

Commerce Commission

Submission on the Schedule 3 Investigation into Regulation of Mobile Termination Issues Paper

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Submission by

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Introduction:

CallPlus welcomes the opportunity to respond to the Commerce Commissions issues paper of the 8th of August 2008.

CallPlus is the largest NZ owned telecommunications company and third largest fixed line telecommunications company operating in New Zealand. Accordingly CallPlus' comments focus on the implications of mobile termination for a fixed line network operator; however CallPlus recognises that the issue of mobile termination has serious consequences on new mobile network operators to the market.

These comments are in addition to the joint submission from Kordia, Orcon, CallPlus & Woosh.

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Summary of position

CallPlus strongly support the regulation of mobile termination as being in the long term interest of competition and has experienced considerable frustration with the attempts from mobile operators to 'ring fence' services in order to limit the impact and minimise the scope of the voluntary undertakings around fixed-to-mobile termination.

The undertakings talked about a 'maximum' rate however in practice this has, not surprisingly, been a minimum. If the high mobile termination rates, both by comparisons internationally and against the commissions initial benchmark, are maintained they will lock consumers into high mobile prices for a number of years.

Callplus has focussed its comments on the following aspects of the issues paper.

Market definition – CallPlus suggests that the market definition for mobile termination includes the following calls and that any artificial differentiation in the rates between these three categories will cause artificial distortions to the market that are not in the long term interest of competition or consumers.

- Mobile to Mobile termination
- Fixed to Mobile termination
- Mobile to Fixed termination (where 'Calling Party Pays' does not apply)

CallPlus recommends that the scope of a schedule 3 investigation incorporates the above.

Artificial differentiation (based on origination) – NZ Mobile operators are attempting to artificially differentiate mobile termination based on origination, despite the fact that this differentiation has no cost basis.

- Mobile operators are proposing that internationally originated calls terminating on a mobile network in NZ should be charged at significantly higher rate than domestically originated calls. This would immediately impact on the ability of CallPlus and others to compete in the wholesale calling market and have consequences on the viability of NZ carriers to extend their network points of presence within New Zealand.
- Telecom is proposing that calls originating on a mobile network and terminating on a fixed network, which are chargeable to the terminating carrier (e.g. Mobile to 0800), are charged at a significantly higher rate than fixed to mobile termination rates. This gives an integrated fixed & mobile operator an artificial advantage when competing for these services.

CallPlus recommends that a schedule 3 investigation commence with a view to regulating a service which prevents artificial differentiation by originating network or geography.

Other markets effected – The increasing prevalence of ‘on-net’ pricing, calling circles and the bundling of mobile calling with broadband and fixed line access means that significant market power and resulting high returns in the mobile market is being leveraged to gain share in the fixed access and broadband markets through offers that efficient competitors cannot match on a sustainable basis.

CallPlus recommends that a schedule 3 investigation commence with a view to regulating a service which has termination rates set at a level which prevents ‘monopoly profits’ from mobile termination being used to predatory price in other markets.

‘Minute + second’ rounding – The application of ‘Minute + Second’ rounding is out of step with international practice and has significant impact on the ‘true cost of termination’ given the high price per minute of mobile termination when compared to fixed termination and the high proportion of short duration calls on a mobile network.

- Mobile operators make ‘abnormal’ margin out of short calls. Furthermore it does not encourage efficient networks as operators are rewarded for short calls which are often the result of network issues such as ‘poor quality’ calls, out of coverage and dropped calls.
- ‘Minute + Second’ rounding creates a significant barrier to entry for any carrier wanting to enter the wholesale market for terminating ‘internationally originated’ calls terminating in New Zealand. The international market is based on ‘Second + Second’ rounding and the NZ mobile operators themselves offer overseas carriers termination on this basis.

Carriers, such as CallPlus, must offer ‘Second + Second’ but accept the risk & cost of a domestic ‘Minute + Second’ regime.

The result of the above is a barrier to entry to competition and a higher cost of mobile calling for consumers, overseas callers & travelling kiwis wanting to contact NZ consumers & businesses.

CallPlus recommends that a schedule 3 investigation commence with a view to regulating a service based on second + second termination.

Specific comments

1. Market Definition

CallPlus suggests that in looking at mobile termination the scope needs to cover the following types of calls.

- Mobile to Mobile termination
- Fixed to mobile termination
- Mobile to fixed termination where 'calling party pays' is not the model

There is a high degree of substitutability between the fixed and mobile markets, there are more mobiles than people and every house has a phone. If artificial distinctions are made then there will inevitably be undesirable and artificial distortionary effects.

Furthermore SMS & Mobile Data are an integral part of a mobile service and a critical element to any new entrant to the mobile market. Accordingly to not encapsulate these services as well as Mobile termination for Voice services would allow an incumbent, with significant market power, to ameliorate the effectiveness of any regulation.

2. Artificial differentiation based on origination

2.1. Internationally originated calls

Mobile operators are attempting to differentiate the termination rate they charge for 'calls originated internationally' from those originating domestically. [

JCOI. Obviously a carrier has a monopoly on calls terminating to its own network and if they are allowed to differentiate in this manner it will have serious flow on consequences for competing domestic carriers such as CallPlus impacting on:-

- Their ability to achieve economies of scale if they extend their own network coverage and points of presence in NZ
- Their ability achieves savings by electing to terminate traffic they originate in New Zealand which terminates overseas directly with overseas carriers.
- Their ability to compete in the wholesale market for fixed and mobile termination into New Zealand

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It is important to note that the distinction of internationally originated traffic has no basis in additional costs over and above domestically originated traffic. In all cases the transiting carrier pays all costs associated with originating these calls,

international backhaul and hands over the traffic to the NZ mobile operator in a similar manner to domestic calls.

It should also be noted that the use of a 'minute + second' termination regime, unique to NZ, also unfairly advantages mobile network operators and creates a barrier to entry.

2.2. Mobile Origination

CallPlus does not agree that Mobile-to-mobile calls should attract a higher interconnection rate than fixed to mobile. What is more Telecom is attempting to differentiate the rate it charges [JCOI for calls from Mobile networks terminating on a fixed network (Mobile-to-Fixed) where the 'Calling Party Pays' principle does not apply. The most obvious example of this type of call, whereby the charge is levied on the terminating carrier, is mobile-to-toll-free.

The impact of this is that an integrated fixed & mobile competitor has an unfair advantage in these markets over a non-integrated carrier. Furthermore CallPlus does not believe there is any validity in charging a higher rate for mobile origination over mobile termination.

There are offers in the market which suggest that the true cost of originating calls on a mobile network is well below the 16c per minute rate. V8card service (<http://www.v8phonecard.co.nz/>) is an example. The website states: -

"With a V8™ phone card under your bonnet, you can call overseas at a tiny price from your Vodafone mobile in NZ. Calls start at just 5c a minute to more than 30 countries, plus a call connection fee of 19c. > [See the rates.](#)

A 30 minute call to the UK will cost \$1.69, a fifteen minute chat to someone in India \$2.44, or an hour long call to the USA just \$3.19.

Just pick up a V8 phone card, dial 449 from your Vodafone mobile and make your call!"

CallPlus also understands that Telecom have raised the prospect that 'internationally originated' calls from a Mobile network be charged differently to internationally originated fixed line calls. This raises the same concerns as those expressed in points 2.1 - 2.2. In addition this would be impossible to implement as a significant percentage of calls from overseas are received with a "0000" in the A party number. This is established industry practice and simply the result of calls being passed through multiple carriers around the world using different links. A suggestion such as this as well as being unreasonable would be impractical and create barriers to competition by placing artificial operational issues and inefficiencies on transit carriers attempting to differentiate traffic types.

3. Other Markets Affected

Mobile & Fixed telecommunications is rapidly converging and there is a high degree of inter-relationship. If mobile operators are able to leverage significant market power & charge artificially high mobile termination rates then they are able to undertake predatory pricing practices in other markets which efficient rivals cannot match. This is achieved through bundling and cross subsidising into the fixed line calling, broadband & access market or through on-net mobile pricing.

CallPlus does not suggest that Bundling & On-net pricing per se is anti-competitive. Simply that it is critical that mobile termination rates are set at an appropriate level (where monopoly profits are not extracted by a dominant player) in order that competition in the mobile, fixed line access, broadband and fixed line calling markets is on a 'level playing' field. The optimal solution is bill and keep.

Vodafone in particular, following its acquisition of ihug, is best able to exploit its position as the dominant mobile operator but with a small share of the fixed line. CallPlus believes that there is clear evidence of this in the NZ market.

A number of carriers, including CallPlus, have expressed their concerns to the Commission over the last 12 months with respect to predatory pricing around: -

- Vodafone business toll packages offering tolls packages with calls from a fixed line to on-net mobiles at 15c per minute (2c below the interconnect rate at that time)
- Vodafone's 'talk 0' plan offering unlimited calls to Vodafone mobiles for \$6 per month (incl GST). The retail price would cover a competitors interconnect costs for a mere one minute per day.
- Vodafone's & Telecoms 'on-net' pricing for mobile to mobile & calling circle which are difficult for a non integrated fixed line operator to compete against.
- The Vodafone offer in 2008 of a bundle of Homeline, Broadband and Calling, either a mobile plan or a fixed plan, which offered a free broadband connection up to the value of \$30 through to 31st December 2008 – it also offered 30 day money back guarantee: <http://www.vodafone.co.nz/specials-promos/broadband-at-home/>. This 8 month offer came 'hot on the heels' of Vodafone's 12 month free broadband offer that ran for four months in 2007.

These are not short term promotional offers and CallPlus believes that a competitor would make a loss at even the gross margin level, without even considering many other direct and indirect costs.

If this type of activity continues and mobile termination rates are artificially high then it will not be in the long term interest of consumers as: -

- The fixed line access, calling & broadband market will experience a reduction in the level of competition – leading to a 'cosy' duopoly of two integrated, fixed & mobile operators.
- There will be significant barriers of entry to new mobile entrants.

4. Minute-Second rounding for interconnection

4.1. Inhibits Wholesale competition

Given that the International market operates on 'Second + Second' rounding, and incumbents offer 'second + second rounding to overseas carriers, any domestic carrier must offer this even though it faces a 'Minute + Second supply side termination cost. This means nearly all sub 1 minute calls are at a loss.

This creates a significant barrier to competing in a price driven inter-carrier wholesale market. The impact of an NZ carrier being precluded from the wholesale market for internationally originated market is outlined above.

4.2. True mobile termination rates are masked

New Zealand consumers ultimately bear the cost. The impact of this regime on the effective price of termination is considerable given the nature of the mobile networks and the very high price of mobile termination. The latter both impacts on the financial impact on interconnected parties and the incentive for consumers to keep calls short.

Furthermore it does not encourage effective network operation – a mobile operator is effectively rewarded for calls that drop out, calls where the called party is out of coverage and the call goes to voicemail or calls where call quality is poor and a customer hangs up.

CallPlus has done the following analysis on call duration and the impact of the 'Minute + Second' rounding regime on its cost of termination.

The charts in Appendix A are the result of an analysis of CallPlus traffic for the month of July 2008 for calls terminating on both Telecom and Vodafone's mobile networks. It can be seen that the majority of calls are less than 60 seconds call duration and heavily skewed to the shorter duration periods.

The following table summarises the position: [

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5. Other comments

CallPlus would like to make the following comments on other aspects of the commission's issues paper: -

5.1. Additional 'hidden' costs associated with mobile calling - Telecoms template ICA (Schedule 4, 4.1 i) includes a *'per-Call charge of 0.5 cents each time one of the non-geographic service codes allocated under the provisions of the NAD is dialled from a Local Number for which Telecom provides 02 Non-Code Access'*.

CallPlus believes that this charge is unreasonable and not justifiable in an environment where porting is required.

5.2. Refusal to stand up additional capacity – CallPlus has first-hand experience of a mobile carrier refusing to stand up capacity for interconnection and had to resort to the commission to help assist with resolution. The impact of such a refusal is to immediately constrain a competitor's ability to increase its business across the board and expose it to considerable transit costs should its network usage increase.

5.3. Pass through of lower wholesale rates to consumers – CallPlus suggest that the key reason for the decline in prices between 2004-2008, identified by the commission in its paper, is a direct result of the lowering of interconnect rates, which occurred from mid 2004 onwards.

The costs of calls to mobile has increasingly become the most significant 'calling price component' for residential and businesses when assessing alternative providers. The increasing prevalence of 'on-net' pricing and calling circles recognizes this and has further reinforced the importance of mobile pricing in both the business and residential markets.

In CallPlus' view, given customers focus on Mobile calling prices, it is inevitable that competitors will pass through reductions in wholesale rates for mobile termination in order to compete effectively, retain and grow their customer bases. Reductions in prices to consumers are likely to occur quickly, we would estimate within 3 – 4 months of interconnect rates declining.

Conclusion

CallPlus believes that mobile termination rates are the most critical issue in the telecommunications market at this time.

Current mobile termination rates are significantly higher than the true cost. In the absence of competitive pressure there is no mechanism to lower either the consumer or wholesale price to competitors.

This will produce some serious implications (in the absence of regulation of Mobile to Mobile, Fixed to Mobile and Mobile to Fixed termination) with a resulting lessening of competition in the fixed market and a continuation of the dominance of Vodafone and Telecom in the mobile markets.

Fixed line competitors will continue to experience predatory pricing in the calling, access and broadband market as a result of cross subsidy from mobile operators who are able to charge artificially high mobile termination rates, maintain high consumer prices and make monopoly profits as a result.

New entrants to the mobile market will struggle to achieve scale and return on their investment when faced with deep pocketed dominant players using tactics such as closed network prices and bundling across services.

It should be remembered that the voluntary undertakings were for the maximum charges, in reality they are the minimum. Mobile operators continue to look for ways to isolate, ring fence or minimise the impact through artificial differentiation of call types the calls covered by the undertakings.

Ultimately the level of competition across the fixed and mobile telecommunications markets could decrease with the dominant fixed and mobile network operators being the winners.

The ultimate losers will be NZ consumers and businesses.

Appendix A

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