



TelstraClear Limited

Schedule 3 investigation into
regulation of mobile termination

Cross submission on
Commerce Commission's
Draft Report

12 August 2009

Introduction

1. TelstraClear welcomes the opportunity to comment on the recent submissions made in respect of the Commission's Schedule 3 investigation into regulation of mobile termination.
2. In summary, TelstraClear has the following comments:
 - 2Degrees proposed undertaking addresses a significant number of the non-price concerns around MTAS. However 2Degrees proposes either Bill and Keep or alternatively an MTAS rate below the likely TSLRIC cost. Both options risk distorting the market, as asymmetric traffic flows would drive costs into one terminating network, without compensating for the costs imposed by the other party.
 - Telecom's proposed undertaking represents a significant improvement to its initial undertaking, with a glide path of one year to get to the ACCC's current regulated rate. However, this rate remains significantly above the WIK modelling the ACCC commissioned of the TSLRIC cost to terminate mobile traffic in Australia. Furthermore, the Telecom revised undertaking assumes symmetric termination rates from other mobile providers. The rates proposed in Vodafone's initial undertaking remain materially higher.
 - TelstraClear does not have access to the rates agreed between Vodafone and 2Degrees, and can not therefore comment on its potential impact on the Commission's cost-benefit analysis. However, it is apparent that the rates differ from mobile termination rates available to other telecommunications providers. We note that a benefit of regulated MTAS would be consistent cost-based termination rates that are available to all parties through the Standard Terms, thereby ensuring competition.
 - Concern has been expressed around the risk of creating investment uncertainty between the fixed-to-mobile termination agreements that Telecom and Vodafone have with the Crown, and the Commission's current investigation into MTAS rates. TelstraClear considers that this risk is overstated as the agreements with the Crown expressly provided for future investigation by the Commission. Furthermore, the Commission has clearly demonstrated the net benefit of designation of the wider MTAS service.
3. These issues are discussed in further detail overleaf.
4. This cross-submission is public.

2Degrees Revised Undertaking

5. In its submission, 2Degrees notes that it would be prepared to submit a revised undertaking that:
 - includes termination of FTM and MTM voice calls;
 - is open to all access seekers, including wholesalers and re-sellers of mobile services; and
 - incorporates the standard access principles and limits on the application of the standard access principles set out in Schedule 1 of the Act.
6. 2Degrees' proposed undertaking addresses the key non-price concerns that TelstraClear identified with 2Degree's previous undertaking, including the inclusion of both FTM and MTM traffic and wholesale customers. However, TelstraClear does not consider that 2Degrees proposed termination rates are likely to reflect the costs of termination.
7. 2Degrees notes that it "would also be prepared to offer any alternative (non BAK) undertaking that specifically addressed the concern raised by the Commission that having separate FTM and MTM termination rates creates potential distortions and arbitrage opportunities. By the same logic, and while we maintain that BAK remains the best solution, rates for termination of FTM, MTM and MTF calls should be equivalent."¹
8. 2Degrees proposes:
 - a termination rate for FTM and MTM voice calls of NZD 1 cpm; and
 - a termination rate for SMS of NZD 0.1 cents per SMS.
9. 2Degrees then notes that "[t]he proposed FTM and MTM termination rate is based on the cost of termination on Telecom's fixed PSTN calculated by the Commission in connection with the application by Telecom and TelstraClear for a determination on the price of interconnection between their respective fixed PSTNs set out in the Commission's Draft Determination on the Application for Pricing Review for Designated Interconnection Services dated 11 April 2005."
10. TelstraClear has always maintained, and consistent with international experience, that mobile termination service should reflect the costs to terminate traffic – no more and no less.
11. The appropriate definition of cost continues to be the subject of debate. Consistent with other sections of the Telecommunications Act, the Commission has commonly applied the TSLRIC (Total-Service Long Run Incremental Cost) standard. For the purposes of maintaining consistency with other parts of the Telecommunications Act, and the Commission's analysis in its draft report, we consider that a TSLRIC cost standard should be used.
12. The Commission's international benchmarking analysis shows the MTAS costs calculated in other jurisdictions on forward-looking cost-based rates. The Commission's preliminary view is that the benchmarked countries sufficiently comparable to New Zealand for voice (FTM and MTM) in 2009 are NZ7.2cpm and

¹ 2Degrees – Submission on Commerce Commission Draft Report on MTAS, 28 July 2009, p. 49

NZ0.95 cents per SMS.² The proposed pricing by 2Degrees is therefore significantly below the Commission's benchmarking of MTAS.

13. TelstraClear did not support 2Degrees' initial undertaking which proposed BAK for MTM traffic, on the basis that it is efficient for parties to incur the cost that termination imposes on another network. While symmetric traffic flows between two providers would have effectively netted out any termination cost between those parties, there is a material risk that asymmetric traffic flows drive costs into one terminating network, without compensation for the costs imposed by the other party. This conclusion is consistent with the experience of the French regulator, OFCOM, and the Commission's analysis in its draft report.
14. TelstraClear considers that pricing of MTAS services as proposed by 2Degrees risks creating the same distortionary outcomes as BAK where asymmetry exists, as the costs of terminating traffic would not be borne by the party causing it. The purpose of cost-based MTAS rates is to ensure that all providers can compete on an equitable basis, without market distortion through MTAS rates above or below the correctly determined costs.
15. Given that 2Degrees has proposed an undertaking containing rates significantly below the Commission's own estimate in the draft report of termination costs, we would support 2Degrees making a revised undertaking with proposed MTAS pricing that more closely aligns with the Commission's benchmarked long-run incremental costs.
16. However, given the very recent entry and small market share of 2Degrees, the potential benefit of accepting such an undertaking, in the absence of similar undertakings from both Vodafone and Telecom, would be small. Furthermore, accepting 2Degrees revised proposed undertaking in isolation would entrench asymmetries in MTAS rates between telecommunications providers.

² Commerce Commission, *Draft Report on whether the mobile termination services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination) should become designated or specified services*, 30 June 2009, Executive Summary, para. xxxviii.

Telecom Undertaking

17. Telecom has provided a revised undertaking, noting that the revised undertaking is based on the current regulated MTR set in Australia by the ACCC (A9cpm), and that “with only moderate amendments to the CBA, for example, the significant MTR reductions proposed in our revised Undertaking can be shown to be far preferable to regulation”.³
18. Telecom’s undertaking provides a significant improvement to its initial undertaking, with a glide path of one year to get to the ACCC’s current regulated rate. A condition of the proposed undertaking is reciprocity. Accordingly, to have practical effect, Vodafone would have to provide an undertaking with a similar pricing structure, which it has not done.
19. TelstraClear notes that the ACCC view was that the MTAS service price should be set at 9 cents per minute (Australian), although the WIK model in November 2007 produced a TSLRIC range of 6.1 to 6.6 cents per minute (Australian). More recently, the outputs produced by the WIK model were even lower, ranging from 5.8cpm to 6.1cpm, depending on the assumed market share of the efficient provider.
20. Telstra has 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).
21. The Commission’s preliminary view is that the benchmarked countries sufficiently comparable to New Zealand for voice (FTM and MTM) in 2009 are NZ7.2cpm and NZ0.95 cents per SMS.
22. This suggests that the proposed rates, while significantly improved, remain above efficient long-run costs, and as a result risk continuing to lock in wholesale mobile termination rates above cost, perpetuating the competition issues the Commission has identified in its original decision to investigate mobile termination services.

Vodafone / 2Degrees Interconnection Agreement

23. In its submission, Vodafone advises that it would be comfortable to release public details of the interconnection arrangement between 2Degrees and Vodafone, but Vodafone is prevented from doing so because 2Degrees has denied repeated requests to make the agreement public.
24. Vodafone has offered to extend the arrangement to other parties, and submits that “2Degrees will be better off with this “secret deal” than with regulation”.⁴ Absent 2Degrees’ willingness to consent to make that interconnection agreement public, it isn’t possible for TelstraClear to comment whether, if

³ Telecom, *Schedule 3 Investigation into regulation of mobile termination access service, Submission on Draft Report*, 28 July 2009, para. 5.

⁴ Vodafone, Vodafone New Zealand Limited Submission to the Commerce Commission, Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination Access Services, 28 July 2009, para. 39.

extended to other parties, it would materially reduce the current net benefit of MTAS regulation in the Commission's draft report.

25. As Vodafone states, "[t]his deal was put together with the encouragement" from the then Minister of Communications and with the full knowledge of the Commission".⁵
26. Given the identified benefits of long-run cost-based MTAS pricing, a recommendation to regulate MTAS would ensure a Standard Terms Determination that provides clear and transparent cost-based pricing to all parties. Such side arrangements risk further distorting competition, by providing differential pricing between providers, whether mobile, fixed or both, not on the basis of cost but instead on political tradeoffs. Cost-based MTAS pricing, available to all telecommunications providers would deliver significant additional benefit over the status quo, and prevent further competitive distortion in a transparent equitable manner.

Regulatory Certainty

27. As Business New Zealand note, "Business New Zealand fully endorses the independence of the Commission to investigate areas which it believes produce significant market inefficiencies, as the freedom to do so is a cornerstone of its existence".⁶
28. Business New Zealand then go on to discuss their concern around the formal commencement of an investigation into MTAS 19 months after a commercial solution for five years was agreed between Telecom and Vodafone, together with the Government.
29. While TelstraClear agrees the principle that certainty is required, we consider that the concerns raised by Business New Zealand in respect of mobile termination are overstated. The Commission's investigation relates to the wider MTAS service (including FTM, MTM and SMS) while the current agreements relate to fixed-to-mobile termination only. As the Commission's draft report identifies, there is a significant difference between the factual (continuation of the agreements between Telecom and Vodafone) and the counterfactual (regulation under the Telecommunications Act).
30. Both parties' agreements with the Crown expressly contemplate ongoing review of mobile termination rates by the Commission. 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.

⁵ Ibid, para. 38.

⁶ Business New Zealand, *Submission for BusinessNZ to the Commerce Commission on Mobile Termination Access Services*, 28 July 2009, para 3.11

- 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.

31. 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.

32. 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.