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Submission:

Objection to 700mhz acquisition clearances

November 2013

KLR background

KLR is a part of the KLR HK group, a foundation investor in Two Degrees Mobile Limited, New Zealand's third mobile operator.

KLR purchased & financed spectrum in association with Northelia & Econet in 2001, and worked with associated investors to finance and build a 3rd mobile phone network in NZ.

Competition came to NZ some 8 years after the previous spectrum auction – in part to the failure of the MED to tie regulatory conditions to the sale of the spectrum. Finance was only available for a 3rd mobile phone network when conditions promised by the 2001 Telecommunications act were in fact available (after the publication of the 2006 Mobile Market review).

KLR & related entities owns a minority stake in 2Degrees. Tex Edwards an employee of KLR, was one of the first senior employees of 2D to be fired.

KLR does not represent 2degrees nor are its comments to be taken as those of 2degrees or its employees, board or other shareholders of 2degrees nor those of Hautaki Limited or the Te Haurahi Tika Trust , or Turopaki Telecommunications or Huawei or EWG.

Introduction

Thank you for the opportunity to comment on the review spectrum clearances.

The commission must reject the applications for Voda and Telecom to buy spectrum.

NZ has lagged behind the rest of the world in developing competition in its wireless markets. This is because until as recently as 2009, the NZ regulatory environment was behind the rest of the world (reference 2008 ComCom Market Monitoring report – pg 21- illustrating pricing being on average 30% higher than other OCEDs)

KLR believes effective & sustainable competition is not in place in today's mobile market and the Commission and MBIE have been gamed by Voda into believing that 2D is already in a financially sustainable position with competition existing in every market segment. This is not the case.

The Commission must not be spineless in preventing poorly briefed politicians pursuing short term policies that give consumers interim infrastructure benefits but forgo medium to long term competition benefits and competition safeguards.

The ComCom must ensure that sensible (and benchmarked) competition analysis takes place before any clearances are made to deliver more spectrum to the incumbents .

Competition is no accident = it requires policy re-alignment with our EU trading partners, it also requires thorough analysis

In SUMMARY

Vodafone has benefited from a plethora of regulatory indulgence over the last decade –

- 900mhz spectrum monopoly for over a decade
- $NZ300m + taxpayers subsidy to develop rural superiority
- Benefit of 15 year first mover advantage in GSM
- Depreciated cell tower infrastructure in pre RMA costs
- Financial dominance in the wireless markets because of the superior profitability of GSM v CDMA

It's time for this indulgence to STOP

Voda has dominance and SMP (significant market power) , this has not been measured by the ComCom and as a consequence ComCom and MBIE are making decisions on erroneous data .It's essential that the Commission do this so the commission satisfies its statutory charter on which the Commission's work is based .

A series of governance blunders by the ComCom has seen the MBIE develop policy of inaccurate and misleading information – as a consequence the ComCom should not sanction further spectrum ownership (including any 700mhz until the following has happened

1. A correct HHI has been completed on a geographic basis

2. A comprehensive financial analysis has been completed on Vodafone NZ accounting correctly for its capital expenditure and pre Voda PLC royalty profits. _(simply put – how the hell can the Commission make any sort of sensible decision and judgement on competition if it doesn't know the financial position of the market structure its making a judgement on)

The core messages of this submission are

- The basis on which the Commission understands the mobile market is flawed (the Market Monitoring report is inaccurate)

- NZ regulators have failed to understand the impact of financial dominance in NZ and the incentives that there are by incumbents to increase the costs of new entrants.

- There is no financial analysis on the business models of all 3 mobile operators and therefore the Commission can't judge what impact this spectrum ownership will have on competition. The Commission is not doing its work correctly .

- There is no peer group (by similar country) completed on spectrum ownership in a market where one player has the level of dominance Voda NZ has .

- The MBIE who claimed to supporting long term competition failed to complete even the most basic business case analysis of a 3rd operator or the business case of a third operator when 1 player has 60% + revenue market share and xx% of the profit

WHAT THE COMMMISSION MUST DO TO

1. Reject the applications for Vodafone to own spectrum until the following is done
   - A comprehensive HHI ratio is calculated on a geographic basis by revenue.
   - Complete a comprehensive analysis of the management accounts of Vodafone to evaluate the size of their dominance on the total wireless markets.
   - Consider the impact of the Chairman Berry's comments about the impact that section 36 of the commerce Act would have on a challenger (and its ability to raise capital in NZ) .
   - Catalogue in its report the motivation of a dominant player in the mobile market and the duty it (the dominant player) has to its shareholders to maintain its dominance and superior return on equity.
   - Consider completely outsourcing some regulatory functions to Australian or EU regulators with guidance on what needs to be achieved.
2. Aggressively question the MBIE why the ComCom is not managing spectrum, it is handled by the telecommunications regulator in most jurisdictions.
3. Study the long term benefit available to Telecom NZ in spectrum valuation as a consequence of having many cell towers designated and therefore not subject to RMA during network upgrades .

IMPACT 700 MHz SPECTRUM DOMINANCE WILL HAVE ON THE NZ WIRELESS MARKET

1. It will make it more difficult for challenger operators to raise capital, refinance or recapitalise.
2. It will deliver a permit cost of production benefit to Vodafone an operator who already has dominance.)
3. It will demonstrate to some of the shareholders of 2degrees that the Commission is not interested in long term wireless competition in NZ and that the commission is incapable of detailed analysis or following up on its MMR report of 2006 .
4. It will demonstrate that no peer review of competition in the NZ wireless market has taken place.

DISCUSSION OF THE COMCOM CRITERION

1. Existing competition
2. Potential competition
3. Countervailing market power
4. Co-ordinated behaviours

Existing Competition

1. Competition is virtually non-existent in 3 out of the 4 major market segments in Mobile
2. The NZ 3rd operator has yet to reach scale or participate in the most profitable market segments
3. The ComCom's work in studying this is seriously flawed
4. 2D has not been able to XYC * (CIC)
5. 2D has not been able to WQS * (CIC) inhibiting it from !@#
6. There is no peer review of the MBIE or ComCom work reviewing the business case of operators with such dominance.

Potential competition

There is not like for like competition currently, spectrum dominance will mean that the existing challenger and new challengers will not be able to be financed.

Potential competition that could be expected in other segments will collapse because of an inability to finance itself and meet basic targets.

Countervailing market power

If the spectrum acquisition was to be sanctioned it would further strengthen market power, further inhibiting competition.

What is the true market position of bloody Vodafone NZ ? – NO one in the ComCom knows – because they can't use section 69z of the Telco act to get its financials and it seems they are too indolent to consider the real HHI ratios that impact competition. The Commission is misguided and spineless on this critical matter – the basic DNA of competition – which is the investment dynamics of the market opportunity.

Co-ordinated behaviours

It's the KLR position that Voda dominants the north island and Telecom the South Island. The impact of this has not been reviewed by the ComCom. Again the Commission is gutless in reviewing this matter.

For over a decade Telecom and Voda have worked to delay, frustrate and increase the capital costs of a new entrant**, these** historical positions must be reviewed, because they create the market structure of today**.**

This market is characterised with many barriers to entry, created by rational tactical behaviours. In particular the ComCom must complete a further review of the 2100mhz spectrum including algorithmic analysis of bidding in previous auctions, and the impact of delayed entry has had on a competition, in particular the difference in entrance barriers at 110% penetration relative to 50% penetration - why – because some barriers to some mobile market segments still exist in 2013. The 2006 Mobile Market review must be revisited .

Voda PLC didn't invest NZD $3bn in NZ infrastructure , kiwi consumers did, by paying high prices for mobile for over a decade

Challenger's strategy

Get to financial safe harbour as quick as possible , earn an economic return on its capital base, and thrust up from entry level market segments to becoming a like for like player in all segments in post-paid , it must address infrastructure differentials and SAC differentials as best it can, often with support from the regulator . Governments break up monopolies the private sector invests in business cases.

In NZ legacy market power is perpetuated by a SAC war that only legacy monopoly rents can finance.

Reasons to reject the clearance of 700mhz	Comment	Impact
The Market monitoring report is inaccurate	The decision would be being made on faulty information	Investors will lose confidence, WACC for new entrants will rise
Voda NZ will have unassailable dominance and perpetual lowest cost delivery –	If approved Voda will perpetually have lower operating costs across 4G delivery	The Commission will have created a new dominant player , giving rise to the same problem they had with Telecom fixed line operator during the 1990s and early 2000s
There is no international precedent to facilitate that much spectrum allocation to a player with that much dominance	The minister is factually wrong, that 10mhz is enough to run a 4G service , the issue is a challenger can't finance themselves where there is a bad regulator and erroneous regulatory decisions	
The Commission has not met its test as laid out by statute	High HHI ratios illustrate no competition ,	Challengers will stall in their mission to create effective competition in all segments and reach financial safe harbour as companies
It will require a lot more work in future years to fix up competition	The commission has a rich history in policy errors – The Commission sent the mobile market to hell in 1990s by allocating all the 900mhz spectrum to one operator	A decision to allocate will merely perpetual previous errors and eventually consumers will suffer
The market has yet to recover from previous tactical blunders by the Commission	For over a decade kiwis suffered with a GSM monopoly	Mobile networks have a 20 year investment horizon – NZ is not yet recovered from previous mistakes

What is Vodafone's strategy?

Vodafone doesn't really want to drop pricing in mobile markets as it hurts it more than other players , instead it wants to place a TAX and increase the costs of new entrants and challengers ,= it wants pyrrhic competition to keep the regulator asleep .

Voda increases the costs of new entrants by

1. Persuading the MBIE the spectrum is worth lots (increase in spectrum price is a better barrier than lowering airtime costs for an incumbent)
2. Making Co location unviable by having very high costs
3. Securing govt subsidies to build rural areas (and therefore giving their business the advantage of scale)
4. Ensuring that SAC and related handset subsidises are so high that challengers are taxed out of some market segments
5. Bundling aggressively to raise the cost of market entry
6. Ensuring that Corporates and business give all their business exclusively to one player (thereby preventing challengers from gaining a beach head in business segments.

Voda's job is to raise the costs of a new entrant so it's blocked from critical market segments, and to ensure that its position is protected.

With such scale it becomes the lowest marginal cost operator- and then goes about persuading the government that it's the most efficient operator and that there is only room for one operator in many rural markets.

The acquisition of this spectrum merely assists building this process of building scalable and unsalable market structure.

Once Voda has ensured that a challengers capital base (and access to capital) is exhausted they will consider a period of pricing at marginal cost to legitimately squeeze out a challenger and get the market structure more rational and profitable . Meanwhile Voda will lobby around politicians and officials explaining consumers are better off and that they can provide service at lower costs .

In the coming years the CEO of Voda NZ will be replaced and a "cost cutter " CEO will start his or her tour of duty . Their job will be to ensure that the business is the lowest cost operator and it can control the market , quarantine challengers to merely pyrrhic competitors.

7. A summary of KLR's position on the 700mhz clearance

Consultation item	KLR response	Comment
Co-ordinated behaviours	The ComCom must do a regional HHI – this will illustrate	It beggars belief that the ComCom has not been able to produce some statistics on regional dominance and the impact that this has a barrier to entry
Existing competition	This has not been correctly reviewed by the commission	KLR urges the ComCom to get their work peer reviewed
Potential competition	There is none , there are barriers to entry	The ComCom has seen the movie before – spectrum dominance stalls competition
Market power	This is not known to the ComCom, they have failed to study it , yet the Chair of the Commission explains section 36 is a problem	The ComCom knows it's a problem ,its politicians who are lobbied too much who will prevent section 36 from being fixed
Impact on rural deployment	The government are guilty of accepting infrastructure bribes for improved policy for dominant players	Short term great, long term it will create the same problems as the rural sector suffered from in the 90s and early 2000s
Impact on UFB	By delivering benefits to an organisation that can win a UFB SAC war doesn't make sense	Long term this move will slow down UFB because it will concentrate the number of scalable players in NZ , not increase the number of players
Kiwi consumers	They will listen to a pile of embellishment by Voda , but eventually suffer as competition fails consumers in many market segments	The Commission need to be reminded the that they must work in the long term interests of consumers and the short term benefits of a large pile of spectrum in rural is different to long terms interests of consumers

Summary of Key Points

- The Commission must reject Vodafone request to ownership of 700mhz spectrum until,
  - A HHI ratio is calculated on a revenue basis on a geographic and market segment basis
  - A review of Vodafone NZ's true financial position prior to transfer pricing of inputs and royalties to its Swiss and Cayman subsidies takes place
  - The Commission has completed a financial model of what the market structure of a competitive NZ market looks like
  - Until the Maori claim on spectrum has been considered by the Waitangi tribunal

    A proper peer group review of competition analysis takes place

It's possible to diagnose the problem as the Incumbent essential offering the NZ govt a infrastructure bribe – trading off competition in wireless markets in exchange for its commitment to build out its competitors in the rural areas.

- The Commission must look beyond this offer from Vodafone to spend some of its monopoly rents building infrastructure in exchange for weaker competition, and therefore reject the application by Voda for more spectrum .

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