

Memo

To: Commerce Commission
Date: 9 October 2009
From: James Mellsop
Subject: MTAS Conference Numerical Examples

1. Introduction

The Commission has asked the experts advising interested parties to the MTAS Investigation for any written clarification of their views on the “whiteboard example” from the MTAS conference.

I interpret the Commission to be interested in the “whiteboard example” for two reasons:

- As evidence of a possible price squeeze being imposed by Telecom and Vodafone (Commissioner Mazzoleni introduced the whiteboard example, and asked the experts whether it implied “market foreclosure”¹); and
- As evidence of the level of the cost of providing mobile termination.

I briefly comment on each of these points below.

2. Price Squeeze

I have read the transcript of my comments during the conference on the “whiteboard example”, and I do not really have anything to add.² To summarise my comments:

- It is appropriate to undertake price squeeze tests for the purposes of the MTAS Investigation;
- However, to be useful, a price squeeze test needs to include all relevant costs and revenues, and be applied in the appropriately defined market (i.e., not just in a particular segment of that market). It is my understanding that the whiteboard example does not contain all relevant revenues and costs given the market definition. On the Commission’s definition of the relevant market (mobile services), other revenues would include those related to mobile

¹ Page 64, lines 22-26 of the transcript.

² See pages 73 to 75 of the transcript.

connection, handsets, subscription, mobile-to-fixed voice calling, MMS, and data,³ while costs would include origination costs, customer acquisition costs, billing costs, etc. This is analogous to the point I made about the Commission's FTM price squeeze test at page 56, lines 2-3 of the transcript, i.e., that tolls revenue would need to be included as well as FTM revenue;⁴

- A price squeeze test is just a tool, and other evidence should also be considered when analysing whether behaviour is anticompetitive. As I emphasised during the conference, one of those pieces of evidence is the observed entry and expansion by mobile network operators overseas in the face of above cost MTRs and on-net/off-net pricing by incumbents, as documented in the 18 August 2009 NERA report.

3. On-Net Pricing as Indicator of MTR TSLRIC

I understand that the Commission considers that the average on-net calling price, divided by two and then less 18%, provides an indicator of the TSLRIC of mobile (call) termination, or at least an upper bound on the TSLRIC.

This is perhaps true, but it is important to keep in mind the following points.

Firstly, it is actually very difficult to identify the average on-net calling price. As Armstrong and Wright (2007) state:⁵ "It is a complicated, and to some extent arbitrary, task to give precise estimates for the prices of the various types of calls. This is because mobile networks each offer a wide variety of tariffs, with different monthly rentals (where applicable) corresponding to different volumes of inclusive call minutes." To make matters more complicated, I understand that Telecom and Vodafone offer quite different pricing structures.

Secondly, TSLRIC is a regulatory pricing principle, which does not necessarily correspond with commercial pricing principles. For example, TSLRIC is an average cost⁶ concept, whereas real world mobile pricing:

- Is based on forward-looking (non-sunk) costs and demand curves;
- Involves multi-part tariffs; and

³ In addition, revenues from MTM calling and SMS would be considered as part of the same price squeeze test, rather than separately as is implied by the whiteboard example.

⁴ See also the 28 July 2009 NERA report.

⁵ Armstrong, Mark and Julian Wright (2007), "Mobile Call Termination in the UK", MPRA Paper No. 2344, 21 March, Footnote 9.

⁶ In the sense that the estimated long-run incremental costs are divided by expected demand.

- Takes account of the two-sided nature of the mobile platform.

For these reasons, there may be circumstances (e.g., as part of a bundle multi-part tariff) when it is rational for an MNO to set on-net calling prices below TSLRIC, but nevertheless above forward-looking costs. Indeed, forward-looking costs may be particularly low (essentially zero) when demand is low compared to capacity, e.g., at off-peak times.⁷

Also, it may be that existing retail pricing across some bundles is set so as to encourage off-peak use. If existing retail pricing is then used to set a uniform regulated price for all periods, then that regulated price may not be reasonable at peak periods.

For these reasons, I think caution is required in attempting to draw conclusions about costs from the data and quantity data the Commission has.

⁷ Flattening out the load profile may lower the average cost per minute and provide benefits for both the firms and consumers.