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1 October 2009

Shane Kinley
Senior Analyst
Telecommunications Branch
Commerce Commission

By email: shane.kinley@comcom.govt.nz

Dear Shane

RE: request for additional information after the MTAS Conference

I refer to your email of 15 September 2009, in which you asked Vodafone to provide information relating to certain matters raised at the MTAS conference of 2 and 3 September 2009. I refer also to discussions between ourselves on 25 September 2009 and again yesterday, in which you extended the timeframe for providing this material. On the basis of these discussions, certain of the information requested on 15 September 2009 will be provided in this letter, while information relating to traffic flows between our network and those of our interconnect partners will be provided on or before 7 October 2009.

Vodafone is grateful for the opportunity to provide this information. It sets out material evidence that goes right to the heart of the debate regarding whether existing mobile termination rates and on-net retail pricing behaviour represent a market foreclosure concern for new entrants to the mobile market in New Zealand.

We have provided VNZAPI, VNZRI and public versions of this letter.

Summary

During this investigation, two contrasting theories have been presented as to whether existing market arrangements are likely to provide a barrier to entry and expansion for new mobile entrants. Where contrasting theories are put forward, we believe the Commission needs to pay careful attention to evidence of actual market behaviour – as opposed to simple theoretical postulations – to determine whether an actual problem exists. The data requested by the Commission provides important evidence to show that:

- our on-net offerings for voice involve calling circles that are small and not linked;
- customers that have previously purchased on-net plans on our network are porting to 2degrees;
- customers that have previously purchased on-net plans are churning off our network;
- consistent with expectations set out in our submissions during this investigation, 2degrees has been a [] VNZAPI termination revenue since 25 August 2009; and
- on-net retail offers do not greatly affect the balance of traffic flows between networks.

When combined with actual evidence of the closed nature of on-net pricing bundles offered in New Zealand, and the large numbers of customers that do not acquire on-net bundled offerings, this implies that there is no foreclosure problem of the type considered at the conference.

The foreclosure argument relies on calling circles being large or linked. They are not. It relies on 2degrees being forced to offer any-net bundles to compete. It has not done this – nor does it need to. It relies on the argument that on-net calling on large networks is so attractive so as to prevent subscribers shifting networks. This has not happened - subscribers that have purchased on-net plans are porting to 2degrees and churning off Vodafone's network.

Because the mobile market is not foreclosed, there is no urgent need to cut termination rates. In addition, a rapid reduction in termination rates would be harmful to consumers due to the waterbed effect that exists in fixed to mobile, and the extent to which large reductions in mobile-to-mobile termination rates will change the relative attractiveness of certain customer segments (with consequential negative impacts for some customer groups such as low-spend pre-pay consumers).

The evidence provided in this letter should lead the Commission to take a more considered approach to regulation, safe in the knowledge that more gradual decreases in mobile termination rates will not adversely affect competition in the retail mobile market.

The following sections address the specific questions raised by the Commission in its email of 15 September 2009.

1. Foreclosure model - provision of model relating to foreclosure

The model referred to at pages 77 and 80 of the transcript of day one of the conference is the basis for the Frontier paper on foreclosure by Dan Elliott which is part of Paper 8 of the Vodafone Policy Paper Series previously submitted to the Commerce Commission as part of our submission on the Issues paper in September 2008. This spreadsheet model was emailed to the Commission on 30 September 2009. Dan Elliot is happy to answer any questions the Commission may have and his contact details are set out below:

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This model can be made public.

2. Churn data - data relating to churn of customers with "Best Mate or TXT2000 or types of on-net plans"

If the market is foreclosed by on-net pricing behaviour, customers that purchase on-net bundles would be reluctant to leave their network or move to a different network. The extent to which customers leave our network can be measured by churn statistics; while the extent to which customers move to other

networks can be measured by the extent to which they port their number to another network. Both churn¹ and porting data show that the market is not foreclosed by our on-net pricing offers because subscribers with BestMate and txt2000 are churning off our network and porting to 2degrees.

Prepay churn data shows that on-net bundles are not foreclosing the market. The churn rate for prepay customers that have purchased an on-net bundle such as BestMate or txt2000 is [] VNZRI. In other words, [] VNZRI of customers who purchase one of these on-net bundles churn away from our network each year. This implies purchase of these bundles does not “lock” customers onto our network such that the market is not foreclosed. The churn rate for prepay customers that have not purchased on-net bundles is [] VNZRI.

Porting data for both prepay and on account customers also shows that on-net bundles are not foreclosing the market. If on-net plans were foreclosing the market then we would not expect customers that have taken advantage of on-net plans to port their number to a smaller network. As at the time of the MTAS conference, [] VNZRI of numbers ported to 2degrees had purchased BestMate or txt2000. Again, subscribers that have purchased on-net bundles are available to other carriers, and the market is not foreclosed.

On-account

At any point in time about [] VNZRI of our on-account customers are out of contract—the actual figure for July 2009 was [] VNZRI. This shows that a large number of our on-account customers are out of contract and able to easily move to another network.

3. BestMate calling circles – figures of the number of people with “reciprocal Best Mates” and whether one subscriber with a Best Mate was connected to another subscriber with a different Best Mate

The argument put by some during this investigation is that they will need to offer low “any-net” rates to all consumers in order to compete with our low on-net prices. In the first instance, we do not believe this is the right way to analyse competition in the retail mobile market. In reality, mobile operators compete over a broad bundle of services – including access fees, on-net rates; off-net rates; SMS services; voice services; MMS services; mobile - to - fixed (MTF) services etc. Mobile operators will compete across this

¹ A customer is defined to “churn” if s/he either has not topped up their account for 12 months, or there has been no activity for 180 days. The rates are annual rates.

full suite of offerings, and not simply on the basis of on-net rates. We believe this is too narrow a focus for a proper competition analysis.

In any case, even if the focus is narrowed down simply to on-net rates, the data set out below shows that:

- the majority of our customers do not purchase on-net bundles; and
- of those that do purchase on-net bundles, calling circles are small.

This data is from the end of June 2009 and includes on-account and prepay BestMates.

The implication is that even if a new entrant chooses to compete by focusing narrowly on our on-net offerings, it does not have to respond to our on-net prices by offering low any-net rates for calls to all consumers. They merely have to attract 1 or 2 or 3 or 4 customers and offer them a better deal.

	Number of subscribers	Percentage	Calling circle size
Total BestMates	[] VNZRI	100%	
Exclusive reciprocated	[] VNZRI	[] VNZRI	2
Exclusive unreciprocated	[] VNZRI	[] VNZRI	2
Pay for more than one BestMate	[] VNZRI	[] VNZRI	3 or 4
Other	[] VNZRI	[] VNZRI	

Of all BestMate customers, [] VNZRI are exclusively reciprocated so that both parties pay to be each other's BestMate, and do not pay to be any other person's BestMate.

A further [] VNZRI are exclusive one-way BestMates, where one party pays, and the receiving party does not pay to be any other person's BestMate.

Overall, the data indicates that almost all (i.e. [] VNZRI) BestMate customers are in calling circles sized 2. For all other calls they make to consumers outside this bundle, they will not face the low on-net rates implied by our BestMate offerings.

A further [] VNZRI pay for more than one (2 or 3) BestMates and are therefore part of calling circles sized 3 or 4.

Calling circles of 1

At the conference, Tom Chignell referred to the number of customers that have no on-net plan (refer to page 91 of the transcript). There are about [] VNZRI million *active*² prepay customers that have no on-net bundle and face the headline rate for calling and SMS. These customers are part of calling circles sized 1.

4. Traffic flow information from overseas - international information in relation to the kind of traffic flows that would be expected or have been observed when a small new entrant comes into a market

The argument has been put forward that 2degrees must offer any-net plans that mimic the on-net plans of larger networks if it is to be able to compete in the retail mobile market. It is then argued that this will lead to traffic imbalances and high net termination payments that would undermine its ability to compete. The rationale is that if a new entrant offers lower off-net rates than an existing operator, the new entrant's customers will make more calls, on average, to the existing operators' network than they receive in return.

The reality, however, is that we are not observing large asymmetries in the traffic flows between the Vodafone and 2degrees networks since its launch in August of this year. We have also not observed large traffic flow imbalances between our network and Telecom's in the past – irrespective of the various retail offerings that existed in the market at the time. As indicated above, we will provide further data on this point to the Commission on 7 October 2009.

At the conference, however, Vodafone was asked whether it had any information on traffic flows from overseas jurisdictions.

Vodafone has been able to attain voice traffic flow information from three overseas markets where it is a network operator with a relatively small market share. In this regard we have traffic flow data from Qatar (2009), Hungary (2008), and the Czech Republic (2008). In all cases, traffic flows are close to balanced. We have not been able to get any data on SMS in these markets.

² An active customer is defined as one who has topped up their account at some point during the previous 12 months and has activity in the previous 180 days.

Qatar is an unregulated market at this point; while Hungary and the Czech Republic are both regulated markets. The termination rate in the Czech Republic in 2008 was 12.55 euro cpm and 8.57 euro cpm in Hungary.

Vodafone Czech Republic:

[

] VNZRI

Vodafone Hungary:

[

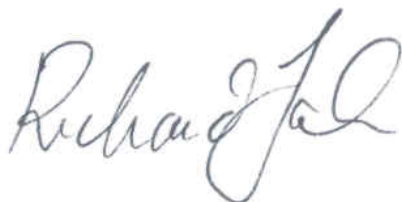
] VNZRI

Vodafone Qatar:

Vodafone Qatar commercially launched in July this year, and is competing against a large existing operator (QTEL). Outbound was [] VNZRI than inbound until prepay was launched on 9 September 2009. From that point inbound is [] VNZRI than outbound.

Should you have any further queries in relation to this data, please feel free to contact me on 021 882 429.

Yours sincerely,



Richard York
Regulatory Manager
Vodafone New Zealand Limited