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**SUBMISSIONS TO THE COMMERCE COMMISSION IN SUPPORT OF LAUNCH OF  
SCHEDULE 3 INVESTIGATION INTO DESIGNATION OF ROAMING**

**26 September 2008**

**Public Version  
(there are also separate confidential appendices)**

## TABLE OF CONTENTS

<b>1</b>	<b>Introduction .....</b>	<b>3</b>
<b>2</b>	<b>Framework for the Commission’s decision whether to launch an investigation.....</b>	<b>3</b>
<b>3</b>	<b>Framework for the counterfactual analysis .....</b>	<b>4</b>
<b>4</b>	<b>Minute-minimum termination rates .....</b>	<b>9</b>
<b>5</b>	<b>Trends overseas.....</b>	<b>9</b>
<b>6</b>	<b>Consistency .....</b>	<b>10</b>
<b>7</b>	<b>Strategic price discrimination .....</b>	<b>10</b>
<b>8</b>	<b>Non-Price regulation, without price regulation, has proven to be gamed and ineffectual in practice.....</b>	<b>10</b>
<b>9</b>	<b>Conclusion.....</b>	<b>11</b>

## 1 Introduction

- 1.1 Thank you for giving us (Woosh, Kordia, Orcon and CallPlus) the opportunity to submit. We seek an investigation into whether roaming should be designated (i.e. whether there should be the ability under the Act to seek a determination as to price).
- 1.2 Each of us has spectrum suitable for WiMAX. We can therefore provide additional facilities-based competition in the cellular market, beyond Vodafone, Telecom and NZ Comms. With the right conditions, there can be four to six Mobile Network Operators.
- 1.3 However, reasonable roaming prices are essential to justify our business cases. Absent designation of the roaming service, we consider such pricing is most unlikely, based on our experience and that of others. The ongoing problems with mobile co-location, due – among other things – to that service not being designated, and the approach of the access providers, show that the same sort of issues will play out for roaming unless there is designation. That is the practical reality.
- 1.4 We have focussed on the counterfactual below, noting that the approach should be based on the final pricing principle not the initial pricing principle. We note that the latter approach appears to have been taken for some time before the Commission, without contrary submission to the Commission. The first mobile termination investigation did not have participants that would have argued against the approach based on initial pricing principles, which favours the two mobile network operators. It appears understandable that this problem continues until this point.
- 1.5 Each of us, in the Appendices, has provided Restricted Information, to be withheld from other parties (and from each other) on the usual basis adopted by the Commission.

## 2 Framework for the Commission's decision whether to launch an investigation

- 2.1 The Commission must be satisfied there are reasonable grounds to start an investigation.<sup>1</sup> Significantly, those grounds are not limited to the minute-minimum issue. The Commission can (and must) take into account other grounds.<sup>2</sup> As the Minister said in his request:<sup>3</sup>

*This will ... require a consideration by the Commission of whether it is satisfied under clause 8(2) that the New Zealand Communications Claim [as to minute-minimum billing], **together with any further information it may receive relevant to national roaming**, provide reasonable grounds for such an investigation to be commenced. (Highlighting added)*

- 2.2 There are grounds which are new and/or were not raised in the last investigation, that justify a new investigation.
- 2.3 In any event:

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<sup>1</sup> Clause 8(2) Schedule 3.

<sup>2</sup> Even if grounds are outside the Minister's request, the Commission of its own volition can consider additional grounds. Clause 8 of Schedule 3 Telecommunications Act 2001.

<sup>3</sup> In his letter dated 5 September.

- 2.3.1 the Commission can and should take into account all relevant grounds, including pre-existing grounds;
  - 2.3.2 the scale of the grounds for an investigation, the long term interests of end-users, and also encouragement of competition, substantially outweigh the interests of regulatory certainty (that is, the argument that a new investigation should not be opened so soon after the last, in the interests of certainty). Significant is that the investigation as to whether to designate is a confined issue. It can be handled relatively quickly, thereby reducing uncertainty.
- 2.4 In deciding whether to launch the investigation, the Commission does not need to replicate consideration of the issues to the same degree as in an actual investigation. That is a matter for the investigation itself. There is a lower threshold for this decision as to whether to commence an investigation. It is on that basis that we address issues below when we refer to the issues relevant to the investigation, but there is a lower threshold for the decision at this point, as to whether to investigate.

### 3 Framework for the counterfactual analysis

- 3.1 In the last investigation, the Commission compared the headline rates in the NZ Comms agreement, with its estimation of the regulated roaming price, in deciding that the net benefit did not justify designation. We have an overriding submission on the appropriate factual and counterfactual to be applied, which impacts the rest of this submission. We refer back to Para 1.4 above, in relation to the use of the initial pricing principle thus far.

#### Factual

- 3.2 The factual should be an estimate (which can only be an approximation during the investigation phase) of the likely regulated price. This should be based on the Final Pricing Principle (FPP) not the Initial Pricing Principle (IPP). That of course is the ultimate regulated price. Benchmarked pricing (the IPP) is only a stepping stone to the ultimate regulated price.
- 3.3 The estimated FPP is the factual, not the estimated IPP.
- 3.4 The universally applied costs-based FPP in New Zealand is TSLRIC. While that could change in the future (for example, to reduce or eliminate allocation of common cost to termination rates, as is being suggested in Europe), the objective is to estimate the regulated price on a TSLRIC basis, using suitable information.
- 3.5 Termination services are appropriately used as the proxy to derive the estimated roaming price: the elements in both are the same or similar. However, while termination **cost** data is available, the Commission instead used **actual** termination prices, with some adjustment,<sup>4</sup> as the proxy. As we show below, the Commission even constructed a formula to move data away from **cost** to create an artificial **actual** price (that is, it moved away from the objective (estimating cost) back to a step on the path to the objective (benchmarked actual price)).

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<sup>4</sup> For example, it excluded externality and 3G spectrum costs from the rates determined by Ofcom.

- 3.6 For mobile termination rates, there is a substantial difference between **actual** pricing (an IPP approach) and underlying **cost** (an FPP approach). The problem is particularly acute for termination rates.
- 3.7 The Commission should use available information – not limited to regulated rates – to derive an approximation of the roaming price on an FPP basis. Using only regulated rates can produce the wrong result, when use of a wider array of information can be more accurate overall, even if some of that information has not been subject to the rigour of a regulatory decision.
- 3.8 This includes consideration of, as NZ Comms observe in their mobile termination submissions, where the regulated price will end up. (As they point out, the assessment should be forward-looking and actual rates are historical). Often, the end-point will be the price at the end of a glide path, not the current price. However, it is appropriate for the Commission to take into account other indications (beyond regulated glide paths) that prices will change.
- 3.9 To achieve the ultimate objective (an approximation of TSLRIC) other information can be considered. This information can be adjusted and weighted as appropriate (for example, to reflect the “weight of the evidence”), in the search for the ultimate objective (an estimate of the FPP). For the purposes of an investigation, an approximation only is sought, and so this does not require the rigorous analysis appropriate for determining the actual ultimate IPP or FPP. Therefore this does not need to be an unwieldy exercise.
- 3.10 However, the Commission should err on the side – in the example of the factual – of the lower end of the range, to minimise risk of not regulating when there should be regulation.
- 3.11 We now provide two examples of where cost-based data can and should be used.

**First Example: the Commission’s use of the ACCC termination rate determination for voice**

- 3.12 The Commission’s application of ACCC’s November 2007 termination rate decision illustrates the issues.<sup>5</sup> In the last roaming investigation, the Commission used the **actual** rate determined by ACCC (9 cpm (Aust)), not the **cost**, as assessed by ACCC (a range of 6.1- 6.6 cpm (Aust)).
- 3.13 It was ACCC itself which decided the 6.1-6.6 cpm costs, not ACCC’s advisers, WIK. This is part of its determination. ACCC started with an assessment of costs by WIK, adjusted WIK’s conclusions, and then arrived at its own conclusion of costs at 6.1-6.6 cpm.
- 3.14 Thus, the Commerce Commission has strong evidence – as assessed and adopted by ACCC – of the FPP.
- 3.15 Having calculated **cost** at 6.1-6.6 cpm, ACCC, for policy reasons unrelated to cost, added nearly 3 cpm to the rate to get to the actual price of 9 cpm. It set this rate, in November 2007, for the period up to 31 March 2008, noting that it would look at a

<sup>5</sup> MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 (November 2007).

downward movement of rates from that point.

3.16 Thus, ACCC expressly acknowledged that cost-based pricing was 6.1 to 6.6 cpm but increased the actual price for different reasons.

3.17 As the ACCC report notes, when dealing with cost assessment followed by a price uplift, on top of the cost, for policy reasons.<sup>6</sup>

*The WIK Mobile Network and Cost Model (WIK Model) Version 1.2 estimates suggest the cost of the supply of the MTAS [Mobile Termination Access Service] for an efficient operator unconstrained by an existing network structure in an Australian context. These efficient cost estimates, which when adjusted for traffic and further adjustments to contextualise the WIK Model for Australian conditions (as outlined in Annexure A.2.2.1) result in a range of **6.1 cents per minute (cpm) to 6.6 cpm.***

*The Commission is cognisant that there are certain constraints that mobile network operators (MNOs) face that may be appropriate to consider in a policy context to establish indicative prices for the MTAS.*

3.18 This led to the uplift to 9cpm. In using that 9 cpm, the Commission used the equivalent of the IPP not the FPP. In New Zealand the FPP is TSLRIC. It is not “*TSLRIC plus some variation due to other policy reasons*”. The factual for the investigation must be based on TSLRIC without alteration. The Commerce Commission is able to unpick the determined cost (6.1-6.6 cpm) as a component of the actual price. (Alternatively, the Commission is given strong evidence of the cost).

3.19 In addition, ACCC set the rate for the period only to the end of 2008 (when dealing with this in November 2007). It gave indications that there may be downward movement beyond December 2008. On a forward looking basis, those matters are relevant.

3.20 To be remembered of course is that the Commission, in the investigation, is not setting the ultimate rate: it is carrying out a counterfactual analysis as to whether there should be regulation.

### **Second example: the Commission’s handling of ACCC’s approach to SMS**

3.21 For SMS, the Commission used a single reference point: information from the French regulator, ARCEP. It did so as the cost analysis was followed by a regulated price. The Commission relied on the Analysys report to ARCEP which calculated SMS costs at the equivalent of 1.1 NZ cents for 3G SMSs and 1.31 NZ cents for 2G messages.

3.22 Using a formula based on its conclusions from **actual** termination rates for voice termination, the Commerce Commission then uplifted the French SMS **costs**, to achieve a proxy of a benchmarked **actual** price, to arrive at a range of 1 to 2.6 NZ cents per message. The 2.6 cents is the uplifted actual price, calculated in this way.<sup>7</sup>

<sup>6</sup> At Page 1 of MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008.

<sup>7</sup> The Commission, in its final report on Roaming, deals with SMS at Paras 240-251.

- 3.23 The 2.6 cents end of the range moves away from **cost** (the objective of the analysis) to a benchmark based on **actual** price. Actual price however is supposed to be only a stepping stone to get back to **cost**. This is the reverse of what should happen.
- 3.24 As ACCC did not regulate SMS messages, the Commission said that it would not use WIK's SMS cost estimate, for ACCC, of 0.03 Australian cents per SMS. WIK's calculation is a fraction of the French rate assessed by Analysys.
- 3.25 The Australian SMS information indicates that a New Zealand cost assessment may (but not necessarily) produce a much lower cost-based SMS price. Given that the objective is to get an approximation of the likely regulated rate on an FPP basis, the Commission can take the Australian data into account, weighting its use relative to other data, rather than discounting it entirely. In this instance, the Commission used only one data point (France). (The limited data set in itself points to the desirability of using other data.) Then it uplifted the cost figure to move away from the objective (estimating cost) back to what is just a benchmark (actual price) on the path to that objective.
- 3.26 This also demonstrates that it will not always be more reliable to rely on regulated rates, in isolation from other data. It can be much more reliable to rely on a range of data to estimate the factual for the investigation. This does not have to be an unwieldy exercise at the level of an investigation.

### **Counterfactual**

- 3.27 Particular care is needed in using the NZ Comms Agreement as the counterfactual. Other parties have not seen this Agreement. We have not had the opportunity to submit on the use of headline rates from that agreement in view of this.
- 3.28 It is not known whether terms, other than headline roaming rates, impact on the pricing. Price and non-price terms typically are intertwined and affect each other.
- 3.29 An example of this problem is the minute-minimum issue: we do not know how that is treated in the NZ Comms agreement. Yet it makes a major difference.
- 3.30 Difficulties with privately negotiated agreements particularly apply to roaming. Unlike most other regulated services, the service to each individual access seeker will be different. As the service description outlines, the access seeker's individual plans are an integral part of this service. They will vary markedly between access seekers. What applies to one access seeker (including as to headlined roaming price) does not necessarily apply to another.
- 3.31 Using a confidential agreement with one access seeker, instead of a public reference offer, has inherent risk. And in this instance the public reference offer equivalent (the Vodafone draft undertaking) would have justified designation (as the Commission's decision notes).
- 3.32 Additionally using only NZ Comms in the cost-benefit analysis excludes the impact in relation to other network providers that may roam, such as our companies. We expect the net cost-benefit is therefore understated.

- 3.33 The information from overseas indicates that both the NZ Comms pricing, and the estimated regulated roaming rate, are substantially larger than cost-based pricing. That is increasingly so, as we note below.
- 3.34 Other access seekers should not be bound by NZ Comms' commercially negotiated position.

## **4 Minute-minimum termination rates**

- 4.1 Since the roaming investigation, this issue has been raised for the first time. It was addressed, by the Commission, in its Mobile Termination Issues Paper (and it has also been raised by us and by NZ Comms in relation to that Issues Paper).
- 4.2 The Spreadsheets provided separately with this submission set out, as Restricted Information, the duration of calls from our networks to the Telecom and Vodafone mobile networks. The minute-minimum, when compared to a per-second approach, substantially increases the net termination rate. This in turn impacts on the rate chosen for the counterfactual analysis, and the relativity to overseas benchmarks.
- 4.3 Summarising the information in the Appendices, the additional cost caused by the minute-minimum is around 25%.
- 4.4 That is a highly material difference. However, we are expecting that this will significantly understate the difference across all providers. For example, callers using toll bypass services will exhibit different calling characteristics to customers on other networks such as Telecom PSTN customers. The Commission is able to (and, we submit, should) get the full data set from Telecom and Vodafone.
- 4.5 The Commission is able to verify, with overseas regulators, the approach to wholesale per second billing. What the MNOs do, as to minimum call charges, is relevant even if this is not regulated. As noted above, it is not just regulated information that is material. Nor is the headline pricing, in isolation, the only relevant material. The wholesale approach to minimum charges feeds into the headline rates.

## **5 Trends overseas**

- 5.1 As outlined in our submissions, and NZ Comms' submissions, in respect of the Termination Rates Issues Paper:
  - 5.1.1 Termination rates have continued to tumble since the data used in the last roaming investigation;
  - 5.1.2 some regulators are arguing that the cost-based methodologies to derive termination rates need to be changed or applied in a way which substantially reduces those rates;
  - 5.1.3 the EU's Commissioner Reding targets termination rates equivalent to 2-4 New Zealand cents by 2012; and
  - 5.1.4 there are new studies and literature supporting substantial drops in termination rates (and Bill and Keep solutions as well, which of course do not apply to roaming, but they reflect the same pricing trends).
- 5.2 An assessment of the factual now is likely to produce a significantly lower price for these reasons alone.

## **6 Consistency**

- 6.1 In its Mobile Termination Issues Paper, the Commission noted a concern that MTM termination rates should be considered in the context of FTM termination rates.
- 6.2 As the elements constituting the roaming service are similar (and TSLRIC or some other cost-based model would determine pricing), consistency is more likely if all services are designated.
- 6.3 As we identified in our submissions on termination rates, Ofcom has identified this year as the second major turning point in the history of mobile, and it is time to take a broader and more strategic look at mobile regulation. Reviewing roaming with other mobile wholesale inputs is desirable in that context.

## **7 Strategic price discrimination**

- 7.1 This arose, in an investigation context, for the first time after the Roaming Report.
- 7.2 The Commission raised strategic price discrimination, in its Mobile termination Issues Paper, as a possible reason to launch a mobile termination investigation.
- 7.3 In response, we provided, in our Mobile Termination submissions, extensive reasons confirming that strategic price discrimination is a severe market issue, supporting an investigation.
- 7.4 These issues (e.g. vertical and horizontal price squeeze, on/off-net pricing and anti-competitive geographic discrimination) apply just as much to roaming. Strategic price discrimination is a significant (and newly raised) reason to have an investigation into designation of roaming.
- 7.5 An inappropriately high roaming rate increases the likelihood of vertical price squeeze (as between the wholesale input (roaming) and the access providers' retail prices). Roaming raises obvious risk around geographic price discrimination, as well as bundling issues.
- 7.6 A major issue identified in the Issues Paper and in our and NZ Comms' submissions, is anti-competitive price discrimination relating to on-net pricing.
- 7.7 These are all issues adversely impacted by unregulated/high roaming prices.

## **8 Non-Price regulation, without price regulation, has proven to be gamed and ineffectual in practice**

- 8.1 While access seekers can later request an investigation (seeking designation) when price negotiations break down, inability to achieve a satisfactory commercial outcome, absent designation, is likely. The substantial delay and risk of going back to the Commission for roaming designation does not seem warranted, particularly when the additional cost of an application for a price determination is small compared to the benefits, when non-price issues can be expected to be before the Commission anyway.
- 8.2 Price and non-price issues are intertwined and dependent on each other.

- 8.3 The theory of not designating, as that can happen later if problems become apparent, is considerably outweighed by the practicality that:
- 8.3.1 large access providers use lack of designation to put pressure on –generally – smaller access seekers;
  - 8.3.2 it can take many months (and generally close to a year) to get designation, which can be utilised by access providers against access seekers; and
  - 8.3.3 the mobile co-location experience shows that the theory does not work well in practice.
- 8.4 Access providers have had the opportunity to make the theory work in practice. It hasn't. It is best, generally, to allow for price and non-price terms regulation at the same time.

## **9 Conclusion**

- 9.1 Reasonable grounds exist for an investigation into designation of roaming. This is likely to enhance competition and the long term interests of end-users. More facilities-based competition is likely to happen, and to happen more quickly. Without designation, further delay in the order of a year can be expected. That may be fatal to facilities based competition.

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