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Commerce Commission
Mobile Termination Issues Paper
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Re: Mobile Termination Issues Paper – June 2004

AT&T Corp. and AT&T Global Network Services International Inc. – New Zealand Branch (collectively, "AT&T") are pleased to provide comments on the Commerce Commission ("ComCom") Issues Paper *"Telecommunications Act 2001: Schedule 3 Investigation into Regulation Of Mobile Termination*," issued 21 June 2004 (the *"Issues Paper"*). AT&T provides a large volume of telecommunications services to New Zealand and has an interest in this proceeding because excessive mobile termination charges in New Zealand have a very negative impact on AT&T's customers who make calls to New Zealand. AT&T applauds the ComCom for conducting the investigation into mobile termination, having considered complaints that a lack of competition in the market for mobile termination is resulting in unreasonably high charges for fixed to mobile calls. (*Issues Paper* at ¶3.)

AT&T supports ComCom's preliminary view that the market for wholesale mobile termination on each mobile network is a distinct market, as it is purchased by other networks for purposes of interconnection independent of any additional mobile services. *(Id.* at ¶105.) Similarly, AT&T shares the ComCom's concern that limited competition in the market for mobile termination may result in mobile network operators ("MNOs") setting mobile termination rates considerably above costs, leading to unreasonably high cost of service in the downstream markets. *(Id.* at ¶9.) Finally, with respect to ComCom's consideration of different corrective pricing principles, AT&T recommends an immediate mandated reduction to cost-oriented rates, noting that New Zealand's WTO General Agreement on Trade in Services commitment requires it to ensure that its "major supplier" – which would include

MNO provision of termination services -- must provide interconnection at cost-oriented rates,[1] a concern raised by the USTR specifically with respect to New Zealand mobile termination rates.[2]

I. High Mobile Termination Rates Harm the Long Term Interests of End Users

Excessive mobile termination charges send distorted price signals that foster inefficient consumption, investment and operations, and unfairly distribute benefits and costs by harming consumers making calls to mobile users, particularly from fixed networks. High mobile termination charges also allow MNOs either to cross-subsidize the costs of their more competitive services or to retain unjust profits. ComCom correctly recognizes in its *Issues Paper* that above-cost mobile termination rates are a major concern and one that increasingly is being recognized consistently by regulators in many countries.

The harm to consumers' long-term interests is highlighted by a recent Ovum study finding that "[t]here are no effective market mechanisms to curb the price of the mobile termination service" and that "[t]here is considerable evidence that mobile termination rates (MTRs) are well above costs in most countries." (David Rogerson, *Mobile Termination Rates*, Ovum, Jan. 2004, at 1.) Ovum further states that they "estimate that profit margins of over 100% are commonplace for most mobile network operators (MNOs)." (*Id*.) Consistent with ComCom's preliminary findings, Ovum states, "[i]n markets where the calling party pays for making calls to a mobile phone, mobile termination rates take on the characteristics of a 'bottleneck' service." (*Id*. at 4.) "By this we mean a service for which the normal disciplines of the competitive market are narrowed to such an extent that they no longer constrain the behaviour of the service provider." (*Id*.) The result is unreasonably high mobile termination rates, which in turn requires mobile rates to be "regulated and brought towards cost levels in order to correct these competitive distortions and network inefficiencies." (*Id*. at 1.)

As with Ovum's findings, other national regulators have reached conclusions about the harm to end users similar to the ComCom's preliminary view. For example, the ACCC's *Final Decision* in its Mobile Terminating Access Service review found a strong basis for regulation of mobile termination rates, and in turn, appropriately cites the regulatory actions undertaken by Ofcom (formerly OFTEL), in finding that each mobile network operator exercises market power over call

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[1] New Zealand made "additional commitments" under the WTO Reference Paper to ensure that "[i]nterconnection with a major supplier" is provided at "cost-oriented rates." (World Trade Organization, *Fourth Protocol to the General Agreement on Trade in Services*, Apr. 11, 1997, New Zealand, Schedule of Specific Commitments, at 5).

[2] *Results of 2004 Section 1377 Review of Telecommunications Trade Agreements*, Apr. 7, 2004, at 2, available at: http://www.ustr.gov/sectors/industry/Telecom1377/2004/1377report.pdf

termination on their networks and should therefore be subject to termination rate regulation.[3] Similarly, the European Commission has issued a recommendation designating the market for voice call termination on individual mobile networks as one where European Union Member State remedies are presumptively necessary.[4] Likewise, regulators in other regions, such as the Office of Utilities Regulation in Jamaica, have set forth consistent views that MNOs possess market power for termination service and must be regulated to ensure cost-based pricing.[5] The OECD has also recently referred to the markets in which call termination services are supplied.[6] Finally, the Office of the United States Trade Representative ("USTR"), in its 2004 Section 1377 review cites "some progress" in reducing mobile termination rates toward more competitive levels, but also states that "mounting evidence suggests that operators in many countries are attempting to raise rates without justification."[7] ComCom's preliminary views are consistent with, and supported by, ample precedent that have uniformly rejected MNO arguments that regulation was inappropriate.

Against the background of evidence that above-cost mobile termination rates are a persistent problem in New Zealand in the absence of effective market forces, the ComCom has properly framed the need to protect the long term interests of end users by regulating mobile termination rates.

II. The ComCom Properly Defines the Relevant Market and Justifies the Need for Direct Regulatory Control of Mobile Termination Rates

In most circumstances, because competitive forces can overcome market failures and can respond dynamically to consumer needs, a light-handed approach to regulation will achieve better results for the public than would regulatory intervention. However, in those circumstances where market failures make it impossible for competitive forces to discipline rates effectively, it is necessary to intervene with direct regulation. Unconstrained wholesale mobile call termination rates sit squarely within this latter category, and require the ComCom to take action to protect the long-term benefits of end users through regulation.

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[3] ACCC, *Mobile Services Review, Mobile Terminating Access Service, Final Decision* at 37 (June 2004).

[4] *See Commission Recommendation 2003/31/EC on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation*, OJ L 114, 8.05.2003, at 45, market 16 of the Annex. Regulators or competition authorities in Belgium, Finland, France, Greece, Hungary, Jamaica, the Netherlands and Sweden have also found that mobile operators have market power.

[5] *See* Office of Utilities Regulation, *Assessment of Dominance in Mobile Call Termination, Supplementary Consultative Document*, TEL 2004/03 (released March 30, 2004).

[6] OECD, "Access Pricing in Telecommunications" 2004, at 141.

[7] *2004 Section 1377 Review* at 2.

Upon analyzing the potential competitive restraints on mobile termination charges, ComCom dismisses the option to include mobile termination within a broader cluster of retail mobile services (*Id.* at ¶92), and properly concludes that there is a separate market for the wholesale supply of mobile termination services on each mobile network. *(Id.* at ¶105.) ComCom has identified specific market flaws to include:

(a) High barriers to entry;
(b) Substantial market power in the hands of mobile network operators, because of the CPP arrangement, the state of current technology, and the lack of countervailing power in the hands of purchasers of termination services;
c) Termination charges that are substantially above the costs of services in comparable jurisdictions;
(d) Termination charges that appear to be substantially above the costs of supplying such services. (*Id.* at ¶124.)

In finding these market flaws, ComCom rightly identifies that there are insufficient supply-side and demand-side substitutes for the wholesale mobile termination service. There is no effective demand-side substitute for the calling party or the called party, because the potential substitutes (*e.g.*, placing calls to fixed rather than mobile lines, and sending an e-mail, or sending a SMS--commonly known as text messages) are clearly imperfect and also would undermine the quality and convenience factors that create demand in the broader mobile market. The Calling Party Pays ("CPP") system exacerbates these demand side competitive concerns, because the consumer who subscribes to the CPP mobile operator is not the same consumer who pays the CPP mobile operator for call termination, and there is no market constraint on CPP mobile operators to reduce high call termination fees. Furthermore, these consumers (especially those located abroad) maybe unaware of whether their call is to a mobile versus a fixed line telephone, and thus are unable to make a properly informed choice as to the advisability of the call. Additionally, there also is no effective supply-side substitute, which would require a competing operator to have access to the details of the end user's SIM card, and the mobile operator can simply refuse to share this information with other operators.

Under the circumstances, corrective action is both justified and necessary. Indeed, New Zealand's WTO commitments in telecommunications services under the General Agreement in Trade in Services also require the provision of cost-oriented rates for call termination on the networks of mobile carriers in New Zealand.

III. The ComCom Should Implement Mobile Termination Rate Reductions Immediately, and Should Establish LRIC-based Rates

After defining the mobile termination market, and confirming the absence of price-disciplining market forces, the ComCom should establish a cost-oriented pricing principle. As an initial effort to rapidly reduce mobile termination prices towards cost, AT&T would support use of a cost-proxy model, such as either ComCom's proposed mobile-to-mobile proxy, or a benchmark comparison to cost-oriented rates mandated by overseas regulators. Under either approach, a one-step reduction to a cost-oriented rate is more appropriate than a protracted glide-path, considering the lengthy historic period during which MNOs have collected monopoly rents. Further, in parallel with setting this initial reduction based on a cost proxy, AT&T recommends that ComCom set LRIC-based termination rates, without including a mark-up for putative network externalities.

Initially, AT&T would view as justifiable the ComCom's proposed "rough proxy," that takes "half the cost of cheapest average off-net mobile-to-mobile calling cost available to an individual under a postpaid plan as an estimate of the upper bound of the cost of mobile termination (since the other half of the cost could be attributed to mobile origination –taking the call from the handset to the [point of interconnect] ("POI")." (*Id.* at ¶123.*)* This methodology would suggest a marginal mobile terminating cost ceiling of NZ $0.075 (US $0.049), (*Id.*) a fraction of the prevailing rates in New Zealand. By contrast, the per minute mobile termination rates in New Zealand are among the highest in the Asia Pacific region—ranging from NZ $0.335- NZ $0.457 (US $0.220-$0.300)—and are more than fourteen times higher than the rates paid to terminate calls on fixed networks in New Zealand. On this basis, AT&T urges the ComCom to impose a remedy that ensures immediate mobile termination rate reductions to cost-oriented levels, and we support ComCom's preliminary view that a significant reduction in mobile termination rates is likely to lead to a significant reduction in retail fixed to mobile rates. *(Id.* at ¶156.) This will benefit end user interests in the short term and the long term.

Another cost-proxy approach that ComCom could consider would be to benchmark mobile termination rates in New Zealand against overseas cost studies. By now, as demonstrated in the ACCC *Final Decision*, a sufficient number of cost studies have been completed by overseas regulators and operators to demonstrate that cost-oriented mobile termination rates fall within a limited band, e.g., approx 6-13 NZ cpm (4-9 US cpm), regardless of highly varied factors such as population density, varied topography, or cost of infrastructure. It strains credibility for New Zealand MNOs – with mobile penetration approaching 75% -- to suggest that their incremental cost structure is several multiples of costs for MNOs in countries such as Australia, Malaysia, South Korea or India – all of which have their own infrastructure roll-out challenges.[8] For example, the ACCC *Final Decision* refers to the 2003 rates in South Korea as 40 Won—equivalent to NZ $0.053 (US$0.035), and the final glide-path rate in Australia as NZ$0.13 (US$ 0.08).

Although the cost-proxy models do offer the important benefit of rapid implementation, for optimal regulation of the mobile termination market, AT&T also recommends use of a LRIC-based cost control that could be developed as a second phase after ComCom mandates the initial reductions based on cost-proxy. LRIC-based cost modeling is the proper foundation from which to develop charge control, and "bottom-up" LRIC modeling is the appropriate method for establishing costs in a dynamic mobile industry. In a fully competitive and efficient market, carriers set rates based on the long run incremental cost of providing the service in question. Absent competitive market forces, LRIC-based charge controls are appropriate to replicate the price-disciplining effects of a competitive market.

As an additional pricing consideration when establishing a pricing principle, either through a cost-proxy or a LRIC-based model, AT&T advises against accepting MNO arguments to add a network externality surcharge above the LRIC rate – i.e., an above cost implicit surcharge to cross-subsidize mobile subscription services. The value-of-service-based "network externality" mark-up is an empirically unsubstantiated and entirely inappropriate subsidy, particularly given that the mobile penetration rate in New Zealand covers nearly 75% of the population. The network externality subsidy is a departure from LRIC principles, which ensure that the calling party pays all incremental costs of the call, and that there is no incremental financial burden on the called party for receiving the call. Because LRIC efficiently recovers costs, the mark-up over LRIC is not necessary to ensure efficient subscription to mobile services. Furthermore, imposition of this subsidy will distort economic price signals to the market concerning the most efficient technology for call termination, thereby affecting customer calling patterns and competition among telephone technologies, creating a regulatory preference for mobile over fixed service providers. Thus, AT&T does not support proposals to permit a network externality mark-up.

AT&T would support a one-step decrease from current prices to cost-oriented rates, and does not find merit in arguments calling for gradual adjustments to the target price. Rather than allowing the MNOs to continue extracting super-normal monopoly profits from call termination services, the ComCom should eliminate this market distortion in one step. No transition period is necessary, particularly given that the MNOs have understood for several years that charges should come down towards cost-based levels. A lengthy transition period rewards the MNOs for their prior misbehavior in maintaining unreasonably high rates.

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[8] See, e.g., ACCC *Final Decision* that refers to Analyses, an international consultancy firm, that assisted the Commission with a report that contains a detailed discussion of the relevant cost drivers and how they impact in different countries, Annexure at 229.

For the above reasons, AT&T applauds the ComCom's effort in the *Issues Paper* to take steps to correct the mobile termination rate market failure, and respectfully urges ComCom to implement a pricing principle that will align rates with underlying costs without delay.

Respectfully submitted,

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