

Version FINAL 4

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Submission:

Cartel Criminalisation

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Introduction

Thank you for the opportunity to comment on some of the issues raised in the MED discussion paper *Cartel Criminalisation* (January 2010).

Two Degrees Mobile Limited is New Zealand's third mobile operator. We entered the market at a 110 percent penetration and, so far, have invested \$250m building 2G/3G infrastructure in Auckland, Wellington, Christchurch and Queenstown. Our roaming agreement requires us to have a nationwide network and we are currently gearing up for Phase 2 of our infrastructure building programme.

Overview

We naturally agree that cartels are bad for consumers and bad for the economy in general. However, as a participant in a major network sector, telecommunications, 2degrees is more concerned with anti-competitive behaviour opportunities that fall outside the normal definition of a hard-core cartel, that is 'an agreement between competitors to restrict competition'.

Within the New Zealand telecommunications sector, it is not necessary to collude with a competitor to restrict competition. By operating in a way which appears within the parameters of the Commerce Act, an established participant with the benefit of an historical accident or two can achieve the same result

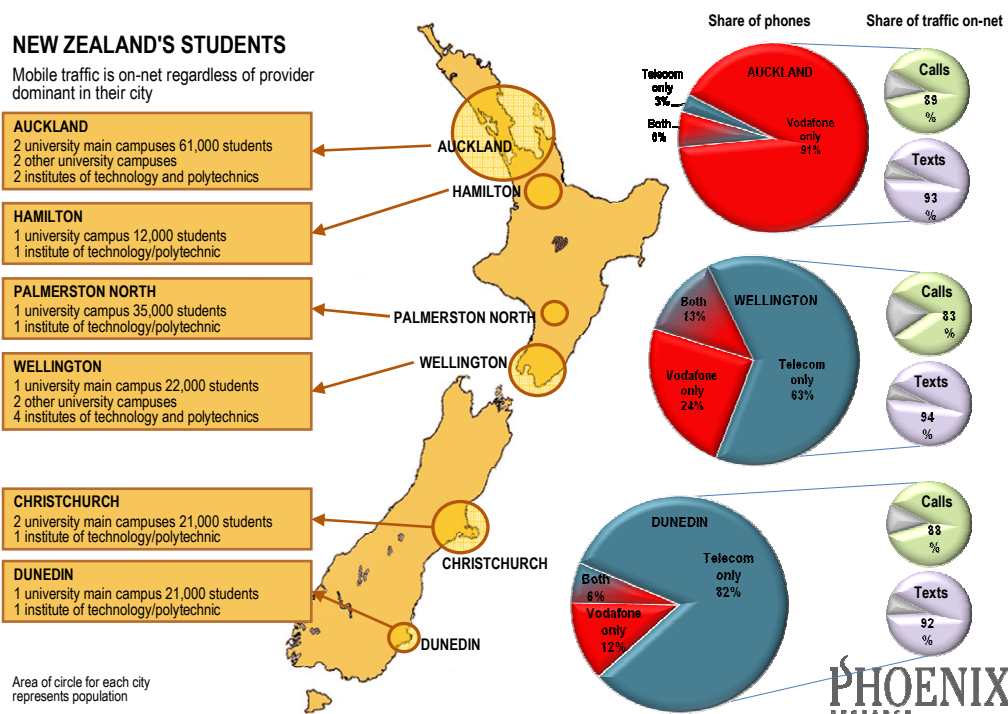
Poor decisions from the past have created a situation in which price setting and what is effectively market allocation are condoned and even encouraged by the very legislation that was intended to promote open competition. No reasonable person would call this cartel behaviour. But the consequences are exactly the same as if it was cartel behaviour: some businesses are allowed to prosper at the expense of other businesses. And the consumer gets a worse deal than they would otherwise.

While we support criminalising cartel behaviour in principle, we are concerned that there is a real danger that too much effort will be put into penalising the criminal and not enough effort will go into preventing the behaviour in the first place.

We accept that in some other sectors criminalising cartel behaviour may discourage anti-competitive behaviour. However, in the telecommunications sector, we do not believe it will have a significant impact. In our view, a rigorous review of the Commerce Act, section 36 in particular, will do far

more to create competition and enable New Zealand to develop a world class telecommunications environment for the benefit of Kiwi consumers.

Is the telecommunications industry a cosy cartel?



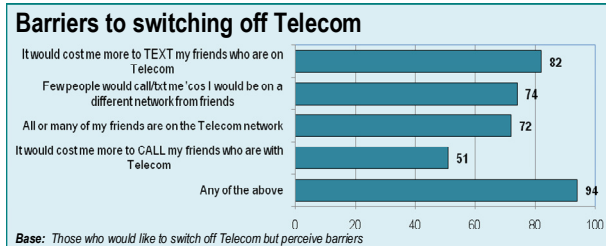
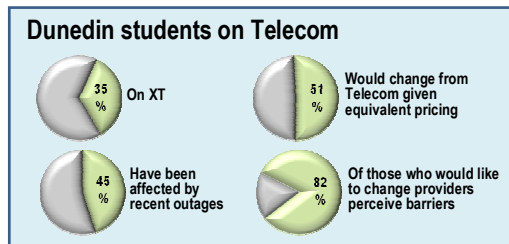
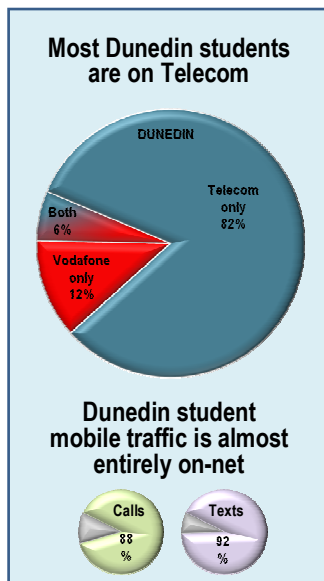
This chart was produced by the Phoenix research company, an independent research house based in Auckland. It illustrates that Telecom and Vodafone have geographically split the entry-level prepaid market segment by city despite offering virtually identical retail prices to consumers.

Here are the pricing plans associated with the incumbents

	Standard voice call / min	Standard SMS / message	Large SMS bundle >1000 SMS	Free calling to a single, On-net number for a month
Vodafone	89c	20c	\$10	\$6/number (max 3 numbers)
Telecom	89c	20c	\$10	\$6/number (max 3 numbers)

Table 1. Prepaid call and text plans from incumbent mobile providers

Dunedin students who want to switch are trapped



They are trapped by closed network pricing

PHOENIX
RESEARCH

This chart is produced by the Phoenix and illustrates that customers are trapped and unable to swap networks by closed network pricing.

The impact of the geographic split and closed net pricing is to create a barrier to entry for a third operator and to restrict a third operator to only a small market segment of the pre-paid market. How did this happen? Why was it allowed to happen? The impact of it is so dramatic that when the XT network failed many consumers were trapped and couldn't swap networks. Is this a cartel? Or is this tacit collusion and a failed competition policy? It is certainly not perfect competition and should be the focus of regulatory resources.

Noteworthy features of the NZ telecommunications industry

- Pre-paid calling costs are basically identical
- Geographic market segmentation exists
- No "same" technology competition existed for years and its only in infancy now
- There are over ten self-regulatory bodies
- Regulation of the industry is managed by three government agencies

Comments on the MED's discussion paper

(Section 1.4.1.1) The Commerce Commission receives approximately \$14m a year, of which approx \$3m is spent on looking at cartels. It is 2degrees' observation that the Commerce Commission is stretched as a consequence of extra work caused by incorrect legislative settings in the 2006 Telecommunications Act and the MED's industry policy. We believe that the Commerce Commission is under funded relative to the size of the market and relative to its peer group of Ofcom & the ACCC.

The Commerce Commission is often executing policy work to create competition rather than to protect competition. In this respect, the Commerce Commission is doing the MED's job. For this reason we believe that the MED should conduct its own review of the mobile market, in conjunction with a review of the spectrum cap. This would enable more integrated policy settings to be made, which would then free up the Commerce Commission to police competition more effectively.

(Section 1.4.1.3 Rewarding & Encouraging Whistleblowers) This is a common place technique; however, this is not as constructive as encouraging entrepreneurs and new market participants. Many smaller operators in the telecommunications industry feel threatened by large incumbents (on whom they rely for supply agreements) if they complain to the Commerce Commission.

(Section 1.4.2.3 Private Enforcement) This section illustrates that the Commerce Act proceedings don't work and are too expensive and slow often only delivery an outcome after many years and numerous appeals. There have been no actions commenced by the private sector. The notable litigants in the 0867 case have *settled out of court* and, as a consequence, the Commerce Commission brought the cases to court and pursued the appeals. Clearly experience shows that general competition law in NZ is so expensive that many private firms drop the cases or accept settlements to shut the cases down.

Self-regulatory tests 2degrees believes that self-regulatory concepts are used extensively in NZ. In the telecommunications industry many matters which are dealt with by the regulator are dealt with under self-regulatory processes. On some occasions this means that large incumbents are able to obstruct new entrants and small player initiatives.

The self-regulatory ideology is a hangover from the 1980s and 1990s. 2degrees believes that the MED should ensure that a test exists for when and

where certain matters can be decided on in self regulatory forums. For example, spectrum management matters and the co-siting of radio antennas should be passed to the regulator, as should all access matters.

In answer to some of the specific points raised ...

Detecting and deterring cartels

Q. Do you consider cartels to be harmful?

A. Yes. However, as we have already noted, the harmful activity that has been taking place in the New Zealand telecommunications sector – There are in our view more pressing matters requiring regulatory resources in the telecommunications industry, in particular closed net pricing.

Q. Are the current penalties for cartel activity sufficient to deter and detect cartels? Is there any evidence to support this judgement?

A. No, because the incentives are higher than the penalties.

Q. What do you consider would be the most effective means of increasing the deterrence and detection of cartels?

A. Better competition law and more focus on market structure by the MED.

Q. What are the costs and benefits of the options outlined for increasing deterrence and detection?

A. The benefits of better competition law would be a more open telecommunications market, a better deal for consumers, and a greater willingness on the part of investors to contribute capital in the knowledge that a better product or service could compete on a level playing field.

Defining the offence

Q. Are there any categories of cartel conduct, not included in the OECD recommendations that should be criminalised in New Zealand?

A. Closed networks are effectively market allocation mechanisms and, in our view, they should be considered as such.

Q. Should there be a clearance regime for joint ventures?

A. Providing the joint venture did not unnecessarily reduce or restrict consumer choice or the ability of a competitor outside the joint venture to compete fairly.

Q. Should there be a clearance regime for other potentially restrictive trade practices?

A. As above.

Q. Should there be a legislative exemption for joint buying arrangements?

A. Perhaps. However, the joint buying arrangements should still add value in the marketplace and not simply penalise a competitor who was not part of the joint buying arrangement.

Choice of options

Q. Which of the three approaches – adaptation of section 30, adopting Australian legislation, or greenfields – should be adopted?

A. It seems inevitable that a degree of tailoring would be required.

Criminal procedures and penalties

Q. Should corporations be criminally liable for cartel offences?

A. Yes

Summary

2degrees' primary focus is on generating competition. We believe the primary focus of the MED should be on removing the barriers to entry for new industry players and revisiting the 1986 Commerce Act to ensure it is up to date with new technological developments.

2degrees is available for further consultation on competition in network industries.

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Public Policy

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