



Hon David Cunliffe

MP for New Lynn

Minister of Health

Minister for Communications and Information Technology

5 SEP 2008

8 SEP 2008

Ross Paterson
Telecommunications Commissioner
Commerce Commission
PO Box 2351
WELLINGTON 6140

Dear Ross

NATIONAL ROAMING

As you may know, I have now accepted the Commerce Commission's recommendation against the designation of national roaming, as contained in its Final Report dated 10 March 2008, prepared under Schedule 3 of the Telecommunications Act 2001 (the "Act").

Following my decision, the Ministry of Economic Development received a letter from New Zealand Communications dated 7 August 2008, a copy of which is attached. The letter states that the commercially negotiated national roaming rate in the New Zealand Communications-Vodafone agreement, which I understand is dated 16 November 2007, uses "per second" billing only after a first indivisible minute. The letter claims that this charging structure

"provides an artificial inflation of up to 50% above the headline roaming 'per minute' rate because we understand that up to 70% of mobile calls in New Zealand are of less than 1 minute duration".

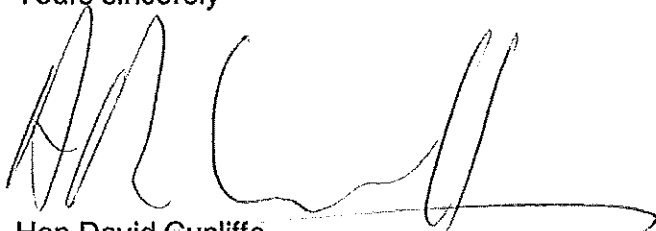
I understand that this claim was not brought to the Commission's attention during the process leading up to the Commission making its recommendation to me. However, having now received this new information, I consider that the proper course is to request a new investigation of the matter under Clause 8(1) of Schedule 3 of the Telecommunications Act so that this issue and its significance can be fully assessed by the Commission. This will in turn require a consideration by the Commission of whether it is satisfied under Clause 8(2) that the New Zealand Communications' claim, together with any further information it may receive relevant to national roaming, provide reasonable grounds for such an investigation to be commenced.

I accordingly request, pursuant to Clause 8(1) of Schedule 3 of the Act, that the Commission commence a fresh investigation into whether, in light of this new information, Schedule 1 of the Act should be altered by:

- omitting the national roaming service from Part 3 as a specified service; and
- adding it to Part 2 as a designated service.

I look forward to learning the outcome of your consideration.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David Cunliffe', with a long horizontal flourish extending to the right.

Hon David Cunliffe

Minister for Communications and Information Technology

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7 August 2008

Telecommunications Commissioner's response to the Minister for Communications and Information Technology on the Commission's national roaming report.

Dear Reg,

Thank you for your letter dated 29 July providing details of the Commissioner's response to the Minister on the above topic.

I had hoped that the Commission may have provided some additional workings in their response to the Minister that showed how they had calculated the overall cost differences between the commercially agreed roaming prices and the Commission's anticipated roaming prices had the service been designated. As this has not been provided I have had to make some assumptions about their calculations that are implied in their Final Report on the matter dated 10 March 2008 and supported by verbal conversations I have had with economists at the Commerce Commission that have significant consequences on their findings and final recommendation. Indeed, it is likely that they will need to reverse their recommendation on designation should their calculation be flawed in the way it seems to be.

Our understanding of the Commerce Commission's calculations of the costs of roaming is that they have in all likelihood compared their benchmarked prices – calculated on a per second basis, directly with charges that have been rounded to the first minute. This can only be appropriate if all calls made by end users are over 1 minute in duration. The reality is that end user behaviour results in a substantial volume of calls of less than 1 minute duration and therefore comparing the two scenarios directly is fundamentally flawed. Had the Commission taken account of user behaviour, they would have calculated that the cost of national roaming under the commercial agreement with Vodafone was of the same order as their calculation of Vodafone's 2 November 2007 Roaming Undertaking. A cost that they judged to be too high. Commenting on Vodafone's 2 November 2007 Undertaking the Commission stated in its 10 March Final report (paragraph 266) that *"the price terms ... are substantially inferior to cost-based regulation and on this basis alone [the Commission] would not accept the undertaking"*.

If the Commission has as we suspect simply missed the rounding issue, then if they were to re-run their calculations against their own cost-based MTR benchmarks, they would conclude that the voice roaming costs incurred by NZC under the commercial roaming agreement would be almost identical to the costs that they had themselves deemed substantially inferior

to cost based regulation and would have little option but to recommend designating the service.

The significance of this is critical to NZC and has a cost implication of the order of \$60m over 5 years. I would be grateful if you could consider requesting that the Commission provide you with a specific explanation of their calculations so that you can be assured that they have not misinterpreted their own analysis and therefore made an error in their final recommendation, or if an error has been made, that they reconsider their recommendation in light of any new findings that they may make.

A more detailed explanation of the issue:

The Commission's Final Report of 10 March 2008, stated in paragraph 274 that it had used "quantitative modeling to assist in determining whether designation of the service would promote competition, including by reducing barriers to entry". This is a sensible approach given the single provider situation in New Zealand.

The Commission had found that the impact of regulation (in favour of the new entrant) as compared to the commercial agreement was on average \$2 million per year (para.271). It went on to state (para. 272) that "the results of the Commission's analysis of the impact of designation indicate that the terms of the commercial agreement are such that the incremental impact of designation on entry becomes relatively minor and is unlikely to give best effect to section 18 of the Act and in particular the prices contained in the commercial agreement are unlikely to foreclose efficient entry".

When comparing the relative costs of the commercially negotiated prices and those that would be applied under a designated service, the Commission calculated a benchmark for voice traffic "based on the estimated costs of providing roaming services as proxied by a cost-based mobile termination rate" (para. 224). It then goes on to benchmark cost-based MTRs across a range of countries and shows them in Table 3 with a median MTR of \$0.1076, and finally, in paragraph 239 they state that "for the purposes of considering whether to move the national roaming service from a specified to a designated service, the Commission has adopted a factual roaming rate of 12cpm for voice calls".

The MTR benchmarking calculation (Table 3) was based on countries where per second billing at the wholesale level is the norm. So, if the Commission believes that 12cpm is an appropriate benchmark based on "per second" cost-based MTRs then it follows that their assumption is that per second billing is appropriate – at least to the extent that they use it for comparing costs with the 2 November Undertaking and the Commercial agreement between NZC and Vodafone.

The Commercial agreement in place between NZC and Vodafone provides a wholesale charge that is charged on a *first minute* then per second basis. This is unprecedented in other wholesale roaming (and mobile termination) markets and creates significant distortions when comparing New Zealand prices with International benchmarks. We estimate that Vodafone's charging structure provides an artificial inflation of up to 50% above the headline roaming "per minute" rate because we understand that up to 70% of mobile calls in New Zealand are of less than 1 minute duration. When the effect of the minimum one minute charge is taken into account, a hypothetical 14c roaming rate is likely to be equivalent to 21c

per minute when comparing rates with the Commission's international (per second) benchmark of 12c per minute.

It is easy to understand how the artificial inflation could have been completely hidden in any calculations because multiplying the per minute cost by the total number of minutes does not anticipate short call durations. This is what we suspect has happened. If however, the Commission had understood and accounted for typical end user behaviour and the impact of the first minute rounding approach, then they would have ensured that they were comparing like-for-like costs under the different scenarios summarized in Table 5 of the Final Report and would have concluded that directly comparing per minute billing with per second billing would have distorted the outcomes by a very wide margin (around 50%).

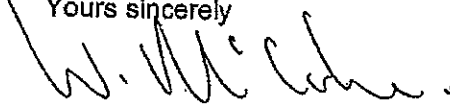
Voice roaming costs as calculated by the Commission according to their own roaming forecasts were as follows:

The Commission would not accept Vodafone's 2 November Undertaking as it was substantially inferior to cost-based regulation.

It stands to reason that had the Commission been consistent in their calculation - i.e. calculated the cost per second used for the commercial agreement as they did for the benchmarking used to calculate the hypothetical regulated outcome, they would have concluded that the commercial agreement was substantially inferior to cost-based regulation and therefore recommended to the Minister that the service be designated.

I trust my explanation of this issue is clear but I would be happy to meet to discuss it in detail if you so wish. Perhaps you could confirm whether you share my concern that the Commission may have misinterpreted their own findings and whether you also agree that it would be necessary for them to re-visit their calculation.

Yours sincerely



Bill McCabe