



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

26 May 2010

Introduction and executive summary

- 1 Telecom believes that the case for accepting the undertakings as an alternative to regulation has become compelling in light of Vodafone's recent decision to withdraw its "Talk Add-On" plan.
- 2 Given that the reconsideration process is limited in its scope to assessing the materiality of new retail plans released since 22 February 2010 and plans which may be released before June 2010 on the original recommendation, there is now no case for altering the original recommendation and for not putting the undertakings back on foot.
- 3 In addition to Vodafone's decision to withdraw its plan, points raised in submissions also support the case for returning to the original recommendation.

Implications of Vodafone withdrawing its "Talk Add-On"

- 4 Vodafone's voluntary decision to withdraw the "Talk Add-On" has three implications:
 - (a) The specific plan that was perceived as prima facie impacting on the status quo ability of 2 Degrees to compete in the prepay market, and which prompted the reconsideration process, has been neutralised. Thus the need for any further regulatory response to counter that specific plan (if there ever was such a need) has fallen away.
 - (b) In terms of the wider context, the decision proves that the threat of replacing the undertakings with MTR regulation works for disciplining retail conduct by network operators. As noted in our previous submission, we believe that this leverage will remain in place for the duration of the undertakings. In contrast, if MTRs had already been regulated there would have been no obvious reason why Vodafone would have withdrawn its plan (unless the Commerce Commission (**Commission**) or a third party was prepared to challenge the plan under the Commerce Act 1986). Therefore the assumptions that led to the majority decision of the Commissioners, that the undertakings were adequate for the purposes of constraining future pricing conduct, are fundamentally still valid.
 - (c) The reconsideration process has vindicated the Commission in that its actions have forced Vodafone to alter its retail pricing conduct in order to address Commission concerns.

- 5 When the implications of Vodafone's decision are compared against the narrow scope of the reconsideration, there seems to be no reason not to put the original recommendation back on foot:
- (a) Vodafone withdrawing the "Talk Add-On" has addressed any impact of new plans released since 22 February 2010 and also confirmed that the underlying assumption of Commissioners as to the adequacy of the undertakings was correct; and
 - (b) We have no visibility of plans due to be released before the Final Reconsideration Report but note that the Commission has not raised any concerns in relation to these.
- 6 While the replicability of the "Talk Add-On" is now moot, we agree with Vodafone's general proposition that when a plan is assessed for replicability by a new entrant or efficient rival etc the Commission should take into account all revenue streams associated with the plan, such as off net calls and other services that a customer of the plan is reasonably likely to use.
- 7 Finally we note that the Commission was not willing to grant Vodafone an extension for Covec to undertake further analysis of the "Talk Add-On". We note that part of the reason for this is that the plan has now been withdrawn. Our view of that decision is that:
- (a) If the underlying implications of the "Talk Add-On" have become irrelevant to the Commission's decision on whether to regulate, then we support the Commission's decision as being practical and efficient; however
 - (b) If the Commission makes a decision on whether to recommend regulation based on its view of the underlying implications of the plan, then Vodafone should be given a proper opportunity to comment on those underlying implications.

Response to key points raised in submissions and why acceptance of undertakings remains the better option

Regulated MTRs will not remove on-net/off-net pricing differentials

- 8 2 Degrees' submission essentially accepts that regulation of MTRs would not remove the ability of network operators from being able to use on/off net price differentiation as a means of raising switching barriers. As noted in our previous submission, the perceived problem arises more as a result of an established network operator keeping its off-net price high relative to its on-net price to "punish" customers if they switch provider. The barrier is not caused by a network operator pricing its on-net price so low that a new entrant cannot replicate that offer. Reducing MTRs even to well below cost would not resolve the problem of large relative differentials between

on and off net prices in retail mass markets (although it would introduce market distortions). This supports our view that the value of MTR regulation as a means of addressing concerns with on net pricing is low.

Regulated MTRs will not necessarily lead to lower retail prices for consumers

- 9 Many of the parties who are advocating for regulation (such as those referred to in the Drop The Rate Mate poll) are doing so in the expectation that regulation will lower mobile retail prices for consumers. Given that there is in reality no indication that regulation will directly or indirectly deliver lower mobile prices to consumers than the undertakings, this support for regulation is misplaced.
- 10 (To be clear we wish to emphasise the context of our submission that there is no evidence that regulation will lead to lower retail prices. This submission is made in the context of the likely retail outcomes following acceptance of the undertakings versus the likely retail outcomes generated under a regulated outcome.)
- 11 In this regard we note that the way in which the Drop The Rate Mate Poll has described the decision on whether to regulate MTAS rather than accepting undertakings incorrectly gives the impression that regulation will lead to lower retail prices.
- 12 The poll states:

Termination Rate Recommendation

The main point of this poll is to get your opinion on a major decision the government has to make shortly. The issue is the amount mobile phone companies charge when you call or text someone on a different network. Currently, the companies charge twice as much as it costs to connect a call.

The Government has two choices: Option 1 is to accept binding promises by Telecom and Vodafone to voluntarily reduce these charges over a number of years.

Option 2 is to force them to lower the costs more quickly using regulations.

Do you think the Government should (1) accept Telecom and Vodafone's binding promises to make the prices lower or

(2) introduce regulations to force them to more quickly make the prices lower?

- 13 The key flaws in this description are as follows:
 - (a) Neither the undertakings, nor regulation are about directly lowering retail prices. Indeed one of our objections to continuing the regulatory process is the fact that there is no evidence that a regulated outcome will result in lower prices for consumers than the undertakings driven outcome.
 - (b) Once undertakings have been accepted, the parties who offered the undertakings are bound to reduce prices – there is nothing voluntary about those reductions.

- (c) A point that is also open to interpretation is the assertion that a regulated outcome would result in quicker reductions than an undertakings driven outcome. While a regulated price path may ultimately be lower than an undertakings driven price path, a significant initial reduction in MTR rate would occur more quickly under the undertakings outcome. (In terms of what the people who answered the poll are interested in, it is unclear how, if at all, further reductions in MTRs beyond the initial reduction would translate into lower retail prices.)
- 14 We also note that the questions preceding the poll's description of MTAS issues all focus on what people think about the retail prices that they pay. This significantly compounds the expectation created by the poll that MTAS is concerned with retail pricing, rather than wholesale pricing. Indeed there is no mention of the fact that MTAS is about wholesale pricing between carriers at all.
- 15 Overall, the Drop The Rate Mate poll leads people to believe that the issue before the Commission is whether to lower retail prices for consumers by regulation or to trust Telecom and Vodafone to do it voluntarily. Thus the results of the poll are of little, if any, value as the question asked is based on an incorrect account of the issues at play.
- 16 It may have been more helpful had the survey explained that the issue was about regulating the prices that carriers charge each other and presented customers with an example of the kind of pre-pay pricing that prevails in countries which have much lower MTRs. Such a survey could have assessed the customer preference between pre-pay pricing in those countries and what is currently available in New Zealand. For example, AT&T's Pay as You Go Simple plan charges 25 cents (USD) per minute for both **incoming** and outgoing calls on a minute+minute basis and has a 30-day balance expiry. Verizon Wireless' Prepaid Basic plan has essentially the same terms. The reason for charges for receipt of calls and short balance expiry is that with very low or zero termination rates it is uneconomic for mobile networks to support casual usage pre-paid customers.
- 17 In this regard the Drop The Rate Mate campaign may not have fully represented to all of its members the true implications of lower MTRs.
- 18 We also note that some of the poll's supporters include NZUSA and Unite for example whose members are predominantly pre-paid customers.
- 19 While it is difficult to predict exactly how MTR regulation would impact on retail prices, one thing that is clear is that the relative value of a customer who receives more calls than he or she makes diminishes against the value of customers who make lots of calls (many students fall within this category, as do low income customers).

- 20 As a consequence, these kinds of customers could even be worse off under a low termination rate model. In contrast, high call volume customers such as business users would become relatively speaking more valuable. We may see the change in the relative value of customers flow into the offers that are put to market.
- 21 Thus a logical market consequence of lower MTR rates (at least below those set out in the undertakings) is not so much a net reduction in retail prices as a shift in benefits from one category of user to another. As noted previously we do not regard a mere transfer in benefit from one consumer group to another to be an economic benefit of regulation.

The undertakings will lead to a faster resolution

- 22 There is an across the board desire to see a swift resolution to MTAS – acceptance of the undertakings is by far the swiftest means of arriving at a speedy and certain resolution.
- 23 The uncertainty that has been hanging over industry over the past six years during the MTAS investigation has been an ongoing drag on the market – continuing the regulatory process would needlessly extend this uncertainty.
- 24 Apart from Telecom, no party seems to have fully turned its mind to the work and complexity required to arrive at a regulated outcome relative to an undertakings driven outcome. In our mind that work, together with the ongoing constraint that would be imposed upon network operators if they were required to deliver a service in accordance with regulated specifications and mechanisms, rather than being able to adapt processes with business and customer needs, is a core part of the cost benefit analysis, which needs to be weighed in the mix.

Regulation should only be imposed where there is a clear overall benefit

- 25 The fundamental philosophical concept underpinning the Business Round Table submission is correct. Regulation is a form of intrusion that destroys value for those who are regulated and limits the ability of businesses to adapt services and systems either to their own requirements or to those of the customer. Therefore regulation should only be imposed where it can be demonstrated with a reasonable degree of certainty that there is a clear overall benefit to be gained through regulation. In this case regulation would come at a cost for businesses but it is by no means clear that it would provide a better solution to concerns in relation to on/off net pricing than the undertakings and it is also by no means clear that it would result in lower prices for consumers.

Proposed changes to pricing principles

Initial Pricing Principle

- 26 We note Vodafone's submission to the effect that the Commission has altered the initial pricing principle (**IPP**) from benchmarking against prices in other jurisdictions to benchmarking against costs in comparable jurisdictions.
- 27 We refer to our 8 March 2010 submission to the effect that it was inappropriate for the Commission to depart from the prices actually used in other jurisdictions and instead rely upon the theoretical prices or "costs" identified in those jurisdictions.
- 28 In our view, the IPP is intended to serve as a quick proxy for the Final Pricing Principle (**FPP**). The correct IPP to select is therefore the methodology that serves as the best proxy for the FPP. This in turn requires the Commission to think about issues that might arise when seeking to generate a view of cost by applying the FPP.
- 29 In terms of applying the FPP we note that it remains extremely difficult to calculate what the cost of a mobile call is. When you look around the world it is clear that the cost estimates calculated by regulators (using in theory the same methodology) vary significantly¹. Accordingly many regulators build extra headroom within their cost estimates because it is not clear what cost is. Thus even if market outcomes could be improved via regulation, the exercise of getting the regulatory settings right will be fraught with difficulty and could damage incentives to invest.
- 30 Assuming that the same issues arise in New Zealand that have arisen in the rest of the world, we believe that the uncertainty as to what cost is likely to feed into the application of an FPP here. This therefore should be captured by the IPP benchmarking if possible. Because the other jurisdictions have chosen to depart from their theoretical prices owing to a lack of confidence in terms of whether the theoretical costs reflect costs that are achievable in reality, we consider benchmarking against actual pricing to be a better proxy for an appropriate price generated using TSLRIC methodology than the theoretical costs.

Final Pricing Principle

- 31 We note 2 Degrees' proposal that the Commission should include LRIC as a FPP. It would create too much uncertainty for further FPPs to be inserted into the Act if MTRs are regulated. Further, there is nothing within the recent retail offers that could justify a change to the regulatory pricing principles that the Commission was previously considering.

¹ The WIK report provided to the Commission suggests that there should be no more than a 30% difference between the highest and the lowest modelled costs. Yet the Commission's benchmarked range has a 155% difference.