



ECONET WIRELESS NEW ZEALAND LTD

**SUBMISSION TO COMMERCE COMMISSION:
CROSS-SUBMISSION ON MOBILE TERMINATION RECONSIDERATION
DRAFT REPORT**

21 FEBRUARY 2006

Econet Wireless New Zealand Limited (“Econet”) thanks the Commission for the opportunity to make this submission. We make some general comments below, which are followed by specific references to submissions made by other parties.

1. Econet re-affirms its previous submissions that the fundamental way that the Commission should seek to reduce mobile tariffs is to ensure the broader regulatory framework encourages new entry. Specific price regulation of mobile termination should be a secondary measure, to be brought into play only if the fundamental measure of encouraging new entry has proven not to be effective. However, this can only be determined on the basis of an effective regulatory system, which New Zealand currently does not have. Therefore, while we welcome the policy objectives of the Commission in seeking to reduce mobile retail prices, we believe the Commission’s first duty is to amend the regulatory system itself to ensure that mobile new entrants are encouraged. Only then should it turn its attention to regulating mobile termination rates.
2. None of the parties’ submissions dealt with the issue of asymmetric termination rates. This is a major component of the problem of ‘closed network pricing’. Closed network pricing is a combination of two factors: termination rates, and retail prices. In relation to retail rates, it describes the practice of an incumbent network lowering its retail rates to callers within its own network: eg, a Vodafone customer calling another Vodafone customer, when the same customer is charged a higher rate to call a new entrant network. The market problem this creates is that it offers no incentive for consumers to join a new entrant network.

It is arguable that at the beginning of a new entrant’s business, there is little incentive on the incumbent to drop retail rates across its large customer base in order to shut down a new entrant with a small customer base. However, it is rational for an incumbent to incur a loss relative to its retail revenues, in order to eliminate a new entrant who might pose a threat to it in the future. Also, incumbent networks do not always act rationally, and for this reason there should be a clear signal within the regulatory system to ensure this practice does not occur.

Closed network pricing behaviour should be proscribed even when the incumbent is not pricing below cost (in terms of the Commerce Commission’s 1998 decision regarding Saturn and Telecom). This is because where monopoly rents exist, an incumbent can aggressively reduce the price of a service so as to eliminate a competitor, while still pricing substantially above cost.

This very problem was faced by Clear Communications in the 1990s in seeking interconnection with Telecom. Telecom's argument in that dispute was that since Clear's network was of lower value to Telecom than Telecom's network was to Clear, Telecom was justified in charging Clear a higher termination fee that Telecom would pay to Clear. The Courts' decision in that case resulted in the Baumol-Willig rule, now specifically outlawed by the Telecommunications Act 2001. The result of this decision was the disaster that was fixed line telecommunications in the 1990s. Arguably, that disaster led to the current Act and, by extension, the current investigation.

Therefore, it is beyond doubt that a problem exists where new entrants come into the market and face interconnection hurdles from incumbent players – and so the Commission needs a way to ensure that the new entrant is enabled to grow its network when it has very little market power.

The Commerce Act 1986, (ss 36 and 27) are not sufficient to deal with the problem, given the bizarre jurisprudence in New Zealand where decisions of the Commerce Commission and Court of Appeal have led to both the introduction of the Baumol-Willig rule, and the elimination of Saturn Communications from the market in 1999. Further, New Zealand is an anomaly in that the law dealing with market behaviour is contained in the Commerce Act (and dealt with under normal *ex post* legislation), while the law dealing with market access is contained in the Telecommunications Act (and dealt with under *ex ante* regulation). A more streamlined and internationally normal system would see both behaviour and access being dealt with in the same system – ie, a single regulatory body would have control over both aspects. This would have the benefit of allowing the Commissioner to have the full set of regulatory tools available to him. It would also bring focus on problems caused by substantial market power, that go beyond the problems that the Commerce Act can deal with. In the EU and elsewhere (notably Australia), significant market power is a threshold which gives rise to a range of regulatory consequences – some dealing with behaviour, some dealing with access – and overseen by the same regulatory agency. New Zealand, the Commissioner is less able to deal with problems of significant (or substantial) market power because he is not able to use the full set of tools that his overseas peers are able to.

When market power problems are expressed through termination practices (eg, as with Telecom and Clear), it spans both behaviour and access. But because the two are split into two different legal spheres, the law is weaker than it should be in a developed OECD market – and therefore there is a pronounced need for regulation to enable and encourage competition through new entry.

The way to overcome the problems of closed network pricing is to regulate mobile termination rates asymmetrically in favour of the new entrant. This is, in effect, the opposite of the Baumol-Willig rule: instead of entrenching monopoly

rents and specifically allowing incumbents to shut down new entrant businesses, it recognises the problems of market entry and realigns the playing field in order to overcome the incumbent's incentive to use market power to slow or eliminate their entry from the market. This approach is seen most notably in the EU, where it is becoming an accepted regulatory tool to enable new entrants to gain a foothold in the market and provide competition. We would be happy to explain our views in relation to asymmetric termination rates in more detail with the Commission.

3. Econet disagrees with Vodafone and Telecom that MTR regulation represents a significant threat to dynamic efficiency. Econet re-iterates its view that 3G is not a risky technology and that 3G investment is driven by a combination of future data opportunities (which are not being regulated) and the fact that 3G is more efficient than 2G at carrying voice. This has been acknowledged by Vodafone internationally on numerous occasions. Finally, when determining a regulated rate, the Commission allows a reasonable rate of return for investors.
4. Econet supports the proposed service-based rather than technology-based service description. This distinction recognises that operators offering termination will always have substantial market power when determining access to their network, regardless of the technology they choose to use on that network.

TELSTRA CLEAR'S SUBMISSION

5. Econet supports TelstraClear's submission that the service-based description will bypass potential billing issues and confusion for end users that would potentially be made under a technology-based description. Econet reminds the Commission that Telecom also argued strongly during the MTR Conference that a technology-based description could lead to a difficult, unwieldy system and confusion for end customers.
6. Econet agrees with TelstraClear's view that retail pass-through of any reduction in MTR is not required and that pass-through can be expected to occur through normal competitive pressure.
7. Econet agrees with TelstraClear that the Commission should not accept the commercial offers put forward by Telecom and Vodafone. Econet agree that regulated MTR will make no difference to the current incentives on mobile operators to voluntarily reduce termination rates.

VODAFONE'S SUBMISSION

8. There is a general theme in Vodafone's submission that it is keeping Telecom honest, and therefore the Commission should not penalise Vodafone for providing

much-needed competition. Vodafone suggests that “Vodafone is Telecom’s most significant competitor” and “disadvantaging Telecom’s biggest competitor and thereby increasing Telecom’s revenues is bad public policy”.

Econet challenges this theme in the strongest possible terms. If Vodafone was providing effective competition to Telecom, why are New Zealand’s retail rates the highest in the OECD? Vodafone represents around 65% of the mobile market calculated by revenue, and has a significantly lower cost base than Telecom. Econet believes that Vodafone’s pricing is directly related to Telecom’s cost structure, which is multiples higher than Vodafone’s own. In this situation, how can Vodafone be said to provide effective competition? In fact, what Econet believes it is doing is simply matching the prices that Telecom sets on account of its higher cost base. Vodafone has no GSM competitor to constrain it – unlike every other country in the OECD. It has only a CDMA competitor, which is isolated internationally (in contrast to Vodafone which is part of the world’s largest telecommunications company) and it has a fundamentally higher cost base.(please reference the telestra Australia decision to close their CDMA network down) Therefore how can it effectively compete? The relationship between Vodafone and Telecom is not effective competition its duopolistic behaviour– it is the structural reason behind New Zealand’s worst rating in the OECD for mobile pricing.

9. Section I - Summary - Page 2 of 43:

“Regulation will slow innovation: The Commission is also underplaying the downside of MTR regulation. Our plans to use our 3G network for local services, for wireless broadband, and for aggressive reductions in mobile retail prices will be undermined by the proposed MTR regulation.”

Econet’s position: This is false because innovation will come from true network competition, not from Vodafone alone. In the current environment, Vodafone has little incentive to reduce retail prices. Currently there is no network competition because there are inadequate regulatory road rules to allow a successful new entrant.

10. Section I - Summary - Page 3 of 43:

“The case for MTR regulation rests on regulating 3G networks. The Commission assumes that Vodafone’s 3G network is mostly rolled out, it is very cheap to provide services, and most of the services we provide over it will not be regulated anyway. So we will not do anything different if our termination rates are cut by 33%.

Econet’s position: Vodafone is merely transferring a GSM monopoly to a 3G monopoly. Econet invites the Commission to discuss in more detail the actual cost

of building a 3G network and related services so the Commission will see the true level of capex required after cellsite acquisition.

11. Section IV - Context for Regulation - Page 10 of 43:

“New Zealand’s current MTRs are just slightly above the average prices of countries in which Vodafone operates, and the Commission’s proposed prices would, in one step, make New Zealand’s rates amongst the lowest in the world.”

Econet’s position: New Zealand’s currency and peculiar market structure makes it one of the cheapest countries in the world to operate in. Specifically, the UK example in Vodafone’s submission is not logical given Vodafone’s lower spectrum costs in New Zealand and New Zealand’s lower salary costs. Further, there is a dramatic difference between New Zealand and other OECD countries at the distribution level, where other OECD countries must provide both handset subsidies and distribution fees on a percentage of ARPU basis, whereas in New Zealand Vodafone makes positive handset revenue and pays few, if any, distribution margins.

12. Section VII - The cost of termination in New Zealand - Page 27 of 43:

“Combined together, these two numbers give total voice minutes per square kilometre of network coverage. We think that this is a useful barometer of likely network costs in each country.”

Econet’s position: Econet would like to see the Commerce Commission complete a detailed study of the Vodafone NZ profitability (before inter-company transfers) so the Commission may see the level of monopoly rents extracted from the New Zealand consumer. Specifically, given the non-existent GSM competition in New Zealand, many of the competitive distribution costs that exist in the UK simply do not exist in New Zealand.

13. *“Of course, there are many other relevant factors, including land costs, spectrum costs, wages, incomes, and the costs of radio equipment. But this basic measure gives some support to the argument that costs may be higher in New Zealand.”*

Econet’s position: It’s interesting to note here that Vodafone are saying costs may be higher in New Zealand. We challenge the Commerce Commission to review and publish these costs and compare them to other OECD environments.

14. *“Subscriber numbers are typically lower in New Zealand than other countries, and usage per subscriber is also much lower.”*

Econet’s position: We agree that usage in New Zealand is low. However this is purely and simply a result of high prices. It’s Econet’s view that the crisis in New Zealand in broadband is replicated in mobile, with New Zealanders having not embraced the mobile technology because of high cost.

15. *“A large coverage requirement combined with few minutes of use means a relatively high cost network on average.”*

Econet’s position: Econet challenges the Commerce Commission to review in detail the actual cost structure of Vodafone NZ, specifically highlighting the free cash that is generated by its current business relative to its very small level (less than \$200m after its 2005 \$500m special dividend paid to Vodafone Plc) of shareholders funds.

16. *“The implication is that economies of scale are likely to be more significant in New Zealand than in other countries that have higher usage and more dense populations, and this will tend to push up unit costs.”*

Econet’s position: Econet’s reiterates its position from its own experience in GSM operations that mobile phone airtime production is cheaper in New Zealand. In contrast, monopoly rents are extracted from consumers in city areas in New Zealand.

Section VII - The cost of termination in New Zealand - Page 28 of 43:

17. *“But we only have about a tenth of Vodafone UK’s demand. Vodafone UK has eight times our subscriber base, and on average each of our customers make and receive about 30% fewer minutes of voice calls each year.”*

Econet’s position: UK subscribers make more calls because prices are lower. New Zealand consumers are suffering because they would like to make more calls but pricing is ridiculous. This is the reason why texting is so popular in New Zealand – more so than in the rest of the world where voice prices are lower.

18. *“The Commission has formed the view that our 3G network is substantially rolled out, that our 3G investment is not as dependent on voice termination revenues, and that therefore regulation will not affect our investment decisions.*

“On 10 August [Vodafone] announced that 3G coverage was available in Auckland, Whangarei, Hamilton, Christchurch, Wellington, Queenstown, Dunedin, Hastings, Napier, Nelson, New Plymouth, Palmerston North, Rotorua, Taupo, Tauranga, Mt Maunganui, Wanganui, Pauanui, and Whangamata. While this still leaves areas of the country, possibly including areas within the listed towns and cities, without coverage, Vodafone has deployed 3G coverage to the vast majority of the population.”

“The greater capacity offered by 3G networks is being used to broaden the range and improve the quality of data services that can be offered to end users, and 3G investment is likely being driven by the future growth opportunities in data services in particular.”

Econet's position: As infrastructure providers, Econet respects the capital expenditure that Vodafone has spent in servicing these cities. However, the bulk of this capital expenditure came at a time when mobile penetration was very low and competition was very poor relative to world standards. Econet believes that this capital expenditure has been paid for many times over by monopoly rents that have been extracted from the New Zealand consumer. Over the last 7 years that Vodafone has operated in New Zealand. Vodafone's dividend payment in last year's accounts of \$500 million to its overseas parent – during a year of supposedly huge 3G investment - is a clear indication of the return on capital that Vodafone now enjoys.

X - Conclusions - Page 42 of 43:

19. *“Regulation will mean higher mobile retail prices.”*

Econet's position: Econet has no doubt that Vodafone will indeed increase prices, unless a new network is successfully launched in New Zealand within the next 12 months.

20. *“Regulation of Vodafone's MTRs will not promote competition overall. There is no market failure that regulation can overcome. We are not putting on a price squeeze in the FTM calling market.”*

Econet's position: There certainly is a market failure – namely, the highest prices in the OECD, and the only OECD country with only one GSM network. If this is not market failure, Econet would like to know what market failure is. We do not believe MTR regulation is the total cure for this failure – as we have said in our introduction, we believe the overall objective for the Commission should principally be to encourage new entry. However, there is no doubt that a market failure exists, and reducing mobile termination rates will help to correct it.

21. *“We have offered to reduce our MTRs without regulation. The Commission should recommend that the Minister enforce the reference offers and Telecom's passthrough commitment.”*

Econet's position: Econet believes the Commission should take a strong stand against this kind of commercial deal. It is offensive to the Commission and the rest of the industry for Telecom and Vodafone to push the Commission right to the edge of regulation, and then try to claw back the ground with a commercial offer. This type of behaviour, while rational for the incumbent, is against the interests of the industry, and the Commission should not accept it.

For the Commission to accept this type of behaviour significantly increases regulatory risk and the risk of investment. Investors are lining up behind New Zealand new entrants, waiting to plough money into providing competition, but

they will not put themselves in front of a speeding train. They want to see that the regulatory system will support their investment. When the Commission accepts a commercial deal, it makes the Commission appear toothless, willing to compromise, and without a clear vision for the future of the industry. It allows the incumbents to make fools of the Commission and the government by pushing things to the limit before finally changing their minds and doing as they are asked. This is not the way to conduct regulatory policy, and Econet would like the Commission to reject this behaviour in the strongest possible terms.

TELECOM'S SUBMISSION

A - Executive Summary - Page 3:

22. *"...Competition in the mobile and fixed line toll calling markets continues to be fierce, to the benefit of consumers. The Commission's assessment that these markets are not competitive is out of touch with the standard of workable competition in New Zealand markets, and seems driven by a concern that to concede that they are competitive would count against regulation."*

Econet's position: The market is not competitive. If it was, New Zealand would not have the highest prices in the OECD. It is that simple. Telecom's assertion conflicts with the shareholders view of Telecom. Econet would be happy to supply reports written by Merrill Lynch, ABN Amro, Macquarie, Citigroup, and Forsyth Barr, all of which highlight the fact that Telecom produces a very high dividend yield because of benign competition and relatively light handed regulation in its core markets.

A - Executive Summary - Page 4:

23. *"Dynamic efficiency impacts must be assessed from the perspective of the investor. Bringing a new technology and innovative services to market is a risky and expensive decision. If the Commission signals that it sees nothing wrong with regulating (at cost) only months after an investment is made, investors will react to the uncertainty by investing later than they otherwise would have. New Zealand consumers will lose out."*

Econet's position: Econet would like to submit to the regulator in confidence a profile of its investor roadshow in 2002. Econet has more experience than Telecom in communicating with real greenfields investors who wish to introduce fresh capital into the country for the specific purpose of building infrastructure. Having recently paid out \$2 billion in dividends, Telecom is in no position to talk about the dynamics of investors providing innovative services and new technology. Econet has roadshowed the NZ telecommunications market in the financial capitals of the world over the last five years. Most investors will not invest in New Zealand because of the lack of an internationally normal regulatory environment.

In Econet's opinion, Telecom in contrast only has experience in dealing with stockmarket investors who are trading in the secondary (not primary) equity markets. For years, Telecom has marketed itself to the capital markets as a dominant player with a lack of competition. Econet would suggest that the Commerce Commission involve the investor base of Telecom - namely Capital Group, Brandis, and, Fidelity and Templeton, in this inquiry in order to gauge first hand how they view the regulatory environment in New Zealand relative to the other telecommunications companies they all have invested in. Econet would also like the Commerce commission to study the impact of brokerage collected by the financial community from the trading of Telecom. Its needs to be noted that nearly 40% of all the NZ share brokers share trading brokerage income comes from the one stock telecom. (a larger amount than its respective market capitalisation position, because of the liquidity of the company). NZ stock brokers have behaved like the Telecom Board in faulty analysis of this company . This is because of their vested interest in perpetuating this brokerage revenue Should the company halve in value NZ stockbrokers take an approximate 20% income drop . Such is the unusual influence of this company.

C - The Impact of Regulation and Cost Benefit Analysis - Page 12:

24. *“While the Commission believes that 3G is no longer a “new risky” investment, this qualification cannot possibly apply to future generations. Any future investments in new generation technologies will involve large amounts of capital expenditure and associated risk in obtaining a return on that expenditure.”*

Econet's position: Econet requests the Commerce Commission to more actively research 3G construction and equipment costs for operators who already own customers and cellphone towers. It is our experience that 3G costs are low. This is particularly the case in New Zealand, where, due to the lack of competition, new technologies services are rolled out years behind Europe, US, Asia and Australia – and therefore are mature and relatively cheap by the time they are finally brought to New Zealand.

C - The Impact of Regulation and Cost Benefit Analysis - Page 13:

25. *“Telecom (and presumably Vodafone) has made large capital investments to upgrade its network to 3G. Consumers are benefiting significantly, with numerous new services being made available, such as mobile broadband, video clips, push-to-talk and picture messaging.”*

Econet's position: As discussed above, New Zealand is considerably behind the OECD in value added services, mobile internet access, gaming, content, open portals and the like, because there is no competition. Vodafone is part of the largest mobile telecommunications group in the world, and has recently restructured in order to take advantage of its huge economies of scale by sourcing its value-added

services directly from its UK parent. Therefore we are very sceptical about the levels of investment it has provided in order to compete against Telecom – who is hamstrung by a CDMA operating system and not on the same planet as Vodafone in terms of purchasing power for content and value-added services.

26. *“Despite this, the Commission has ‘dropped the axe’ on this investment by proposing regulation of 3G voice calls. This sends very poor signals for firms considering future investments in New Zealand markets.”*

Econet’s position: Econet is perhaps the only player in the market who can speak with any authority on this topic. Telecom is 100% wrong in its assertion. In fact, investors are excited about the prospect of regulation, even when it could affect their revenue streams, as is the case with mobile termination regulation. This is because a strong mobile termination decision from the Commissioner sends the signal that the Commission is strong on regulation, and will do what it takes to provide a platform for competition. As stated previously, we believe that mobile termination regulation should be adopted only when regulation that is more enabling of new entry has failed; nevertheless, even mobile termination regulation sends a positive signal to investors that New Zealand finally sees itself as part of the OECD and wants to follow its precedents. It is new entry investors, not incumbent investors, that the Commission needs to be concerned about. Specifically investors query Econet about the commerce commissions analysis and compliance with OECD regulatory norms

C - The Impact of Regulation and Cost Benefit Analysis - Page 14:

27. *“Regulatory intervention of this nature will risk curtailing investment in the mobile technology sector. Telecom submits that the Commission has not taken adequate account of this risk. Investment in new mobile networks requires significant up-front capital expenditure, and sufficient confidence about the level of ongoing cashflows that will be realised from that network to justify the upfront expenditure. The very real risk introduced by the Commission’s proposed forward-looking regulation is that it will cause one or both of the mobile operators in the future to delay committing to make the upfront capital expenditure required for a new network, or to decline to do so altogether.”*

Econet’s position: Again, the Commission needs to be concerned about new entrant investment, not incumbent investment. If new entrant investment is encouraged and promoted, this will bring a competitive dynamic into the marketplace which will force incumbent investment to follow. To deny new entry, all the Commission will achieve is to maintain a comfortable status quo in which there is significantly *less* incentive for incumbent investors to provide competitive services and prices. Therefore the Commission must quickly move to ensure that regulation for new entry is similar to OECD countries in which competition flourishes, and in this way ensure that New Zealand attracts more infrastructure investment and more competition.

Telecom has got its position embarrassingly wrong ,here, there has been no regulation and there has been no investment , Lets case study Telecoms own investment position in Mobile , During the years of no regulation , specifically the 90s , telecom ran a AMPs network (a network that the Australians shut down in 2000) and telecom ran a network for kiwis with No text and no international roaming , creating a position which was clearly 7 years behind Europe. Additionally No number portability was available, a service that the Vodafone network's previous owner pleaded for before giving up on NZ

GENERAL COMMENTS

Participation

Econet is concerned that most of the players who have an interest in marketing and creating competition for calls terminating in mobile networks are not participating in this enquiry. In New Zealand, there is a whole range of smaller telecommunications companies who have not participated because they are either too scared of the incumbents' reaction (who they must interconnect with) or don't have the resources to fight through thousands of pages of material created by incumbents to delay and postpone regulation and clog up the regulatory system, preventing the Commissioner from conducting more important work. Its not industry democracy when 2 companies take all the energy from the commerce commission

We understand that CallPlus, Digital Island, Cry Communications, WorldxChange, Compass Communications and Woosh have not participated in this review. This represents a failure to engage the smaller players and illustrates the clogging up of the system by the incumbents.

Competition

Econet violently disagrees with Telecom that there is fierce competition in the New Zealand cellular market. Econet will not waste the time of the Commerce Commission by reiterating the huge amount of material that conclusively illustrates the total lack of competition in New Zealand. Econet, however, will be available on request to demonstrate to the Commission that New Zealand is the most uncompetitive market in the OECD, and that most developing countries (which Econet will not disrespectfully label third world) have more competitive markets – usually with at least three same technology competition networks.

The reason why there is no competition is that the incumbents have stalled, obfuscated and delayed both the Telecommunications Act itself, as well as the regulatory process that the Telecommunications Act has generated.



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