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Telecommunications Development Levy Liability Allocation Determination for the period 1 July 2010 to 30 June 2011

Final Telecommunications Development Levy (TDL) Liability Allocation Determination under section 87 of the Telecommunications Act 2001 ('the Act') of matters set out in section 88 of the Act for the period 1 July 2010 to 30 June 2011.

The Commission	Dr Ross Patterson Gowan Pickering Anita Mazzoleni Pat Duignan
Date of Determination	30 November 2011

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LIST OF DEFINED TERMS AND ABBREVIATIONS

Amendment Act	Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011
LRTS	Local Residential Telephone Service
TDL	Telecommunications Development Levy
Telecom	Telecom Corporation of New Zealand Limited and Telecom New Zealand Limited
TRS	Telecommunications Relay Service
TSO	Telecommunications service obligations in relation to a TSO instrument
TSO deed	For LRTS it is the deed contract between Telecom and the Crown, and for the TRS it is the contract between the Crown and Sprint International New Zealand Limited ("Sprint").
TSO provider	Telecommunications service obligation provider (Telecom for LRTS and Sprint for TRS).

EXECUTIVE SUMMARY

Introduction

i.) The Telecommunications Act 2001 ('the Act') regulates the supply of telecommunications services in New Zealand.

ii.) Part 3 prescribes the Commission's annual procedure for determining the amount of Telecommunications Development Levy (TDL) payable by each liable person. The TDL was established under the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011 (the "Amendment Act") to assist the Government in funding improvements to New Zealand's telecommunication infrastructure and to pay TSO charges.

Liability Allocation

iii.) The proportion of the TDL required to be met by each liable person is determined by their share of qualified revenue. For the purposes of section 88(c) of the Act, the methodology applied by the Commission in determining the qualified revenue uses a net-revenue approach.[1] This approach eliminates from the calculation any qualified revenue generated from intra-industry sales in accordance with the approach set out in paragraphs 13 to 17. This is the same approach the Commission has taken in previous liability allocation determinations.

iv.) In accordance with section 88 of the Act, the following table shows the qualified revenue amounts that have been determined by the Commission and the amount of TDL payable by each liable person.

Liable Person	TDL Qualified Revenue	% of total	Amount Payable
Telecom	$2,456,171,000	65.419%	$32,709,384
Vodafone	$959,807,000	25.564%	$12,781,967
TelstraClear	$233,463,000	6.218%	$3,109,080
2degrees	$56,894,000	1.515%	$757,670
Orcon	$26,591,740	0.708%	$354,128
CallPlus	$9,719,000	0.259%	$129,430
WorldxChange	$7,734,960	0.206%	$103,008
Compass	$4,155,000	0.111%	$55,333
Total	$3,754,535,700	100%	$50,000,000

[1] Section 85(2) of the Act.

INTRODUCTION

1. The Telecommunications Act 2001 ('the Act') regulates the supply of telecommunications services in New Zealand.

2. This document is the TDL Liability Allocation Determination for the period 1 July 2010 to 30 June 2011, required by section 87 of the Act. This determination sets out the liable persons' respective contributions to the total TDL amount of $50 million.[2]

3. This determination does not contain any confidential information and, as a consequence, the Commission does not consider it necessary to issue a confidentiality order under section 100 of the Commerce Act 1986 and section 15(i) of the Telecommunications Act 2001 to prohibit the publication of, or restrict access to, any confidential information.

Submissions

4. The Commission released the *Draft Telecommunications Development Levy Liability Allocation Determination for the period 1 July 2010 to 30 June 2011* (the 'draft Determination') on 20 October 2011. The closing date for submissions was 2 November 2011. The Commission did not receive any submissions discussing the substantive content of the draft Determination. Vodafone did provide an acknowledgement that the draft Determination's appeared to comply with the Act.

[2] $50 million is the total TDL levy amount that applies to the 2010/11 TSO financial year as provided for in Schedule 3B of the Act.

LIABILITY ALLOCATION

5. Recent amendments to the Telecommunications Act 2001 have resulted in significant changes to the way Telecommunication Service Obligations (TSO) cost calculation and liability allocation processes are conducted.

6. The main changes enacted by the Amendment Act is to require liable persons to contribute to the TDL (proportionate to their qualified revenue) by making the required payment to the Crown and to abolish the requirement for payment by liable persons direct to the TSO provider.

7. The processes for assessing TSO net cost and liability allocation have been separate for some time now. However, the Amendment Act further separates these processes by providing that the cost of TSO services will be paid for by the Crown. Prior to the 2010/11 financial year, payment was made by liable persons direct to the TSO provider.

8. The Amendment Act provides that for the 2010/11 financial year, transitional processes for determining 'liable persons' and 'qualified revenue' apply. Those transitional processes are set out in section 29 of the Amendment Act which is outlined, and explained further in the Appendix to this TDL Liability Allocation Determination. Different processes for determining liable persons and qualified revenue will apply for the 2011/12 year, and for all subsequent financial years.

Determining liable persons for the 2010/11 financial year

9. For the 2010/11 financial year, liable person is defined by section 29(2)(b) of the Amendment Act as a person identified as a liable person in the 2009/10 Final Cost Allocation Determination (in relation to the Local Residential Telephone Service TSO), whose qualified revenue for the year ended 30 June 2010 was $5 million or more.

10. In accordance with section 29 of the Amendment Act (which is outlined in the Appendix to this TDL Liability Allocation Determination) the liable persons for the purposes of this determination are:

    1) Telecom New Zealand Limited/ Telecom Corporation of New Zealand Limited;
    2) Vodafone New Zealand Limited;
    3) TelstraClear New Zealand Limited;
    4) Two Degrees Mobile Limited;
    5) Orcon Internet Limited;
    6) CallPlus Limited;
    7) WorldxChange Communications Limited; and
    8) Compass Communications Limited.

Determining TDL-qualified revenue for the 2010/11 financial year

11. Once it has been established who is a liable person, the next step is to determine each liable person's TDL-qualified revenue.

12. For the 2010/11 financial year 'qualified revenue' is defined by the section 29(2)(d) of the Amendment Act as meaning "the amount of revenue (as determined in accordance with any specifications set by the Commission) that during the financial year each liable person received for supplying all or any of the following:

    (a) telecommunications services by means of its PSTN:

    (b) telecommunications services by means that rely primarily on the existence of its PSTN or any other PSTN:

    (c) directory services in respect of PSTN numbers; ..."

13. In calculating TDL-qualified revenue the Commission has taken a net-revenue approach that eliminates TDL-qualified revenue generated from intra-industry sales. This approach is expressly contemplated by section 85(2) of the Act which states that "to avoid doubt, the Commission may determine what revenue basis to use for the purposes of subsection (1)(a) (for example, a net-revenue basis)."

14. The net-revenue approach is the same approach the Commission has taken in previous liability allocation determinations. For the reasons set out in the 2002/2003 TSO Determination, the Commission considers that the net-revenue interpretation is consistent with Part 3 of the Act. The net-revenue approach is superior to the retail revenue approach (which measures only retail revenues) because it minimises the risk of deterring the resale of retail services. The net revenue approach is most likely to promote competition in telecommunications markets for the long-term benefit of end-users within New Zealand.

15. The net-revenue approach constitutes the methodology applied by the Commission in making the determination for the purposes of section 88(b).

Deduction of payments to non-liable persons

16. The net-revenue approach eliminates TDL-qualified revenue generated from intra-industry sales by deducting from gross revenue any amounts payable to other carriers for the provision of services that are telecommunications services. However, this does not necessarily mean that all payments to other carriers for telecommunications services are deductible. Deductibility needs to be considered in the context of the pool of industry revenue that the Commission is required to measure. For TDL purposes, the relevant pool of revenue is that generated by liable persons from supplying telecommunications services to anyone who is not a liable person. Only amounts payable to other liable persons for telecommunications services should, therefore, be deducted.

17. In addition, there are cases where telecommunications services are purchased from a non-liable person acting as an intermediary between a liable upstream provider and a liable downstream provider. The Commission allows a deduction for amounts payable to non-liable persons for the purchase of telecommunications services when the service the non-liable person provided was purchased from a liable person. The Commission has received the names of non-liable persons potentially engaged in reselling PSTN services to liable persons in the 2010/11 financial year. The Commission requested this information from liable persons under section 83 of the Act.

Consistency of revenue information

18. To qualify as TSO-qualified revenue, revenue must be received by the liable person for supplying telecommunications services either by means of its PSTN or by means that rely primarily on the existence of its PSTN or any other PSTN, or for supplying directory services in respect of PSTN numbers.

19. The Commission considered the meaning to be given to the words 'by means of' in Decision 525,[3] and concluded that 'by means of' requires a meaningful or not insignificant participation by some component of a PSTN operated by that person in provision of the service. The Commission has also reconsidered the meaning of this term in previous TSO cost allocation determinations. TDL-qualified revenue includes revenue received by a liable person for providing telecommunications services through a meaningful or not insignificant participation of a component of a PSTN operated by that person in providing the telecommunications service.

20. When applying these criteria in prior TSO determinations the categories discussed in paragraphs 21-28 (with the exception of paragraph 24), were considered to be qualified revenue. These categories are also considered qualified revenue for the 2010/11 TDL Liability Allocation Determination.

Calling card revenue

21. Calling card revenue for calls which are not switched by a liable person is TDL-qualified revenue. Such revenue is received by the liable person for providing telecommunications services that rely primarily on the existence of its PSTN or another PSTN.

Inbound roaming revenue

22. Revenue from roaming of overseas mobiles on New Zealand mobile networks is TDL-qualified revenue because it is a telecommunications service provided by means of a New Zealand mobile carrier's PSTN.

Confiscated prepay credits

23. Prepay mobile calling is a telecommunications service that is provided by means of a mobile carrier's PSTN is TDL-qualified revenue. The operator sells this service by selling fixed amounts of prepay credits that have an expiry date, and the value of the credit sold must be counted as TDL-qualified revenue. The Commission considers that there should not be a deduction on the basis that some of the credit remains unused by the end-user before its expiry date.

Cost of handsets

24. Revenue from the sale of a mobile handset, which is not recovered through mobile access and calling charges, is not TDL-qualified revenue because it does not satisfy the tests in the definitions relating to the provision of telecommunication services namely, by means of a liable person's PSTN or by means that rely primarily on the existence of the liable person's PSTN or any other PSTN.

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[3] Paragraph 84 of Decision 525, Determination on the TelstraClear Application for Determination for 'Residential Wholesale' Designated Access Service, June 2004.

Mobile access and calling revenue

25. The access and calling revenue received by a mobile carrier is TDL-qualified revenue as it is revenue received from providing telecommunication services by means of the operator's PSTN. Whether the operator treats some portion of its access and calling revenue as attributable to the cost of handsets is not relevant and does not alter the nature of the revenue. This view is consistent with the Commission's net-revenue approach which only eliminates revenue generated from intra-industry sales, and does not exclude other costs that are recovered through mobile calling or subscription charges.

Naked DSL

26. Naked DSL services generate TDL-qualified revenue under the definition of PSTN[4] in the Act. This is because a naked DSL broadband service (i.e. a DSL service provided without access to a POTs service) is provided via the copper pair connecting the end user's telephone device[5] to the exchange, and as such it is provided by means that rely primarily on the existence of Telecom's PSTN.

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27. The fact that the copper local loop is not being used by Telecom and is connected to a liable person's equipment located in a Telecom exchange does not alter the fact that the competitor (the liable person) is supplying service by means of a component of its PSTN, and therefore generates TDL-qualified revenue by means of its PSTN.

28. Similarly, the liable person supplying the retail service via Telecom's unbundled copper local loop is providing telecommunication services by means of its PSTN (including a component of the PSTN) or by means that rely primarily on the existence of Telecom's PSTN, and therefore also generates TDL-qualified revenue.

Audit Reports

29. In its TDL-qualified revenue instructions the Commission required that liable persons provide a report prepared by a qualified auditor that includes a statement of whether or not all the information provided complies with all the Commission's requirements. In order to provide more assurance when liable persons have significant TDL-qualified revenue, the Commission required liable persons (including Telecom) that are listed companies with a PSTN to provide a 'long form audit engagement report'. All other liable persons were requested to provide, as a minimum, an 'audit engagement report'.

Liable Persons TDL-Qualified Revenue

30. The following table shows the TDL-qualified revenue amounts determined by the Commission from the information provided by liable persons as at the date of the determination, and the resulting allocation percentages. While the percentages

[4] PSTN or public switched telephone network means a dial up telephone network used, or intended for use, in whole or in part, by the public for the purposes of providing telecommunication between telephone devices.

[5] Telephone device means any terminal device capable of being used for transmitting or receiving any communications over a network designed for the transmission of voice frequency communication.

shown are rounded to three decimal places, the actual percentages without any rounding will be used in the calculation of the TDL Liability Allocation Determination.

Table 1: Liable Persons Qualified Revenue for Period 1/7/2010-30/6/2011

Liable Person	TDL Qualified Revenue	% of total	Amount Payable
Telecom	$2,456,171,000	65.419%	$32,709,384
Vodafone	$959,807,000	25.564%	$12,781,967
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WorldxChange	$7,734,960	0.206%	$103,008
Compass	$4,155,000	0.111%	$55,333
Total	$3,754,535,700	100%	$50,000,000

Dated this 30 of November 2011

Dr. Ross Patterson
Telecommunications Commissioner

ATTACHMENT 1 - THE FRAMEWORK FOR THE TDL LIABILITY ALLOCATION DETERMINATION

31. This Attachment outlines the legislative framework for this Draft TDL Liability Allocation Determination.

Process

32. Part 3 prescribes the annual procedure for determining the amount of TDL payable by liable persons to the Crown and the annual procedure for determining the net cost of each TSO instrument. This TDL Liability Allocation Determination for the 2010/11 financial year is made only in relation to subpart 2 of Part 3 relating to the liability allocation determination.

33. Section 29 of the Amendment Act sets out transitional processes which apply for the purpose of this TDL Liability Allocation Determination. The requirements of these processes are described throughout this Attachment.

34. Under section 83, every liable person must provide to the Commission the financial and other information specified by the Commission. Section 83 states:

Liable persons must produce information for purposes of liability allocation determination

(1) Not later than 60 working days after the end of each financial year, each liable person must provide to the Commission—

(a) all prescribed information or, if there is no prescribed information, information specified by the Commission, for the purpose of enabling the Commission to make its determination in accordance with section 88 (a); and

(b) a report that complies with subsection (2).

(2) A report complies with this subsection if—

(a) it is prepared by a qualified auditor; and

(b) it includes a statement of the extent to which the information provided by the liable person under subsection (1)(a) is correct and complete.

35. The Commission requested information in accordance with this section on 15 July 2011.

36. On 20 October 2011, the Commission prepared a Draft TDL Liability Allocation Determination in accordance with section 84 and which included all of the matters set out in section 85(1). Section 85(1) is set out below:

(1) A draft liability allocation determination must include -

(a) the amount of each liable person's qualified revenue; and

(b) the amount of the telecommunications development levy payable by each liable person for the financial year, calculated in accordance with the following formula:

$$\frac{a}{b} \times c$$

Where–

a is the amount of the liable person's qualified revenue

b is the sum of all liable persons' qualified revenue c is the telecommunications development levy specified for the relevant year in Schedule 3B;

(c) the methodology applied by the Commission in preparing the determination ; and

(d) the reasons for the determination.

37. Section 85(2) of the Act states that “to avoid doubt, the Commission may determine what revenue basis to use for the purposes of subsection (1)(a) (for example, a net-revenue basis).” In this TDL Liability Allocation Determination the Commission has used a ‘net-revenue basis’ to determine the amount of each liable person’s qualified revenue which is in accordance with the example specified in section 85(2).

38. Once the Commission has completed the required consultation under the Act, section 87(1)(a) requires the Commission to prepare a final liability allocation determination. Section 87 provides as follows:

(1) The Commission must –

(a) prepare a final liability allocation determination; and

(b) give public notice of that final determination; and

(c) give a copy of that final determination to all liable persons.

(2) The Commission must make reasonable efforts to do the things referred to in subsection (1) not later than 20 working days after the closing date for submissions specified in accordance with section 84(1)(c).

39. This TDL Liability Allocation Determination satisfies section 87(1)(a) of the Act.

40. Section 88 requires that the final liability allocation determination under section 87 must include:

(a) the amount of each liable person’s qualified revenue; and

(b) the amount of the telecommunications development levy payable by each liable person, calculated in accordance with the formula set out in section 85(1)(b); and

(c) the methodology applied by the Commission in preparing the determination; and

(d) the reasons for the determination.

41. This TDL Liability Allocation Determination includes all of the matters set out in sections 85 and 88 of the Act.

Prioritisation

42. Section 91 requires the Commission to complete and give public notice of the final Liability Allocation Determination before giving public notice of a final TSO cost calculation. Section 91 provides as follows:

(1) The Commission may determine the priority between the preparation of liability allocation determination and the preparation of a TSO cost calculation determination and, accordingly, may comply with sections 84 to 88 and sections 94F to 94K in the sequence, as between those two sets of sections, as it thinks fit.

(2) However, the Commission must publicly notify a final liability allocation determination for each financial year in accordance with section 87(1)(b) before it publicly notifies any final TSO cost calculation determination for that financial year in accordance with section 94J(1)(b).

43. The Commission will be required to prioritise in accordance with section 91 but only in respect of the 2010/11 TRS Cost Calculation Determination and this Draft TDL Liability Allocation Determination. The Commission will follow section 91 by publicly notifying this TDL Liability Allocation Determination before the TRS Cost Calculation Determination.

44. The Commission will not be required to prioritise in relation to the LRTS TSO Cost Calculation Determination because section 69 of the Amendment Act requires that during the 2010/11 financial year Telecom may not notify the Commission that it wishes to invoke the procedure for the preparation of a TSO cost calculation determination. Section 69 provides that:

> (1) Despite section 94, a TSO provider under a TSO instrument that does not contain a specified amount may not notify the Commission that it wishes to invoke the procedure in sections 94D to 94K for the preparation of a TSO cost calculation determination for the financial year in which separation day occurs.
>
> (2) To avoid doubt, for the financial year in which separation day occurs, the TSO charges for a TSO instrument that does not contain a specified amount are deemed to be zero as provided in section 94C.

Liable Persons

45. In order to allocate the TDL amongst liable persons the Commission first has to establish who is a liable person.

46. The Amendment Act made significant changes to the way net cost and liability allocation processes are conducted. These processes have now been separated to a greater extent with the Crown paying for the TSO services and liable persons now paying for the TDL.

47. Section 29 of the Amendment Act allows a transition period to take place for the 2010/11 financial year. Section 29 is set out in full at the end of this Appendix.

48. During the transition year and for the purpose of subpart 2 of Part 3, a "liable person" is defined by the section 29(2)(b) of the Amendment Act as:

> (i) a person−
>
> (A) who is identified by the Commission as a liable person in its final cost allocation determination, for the financial year ended 30 June 2010, in relation to the deemed TSO instrument known as the Telecommunications Service Obligations (TSO) Deed for Local Residential Telephone Service; and
>
> (B) whose qualified revenue for the financial year ended 30 June 2010 is equal to or greater than $5 million; and
>
> (ii) Telecom

49. In accordance with section 29(2)(b) of the Amendment Act the liable persons for the purposes of this determination are considered to be:

- Telecom New Zealand Limited/ Telecom Corporation of New Zealand Limited;
- TelstraClear New Zealand Limited;
- Vodafone New Zealand Limited;
- Compass Communications Limited;

- CallPlus Limited;
- WorldxChange Communications Limited;
- Orcon Internet Limited; and
- Two Degrees Mobile Limited.

50. Under section 79 of the Act, Kordia is treated as the same liable person as Orcon because it owns Orcon.

Qualified Revenue

51. For the purpose of subpart 2 of Part 3, "qualified revenue" is also given a particular meaning during the transition year. Specifically, section 29(2)(d) provides that the following definition of "qualified revenue" applies for the purpose of this Liability Allocation Determination:

> The amount of revenue (as determined in accordance with any specifications set by the Commission) that, during the financial year, each liable person received from supplying all or any of the following:
>
> (i) telecommunications services by means of its PSTN:
> (ii) telecommunications services by means that rely primarily on the existence of its PSTN or any other PSTN:
> (iii) directory services in respect of PSTN numbers; and

52. The Commission has applied "the net-revenue" approach to its determination as described at paragraphs 13 to 17 of this TDL Liability Allocation Determination.

Transitional provision concerning liability allocation determination for 2010/11 financial year

53. The transitional arrangements applying to this 2010/11 TDL Liability Allocation Determination are set out in section 29 of the Amendment Act. Section 29 provides as follows:

29 Transitional provision concerning liability allocation determination for 2010/11 financial year

(1) This section applies in respect of the financial year ended 30 June 2011.

(2) For the purposes of subpart 2 of Part 3 of the principal Act,—

- (a) the definition of liable person (as substituted by this Act) does not apply; and
- (b) **liable person** means—
-
    - (i) a person—
        - (A) who is identified by the Commission as a liable person in its final cost allocation determination, for the financial year ended 30 June 2010, in relation to the deemed TSO instrument known as the Telecommunications Service Obligations (TSO) Deed for Local Residential Telephone Service; and
        - (B) whose qualified revenue for the financial year ended 30 June 2010 is equal to or greater than $5 million; and
    - (ii) Telecom; and
- (c) the definition of qualified revenue (as substituted by this Act) does not apply; and
-

- (d) **qualified revenue** means the amount of revenue (as determined in accordance with any specifications set by the Commission) that, during the financial year, each liable person received from supplying all or any of the following:
-
    - (i) telecommunications services by means of its PSTN:
    - (ii) telecommunications services by means that rely primarily on the existence of its PSTN or any other PSTN:
    - (iii) directory services in respect of PSTN numbers; and
- (e) sections 81(1) and 82 do not apply.
-

(3) For the avoidance of doubt,—

- (a) section 81(2) and (3) apply for the purpose of determining whether a person is a liable person, within the meaning of subsection (2)(b)(i) of this section, to whom subpart 2 of Part 3 of the principal Act applies in respect of the financial year ended 30 June 2011; and
-
- (b) except as provided in subsections (1) and (2) of this section, subpart 2 of Part 3 of the principal Act (as substituted by this Act) otherwise applies in respect of the financial year ended 30 June 2011.