



TelstraClear Limited

**Submission relating to Schedule 3
investigation into regulation of
mobile termination – issues paper**

5 September 2008

Executive Summary

- (i) TelstraClear remains concerned with the state of the mobile termination market in New Zealand, and supports the Commission's proposed Schedule 3 investigation into wholesale mobile termination.
- (ii) The agreements reached by Telecom and Vodafone directly with the Minister set prices for fixed-to-mobile termination that are significantly above internationally benchmarked wholesale mobile termination rates.
- (iii) TelstraClear is concerned that limiting the scope of the investigation to the mobile-to-mobile termination risks creating a future price differential between mobile-to-mobile and fixed-to-mobile termination.
- (iv) TelstraClear recommends that the scope of the Schedule 3 investigation traverses wholesale mobile termination more generally, irrespective of whether calls are originated on fixed or mobile networks.
- (v) Such an approach will ensure that the Commission satisfies itself that termination of traffic on both fixed and mobile networks is cost-based, and that concerns that the Commission may have around significant market power arising from wholesale termination, and its affect on downstream retail markets, is addressed.

Introduction

1. TelstraClear welcomes the opportunity to comment on the Commission's proposed Schedule 3 investigation into the regulation of mobile termination. TelstraClear agrees with the Commission's preliminary conclusions set out in the Issues paper that there are reasonable grounds to commence an investigation into mobile termination.
2. TelstraClear remains concerned with the state of the mobile termination market in New Zealand. TelstraClear was supportive of the Commission's recommendation in its mobile termination reconsideration report¹ issued in April 2006, recommending that the Minister regulate fixed-to-mobile termination under the Telecommunications Act. TelstraClear therefore believes the Commission should regulate all voice calls terminating on mobile services, whether they originate from fixed or mobile networks.

Fixed to mobile termination

3. The Commission's reconsideration report² into fixed-to-mobile termination, issued in April 2006 recommended designation of mobile termination on the basis that:
 - its cost-benefit analysis identified a net benefit over a 5 year period, including distributional effects of between \$46m and \$63m;
 - the static net benefit in the cost-benefit analysis would outweigh any dynamic risk to investment in further 3G roll-out; and
 - the cost-benefit analysis estimated that mobile termination pass through of 85%.
4. The Commission's recommendation was that the initial pricing principle should be internationally benchmarked cost-based price, with a final pricing principle of TSLRIC. The Commission's international benchmarking identified an average cost of 10.94cpm.
5. As an alternative to regulation, Telecom and Vodafone submitted commercial proposals directly to the Minister, and sought a commercial outcome in lieu of the regulation of mobile termination rates. The agreed wholesale price paths were:

Year	Telecom rate ³ (cpm)	Vodafone rate ⁴ (cpm)
2007/08	17	17
2008/09	16	16
2009/10	15	15
2010/11	14	14.4
2011/12	12	14

¹ Commerce Commission, *Telecommunications Act 2001, Schedule 3 investigation into regulation of Mobile Termination, Reconsideration Final Report*, 21 April 2006.

² Commerce Commission, *Telecommunications Act 2001, Schedule 3 investigation into regulation of Mobile Termination, Reconsideration Final Report*, 21 April 2006.

³ Telecom, *Deed Poll by Telecom New Zealand Limited relating to fixed to mobile termination rates*, 11 April 2007

⁴ Vodafone, *Deed of Undertaking relating to the provision of mobile mobile termination services*, 20 April 2007

6. The agreements reached by Telecom and Vodafone directly with the Minister set prices for fixed-to-mobile termination which are significantly above the internationally benchmarked rates identified by the Commission. TelstraClear understands that, outside that agreement, Vodafone and Telecom offer wholesale mobile-to-mobile termination rates consistent with those prices.

ACCC mobile termination cost modelling

7. The ACCC commissioned WIK to develop a mobile network and cost model. In November 2007, the ACCC released its pricing principles for the MTAS, as well as its view of the appropriate price for the service between 1 July 2007 and 31 December 2008. The ACCC's view was that the MTAS service price should be set at 9 cents per minute (Australian), although the WIK model produced a TSLRIC range of 6.1 to 6.6 cents per minute (Australian).⁵ Importantly, the MTAS regulated by the ACCC includes all voice calls terminating on the mobile network, whether they originate from fixed or mobile services (see below).
8. Telstra recognised that the outputs generated by the WIK model were in line with other sources, and that the efficient cost of supplying the MTAS was in the order of 5-6 cpm (Australian).⁶
9. TelstraClear remains of the view that the Commission's recommendation to the Minister to regulate mobile termination through its inclusion into Schedule 1 of the Telecommunications Act would have delivered improved competitive outcomes in the market.

Artificial distinction between mobile-to-mobile and fixed-to-mobile termination

10. TelstraClear remains of the view that the wholesale fixed-to-mobile termination rates agreed with the Minister are likely to be significantly above efficient costs.
11. The current investigation appears to be considering mobile-to-mobile termination, in potential isolation from fixed-to-mobile termination. In a practical sense, TelstraClear does not consider that the services either fall within a separate market, or are materially different in termination cost. TelstraClear therefore believes that the Commission should regulate all voice calls terminating on a mobile network, irrespective of the nature of the service from which they originate.
12. In Australia, the Mobile Termination Access Service (MTAS) was declared as a service under section 152AL of the Trade Practices Act 1974 with effect from 1 July 2004. MTAS is a wholesale input used by providers for both

⁵ see "MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report", ACCC, November 2007, p1.

⁶ Telstra, *Submission in response to the ACCC's Discussion Paper on the WIK Mobile Network and Cost Model to inform the MTAS Pricing Principles Determination 1 July 2007 to 30 June 2009*, March 2007

fixed-to-mobile and mobile-to-mobile voice calls. The ACCC described the service as:

a wholesale input, used by providers of calls from fixed-line and mobile networks, in order to complete calls to mobile subscribers connected to other networks.⁷

13. Consistent with the Commerce Commission's recommendation in the New Zealand context for fixed-to-mobile termination, the access pricing principle of TSLRIC was adopted for MTAS pricing in Australia.
14. In contrast to Australia, fixed-to-mobile and mobile-to-mobile termination in New Zealand is being dealt with separately, with separate proceedings with different timeframes. TelstraClear considers that this raises practical difficulties, particularly if ultimately the Commission were to conclude that mobile-to-mobile termination should be regulated at cost-based prices, while fixed-to-mobile termination rates remained significantly above cost under the commercial agreements between the Minister, Telecom and Vodafone.
15. The separation of fixed-to-mobile and mobile-to-mobile termination also appears to be inconsistent with the Commission's treatment of fixed network interconnection.
16. Termination of calls onto fixed PSTNs is currently regulated under the Telecommunications Act, with two designated services, *Interconnection with Telecom's fixed PSTN* and *Interconnection with fixed PSTN other than Telecom's*.
17. In the Vodafone PSTN determination⁸, the Commission noted that:

"it is not necessary to further define the features of a local voice call beyond the link to a local number. In particular, the interconnection service should not be defined with reference to the characteristics of the proposed Vodafone retail services"...

The Act does not require that Vodafone operate a fixed PSTN in order to gain access to the designated access service for any specific call type.... In particular, the Act neither requires that the Commission determine the characteristics of the access seeker's retail product, nor does it impose requirements of the characteristics of the access seeker's retail product."⁹
18. While the focus of the Vodafone determination centred around the legal scope of the interconnection service under Schedule 1 of the Act and whether the service was a "local" service, the Commission appears to have taken a technologically neutral view of the originating service, in assessing termination charges on to Telecom's PSTN.

⁷ <http://www.austlii.edu.au/au/cases/cth/ACCompT/2006/8.html>

⁸ Commerce Commission, *Final Determination on the application for determination for "Interconnection with Telecom's fixed PSTN"*, 28 September 2006.

⁹ Commerce Commission, *Determination on the TelstraClear Application for Determination for Designated Access Services*, Decision 477, 5 November 2002, Paragraph 50

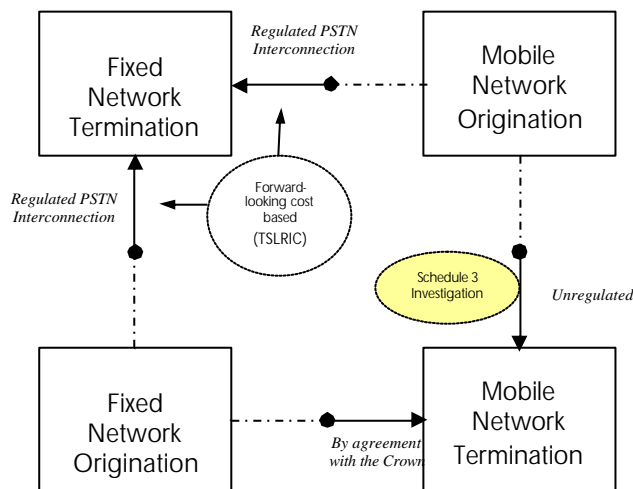
19. Likewise in the TelstraClear PSTN interconnection determination, the Commission also considered whether fixed interconnection applied to mobile, as well as fixed, originating traffic.

...the following elements of fixed-to-mobile and mobile-to-fixed calls fall within the designated service...

- the originating leg of a fixed-to-mobile call on a fixed PSTN (i.e. between the calling party and the local switch or equivalent facility); and
- the terminating leg of mobile-to-fixed call on a fixed PSTN (i.e. between the local switch or equivalent facility and the called party).¹⁰

20. As a result, the current designated services for PSTN interconnection address the termination of traffic on to fixed PSTN networks for both fixed and mobile originated traffic.

21. The following diagram identifies the current regulation of wholesale fixed termination (both mobile and fixed), an agreement with the Crown for wholesale fixed-to-mobile termination only, and the currently unregulated mobile-to-mobile which is subject to the current investigation.



22. The problems of the narrow scope of the agreements accepted in lieu of regulation under Schedule 1 of the Act have become apparent with the proposed Schedule 3 investigation into mobile-to-mobile network origination.

23. TelstraClear is concerned that narrowing the scope of the investigation to the mobile-to-mobile termination risks creating a future price differential between mobile-to-mobile and fixed-to-mobile termination. Such an outcome could occur if, as the result of a Schedule 3 investigation, the

¹⁰ Para 24, Decision 477

Commission were to conclude that mobile-to-mobile termination service should be regulated at a forward-looking cost.

24. In such a scenario, given international benchmarks for mobile termination rates, it is foreseeable that the mobile-to-mobile cost would be lower than the fixed-to-mobile price path agreed in the agreements between the Crown, Telecom and Vodafone.
25. As the Commission identifies, "a telecommunications provider with significant market power ("SMP") in termination services could charge wholesale prices above costs." The Commission then outlines the impact that such market power in the upstream wholesale termination market, and the extent that the charge exceeds cost, that this would be likely to affect the downstream retail market.¹¹
26. The ACCC has acknowledged the competitive benefits that will result from regulating fixed to mobile calls, as well as mobile to mobile calls, as part of its MTAS service. In rejecting undertakings filed by Hutchison Telecommunications (Australia) Limited and Hutchison 3G Australia Pty Ltd in 2005, the ACCC rejected Hutchison's attempt to charge a potentially higher termination charge for fixed-to-mobile than mobile-to-mobile rates. In endorsing a similar approach to regulating mobile-to-mobile calls as fixed-to-mobile calls, the ACCC commented that:

"... the Commission is of the view that a closer association of price and cost will allow equally or more efficient FTM [fixed-to-mobile] providers to place more competitive pressure on integrated providers of FTM services to improve their own efficiency and reduce the FTM prices charged to their own subscribers. Therefore, this approach to pricing is likely to provide a stimulus for increased competition between existing FTM providers and possibly also from new entrants. The Commission notes that this increased competition in the quality and range of product offerings made available by providers of fixed line services."¹²

The ACCC added that:

"the Commission considers that such competitive benefits could be greater the more immediate and complete the price of the MTAS was reduced towards its underlying efficient cost (TSLRIC+) of providing the service – further if the 12cpm rate applied to all calls regardless of the originating network ..."¹³

27. If the Commission sought to deal with only mobile-to-mobile termination, rather than wholesale mobile termination more generally, it is clear that any intervention would not fully mitigate the affect on downstream retail markets as a result of the impact of any SMP found in the wholesale termination market. Similarly, the competitive benefits that would be derived from reduced wholesale termination rates for fixed services would be lost.

¹¹ Commerce Commission, *Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination – Issues Paper*, 8 August 2008, para 35

¹² "Hutchison's Undertakings with respect to the supply of its Mobile Terminating Access Service (MTAS), Final Decision", ACCC, June 2006, at pp30-31.

¹³ *Ibid*, p31.

Commission should extend Schedule 3 investigation to Mobile Termination service

28. TelstraClear recommends that the Commission extend the scope of the proposed Schedule 3 investigation to wholesale mobile termination more generally.
29. Such an approach would ensure that the Commission has satisfied itself that termination of traffic on both fixed and mobile networks is cost-based, and that concerns that the Commission may have around SMP arising from wholesale termination, and its affect on downstream retail markets, is addressed.
30. In TelstraClear's view, the Commission is not constrained from undertaking a wider Schedule 3 investigation of the wholesale mobile termination market, despite the agreements between the Crown, Telecom and Vodafone. Both agreements appear to contemplate ongoing review of mobile termination by the Commission.
31. The Telecom agreement states that:
 - 6.3 The obligations under this deed expire at midnight on 30 June 2012 unless terminated earlier by law or in accordance with clause 6.3 below.
 - 6.4 This Deed will terminate immediately if:
 - 6.4.1 The Telecom Fixed to Mobile Termination Service becomes, or becomes part of, a designated service under the Act.
 - 6.4.2 The Telecom Fixed to Mobile Termination Service is registered as an undertaking in accordance with schedule 3A of the Act.
 - 6.4.3 Either the Telecom Fixed to Mobile Termination Service or Fixed to Mobile Service is included in an undertaking under part 2A of the Act.
 - 6.4.4 Anything is done by or on behalf of the Crown or any regulator that has the same effect as any of the clauses 6.4.1 to 6.4.3.
32. Similarly, in the Vodafone agreement:
 - 2.2 This deed expires at midnight at 31 March 2012 (the **Expiry Date**), unless terminated earlier by law or in accordance with clause 2.3 below.
 - 2.3 This Deed will terminate immediately if the Mobile Termination Service, or a telecommunications service that is substantially the same as the Mobile Termination Service:
 - (a) becomes a designated access service under the Telecommunications Act 2001 and Vodafone is an access provider; or
 - (b) is the subject of an access undertaking submitted to the Commerce Commission by Vodafone and accepted by the Minister of Communications under Schedule 3A of the Telecommunications Act 2001.
33. Both agreements can be terminated at such time as either a new service is specifically designated under Schedule 1 of the Act. Inclusion of a new service under Schedule 1 would occur through a recommendation to the

Minister of Communications, following a Schedule 3 review concluding that the mobile termination service should be regulated under the Act.

34. These agreements were made outside Schedule 3A of the Act that allows access providers to submit an access undertaking.
35. The wording of the agreements specifically contemplate that a Schedule 3 investigation, in respect of fixed-to-mobile termination, could be undertaken during the course of the agreements which are scheduled to expire in 2012.
36. Given the Commission's concerns around the impact of SMP in the wholesale termination market and its impact on downstream retail markets, as well as significant international benchmarking of cost-based mobile termination costs being materially below the agreed price paths, TelstraClear considers that reasonable grounds exist to extend the proposed scope to mobile termination more generally.
37. Consistent with previous Schedule 3 investigations, TelstraClear supports the development of a cost-benefit analysis to assess the net benefit, if any, from the regulation of mobile termination rates (from both fixed and mobile services). As part of that analysis, the counterfactual would include the current fixed-to-mobile termination rates under the agreements with the Crown.
38. By incorporating fixed-to-mobile termination into the Schedule 3 investigation, access providers of fixed-to-mobile termination would also have the opportunity to submit undertakings under Schedule 3A with fixed-to-mobile termination rates that better reflect forward looking costs.
39. If the Commission doesn't widen the scope of the Schedule 3 investigation to mobile termination more generally, then the opportunity to align fixed-to-mobile termination rates to forward-looking cost-based rates, is effectively closed until 2012.

Market Definition

Commission Question 4.1 (a) Is the approach that termination is likely to be a bottleneck appropriate?

40. The Commission notes that:¹⁴

Relevant markets for terminating services are generally defined as *voice call termination on an individual (fixed or mobile) network*. This definition is consistent with that applied in other jurisdictions, particularly those countries in the European Union. Within *mobile termination services* the EU divides markets into the *national wholesale markets for mobile termination services on each mobile network* (the "wholesale mobile termination market"). Currently the European Commission is

¹⁴ Commerce Commission, Telecommunications Act 2001: Schedule 3 Investigation into regulation of Mobile Termination, Issues Paper, 8 August 2008, para. 30

concerned about the relative tariffs between mobile to mobile and fixed-to-mobile termination rates.

41. The market definitions identified from other jurisdictions do not appear to distinguish between mobile termination from either mobile or fixed networks. The approach taken in the EU is consistent with the approach taken by the ACCC as “a wholesale input, used by providers of calls from fixed-line and mobile networks, in order to complete calls to mobile subscribers connected to other networks.”

42. In declaring the MTAS service, the ACCC concluded that:¹⁵

Given the MTAS provided on each individual mobile network is defined to be provided in its own individual product market, it follows that each network operator has a monopoly over the provision of the MTAS on its own network. Therefore, each MNO can heavily influence the prices paid for the supply of termination services on its network, and in doing so has the ability to set termination charges well above the underlying costs of providing the service.

43. In concluding that mobile termination was a bottleneck service, the ACCC also considered whether a distinction should be drawn on the nature of the origination component:¹⁶

... [t]he Commission considers that the supply of termination on mobile networks for calls originating on fixed lines is fundamentally the same as the supply of termination on mobile networks for calls originating on mobiles. Therefore, if the Commission finds the supply of either mobile termination services for fixed-line originating calls or the supply of the mobile termination services for mobile-originating calls is an essential input with potential bottleneck characteristics, then it follows that the supply of the other is also an essential input with potential bottleneck characteristics. To specify a service description for the MTAS which depends on the nature of the line on which a call originates would be to ignore the structure of the market for this service and the nature of its supply

... the Commission finds that all mobile operators – irrespective of their size – have market power when it comes to terminating calls on their network. In turn, the Commission believes this gives mobile operators the ability to raise the price of the MTAS above its underlying cost of production. This conclusion is consistent with that made by regulators in a number of overseas jurisdictions.¹⁷

Commission Question 4.1 (c) What factors can potentially lead to on-/off-net call discounts?

Commission Question 5.1(b) Can the decrease in fixed-to-mobile rates from 2004 to 2008 be explained by a pass-through from lower wholesale termination rates? Are there any other potential explanations for this decrease?

44. At a retail level, mobile services are generally sold as a bundle. This will often include a handset, access and calling services. Likewise in the fixed market, mobile termination is not commonly purchased as a standalone service. The total package price to the consumer reflects the total value of

¹⁵ ACCC, *Mobile Services Review, Mobile Terminating Access Service*, June 2004, p.93

¹⁶ ACCC, *Mobile Services Review, Mobile Terminating Access Service*, June 2004, p.52

¹⁷ ACCC, *Mobile Services Review, Mobile Terminating Access Service*, June 2004, p. 11

the bundle sold. Pricing of individual components with a retail bundle may be designed to attract customers, rather than reflecting the underlying cost of delivering the service component per se. For that reason, differential pricing between termination of calls on or off net may reflect the marketing proposition, rather than simply reflecting the cost of mobile termination as a stand-alone service.

45. A significant issue during the previous deliberations was the retail pass-through of reductions in the wholesale fixed-to-mobile termination rate. In the Commission's reconsideration report, the cost-benefit analysis estimated that mobile termination pass through of 85% would occur.
46. In providing its offer to the Minister in lieu of designation of the fixed-to-mobile termination service, Vodafone argued that "[t]he reality, based on both historical New Zealand data and international experience, is that pass through rates will not increase voluntarily and the Commission's assumption that pass-through will increase to 100% from the current 68% - simply because of regulation - is lacking in credibility." ¹⁸
47. The Issues paper notes that to assess the potential allocative and productive efficiencies, one of the three isolated effects that would need to be taken into account is the price effect on the retail level, which would reflect the wholesale price effect and the level of pass-through.
48. TelstraClear agrees with the Commission that it would need to take into account the extent of pass-through in its consideration of the benefits of mobile termination regulation. However, given the nature of retail mobile bundles, TelstraClear considers that it is inappropriate to focus solely on the extent of pass-through based on retail termination rates.
49. This view is consistent with the ACCC's conclusions on the likely extent of retail pass through of wholesale termination savings. In designating MTAS in Australia, the ACCC identified that: ¹⁹

... the Commission believes it is difficult to accurately measure the extent of FTM pass-through in any given period, as the price of FTM calls can vary for reasons other than changes in the price of the MTAS. In particular, the Commission notes that changes in the price of other inputs, expansions in demand for the services and contract lags can all influence the price a FTM service provider will set for this service. Accordingly, it is difficult to isolate how much of a given change in the price of FTM services is due to changes in the price of the mobile termination service.

50. The ACCC has also recognized the importance of reduced MTAS rates for improving the level of competition more generally for fixed network services, which need not translate directly to reduced retail fixed-to-mobile call rates. For example, in its decision to reject an undertaking by Vodafone which sought to impose an obligation upon fixed-to-mobile operators to reduce

¹⁸ Letter from Vodafone to the Minister of Communications, 20 September (Released under the Official Information Act).

¹⁹ P. 129

[http://www.accc.gov.au/content/item.php?itemId=551419&nodeId=869923e2dc6450fb03830deb9aca5c19&fn=Final%20Report%E2%80%9494mobile%20terminating%20access%20service%20\(Jun%202004\).pdf](http://www.accc.gov.au/content/item.php?itemId=551419&nodeId=869923e2dc6450fb03830deb9aca5c19&fn=Final%20Report%E2%80%9494mobile%20terminating%20access%20service%20(Jun%202004).pdf)

their fixed-to-mobile charges for calls terminating on Vodafone's mobile network, the ACCC commented that:

"Further, the Commission does not believe that the extent of FTM pass-through should be seen as the only measure of the extent to which a lower price for the MTAS promotes competition in the market within which FTM services are provided, or the LTIE [long-term-interests of end-users] more generally. A reduction in the MTAS rate alone might put in place necessary preconditions for improved competition and efficient use of and investment in infrastructure. Putting into place those preconditions can itself be in the LTIE, even if there is no certainty that the necessary preconditions will be taken advantage of.

Secondly, to the extent that such preconditions are taken advantage of, improved competition can manifest itself in many forms other than just price reductions. In particular, improved competition may be associated with improvements in the quality of services provided (which may increase the cost of providing FTM call services). Further, lower input costs may be passed-through in the form of reductions in the price of other services provided in the bundle of pre-selected fixed line services. ..."²⁰

51. The Australian Competition Tribunal took a similar view in rejecting Vodafone's MTAS undertaking on appeal:

"We are also concerned that the Pass Through Safeguard is inflexible in relation to the opportunity for competition to be promoted as a result of any reduction in the price of the VMTAS [Vodafone MTAS]. It limits the opportunity of access seekers to determine the form in which any reductions they may receive in the supply of the VMTAS may be passed through to the retail fixed services market.

We consider that the pass through provisions in the undertaking deprive access seekers of the flexibility to determine competitively the individual price elements for services within the basket of services that are supplied within the fixed-to-mobile market, and the form in which pass through will take place. This approach retards allocative and dynamic efficiency, inhibits competition, is not in the long-term interests of end-users and, in our view, is not reasonable."²¹

52. TelstraClear recommends that the Commission should similarly adopt a broader approach to encouraging increased competition in the market for fixed network services. Attempting to assess that increased level of competition only by focussing on retail stand-alone mobile termination services, which are not purchased independently of a retail bundle, rather than considering the full dynamics of the market (including the ability of providers to improve service levels, or enhance competition through price reductions to other services) will likely substantially understate the competitive benefits achieved.

²⁰ "Assessment of Vodafone's mobile terminating access service (MTAS) Undertaking, Final Decision", ACCC, March 2006, at p80.

²¹ Australian Competition Tribunal: Application by Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1, at pp89-90.

Conclusion

53. TelstraClear remains concerned with the state of the wholesale mobile termination market in New Zealand.
54. TelstraClear recommends that the Schedule 3 investigation into mobile termination should review termination of calls onto mobile networks, irrespective of whether those calls are originated on fixed or mobile networks.
55. This Schedule 3 investigation represents an opportunity to address mobile termination issues that have arisen as a result of an artificial distinction between fixed-to-mobile and mobile-to-mobile wholesale termination.
56. TelstraClear recommends that the Commission should similarly adopt a broader approach to encouraging increased competition in the market for fixed network services. Attempting to assess that increased level of competition only by focussing on retail stand-alone mobile termination services, which are not purchased independently of a retail bundle, rather than considering the full dynamics of the market (including the ability of providers to improve service levels, or enhance competition through price reductions to other services) will likely substantially understate the competitive benefits achieved.