Questions and answers – mobile termination rates

Why did the Commission decide to regulate mobile termination rates?
There are a number of features of New Zealand's telecommunications markets which indicate a lack of effective competition. These features include a high concentration of market share, regional variances in market share, high rates of people switching networks, high retail prices compared to other OECD countries (particularly for prepay customers), and low mobile call volumes compared to other countries.

New Zealand is one of the last OECD countries to introduce regulated mobile termination rates. Prior to today, the prevailing mobile termination rates in the New Zealand market were approximately 15 cents per minute for call termination on Telecom's network, approximately 17 cents per minute for call termination on Vodafone's network and 9.5 cents per text for text messages on each network.

During the Commission's previous investigation into whether the MTAS should be regulated, Telecom and Vodafone offered undertakings that would have reduced the wholesale price for calls to 12 cents from 1 October 2010, 10 cents from 1 January 2011, with further reductions to 6 cents from 1 January 2014.

The Commission recommended these undertakings be rejected as they would not have addressed the Commission's concerns about competition in the mobile market. Specifically the Commission was concerned that small operators would not be able to compete with plans offering flat-rate retail on-net plans, while incurring the mobile termination rates in the undertakings.

Under what legislation has the Commission conducted this regulation?
On 27 September 2010, the Commission commenced the process of regulating the standard terms for the mobile termination access services (MTAS) under Schedule 1 of the Telecommunications Act 2001.

What is the new wholesale price for mobile calls and text messages?
Termination rates for calls will drop from the current level of approximately 15 to 17 cents to about 7.5 cents on 6 May 2011. There will be a one year gradual decrease, or glide path, to less than 6 cents on 1 October 2011, to less than 4 cents on 1 April 2012, with further annual reductions until 2014.

Termination rates for text messages will decrease from the current levels of 9.5 cents to 0.06 cents on 6 May 2011.

What do the proposed changes mean for mobile phone users?
The Commission expects a reduction in wholesale termination rates for calls and text messages to flow through to retail prices. The exact timing of these reductions will be determined by competitive forces.

The Commission also expects to see an increase in cross-network traffic for calls and text messages to that reflecting a competitive mobile market, and a decrease in the difference in prices between on-net and off-net calls and texts.

Do the phone companies have to pass on price reductions to consumers?
No, however the Commission will be monitoring this situation closely, including publishing monthly reports, and expects competitive forces to pass through the reduction.

Will the regulated mobile termination rates come into effect straight away?
Yes, but with there will be a graduated reduction, or glide path, which will allow mobile operators time to adjust retail prices.

If we don't see the expected increase in cross-network calls and text messages based on lower costs, when will the Commission impose more conditions? What is the trigger/mechanism for any new conditions?
If the Commission's monitoring does not show an increase in cross-network traffic for calls and text messages to that reflecting a competitive mobile market, and a decrease in the difference in prices between on-net and off-net calls and texts, then the Commission could impose a condition limiting on-net off-net price differentiation.

The Commission's monthly monitoring reports will provide comments on whether the Commission continues to have concerns such that a condition limiting on-net off-net price differentiation may need to be imposed. If such a condition were appropriate, the Commission could conduct a review to impose a condition relatively quickly.

Has there been any international comparison or benchmarking as part of this review?
Yes. The Commission's benchmarking identified 12 comparable countries that had cost-based regulated mobile termination rates for calls, ranging from approximately 3 to 11 cents. Three comparable countries had benchmarks for texts, ranging from 0.06 to 0.48 cents.

What does on-net mean?
On-net are calls or texts to someone on the same network as you.

What does off-net mean?
Off-net are calls or texts to someone on a different network than you.

What are calling externalities?
Calling externalities are where the benefits of a call are enjoyed not only by the party making (and paying for) the call, but also by the recipient of the call.

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COMMERCE COMMISSION

Executive summary of Standard Terms Determination for the designated services of the mobile termination access services (MTAS) (fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging services (SMS))

Decision 724

Determination under section 30M of the Telecommunications Act 2001

The Commission: Dr. Ross Patterson
Anita Mazzoleni
Gowan Pickering

Date of Determination: 5 May 2011

CONFIDENTIAL MATERIAL IN THIS DETERMINATION IS CONTAINED IN SQUARE BRACKETS

EXECUTIVE SUMMARY[1]

Introduction

i. The mobile termination access services (MTAS) are three designated access services that provide for the termination on a cellular mobile telephone network of voice calls and the short-message-service (SMS) from either:

- a fixed telephone network, in the case of fixed-to-mobile (FTM) voice calls; or
- another cellular mobile telephone network, in the case of the mobile-to-mobile (MTM) voice calls and the SMS service.

ii. In this standard terms determination (STD), the Commerce Commission has determined the price and non-price terms for the MTAS.

iii. The Commission has under section 18 taken into account the current state of the New Zealand mobile market in reaching its decisions in this MTAS STD, with the objective of removing the barriers to the efficient expansion of smaller operators found in the MTAS schedule 3 investigation.

iv. The following features of this market are relevant to the Commission's assessment:

- there is a high level of concentration;
- there are significant on-net off-net price differentials;
- there is very little cross-net traffic;
- there are regional variances in market share;
- churn rates are high;
- prices are high relative to other OECD countries (particularly for prepay customers); and
- mobile voice usage is low compared to other countries.

v. The Commission has identified the following competition concerns arising from these market features:

- above cost mobile termination rates (MTRs) make it difficult for a small operators to set off-net prices that match the incumbents' on-net pricing; and
- incumbents have an incentive to set high off-net rates in order to reduce the number of calls that the small operators' subscribers receive (making the small network less attractive).

[1] This executive summary does not form part of the Commission's Standard Terms Determination.

vi. The Commission considers that the decisions made in this MTAS STD are those that are most likely to promote competition for the long term benefit of end-users. The Commission has also considered the efficiencies that will result from its decisions.

vii. This STD contains sufficient terms on which 2degrees, Telecom and Vodafone (the mobile network operators or MNOs) and any future provider of the MTAS must supply any of the MTAS to an Access Seeker without the need for the Access Seeker to enter into an agreement for provision of the service. The key terms of this MTAS STD are summarised below.

Pricing principle

viii. The Commission has considered whether a forward-looking cost based price or a Bill and Keep (BAK) or a Hybrid BAK pricing principle will best promote competition for the long-term benefit of end-users in New Zealand. In considering whether a BAK or hybrid BAK pricing principle will, or is likely to, best promote competition, the Commission has taken into account the following factors:

- whether the net payments that would be required under a price based on benchmarking[2] are relatively low, due to cross-network traffic being relatively balanced and/or there being a low MTR; or

- whether calling externalities are significant.

Price for the voice MTAS services

ix. The Commission has determined in relation to FTM and MTM voice calls (collectively the voice MTAS services) that:

- all voice benchmarks that meet the Commission's benchmarking criteria should be included in the voice benchmark set. It is not possible, or desirable, to adjust for all factors that drive differences in cost estimates in establishing the voice benchmark set. In confirming its final benchmarking criteria, the Commission has taken account of the views of participants at the MTAS STD Conference that it is preferable to retain a larger benchmark set, and take account of the range of factors influencing MTAS costs in selecting a price point;

- the 25th percentile of the voice benchmark set is appropriate as the price point as there are a range of comparability factors that suggest the efficiently incurred costs of providing the voice MTAS services in 2011 are below the median of the voice benchmark set. In addition, the 25th percentile benchmarked price is most likely to address the competition concerns identified in paragraph iii above;

- the median cost path of the voice benchmark set is appropriate, as there is no reason to consider that costs in New Zealand will change at a rate that

[2] The Commission has benchmarked against cost-modelled rates using the forward-looking total service long run incremental cost standard.

is different to overall international trends, reflected in the cost paths in the voice benchmark set. This is appropriate when considered in combination with the price point of the 25th percentile, which takes into account the impact of factors such as increases in mobile data usage on the costs of the voice MTAS services;

- cost-based MTRs are appropriate, as a forward-looking cost-based price should enable small operators to compete with existing on-net pricing from the larger operators and will also improve competition in the provision of retail FTM and tolls services; and

- asymmetric MTRs[3] are not appropriate as they would be likely to contribute to continuing on-net off-net price differentiation and therefore would not respond to the competition concerns identified in paragraph iii above.

x. In addition, the Commission has determined that a one year glide path is appropriate for the voice MTAS services. This was a very finely balanced judgment, as having no glide path would more immediately respond to the competition concerns that the Commission is addressing in this MTAS STD. However, the Commission considers that a glide path is appropriate in order to allow operators time to adjust retail prices to the reduction in MTRs under this MTAS STD and that, over the long term, this will best promote competition. Commissioner Mazzoleni has a different view on this point and considers no glide path is more appropriate to address the competition concerns in the New Zealand mobile market, as set out at paragraphs 602 and 603.

xi. The glide path adopted is based on a proposal by Telecom that the MTR for 2011 should be based on the medium of the range of regulated outcomes for 2011 put forward by the Commission in its final Schedule 3 report (7.48 cpm), but modified with an additional adjustment on 1 October 2011 of a 50% reduction to 5.88 cpm.

xii. As a result of the above decisions, the MTRs for the voice MTAS services from 6 May 2011 to 31 March 2015 are:

Effective from	6 May 2011	1 October 2011	1 April 2012	1 April 2013	1 April 2014
MTR for voice MTAS services (NZ cpm)	7.48 {4.28}	5.88 {4.28}	3.97	3.72	3.56

(the figures in { } show the MTR that would have applied if a glide path had not been provided for).

Price for the SMS service

xiii. The Commission has determined in relation to the SMS service that:

[3] Where different MTRs are paid to different MNOs.

- all SMS benchmarks that meet the Commission's benchmarking criteria should be included in the SMS benchmark set, consistent with the approach taken to the voice benchmark set;
- the lower bound of the SMS benchmark set is appropriate, as this is the most recent benchmark, suggesting the efficient costs of SMS termination are likely to be below the median;
- while market conditions suggest that a BAK pricing principle is appropriate, in order to mitigate against the risk of SMS spam, the Commission has determined that a forward-looking cost-based price for SMS termination is appropriate; and
- while the costs of SMS termination are likely to fall over time, in the absence of benchmarked reductions in the costs of providing the SMS termination service over time, no cost-path has been applied to the SMS termination rate.

xiv. In addition, the Commission has determined that no glide path is appropriate for SMS.

xv. As a result of the above decisions, the MTR for the SMS service from 6 May 2011 is 0.06cpSMS.

Conditions

xvi. The Commission has jurisdiction to impose a condition limiting on-net off-net price differentiation under section 30O of the Act as a part of the regulation of wholesale MTRs, if it considers this is necessary in order to address the competition concerns identified in paragraph iii above.

xvii. On-net off-net price differentiation can be pro-competitive. However, New Zealand market conditions indicate that on-net off-net price differences have had the effect of limiting the expansion of smaller operators and thereby prevent effective competition from evolving in the New Zealand retail market.

xviii. While cost-based MTRs are likely to reduce the cost-based incentives for on-net off-net price differentiation, the strategic incentive to differentiate between on-net and off-net calls is likely to remain even after MTRs are regulated at cost. However, once MTRs are regulated at cost, the scope for potential anticompetitive behaviour with regard to off-net pricing is likely to be significantly reduced.

xix. The Commission determines that the most appropriate approach is to monitor the market very closely after the MTAS STD has come into effect and assess trends on a monthly basis to determine whether cost-based MTRs are addressing the competition concerns the Commission has considered in this MTAS STD.

xx. In a situation where MTRs are regulated at cost, and market forces are effective in delivering more competitive outcomes, the Commission would expect to see (within a reasonably short time):

- an increase in cross-network traffic for voice and SMS to that reflecting a competitive mobile market;
- a decrease in the difference in prices between on-net and off-net calls and SMS; and
- a decrease in the customer churn-rate for the smaller operator.

xxi. Given the significance of on-net off-net price differentiation in the New Zealand market, the Commission intends to publish the results of monitoring of the first two indicators above on a monthly basis. These reports will provide comments on whether the Commission continues to have concerns such that a condition limiting on-net off-net price differentiation may need to be imposed. If such a condition were appropriate, the Commission could conduct a section 30R review to impose a condition relatively quickly.

Service description

xxii. The Commission has determined that the MTAS services covered by the MTAS STD should:

- not include domestic transit or transport services, as these are available commercially and do not need to be included in the scope of the MTAS STD; and
- only include web to text SMS that originate from a cellular mobile telephone network and have an associated MTAS reply path. Other forms of SMS, such as SMS that originate on the internet, machine to man and machine to machine SMS, have been excluded from the MTAS STD as these are outside the scope of the regulated SMS service.

Sundry charges and non-price Terms

xxiii. The Commission has determined that all set-up arrangements should be subject to a price on application charging arrangement. Where there is a dispute over this price, then the set-up build must proceed while the price is subject to a dispute resolution process.

xxiv. The Commission has also determined the non-price terms for access to the MTAS services. These non-price terms include:

- an artificial inflation of traffic provisions has been reinserted into the MTAS STD, as there was general industry support that this would support existing pro-consumer anti-SPAM limitations set out in legislation; and
- Access Seekers are prohibited from knowingly using or allowing the use of SIM boxes by members of their Group.

Implementation

xxv. The Commission has determined that:

- the changes to cost-based MTRs for the voice MTAS services and the SMS service should come into force immediately upon a request for the service by an Access Seeker, with a reconciliation process for any credits required as a result of billing system changes. Where requested by an Access Seeker, any such credit must be refunded by the Access Provider, with interest being payable if the refund is not paid within 20 Working Days; and

- parties should be given a reasonable time to complete any technical or systems changes, or network design changes, necessary to implement the MTAS services - these timeframes are between 45 to 90 Working Days.

Key documents are available on the Commission's website at:
http://www.comcom.govt.nz/mobile-termination-access-services-std/