Inquiry into the Services Sector
New Zealand Productivity Commission
PO Box 9036
The Terrace
WELLINGTON 6143

Dear Sir/Madam

BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR: 2ND INTERIM REPORT, COMPETITION AND ICT

2degrees welcomes the opportunity to comment on the Productivity Commission's *2nd Interim Report into "Boosting productivity in the Services Sector"*. 2degrees is a strong advocate of the benefits of competition and ICT and supports the Productivity Commission's focus on stimulating competition in services to drive productivity gains.

For the purpose of this submission, we have focussed our response on four key areas, which directly relate to mobile services markets:

- The benefits of increased competition in mobile services;
- Addressing search and switching costs;
- Improving competition law; and
- International connectivity.

Competition has driven significant benefits in mobile

As has been evident in the mobile telecommunications sector following 2degrees' entry, increased competition, facilitated through pro-competitive regulatory settings, can act to drive efficiencies, reduce consumer prices and increase market innovation.[1] This in turn encourages increased uptake and usage of ICT. Numerous international studies link mobile usage to gains in productivity, including as a result of reducing the need for travel (saving time and expenditure on travel) and improved efficiency while working off-site.[2] The potential benefits will continue to increase as new innovative mobile applications emerge and the shift towards smartphones and smart devices continues.

In 2013 2degrees specifically engaged Venture Consulting to carry out an analysis to calculate the economic value to the NZ economy of having an additional third player competing in the mobile services market, in contrast to the previous duopoly structure. Venture estimated that 2degrees' entry had led to benefits of $3.9 billion to 2012 with a further (conservative) economic uplift of $12 billion by 2022 should three-player competition continue. While the latter did not quantify additional benefits including productivity benefits to the economy, it noted that these are potentially significant.[3] The study highlights the importance and value of ensuring policy settings continue to support the development and sustainability of competition in the mobile services market. The reality for the mobile services market is that mobile competition is still in its infancy,

[1] For example at launch 2degrees halved standard call rates from 88c to 44c per minute. 2degrees market innovations have included the introduction of the prepay "combo" pack, Carryover Minutes/Carryover Data, which allow customers to keep unused minutes and data, Shared Data/Share Everything, which allows customers to increase utility by sharing voice, text and data allowances. 2degrees also introduced Aussie Talk and Text, which allows customers to call Australia from their plan minutes at no extra cost.

[2] For example, see Deloitte, *What is the impact of mobile telephony on economic growth? A Report for the GSM Association*, November 2012; Deloitte, *Boosting Public Sector Productivity by Going Mobile Report – 2013*.

[3] Venture Consulting, *Economic Study of the Benefits to the Economy of Three-Player Competition in the NZ Mobile Market–May 2013*.

with Telecom and Vodafone controlling the vast majority of the retail market (including postpay and business markets), with 2degrees yet to make a profit.

More generally 2degrees sees a key challenge for Government/regulatory settings is to balance not only short term consumer interests with long run interests in terms of upgrades in technology (as identified in the document), but also to balance these with long run consumer interests in maintaining a sustainably competitive marketplace. Further, it is important that Government policy objectives or interventions (which could also include ICT promotion) do not inadvertently undermine the development of competition in services sectors, for example by favouring a particular technology or service provider without sufficient competition safeguards.

Search and switching costs

2degrees supports the Productivity Commission's focus on consumer switching costs. While the Productivity Commission correctly notes that mobile number portability has had a considerable impact on the ability of mobile consumers to switch mobile provider, 2degrees' experience is that there remain considerable switching barriers in relation to consumer postpay and business (SME and Corporate) mobile markets. This limits the benefits of competition in these markets and associated productivity gains.[4]

In particular, these markets are characterised by longer term contracts with high Early Termination Charges (ETCs). Further, there is an asymmetry of information whereby network operators are able to target their customers approaching term expiry dates, and, unlike in other markets, most mobile customers need to ring their current service provider in order to assess ETCs and port their number. In combination, these switching barriers have the effect of reducing churn in mobile services markets without the benefits of increased competition being offered to the whole market: 2degrees' experience is that a significant number of contracts are rolled over early by the current provider, with ETCs waived and/or non-advertised pricing offered. This could be considered a particular issue in markets dominated by two incumbent operators. Customers can find themselves locked into a further long term contract where they are paying significantly more than with an alternative provider. It is not clear these issues will be addressed with recent legislation that prohibits the use of certain "unfair contract terms".

Given clear differences between each of the prepay, postpay and business markets, 2degrees considers that the Commerce Commission should conduct a switching study that considers each of these markets separately. Notably, the previous switching study referred to in the Productivity Commission report was limited to consumer (not business) switching barriers.

2degrees notes in relation to the Productivity Commission's comments on search costs that the Telecommunications Carriers Forum (TCF) have recently adopted a Broadband Information Disclosure Code (initially applying to fixed services) that should address search costs for broadband services. This requires broadband service providers to provide standardised "offer summaries" to consumers, which summarise in a comparable way key features of broadband service plans.[5]

Improving Competition Law

2degrees strongly supports the Productivity Commission's recommendation that the Government review section 36 of the Commerce Act, including consideration of the adoption of an "effects" based test and a shift away from sole reliance on a "counterfactual" test. Section 36 has proven itself ineffective in addressing market power abuses, as evident from the extended 0867 case (that took

[4] Notably the Commerce Commission's international mobile benchmarking report (March 2013) indicates that the benefits of competition are most pronounced in the mobile prepay (as opposed to postpay and business markets).
[5] See the TCF website for more details: http://www.tcf.org.nz/content/72e2572f-fd9e-49fc-b2de-05a73bb5701d.html.

over a decade to resolve) and widespread criticism of this section of the Act, including from the Commerce Commission itself.

Given the light-handed nature of the telecommunications regulatory regime, which focusses on wholesale access rather than behaviour-type issues, and the continued dominance of Telecom and Vodafone in retail fixed and mobile markets, 2degrees considers it essential that an effective competition law regime is in place.

2degrees notes there are also concerns regarding the potential for section 47 of the Act to allow "creeping acquisitions" (that is, when a series of smaller acquisitions which individually do not trigger the "substantial lessening of competition" threshold but cumulatively do lead to a substantial lessening of competition). For example, this is particularly a concern in prospective markets, such as mobile spectrum markets, where long term management rights are involved and there is considerable uncertainty in relation to use and timing of spectrum commercialisation. Over time, incumbent mobile operators have acquired significant holdings of spectrum (not all of which is currently in use, but will be in the future). For example most recently Vodafone (as part of the acquisition of TelstraClear) was able to gain substantial holdings of 1800MHz, 2GHz, 2.1GHz, 3.5GHz and 25GHz spectrum bands. The Commerce Commission is currently considering further acquisitions of 700MHz spectrum. Notably, remedies under the Commerce Act are limited to within two years (for a divestment remedy) and three years (for other remedies) following any anticompetitive acquisition, making it extremely difficult to reverse an anticompetitive spectrum acquisition, should that not manifest itself until a number of years later.

2degrees supports the Commerce Commission, as the independent competition regulator, being provided powers to undertake market studies as to the state of competition in different markets. 2degrees considers similar powers under section 9A of the Telecommunications Act to conduct inquiries in relation to telecommunications markets to be a useful addition to the regulatory toolkit.

International connectivity

Sufficient international capacity is critical to ensuring New Zealand benefits from new technology advances and global information sharing. The Productivity Commission has welcomed views on capacity supply and pricing. 2degrees understands that there is currently significant excess capacity on the Southern Cross cable, however 2degrees shares industry concerns regarding market power on this route and considers that the main competitive constraint on pricing has been the threat of new cable entry (including from Pacific Fibre, Optikor and Hawaiki).

We note that there are also market power concerns in relation to an undersea cable owned by a Telecom/Vodafone/Telstra consortium, with clear vertical and horizontal integration issues. This allows significant scope for the exercise of co-ordinated market power and risks reinforcement of dominant positions in downstream telecommunications markets over the medium to long term. Such concerns have previously been raised by a number of industry stakeholders including TUANZ, CallPlus, Snap Internet and Internet NZ. The extent of concerns will be dependent on the final consortium structure and wholesale arrangements. It will be important to ensure that other ISPs have competitive access to international bandwidth.

Yours sincerely

S Lipanovic

Sara Lipanovic
Regulatory Policy Manager