



Commerce Commission Schedule 3 Investigation into Regulation of Mobile Termination Services

Submission from Telecommunications Users Association of NZ Inc (TUANZ)
5 February 2009

Introduction

TUANZ makes this submission in response to the Commission's invitation to comment on the submission of draft undertakings by Telecom, Vodafone and NZ Communications.

We understand that the Telecommunications Act requires the Commission to consider, during an investigation, any undertakings that are proposed as an alternative to regulation, and to give submitters an opportunity to amend draft undertakings before deciding whether to accept or reject an undertaking.

In this case, it is apparent that the draft undertakings are incompatible with each other to a degree that could only be resolved by a complete withdrawal and resubmission of a radically different undertaking by NZ Communications, or radically revised undertakings by both Telecom and Vodafone.

In our view, the Commission could not accept NZ Communications proposal for a zero MTAS termination rate, ie. Bill and Keep (BAK) system, without rejecting the draft undertakings of both Telecom and Vodafone, since the implications of BAK affect the whole commercial structure of cellular mobile services.

TUANZ notes that the global regulatory environment for termination services is currently in a state of unprecedented flux. Regulators in Europe and in Asia are in the process of delivering significant rulings that may restructure the market for termination services, by regulating significantly reduced termination rates or by restructuring the payment obligations of operators and end users. The possible move to a BAK system is under serious discussion and gaining strong support particularly among competitive MNOs and pro-competition business organisations. The UK Regulator, Ofcom, has initiated a wide-ranging inquiry into mobile termination issues that will not be concluded until late 2009.

In Australia, a draft ACCC recommendation to fix mobile termination rates at A\$9cents per minute for the next three years has met with condemnation from all but the few MNOs who will profit from it. The Competitive Carriers Coalition and the Australian Telecommunication Users Group have both opposed it. If confirmed by the ACCC, it is likely to be challenged in the Australian Competition Tribunal.

In Europe, the EC regulator will within weeks deliver a recommendation proposing very significant cuts in mobile termination rates on a steep glide path, and some European national regulators (eg in France and in Cyprus) have already introduced rates far below those proposed in the draft undertakings of Telecom and Vodafone.

Some of these significant international benchmark factors may become clear during the life of this investigation, but none are clarified yet. The Commission therefore does not have a reliable set of international benchmarks or best practice examples for reference in consideration of the New Zealand case.

Proposed Termination Rates

Nonetheless, even at this early stage of the investigation it is clear that, even if the global termination services market were completely stable, the offers in the draft undertakings of Telecom and of Vodafone fall far short of an acceptable response to the Commission's objective to foster the competitive delivery of telecommunication services in New Zealand.

The most credible cost-modeling that has been done (by the WIK consultancy) separately for Australian and for European regulators has proposed efficient costs of no more than 6-8cents per minute for mobile termination. That rate includes, in our view, very generous allowances for common costs and for return on investment, and is explicitly based on the cost structures for 2G cellular networks. 3G mobile network infrastructure is acknowledged to be far more cost-efficient than 2G or fixed line infrastructure, and to have very rapid investment payback in any developed market, so real forward-looking cost structures will certainly be less than those allowed in the WIK model.

Other consultants submit that the real marginal cost of call termination is already close to zero. If the internal costing of on-net termination can justify the extremely low or zero pricing of on-net calls offered by MNOs, then additional marginal cost for off-net termination seems to consist mainly of billing and accounting charges plus discriminatory price margins that can be imposed in a monopoly environment of termination to a unique network device.

MNOs have argued that "customer acquisition" costs are a legitimate part of the cost base on termination services. TUANZ disputes that margins of profit on termination services can be justified when they are used to cross-subsidise the churning of customers through handset subsidies and discriminatory practices such as on-net/off-net retail price differentials and bundling with fixed voice or data services.

Incumbent operators must not be allowed to use voluntary undertakings to lock in several years of profit margins that are way over directly related marginal cost.

Telecom's assertion that its proposed rates are "within the range" of European reported termination rates is not impressive when the document quoted (from Cullen International consultants) shows that the only European countries with higher rates than New Zealand are those that are least competitive and not a worthy benchmark for New Zealand.

Pass-through

TUANZ believes that the only effective guarantee of pass-through is robust competition. Both Telecom and Vodafone quote the ACCC draft report noting that New Zealand's current model of voluntary undertakings may have produced better pass-through of price reductions to consumers than was achieved in Australia by a price determination. While the quote is accurate, the ACCC in the same report indicates clearly that the reason pass-through did not occur was that it was not regulated, and that there was opportunity for Telstra, in particular, to protect its profit margins by significantly raising, during 2008, fixed to mobile termination rates that had not been subject to any price regulation. This act of transfer pricing between product lines more than negated modest regulated declines in mobile-to-mobile termination rates. "Calls to Mobile" termination charges now typically comprise more than 50% of fixed-line retail service charges to Australian users.

Regulated pass-through requirements may still be necessary to establish benchmarks in the New Zealand context, but as has been shown in Australia the true pass-through to end users can be reduced or negated by network operators raising charges for non-competitive services. Integrated and multi-service carriers also have many opportunities to rebalance revenues by offering service "bundles" that target the markets of those carriers (particularly newer entrants with smaller market shares) who do not have the multi-service bundling opportunity. They may thus constitute a form of anti-competitive predatory pricing.

Bill and Keep proposal

TUANZ is attracted to many aspects of the BAK system of zero termination rates proposed in the draft undertaking from NZ Communications Ltd. In principle, BAK offers many efficiencies by eliminating costly billing and accounting regimes, as well as reducing the need for monitoring and modeling processes to determine cost-based rates for regulation or for evaluation of proposed rates in voluntary undertakings. BAK reduces the incentive for MNOs to construct exaggerated cost models. For that reason BAK could be a particularly attractive solution in a small country like New Zealand, where regulatory costs per capita are relatively high, market mechanisms are relatively transparent, and legal and regulatory systems are sound.

BAK was a major topic of discussion at the December 2008 conference of the European Competitive Carriers Association (ECTA), in which the International Telecommunication Users Group INTUG, of which TUANZ is an active member, played a prominent role. The conference was also attended by the Commission and by TUANZ's sister organization ATUG. Presentations suggested that while BAK reduces costs to all carriers and to regulators, the greatest benefits of a BAK system are felt by newer market entrants with smaller market shares, who therefore have the highest proportion of off-net calls to on-net calls. Incumbent MNOs with larger market shares lose the leverage to apply discriminatory retail pricing through on-net call subsidies. Most of the evidence so far suggests that Bill and Keep termination arrangements are pro-competitive, provided that they are backed up by a sufficient level of genuine competitive presence (including regulatory safeguards if necessary) to ensure pass-through to end users of the considerable administrative savings.

We recommend that the Commission not accept any long-term undertakings from any carrier until the option of Bill and Keep termination has been thoroughly examined with reference to international benchmarks and experience.

Non-Price Conditions

TUANZ is disturbed that the draft undertakings from Telecom and Vodafone both include a range of fairly arbitrary conditions under which the carrier may suspend termination of calls from another carrier.

We find this infringes the fundamental any-to-any connectivity principle of the public switched telephone network, subject only to unavoidable technical failure. Any undertaking that gives a carrier the right to suspend call termination services on inter-carrier commercial grounds alone must be rejected. For legitimate protection against telephone or SMS spam (for example from automated calling equipment), carriers could suspend outgoing payments to the source network of nuisance calls pending dispute resolution, but they should never arrogate the right to suspend all incoming calls including those from innocent end users. In a BAK environment where outgoing payments would not be relevant, a registered industry code of practice would be the appropriate safeguard.

TUANZ also finds it unacceptable and anti-competitive that both Telecom and Vodafone have claimed the right to suspend all termination if another carrier seeks to terminate messages that promote the originating carrier's services. This is an outrageous claim which infringes on the right of communication enshrined in International Telecommunications Regulations of the ITU, following the earliest telegraph treaties establishing global network interconnection. Termination may not be refused because of the content of the call or the message. Promotional calls and messages should be controlled in the interest of the end user by relevant national laws and codes of practice, not unilaterally to protect the commercial interest of a network operator.

Complexity

TUANZ is concerned that end users would be disadvantaged by the complexity of a multi-undertaking regime that could threaten the fundamental terms of any-to-any connectivity, and in which each bilateral arrangement between carriers could carry different caveats and conditions potentially reducing the amenity of the end user without the end user's knowledge.

The three draft undertakings each provide extensive ranges of definitions, terms and conditions that are different in ways that an end user could not be expected to know or understand.

When an end user is offered a service as a subscriber, the user must be informed, in simple and plain language, that the network operator guarantees delivery of every call or message initiated by the subscriber, subject only to matters strictly beyond the control of the network operator.

TUANZ suspects that the differences in market positions and strategic options between New Zealand's three MNOs make it very unlikely that three compatible voluntary undertakings could emerge from this investigation. The variations would

complicate the considerations for any additional operators proposing to enter the market for fixed line or internet-based services that would need to offer subscribers termination to cellular mobile subscribers for voice, SMS or data. In fact, the Telecom and Vodafone draft undertakings specifically exclude internet-based service providers from the terms of the undertaking.

Conclusion and Recommendations

TUANZ trusts that by the time the Commission is preparing its draft report, more direction will be evident in international regulatory practice, to inform the Commission in recommending a path conducive to competitive telecommunication service development in New Zealand. Any premature acceptance of medium-term undertakings would be unsafe, let alone any five-year undertaking.

In the absence of acceptable cost-based and competitive undertakings, we recommend:

- 1. The Commission facilitate industry-wide study of the benefits, costs and commercial implications of transition to a zero-rate termination system for voice and data mobile termination access services in New Zealand, drawing on international experience and research.*
- 2. The Commission make a determination that MTAS is a designated service under Schedule 3 of the Telecommunications Act, with a pricing principle providing a steep glide path to zero termination rates.*

This would establish a transition timetable to BAK while allowing reasonable time for the adjustment in carrier relationships (and perhaps in retail packaging) that may be required.

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