



## COMMERCE COMMISSION

Please refer to:

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### **Reasons for Commerce Commission decision to investigate mobile termination access services**

#### **Purpose**

1. The purpose of this document is to set out the reasons for the Commission's decision to commence an investigation into mobile termination access services (**MTAS**).
2. This reasons document and other documents relating to the investigation are available on the Commission's website at

<http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/Investigations/MobiletoMobileTermination/mobiletomobiletermination.aspx>

#### **Introduction**

3. The Commerce Commission today announced it was commencing an investigation under Schedule 3 of the Telecommunications Act 2001 (the **Act**) into whether or not the **MTAS** (incorporating mobile-to-mobile (**MTM**) voice termination, fixed-to-mobile (**FTM**) voice termination and short-message-service (**SMS**) termination) should become designated or specified services under Schedule 1 of the Act. Under clause 1(1) of Schedule 3 of the Act, the Commission may commence an investigation into whether or not Schedule 1 of the Act should be altered by adding a telecommunications service if the Commission is satisfied that there are reasonable grounds for an investigation.
4. This decision follows the Commission informing interested parties on 8 May 2008 that it was considering commencing a Schedule 3 Investigation into whether or not to subject **MTM** termination rates for both voice and **SMS** to regulation and seeking the views of interested parties.<sup>1</sup> On 14 May 2008, the Commission wrote to interested parties informing them that if, following the receipt of initial views from interested parties, there appeared to be reasonable grounds to commence an investigation, the Commission proposed testing the issue further by releasing an Issues Paper and seeking submissions before deciding whether to commence a formal Schedule 3 investigation.<sup>2</sup>
5. Following the receipt of submissions from interested parties, the Commission considered that there appeared to be reasonable grounds to commence an investigation into mobile termination; however it wanted to test a number of issues

<sup>1</sup> Letter from Patterson (Commission) to interested parties, 8 May 2007.

<sup>2</sup> Letter from Borthwick (Commission) to interested parties, 14 May 2007.

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further. The Commission therefore released the Issues Paper<sup>3</sup> on 8 August 2008 and called for submissions.

### **Submissions on the Issues Paper**

6. The Commission received nine submissions on the Issues Paper (submissions from Vodafone, Telecom, Business New Zealand, the Business Roundtable, TelstraClear, NZ Communications, TUANZ, a combined submission from Kordia, Callplus, Orcon and Woosh, and a supplementary submission from Callplus).
7. The key points from the submissions are:
  - a. Vodafone, Telecom and the Business Roundtable did not support a Schedule 3 investigation being undertaken, on the grounds that they did not consider the case for regulation had been made or that on-net pricing was discriminatory;
  - b. Business New Zealand provided comments on the issue raised by the Issues Paper and appeared not to support a Schedule 3 investigation, and expressed reservations about including SMS termination as part of any Investigation; and
  - c. Kordia, Callplus, Orcon, Woosh, TelstraClear, NZ Communications and TUANZ supported a Schedule 3 investigation, with:
    - i. a mixture of preferences on the approach that should be taken to pricing, including bill-and-keep pricing, asymmetric pricing, second-and-second termination, marginal cost, and long-run incremental cost (LRIC) excluding common costs;
    - ii. some parties seeking restrictions on pricing discrimination, that is submitting against allowing differences between on-net and off-net prices; and
    - iii. some parties proposing that bundling, cross-subsidisation, international originating calls, toll-free calling and mobile-to-fixed termination should be included in the review.

### **Commission's assessment of issues raised in submissions on the Issues Paper**

8. This reasons document outlines the following key factors that the Commission considered, in light of the above submissions, in reaching its decision that it is satisfied that there are reasonable grounds to commence a Schedule 3 investigation into whether or not MTAS (voice and SMS) should be regulated:
  - a. the scope of the MTAS;
  - b. current benchmarking of cost-based mobile termination rates (MTRs);
  - c. concerns about barriers to entry;
  - d. concerns about differentials between on-net and off-net retail prices;

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<sup>3</sup> Commerce Commission, *Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination – Issues Paper*, 8 August 2008.

- e. commercial interconnection agreements and offers; and
- f. the cost and reasonableness of commencing a Schedule 3 investigation.

#### The scope of the MTAS

9. The MTAS are used as inputs into the supply of downstream retail calls that terminate on a mobile network, such as MTM and FTM calls, and the downstream retail SMS that terminate on a mobile network. The MTAS do not distinguish between where the call or SMS originated from.
10. The Commission therefore considers that the appropriate scope of the MTAS to be considered in the Investigation should be all MTAS (incorporating MTM voice termination, FTM voice termination and SMS termination).

#### Current benchmarking of cost-based MTRs

11. The Commission considers that current wholesale MTRs, as set out in the Deeds of Understanding between the Minister and Telecom and Vodafone<sup>4</sup> are significantly in excess of cost-based benchmarks. The current MTR applying to both FTM and MTM calls is 16 cpm, while the current cost-based benchmark used by the Commission in its Schedule 3 investigation into amending the roaming service<sup>5</sup> is just over 10 cpm. The Commission has revised downwards its median benchmarked estimate of cost-based MTRs, as a number of the benchmarks previously used (such as in Australia and the UK) have been reduced; for example, the ACCC has reduced its recommended MTR, from 12Acpm in 2006/07, to 9Acpm for 2007/08.<sup>6</sup> A number of additional jurisdictions with cost-based rates have also been identified since the Commission's previous Schedule 3 investigation into MTRs, including Spain and France.
12. The Commission also notes that SMS termination rate is a potentially significant issue. The Commission understands that the prevailing SMS termination rate between Vodafone and Telecom is around 9.5 cents per SMS. These rates are considerably above the estimated cost of SMS termination, which the Commission determined as part of its roaming investigation to be between 1-2.6 cents per SMS.
13. The Commission considers that current international benchmarks for cost-based MTRs indicate that the prevailing MTRs in New Zealand are likely to be significantly above the cost of providing the service, and that the reduction in MTRs that would result from regulation may result in lower retail prices and therefore may increase the long-term benefit to end-users. This indicates that there are reasonable grounds to

<sup>4</sup> See [http://www.med.govt.nz/templates/ContentTopicSummary\\_26543.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_26543.aspx).

<sup>5</sup> Commerce Commission, *Schedule 3 Investigation into Amending the Roaming Service*, Final Report, 10 March 2008

<sup>6</sup> See ACCC, *MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report*, November 2007, <http://www.accc.gov.au/content/item.phtml?itemId=804768&nodeId=d5983a0a28e85ce384267d635824d04d&fn=MTAS%20pricing%20principles%20determination%20report.pdf>

commence a Schedule 3 Investigation. Such developments are continuing to occur,<sup>7</sup> and are new factors that were not considered in the previous Schedule 3 investigation.<sup>8</sup> The Commission is interested in exploring recent developments in respect of cost-based MTRs under the proposed Schedule 3 investigation.

#### Concerns about barriers to entry

14. Above-cost MTRs may also represent an entry barrier for new entrants into the mobile market. This will depend on traffic flows between an entrant and established incumbent mobile networks. If traffic flows between a mobile entrant and incumbent are symmetrical, and symmetric MTRs are applied, termination payments will cancel each other, in which case the entrant's costs will be insensitive to the level of MTR.
15. At this stage, the Commission is of the view that traffic profiles between a prospective entrant and the established incumbent networks cannot be determined, and hence a definitive conclusion on the net effect of MTRs on the entrant cannot be drawn. Further information is therefore being sought to inform an assessment of the net effect of MTRs as part of this investigation.
16. In the absence of such a conclusion, the Commission re-iterates the observation made above that current MTRs appear to be considerably in excess of cost-based benchmarks of MTRs, and that in a number of cases, even those cost-based benchmarks appear to exceed the results of regulatory cost models.<sup>9</sup> To this extent, above-cost MTRs may represent an entry barrier, as an entrant would incur a higher cost to have its calls terminated on an incumbent network, than the incumbent pays to terminate its own calls.
17. As entry barriers foreclose efficient entry that would otherwise deliver benefits to end-users in the form of lower prices and greater quality of service,<sup>10</sup> the Commission considers that there are reasonable grounds to commence a Schedule 3 investigation in order to further consider the case for regulation of MTAS, and more specifically

<sup>7</sup> See European Commission, *Lower charges, greater consistency, more competition: Commission consults on bringing down mobile phone tariffs in Europe*, Press Release, 26 June 2008, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1016&format=HTML&aged=0&language=EN&guiLanguage=en> and European Commission, *Draft commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*, at [http://ec.europa.eu/information\\_society/policy/ecomms/doc/library/public\\_consult/termination\\_rates/termination.pdf](http://ec.europa.eu/information_society/policy/ecomms/doc/library/public_consult/termination_rates/termination.pdf).

<sup>8</sup> See Commerce Commission, *Report under clause 4 of Part 1 of Schedule 3 of the Telecommunications Act 2001 on whether or not mobile termination should become a designated or specified service*, 9 June 2005 and Commerce Commission, *Reconsideration Final Report on whether mobile termination should become a designated or specified service*, 21 April 2006.

<sup>9</sup> As noted earlier, the ACCC set a MTR of A9cpm for 2007/08, even though their model indicated that the efficient cost of terminating calls on a mobile network in Australia is between 6.1 and 6.6 Acpm.

<sup>10</sup> In addition to above-cost termination rates potentially representing a barrier to entry, such rates may also represent a distortion to the extent that they encourage an entrant to target customers with a particular calling profile. This may not be allocatively efficient, as the allocation of resources will not reflect underlying costs.

whether above-cost MTRs represent an entry barrier for new entrants into the mobile market.

Concerns about differentials between on-net and off-net retail prices

18. In the Issues Paper, the Commission noted that lower on-net calling prices may impair the ability of an entrant to attract subscribers. NZC submitted that the higher the level of MTRs, the greater the incentive to differentiate between on-net and off-net call prices. According to NZC, this can make it more difficult for an entrant to compete with established incumbent networks, as the entrant would have to attract not only an individual subscriber, but also that subscriber's "calling circle". Vodafone's response on this issue is that such calling circles are typically small, and so this does not represent a major barrier for a new entrant.
19. Given the growth of on-net pricing plans in New Zealand over the last two years, the Commission considers that there are reasonable grounds to investigate this issue in the context of a Schedule 3 investigation into MTRs.

Commercial interconnection agreements and offers

20. The Commission also considered whether an investigation is appropriate given the recent commercial interconnection agreement between Vodafone and NZC, and Telecom's reference offer for mobile interconnection. Telecom's reference offer includes MTRs that are based on the Deed accepted by the Minister in respect of FTM termination.<sup>11</sup> As noted earlier, these rates (currently 16 cpm) appear to be considerably in excess of cost-based benchmarks.
21. Notwithstanding the above commercial developments, the Commission considers that there are reasonable grounds for commencing a Schedule 3 investigation. If an investigation is launched, both Vodafone and Telecom may submit undertakings based on their current offers, or lower rates. Whereas the current commercial agreement with Vodafone is restricted to NZC, a regulated rate or an undertaking would be applicable to all access providers and access seekers, and may better give effect to the long-term interest of end-users than an offer that is restricted to only one party.
22. The Commission will, however, consider during the Schedule 3 investigation the potential impacts of a decision (if any) to regulate MTAS on the incentives to reach commercial interconnection agreements in the future.

Cost and reasonableness of commencing a Schedule 3 investigation

23. The Commission also considered whether an investigation is appropriate in light of the cost associated with an investigation for both the industry and the Commission. Some parties have submitted that these costs will be significant, and that it is not reasonable to tie up resources in this way when the previous Schedule 3 investigation

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<sup>11</sup> Source: <http://www.telecomwholesale.co.nz/wintercon>.

into FTM MTRs concluded less than two years ago with the Deeds of Undertaking that provide certainty in terms of benefits to end-users.

24. The Commission considers, however, that the above factors are significant changes since the previous investigation was concluded in April 2006. Furthermore, the previous investigation did not consider mobile-to-mobile termination and was restricted to fixed-to-mobile termination. As a result, these cost and reasonableness arguments do not outweigh the other factors that suggest there are reasonable grounds for a Schedule 3 investigation.

#### **Commission's decision**

25. After considering the issues outlined in this reasons document and having regard to the submissions received, the Commission is satisfied that there are reasonable grounds to commence an investigation into the MTAS (incorporating MTM voice termination, FTM voice termination and SMS termination) should become a regulated service under Schedule 1 of the Act.

#### **Next steps**

26. Under clause 15 of Schedule 3A of the Act, any access provider that wishes to make an undertaking must do so not later than 12 January 2009. In the absence of any undertakings being lodged, the Commission expects to issue a draft report on this matter in February 2009.
27. As noted above, the Commission has identified that further information will be needed for the assessment of whether the MTAS should become a designated or specified service under Schedule 1 of the Act. The Commission has separately written to interested parties seeking information to inform this investigation.

**DATED** at Wellington this 6th day of November 2008



Paula Rebstock  
Chair  
Commerce Commission