

5 September 2008

Dr Ross Patterson
Telecommunications Commissioner
Commerce Commission
PO Box 2351
WELLINGTON

Dear Dr Patterson

**Submission on the Issues Paper on the Telecommunications Act 2001:
Schedule 3 Investigation into Regulation of Mobile Termination**

This submission on the Commerce Commission's August 2008 issues paper considering whether the Commission should launch a Schedule 3 investigation of mobile termination under the Telecommunications Act 2001 is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

The Commerce Commission considers that there are reasonable grounds for commencing an investigation. The issues paper suggests that New Zealand should have four or more mobile operators. It proposes that mobile wholesale maker termination rates could be set at an administratively determined long-run incremental cost. It endorses an overseas median benchmark of 10.76 cents per minute, in contrast to a current domestic rate of 16 cents per minute. It also considers that on-net price "discounts" might represent undue entry barriers.

However, the Commission's concerns about lack of entry ignore actual developments. NZ Communications is investing heavily in mobile, and, since the issues paper was released, communications giant Telstra Clear has announced that it is entering the market to provide "staggeringly cheap" services.

Nor does the issues paper make any case that its median benchmark is an appropriate guide to the New Zealand situation. New Zealand has a very small and widely dispersed population compared to most OECD countries. It also has its own distortive regulatory structure.

Another concern is that the issues paper does not provide any evidence to support its central proposition that any imbalance in net termination payments at the expense of a new entrant would occur to a degree that would be a material entry barrier. It does not even demonstrate that countries with lower termination charges tend to have more new entrants as a result.

The issues paper's argument for pricing at long-run incremental cost is wrong. At paragraph 72 it correctly (if irrelevantly) observes that in the textbook case of perfect competition, prices would equal average cost in a static long-run equilibrium. But in this idealised situation there would be no chance of superior returns, no innovation, no net entry and no price discovery. The paragraph is wrong therefore to immediately infer that "[s]etting prices according to long-run cost will lead to an efficient outcome in terms of incentives for market entry". In fact, no conclusions about optimal prices for New Zealand's dynamic disequilibrium situation can be

drawn from the idealised case. Even, in a regulatory situation, it is not obvious that cost-based pricing for mobile termination would be the best option.

The Commission's static framework neglects the need for incumbents to have an incentive to improve the infrastructure they own. For example, paragraph 86 effectively denies that a reasonable expectation of super-normal returns is necessary to attract investment for incumbents and new entrants alike. Paragraph 73 essentially denies the need for recovery of sunk costs by asserting that prices should be geared to "the costs of an efficient operator employing the latest available technology".

Another troubling analytical problem is that the issues paper appears to confuse an imposed change in prices with a change in real resource costs. (See paragraphs 51 and 85.)

Paragraph 91 combines these errors, of static analysis and confusion about real resource costs, to draw an invalid central conclusion: "[p]otential benefits from regulating termination services can be obtained by comparing termination costs that would be paid by an entrant absent regulation, with the likely termination costs under regulation". The remainder of the paragraph fails to consider offsetting considerations, thereby giving the impression that the Commission considers that anything that transfers income from an incumbent to a new entrant is good for the nation. Such loose reasoning provides an unfortunate signal to investors.

The Commerce Commission needs improve its analytical framework. Competition policy is not about counting the number of competitors in a market, particularly in the case of a small market like New Zealand. It needs to take a more balanced approach that focuses on efficiency rather than entry and explicitly recognises that regulation must provide a positive incentive to invest for incumbents if the backbone infrastructure they own is to be enhanced in the national interest.

Schedule 3 investigations are a distracting, costly and time-consuming matter and we commend the Commission for deciding on this occasion to solicit comments on an issues paper prior to a decision to investigate.

On the above analysis it is clear that the Commission is not in a position where it could reasonably conclude that the benefits from proceeding with a schedule 3 investigation would be likely to exceed the costs. If it wishes to take this issue any further it should, at the very least, do a lot more to establish that there really is an entry problem.

Yours sincerely



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