



**Submission on the Commerce
Commission's Draft Reconsideration
Report on Mobile Termination and Access
Services**

19 May 2010

Introduction and executive summary

- 1 Telecom is disappointed by the turn of events that led to the reconsideration of the recommendation to accept undertakings as the most appropriate resolution of the Mobile Termination Access Services (**MTAS**) investigation.
- 2 From Telecom's perspective, a complete commercial package that could resolve competition concerns in relation to mobile to mobile calling (**M2M**), fixed to mobile calling (**F2M**) and texts or short message service (**SMS**), has been jeopardised. The industry as a whole is now faced with a real possibility of having to continue the regulatory process through to a regulated outcome.
- 3 At this stage it is timely to reflect on what the journey to regulation will actually involve in practical terms. More specifically, a regulated outcome would require the Commerce Commission (**Commission**) and industry to develop regulated services that multiple Access Providers will each likely be required to offer to multiple Access Seekers. We believe that the task of attempting to define a standard terms determination (**STD**) for interconnection that is workable for three different network operators and the Access Seekers will be a real challenge.
- 4 It seems unlikely to us that regulating mobile termination rates (**MTRs**) will remove the ability of network operators to engage in either competitive or anticompetitive on-net pricing. It also seems unlikely that regulation of MTRs will result in lower retail prices for consumers than the undertakings solution. Therefore we do not see the value in taking on the cost, uncertainty and complexity to arrive at a regulated outcome.
- 5 In contrast, the undertakings could be used in subtle way to address the Commission's concerns with on-net pricing. Network operators stand to lose anything that they might gain through the acceptance of the undertakings if they engage in contentious conduct. Parties are now clear from the reconsideration process, if they were not before, that the Commission can always recommend regulation to replace the undertakings, if the undertakings do not deliver.
- 6 The fact that Vodafone has offered to withdraw its contentious "Talk Add-On" in order to put the undertakings back on foot is evidence that the undertakings can work effectively in this regard. If the Commission abandons the undertakings and recommends regulation, the leverage is lost, particularly as the jurisdiction of the Commission is limited to regulation at the wholesale level.
- 7 The key points that Telecom wishes to raise on the Draft Reconsideration Report in support of our proposition that the undertakings remain the best solution are summarised below:

- (a) Under regulation on-net pricing, whether for competitive or anticompetitive reasons, will still be possible if MTR rates are reduced to cost, or even below cost. We note, for example, on net pricing in US markets where MTRs are effectively \$nil supports this proposition, as does the implication of the research by Phoenix that 2 Degrees has submitted as part of the reconsideration process.
- (b) In contrast the potential threat of replacing the undertakings with regulation is a lever available to the Commission to ensure appropriate conduct. The undertakings are thus a better means of achieving the Commission's ends than regulation.
- (c) The undertakings still constitute a pragmatic and appropriate resolution of the MTAS investigation in line with international benchmarks that have significant benefits over regulated outcome, including in terms of timeframes, cost and certainty. In particular, the work necessary to arrive at a single, workable STD for interconnection that multiple parties are required to offer needs to be carefully thought through. (We also note from other submissions that a regulated outcome may not necessarily mean lower prices for consumers than the undertakings driven outcome.) This point should not be lost sight of as a consequence of one contentious offer to market that is before the Commission (assuming no parties to the MTAS investigation have indicated an intention to release any similar offers).
- (d) With the focus of the MTAS investigation on possible anticompetitive use of on-net pricing in retail mass markets, it is also worth not losing sight of the fact that on-net pricing is not an anticompetitive practice per se and in many instances it is an appropriate and competitive practice.
- (e) Telecom does not have visibility of the costs underlying the Vodafone "Talk Add-On" which precipitated the reconsideration and the Commission's view that MTRs should be regulated. However, we do not believe that the Commission's assumptions around customer utilisation of the minutes are necessarily correct. Therefore the impact of the plan may be overstated by the Draft Reconsideration Report.
- (f) We note that the service description of the Draft Reconsideration Report now expressly captures a number of additional services that were not fully canvassed throughout the MTAS investigation. One of these is the category of internationally originated SMS, which we do not believe should be regulated. There is no competition issue that needs to be addressed in relation to internationally originated SMS. To regulate this service could drive cost and inefficiency into Access Providers' existing international SMS hubbing agreements and potentially give international mobile network operators an

unfair advantage in that they may not necessarily offer reciprocal terms for New Zealand originated SMS that we send to them.

On-net pricing would be possible under regulation

- 8 The use of on/off net price differentiation in such a way as to raise barriers to consumers switching in the retail mobile mass market has emerged as being the key concern that the Commission wishes to address in its resolution of the MTAS investigation. The Commission's theory is that regulating MTRs will address this concern.
- 9 However, on-net pricing is still present in competitive markets with very low MTRs. In US markets, for example, network operators offer significant differentials between calling on net and off net despite the fact that termination tends to be offered on a bill and keep (**BAK**) basis (i.e. \$nil). Accordingly regulating MTRs down to cost (assuming cost can accurately be ascertained – which we think is a problem in itself) would not necessarily remove on-net pricing. Regulation of MTRs would also not impact on whether that on-net pricing was being used for competitive or anticompetitive purposes.
- 10 Telecom's view now seems to be supported by the Phoenix research attached to 2 Degree's letter dated 3 May 2010. What that research appears to show is that a player with a critical mass of customers can structure its pricing so as to keep customers from switching to a competitor, even if the competitor is offering both lower on and off net pricing than the party with the critical mass. If the Phoenix research is correct, then simply reducing MTR rates will likely not remove the ability of network operators to use on net and off net price differentiation to erect barriers to switching. (We note that in the example employed by Phoenix the barrier allegedly caused was not so much by an on-net price that could not be replicated by a competitor, but by a high off-net price that "punished" customers for switching. Taking that example, lowering MTRs would not deal with the issue of a very high relative off-net price.) Accordingly, we believe that the value of regulating MTRs as a solution to a perceived problem with on/off-net price differentiation would be low.
- 11 The appropriate tool for dealing with any anti-competitive on net pricing differentials is the Commerce Act.

Undertakings have the potential to generate good market outcomes

- 12 for as long as the undertakings remain in force, the Commission has leverage over network operators in terms of being able to recommend regulation if mobile network operators engage in contentious on/off-net price differentiation in the retail mass market.

- 13 We believe that the reason why the undertakings were not effective to date (in terms of deterring Vodafone from making a contentious offer to market) is simply because Vodafone did not fully appreciate what was at stake previously. This is evidenced by the surprise in the Vodafone letter dated 28 April 2009 that the "Talk Add-On" should have triggered a reconsideration.
- 14 Once the situation became clear, Vodafone immediately signaled it would withdraw its "Talk Add-On" and correct its retail pricing in accordance with any concerns the Commission had in order to put the undertakings back on foot (see 28 April letter). This demonstrates that the threat of regulation has the power to constrain the pricing behavior by network operators.
- 15 Contrary to the Commission's view that Vodafone withdrawing its "Talk Add-On" would not preclude them (or us) from putting out some other contentious on/off net price differentiation offer in the retail mass market over the life of the undertakings, we think that it is now clear that if any network operator engages in such conduct the Commission may respond by recommending the regulation of MTRs.
- 16 This leverage will last for the full course of the undertakings and beyond. Accordingly, the undertakings in fact serve as a more effective constraint on on-net/off-net price differentiation than regulation of MTR rates.
- 17 Recommending that the Minister accept the undertakings would also not preclude the Commission from being able to:
- (a) Separately investigate any mass market retail plan in terms of Commerce Act compliance if that was considered necessary; and
 - (b) Develop Commerce Act guidelines to provide even greater clarity around the kinds of on-net pricing offer that the Commission would closely scrutinise for Commerce Act compliance.

Undertakings provides further benefits over regulation

- 18 Although the focus of the reconsideration is on how any new retail offerings impact on the adequacy of the undertakings, it is important not to lose sight of where the industry will be left if the Commission recommends regulation.
- 19 If the undertakings were to be accepted there would be immediate certainty for future MTRs, the new price path would be put into effect as of October 2010 and no further work would be required in terms of developing contractual mechanisms and aligning reciprocal terms and conditions between network operators.

- 20 In contrast, there is substantial complexity, cost and risk involved in the regulatory process. Most significant is the time and effort required to arrive at a final set of standard terms.
- 21 There are a vast number of minor technical differences between the Telecom and Vodafone undertakings. These differences do not need to be aligned if the undertakings are both accepted, since neither document takes precedence over the other.
- 22 With the undertakings, we anticipate that the key terms (principally price) would be included in our existing interconnect agreements and it would be unlikely that anyone actually signed up to the undertakings documents themselves. Therefore, if there are mechanisms or aspects of the documents that are not perfect in their execution, this does not matter as any minor technical or commercial differences between interconnect parties will already feature in their interconnection agreements.
- 23 In contrast to the undertakings, to implement an STD it would be necessary to define a single comprehensive set of documents (because it actually would be used) and it would need to be workable for all parties required to offer the regulated services.
- 24 In this context it is worth noting that interconnect agreements are among the most complex of all telecommunications contracts. In the past where the Commission has regulated terms for interconnection it has effectively allowed the parties to negotiate the standard terms themselves (e.g. when it was just TelstraClear and Telecom, they were able to negotiate the detailed terms between themselves and the Commission endorsed the final document). However, because of the multi Access Provider and Access Seeker dimension at play in this case, the situation here will be very different. The Commission will be required to fully engage in the commercial drafting itself.
- 25 Given the number of differences between Telecom and Vodafone mechanisms and processes, this alignment to a single comprehensive set of documents would be a major piece of work. Further, the documents would need to be workable for 2 Degrees as well. Inevitably a process or mechanism that would work for one provider, may not work for another. Change management of the document would also be difficult because an operational change may suit one Access Provider and its Access Seekers but not another.
- 26 To make the task even more complex, the Commission's service description in the Draft Reconsideration Report includes a number of fringe services including internationally originated SMS. Currently Telecom's undertakings have no processes, procedures, mechanisms or safeguards to cover this service. Again it would be a

significant piece of work to develop and include something that is workable for all parties in a final STD.

- 27 Overall, we believe that the Commission and 2 Degrees may not have fully appreciated how hard it will be to arrive at a standard workable regulated set of interconnect terms and conditions that multiple parties are required to offer.
- 28 This could be avoided if the undertakings are accepted and parties adopt the pragmatic solution of incorporating the key terms from those undertakings into their interconnection agreements.
- 29 We also believe that the journey to an STD would involve a significant degree of uncertainty as to what the final price path will be. In this regard we note that:
- (a) Within the Commission's final report that went to the Minister on 22 February 2010 there was a wide range of possible price outcomes, that turn on where New Zealand prices should sit within the upper and lower bounds of a regulated outcome and whether a glide path should apply (the parties will have divergent views on this); and
 - (b) There is also likely to be a challenge to the Commission's analysis of the parameters of a regulated outcome. In this regard we note the concerns we raised in relation to the Commission's analysis of the regulatory range as set out in our submission to the Minister on the Commission's 22 February 2010 recommendation.
- 30 Ultimately regulation will not lead to a better outcome, in terms of constraining on/off net price differentiation, than acceptance of the undertakings. Therefore the benefits of regulation do not justify the additional time, cost and uncertainty of pursuing a regulated outcome.
- 31 To add to the point above, we have noted statements in both submissions and in the media¹ during the reconsideration process that regulation won't necessarily deliver lower prices to consumers. This again raises a question as to the value of going through the cost and uncertainty of the STD process.
- 32 Further, we do not believe that 2 Degrees is in such a vulnerable position in the market that the Commission should disregard the undertakings as the means of ensuring the appropriate conduct in the first instance because:

¹ See for example *Regulating rates 'no guarantee of cheaper calls'* (New Zealand Herald – 13 May 2010) by Kelly Gregor

- (a) 2 Degrees is currently sheltered by its special interconnect agreement with Vodafone;
- (b) 2 Degrees has effectively entered the New Zealand market and it seems to be rapidly gaining customers (206,000 according to the Draft Reconsideration Report); and
- (c) An immediate correction of retail pricing by Vodafone (if that is a possibility) would likely provide 2 Degrees with more immediate relief than a recommendation to regulate that could take a year or so to implement.

Upcoming retail plans

- 33 We have no visibility of any upcoming retail plans by Vodafone or 2 Degrees. However, it seems to us that the Commission's view that MTAS should now be regulated has not been driven by anything that either of those parties has in the pipeline.
- 34 The focus appears to be on the implications of Vodafone's "Talk Add-On" plan and more importantly whether that one move undermines the Commission's general assumptions in relation to the incentives created by the undertakings. If we have misunderstood the situation we request the opportunity to gain some insight into those upcoming offers and to comment.

Vodafone's "Talk Add-On" Plan

- 35 We do not have visibility of the cost inputs into Vodafone's "Talk Add-On" plan that would determine ultimately whether that particular plan would be replicable by 2 Degrees, a hypothetical new entrant, or ourselves. We also do not know whether it would raise or lower average on net rates (a potential trigger for reopening the undertakings to further scrutiny). Therefore we are at a significant disadvantage in the reconsideration process.
- 36 Despite our position, we believe that the Commission's view of the extent of on-net discounting that the plan entails may be overstated. The key issue is the likely utilisation of the 200 minutes by customers.
- 37 The Commission has assumed that utilisation will be at a high level (90% in the first instance and 70% in the second) because there is no marginal cost for consumers making additional calls up to the limit of the calling.
- 38 While the Commission's proposition has a theoretical logic, it is inconsistent with our observation of customer behavior. In our view, prepay consumers generally have significantly less calling than 200 minutes per month on average. Based on our

understanding of consumer behavior, consumers may well increase their calling to some extent if they are given extra minutes for the same price but they would rarely exponentially change their calling habits simply because additional calls do not have a monetary cost (especially over the short term).

- 39 There are many goods and services that are commonly sold which demonstrate that a consumer will not necessarily consume everything offered if there is no additional cost. For example:
- (a) Local calling in New Zealand on fixed lines is free – yet consumers do not spend all of their time making local calls because they are free;
 - (b) Consumers with broadband plans generally do not consume all of the data that comes with their plan each month; and
 - (c) In a restaurant customers won't necessarily eat everything on their plate simply because there is no extra charge if they do – they will eat what they want and leave what they don't want – the same principle will be true of the "Talk Add-On".
- 40 Accordingly the Commission should be cautious when assuming what future utilisation may be, if the assumption is not evidence based. Ideally any analysis of the plan should be based on empirical evidence.
- 41 At the same time, it would be worth testing assumptions around the split of M2M versus mobile to landline calling.

Internationally originated SMS

- 43 In the Draft Reconsideration Report the Commission has decided to include a number of non-core services into its service description of services covered by MTAS such as VOIP and internationally originated SMS. We included VOIP based calls to mobile in our undertaking because it was something Access Seekers valued and doing so did not cause any undue operational, technical or commercial issues. The same is not true of internationally originated SMS and this service was not canvassed in any detail over the course of the MTAS investigation.
- 44 Telecom set out in its submission to the Minister on 9 March 2010 our position that internationally originated SMS was better dealt with outside the undertakings. For

the same reasons, we are strongly of the view that it is not appropriate to include this class of SMS within the scope of the MTAS being considered for regulation.

- 45 The primary reason for this is the nature of the arrangements for international SMS which are distinctly different to domestic SMS and any other service that is being considered under the MTAS investigation.
- 46 Telecom uses SMS hubbing providers to avoid the huge cost and resource required to set up agreements and interconnection to each of over 640 overseas operators. The SMS hubbing providers deal with the complexities that arise from mobile number portability, the differing technology platforms for mobile networks exchanging SMS (CDMA and W-CDMA), and the sheer number of operators involved. The SMS hubbing providers need to pass on the termination charges that they are charged by the terminating carrier, although in practice they average these out into groups or zones.
- 47 The nature of bilateral international SMS agreements is reciprocal and so is dependent on the other carrier agreeing to offer the same terms. In the hubbing scenario we have no control over the termination charges at the distant end, and have no individual agreements with the operators.
- 48 We have referred in earlier submissions to the issue of SMS spam, which is an international problem. To date, this has not been a significant problem in New Zealand, which is largely credited to the existence of a termination charge that dissuades network operators from allowing significantly out of balance SMS traffic. Therefore the pricing mechanism which is appropriate for domestic SMS may not be appropriate for overseas SMS.
- 49 For the reasons set out above we do not believe the arrangements for domestic SMS interconnection should be regulated to apply to internationally originated SMS. If the Commission decides that the competition benefits to regulation of internationally originated SMS are compelling, it must take precautions to ensure that Access Providers are not unfairly disadvantaged by having to give offshore network operators regulated terms for SMS termination but not receiving reciprocal terms from those network operators for outbound SMS from New Zealand. Such precautions would include a requirement that any foreign mobile network operator who wants to become an Access Seeker for the purposes of SMS termination:
 - (a) Hand over of SMS traffic in New Zealand in the same manner as a domestic Access Seeker does, and
 - (b) Offers Telecom and other Access Providers a reciprocal SMS termination service on the same terms including pricing.

