

**MTAS Commerce Commission - Opening Speech by Russell Stanners**

**Wednesday 2 September 2009, Holiday Inn, Wellington**

**The “20c Conference”**



## Outline

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Good morning.

[Introduce team]

By way of an introduction to Vodafone's contributions to this conference, I wish to pose a few questions which I believe go to the heart of the issue of mobile termination and help to explain Vodafone's position.

- Firstly, why is mobile termination so important to Vodafone?
- Secondly, is there really a pricing issue in the mobile market?
- And thirdly, is the mobile market competitive?

I will then summarise why Vodafone believes that the Commerce Commission has made errors in constructing its draft report and why the Commission should not be concerned over the ability of a new entrant to compete in the mobile market.

## Why is the issue of mobile termination regulation so important to Vodafone New Zealand?

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Vodafone supports fair competition. However, the Commission is in danger of distorting the market and undermining the gains of the last decade which we have worked hard to deliver and which are now too easily taken for granted.

The potential for further regulation of wholesale mobile termination rates is a serious board level issue for Vodafone for five reasons:

1. For Vodafone, a deal is a deal. The effect of the MTR Deeds was to deliver a better outcome for consumers than regulation could have achieved. We and Telecom have honoured our side of the bargain. But here we are today debating the prospect of throwing away this contract. This might have been a price worth paying if there were large gains to be made. But the net gain for consumers is tiny and the negative underlying wealth transfers are enormous. I call MTR the “20c issue” – because if you allocate the suggested consumer welfare across consumers, by the Commission’s own calculations, it will benefit the average person on the street to the tune of only 20c a month. It is that important.

2. Should the commission proceed with its recommendation, Vodafone's future revenues and cash will be impacted to the order of \$40m in the first year, growing to a total of over \$500m over five years. This is a material impact to any business and will significantly reduce our ability to invest as a partner in the government's fibre broadband initiative.
  
3. MTR regulation leads to massive wealth transfer from our mobile customers and from Vodafone itself on the one hand to fixed customers and fixed operators on the other hand. These fixed operators are our competitors. Recent information supplied by the Commission and analysed by Covec tells us they will pocket 70% of the termination rate reductions on offer. In Australia, Telstra pocketed 83%. It's a great way for them to increase margins. I should add that both Telecom and Vodafone are firmly outside this grouping having followed through on their 5 year undertaking to pass through 100% of the reductions in mobile termination rates in line with their MTR Deeds.

4. Our low income mobile consumers, will be unfairly impacted. For them, the termination revenues contribute over 40% of their aggregate value to Vodafone and without it many of these customers would cease to be viable. If, for example, we implemented a minimum spend of NZ\$5 a month to offset lost termination revenues, in line with what is done in other countries, 800,000 Vodafone customers would have to pay more than they do today. One can only imagine that a further 800,000 Telecom customers would fall into the same category. In other words, about 1.6m low income Kiwis would be paying more than they do today.
  
5. And finally there is the issue of text spamming. At zero or low text termination rates that the Commission is proposing we will see an explosion of text spamming. I do not want New Zealand to become the text spamming capital of the world. This was a key reason why the only regulator in the world to follow through with wholesale text regulation, namely the French regulator, decided on a rate of €3.5c or NZ7.3c. Let's not allow spamming to spill over from the internet into the text market.

## Is there a mobile pricing issue that we need to address?

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Over the last two years we have seen a sustained lobbying campaign challenging the value mobile operators deliver to their customers.

We say the facts do not support this claim.

### OECD benchmarks

From 2004 through to today we have been aggressively driving prices down and usage up. BestMate, TXT2000, TXT600, Family, Free Weekends, TalkZone, Mega, Texter, Talker and Easy plans are all examples of value offerings we have delivered.

Over the last five years we have driven voice per minute pricing down by 15% per annum and text pricing by a huge 29% per annum.

In 2009, New Zealand consumers are getting prices that rank in the cheaper half of the OECD, using the Teligen benchmark which is the yardstick that pricing is measured on. Our own internal benchmarks which divide our revenue by the usage on the network support this by showing that our voice pricing is better than our sister companies in markets we are often compared to.

## Comparison with Australia

Now, I hear you say, “*Hang on Russell, what about prices in Australia, they offer better value? In Australia, I can get a Megacap plan offering AU\$150 of value for AU\$29.95 which is better than what is on offer in New Zealand.....*”

My answer to that is that we have done the comparisons of plans, and in line with the results of our internal benchmarks, I can tell you that New Zealand consumers are in fact getting better value.

And if we compare the two countries for casual prepay prices for a minute long call, Kiwis are getting a great deal. In Australia, you pay between AU\$1.08 per minute and AU\$1.25 c per minute for the first minute which includes a AU30 to 35c flagfall charge. This compares to New Zealand customers who pay 89c per minute on Vodafone or just 44c on 2degrees. The Aussie prepaid customers are paying a whopping 50% to 250% more than their Kiwi cousins.

And before I forget, in Australia you have SIM locking, monthly expiry of prepaid top ups and 12 or 24 spend commitments, even on prepay plans.

## **Fixed to mobile pricing**

And finally, you may claim that the real issue is that we are paying too much for calls from fixed to mobile phones?

In Australia during 2008, consumers paid on average AU36c (=NZ44c) for fixed calls to mobiles whereas New Zealand consumers paid NZ31c. So Aussie consumers paid a 40% premium, even though mobile termination in Australia has been regulated and lower than New Zealand rates for some time.

## **Is the state of competition in the mobile industry a concern?**

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If prices are not a reason to regulate then perhaps the issue is lack of competition.

We made a decision back in 2004 to actively support market entry through commercial solutions for wholesalers and potential builders alike. The result is today we have three mobile networks and six MVNOs that can offer you a mobile pricing package for 4.3M people which compares very favourably to three networks and five MVNOs for 22M people across the ditch.

## Is bundling anti-competitive?

Having said this, one competitor, namely 2degrees, having already entered the market is claiming that it cannot compete effectively without further regulatory support. 2degrees has been running a campaign to say that the industry's offerings such as BestMate, Family, TXT2000 and free weekends are anti competitive.

This couldn't be further from the truth. Our bundles are precisely how we compete, innovate and deliver value to our customers based on real customer insights.

The concept of bundling to create value is not unique to our industry:

- MacDonalds has the value meal and combo approaches,
- Hallensteins socks are cheaper if you buy the three pack,
- Six packs of beer or wine are cheaper than by the bottle, and
- Microsoft Office pack is better value than the components parts.

There is nothing anti competitive about our approach to pricing. To illustrate, let me suggest to the Commission and 2degrees how a new entrant could compete effectively with our value bundles.

It is simple. In the voice market, launch some value bundles of your own. You only have to win 2 customers at a time to make a BestMate bundle work, or two to four customers to make a Family bundle work .

Likewise, in the text market, launch some on net or any net bundles. We know that for every text you send, on the whole you can expect one will come back, meaning text termination costs largely balance themselves out.

The Commission should research the entry of Telecom with \$10TXT into the text market in September 2003. All of a sudden, and very cleverly, Telecom who had a very small share of the text market, launched its 500 any net text bundle. The effective retail price per text dropped to 2c whilst the interconnect rate at the time was 14c. We initially calculated that Telecom would lose around \$35 each month for every \$10TXT customer due to the volumes of off net texts incurring interconnect costs.

How wrong we were! The reality was there was no perceptible change in the balance of text traffic between our two networks, meaning the higher interconnect text costs were not a barrier for the smaller text player.

Telecom took significant market share and it took us two years to respond.

And finally, the good news for 2degrees is that not all our customers buy text bundles. Our TXT2000 and TXT600 bundles have less than 450,000 customers. This leaves 80% of our customer base, of which 1.5m are prepay customers, without text bundles open for offers from 2degrees and others.

## The Commission's analysis has errors and leads to the wrong conclusions

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Let me move on to some facts on the Commission's analysis of mobile termination, retail pricing, and competition in the industry.

We believe the Commission has made four fundamental errors – any one of which, if corrected, would eliminate the case for regulation.

- The first is the assertion that so called “above cost” termination rates represent some sort of barrier to entry for 2degrees and others.
- The second is the Commission's new and radical approach to “international benchmarking”.
- The third are the Commission's heroic assumptions for pass through to fixed to mobile retail pricing.
- And the fourth is the Commission's position on the waterbed effect.

I have dealt with the first issue already. The facts are that mobile termination rates are not a barrier to a new entrant.

The fourth issue is rather technical and worthy of debate between the economists amongst us. All I would say is that for Vodafone the waterbed is real.

I would like to cover benchmarking and pass through.

## **International benchmarking**

The benchmarking method employed is absolutely critical to the regulatory decision. For reasons that are not explained or justified, the Commission has chosen to completely change its approach to benchmarking. This has resulted in selecting a benchmark which is half (7.2c) of what it would have been (14.3c) had it continued with its best practice approach deployed in the first investigation in 2006.

Furthermore, Analysys Mason, the global expert which developed 7 of the 9 models the Commission has used in its benchmarking, states that the Commission's approach is fundamentally flawed. These observations from the world's leading expert in this field cannot be ignored if the Commission aspires to produce a quality recommendation to the government.

We say, return to best practice benchmarking.

## Pass through

The Commission has assumed that pass through of reductions in mobile termination rates will climb from 85% in year 1 of its model to 100% in year 5. We say, there is no evidence to support this.

The evidence is that pass through is more likely to sit at about the 40% level.

That is why the MTR Deeds were so attractive to Trevor Mallard and the government at the time. The Deeds give certainty of 100% pass through which cannot be guaranteed through regulation.

## Conclusions

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So, in summary, Vodafone argues that it is a fallacy that 2degrees will struggle to compete in the market under the current interconnect arrangements.

- In 2009 the mobile market is competitive and delivering prices which are of great value to consumers by any measure, be it the OECD benchmark, our internal benchmarks, or in comparison to similar markets.
- Further, there are clear opportunities for a new entrant to compete. The fact we have had six new mobile entrants in the last year proves this to be the case. Don't dismiss the ability of the market to compete on the claims of one player.

- If corrected, the Commission's benchmark will show that the current MTR deeds should be honoured through to their expiry in early 2012 which is just one year after the earliest date that regulation could come into effect.
- Once the undertaking or new Deeds are in place, we would appeal to the Commission and government to leave well alone for their 5 year term so that all the parties can get on with what really makes a difference – competing in the market to the long term benefit of consumers.

Thank you.