



**TelstraClear Limited**

**Closing presentation**

**SCHEDULE 3  
INVESTIGATION INTO  
REGULATION OF MOBILE  
TERMINATION**

**23 – 25 February 2005 Commerce Commission Conference**

**25 February 2005**

## **Introduction – regulation is to the long-term benefit of end-users**

1. Three days of detailed question and answer sessions on a number of topics have, in TelstraClear's view, reinforced the Commission's draft view that the designation of fixed-to-mobile voice termination services would promote competition to the long-term benefit of end-users in New Zealand.
2. Unequivocally:
  - a. Telecom mobile and Vodafone have monopoly market power over the setting of the termination rate on their networks;
  - b. The rates for mobile voice termination and other mobile services are, by international standards high – consumers are paying too much;
  - c. Regulating voice termination will result in lower rates being paid by consumers; and
  - d. Lowering of voice termination rates will facilitate competition in the fixed to mobile and tolls market -- to the long term benefits of end users.
3. The OECD, the European Commission, and the UK, Australian and Irish regulators – amongst others – have all concluded that regulation of fixed-to-mobile termination rates is necessary, efficient and to the long-term benefit of end users. TelstraClear does not consider that there are reasons why leaving fixed-to-mobile termination rates to the whim of incumbent mobile termination access providers in New Zealand is efficient, when it has been found to be inefficient and to the long-term detriment of end users in a large part of the world.

## **Mobile Termination – a market on its own or one side of a wider market?**

4. While there are clearly interrelationships between fixed-to-mobile termination services and retail mobile services, these interrelationships do not operate in a way that effectively constrains fixed-to-mobile termination rates.
5. As Valletti has said, and the OECD, the European Commission, and the UK, Australian and Irish regulators – amongst others – found, in the absence of regulation fixed-to-mobile termination rates will be set at monopoly levels – because they can.
6. The level of competition in the mobile services market will determine what proportion (if any) of fixed-to-mobile termination profits is passed on to mobile end users, but will not act to constrain fixed-to-mobile termination rates.
7. Whilst the rates charged by Telecom and Vodafone to each other may converge due to the reliance of both termination access providers on each other, fixed network operators are not able to exert much countervailing buying power against a mobile termination operator.

## **Fixed-to-Mobile and Toll Calls market – will regulation of MTRs promote competition?**

8. On Wednesday, Charles River Associates argued that the costs of doing business are not a barrier to entry – rather, a barrier to entry exists when there is an

asymmetry between the costs faced by an incumbent and the costs of an entrant.

9. TelstraClear more or less agrees – this is exactly the case in the fixed-to-mobile/toll call services market. Regulating F2M will not only reduce overall input costs but will also reduce, if not remove, the asymmetry in the costs faced by an incumbent (TCNZ) versus an entrant!!
10. The introduction of Carrier Pre-selection removed a technological barrier to entry. The introduction of number portability will remove a barrier to switching. Customers are becoming increasingly aware of and sensitive to the cost of fixed-to-mobile calls. What is needed now is to remove the ability of the vertically integrated incumbent provider to raise the costs to competitors of providing the fixed-to-mobile service to be addressed.
11. As the draft report recognised, in recent (2004) reports both the ACCC and OfCom have found evidence that reduced F2M are flowing through into lower retail fixed-to-mobile rates.
12. If fixed-to-mobile termination rates are designated to an efficient cost-based level, competition will be promoted, prices will come down, fixed-to-mobile end users will benefit.

**The Retail Mobile Market – will regulation of F2M rates negatively affect this market?**

13. On Thursday we were told that the impact of a reduction in f2m on the retail mobile services market would depend on the level of competition faced by the operators in that market. The greater the level of competition the greater the flow through impacts of changes in termination rates.
14. The New Zealand mobile market appears to be significantly less competitive than mobile services markets overseas, such as the UK and Australia:
  - a. The market is highly concentrated - currently it has 2 players in the mobile services market with similar market shares.
  - b. As the Commission pointed out in its draft report, mobile access and calling costs appear to be consistently high when benchmarked against OECD countries:
    - i. In 2002, NZ ranked 25<sup>th</sup> in the OECD (out of 30) and prices were 26% above the OECD average for a low user.
    - ii. By 2004, NZ had dropped to 28<sup>th</sup>, with prices 46% above the average.

On the evidence produced to date, there is no reason to presume that it is more costly to provide mobile services in NZ.

- c. There are significant barriers to entry at the network level in the NZ mobile market. As noted by the Commission in its draft report, these

include the importance of achieving comprehensive coverage and the need for substantial sunk investment.

15. Against this backdrop, Vodafone and Telecom both argue that the effect of a regulated reduction in fixed-to-mobile termination rates would be to increase prices and reduce subscriptions in the mobile services market. Professor Hausman tells us to expect a 7% price increase and a drop in subscribers of 120,000.
16. Yet, regulators in countries with four or more mobile operators, lower OECD price rankings, and who already have many more innovative services than NZ, concluded that fixed-to-mobile termination rate reductions are unlikely to have an effect on mobile prices and penetration.
17. No cogent empirical evidence has been presented that this ‘waterbed’ effect has in fact occurred in countries where fixed-to-mobile termination rates have been regulated. This is, despite fixed-to-mobile termination regulation having existed in a number of countries for a number of years. The empirical evidence presented that has been presented in submissions has been limited to penetration data in a selective time period in the UK. More recent UK data, as presented in TelstraClear’s submissions, contradicts this and negates any waterbed effect. In its recent report the ACCC concluded a waterbed effect was unlikely to occur and indicated that:

*“It was provided with little evidence to suggest that mobile subscription charges have increased in the UK in response to regulated reductions in the price of the mobile termination service”.*

#### **Why designate? – The need for a regulatory backdrop to F2M negotiations**

18. On Thursday we heard that mobile termination access providers expect prices to come down in line with cost reductions.
19. As always it needs to be remembered that in the New Zealand context, the regulation of f2m termination service merely sets the regulatory backdrop against which the voluntary, good faith intentions of the monopoly providers can be tested against and held to. When regulation of f2m is in place, there will be every incentive and no constraint on the mobile operators to voluntarily reduce prices. If they fail to reduce prices to efficient levels, then and only then, can the regulator step in and determine a price.
20. In recommending the designation of fixed-to-mobile voice termination services, the Commission would not be setting the price for the service at that time. Rather, the Commission would, by recommending the creation of a regulatory backdrop to these negotiations, be addressing the asymmetric bargaining power present when there is a mobile terminating network monopoly problem, as it has in the case of fixed termination, where similar ‘access bottleneck’ concerns exist.

#### **Are we regulating a voice termination service or a network technology?**

21. The bottleneck nature of the switched voice termination service – f2m – is a bottleneck regardless of what technology is used within the network to deliver

the call. Moving from 2G to 3G does not remove the bottleneck nor does it reduce the mobile operator's market power.

22. We have heard yesterday that Telecom consider that their 027 network is a 3G network. On this assertion, providing a carve out for 3G switched voice, would render any regulation today or in the very near future, worthless.
23. We have heard that 3G, for Telecom at least, refers to a number of incremental network investments. Those investments have been to provide the opportunity to deliver new data based services.
24. The ACCC and the Irish regulator have both recently decided that efficient 2G voice termination costs are a good proxy for efficient 3G voice termination costs. They have chosen to regulate 2G and 3G voice termination based on the 2G efficient cost. This is the correct approach. We agree with Vodafone that regulation should ensure that mobile network operators are able to recover the efficient cost of termination. The determination process should ensure that mobile operators do not under recover the blended cost of terminating voice calls on their network. Determinations calculate the cost-based price for a designated service at a point in time for a specified period.

#### **Will efficient investment be deterred by designation of mobile voice termination?**

25. TelstraClear agrees that regulation should be careful to avoid deterring efficient investments. However, we consider that it is not efficient for monopoly prices charged to fixed network consumers to fund investments in new non-voice services offered to mobile consumers.
26. In setting the fixed voice termination rate at 1.13c the Commission did not permit a higher price to be determined because of the need not to deter fixed network operators investments in broadband Internet access technology. Nor should mobile voice termination rates be permitted at bottleneck monopoly levels because a mobile operator has chosen to take a punt on technology to allow it to offer potentially risky new non-voice services.
27. We note that the Australian and UK regulators found that regulating mobile termination rates was likely to improve dynamic and allocative efficiency, not the opposite. In the absence of regulation, fixed-to-mobile termination rates above the efficient level encourage **greater** investment in the equipment used to provide mobile services than is optimal, and **lower** investment in equipment used to provide fixed-to-mobile services than is optimal.

#### **Cost Benefit Analysis**

28. We consider that the above qualitative reasons why fixed-to-mobile termination rate regulation will promote competition to the long-term benefit of end users can be demonstrated quantitatively.
29. The CBA in the draft report understated the benefits of regulation due to the compounding effect of conservative assumptions. A terminal value should be included in the model, benchmarked fixed-to-mobile termination costs should be reduced, and the relative impact of regulation on fixed-to-mobile pass-

through is understated, as is the organic growth in fixed-to-mobile call volumes.

30. Further, TelstraClear does not consider that in the absence of regulation, fixed-to-mobile termination rates will drop to efficient levels – the existence of countervailing buying power is true in the case of mobile-to-mobile termination, but not true of fixed-to-mobile termination.
31. Indirect costs should only be modelled if these effects are individually specified and quantified. TelstraClear has explained why 3G investment effects and the waterbed effect should be discounted. No other indirect costs have been specified at the conference. Further, if 3G is carved out from the regulation this indirect effect should not be included in the CBA.

### **Wealth Transfers**

32. The Act via its section 18 and via Parliament, as articulated by the Hon David Cunliffe and other speakers, has made it very clear that the purpose of the act is to deliver benefits for end users. The Commission's approach in their draft report, as it was in their LLU investigation, is the correct interpretation of the Act.

### **Concluding remarks**

33. I conclude by returning to key issues of this investigation:
  - a. Telecom mobile and Vodafone have monopoly market power over the setting of the termination rate on their networks;
  - b. The rates for mobile voice termination and other mobile services are, by international standards high – consumers are paying too much;
  - c. Regulating voice termination will result in lower rates being paid by consumers; and
  - d. Lowering of voice termination rates will facilitate competition in the fixed to mobile and tolls market -- to the long term benefits of end users.

Grant Forsyth  
Manager, Industry & Regulatory Affairs  
TelstraClear