

Margin Squeeze Imputation Test

1. Refer Paras 4 and 12 Opening Submission (CP and Kordia). As John Small notes, with pricing at TSLRIC, retail pricing below that can be expected, above levels that would be regarded as predatory pricing.¹
2. Regulation applies where anti-trust cannot cater for the market problem. While informed by anti-trust margin squeeze concepts², the regulator designs the imputation test to cater for the specific problem. If, for example, the “average customer” is an aspect of anti-trust, as noted by James Mellsop, the test can vary, or not incorporate, that requirement. Anti-trust in NZ is most unlikely to provide a remedy (limited ambit of Section 36 (however interpreted by the Supreme Court; question whether margin squeeze is an NZ anti-trust remedy), time delays (ex post remedy rare) etc).³
3. The degree and level of on/off-net pricing, relative to the ultimate MTAS wholesale input price (whether, say, 7.2cpm or much less), indicates major margin squeeze issues, not solved by simply regulating MTAS.⁴
4. Take the recognition, noted at the conference, of the increasing incidence of bundling, which suggests the need for a test. For example, the business bundle in the draft report in Para 691 (in that bundle, Vodafone sells FTM at retail at 13cpm when the wholesale input (MTAS) is 15cpm). Anti-trust may require review of other bundles (ie: this bundle arguably cannot be viewed in isolation). But, from a regulatory perspective, this middle-of-the-road example⁵, where the retail price is below the cost of only one of the cost components (MTAS) in the retail supplier’s cost stack, strongly indicates market failure problems. This is unlikely to be remedied by a significant drop in the MTAS price (eg MTAS providers have ample space to retail price below a TSLRIC MTAS price (or below a cost stack including the MTAS price). However framed,⁶ this appears to be a squeeze that regulation should cover, given the same relative problem is likely as the MTAS price reduces. If we assume the NERA⁷ approximation of the cost of supplying an FTM retail service, in addition to the MTAS cost, at around 4cpm, then an efficient competitor⁸ currently has a cost of 19cpm (as against the retail price offered by the MTAS supplier of 13cpm. It can be expected that a drop in MTAS to 7.2cpm or less will leave in place substantial margin squeeze (which will cause market failure even if the squeeze is much less than the position today). Of course, the MTAS supplier’s retail price for the retail FTM service can exceed

¹ Margin squeeze is related to but not the same as the anti-trust concept of predatory pricing. Margin squeeze is not about an **absolute** price (eg; the wholesale input (MTAS) and the retail price: it is about the **difference** between prices

² For example, while margin squeeze in anti-trust is well established in Europe, the opposite applies in the US. Earlier this year, in *Linkline*, the US Supreme Court, in a Telco case, rejected margin squeeze, a key reason being that this is an issue for the regulator (FCC) not anti-trust. So it is the primary role of the regulator to deal with margin squeeze concerns, not anti-trust.

There are valuable insights into the approach in decisions such as the Albion Water (UK CAT 2006) and the EU Deutsche Telekom margin squeeze decision of the Court of First Instance.

³ Article 82 is a significantly more potent remedy than Section 36. Even so Ofcom consider ex ante anti-trust has limited impact on mobile termination: see its May 2009 report on MCT Para 6.88-6.91

⁴ At the least, on the face of it, it suggests price discrimination on the basis of the “customer” being a competitor.

⁵ E.g this is not a classic example of an outlier type of service, priced low, to be taken into account, in anti-trust margin squeeze analysis, such as a loss leader, designed to attract new entrant customers

⁶ Whether one of the two classic anti-trust tests (outlined in cases such as Albion Water (2006 UK CAT) and Deutsche Telekom (CFI), or some other test is used, an efficient competitor cannot compete when relying on the wholesale input (MTAS) over which the vertically integrated operator has a monopoly/SMP

⁷ NERA submission on Draft MTAS Report

⁸ or, notionally, the MTAS supplier itself assuming it must pay the MTAS price (applying one of the two standard anti-trust tests)

the MTAS price, and there is still a price squeeze. The fact that the current package has a retail price below the MTAS price is strongly indicative of margin squeeze.

5. The Commission can, in order of preference:⁹
 - a. Include in the service description a single sentence requirement for a margin squeeze imputation test (“test”) to be included in the determination (the detail of which is to be resolved during the determination)¹⁰;
 - b. The same but add a decision point, in the determination phase, as to whether or not there would be a test;
 - c. In its report, indicate that the Commission is minded to have or consider a test when it comes to the determination phase (such signals are important, including in view of their importance in helping parties make their decisions during a negotiation phase with the Minister).
6. Dealing with margin squeeze is complex.¹¹ But tough problems call for tough solutions. Without having a test, simply moving the MTAS price south (even considerably south) will not solve the problems caused by MTAS. The Commission will have hardly dented the problem. As the example shows, the impact extends beyond pure mobile service problems (which are typified by SMS/MTM on-net/off-net pricing), to services offering fixed and mobile bundles. It is hard or impossible to compete in the broader telecoms market due to the squeeze. The impact is wide.
7. There is guidance from overseas as to the design of a test with which MTAS suppliers must comply to avoid what the Commission considers to be unacceptable margin squeeze.¹² The Commission itself has applied an imputation test in relation to bundled services in NZ, most notably to Telecom bundles in 2007. Anti-trust principles provide a valuable starting point, such as the 2 standard anti-trust tests noted in Albion Water (UK CAT (2006)) and elsewhere.

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⁹ There are tools the Commission can use to expedite working out the approach in a practical way, such as a Section 9A review. This can make the determination phase proceed in more expeditious manner.

¹⁰ As a condition, access principle or IPP/FPP under Section 66

¹¹ The more so when to deal with the problem adequately, it is necessary to cover horizontal as well as vertical margin squeeze, as is the case here, in view of bundles.

¹² For example, ACCC’s margin squeeze imputation tests for Telstra, and the position in Ireland (see eg. Oxera’s report to Comreg, Bundling and Retail-minus regulation – Developing an imputation test (which came out in the same month as the Commission’s own valuable December 2007 report on DSL bundling). There are the useful ACCC reports, Assessing vertical price squeezes for ADSL Services, Bundling in Telecommunications Markets, and the underlying NERA reports, including their report, Imputation Tests for Bundled Services