



COMMERCE COMMISSION

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cc: Interested Parties to the MTAS Investigation

Process for the final stage of the MTAS investigation

Purpose of this letter

The purpose of this letter is to notify parties of the Commission's process for the final stage of the MTAS Investigation.

Background

The Commission received revised undertakings from 2degrees, Telecom and Vodafone on 2 October 2009 (the "**Revised Undertakings**")¹. Submissions on the Revised Undertakings were received on 16 October 2009.

On 9 November 2009, the Commission wrote to 2degrees, Telecom and Vodafone inviting them to engage with each other in a transparent and constructive manner to discuss and, where possible, reach consensus as to how reciprocity in price and non-price terms between their respective Revised Undertakings could be achieved. The Commission further indicated its preliminary view that symmetry in the price terms and services covered by each of the Revised Undertakings was strongly desirable to avoid the potential distortions and inefficiencies associated with asymmetric rates.

Results of the parties' discussions

On Friday 20 November 2009, 2degrees' nominated counsel advised the Commission by email that the discussions had not reached an agreed position between all three parties and requested, on 2degrees' behalf, that the Commission proceed to make its recommendation.

On Monday 23 November 2009, Telecom and Vodafone jointly submitted a report on the discussions and a proposal for consideration by the Commission (the "**Telecom/Vodafone aligned proposal**"). Telecom and Vodafone advised that they have agreed alignment on all material non-price issues and have proposed alignment on price terms on the glide path set out in the Revised Undertaking submitted by Vodafone as "holding pattern price terms". Telecom

¹ Copies of all relevant correspondence are available on the Commission's website at <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/Investigations/MobiletoMobileTermination/mobiletomobiletermination.aspx>.

and Vodafone also made a number of observations in their letter with respect to undertakings submitted by 2degrees and reciprocity, the details of which are noted.

Assessment of the Telecom/Vodafone aligned proposal

The Commission's preliminary view, on the basis of its assessment of the rates reflected in the Telecom/Vodafone aligned proposal, is that it does not deliver sufficient benefits compared to the factual of regulation to be capable of being recommended for acceptance. Specifically (but without limitation), the Commission notes that:

- the rates contained in the Telecom/Vodafone aligned proposal exceed both the likely cost of the MTAS and the average on-net wholesale rates such that the Telecom/Vodafone aligned proposal would not sufficiently address concerns over removal of barriers to efficient entry;
- the voice rates in the Telecom/Vodafone aligned proposal do not fall within the range of the Commission's voice benchmarks until 2015;
- its quantitative analysis demonstrates that the net benefits provided by the Telecom/Vodafone aligned proposal are significantly less than the net benefits of cost based regulation of fixed-to-mobile ("FTM") termination rates; and
- the aligned MTRs for mobile-to-mobile ("MTM") termination in the Telecom/Vodafone aligned proposal do not fall within the range of wholesale MTM rates implied by the average on-net MTM retail prices charged by Telecom and Vodafone until 2013 and fall below this rate only from 2014 onwards (based on the average on-net MTM rates in 2008, allowing for a 5% annual price reduction).

In their letter of 23 November 2009, Telecom and Vodafone stated that "an aligned industry undertaking on MTAS that is acceptable to the Commission remains a better outcome for customers than the regulatory alternative." The Commission shares this view and reiterates its preference for commercial solutions where possible. It is noted however that the rates set out in the Telecom/Vodafone aligned proposal are offered some ten months after the date of first submission of undertakings by the parties. The Commission regrets that, notwithstanding this extensive period, the Telecom/Vodafone aligned proposal continues to reflect rates which are not, in the Commission's preliminary view, capable of being recommended for acceptance.

Commission's preliminary views on the Revised Undertakings and Telecom/Vodafone aligned proposal

The Commission considers that, of all factors to be considered, acceptable price terms and reciprocity are critical factors in its assessment of the acceptability of undertakings as a viable commercial alternative to recommending regulation.

It is noted that, of the Revised Undertakings, the price terms proposed in 2 degrees' Revised Undertaking are alone within the range of the Commission's benchmarks from 2010. Such rates are clearly attractive to the Commission in the context of a comparison to the factual of regulation. However, it is noted that such rates are not, and appear unlikely to be, reciprocated by Telecom and Vodafone in their undertakings. Without such reciprocity, such an undertaking appears incapable of being effective. In the context of acceptance of the Revised Undertaking from 2degrees only, if the reciprocity condition is removed and Telecom and Vodafone charge different rates than 2degrees, the Commission's preliminary view is that this

may lead to market distortion and asymmetric pricing which is undesirable in the context of its assessment of what is acceptable as a commercial undertakings solution.

On the other hand, it is noted that while the Vodafone/Telecom aligned proposal addresses reciprocity as between Telecom and Vodafone, the price terms proposed (which derive from Vodafone's Revised Undertaking) are not capable of being recommended for acceptance. The Telecom/Vodafone aligned proposal did not adopt the proposal made by Telecom in its letter to the Commission of 28 October 2009 as to the terms of an undertaking to which Telecom may be willing to commit on an aligned basis. Instead, under the Telecom/Vodafone aligned proposal, it is proposed that Telecom would align its undertaking at the higher voice rates (with an upwards adjustment to take account of second-plus-second conversion of those rates) and SMS rates proposed in Vodafone's Revised Undertaking. The Commission has indicated its preliminary view that a proposal based on the alignment in the Telecom/Vodafone aligned proposal is not capable of being recommended for acceptance because it does not deliver sufficient benefits compared to the factual of regulation.

The terms of parties' undertakings are a matter for them to determine. With a view, however, to providing further guidance to parties as to an outcome which may be considered acceptable to the Commission in the context of a commercial undertakings solution, the Commission has set out its preliminary views on Telecom's 28 October 2009 proposal in this letter.

Commission's preliminary views on Telecom's proposal of 28 October 2009

In its letter to the Commission on 28 October 2008, Telecom indicated that it was "willing to commit to an aligned undertaking that takes the lowest prices in every year covered by both the Telecom and Vodafone revised undertakings – converted to a second + second charging structure – and an improved position on out of balance SMS tariffs to apply in a hybrid bill and keep charging structure" (the "**Telecom 28 October proposal**").

The voice rates in the Telecom 28 October proposal are above the range of the Commission's benchmarks and in that respect are not attractive in the context of a regulated outcome. However, in the context of a commercial undertakings solution, the Commission's preliminary view is that, on the whole, the voice and SMS rates in the Telecom 28 October proposal appear likely to generate broadly sufficient benefits when compared to the factual of regulation such as to be capable of being closely considered for being recommended for acceptance. The voice rates in the Telecom 28 October proposal align with the cost-path implied by the average on-net retail prices charged by Telecom and Vodafone in 2011 (rather than 2013 as is the case with the Telecom/Vodafone aligned proposal). Such early alignment is an important factor in the Commission's assessment, amongst other matters, as to the ability of a new entrant to compete and consequently the possible acceptability of the Telecom 28 October proposal. The Commission would be unlikely to recommend acceptance of an undertaking with higher rates than the Telecom 28 October proposal.

The Commission notes that in their letter of 23 November 2009, Telecom and Vodafone state:

"One possible issue that may require further discussion is the apparent difference between the Commission and Vodafone view of the shape of any glidepath for FTM termination rates. Telecom has an open mind as to what the glidepath should look like, but considers that a reasonably measured glidepath mitigating market shocks is important and that alignment between Telecom and Vodafone in any final undertakings is critical. Therefore it is worth holding further discussions to consider whether an agreement can be reached. Clearly we would welcome the opportunity to discuss these issues further with you"; and

“Telecom and Vodafone have also aligned on the glide path set out in Vodafone’s undertaking as **holding pattern price terms** pending further discussions with the Commission.” (emphasis added)

The Commission’s preliminary view is that the glide path adopted in the Telecom 28 October proposal is reflective of what is likely to be acceptable to the Commission in the context of a commercial solution based on undertakings.

Commission’s preliminary view on likely acceptable undertakings

While the terms of their undertakings are a matter for each party, it is noted that were the parties to address reciprocity and symmetry by submitting revised undertakings reflecting the price terms and price path of the Telecom 28 October proposal and alignment on material non-price terms, the Commission’s preliminary view is that such undertakings are likely to be capable of being closely considered for being recommended for acceptance (subject to compliance with the general requirements of Schedule 3A of the Telecommunications Act 2001).

If no parties fulfil reciprocity and symmetry in their undertakings, the Commission’s preliminary view is that it would be difficult to recommend acceptance of such undertakings.

These views are without prejudice to the Commission’s right to consider the acceptability of all undertakings submitted to it on a case by case basis, where those undertakings address the Commission’s views in this letter.

Commission’s current views on certain matters

With a view to informing all parties on the Commission’s current views on a number of matters relevant to the Commission’s assessment framework as developed since the draft Report, the Commission includes a synopsis of its current assessment with respect to such matters in the Appendix to this letter. These current views arise following analysis of all parties’ submissions and as a result of updated information regarding overseas benchmarks. The Commission does not intend to seek further submissions on the current views set out in the Appendix.

Process for the final stage of MTAS investigation

In light of the information included in this letter and the Appendix, parties are invited on this final occasion to submit revised undertakings should they wish to do so in accordance with the process set out in the following paragraph. Parties are advised that this is the final invitation which the Commission anticipates affording to parties prior to finalising its recommendations and publishing the final Report.

The Commission does not consider that further discussions with the parties with respect to their undertakings would be constructive having regard, amongst other matters, to:

- the fact that the parties were not, as a commercial matter, able to reach acceptable alignment in their undertakings in a manner which the Commission considers capable of being recommended for acceptance; and
- the lengthy consultation and undertakings opportunities already afforded to all parties during the MTAS Investigation.

Next steps

The Commission invites 2degrees, Telecom and Vodafone to submit any further revised undertakings that they wish the Commission to consider, in light of the parties' discussions over reciprocity issues and the Commission's views set out in this letter, **by 5pm on Tuesday 15 December 2009**. If parties do not intend to lodge further revised undertakings, they are requested to advise the Commission of this **by 5pm on Tuesday 15 December 2009**, indicating also the status of their Revised Undertakings and whether they should still be considered by the Commission in reaching its final recommendation to the Minister.

The Commission intends to then proceed to complete its analysis and to make its recommendation in the final Report to the Minister. To allow time for the Commission to fully consider any revised undertaking, the Commission has informed the Minister that finalisation of its report will occur very early in 2010.

Parties are reminded that while the views expressed by the Commission in this letter and Appendix follow substantive analysis and consideration of all parties' submissions to date, such views are preliminary. The Commission will express its final views in the final Report.

Should you have any queries in relation to this letter or the MTAS investigation generally, please contact Tom Forster on (04) 924 3742 or by email at tom.forster@comcom.govt.nz.

Yours sincerely

A handwritten signature in blue ink, consisting of a large, stylized 'P' followed by a long, horizontal flourish that tapers to the right.

Dr Ross Patterson
Telecommunications Commissioner

Appendix

Commission's current views on changes to the assessment framework

The Commission has assessed all of the relevant submissions made to it during the course of the MTAS Investigation. Following such analysis, the Commission has revised its preliminary views in relation to a number of the parameters of the assessment framework as expressed in the Commission's draft Report. The Commission has also received updated information regarding overseas benchmarks and has reflected that information in its benchmarking assessment.

The Commission's current views on the following matters are:

- **benchmark set** – the Commission has reviewed the composition of the countries in the benchmark set for voice, in response to submissions from parties, and is now of the view that Hungary should be added to the benchmark set and France should remain in the benchmark set. The Commission does not consider that Greece should be added to the benchmark set;
- **price-point selection** – the Commission has reviewed its price point selection and is of the view that a range is acceptable for the purposes of setting a proxy factual price for voice in the context of a Schedule 3 investigation given that a Schedule 3 process does not set an initial pricing principle. This range begins from the average of the lowest three benchmarks and ends at the median of the benchmarks (the rate of which is as amended by the inclusion of Hungary). This means that the 2009 benchmark for voice in the assessment framework is from 5.1cpm to 8.3cpm (second-plus-second). The Commission considers that a decline in the cost path over time on the basis of a range between 6% (at the lower bound) and 10% (at the upper bound) is appropriate;
- **SMS pricing principle**– the Commission considers that some form of bill and keep would be an appropriate pricing principle for the Commission's assessment for the factual for SMS;
- **factual MTR for 2010** – the Commission considers that 15cpm (minute-plus-second) is an appropriate rate for the factual for 2010 having regard to the rate under the FTM Deeds²;
- **average on-net rates** – the Commission has amended its calculation of the average on-net retail prices for MTM and SMS from the draft Report, to ensure that subscription revenues are apportioned on a consistent basis. The Commission has estimated a range of implied on-net wholesale termination rates for 2008, based on revenue and volume data, of between []RI cpm for MTM (second-plus-second), and []RI cpt for SMS. The Commission has then allowed for an annual 5% reduction in these on-net rates.

² This is equivalent to 18.45cpm on a second-plus-second basis. The minute-plus-second rate is used here for ease of reference to the rates in the FTM Deeds.

Please note that the views set out in this Appendix are the Commission's current views only and the Commission's final decisions will be set out in the final Report. This Appendix does not indicate all changes to its assessment framework which the Commission may adopt in the final Report. The final Report will include the details of and reasons for any material differences between the draft Report and the final Report.