inefficiencies. The problem created by these distorted incentives is particularly acute for SMS due to A2P traffic.
- 60. The basic problem with A2P traffic is illustrated in Figure 1 below. In this example there are two mobile networks. Network A has 80% market share and network B has 20%. A2P traffic termination will be distributed according to these shares, and thus any given A2P provider will send 80% of its traffic to network A and 20% to network B, and the two networks will bear these proportions of the cost of terminating this traffic.

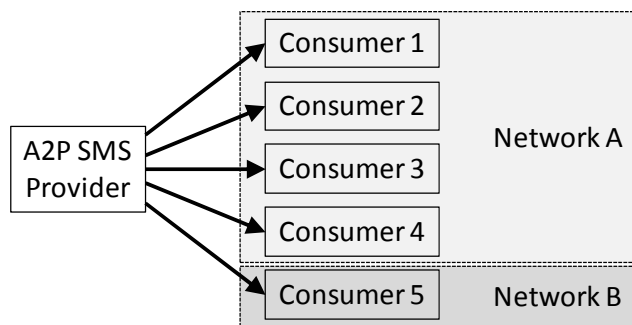


Figure 1 SMS A2P traffic example.

- 61. If the SMS termination rate equals cost, both network A and network B can compete on an equal footing for A2P traffic, regardless of their market shares of end-users. However, under

²¹ That bill and keep will not lead to the same outcomes as a positive termination rate when traffic flows are balanced is known as the 'bill and keep fallacy' (Laffont & Tirole, *Competition in Telecommunications*, MIT Press, 2001, p. 190).

BAK, network B will have an advantage when providing the service because it can terminate traffic on network A for free, and most of the traffic goes to network A.

62. Since A2P traffic can be generated by signing up A2P providers, the amount of such traffic generated does not depend on a network's market share of end-users. In the example above, network B will always be able to offer lower prices to A2P providers under BAK because it can terminate 80% of A2P traffic on network A for free.
63. In general, a network with lower market share will always have a lower cost of A2P traffic than a network with a larger market share under pure BAK. A small network will therefore have an incentive to sign up A2P providers, generating revenue and allowing it to pass most of the costs of terminating this traffic on to its larger rivals.
64. As an aside, it is also not true to assert that on-net SMS traffic is provided on a BAK basis. This is because networks face their own costs for all on-net SMS, including the cost of termination. As explained above, when costs can be shifted to another network, as happens under BAK, the originating network doesn't face the termination cost and this can lead to distortions. This is fundamentally different to on-net traffic where all costs, including termination, are internalised in the network's decision-making.
65. It is also fallacious to imply, as 2degrees does²², that as termination costs for SMS may be very low, then the termination rate can be rounded to zero. The volumes of SMS that are sent in New Zealand mean that any non-zero cost will be material.

²² See 2degrees, *op. cit.*, at para [7] on p. 6.

Pure BAK will increase the risk of SMS spam

66. Vodafone has consistently argued throughout this investigation that BAK pricing for SMS termination will increase the risk of SMS spam²³. Like e-mail spam, SMS spam has the potential to be a significant nuisance and detriment for mobile phone users. Indeed, mobile phone spam may be even more of a nuisance for mobile phone consumers who tend to always have their mobile phone with them and turned on. Many consumers activate their mobile phones so that a “tone” will sound when an SMS arrives. This is because consumers enjoy knowing when an SMS arrives, as they are confident it is not spam and likely to be of value to them. SMS spam is also potentially more annoying for end users than email SPAM, as it is usually difficult or impossible to delete an SMS message without first reading it. Further, end users will be less capable of controlling SMS spam when compared with email spam, because anti-spam technology traditionally only relates to email spam.
67. The utility of SMS communications would be greatly undermined if SMS spam became prevalent and consumers had less confidence that incoming texts were not spam.
68. To date, SMS spam has not been a significant problem for New Zealand mobile phone users. Partly, this is because of the non-zero SMS termination rates that have existed to act as a cost to parties wishing to send bulk texts to mobile phone users. Where a mobile operator faces a cost to terminate large bulk numbers of SMSs on another carrier’s network, it is incentivised to ensure SMS spam does not originate from its network. Higher SMS termination rates will align cost incentives with the party that is best placed to prevent or control the sending of such SMS spam: that is, the originating network operator.
69. This can be contrasted with email traffic which is passed between interconnecting networks on a BAK basis. For e-mail, it is Vodafone’s experience that over 97 to 99 per cent of emails we receive on our fixed-line network are filtered as spam (and even then some spam still gets through these filters). While we seek to minimise the impact of this on our consumers by installing anti-spam filters in our network, not all e-mail spam is prevented from reaching consumers. Further, installing such software comes at significant cost to network operators (and continuing cost as spammers find new ways around existing anti-spam software and filters). Ultimately, such costs are borne by consumers through higher prices for services they receive.
70. The risk of SMS spam will be greater under a pure BAK arrangement. While there have been limited instances of SMS spam to date, it is noteworthy that large levels of unbalanced traffic have arisen in some of our operating companies that have caused problems under pure BAK

²³ See, for instance, Vodafone Submission to the Draft Report, 28 July 2009, at pars [402] – [408] at pps. 109 – 100.

arrangements. For instance, and as indicated by Mr Partridge at the MTAS conference²⁴:

... Vodafone Australia has found recently one international operator where the out-bound SMS were around 1,000 per month and the in-bound were around 2 million per month.

71. In its submission in support of its revised undertakings, 2degrees notes that spam is dealt with under the UEMA, and so should not be of concern. As indicated at the MTAS conference, however, the UEMA is also designed to deal with e-mail spam. We would submit that e-mail spam is still a continuing nuisance for consumers despite the passing of the UEMA. Further, the UEMA does not prohibit the sending of SMS spam that is not of a commercial nature. As the UEMA only prohibits the sending of “commercial electronic messages”, the UEMA does not even apply to all forms of SMS spam and therefore will not prohibit or deter the sending of such messages. We do not share 2degrees’ confidence that the UEMA will be sufficiently able to deal with SMS spam.
72. In the context of attempting to explain why spam should not be a concern, 2degrees makes the point that both the Vodafone and Telecom undertakings explicitly provide for suspension and termination rights when spam could be an issue.²⁵ Relying on suspension and termination rights as a method for dealing with spam is, in our view, ill-considered. It is inefficient for an access provider to have to continually rely on its suspension and termination rights each time a spam issue arises. Exercising suspension and termination rights should be carried out only as a tool of last resort. It is not satisfactory for either an access provider or an access seeker to be part of an interconnect arrangement which is constantly under the threat or reality of suspended or terminated services. The most efficient way to address spam is to prevent it arising in the first place. As we have said many times before non zero termination rates can act as an effective barrier to SMS spam because the reciprocity in communication that exists for legitimate SMS is absent for SMS spam.
73. In addition, we are confused by the comment made by 2degrees that both Vodafone’s and Telecom’s undertakings explicitly provide for such rights. We do not envisage spam being an issue because in our undertaking we have not provided for SMS on a BAK basis. In the unlikely event that spam did become an issue, the suspension and termination rights could be used as a last resort. We note that 2degrees has deleted certain suspension and termination rights relating to SMS²⁶, and because 2degrees has adopted BAK for SMS, this comment is irrelevant to its undertaking.

²⁴ MTAS conference, *op. cit.*, at p. 108.

²⁵ 2degrees, *Undertaking Submission*, 2 October 2009, para [6].

²⁶ 2degrees, *Undertaking Submission*, 2 October 2009, para [3(b)].

74. Overall, there are measures that can be taken to minimise the risk of SMS spam. However, these methods will all be imperfect; require a higher degree of monitoring than is required at present; and will come at significant cost to mobile operators. A far simpler deterrent for SMS spam is to set a non-zero price for the service. Alternatively, if some form of BAK arrangement is to apply, there must be hybrid BAK arrangements to limit the extent to which BAK would apply once traffic exceeds certain out of balance levels.
75. We believe the increased risk of, and costs associated with preventing, SMS spam represent additional detriments that count against accepting an undertaking that involves pure BAK.

Previous attempts to apply BAK commercially for SMS termination in New Zealand have failed

76. In its submission in support of its revised undertakings, 2degrees notes that Telecom and Vodafone used a variant of BAK for SMS termination as recently as 2001. This is true, and was confirmed by Mr Chignell at the MTAS conference.
77. Rather than provide support for a move to pure BAK, however, we believe this example illustrates why pure BAK should not apply for SMS termination. As indicated by Mr Chignell at the MTAS conference²⁷:

.. we did have a bill and keep arrangement at the beginning of the interconnect about 2001 ... But what we did was put a 20% threshold in there, so that if the flows were 20% out of balance consistently for three months, three consecutive months, then either party had the right to go to a paying arrangement. Which we did, I can't remember how many months it ran for but we did certainly before the end of the first year going to a paid arrangement.

78. The attempt to adopt some form of BAK arrangement in New Zealand in the past illustrates two things. First, commercial agreements typically do include measures to limit the type of abuse possible under pure BAK. Second, it illustrates that when applied commercially in the past, traffic flows did slip out of balance such that it was eventually abandoned in favour of moves to a paid arrangement. Since then, other data provided by Vodafone to the Commission shows that traffic flows between Vodafone and Telecom have generally been much closer to being in balance.

Summary on 2degrees undertaking

79. BAK is a commercial practice sometimes agreed on by operators who expect traffic flows between their networks to roughly be in balance. While this is likely to be the case for P2P

²⁷ MTAS Conference, *op. cit.*, at p. 108.

traffic, it is unlikely to be case for A2P traffic. We are not aware of any A2P SMS agreements which are entered into on a BAL basis.

80. To prevent abuse of BAK, it is commercial best practice to impose limits on the extent to which BAK arrangements apply between interconnecting operators. The undertaking provided by 2degrees does not include such limits and is therefore inconsistent with commercial best practice. Setting a price of zero for terminating SMS traffic will also be likely to distort competition and create incentives for inefficient use of telecommunications networks – especially in relation to the provision of A2P services. These concerns with pure BAK help explain why it is not international best practice for regulators to impose pure BAK arrangements for SMS termination.
81. Given the limitations of pure BAK, we do not think the Commission should recommend acceptance of 2degrees' SMS termination undertaking.

Telecom's undertaking in relation to SMS termination

82. In contrast to the pure BAK undertaking offered by 2degrees, Telecom has offered a form of hybrid BAK in its undertaking. Under its undertaking, traffic would be exchanged on a BAK basis so long as the extent of out of balance traffic doesn't exceed certain prescribed thresholds. In this regard, if out of balance traffic exceeds:
 - 7 per cent, out of balance traffic between 7 and 12 per cent will be charged at 3 cpt; and
 - 12 per cent, incremental traffic will be charged at a rate of 8 cpt.
83. There are a number of benefits and detriments of this form of hybrid BAK arrangement. Our views on these matters are set out, in turn, below.

Advantages of Telecom's hybrid BAK proposal

84. Telecom's undertaking provides important measures that serve to limit the extent to which BAK could be abused by interconnecting mobile operators. As indicated above, BAK is a commercial arrangement where carriers agree to interconnect with each other at zero cost because they expect traffic flows between their networks to largely be in balance. Under Telecom's undertaking, traffic will be exchanged for free provided the extent of out of balance traffic remains within reasonable bounds. By only charging for SMS termination once out of balance traffic exceeds certain levels, Telecom's hybrid BAK proposal ensures mobile operators are protected from incurring unbalanced costs to terminate traffic for other operators in the event traffic flows do slip out of balance. This has the advantage of also ensuring mobile operators don't have an incentive to develop products (such as bulk SMS

message services) that “load up” the costs of rival operators who are unable to recover any revenue to cover their costs in assisting to provide the service.

85. A second key advantage of Telecom’s hybrid BAK is that it should act to help prevent SMS spam as existing SMS termination rates do. By setting high “penalty rates” once traffic balances exceed certain limits, mobile operators will be incentivised to ensure they do not originate SMS spam from their networks.
86. Finally, the structure of Telecom’s hybrid BAK arrangements, whereby mobile operators are able to move to charged arrangements when out of balance traffic exceeds basic thresholds is more consistent with international commercial best practice than the pure BAK arrangement offered by 2degrees in its undertaking.

Detriments of Telecom’s hybrid BAK proposal

87. The main concern Vodafone has with Telecom’s undertaking is that it will introduce significant complexity to SMS termination arrangements. The introduction of three-tiered charging arrangements will require modifications to billing arrangements at cost to mobile operators. We believe many of these costs can be avoided if a simple flat rate charging structure is retained for SMS termination services.
88. In addition to this, the hybrid BAK system proposed by Telecom will introduce distortions to pricing arrangements that will push SMS termination prices away from the underlying cost of providing the service. In turn, this risks introducing distortions to retail pricing behaviour. There is no guidance from economic theory on where to set appropriate thresholds or penalty rates under hybrid BAK arrangements.
89. Finally, the three tiered nature of Telecom’s hybrid BAK arrangement will create significant certainty for a mobile operator seeking to develop innovative retail SMS offerings. This is because an operator will be unsure what level of SMS interconnection payments it may or may not need to make. If a new retail offering generates unforeseen traffic imbalances, the mobile operator launching the product could be subject to uncertain termination rate payments. This may serve to limit innovation as compared to what might be expected under a simpler and more transparent flat rate charging structure for SMS termination.

Summary on the undertakings made in relation to SMS by Telecom

90. On balance, we believe the hybrid BAK option proposed by Telecom is superior to pure BAK as it provides protections against incentives to abuse BAK and is more consistent with commercial best practice. However, Telecom’s undertaking would be likely to introduce complexity to interconnection billing arrangements and distortions to efficient retail pricing

signals. We believe many of these detriments can be avoided via a simpler flat rate charging structure for SMS termination.

Vodafone's undertaking in relation to SMS termination

91. The Vodafone undertaking offers an immediate 87.4 per cent reduction in the price of SMS termination to 1.2 cpt from 1 April 2010. This rate responds to signals from the Commission in its Draft Report regarding its benchmark estimates of the cost of providing SMS termination. It also takes into account the comments from Commissioner Mazzoleni at the MTAS conference regarding the average on-net rate for SMS.
92. In the absence of spending considerable time and resources to construct a TSLRIC model to estimate the cost of SMS termination, the Commission does not know with confidence what the underlying cost of terminating an SMS is in New Zealand. The only guidance it has provided during this investigation is the SMS benchmarks set out in its Draft Report. While we have concerns about the reliability of these estimates due to the limited sample size used to derive such estimates, we have used these rates as a basis for determining an appropriate SMS termination rate in our undertaking. Our rate of 1.2 cpt is slightly above the Commission's benchmarks to take account of the uncertainty associated with the limited sample range used in the Commission's SMS benchmarking and the benefits that are provided by moving to this rate earlier than could be achieved under regulation. As indicated above, we have also had regard to comments by Commissioner Mazzoleni at the MTAS conference, and sought to offer a rate broadly consistent with our estimates of 41% of the average on-net rate for SMS in New Zealand.
93. The Vodafone undertaking means that carriers face a cost of SMS termination for each SMS sent off-net. Thus, each carrier must take the costs of their actions into account at all times. This will help to provide more efficient pricing signals than would occur under pure BAK and the hybrid BAK arrangements proposed by 2degrees and Telecom. It will also help to deter abuse of BAK arrangements and SMS spam.
94. In support of our undertaking, we have also done some simple calculations to illustrate the welfare benefits of Vodafone's SMS undertaking relative to regulation. The advantage of our undertaking is that it will deliver benefits from 1 April 2010, whereas regulation will not be effective until 2011 at the earliest. Beyond 2010, the Commission's assumption about SMS termination costs is slightly lower than the termination rate in our undertaking. Under regulation, therefore, it is possible that lower rates might be set from 2011 onwards. However, the potential welfare benefits that might be generated by these lower rates are not sufficient to outweigh the large losses of regulation relative to Vodafone's undertaking in 2010.

95. Figure 2 shows what will happen to SMS termination rates under Vodafone’s undertaking and under regulation. The regulatory scenario takes the Commission’s benchmark of 0.95 cpt in 2009 and assumes a reduction of 10% per annum, but regulation does not apply until 2011. Under this scenario, the SMS termination rate falls from 9.5 cpt in 2010 to 0.81 cpt in 2011, and to 0.53 cpt by 2015. Under Vodafone’s undertaking, the SMS termination rate drops immediately from 9.5 cpt to 1.2 cpt on 1 April 2010, giving an average rate of 3.3 cpt for calendar 2010. In all subsequent years, the termination rate in the undertaking remains at 1.2 cpt.

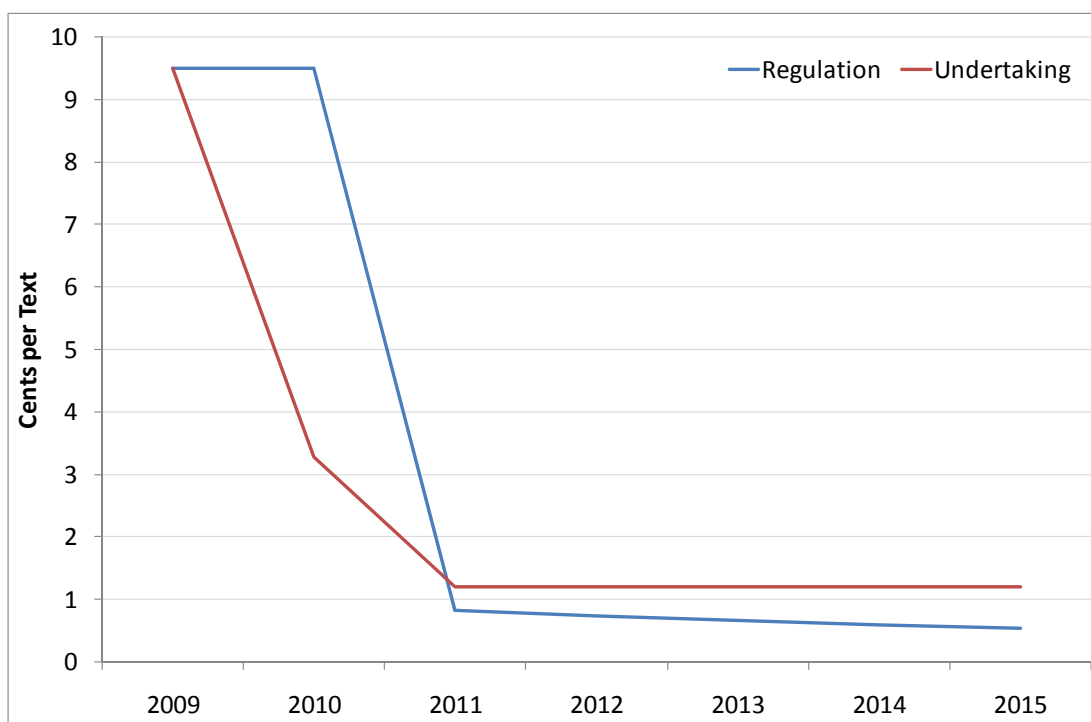


Figure 2 Annual average SMS termination rates

96. We have estimated the welfare effects of these termination rate reductions by assuming a rate of pass-through from termination rates to average retail SMS prices. In doing this, we assume that termination rate reductions affect off-net retail SMS prices only.²⁸ Details of these welfare calculations are given in Appendix B to this submission.

97. Table 1 below shows the results of our welfare calculations, where we express the results as the change in welfare of regulation versus Vodafone’s undertaking. Under all pass-through scenarios, our undertaking leads to greater welfare gains than would be achieved under regulation at the rates contained in the Commission’s Draft Report.

²⁸ If on-net prices are also affected, the welfare effects are in the same direction (i.e. the undertaking is still preferable to regulation) but the effects are larger as a greater volume of text messages are affected.

Passthrough	Consumer Welfare	Total Welfare
50%	14.7	167.8
75%	22.5	251.3
115%	29.6	324.5
130%	38.6	414.1

Table 1 Welfare effects of regulation versus Vodafone's undertaking (NPV \$m).

98. Vodafone's undertaking is simple; sets rates consistent with signals provided by the Commission during this investigation; and contains appropriate pricing signals to discourage SMS spam. By offering immediate and substantial reductions from 1 April 2010, it also ensures greater welfare benefits than are likely to be able to be achieved under regulation of the form proposed by the Commission in its Draft Report.
99. The Vodafone undertakings in respect of SMS termination should be recommended for acceptance by the Commission.

3. Voice termination

100. The revised undertakings submitted by Vodafone, Telecom and 2degrees involve substantial reductions in the price of voice termination. In this regard:

- Vodafone has offered an immediate 20 per cent reduction in the price of voice termination from 1 April 2010, with a further decrease to 10.5 cpm by 1 January 2011. Prices in the Vodafone undertaking will then glide down to 3 cpm by 2015 – an overall reduction in the price of voice termination of 80 per cent over the five years of the undertaking;
- Telecom has similarly offered an initial 20 per cent decrease in termination rates to 12 cpm on 1 January 2010, followed by a further decrease six months later by changing the rounding of its termination rates to second plus second. It has then offered to reduce prices steadily to 7 cpm (on a second plus second basis) by 1 January 2014; while
- 2degrees has offered an immediate reduction of around 65 per cent in voice termination rates²⁹, with subsequent reductions to 3.45 cpm by 2015.

101. Given the views expressed by the Commission in its Draft Report and at the subsequent public session, there should be at least one option within these alternatives that the Commission should find capable of acceptance. Clearly, however, there is a significant difference in the rates contained in the revised undertakings put before the Commission such that we expect it would be unlikely the Commission could accept all three undertakings as they currently exist. Accepting three undertakings with vastly different terms would be likely to distort competition between the three mobile operators over the duration of the undertakings.

102. For the reasons discussed further below in section 4 of this submission, therefore, we believe the Commission should proceed to hold a workshop in line with comments made at the public session to determine whether it can find a way to achieve greater alignment of the undertakings. A workshop would increase the prospect of finding an industry solution to mobile voice termination rates instead of the delay, cost and uncertainty associated with designation of the service.

103. That said, in determining whether to accept an undertaking, it is important to note that the Commission is not engaged in a “beauty contest” process. That is, its objective is not to find

²⁹ Assuming existing minute plus second rounding gives rise to an effective mark-up of 23 per cent, in line with the comments of Mr Walmsley at the MTAS Conference.

the optimal undertaking that delivers the fastest and lowest prices – and be prepared only to accept that option. Rather, the Commission’s objective is to determine whether an undertaking (or set of undertakings) offered by a particular party (or parties) is likely to give rise to outcomes that would be superior to those that would be achieved under regulation.

104. Similarly, the objective in this exercise is not to find the best undertaking provided by any particular party, and accept only that option. Instead, it is to determine whether the undertakings put before it would provide outcomes superior to those that would be achieved under regulation. Hence, if the Vodafone undertaking would provide outcomes better than regulation, but an alternative undertaking would achieve even better outcomes, this should not be a reason to reject the Vodafone undertaking. Consumers as a whole would still be worse-off in these circumstances if the Vodafone undertaking was rejected and the Commission proceeded to regulate the service.

105. The key point of comparison when determining whether to accept an undertaking, therefore, is to compare it to what prices would be set (and the consequences this would give rise to) if the service were regulated. Consistent with our submissions throughout this investigation, we believe regulated rates should have two main characteristics:

- the price of voice termination should not lie below the TSLRIC of providing the service; and
- if existing prices are substantially in excess of reasonable estimates of TSLRIC, then regulated prices should reduce towards TSLRIC over a glide path of no less than three years in duration.

106. We believe such principles are consistent with international best practice for the regulation of mobile voice termination services.

107. We also note the views expressed by Commissioner Mazzoleni at the MTAS conference, where she effectively indicated the price of voice termination should not exceed 41 per cent of the average retail on-net price for mobile-to-mobile calls.

108. To assist the Commission in its consideration of the undertakings put forward by the three parties, we first set out the prices we believe should apply under regulation. We then compare each of the voice termination rates set out in the undertakings to this factual. In summary, we conclude that:

- Telecom’s undertaking “gets the glide path wrong”. Rather than have a set of measured and balanced reductions in termination rates over a number of years, its undertaking involves a substantial initial drop followed by much slower reductions

in later years. While we supportive of undertakings containing a glide path, we believe its schedule of rate reductions should be smoother so that it involves lesser initial reductions, and greater later reductions. Further, while we believe the final price contained in the Telecom undertaking (at 7 cpm) is closer to our view of reasonable cost estimates than those contained in the Commission's Draft Report, we note this price is higher than the final prices contained in the Vodafone and 2degrees undertakings. We do not believe the Telecom undertakings in relation to voice should be accepted in isolation of changes to the undertakings provided by 2degrees and Vodafone; and

- while the 2degrees undertaking ends at essentially the same price as that contained in our undertaking, it does not contain a glide path and is therefore not consistent with international best practice. The absence of a glide path is likely to cause significant disruption to the business plans of mobile operators and is not likely to be in the long-term interests of consumers (especially low-spend pre-pay consumers). We do not believe the 2degrees undertakings in relation to voice termination rates should be accepted.

109. Of the three undertakings provided by the parties, the Vodafone undertaking is the only one that gets the balance right between substantial reductions in line with the Commission's most recent signals on its benchmark estimates of the cost of providing mobile termination and the need for a reasonable glide path in line with international best practice. For this and other reasons set out below, we believe our undertakings in relation to voice should be accepted, and that 2degrees and Telecom should be encouraged to revise their undertakings to bring them to a point of greater alignment with those set out in our undertaking.

The regulatory factual

110. Vodafone agrees with the draft view of the Commission that the appropriate pricing principle for voice termination is TSLRIC (inclusive of a contribution towards common costs). We also accept that the initial pricing principle for voice termination should involve benchmarking against cost-based **prices** for similar services in comparable countries³⁰, where this means benchmarking against regulated prices rather than raw cost model outputs. We believe the best available information today should be used to estimate an appropriate benchmark consistent with this IPP for the purposes of estimating the regulatory factual for any consideration of whether to accept an undertaking.

111. Where we disagree with the Commission is on the estimation of such a benchmark rate. In

³⁰ See, commerce Commission, *MTAS Draft Report*, at para [439] at p. 110.

this regard, we disagree with the Commission in three key respects:

- first, while we believe the Commission should benchmark against regulated prices set by those regulators who have a TSLRIC model, the Commission has changed its approach during this investigation and indicated it believes it should benchmark against raw cost model estimates;
- second, while we believe the Commission should benchmark against the 75th percentile of relevant data points (as the Commission did during the previous MTAS investigation) to take account of the large amount of variability in overseas estimates and the uncertainty this creates when relying on these measures to estimate the cost of providing the service in New Zealand, the Commission now believes it should benchmark against the median point of this range; and
- third, on the basis of advice from Analysys Mason and Covec, we believe France should be excluded from the set of countries against which the Commission has constructed its benchmarks for the Draft Report, while Hungary and Greece should be included.

112. The combined effect of these three issues is significant. While the 75th percentile of prices in our recommended range of data points would suggest a benchmark cost of 14.3 cpm; the median of raw cost estimates from the Commission's preferred range equals 7.16 cpm.

113. We continue to strongly disagree with the approach taken by the Commission in its Draft Report, and do not deviate from the views expressed in our previous submissions on these matters. That said, we understand it is not the Commission's intention that we use this opportunity to submit on revised undertakings to re-agitate our views on appropriate benchmark estimates. Accordingly, while we note the Commission's latest indications of the cost of providing the mobile termination service – and have ensured that our undertaking ensures alignment of prices with these rates by the end of our undertaking – we believe there are good reasons to think the cost of voice termination in New Zealand is likely to be higher than these numbers.

114. As also indicated in earlier submissions, we believe it is international best practice for mobile termination regulation to contain a glide path. This is also supported by the advice of Analysys Mason³¹. In this regard, we also note that Mr Abbott from TelstraClear indicated at the MTAS Conference that³²:

... I do have some sympathy for the need for a glide path ...

115. Mr Abbott did not proceed to specify what period he thought would be appropriate for a glide path.

116. Vodafone has some sympathy for the notion that a glide path should not be endless (and believe our revised undertaking is consistent with this view). That said, we would note that in 2004 the price of mobile voice termination was 28 cpm³³. The price of voice termination has certainly decreased significantly since that time. Further, existing rates (at 15 cpm) are now consistent with the views the Commission expressed about the costs it expected for voice termination in previous investigations. Hence, while views may have changed about the appropriate cost estimate for voice termination, mobile termination rates have been coming down significantly in recent years – based on seeking to achieve a reasonable degree of alignment with previous views of the Commission on the underlying cost of providing the service.

117. Given it is international best practice for regulated voice termination rates to contain a glide path of prices (as distinct from a glide path of costs), and the views of TelstraClear that it has some sympathy for a glide path, we have modelled rates that would apply under regulation if a three year glide path were. Even accepting the Commission’s latest cost benchmarks, this would give rise to the following glide path of voice termination rates:

	2010	2011	2012	2013	2014	2015
Glide path costs	15	11.3	7.6	3.8	3.5	3.1

118. It is against these regulated rates that we now proceed to compare each of the voice undertakings provided by the parties.

Vodafone voice undertaking rates

³¹ See Analysys Mason, *op.cit.*, at pps. 12 – 13.

³² MTAS Conference, *op.cit.*, at p. 157.

³³ Commerce Commission, *MTAS Draft Report*, Table 40, at p. 148.

119. There are six main reasons why the Commission should recommend acceptance of the voice termination rates contained in our undertaking. First, it ensures alignment with the cost benchmarks set out in the Commission's Draft Report by the end of the undertaking. That is, the rates set out in our undertaking will fall by 80 per cent to 3 cpm by 1 January 2015 (or around 3.69 cpm if these rates are converted to a second plus second equivalent). In its Draft Report, the Commission estimates a cost benchmark of 3.8 cpm for 2015. Our undertaking contains these rates even despite our serious reservations about the Commission's benchmark cost estimates.
120. Second, our undertaking provides substantial reductions ahead of when termination rates would fall under regulation. In this respect, our voice termination rates will fall to 12 cpm on 1 April 2010, and again to 10.5 cpm by 1 January 2011. These reductions will occur before the Commission is likely to be able to regulate lower prices if the service is designated. As indicated in our 2 October 2009 submission, this will generate welfare benefits for consumers of \$31.5 million during 2010, even if we accept all the assumptions contained in the Commission's fixed-to-mobile cost-benefit model released with its Draft Report.
121. Third, as indicated in our 2 October 2009 submission, the glide path contained in our revised undertaking is consistent with international best practice, and therefore consistent with the Act.
122. Fourth, when combined with the rates set out in our interconnection agreement (ICA) with 2degrees, the rates contained in our undertaking will not prevent 2degrees being able to compete on its merits with on-net price offerings in the retail mobile market. This is because the voice termination arrangements contained in the ICA are well below our estimates of 41 per cent of the average industry on-net retail price likely to exist in 2010. As indicated in our 2 October 2009 submission, 2degrees is able to continue acquiring mobile termination from us using the rates contained in the ICA if it prefers these arrangements to those contained in our undertaking.
123. Fifth, as indicated in our 2 October 2009 submission, the rates contained in our undertaking will deliver superior welfare outcomes for consumers than those expected under reasonable regulation of voice termination rates following designation. Assuming only a reasonable cost estimate today of 10.21 cpm³⁴; that regulation would contain a glide path of at least three years; and assumptions on the extent of pass-through and the waterbed effect based on indications from the Commission during the MTAS public session, we estimate that consumers

³⁴ This is the median of raw cost model estimates of the advice of Covec and Analysys Mason as to the suitability of France, Hungary and Greece is taken into account. See Vodafone Submission to the Draft Report, 28 July 2009, at pars [152] – [153] at p. 47.

will be better off by between \$18.6 and \$21 million during the five years of our undertaking relative to regulation.

124. Finally, and perhaps most importantly, accepting the rates set out in our undertaking would bring an end to many years of uncertainty and disputation around appropriate mobile termination rates. It would also avoid the need for the industry and the Commission to incur substantial costs agitating over the appropriate price of voice termination under regulation, and potentially years spent developing a TSLRIC cost model to estimate the true cost of providing mobile termination in New Zealand.

The voice termination rates in the Telecom undertaking get the glide path wrong

125. Telecom's revised voice undertaking contains a glide-path, but it is steep initially and shallow in later years. Within the first year, the voice termination rate falls by 35%, yet by 2015 the total reduction is only 62%, in contrast with 80% under Vodafone's revised undertaking. In Vodafone's view, Telecom's revised undertaking does not adequately recognise the costs that will be imposed on mobile consumers and operators of a sudden reduction in the termination rate.
126. In comparison with Telecom's revised undertaking, we believe that our revised undertaking will allow operators to better manage the change created by a loss of termination revenues, while at the same time providing for greater termination rate reductions overall. We believe that the waterbed effect will be strong, and therefore Telecom's revised undertaking risks creating large detriments for mobile consumers in the next few years. Vodafone's revised undertaking will allow us to find ways to adjust more gradually to the loss in termination revenues without imposing excessive adjustment costs on mobile consumers.
127. As an integrated operator with a very large market share in the fixed-line market, Telecom faces significantly less exposure to revenue losses due to reductions in the fixed-to-mobile termination rate compared to Vodafone. This means that Telecom's choice of glidepath will not fully reflect the detriments to mobile consumers of rapid reductions in the voice mobile termination rate. The Commission should therefore not view Telecom's proposed glidepath as being adequate to manage detriments faced by all mobile consumers.
128. In the longer term, Telecom's revised undertaking moves to rates substantially above those set out in the final years of the Vodafone and 2degrees undertakings. While we have considerable sympathy with its choice of a final destination price given it is more likely to be consistent with reasonable cost estimates, we do not believe it should be able to charge higher prices for mobile termination than those that would be set by its rivals. For this reason, we believe its rates should only be accepted if Vodafone and 2degrees are given the

opportunity to re-submit undertakings that offer final rates more consistent with those contained in the Telecom undertaking.

The voice termination rates in the 2degrees undertaking are inconsistent with international best practice

129. The 2degrees revised voice undertaking does not contain a glidepath, with the termination rate dropping immediately to a level that is below a reasonable estimate of current voice termination costs. 2degrees then assumes a cost path that is steep in the early years but flat in later years. That said, our respective undertakings in relation to voice termination rates end at broadly consistent end-points in 2015.
130. As we argued above and in all our submissions, a glidepath is necessary to minimise the negative impacts of lower termination revenues on mobile consumers and is consistent with international best practice. The large initial drop in the voice termination rate proposed by 2degrees will lead to FTM termination revenue losses for mobile operators of more than \$120m in the first year. Such a large reduction in termination revenues will have serious consequences for mobile consumers, as retail mobile prices will have to rise rapidly in response.
131. We are also concerned that the 2degrees voice undertaking rate in 2010 is based off a single cost estimate – the WIK cost model estimate for Australia. There is no reason to believe that Australia is such a good comparator country for New Zealand that it should be used as the sole benchmark, and all the other cost benchmarks that the Commission has gathered should be ignored. We believe that comparability issues are important, but 2degrees has not done the appropriate analysis to show that Australia is the only relevant comparator. In Vodafone’s view, other countries including Norway and the UK are good comparators within the Commission’s benchmarking dataset.
132. In addition, the WIK cost estimate for Australia is below the termination rate that the ACCC has actually regulated. As indicated earlier in this submission, the ACCC has clearly stated that it believes the cost model estimate is below the level achievable in reality. Therefore, even if Australia is the only relevant comparator for New Zealand, the cost model estimate is not an appropriate estimate of the cost of termination in New Zealand.

4. Compatibility of Undertakings

133. At various stages in this investigation, we have identified issues relating to the compatibility of undertakings, as a result of different undertakings being provided by different access providers. In this section we explain in detail some of those compatibility issues in relation to the most recent undertakings offered by access providers, and some suggested ways in which to resolve these issues.

The current state: different undertakings provided by 3 different access providers

134. On 2 October 2009, Telecom and Vodafone each offered one undertaking covering all of FTM and MTM voice and SMS services, and 2degrees offered three undertakings each covering FTM and MTM voice and SMS services. Each of these undertakings provides reciprocity provisions, in that if an access seeker signs up to an undertaking, the relevant access provider will provide back to the access seeker the same services, on the same terms, including price. For example, if 2degrees signed up to Telecom's registered undertaking, then 2degrees would be required to provide, as an access provider, the same services to Telecom on the same terms (including price). 2degrees would not be in the position of an access provider with respect to Telecom, under the terms of its own registered undertaking. This creates an odd "first in first served" situation, whereby as between two parties to an interconnect arrangement, the party who first signs up to the other party's undertaking will be bound by that other party's terms as both an access provider and access seeker. Put another way, 2degrees may have an incentive to not sign up to Telecom's undertaking if it preferred its own terms to apply to its interconnect arrangements with Telecom.

135. Given the reciprocal nature of interconnect arrangements, it makes sense to have one set of terms as between an access provider and access seeker, rather than having each party as an access provider under two different contracts. Having two different contracts apply to an interconnection relationship raises compatibility, operational and legal issues. For example, if a dispute arose, it would not be clear which contract's dispute resolution provisions and procedures would govern the resolution of the dispute.

136. For these reasons, although we do not consider that it is absolutely necessary for the terms of parties' undertakings to be aligned in order for Vodafone's undertaking to be accepted, we believe it is more satisfactory to at least attempt to have one set of agreed non-price terms across all undertakings for all access providers. This means that each party, whether as an access provider or access seeker, will be supplying and receiving the relevant service(s) on the same terms. At this stage in the investigation, the non-price terms of the three access

providers' undertakings in their current form are not significantly different in substance. In addition the undertakings of both 2degrees and Vodafone are almost identical in form. In summary, we believe attempting to align the non-price terms of the undertakings is desirable and we believe this should not be too difficult a task given their current state.

137. In relation to the price terms, we share Telecom's concern with respect to an access provider having its undertaking registered, and having to provide the MTAS at rates lower than those of other access providers who may not have had their undertakings registered (and may not be subject to price regulation for some time).³⁵ We do not think this is a desirable outcome and we are certain other parties will share this view.

A workshop remains necessary

138. Vodafone was encouraged by the Commission's statement during the MTAS meeting on 23 September 2009 that a workshop will occur if at least one undertaking is capable of being recommended for acceptance.³⁶

139. In the event that the Commission recommends acceptance of one undertaking but also recommends regulation for other access providers, the Commission notes that the situation of having different or un-reconciled undertakings would be undesirable and that a process should be provided to address this if possible.³⁷

Potential issues associated with a workshop

140. The Commission has directed, without specifying the detail, that there are 'issues' about the parties discussing price in any workshop that may be held.³⁸ It could be that the Commission is referring to potential competition law issues, in particular the prohibition on restrictive trade practices in Part 2 of the Commerce Act 1986 (**Part 2**). Part 2 includes a general prohibition on contracts, arrangements or understandings that substantially lessen competition, and certain provisions of contracts arrangements or understandings with respect to prices which will be deemed to substantially lessen competition.

141. The Commission may consider that discussions regarding price terms between access providers in respect of the undertakings could be considered contracts, arrangements or understandings, and therefore may breach sections 27 and 30 of the Commerce Act 1986.

³⁵ Telecom, *Submission accompanying revised undertaking*, 2 October 2009, paragraph 26.

³⁶ Commerce Commission, *MTAS Investigation Public Meeting re Clarification of Matters for Submission of Revised Undertakings*, 23 September 2009 page 13.

³⁷ *Ibid.*, page 13.

³⁸ *Ibid.*, page 15.

No competition issues associated with holding a workshop

142. We consider there are two reasons why a workshop is unlikely to raise competition law issues:

- *an undertaking is an offer, not a contract, arrangement or understanding; and*
- *the Commission should take into account that Part 2 does not apply to registered undertakings.*

An offer, not a “contract, arrangement or understanding”

143. Undertakings are an offer made by an access provider to the Commission, and not a “contract, arrangement or understanding” (in the context of Part 2). The offer is to the Commission, not to any access seekers. The undertakings are publicly available and have been independently submitted to the Commission by each access provider. A final report may include a recommendation by the Commission that the Minister should accept the undertaking. If the Minister accepts the undertaking, it is only at that point that the contract, arrangement or understanding (the undertaking) can be said to be entered into and take effect (at which point in time, an exemption exists under clause 9 of Schedule 3A of the Telecommunications Act 2001 (**Act**), as described in the paragraph below).

The Commission should take into account that Part 2 does not apply to registered undertakings

144. In considering whether Part 2 applies to the undertakings process, the Commission should take into account the fact that the Act excludes application of Part 2 to registered undertakings, the potential end result of the current process. Clause 9 of Schedule 3A of the Act provides that Part 2 does not apply in respect of a registered undertaking and any matter necessary for giving effect to a registered undertaking. Any negotiations that lead up to the giving of such an undertaking is unlikely to infringe Part 2. It would be odd if a resulting registered undertaking could be immune, but the negotiations that lead up to the giving of that undertaking were in breach of Part 2.

145. In January 2008, the Commission published guidelines where it acknowledged that it may use its prosecutorial discretion not to prosecute in respect of conduct consistent with a registered undertaking in similar circumstances, where one is not in place.³⁹ We agree with this approach, and encourage the Commission to interpret clause 9 of Schedule 3A of the Act as recognition by Parliament that Part 2 should not apply to registered undertakings, or to the process leading to registered undertakings.

³⁹ Commerce Commission, *The Interrelationship between Part 2 of the Commerce Act 1986 and the Telecommunications Act 2001 Guidelines*, January 2008, paragraph 34, page 7.

146. In summary, our view is that that any process issues at a workshop in regard to how parties come to a 'common standard' can be overcome and managed sensibly. Competition law concerns should not circumvent the ability for the Commission to accept undertakings. Commercially, it would be desirable if parties could reach a common position, before undertakings can be recommended for acceptance. Vodafone would be disappointed and concerned if the Commission did not hold a workshop due to concerns regarding parties discussing price terms.

How could a workshop operate?

147. At the MTAS meeting held on 23 September 2009, it was noted that if a workshop is convened, a process will need to be provided to address the situation of different undertakings.⁴⁰

148. Vodafone considers that there are workable solutions in formulating a process and there are a range of mechanisms and structures the Commission can implement to ensure that competition law issues do not arise, or at least those issues can be managed appropriately. For example, the Commission could:

- structure the workshop so as to allow parties to discuss price terms similar to the way parties currently negotiate and agree interconnection agreements (while acknowledging that interconnection agreements are bilateral agreements, whereas undertakings are offers, as set out above). This could be done by each party providing the others with proposals and counter-proposals;
- to make it clear that any discussions regarding rates are not considered an arrangement, contract or understanding under Part 2, require each party to provide a statement that any rates arising out of any discussions in respect to the undertakings, will not necessarily be used in any agreement with a third party;
- manage and oversee a process for setting timeframes for parties to provide revised undertakings, following a period of consultation and negotiations. This process could take place either at the workshop, or in a series of correspondence following the workshop to see if parties agree price terms; and
- to the extent the Commission considers such discussions may be in breach of Part 2, allow access providers to seek an authorisation under section 58 of the Commerce Act.

⁴⁰ Commerce Commission, *MTAS Investigation Public Meeting re Clarification of Matters for Submission of Revised Undertakings*, 23 September 2009 page 15.

149. Finding solutions to allow any workshop to proceed is in the interests of fair process and is consistent with the process in Schedule 3A of the Act. We look forward to working with the Commission and other parties in relation to this important step in the process for this investigation.

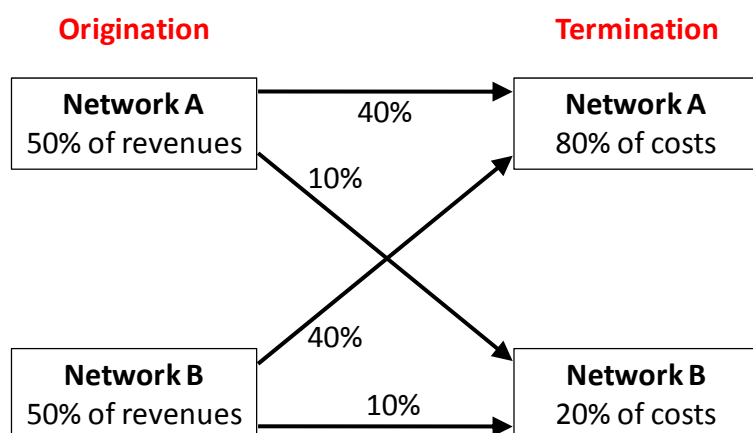
Appendix A: Competition for SMS A2P Traffic

Consider the following simple example that demonstrates how competition between networks for A2P traffic will be distorted by bill and keep:

- Two networks, A and B, have 80% and 20% market share respectively.
- The networks compete for A2P traffic from two providers, each of which generates 50% of all A2P traffic.

First imagine that each network has one of the A2P customers. A2P traffic will be sent in proportion to market shares. So network A sends 80% of its A2P traffic on-net and 20% off-net. Network B sends 20% on-net and 80% off-net.

In this situation, revenue is shared 50/50, origination costs are shared 50/50, but termination costs are split 80/20, with network A incurring the bulk of the termination costs. As A2P traffic is largely one-way (response rates are typically 5%) there is no offsetting origination revenue for A, or termination costs for B. This is illustrated below.

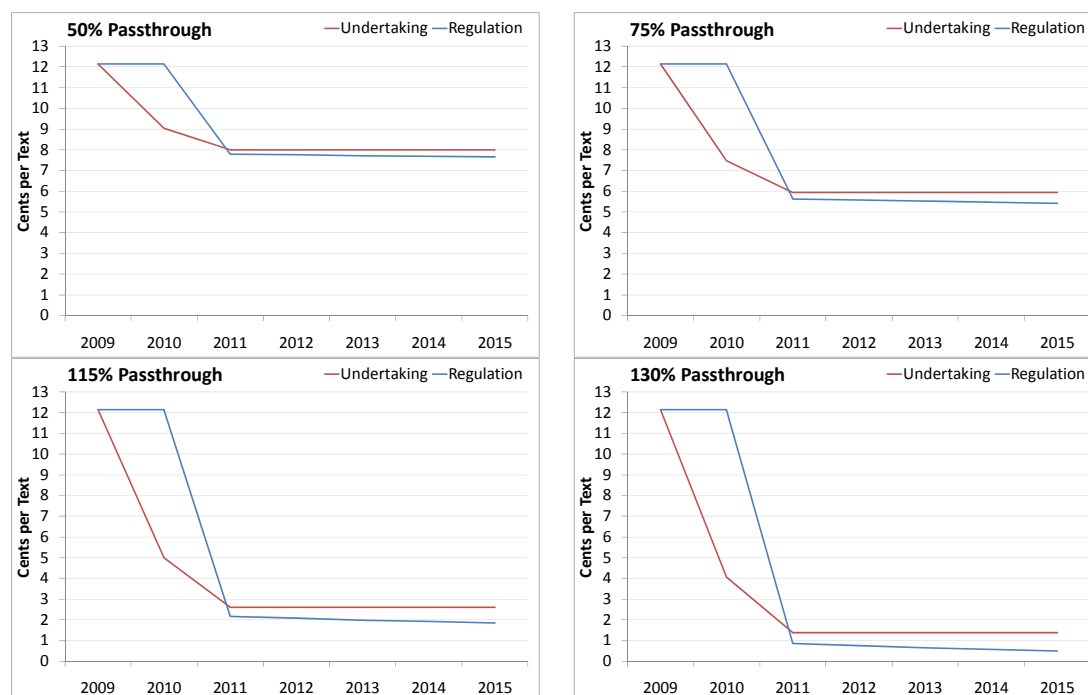


This makes A2P more profitable for carrier B which in turn means that B will be more able to compete for A2P traffic, potentially further magnifying the distortion.

Appendix B: Details of SMS Welfare Calculations

We translated the annual changes in SMS termination rates under the two scenarios shown in Figure 2 to retail prices for off-net SMS using a pass-through assumption and taking our 2008 average off-net SMS price ([] VNZRI) as the starting point. Low pass-through of 50% and 75% assumes that SMS termination regulation will not have a large effect on retail SMS prices. The 97% pass-through scenario is designed to generate an off-net retail price under regulation in 2015 that is equal to the current average on-net retail price (approximately [] VNZRI). The 124% pass-through scenario generates a low off-net retail price under regulation of about [] VNZRI in 2015. Figure 3 shows the price paths under these different assumptions.

Figure 3 Off-net SMS retail price scenarios.



We calculated welfare effects by calibrating a linear demand curve for SMS using Vodafone's average prices and volumes for on- and off-net SMS in 2008 as two points on this curve, scaling up Vodafone's volumes to market volumes using Vodafone's market share of 55%. This gave a demand intercept of [] VNZRI and slope of [] VNZRI.

We then used this linear demand curve to calculate consumer and producer welfare effects for each year from 2010 to 2015 of regulation versus Vodafone's undertaking. Regulation results in higher retail prices and therefore lower welfare in 2010 but lower retail prices and higher welfare in 2011 – 2015 compared to the undertaking. We calculated the net present value of the annual welfare

changes of regulation relative to the undertaking, using a discount rate of 6%.

Appendix C: Comments in relation to non-price terms of the Telecom and 2degrees undertakings

1. This section sets out Vodafone's comments in relation to the non-price terms, contained in the undertakings provided by Telecom and 2degrees. We have provided our comments on the non-price terms within the limited time made available to do so, and in doing so have concentrated on those points which are material. The fact that we have remained silent on any provision in an undertaking should not be interpreted as acceptance by Vodafone of the particular provision.

The Telecom undertaking

Removal of obligation to make premises available⁴¹

2. Making premises available is a separate issue from MSC handover. Telecom's change from PSTN LICA Group handover to Mobile Switching Centre handover is simply a reduction in the number of handover points from 24 at Telecom's PSTN switching centres, to 3 at Telecom's Mobile Switching Centres (Auckland, Wellington and Christchurch). However, Telecom has additionally (in clause 10.11(c)) removed the reciprocal obligation to make premises available at switching centres in which to install access seeker handover points. Premises are a fundamental part of interconnect and are referred to 31 times in Telecom's undertaking.
3. Currently an access seeker has the option to either build or buy interconnect links from the access seeker's switching centre to the Telecom switching centre in order to hand over the access seeker's traffic. These interconnect links are part of the access seeker's network in either case, with the access seeker handover point located at the Telecom switching centre being the demarcation point between the two networks.
4. Under the buy option, the access seeker might, for example, buy multiple 2Mbit/s interconnect links from Telecom Wholesale, and hand over calls at the access seeker handover point located at the Telecom switching centre.
5. Under the build option, the access seeker might build fibre from the access seeker's switching centre to the building in which the Telecom switching centre is located. The

⁴¹ Refer to changes to Schedule 2 clause 10.11(c), Schedule 3 clause 2.1(c), Schedule 4 clause 4.1(e). Note that Schedule 2 clause 11.1(b) has not been extended to include reference to clause 10.11.

access seeker must install equipment in the building, which acts as an interface between the fibre coming into the equipment, and the 2Mbit/s connections out to the Telecom switching centre. This option requires that Telecom make premises available to house the access seeker's equipment.

6. [

] VNZRI

7. By removing its obligation to make premises available, Telecom is removing the option for access seekers to utilise fibre to build their own interconnect links, and is forcing access seekers to buy 2Mbit/s interconnect links from providers such as Telecom Wholesale. It is also important to note that in the case of MTM calls, all New Zealand operators are already currently operating under an MSC handover model, with operators including Telecom having an obligation to make premises available – there is no valid reason for Telecom to remove its obligation to make premises available.

Delay in move from PSTN LICA Group handover to Mobile Switching Centre handover for FTM calls⁴²

8. As noted above, all New Zealand operators, including Telecom, are already operating on an MSC handover model for MTM calls.

9. Vodafone is already operating on an MSC handover model for FTM calls with all access seekers except Telecom. This suits these access seekers as they do not have switches outside of Auckland, Wellington and Christchurch.

10. There is no valid reason why Telecom could not immediately move to an MSC handover model for FTM calls for new access seekers (ie new interconnects).

11. Any changes in FTM handover for calls to and from Telecom comprise two distinct categories:

- *FTM calls where Telecom is the Access Provider*

⁴² Refer Schedule 2 clause 10.11, Schedule 4 clauses 3.1(a) and 4.1(a). Note that these clauses are reciprocal, and cover scenarios where Telecom is the Access Seeker, as well as where Telecom is the Access Provider

For these calls, we are not aware of any access seekers with switches outside of Auckland, Wellington and Christchurch (the Telecom MSC locations). Access seekers are likely to prefer to hand over calls at Telecom MSC locations, rather than 24 PSTN switching centres nationwide. Whilst we think it is reasonable for Telecom to offer to delay until 1 July 2010 imposing a commercially agreed national transport charge under Schedule 4 clause 4.1(a), we do not think it is reasonable for Telecom to delay offering access seekers the benefit of being able to hand over FTM calls at Telecom MSC locations under Schedule 2 clause 10.11 (a) until 1 July 2010. Access seekers are responsible for changing these interconnect links, not Telecom.

- *FTM calls where Telecom is the Access Seeker*

For these calls, Telecom is currently receiving the benefit of avoiding national transport costs, by handing over FTM calls at PSTN switching centre locations where the FTM calls originated, rather than at the MSCs where MTAS is provided. Telecom is requiring, in Schedule 4 clause 4.1(a), that the access seeker's MTAS rate (for Telecom's FTM calls) reduce to 12 cents from 1 January 2010, so Telecom will receive further benefit.

Telecom is responsible for changing its links where it is the access seeker for FTM calls. Given Telecom has such a ubiquitous national network, and that Telecom's standard lead time for provisioning new links is 3 weeks, Vodafone believes that 3 months is a more than reasonable timeframe for Telecom to change its interconnect links for MSC handover of Telecom's FTM calls.

12. In any event, the change to MSC handover for Telecom's FTM calls (which reduces national transport costs for access providers) should not be delayed beyond the date when the access provider reduces its termination rate.

Cost of changes to MSC handover⁴³

13. Vodafone believes it is appropriate that parties bear their own costs for network changes to move from Telecom PSTN switching centre handover to Mobile Switching Centre handover.
14. Schedule 4 clause 3.1(b) only applies where Telecom and the access seeker did not already have an interconnect. Schedule 4 clause 3.1(h) only applies to work that is not covered by

⁴³ Refer Schedule 2 clause 10.8, clause 10.11(e), clause 10.11(f), Schedule 4 clause 3.1(b), clause 3.1(h).

Schedule 3. Vodafone is concerned that there is no express statement in Telecom's undertaking that Telecom will not charge for the change to MSC handover, given the insertion of Schedule 2 clauses 10.11(e) and (f).

15. For the avoidance of doubt, Vodafone accepts that charging is reasonable for other handover changes unrelated to the change to MSC handover, for example if in say two years time, an operator were to build an additional MSC in Auckland for resiliency purposes.

Inappropriate continuing inclusion in MTAS undertaking of conditions around handover of fixed calls⁴⁴

16. Although clause 10.11 is stated to be applicable from 1 July 2010, the remainder of clause 10 does not say it ceases to apply on 30 June 2010, and therefore it appears that clause 10.11 is supplemental to the remainder of clause 10, rather than a replacement for it.
17. Telecom's MTAS undertaking covers the terms around access to mobile termination services on Telecom's network.
18. Firstly, it is entirely inappropriate, for the period both before and after 30 June 2010, for Telecom to include conditions around handover of fixed calls, including fixed calls where Telecom is the access seeker. Vodafone believes clauses 10.3, 10.4 and 10.5 should be removed entirely from the undertaking terms.
19. Secondly, it is unclear to which MTAS services clauses 10.1 and 10.2 in Schedule 2 might apply after 1 July 2010, given the insertion of clause 10.11.

Schedule 4 (Charges), clause 5 ("Hybrid Bill and Keep)

20. If bill and keep was to be used in any undertaking, then on the face of them, these provisions appear workable. However, there are various issues which need further consideration. For example, the provisions do not set out what will take place if the numbers provided by the parties are different (which we think is a real possibility). We are not convinced that reference to the usual dispute resolution provisions (refer to clause 5.3(b)) is the best way to resolve traffic discrepancies. We think the use of the word "invoice" is problematic since in some cases they will be statements showing the number of inbound and outbound SMS of the parties and not invoices. It will only be the creditor party which produces an invoice.

⁴⁴ Refer Schedule 2 clause 10 (especially clauses 10.3, 10.4 and 10.5), as well as clause 10.11.

The 2degrees undertaking

Format of undertaking

21. We note that for various reasons 2degrees has chosen to use Vodafone's form of undertaking as the basis for its own. The result is that two access providers in this investigation have offered undertakings which have terms and conditions which are very similar. While we understand that it is up to each access provider to determine which form of undertaking it wishes to use, any workshop held to discuss alignment of terms and conditions should take this fact into account.

Change throughout Schedule 3 (Terms and Conditions) of term "reasonable opinion" to "opinion, reasonably held"

22. 2degrees has replaced the term "reasonable opinion" with "opinion, reasonably held" throughout Schedule 3. We view this change as being a "distinction without a difference" in that we do not understand the substantive change that 2degrees is trying to make. In any case, our view is that the term "reasonable opinion" is a customary and plain English term which is well known, and so should remain as is drafted in our undertaking.

Schedule 3 (Terms and Conditions), clause 2.15, inclusion of standard access principles

23. The Act states that the Commission must not make a recommendation to accept an undertaking unless it is satisfied that the undertaking complies with the standard access principles and any limits on those access principles.⁴⁵ 2degrees has expressly set out in its undertaking the standard access principles and the limits on those principles.

24. Although the Commission considers that the standard access principles (and the limits on those principles) should be 'built into' the terms of any STD⁴⁶, there is no statutory requirement on an access provider to expressly set out the standard access principles in any undertaking. We do not see any statutory or other need for an undertaking to expressly set out the standard access principles. The Commission may reject an undertaking if it does not comply with those principles, but there is no requirement for an undertaking to expressly state them. The fact that an undertaking does not expressly set out the access principles does not mean it does not comply with them.

25. Moreover, we note that in previous STDs the Commission has elected to refer to the standard access principles in a more generic way, which seems a more sensible approach if

⁴⁵ Clause 4, Schedule 3A, Telecommunications Act 2001

⁴⁶ Commerce Commission, *A Guide to Regulatory Decision Making by the Commerce Commission for the Telecommunications Sector Discussion Paper* 31 July 2009, note 1 at page 39, paragraph 195

they are to be expressly incorporated.⁴⁷

26. We do not understand the link made by 2degrees between clause 9 of Schedule 3A of the Act and Part 2 of the Commerce Act 1986, as justification for mandatory inclusion of reference to the standard access principles.

Schedule 3 (Terms and Conditions), clause 3, amendments to dispute resolution provisions

27. The amendments made by 2 Degrees to clause 3.1 of Schedule 3 mean that neither party is excluded from enforcing the undertaking in a court. Furthermore, use of the dispute resolution procedures (mediation and arbitration) is by agreement only.
28. It is unclear from the amendments made by 2 Degrees whether the right to “enforce” relates only to the actual dispute which has arisen, or whether the right is wider than this. In any case, any contract should provide for an agreed way in which disputes are to be determined. This must be set out at the outset, rather than leaving it to be determined or agreed as and when a dispute arises. If the parties are in a dispute, in our view there is a high probability they will be unlikely to agree on the appropriate method of resolving the dispute. While we have provided for mediation to be used by agreement only, we have provided for a comprehensive arbitration procedure, giving the parties an acceptable degree of certainty as to the process for determining disputes.
29. The alternative dispute resolution procedures set out in our undertaking have been deliberately chosen as methods which are preferable to disputes being litigated in the courts. We do not seek to debate in this submission the merits of mediation and arbitration as compared to use of the courts, however what is clear is that the contract must provide for a pre-determined method of dispute resolution, rather than leaving it to be agreed, as proposed by 2 Degrees.
30. We also note that our undertaking does not exclude a party from seeking urgent relief or an order for specific performance from a court of competent jurisdiction until such time as an arbitral tribunal is constituted (see clause 27).
31. Clause 27.1.1 of Vodafone’s undertaking, is intended to allow parties to seek urgent relief from a court of competent jurisdiction until such time as an arbitral tribunal is constituted. However, we note that the words “whilst the parties are participating in an arbitration under **Clause 3**” could restrict the period that parties are entitled to seek urgent relief from a court from the time when a notice to arbitrate is filed to when the arbitral tribunal is constituted. Accordingly, to clarify Vodafone’s intention that it is at any time prior to the arbitral tribunal

⁴⁷ See for example, clause 2.3 of the Mobile Co-location General Terms

being constituted that parties may seek urgent relief from a court, we propose to remove the words “whilst the parties are participating in an arbitration under **Clause 3**” from clause 27.1.1 of Vodafone’s undertaking. Additionally, we note that there is a minor error in clause 3.6.4 of Vodafone’s undertaking. The cross-reference to clause 29 should be to clause 27. 2degrees may also consider that these changes are appropriate in relation to its undertaking.

Schedule 3 (Terms and Conditions), clause 6, removal of words “or agreement”

32. In its preliminary views, the Commission invited Vodafone to address cross-default provisions within our undertakings. In our undertakings submitted on 6 May 2009, we made changes to clause 6 of Schedule 3, to address this issue, and we explained our drafting in Appendix 1 in our submission of the same date. This included an explanation as to how the cross-default provisions related to commercial agreements. In its draft report, the Commission stated that its concerns around the lack of cross-default provisions in Vodafone’s undertakings had been addressed.⁴⁸ The words “or agreement” in clause 6 should not therefore be deleted as proposed by 2degrees, since this nullifies the cross-default effect we had achieved.

Schedule 3 (Terms and Conditions), clause 6.2, deletion of provisions relating to “stand down” period

33. The rationale behind the stand down provisions in clause 6.2 is to prevent an access seeker from defaulting under the undertaking, and then simply resigning up to the undertaking immediately afterwards. If clause 6.2 is amended in the way proposed by 2degrees, this would render the termination provisions meaningless and would allow an access seeker to game the contract by continually breaching the undertaking, but suffering no consequences.

⁴⁸ See paragraph 934