TELECOM OPENING STATEMENT – COMMERCE COMMISSION PUBLIC CONFERENCE ON MOBILE TERMINATION ACCESS SERVICES – 2 SEPTEMBER 2009

Seven years after the Commission first stated its investigation into this issue, it is still the subject of continual and vigorous debate. This tends to suggest that there is a fair bit of uncertainty associated with it as an issue:

- Uncertainty as to what the competition problem we are grappling with is, or even if there is a competition problem;
- Uncertainty as to what the impact of termination rate regulation will be on fixed and mobile retail prices; and
- Complete uncertainty as to what the efficient cost of termination is, or even whether cost is the appropriate yardstick for termination in a two-sided market.

We have put forward what we consider to be a credible and compelling self-regulatory solution to all of this uncertainty, in the form of our revised Undertaking. It is a genuine attempt to engage the Commission and the industry on a pragmatic and fair solution to a deeply complex and time-consuming issue. It provides a less risky, more managed decline in rates than the proposed regulation, and it provides a much quicker resolution to the uncertainty that I have just spoken of.

The fact that we have spent seven years debating this issue, and the swings in conclusions reached on how best to approach it, should be instructive as to how we think about analysing the same issues today, and that is with due caution.

We don't see that with the Commission's current Draft Report. Instead, we have:

- A cost benefit analysis for one of the four services the Commission proposes to regulate, but not for the other three. In fact overall there is fairly scant analysis of the likely impacts of regulating those other three services full stop, and yet these are the services that are new to this debate;
- A benchmarking analysis that uses hypothetical rates that were not even used by the regulators that calculated them;

- An internally inconsistent application of the waterbed effect – which when corrected makes the CBA scarily sensitive to even small changes in key parameters; and
- Real uncertainty to my mind as to what the purpose of this regulation is.

What are we actually solving for here, other than the one-sided market principle that input prices should reflect costs, and re-distribution of revenue between services providers and between end-user segments? What is it about this regulation – measured against the rates we have put forward in our revised undertaking - that is going to drive real benefits and change for end-users and New Zealand as a whole in the **long-term**?

One theory is that lowering mobile termination rates will allow pure retailers to compete for more customers in the tolls market. In practice though, competition for the customers we are talking about – corporate customers and the like – takes place across a wide range of services and the full commercial relationship. Pushing down on mobile termination rates, which affect only one small component of the bundle of services most of these customers demand nowadays, is simply not going to alter the relative competitive position of retailers in the tolls market.

Likewise, another theory is that lowering mobile termination rates will make it easier for 2 Degrees to expand in the mobile markets. In practice, it is completely unclear whether reducing mobile termination rates will flow through to reduced on-net / off-net differentials (particularly given Telecom's new XT plans, which contain no such differentials), and if so whether this will increase the competition between mobile players. On-net and off-net pricing is a feature of competitive mobile markets around the globe.

I will come back to each of these shortly, but overall, the conclusion I draw from this process to date is that the quantitative and qualitative analysis that has been performed is so sensitive to a large number of assumptions that when it comes down to it you cannot conclude anything other than this is a line call. We don't definitively know the answer to the question of what the efficient termination rate for the long-term benefit of New Zealanders should be.

And perhaps that should not be surprising – as I say, we've been at this for seven years without a clear answer, and around the world there is similarly no clear

consensus as to the appropriate rate to regulate MTRs at, whether they should be based on costs, and if so what measure of cost should be used.

What is surprising though, is the disconnect between the Commission's analysis and its recommendations. On the one hand we have these tentative and uncertain conclusions from the Commission's analysis, which can flip on a single parameter. On the other hand we have the Commission's proposal to implement just about the most extreme form of termination rate regulation you could think of. Even a mandated shift to Bill and Keep hasn't been ruled out.

It is very much mainstream international regulatory precedent to implement a glidepath, and most regulators take a measured and cautious approach to termination rate regulation. I would posit that this is because of the uncertainty associated with this issue, and the potential for interventions of the type proposed by the Commission to distort the market and pricing structure in a harmful way for end-users.

The UK for example remains of the view that efficient termination rates should be about double the Commission's rates. The ACCC is unwilling to risk applying hypothetical modelled costs to real-world, new and expensive mobile networks. Even in France, which has taken one of the more extreme positions on termination rates within Europe, a glidepath has been proposed - because ARCEP believes a direct adjustment of wholesale charges to LRIC levels could undermine the stability of the market.

In New Zealand, the Commission itself acknowledges that a significant reduction in the termination rate will result in higher mobile prices relative to what might otherwise have occurred, and end-users dropping off mobile networks in their tens of thousands. And yet, we are proposing to ignore all of that and go straight to a hypothetical modelled cost.

So it is in the context of all of this uncertainty that we have put our revised Undertaking forward. It is in that context that we have asked the Commission and the industry to consider again how we can ensure that this process gives a commercially pragmatic and negotiated outcome the absolute best chance of success, and it is in that context that we have challenged the rest of the industry to sign up to our undertaking, and to match it.

We think our Undertaking can cut through the delay and unpredictability that traditional regulation will bring with it. It sees New Zealand's termination rate go below the UK at the end of this year, go below Australia at the end of 2011 and sees today's rate cut in half by 2015. It is a pragmatic commercial offer that we think mitigates and manages the shock to the market that a sudden and significant drop in termination rates to hypothetical cost, or bill and keep, levels would create, and the potential harmful side-effects for operators and end-users that would result. We've put it forward in good faith, and we want to engage on it.

Coming back now to the Commission's report, and summarising Telecom's position in as succinct a way as possible, I want to make these few remarks:

- The first is that the Commission's proposed regulation sits uncomfortably toward the extreme end of the spectrum for regulatory interventions in the termination space, and that seems out of step with the fundamental uncertainties underpinning its analysis of these issues. If regulation is to be introduced it needs to be tempered by a more responsible, measured approach than is currently proposed. This means a glidepath to smooth the regulated decline in termination rates, and a move away from a rigid application of hypothetical modelled rates;

- The second, and related point, is that we want to see a benchmark that is more representative of the reality of termination rates internationally and doesn't apply an artificial standard to New Zealand. If the ACCC and ARCEP don't apply their hypothetical modelled results in Australia and in France, why should we apply them in New Zealand? If all of the international evidence suggests that rigid adherence to TSLRIC modelling is not necessarily the most welfare-enhancing or pro-competition regulatory option – and the Analysys Mason piece has a nice little section on this – why did the Commission's benchmarking analysis start with the presumption that it is the **only** regulatory option here?

- And the third and final point, on the process, is this: we want an industry solution to this based on registered undertakings. The concept of registered undertakings was added to the Act for a reason – let's give it a real chance for success.