5 November 2007

Mr Vladimir Bulatovic
Senior Economist
New Zealand Commerce Commission

Dear Vladimir,

Thank you for providing us with the opportunity to comment on the New Zealand Communications proposal that access prices for SMS and data service be calculated on a voice call per minute equivalent. Also, the report which you provided, prepared by WIK for the ACCC in Australia, on mobile termination costs contained useful insight into voice call equivalence for SMS and data services.

As a general response to considering a voice call equivalence, Telecom recommends against the Commission considering a voice call equivalence pricing methodology. This is because the underlying assets required to deliver voice, SMS and data service on a 2G network, despite being broadly similar, will be difficult to appropriately account for in a conversion factor. This challenge is further exacerbated for a 3G network as network assets required for the delivery of these services are fundamentally different. Consequently, using voice call equivalence conversions creates material risks of creating price points which do not reflect the cost structure of these services. This would be inconsistent with the objectives that the government is attempting to achieve.

Telecom believes the New Zealand Communications approach to voice call equivalence to be flawed. Their analysis is at times unclear and represents a misunderstanding of core network configurations and key cost drivers for delivering the end to end services under investigation. We recommend against adopting the approach which they have proposed in their 31 August submission.

In regard to the WIK report, their framework for analysis appears correct provided one is seeking to apply a voice equivalence measure but is only relevant to a 2G network. Applying the same analysis to a 3G network would fail to appreciate that the underlying assets required to deliver each service are substantially different. Given this, we question the usefulness of the WIK report when considering pricing principles for this investigation.

To assist in preparing this response we engaged Alcatel-Lucent, who are currently constructing our new WCDMA network, for their expert advice. Alcatel-Lucent agreed with our views on the New Zealand Communications and WIK approaches. In particular, they expressed material concerns with the arbitrary nature with which New Zealand Communications has gone about constructing a voice call equivalence. In responding to the WIK report Alcatel-Lucent stated the analysis should have no bearing on the Commission's work as the WIK bottom up cost model did not reflect the substantial complexities of a 3G network. Therefore, applying WIK's analysis of a 2G network to a 3G network is of questionable value.

When analysing data services, and as previously submitted to the Commission, we believe that the pricing of data services carry two key risks. The first pertains to the infancy of the data market and in particular 3G data services. Cost based prices are likely to have a number of perverse impacts on the markets development. As a point of principle we would suggest against cost based regulation of a service which is still in a phase of development.

The second key risk to data pricing is if data is priced like it were a homogenous service. There is a rage of different data services with each having various differentiating characteristics that represent substantially different cost drivers. For example, throughput, latency, quality of service and locations fix for an end to end service will all have considerable but different impacts upon price across the network. Therefore, if the Commission were minded to regulate data services we propose that you define a basic data service and regulate only that service.

In conclusion, if the Commission is minded to regulate the price of SMS and data services, we recommend the Commission consider a retail minus construct for each price rather than a conversion factor given the high probability of misspecifications. We believe a retail minus basis for an initial pricing principle is meaningful giving that international cost benchmarks will be problematic to construct given that most jurisdictions do not regulate these services. For a final pricing principle, as previously submitted to the Commission, we would recommend a TSLRIC model for SMS and data services which creates appropriate incentives for build-buy decisions and takes into account regional cost variations.

As always, we are open to assisting and working with the Commission on these complex issues. If there are any points which you would like further clarification on please don't hesitate to contact myself or Antony Srzich. We look forward to our ongoing engagement.

Regards,

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