Submission

By

Business NZ

To

The Commerce Commission

On

Regulation of Mobile Termination Fees

23 December 2005

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1. INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to provide comments on the final report of the Commerce Commission (the Commission) concerning the investigation into regulation of mobile termination. Although Business New Zealand prefers minimal government intervention in the economy, we recognise that in some cases generic competition law might not be sufficient to provide for free and fair competition and to protect and enhance the interests of consumers. While Business New Zealand considers that the Commission has done extensive work in the area of mobile termination, we do not believe a government-led regulatory option in this instance is the best choice. Instead, we support the commercial offers that have been proposed by the major players in New Zealand's mobile market.

2. SUMMARY OF RECOMMENDATIONS

2.1 Overall, Business New Zealand makes the following recommendations:

a) The Commerce Commission deems Telecom's T3G network to be classed as 3G;

b) The Government accepts the commercial proposals by Telecom and Vodafone regarding mobile termination rates, providing the offer by Vodafone is similar to that of Telecom; and

c) The Commission should look to self-regulation as the primary option in any industry investigation when the risk if market failure has been clearly identified.

3. BACKGROUND

3.1 We agree with the Minister of Communications that the Commission has completed a thorough analysis involving an investigation into the regulation of mobile termination. In addition, we also take the same view as the Minister that reconsideration of the final recommendations in the report is strongly warranted, particularly in light of the commercial offers made by Telecom and Vodafone, as well as ambiguity regarding what was or was not considered 2G and 3G technologies.

3.2 The final report covers many complex issues in great detail, which the Government have requested views on. However, Business New Zealand would like to take the opportunity to comment on the three key reasons the Minister has asked for a reconsideration of the final recommendations, namely:

1. Definitional and implementation issues concerning 2G and 3G;

2. The commercial offers made by the major players in New Zealand's mobile market; and
3. How best to ensure end-users benefit from reductions in wholesale termination rates.

3.3 To assist in our submission, Business New Zealand commissioned a report by the economic consultancy agency Infometrics that investigated what would be the best outcome for business in New Zealand of the current scenarios on offer[1]. The Infometrics report focused on various areas of the overall investigation, including the general validity of the Commission's findings and the recommended actions ensuant to those findings. Also, it considered the offers by Telecom and Vodafone with respect to mobile termination rates (MTR) if they might be better than regulation. The findings of the report provide much of the basis for comments in this submission.

4. DEFINITION ISSUES REGARDING OF 2G AND 3G NETWORKS

4.1 Before we look into the issue of regulation, we would question how the Commission has decided to class 2G and 3G networks, as this was part of the key issue for the Commission in determining whether to regulate voice calls on 3G networks. The final report concluded that 3G calls should not be regulated, however 2G calls should. While Business New Zealand is not in a position to discuss the finer details of inclusion/exclusion of the networks, we disagree with the Commission's decision that Vodafone's upcoming 3G network should be excluded from government-led regulation, yet Telecom's current T3G network should be regulated, based on the grounds that it is not 3G.

4.2 We understand that the Telecommunications Act 2001 defines 3G mobile based on the official standards by the International Telecommunications Union (ITU). Since the Government is a signatory to the ITU and has ratified the 3G definitions, we believe that Telecom's network does meet the ITU standard, and therefore should be classed as 3G.

4.3 The current recommendations by the Commission for government-led regulation would see Vodafone's 3G network unregulated, while Telecom's would be. In our view, this would result in unequal regulatory.

4.4 We believe it is unlikely that regulation of 2G MTR will have a direct effect on investment in 3G. However, there is still a concern that the signaling effect from what is essentially piecemeal regulation of the industry could undermine investment and innovation more generally, as companies become concerned that any action on their part could subsequently be met with regulatory intervention.

Recommendation: That the Commerce Commission deems Telecom's T3G network to be classed as 3G.

[1] The Regulation of Mobile Termination Fees: report to Business New Zealand, Infometrics, December 2005.

5. LEVEL OF PROFITS BY THE CURRENT PLAYERS

5.1 The Commission's report found that the price for mobile termination services exceeded marginal cost. In turn, the Infometrics report also agreed there was a convincing argument that excess profits (i.e. supernormal profits) are being earned on MTRs with respect to fixed to mobile connections.

5.2 Therefore, the key issue becomes what should now be done given the results of the investigation into MTR. Developments during the investigation of MTR by the Commission and subsequent offers by the major players have lead to three possible outcomes:

1. The status quo where MTRs exceed marginal costs;
2. Regulated lower MTRs with probably higher prices elsewhere (the 'waterbed' effect); or
3. A possible middle scenario where as far as can be ascertained, the two major telecommunications companies would voluntarily reduce MTRs according to a fixed schedule.

5.3 Regarding the first possible outcome, Business New Zealand does not believe that it is fundamentally in the best interests of telecommunications development and consumer welfare that the current situation of large and persistent supernormal profits are attained by Telecom and Vodafone. Normally when firms are enjoying supernormal profits in an industry, there is an opportunity for other producers to enter the industry to try to acquire some of the profit for themselves. However, at present the ability for new entrants to enter the market is limited given the large capital requirements for entering.

5.4 The second scenario involves the recommendation in the Commission's final report that government-led regulation is warranted. However, if it is to be supported this form of intervention has to deliver a better welfare outcome than the market, and the difference has to exceed the cost of the intervention.

5.5 The primary risk of government-led regulation proposed by the Commission is that in the affected area prices will be pushed down, but that this will cause prices in other telecommunications areas to rise as suppliers look for other options to recover costs, commonly referred to as the 'waterbed effect'. In an ever-changing industry, it can sometimes be difficult to predict exactly where the waterbed effect might occur, which poses further complications if the Commission decides on further regulation to reduce the effect. Telecom noted in their submission that the estimated cost of owning a mobile phone would increase by approximately 3%.

5.6 Given the first two scenarios of either status quo or government-led regulation seem unlikely to be suitable; the commercial proposals by Telecom and Vodafone need to be seriously examined and considered.

6. COMMERCIAL PROPOSALS BY CURRENT MARKET PLAYERS

6.1 The Commission has recommended that the 2G costs be set at 15 cents per minute, which was estimated by international benchmarking. 3G would not be regulated and stay at approximately 26 cents per minute.

6.2 Table 1 shows a summary of the commercial offer that Telecom has proposed to the Commission in response to the Commission's final report. Telecom have also indicated that they would pass through 100% of reductions in mobile termination rates to fixed to mobile callers for both 2G and 3G if their commercial offer is accepted rather than regulation. This compares with the historic pass through of 65%, which the Commission has based its analysis on.

Table 1: Telecom's Commercial Offer

Time Period	Blended rate (2G + 3G)
Sept 2005	24.0 cpm
April 2006	22.5
April 2007	20.0
April 2008	19.0
April 2009	18.0

6.3 The other major player in New Zealand's mobile market, Vodafone, have also submitted an offer to reduce termination rates, starting April 2006 and continuing on an annual update through to 2009. However, the actual values for the blended rates have been kept confidential, although one would suspect they would be close to what Telecom has offered[2].

6.4 The Commercial offers by Telecom and Vodafone are a good example of the type of proactive form of self-regulation appearing in the market to counter an increase in government-led regulation. We believe the Minister has taken the correct steps in requesting that the Commission seriously take into consideration these commercial offers. Business New Zealand would also strongly welcome any review of the commercial offers by Telecom and Vodafone that led to a more competitive offer by the major players. This could involve either a decrease in the blended rates over the specified years or shortening the time period in which the lowest blended rate would be introduced.

6.5 Business New Zealand takes the view that government-led regulation should only occur when there is strong justification, due to a clear case of significant market failure. A "bottom-up" approach is essential when considering the correct regulatory path, which begins with light-handed self-regulated approaches, and only moves up the scale if unquestionably warranted.

6.6 Therefore, we believe that there is a theoretical and practical issue involved. On the theoretical side, should the Commission fundamentally favour self-regulation over imposed regulation? Our answer would be yes. On the

[2] For the purposes of this submission, Business New Zealand will assume that the offer by Vodafone is similar to that of Telecom.

practical side, will self-regulation bring about a higher level of consumer welfare than government-led regulation? To answer this question we need to understand the effects on business.

7. IMPACTS ON BUSINESSES IN NEW ZEALAND

7.1 A key issue relating to what is the best outcome is the effect on business from the different options available. An outcome that leads to greater consumer welfare will benefit businesses that continue to make up an increasing proportion of the mobile market in New Zealand.

7.2 To ascertain a comprehensive picture of what effect on the level of business activity would come about with the different solutions regarding MTR would obviously involve a large-scale analysis of the business sector. This was well beyond the scope of what was requested for the Infometrics report we referred to earlier. Indeed, due to confidentiality issues, even obtaining data on mobile service use by company cannot be attained. However, one can consider some possible outcomes from the recommendations outlined.

7.3 Given Business New Zealand represents members from all industries and business sizes in New Zealand, the recommended solutions also need to be judged by these factors. For small users of telecommunications services, either the regulatory or telecommunications companies' offers may deliver more of a benefit compared to the counterfactual, as larger users have probably been able to negotiate discount deals in the past. However, with a regulated outcome the telecommunications companies would probably increase subscription prices and do so where demand elasticity would be the lowest, as losing a few small customers would be better than losing larger ones. However, the Infometrics report doubted that there would be any significant differential impact by size of business; irrespective of which regime was introduced. Therefore, the impact on a small business regarding a government-led regulatory approach would not be markedly different than for a large business. The same outcome would also apply for the self-regulatory approach.

7.4 There are also timing issues to take into consideration. Telecom's self regulated proposal, if implemented, would start immediately. At this stage Vodafone has indicated that it's plan would begin in April 2006. In comparison, the Commission's regulated approach would start sometime in 2007. Also, providing Vodafone's proposal is very similar to that of Telecom's, a price drop to 18 cents by 2009 would be a better average price for customers than the 15 cents per minute for 2G and 26 cents per minute for unregulated 3G calls under the Commission's proposal.

7.5 The fundamental point to take into account between the two approaches for change is that the commercial offers would be far less likely to involve any waterbed effects that would lead to price rises elsewhere. Therefore, in our view the level of risk of not transferring rents from producers to consumers associated with government-led regulation is higher than that of self-regulation.

Recommendation: That the Government accept the commercial proposals by Telecom and Vodafone regarding mobile termination rates, providing the offer by Vodafone is similar to that of Telecom.

8. WIDER ISSUES REGARDING TELECOMMUNICATIONS IN NEW ZEALAND

8.1 It is important to note that the issue of MTR should not be treated in isolation from the bigger picture of the telecommunications industry and the current path of regulation in New Zealand.

8.2 While we accept that it is the role of the Commission to take an ongoing and active role in accessing the provision of telecommunication services, repeated investigations in various areas such as MTR may highlight questions with some overall regulatory issues in the current regime for the telecommunications sector. For instance, Business New Zealand has long advocated a review of the 'kiwi share' as one of the Telecommunications Service Obligations (TSO). When Telecom was privatised in 1990 the kiwi share was established to ensure universal service to residential users, and restrain increases in telephone line rentals. At that time, the Internet was hardly a factor, and the decision taken on the kiwi share issue has resulted in current local calls for standard dial-up Internet connections remaining free of charge. Given the relative differences in cost between dial-up and broadband connections within New Zealand, dial-up access looks the more attractive alternative if cost is the only issue that customers consider. In addition, the kiwi share may inhibit further entry into the market, as the existing provider cannot increase their charges, which would otherwise provide competitors with a viable opportunity to enter.

8.3 As discussed above, the Infometrics report highlighted the fact the reason mobile termination services may exceed marginal cost is that it offsets other regulatory costs imposed on the industry, notably TSOs. While we do not expect issues such as the kiwi share and other TSO issues to be easily solved, they ought to be kept under active consideration if they are persistently having negative flows-on effects in other areas of the telecommunications sector.

8.4 We also believe the commercial offers by the major players sends a strong signal to Government that government-led regulation should not be the primary tool in which to correct any perceived failure in the market, whether it is in the telecommunications industry or otherwise. Business New Zealand has always advocated that any market failure needs to be clearly incontrovertible if corrective options are tabled. Once established, a self-regulatory mechanism should be the primary option sought, rather than the occasional heavy-handed approach by government-led regulation given that a cooperative approach by business that is more likely to maximise the country's economic welfare.

Recommendation: That the Commission should look to self-regulation as the primary option in any industry investigation when the risk of market failure has been clearly identified.

9. CONCLUSION

9.1 Overall, Business New Zealand believes that the Minister of Communications has made the correct decision in asking for a re-evaluation of the recommendations outlined in the Commission's final report. We would agree any government led regulation that was introduced on grounds that were theoretically questionable and did not take into account offers of self-regulation by the major players in the market should be questioned. Simply put, highly uncertain benefits, insufficient analysis of differential effects on companies most affected, and the potential to introduce further regulation which may stifle future investment does not instil any degree of confidence that government-led regulation would be what businesses wants to resolve this issue.

9.2 We believe that the approach of accepting the commercial offers by both Telecom and Vodafone (providing the offers are similar) will not only provide a better outcome for businesses in New Zealand, but will also send a positive signal that if regulation is warranted, self-regulation should always be the favourable starting point.

10. APPENDIX

10.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 60-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

10.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

10.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.