

13 April 2010

Hon Steven Joyce
Minister for Communications and Information Technology
Parliament Buildings
Wellington 6011



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Dear Minister Joyce

Mobile Termination Access Services – Retail Price Discrimination

I write concerning new information relevant to the Minister's decision on whether to regulate MTAS which we must bring to your attention now.

Today Vodafone introduced an extremely damaging on-net pricing plan called "Talk Add-on". This offers Vodafone pre-pay customers 200 minutes of voice calling to any Vodafone mobile or New Zealand landline for \$12 per month.

Existing Vodafone TXT2000 and TXT4000 on-net bundles have resulted in over 90% of SMS messages in New Zealand being confined to within the same networks. Today's offer extends this incumbent market foreclosure technique to now include voice calling. It has the potential to be deeply damaging to competition and to consumers' legitimate expectation of any-to-any connectivity. The ability for consumers to enjoy the full utility of mobile could be choked off as effectively as it has been for SMS communications. The result will be further entrenchment of the geographic based monopolies so prevalent in New Zealand today.

The development also brings into question the conclusions reached by the Commission in its Final Report regarding estimated on-net retail price reductions and the ability of new entrants to compete.

Vodafone states on its website that its "Talk Add-on" bundle delivers an effective calling rate of 6cpm. It is telling that off-net calling prices remain unchanged at 89cpm, or up to fifteen times the on-net calling rate. It is also telling that the on-net rate on a cost per leg basis is just 2.25c once GST and cost of sales at 18% have been deducted. This is a quarter of the wholesale rates other networks would be required to pay Vodafone from January 2011 if the Final Undertakings are accepted, and clearly demonstrate how far above cost the Final Undertakings must be.

Vodafone has designed this offer to make rival networks as unattractive as possible for its customers to call, and constitutes classic monopoly behaviour. Vodafone seeks to deter consumers from making any off-net calls, and so reduce the utility of subscribing to a competitor as the benefit of receiving incoming calls is lost. Any rival hoping to match Vodafone's prices for calls to Vodafone customers would incur costs of \$26.50 before any margin could be made, over twice the Vodafone retail price – and that is based on Undertakings access prices that start next year.

There are circumstances where 2degrees offers lower on-net rates than off-net rates but these are a direct result of the current MTR regime and are justified solely on differential cost grounds. Where we offer lower on-net prices, we earn comparable retail margins on both on-net and off-net calls.

There is no cost justification for the fifteen fold price differential between Vodafone's on-net and off-net prices. As you will be aware from our submission to the Minister on the Final Report, loss of the benefit of incoming calls is the most common reason given by our customers for leaving our network to return to an incumbent provider.

Designing offers to make new entrants as unattractive as possible is the precise behaviour complained of by Vodafone when it sought and obtained from the Commission an obligation on Telecom not to discriminate against calls to Vodafone's local numbers in the *Homezone* decision because;

"...if Telecom can require callers to Vodafone local numbers to pay higher rates than callers to other local numbers, there could be a significant disincentive to take up Vodafone's local service. Hobbling Vodafone's local service before it begins is unlikely to promote competition for the long-term benefit of end users" (Vodafone, Letter – Commission , 4 April 2006, para 43)

The Commission identified in the Final Report the harm which results from above cost MTRs in combination with on-net / off-net price discrimination and placed significant weight on on-net retail prices as a cross-check on access prices that would enable a new entrant to compete. The Commission estimated that significant barriers to entry could re-emerge if on-net retail prices decreased at a rate greater than 5% pa and committed to monitor on-net retail prices and consider further regulatory intervention if this, or other barriers to entry occurred (para 880 and 954).

This has now occurred, just weeks after the Final Report was published. The Commission must now be duty bound to consider further regulation of retail pricing without further hesitation even before you have made public your decision on whether to regulate MTAS.

However, in order to avoid the delay of a further Commission investigation we urge you Minister to address discriminatory retail pricing now by prohibiting on-net / off-net price discrimination unless it can be justified on cost grounds.

TSLRIC based regulation of wholesale MTRs alone will not address the significant competitive distortions in the New Zealand market. The above-cost rates provided for in the Final Undertakings will certainly fail to do so. However, as Ofcom recently concluded, LRIC based pricing (of around \$0.01) will go some way to doing so in the UK. The New Zealand market however may be more difficult to resolve without appropriate retail intervention given the closed network monopolies that have been allowed to develop.

The case for true cost based pricing is now overwhelming. The risk of not doing so is to subject consumers to further entrenchment of the closed networks, high prices and geographic monopolies that characterise the New Zealand market today.

Yours sincerely



Bill McCabe
Chief Operating Officer
Two Degrees Mobile Limited