

PUBLIC VERSION

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Dear Shane

SUBMISSION ON DRAFT RECONSIDERATION REPORT

We support the Commission's draft recommendation that mobile termination access services (**MTAS**) should be made a designated service under the Telecommunications Act (**Act**) and welcome this opportunity to comment on the Commission's Draft Reconsideration Report (**Reconsideration Report**).

The Reconsideration Report makes it clear that assumptions about future retail market conduct are an unsound basis for departing from international best practice of cost-based regulation of wholesale prices. We agree with those conclusions.

Setting termination rates "at cost" is a necessary, but not sufficient, condition to ensuring New Zealand consumers benefit from full competition. The most efficient cost methodology must be adopted, and recent international developments indicate this is likely to be LRIC or BAK. It is important the Commission future proofs the proposed regulatory change by including LRIC as a potential Final Pricing Principle (**FPP**). Ex-post competition rules also remain entirely inadequate to prevent discriminatory pricing. While incumbents remain free to charge 15 times more for calls and 40 times more for SMS to other mobile networks significant distortions will remain in the market.

We set out our specific comments below.

The proposed regulatory change must include LRIC

The Commission has asked that submissions focus on the proposed regulatory change set out in the Reconsideration Report.

Our view that bill and keep (**BAK**) would best serve the long term interests of consumers in New Zealand remains unchanged. The Commission has acknowledged that BAK provides a "valuable form of compensation" and does not mean "zero" pricing and, even if it was concluded that BAK was below cost, it is important to remember that no evidence of harm from regulating MTRs below cost has been provided.¹

Consumers in BAK countries enjoy some of the lowest prices, highest usage and most innovative and dynamic telecommunications markets in the world. BAK provides the lowest risk and least intrusive option. It is future proof and avoids the protracted process of rent seeking incumbent on LRIC based models. It is pro-deregulation and will deliver benefits of competition quickly where speed is critically important given recent retail pricing behaviours. That said, we acknowledge the Commission favours TSLRIC as the default Final Pricing Principle (**FPP**) under the proposed regulatory change.

We are concerned that the Commission's preference of TSLRIC ignores the clear international trend towards lower marginal cost based rates. As previously submitted, 27 European National Regulatory Authorities have learnt from bitter experience that TSLRIC prices have failed to deliver the benefits of full competition and are currently undertaking further protracted regulatory inquiries and moving to LRIC pricing. By 2012 at least 80% of OECD countries will regulate MTRs to either zero or marginal cost.²

¹ See Commerce Commission, *Final Determination on the application for determination for 'Interconnection with Telecom's fixed PSTN'*, 28 September 2006, (the *Homezone* decision), paras 113-120 and Commerce Commission Final MTAS Report, 22 February 2010, para 474.

² See for example 2degrees, *Submissions to the Minister*, 8 March 2010, paras 2.17-2.22 and 4.1-4.9.

In recent weeks Ofcom has reiterated its plans to adopt pure LRIC, noting that while finely balanced, the evidence favours pure LRIC and that in general lower MTRs (and pure LRIC in particular):

- “ - are more reflective of network cost structures
- lessen incentives to differentiate between on/off-net calls
- are likely to increase output (calls per person) as call charges decline ”³

Given recent and widespread reconsideration of whether TSLRIC, LRIC or BAK pricing best addresses the harm caused by above cost MTRs it is important the Commission does not rule out any particular pricing methodology at this stage. We recommend that LRIC be included in the proposed regulatory change as an alternative FPP in the event the Commission considers (consistent with developments in Europe) that TSLRIC or BAK pricing do not best give effect to the purpose set out in section 18 of the Act.

We **attach** a revised marked-up form of regulatory change for consideration by the Commission.⁴

The harm of closed-net pricing is greater than the Reconsideration Report contemplates

The Commission is correct to focus in the Reconsideration Report on the harm of closed-net pricing and the considerable community (network) benefits available to incumbents.

The Commission has referred to Covec’s evidence on this point and we note that Vodafone itself acknowledged the potential impact of blanket on-net tariffs at the MTAS conference, Mr Feasey commenting:

*“But even more, or at least as significant as that, those customers who have on-net tariffs are not getting on-net access to the entire customer base of Vodafone, particularly in the case of voice pricing **It would be a different argument if there were widespread use of on-net tariffs where the on-net community extended to the entire customer base of the large operators, but that is not the position, not the facts that we see in New Zealand today.**”⁵ [emphasis added]*

The harm of closed-net pricing is far greater than identified in the Reconsideration Report, which assumed that "matching" incumbent on-net pricing would provide a full competitive constraint. In fact, the Phoenix Research survey results recently submitted to the Commission demonstrated that simply matching blanket on-net tariffs with equivalent any-net rates, or even offering further discounted any-net rates, is not compelling to consumers in the presence of large networks employing closed-net pricing and charging excessive fees for off-net calling. Consumers have a reasonable expectation to both make and receive calls.⁶

Retail non-discrimination rules remain a necessity

While we commend the Commission for seeking to address the significant barriers to entry and expansion which exist in New Zealand, cost-based termination will not of itself address current market distortions.

As critically noted by Commissioner Patterson in the Reconsideration report:

*“Whilst recent retail plans offered into the market since the release of the Final Report confirm my view that regulation is appropriate, I also note that, unless they breach the Commerce Act, vigorously competitive retail offerings must be strongly encouraged. The role of the regulator under the Telecommunications Act is designed to ensure that the correct settings are made in the wholesale markets, which allow competition to flourish in the retail market for the long term benefit of end users. Where wholesale prices are **reflective of cost and barriers to efficient entry and expansion are addressed**, there can be no benefit in the regulator prescribing the details of retail plans. ...”⁷ [emphasis added]*

³ Ofcom Stakeholder Workshop, 5 May 2010. Ofcom papers available at <http://www.ofcom.org.uk/consult/condocs/wmctr/smaller-MNOs.pdf>.

⁴ The definition of LRIC used in the revised proposed regulatory change follows the form of the TSLRIC definition in the Act, amended to exclude allocation of common costs.

⁵ MTAS Conference Transcript, Day 2, p225.

⁶ Phoenix Research, Survey Results, May 2010, <http://www.comcom.govt.nz/assets/Telecommunications/Scope-of-Regulation/MTAS/Phoenix-Research-Calling-Plans-Survey-May-2010.PDF>. The results found that prepay mobile users were willing to pay at least 25% more to be on the same network as most of their family and friends.

⁷ Reconsideration Report, para 34.

Wholesale regulation may allow new entrants to offer plans that have comparable outbound calling utility to Vodafone's Talk Add-on or similar products. However, if incumbent operators are able to penalise their own customers with excessive off-net retail prices that choke off cross-network calls and SMS, new entrants will remain severely limited in their ability to compete as their customers suffer from severely restricted inbound call utility. This was recognised by Vodafone as a barrier to entry when it sought BAK with retail price restrictions in the 2006 *Homezone* determination.

While overseas regulators have powers to expediently address anti-competitive conduct, there are significant difficulties and delays associated with enforcing competition law in New Zealand.⁸ The Commission will be well aware the *0867* case has been ongoing for more than 10 years and remains unresolved. The Commission should require retail non-discrimination because the Commerce Act does not adequately address barriers to efficient entry and expansion. There can be no doubt that discriminatory pricing is a significant barrier to entry in its own right.

The Commission was previously willing to prevent discriminatory pricing following submissions by Vodafone that the mere possibility of discrimination would "*hobble*" its Homezone service. We ask for no more here.

Time is of the essence

We welcome the Commission proposal to now recommend international best practice of regulation.

All parties are aware that the process to date has been protracted, and in our view at times subject to regulatory gaming and unnecessary delay. Each day of further delay benefits incumbents, denies consumers the benefits of full competition and materially impacts a new entrant's ability to compete for more than marginal customers.

We urge the Commission to now bring this matter to a speedy resolution.

Yours sincerely



Bill McCabe

Chief Operating Officer

Two Degrees Mobile Limited

⁸ 2degrees, Submission on Draft Report, 28 July 2009, paras 7.1-7.28. Ministerial Inquiry into Telecommunications, 27 September 2000, p21.

2degrees proposal for the form of regulatory change:

Mobile termination access services (MTAS)	
Description of service:	<p>Termination (and its associated functions) on a cellular mobile telephone network of:</p> <ul style="list-style-type: none"> • voice calls originating on a fixed telephone network; • voice calls originating on another cellular mobile telephone network; and • short-message-service (SMS) originating on another cellular mobile telephone network. <p>For the avoidance of doubt, this service includes the termination of internationally-originated voice calls and SMS, and voice-over-internet protocol-originated voice calls, where these are handed over at a mobile switching centre in New Zealand.</p>
Conditions:	Nil
Access provider:	A person who operates a cellular mobile telephone network
Access seeker:	A service provider who seeks access to the service
Access principles:	The standard access principles set out in clause 5
Limits on access principles:	The limits set out in clause 6
Initial pricing principle:	<p>Benchmarking against the costs of providing similar services in comparable countries that result from the application of –</p> <p>(a) a forward-looking cost-based methodology; or</p> <p>(b) if the Commission considers that a forward-looking cost-based methodology does not best give effect to the purpose set out in section 18, whichever of the following methods that the Commission considers best gives effect to that purpose:</p> <p>(i) a pure bill and keep method; or</p> <p>(ii) a pure bill and keep method applied to two-way traffic in balance (or to a specified margin of out-of-balance traffic) and a forward-looking cost-based methodology applied to out-of-balance traffic (or traffic beyond a specified out-of-balance margin).</p>
Final pricing principle:	<p>(a) TSLRIC; or</p> <p>(b) if the Commission considers that TSLRIC does not best give effect to the purpose set out in section 18, whichever of the following methods that the Commission considers best gives effect to that purpose:</p> <p>(i) <u>LRIC, being the forward-looking costs over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, the service, taking into account the service provider's provision of other telecommunications services; but excluding any allocation of forward-looking common costs; or</u></p> <p>(ii) a pure bill and keep method; or</p> <p>(iii) a pure bill and keep method applied to two-way traffic in balance (or to a specified margin of out-of-balance traffic) and a forward-looking cost-based methodology applied to out-of-balance traffic (or traffic beyond a specified out-of-balance margin).</p>
Requirement referred to in section 45 for final pricing principle:	Nil