



COMMERCE COMMISSION

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1009171_1.doc
13.6/11128

Draft Reconsideration Report on whether the mobile termination access services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination) should become designated or specified services

Draft Reconsideration Report under clause 6(2)(b) of Part 1 of Schedule 3 of the Telecommunications Act 2001.

The Commission: Dr Ross Patterson (Telecommunications Commissioner)
Anita Mazzoleni
Gowan Pickering

Draft Recommendation of the Commission:

For the reasons set out in this Draft Reconsideration Report, the mobile termination access services should be made a designated access service on the basis of the proposed regulatory change set out in paragraph 23 (the **proposed regulatory change**) and the Final Undertakings should not be accepted under Schedule 3A of the Act as an alternative to the proposed regulatory change.

Date of Draft Reconsideration Report: 12 May 2010

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS

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EXECUTIVE SUMMARY

Introduction

1. In the mobile termination access services investigation (**MTAS Investigation**), concluded on 22 February 2010, the Commerce Commission (the **Commission**) considered whether or not to recommend to the Minister for Communications and Information Technology (the **Minister**) that the MTAS should become a regulated service under the Telecommunications Act 2001 (the **Act**).¹ As part of the MTAS Investigation, the Commission also considered whether the Final Undertakings submitted by Telecom and Vodafone² should be recommended for acceptance as an alternative to regulation.

Recommendation and views in Final MTAS Report

2. The recommendation of the Telecommunications Commissioner in the Commission's Final MTAS Report³ was that:

“For the reasons set out in paragraphs 531 to 781 [of the Final MTAS Report], while there are grounds to recommend the mobile termination access services should be made a designated access service by adding the item set out in paragraph 366 [of the Final MTAS Report] to Subpart 1 of Part 2 of Schedule 1 of the Act (the **proposed regulatory change**), I recommend that the Final Undertakings are accepted under Schedule 3A of the Act as an alternative to the proposed regulatory change”

3. Associate Commissioner Pickering concurred with the recommendations of the Telecommunications Commissioner.⁴ Commissioner Mazzoleni's view was that the MTAS should be regulated as a designated service on the basis of the proposed regulatory change set out in paragraph 366 of the Final MTAS Report.⁵

Requirement to reconsider recommendation

4. On 26 April 2010, the Minister required the Commission, pursuant to clause 6(2)(b) of Schedule 3 of the Act, to reconsider its recommendation in the Final MTAS Report.⁶ The Minister requested that the Commission:

“consider:

- any relevant retail offers that have been released since [the Commission sent its report to the Minister] on 22 February 2010, or that may be released by the time [the Commission finalises its] reconsidered recommendation; and
- the implications (if any) that those offers have on the [Commission's recommendation that the Minister] accept the undertakings put forward by Telecom and Vodafone.”

(the **reconsideration request**).

¹ The Commission concluded that the format of regulation to be considered is designation, which would involve setting both price and non-price terms for the MTAS.

² Telecom's Undertaking of 11 February 2010 and Vodafone's Undertaking of 16 February 2010, collectively referred to as the **Final Undertakings**.

³ Commerce Commission, *Final Report on whether the mobile termination access services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination) should become designated or specified services*, 22 February 2010 (**Final MTAS Report**), page 15, paragraph xxix.

⁴ Final MTAS Report, page 19, paragraph lv.

⁵ Final MTAS Report, pages 20-23, paragraphs lvi-lxxi.

⁶ Letter from the Minister to the Commission, *Mobile Termination Access Services*, 26 April 2010.

Process and focus of reconsideration

5. In this Draft Reconsideration Report, the Commission has considered information about new retail plans released since 22 February 2010 and information about future retail plans that interested parties intend to release, before the expected date of the Commission's Final Reconsideration Report in early June 2010 (**relevant retail offers**). The Commission has considered whether the relevant retail offers have implications for the recommendation in the Commission's Final MTAS Report. Interested parties also provided information about retail plans that are intended to be released after early June, which the Commission has commented on in this Draft Reconsideration Report in the context of its analysis of possible future market behaviour and the draft reconsideration recommendation.
6. The central issue that the Commission has analysed in this Draft Reconsideration Report is whether the relevant retail offers raise any competition concerns which the Commission had considered in the Final MTAS Report would be addressed by the Final Undertakings, and whether any such competition concerns have implications for the Commission's recommendation in the Final MTAS Report that the Final Undertakings be accepted as an alternative to regulation.
7. The competition concerns identified in the MTAS Investigation were summarised in the Executive Summary of the MTAS Final Report as follows:
 - “xi. The larger {mobile network operators (**MNOs**)} often set retail prices for calls and SMS that remain on the same network at a level that is considerably lower than for calls and SMS between networks (referred to as on-net discounting). Such on-net discounting makes it more attractive for subscribers to belong to a large network.
 - xii. The Commission has concluded that a combination of wholesale mobile termination rates (**MTR**) that are significantly above cost, with significant on-net discounting, creates a barrier that restricts the ability of a small entrant MNO to compete with the larger MNOs. This conclusion applies to both {mobile to mobile} voice and {short message service} services.
 - ...
 - xiv. The competition problem that the Commission has identified in the retail FTM / tolls markets is the barrier to competition created by above-cost MTRs. The difficulties faced by fixed-only operators in supplying {fixed to mobile (**FTM**)} calls are particularly evident where integrated operators have offered retail FTM prices close to or below the wholesale MTRs.”
8. Having regard to the nature of the relevant retail offers (summarised in Section II), which apply predominantly in the retail mobile services market, the Commission's assessment has focussed on competition concerns related to the supply of mobile to mobile (**MTM**) services, and in particular the impact that above cost mobile termination rates (**MTRs**) in combination with substantial on-net MTM discounting could have on the ability of a new entrant to compete in the supply of these services. The Commission has then considered the impact of this assessment in the context of whether or not to recommend acceptance of the Final Undertakings or regulation of the MTAS.

Preliminary Conclusions of the Commission

9. The recent introduction of the Talk Add-on plan by Vodafone offers relatively low retail on-net MTM calling prices. The new plan introduces into the prepay market segment on-net calling to an unlimited number of Vodafone mobiles. The Commission notes that while Vodafone suggests the innovation of the Talk Add-on plan is the provision of cheap mobile

to fixed (MTF) calls,⁷ the provision for cheap calling to Vodafone mobiles, without restriction on the times when these calls can be made, is also a new feature in the prepay mobile segment.

10. The Commission's preliminary view is that a plan such as the Talk Add-on plan is likely to increase the difficulties an entrant faces in competing.⁸ In order to be able to compete with the new Talk Add-on plan, a new entrant may be forced to offer off-net calling at a retail price as low as 7.7cpm (or lower if utilisation is higher than the level assumed in this Draft Reconsideration Report). This represents a significant reduction in on-net retail prices, and a significant widening of the differential between on-net and off-net prices.
11. Given the wholesale MTRs contained in the Final Undertakings, which remain above the Talk retail price until 2014, and that the entrant will incur other costs that would also need to be recovered from the retail price (such as the costs of call origination and marketing), the Commission's preliminary view is that if the Final Undertakings are accepted, the new Talk plan will retain the barrier to expansion that the Commission was seeking to address during the MTAS Investigation.
12. The Commission's preliminary view is that, given the low retail price, the absence of restrictions on the times when the available minutes can be used, and the availability of the new Talk Add-on plan to the broader and important prepay segment of the retail market, is that such a plan is likely to have a significant impact, both in terms of penetration in the retail market, and in terms of competition.
13. While low retail prices arising from the Talk Add-on plan will benefit end users on the Vodafone network in the short-term, the Commission's preliminary view is that there may be longer term detrimental effects on competition in the mobile services market. The issue is not the level of retail pricing *per se*; the competition concern arises from the relationship between the wholesale MTR and the retail price, and the extent to which the combination of low on-net retail prices and above-cost wholesale MTRs erects a barrier to efficient expansion by a new entrant.
14. The Commission notes that even if Vodafone were to withdraw the Talk Add-on plan, it would retain the discretion, and have the incentive, over the 5-year period of the Final Undertakings, to introduce pricing which would cause the barrier to re-emerge.
15. The recommendations of Commissioners Patterson and Pickering in the Final MTAS Report that the Final Undertakings would address the competition concerns identified throughout the MTAS Investigation were based on a number of assumptions by Commissioners Patterson and Pickering about the future behaviour of Telecom and Vodafone based on their past conduct, and statements made by them in the course of the MTAS Investigation. These assumptions are discussed further in paragraphs 26 to 31 of this Draft Reconsideration Report.
16. The Commission's preliminary view is that the introduction of the Talk Add-on plan is evidence that Commissioner Patterson and Pickering's assumptions have been undermined. The conclusion that "the competition concerns identified by the Commission would be

⁷ Vodafone letter to Minister, 26 April 2010, page 2.

⁸ As noted in paragraph 126 below, Vodafone's economic expert, Covec, has noted the implications of such a plan in terms of the difficulties that a small entrant may face in competing.

addressed in a timely manner by acceptance of the Final Undertakings”, which was based on those assumptions, therefore cannot stand.

17. In the Commission’s preliminary view, in light of market developments since the Final MTAS Report, cost-based MTRs will better promote competition in the retail mobile market, when compared to the Final Undertakings, and would therefore be in the best long-term interests of end-users in accordance with section 18 of the Act.
18. The Commission also considers that the introduction of cost-based MTRs, which all parties involved in the MTAS Investigation have agreed will be efficient, will best promote competition in the relevant downstream markets. Where cost-based wholesale MTRs apply, the Commission’s preliminary view is that all MNOs would be expected to be able to vigorously compete for subscribers in the downstream retail market and to provide competitive and innovative calling, SMS, and other services to those subscribers. This would also address concerns raised by Vodafone that the Commission's use of average on-net retail prices as a “cross-check” on MTRs is distorting retail mobile competition.

Commission’s Recommendations and views of two members of the Commission other than the Telecommunications Commissioner

19. Paragraph 23 of this Draft Reconsideration Report contains the Commission’s draft reconsideration recommendation. Paragraphs 25 to 33 set out additional views of Commissioners Patterson, Pickering and Mazzoleni regarding the recommendation.

DRAFT RECONSIDERATION RECOMMENDATION

Framework for recommendation

20. The Act requires the Commission to make a recommendation in the reconsideration which it considers best gives or is likely to best give effect to the promotion of competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand.⁹ In making this recommendation, the Act requires that the Commission consider the efficiencies that will result, or will be likely to result, from its proposed recommendations.
21. In carrying out its assessment for the purposes of and making its recommendations in this Draft Reconsideration Report, the Commission has taken account of the statutory purpose and all required considerations pursuant to the Act.
22. Given that the Final Undertakings were presented as a package of services, incorporating fixed to mobile (**FTM**), **MTM** and short message service (**SMS**), the Commission is required to make a recommendation to either accept or reject the Final Undertakings in their entirety, notwithstanding that this Draft Reconsideration Report has considered competition concerns related to the supply of *MTM* services in light of relevant retail offers introduced since the Final MTAS Report. Additionally, given the reciprocity requirements and symmetric price terms in the Final Undertakings, any finding with respect to the *MTRs* in Final Undertakings in the context of the competition concerns identified by the Commission must have the result that the Commission recommends that both Telecom and Vodafone's Final Undertakings are accepted or rejected in the same manner.¹⁰

Draft reconsideration recommendation

23. Based on the analysis set out in this Draft Reconsideration Report, the Commission's draft reconsideration recommendation to the Minister, under clause 6(2)(b) of the Act, is that:
- the following services should be added to Part 2, Subpart 1 of Schedule 1 to the Act (the **proposed regulatory change**):¹¹

| Mobile termination access services (MTAS) | |
|--|---|
| Description of service: | <p>Termination (and its associated functions) on a cellular mobile telephone network of:</p> <ul style="list-style-type: none"> ▪ voice calls originating on a fixed telephone network; ▪ voice calls originating on another cellular mobile telephone network; and ▪ short-message-service (SMS) originating on another cellular mobile telephone network. <p>For the avoidance of doubt, this service includes the termination of internationally-originated voice calls and SMS, and voice-over-internet-protocol-originated voice calls,</p> |

⁹ See sections 18 and 19 of the Act.

¹⁰ See Final MTAS Report, pages 192-195, paragraphs 836-850.

¹¹ The proposed regulatory change is the same as that assessed by the Commission in the Final MTAS Report.

| | |
|--|---|
| | where these are handed over at a mobile switching centre in New Zealand. |
| Conditions: | Nil |
| Access provider: | A person who operates a cellular mobile telephone network |
| Access seeker: | A service provider who seeks access to the service |
| Access principles: | The standard access principles set out in clause 5 |
| Limits on access principles: | The limits set out in clause 6 |
| Initial pricing principle: | <p>Benchmarking against the costs of providing similar services in comparable countries that result from the application of –</p> <ul style="list-style-type: none"> (a) a forward-looking cost-based methodology; or (b) if the Commission considers that a forward-looking cost-based methodology does not best give effect to the purpose set out in section 18, whichever of the following methods that the Commission considers best gives effect to that purpose: <ul style="list-style-type: none"> (i) a pure bill and keep method; or (ii) a pure bill and keep method applied to two-way traffic in balance (or to a specified margin of out-of-balance traffic) and a forward-looking cost-based methodology applied to out-of-balance traffic (or traffic beyond a specified out-of-balance margin). |
| Final pricing principle: | <p>Either –</p> <ul style="list-style-type: none"> (a) TSLRIC; or (b) if the Commission considers that TSLRIC does not best give effect to the purpose set out in section 18, whichever of the following methods that the Commission considers best gives effect to that purpose: <ul style="list-style-type: none"> (i) a pure bill and keep method; or (ii) a pure bill and keep method applied to two-way traffic in balance (or to a specified margin of out-of-balance traffic) and TSLRIC applied to out-of-balance traffic (or traffic beyond a specified out-of-balance margin). |
| Requirement referred to in section 45 for final pricing principle: | Nil |

and

- the Minister should not accept the Final Undertakings offered by Telecom and Vodafone under Schedule 3A of the Act.

ADDITIONAL VIEWS OF COMMISSIONERS

24. In addition to the preliminary conclusions of the Commission set out in this Draft Reconsideration Report, Commissioners make the following additional preliminary observations.

Additional Views of the Telecommunications Commissioner and Associate Commissioner Pickering

Assumptions about Future Pricing Behaviour

25. In the MTAS Final Report, Commissioner Mazzoleni concluded that where MTRs were above cost, the Final MTAS Report had observed that large mobile network operators were unlikely to retaliate to vigorous competition by dropping on net prices to cost because the size of such reduction would be substantial. She expressed significant difficulty with that outcome if the assumptions upon which this observation were premised did not play out, and stated that regard also needed to be had to the response likely from each large network, rather than simply a weighted average response. She concluded that the MTRs proposed in the Final Undertakings were high enough to retain the barrier to competition.¹²
26. We, on the other hand, concluded that the Final Undertakings would address the competition concerns identified by the Commission ie the barrier to entry/expansion represented by the combination of high MTRs and on-net/off-net price differentials would be removed. We did not think a steeper fall in retail on-net prices, as contemplated by Commissioner Mazzoleni, was likely in the current New Zealand market.¹³
27. As part of our deliberations in coming to this conclusion, we made a number of assumptions about the future behaviour of Telecom and Vodafone, based on their past conduct, and statements made by them in the course of the MTAS Investigation. Those assumptions were:
- that Telecom was not using on-net pricing as a significant marketing strategy and was unlikely to do so in the future.
 - that while Vodafone had used the strategy extensively in the past, it was unlikely to engage in aggressive on-net discounting in the future, as the cost to it in lost revenue if a significant on-net discount was offered across its customer base made such a strategy very unlikely.
 - Vodafone had submitted that the fall in MTRs in its undertakings put at risk revenue of more than \$450 million over five years¹⁴, and that it was not credible to assume mobile operators would not respond in some way, such as increasing retail mobile prices, or reducing such prices more slowly than otherwise would have been the case. Other consequences it claimed were credible included introducing more

¹² Final MTAS Report para lxvi.

¹³ Final MTAS Report para xli.

¹⁴ This figure of \$450million over five years was contained in: Vodafone, *Telecommunication Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination Access Services*, 16 October 2009, page 5, para 7.

stringent top up conditions for pre-pay customers, reducing handset subsidies, reducing investment, and delaying the introduction of innovative new services.¹⁵

- that accordingly Vodafone was highly unlikely to engage in significant on-net price discounting in order to retaliate to vigorous competition, as the cost would only compound the difficulties alluded to in their submission. We accepted Vodafone's submission that it was not credible to assume it would not respond by adopting the opposite strategy, i.e. increasing retail prices and/or imposing more stringent top up conditions for prepay customers.
- that Telecom and Vodafone:
 - having argued that the Commission's benchmarks and proposed use of the median was inappropriate by reference to their costs; and
 - having offered undertakings to reduce MTRs in order to address the competition concerns the Commission had identified,

would be highly unlikely to subsequently lower on-net prices to such a level that, when combined with the reduced MTRs, they would thereby recreate the barrier to entry and expansion that the Final Undertakings they had offered had been designed to remove.

28. The Commission recognised that if the Final Undertakings were accepted, there would be an opportunity for Telecom and/or Vodafone, throughout the Undertaking period, to adopt a strategy which created a price barrier of the nature which the Commission had repeatedly indicated raised competition concerns. This opportunity arose because the termination rates in the Final Undertakings were higher than the Commission's benchmarked range of MTRs. The Commission therefore stated that it would monitor MTRs and would consider further action if it observed a re-emergence of the barriers related to these competition concerns.
29. We concluded, on the basis of the assumptions set out above, that neither Telecom nor Vodafone would be likely to adopt pricing strategies which would recreate such a barrier, that therefore the Final Undertakings would address the competition concerns the Commission had identified, and as a result the threshold test we had described in paragraph xxxix of the Final Report had been met.
30. Our preliminary view is that the introduction of the Talk Add-on plan is evidence that the assumptions we made, at least in respect of Vodafone's future behaviour, have been undermined, and as a consequence our conclusion that "the competition concerns identified by the Commission would be addressed in a timely manner by acceptance of the Final Undertakings", which was based on those assumptions, cannot stand.
31. Had we assumed that it was likely that on-net pricing plans with the characteristics of the Talk Add-on Plan would be released in the future, we would have concluded the Final Undertakings would not address the competition concerns outlined in the Final Report, and we would have recommended mobile termination access services be regulated as a

¹⁵ MTAS Final Report - Appendix 5, page 285, paras 41 and 42.

designated service, and that the Final Undertakings should not be accepted under Schedule 3A of the Act as an alternative to the proposed regulatory change.

32. Commissioners Patterson and Pickering therefore agree with the draft recommendation in paragraph 23.

Additional Views of Commissioner Mazzoleni

33. I have considered the analysis in this Draft Reconsideration Report, of the relevant retail mobile plans offered into the market since the release of the Final MTAS Report. Having reconsidered their impact on the Commission's decision in the Final MTAS Report, my view remains, as fully set out in paras lvi – lxxi of the Final MTAS Report, that MTAS should be added to the Act as a designated service. Retail plans offered into the market since the release confirm my view that regulation as a designated service, rather than Final Undertakings, is the outcome that best promotes competition in telecommunication markets for the long term benefit of end users, and therefore the one that meets the statutory test. I therefore agree with the draft recommendation in paragraph 23.
34. Whilst recent retail plans offered into the market since the release of the Final Report confirm my view that regulation is appropriate, I also note that, unless they breach the Commerce Act, vigorously competitive retail offerings must be strongly encouraged. The role of the regulator under the Telecommunications Act is designed to ensure that the correct settings are made in the wholesale markets, which allow competition to flourish in the retail market for the long term benefit of end users. Where wholesale prices are reflective of cost and barriers to efficient entry and expansion are addressed, there can be no benefit in the regulator prescribing the details of retail plans. A further adverse consequence of the above TSLRIC prices in the Final Undertakings are the perceived distortionary effects on retail plans that are apparent from the additional information provided by Vodafone for this reconsideration. I note that such distortions are unlikely to occur if MTRs are regulated at TSLRIC prices. Such prices will remove the cushion above TSLRIC that large operators would otherwise receive from the Final Undertakings, against which a new entrant is not able to compete.

DATED this 12th day of May 2010



Dr Ross Patterson
Telecommunications Commissioner

SECTION I: BACKGROUND TO RECONSIDERATION PROCESS

Introduction

35. In the MTAS Investigation, concluded on 22 February 2010, the Commission considered whether or not to recommend to the Minister that the MTAS should become a regulated service under the Act. As part of the MTAS Investigation, the Commission also considered whether the Final Undertakings submitted by Telecom and Vodafone should be recommended for acceptance as an alternative to regulation.

Recommendation and views in Final MTAS Report

36. The recommendation of the Telecommunications Commissioner in the Commission's Final MTAS Report¹⁶ was that:

“For the reasons set out in paragraphs 531 to 781 [of the Final MTAS Report], while there are grounds to recommend the mobile termination access services should be made a designated access service by adding the item set out in paragraph 366 [of the Final MTAS Report] to Subpart 1 of Part 2 of Schedule 1 of the Act (the **proposed regulatory change**), I recommend that the Final Undertakings are accepted under Schedule 3A of the Act as an alternative to the proposed regulatory change”

37. Associate Commissioner Pickering concurred with the recommendations of the Telecommunications Commissioner.¹⁷ Commissioner Mazzoleni's view was that the MTAS should be regulated as a designated service on the basis of the proposed regulatory change set out in paragraph 366 of the Final MTAS Report.¹⁸

Request for reconsideration

38. On 13 April 2010, Vodafone New Zealand launched a new Talk Add-on product, which is marketed as providing Vodafone's prepay customers up to 200 minutes to Vodafone New Zealand mobiles and landlines for \$12 a month, and is promoted on Vodafone's website as offering calls for 'just 6 cents a minute to Vodafone NZ mobiles and landlines in New Zealand'.¹⁹
39. On 19 April 2010, the Minister wrote to the Commission advising that Ministry of Economic Development officials had expressed the view that the rates available under the new on-net offer from Vodafone may be material to the determination of the issue of whether or not smaller operators could compete with Telecom and Vodafone's on-net retail rates, which was of significant concern in the Commission's Final MTAS Report to the Minister.²⁰
40. The Minister requested comment on whether or not the Commission considered that this was the case.

¹⁶ Final MTAS Report, page 15, paragraph xxix.

¹⁷ Final MTAS Report, page 19, paragraph lv.

¹⁸ Final MTAS Report, pages 20-23, paragraphs lvi-lxxi.

¹⁹ <http://www.vodafone.co.nz/plans/prepay/cheap-talk.jsp>.

²⁰ Letter from Minister to the Commission, 19 April 2010.

41. On 19 April 2010, the Commission advised that Minister that its:²¹

“initial view is that such a plan (and any market outcomes which may arise from it) may be material. Further, the Commission’s initial view is that such a plan may have the potential to affect the basis for the Commission’s recommendation in the Final Report (with which Commissioner Mazzoleni did not concur) that the Telecom and Vodafone Final Undertakings would address the competition issues which the Commission identified throughout the MTAS Investigation, and should therefore be accepted as an alternative to regulation.”

42. On 26 April 2010, the Minister required the Commission, pursuant to clause 6(2)(b) of Schedule 3 of the Act, to reconsider its recommendation in the Final MTAS Report. The Minister requested that the Commission:²²

“consider:

- any relevant retail offers that have been released since [the Commission sent its report to the Minister] on 22 February 2010, or that may be released by the time [the Commission finalises its] reconsidered recommendation; and
- the implications (if any) that those offers have on the [Commission’s recommendation that the Minister] accept the undertakings put forward by Telecom and Vodafone.”

43. On 27 April 2010, the Commission notified interested parties of its indicative process and timeline for the reconsideration process.²³

Commission’s draft recommendation takes into account statutory purpose and other statutory considerations

44. In carrying out its assessment for the purposes of and making its recommendations in this Draft Reconsideration Report, the Commission has taken account of the statutory purpose in section 18 of the Act and all required considerations pursuant to the Act.²⁴

Scope of issues considered in this Draft Reconsideration Report

45. The Commission noted in its letter of 27 April 2010 that:²⁵

“Given the scope of the Minister’s request, the reconsideration will be confined to the issue of whether any relevant retail offers that have been released since 22 February 2010, or that are to be released before the Commission expects to complete its Final Reconsideration Report in early June, have implications for the Commission’s recommendation in the Final Report. The Commission is aware of two retail offers that have been released since 22 February 2010, being Vodafone’s Talk Add-on plan and 2degrees’ 2cent text to 2degrees mobiles top-up offer.”

46. This reconsideration is of the Commission's recommendation in the Recommendations and Reasons section of the MTAS Final Report, and is limited to the issue noted in paragraph 42 above in accordance with the reconsideration request. Other sections of the Final Report (including findings on market definition, the benchmark set, the factual and

²¹ Letter from the Commission to the Minister, *Commission’s Final Report on Schedule 3 investigation into whether or not mobile termination access services should become regulated services (Final Report)*, 19 April 2010.

²² Letter from the Minister to the Commission, *Mobile Termination Access Services*, 26 April 2010.

²³ Letter from the Commission to interested parties, *Mobile termination access services investigation – indicative process and timeline for reconsideration*, 27 April 2010.

²⁴ The purpose set out in section 18 and other statutory considerations, such as the requirement to consider efficiencies and have regard to economic policies of the Government, are set out in the MTAS Final Report, pages 33-34, paragraphs 42-46.

²⁵ Above note 23, page 2.

counter-factuals, and qualitative and quantitative analysis) are not subject to reconsideration.

47. The Commission has considered the impact of the relevant retail offers in the context of whether or not a recommendation of acceptance of the Final Undertakings or regulation of the MTAS will best give or be likely to best give effect to the purpose of section 18 of the Act.

Structure of this Draft Reconsideration Report

48. The remainder of this Draft Reconsideration Report is structured as follows:
- Section II summarises the competition concerns that the Commission has considered in this Draft Reconsideration Report;
 - Section III summarises information provided by interested parties about relevant retail plans;
 - Section IV analyses whether competition concerns are raised based on the information provided by interested parties about relevant retail plans and the effect (if any) of such concerns on the Commission's recommendation in the Final MTAS Report;
 - Appendix I summarises the Final Undertakings and details of relevant commercial interconnection agreements; and
 - Appendix II provides a sensitivity analysis in relation to the estimated margins that a small entrant would earn when supplying a retail plan in competition with Vodafone's Talk Add-on.

Consultation on this Draft Reconsideration Report

49. The Commission's indicative timetable for the remainder of the MTAS Reconsideration process is as follows:

| MILESTONE | DATE |
|--|-----------------|
| Draft Reconsideration Report released | 12 May 2010 |
| Submissions on Draft Reconsideration Report due | 5pm 19 May 2010 |
| Cross-submissions due | 5pm 26 May 2010 |
| Final Reconsideration Report delivered to Minister | Early June 2010 |

Submissions process

50. Submissions should address and be directly relevant to the matters discussed in this Draft Reconsideration Report. In particular, submissions should address the Commission's draft recommendation in paragraph 23.

51. Parties should not repeat submissions made previously to the Commission or Minister, but where relevant to a submission on this Draft Reconsideration Report, may cross-refer to earlier submissions.
52. To promote an open and transparent process, the Commission intends to publish all submissions on its website. Accordingly, the Commission requests that all submissions are provided in electronic form.
53. Submissions on this Draft Reconsideration Report should be sent to:

shane.kinley@comcom.govt.nz

MTAS Reconsideration
Regulation Branch
Commerce Commission
PO Box 2351
Level 6, 44 the Terrace
Wellington
Enquiries: (04) 924 3686
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Status of information supplied to the Commission

54. The Commission discourages requests for confidentiality over submissions on the Draft Reconsideration Report, unless indispensable to a party's submission, as it is desirable that all the information in submissions be able to be tested as fully as possible in a public manner. The Commission is unlikely to agree to any requests that submissions in their entirety remain confidential.
55. However, the Commission recognises that interested parties making submissions may wish to provide confidential information to the Commission. Accordingly, the Commission issued, on 30 April 2010, a confidentiality order to apply to confidential information provided by interested parties making submissions in this proceeding (the **Reconsideration Confidentiality Order**).²⁶ The Reconsideration Confidentiality Order can be viewed on the Commission's website at www.comcom.govt.nz/mobiletomobiletermination/.
56. Confidential information cited in this Draft Reconsideration Report is subject to the Reconsideration Confidentiality Order. All restricted, additional protection and Commission only information has been extracted from the public version of this Draft Reconsideration Report.
57. After the expiry of the Reconsideration Confidentiality Order, the Commission will follow its usual practices in response to any request for information under the Official Information Act 1982.

²⁶ Pursuant to the Commerce Act 1987, section 100, as applied by the Telecommunications Act 2001, section 15(i).

SECTION II: COMPETITION CONCERNS IN MTAS INVESTIGATION AND RECONSIDERATION

Reconsideration of barriers to efficient entry and expansion

58. During this reconsideration, the Commission is considering whether the introduction of new retail plans since the Final MTAS Report is likely to raise competition concerns in the form of barriers to efficient entry and expansion in the retail mobile market. This section summarises the Commission's analysis and conclusions in the Final MTAS Report, and the sections that follow summarise the new retail plans and assess their implications for the ability of a small entrant such as 2degrees to compete in the supply of retail services when facing the wholesale MTRs contained in the Final Undertakings.
59. The Commission notes that while the Draft Reconsideration Report focuses on the MTR for MTM calls, the decision on whether to accept or reject the Final Undertakings will also have implications for the MTRs that apply for FTM calls and SMS because the Final Undertakings submitted by each of Vodafone and Telecom cover termination of MTM, FTM, and SMS (on a combined basis). Should a recommendation to reject the Final Undertakings and regulate the MTRs be accepted by the Minister, regulation would be introduced for the MTRs for MTM, FTM, and SMS services.

Summary of the competition concerns in the Final MTAS Report

60. An important consideration in the Final MTAS Report was whether an MTR would allow a small entrant to compete with the retail on-net prices of the larger mobile operators. The competition concern identified in the Final MTAS Report was that the combination of a high wholesale MTR and significant on-net discounting at the retail level may result in a barrier to efficient expansion by a small entrant such as 2degrees. For example, in assessing competition in the retail mobile services market, the Commission concluded that:²⁷

“Although a number of barriers to entry to the market have been reduced to some extent in recent times, current pricing practises of the incumbent operators are of concern. In particular, on-net pricing that is prevalent in the market, in combination with significantly above-cost termination rates, has lead to the creation of closed networks, with in excess of 80 percent of voice traffic, and over 90 percent of SMS traffic in New Zealand carried on-net. The Commission considers that this is likely to make it difficult for a new entrant to attract subscribers to its network.

In the presence of significant on-net price discrimination, the extent to which an entrant is able to compete in the market is likely to be highly dependent on the termination rates it faces. Faced with MTRs that are significantly above cost, a new entrant such as 2degrees is likely to be limited in its ability to constrain established operators in the retail market.”

61. The Final MTAS Report concluded that on-net discounting at the retail level would make subscription to a larger network more valuable for consumers. As noted in the Final MTAS Report, Vodafone's economic experts, Covec, acknowledged that on-net discounts will make subscription to a larger network more valuable for consumers, creating a competitive advantage for larger networks.²⁸

²⁷ Final MTAS Report, paragraphs 306-307.

²⁸ Final MTAS Report, paragraph 276.

62. In order to compete with such pricing and attract consumers, a small entrant was likely to have to reduce its off-net price, potentially to the level of the on-net price in order to be able to break into the closed calling circles of consumers on the networks of the larger operators. The relatively low off-net price offered by the entrant was likely to result in relatively high volumes of off-net calls being made by the entrant's subscribers, resulting in a net traffic flow from the entrant to the larger operators. A high MTR applying to the net outflow would result in the entrant incurring a loss on such traffic. As noted in the Final MTAS Report:²⁹

“... the entrant will make a loss on every off-net call, and would have to either increase its off-net price (and in so doing risk becoming unattractive to subscribers due to its relatively small customer base), or maintain the lower price and continue to incur losses on off-net calls. In either case, the entrant may be forced to exit, or at best would be constrained in its ability to compete for subscribers.”

63. To assist in informing its evaluation of whether a MTR would promote or impede competition in the downstream retail mobile market, the Commission's Final MTAS Report compared retail on-net prices to the wholesale MTR. In making this comparison, the Commission used the weighted average retail on-net price for MTM and SMS for 2008.

64. In the Final MTAS Report, the Commission estimated the average retail on-net MTM price to be 28.4cpm in 2008, based on revenue and volume information supplied by the mobile operators. The Commission allowed for an annual reduction of -5% in this average on-net price, and imputed the termination component that is implicit in the average retail on-net price.³⁰ The Commission had regard to the resulting implied on-net termination rates to:³¹

“... inform its evaluation of whether an MTR would allow an efficient entrant to compete in the retail mobile services market, and in particular whether such an entrant would be able to offer prices for off-net services (for which the MTAS is used as an input) that are competitive with the on-net plans of the established mobile operators. A wholesale MTR that lies within the range of implied termination rates for MTM and SMS ... should be likely, **absent other factors and behaviours by established operators**, to enable a small entrant to retail off-net prices that are comparable to the retail on-net prices of the larger mobile operators, and in so doing allow the entrant to compete for subscribers in the retail mobile market.” (emphasis added)

65. Commissioner Mazzoleni did not agree with this view and considered that a steeper fall in retail on-net prices was possible in the current New Zealand market.³²

66. During the course of the MTAS Investigation, the mobile operators submitted a number of undertakings. The Commission considered that the earlier undertakings submitted by Vodafone and Telecom did not offer sufficiently low MTRs to address the barrier faced by a small entrant trying to compete with the retail on-net pricing of the two established mobile operators.

67. In considering the MTRs contained in the Final Undertakings submitted by Vodafone and Telecom, the Commission concluded that the MTRs should (absent other factors and

²⁹ Final MTAS Report, paragraph 584.

³⁰ This imputation involved the deduction on non-termination costs from the retail price, such as the costs of retailing and call origination.

³¹ Final MTAS Report, paragraph 626.

³² Final MTAS Report, paragraph lxvi.

behaviour by established operators) enable a small entrant such as 2degrees to enter and compete with the expected retail on-net pricing of the larger mobile operators.³³

68. In the Final MTAS Report, the Commission also noted that:³⁴

“... were implied average on-net retail prices to decrease more rapidly than the 5%pa that the Commission has assumed ... then it is possible that a barrier to efficient entry and expansion in the mobile services market could re-emerge to the extent that a small MNO is not able to compete effectively. As a part of its monitoring programme, the Commission intends to monitor the mobile market to ensure such a barrier to efficient entry and expansion does not re-emerge. If monitoring indicates any issues in the mobile market, **such as** a reduction in implied average on-net retail prices to the extent that such a barrier re-emerged, then the Commission will consider whether further regulatory attention is warranted.” (emphasis added)

69. In other words, while the Commission considered that the MTRs contained in the Final Undertakings would allow a small entrant to compete with the on-net retail prices that were expected, the Commission noted that steeper reductions in on-net retail prices or other behaviour by established operators could lead to the retention of the barrier to efficient entry and expansion in the retail mobile services market. This would be the case where the entrant could not compete with the lower on-net retail prices, given the wholesale MTRs that the entrant would face.

Summary of competition concerns considered in this Draft Reconsideration Report

70. In this Draft Reconsideration Report, the Commission has considered whether the introduction of new retail plans since the Final MTAS Report is likely to retain or re-create the barriers to expansion in the retail mobile services market that were identified in the Final Report by reference to the Commission’s recommendation in the Final Report that the Final Undertakings be accepted.

³³ Final MTAS Report, paragraph 823.

³⁴ Final MTAS Report, paragraph 880.

SECTION III: INFORMATION ON RETAIL OFFERS CONSIDERED IN THIS DRAFT RECONSIDERATION REPORT

Information Request

71. In its letter of 27 April 2010, the Commission noted that it was “aware of two retail offers that have been released since 22 February 2010, being Vodafone’s Talk Add-on plan and 2degrees’ 2cent text to 2degrees mobiles top-up offer.” The Commission invited interested parties to provide “any information regarding new retail plans that have been released since 22 February 2010, or that are to be released before the Commission expects to complete its Final Reconsideration Report in early June, that parties wish the Commission to consider before issuing its Draft Reconsideration Report.”³⁵

Information provided

72. The Commission received information responses from 2degrees, Telecom, Vodafone, Woosh, the Telecommunications Users Association of New Zealand (TUANZ) and Drop the Rate, Mate. The replies from Woosh, TUANZ and Drop the Rate, Mate were focussed on the impacts of Vodafone’s Talk Add-on in the mobile services market, and have been taken into account in the Commission’s analysis in this Draft Reconsideration Report.

73. Telecom advised that they had:³⁶

“not released any retail plans since 22 February 2010 under which on-net prices were lower than the off-net prices.

As to our intentions going forward, we remain committed to our “One Rate” approach, and have no plans to change this prior to June at present. We will however continue to monitor competitor and market activity and develop commercial pricing plans accordingly.”

74. 2degrees provided the following summary of their current plan:³⁷

“It is prepay only, with 44 cents for any-net calls dropping to 22 cents for on-net and landline calls for 30 days after a customer has ‘topped-up’ their account. 2 cent on-net SMS is also provided for all customers for 30 days following a “top up” event.”

75. The Commission understands that the only element of 2degrees current retail plan that has been released since 22 February 2010 is the on-net text offer from 2degrees. The 2 cents per text rate under this offer compares to 2degrees standard text price of 9 cents per text to any mobile in New Zealand.

76. 2degrees also advised in relation to future pricing plans that [

] 2dCOI.³⁸

77. Vodafone advised that they had a number of:³⁹

“recent and upcoming changes to [their] Prepay offers:

³⁵ Above note 23, page 2

³⁶ Telecom, *MTAS – Indicative Process and Timeline for Reconsideration*, 3 May 2010, page 1.

³⁷ 2degrees, *MTAS – Your Letter regarding Indicative Process & Timeline for Reconsideration*, 3 May 2010, page 11.

³⁸ Ibid.

³⁹ Vodafone, *MTAS investigation – invitation regarding new retail plans*, 3 May 2010, pages 2-3.

- Talk, launched April 13, is an add-on to Supa Prepay that gives customers up to 200 minutes of voice calling to any New Zealand landline or any Vodafone mobile for \$12 a month.

[

]” VNZCOI

78. Vodafone subsequently provided further information on upcoming changes to retail plans:⁴⁰

“[

]” VNZCOI

⁴⁰ Vodafone, *MTAS investigation – additional information regarding new retail plans*, 4 May 2010, pages 1-2.

SECTION IV: ANALYSIS OF RETAIL OFFERS CONSIDERED IN THIS DRAFT RECONSIDERATION REPORT AND IMPLICATIONS FOR THE COMMISSION'S RECOMMENDATION

New retail plans since the Final MTAS Report

79. As discussed in Section III above, the Commission is aware of two retail offers that have been released since the Commission provided the Final MTAS Report to the Minister on 22 February 2010. These two new retail plans are 2degrees' 2 cents per text to 2degrees mobiles top-up offer, and Vodafone's Talk Add-on plan.
80. The new 2degrees pricing is unlikely to create a competition concern, due to the disparity in the market shares between 2degrees and the larger mobile operators. In addition, the new 2degrees pricing is for texts, and the retail price of 2 cents per text does not appear to be excessive when compared to the average termination rates for texts under the Final Undertakings that the Commission referred to in the Final Report.⁴¹
81. Vodafone's new Talk Add-on plan offers up to 200 minutes that can be used for on-net MTM calls or MTF calls, at a monthly price of \$12, including GST. According to Vodafone, the Talk Add-on plan provides for a retail calling price as low as 6cpm.⁴²
82. Based on data supplied by Vodafone during the MTAS Investigation, the Commission has estimated Vodafone's average retail price for on-net MTM calls in 2008 to be []VRIcpm.⁴³ Using the same approach, the Commission has estimated Vodafone's average retail price for MTF calls in 2008 to be []VRIcpm. The introduction of the new Talk Add-on plan, with average retail calling rates (for on-net MTM and any-network MTF) of as low as 6cpm, therefore offers prepaid subscribers significantly lower retail prices compared to Vodafone's average retail prices for such calls, and is likely to lead to an expansion in demand for MTF and MTM calls.
83. While low retail prices will benefit end users on the Vodafone network in the short-term, there may be longer term detrimental effects on competition in the mobile services market. The issue to be considered in this Draft Reconsideration Report is not the level of retail pricing *per se*; the competition concern arises from the relationship between the wholesale MTR and the retail price, and the extent to which the combination of low on-net retail prices and above-cost wholesale MTRs results in a barrier to entry and expansion to a new entrant.
84. In this section, the Commission compares the new Talk Add-on plan with other on-net calling plans that have been available in the New Zealand mobile services market. The Commission then analyses the new Talk Add-on plan, including the ability of a small entrant to offer a competitive retail plan, and considers whether such a plan is likely to retain the barrier to entry and expansion for a small entrant that was identified in the Final MTAS Report, and which it was considered that the Final Undertakings would address.

⁴¹ See for example, Final MTAS Report, paragraph 814, where the Commission referred to average text termination rates of between 0.71 cents per text and 0.98 cents per text under the hybrid BAK proposed in the final undertakings.

⁴² see <http://www.vodafone.co.nz/plans/prepay/cheap-talk.jsp>. The 6cpm figure appears to be based on \$12/200 minutes.

⁴³ As explained in the Final MTAS Report, this average price is calculated by adding retail on-net MTM calling revenues and a proportion of subscription revenues (with this proportion based on actual minutes), and dividing by the volume of actual on-net MTM minutes. See Final MTAS Report, from paragraph 590.

Comparing Vodafone's Talk Add-on plan with pre-existing on-net calling plans

85. On-net discounting has been a feature of the New Zealand mobile market for a number of years, with a number of retail plans offering lower prices for calls (and texts) between subscribers of the same network.
86. During the Commission's MTAS Investigation, there were a number of on-net plans available to end users. Vodafone's pre-existing on-net plans include the Best Mates plan, \$2 for 2 hours, Mega 20, and Talker plans, as well as the Family Add-on plan. Vodafone's You Choose contract plans have a number of add-on options, one of which (YourTime 200) provides a monthly allocation of off-peak on-net minutes. Vodafone's Motormouth on-account plan includes a bucket of on-net minutes and SMS.
87. Telecom's pre-existing on-net plan on its XT network is the My Favourites plan, offering unlimited calls to one other Telecom mobile or landline. Telecom has a number of Freetime plans on its CDMA network with on-net features.
88. In terms of on-net plans available to the prepay segment, which Vodafone has stated is its key retail market segment,⁴⁴ and the segment in which 2degrees currently competes, Vodafone's Best Mates plan offers unlimited calling, SMS, and MMS to **one** nominated Vodafone mobile subscriber.⁴⁵ Similarly, Telecom's My Favourites offers unlimited calling to **one** nominated Telecom mobile or landline. By comparison, Vodafone's new Talk plan offers 200 minutes per month to **any** Vodafone mobile (the Commission estimates Vodafone has around **2.4 million** active mobile subscribers) or any landline.
89. [Table 1](#) summarises these plans with on-net features, along with the new Talk Add-on plan.⁴⁶ The table does not include any-network plans such as those on Telecom's XT network, or any-net add-ons such as those available on Vodafone's Talker, Texter and You Choose plans, as these plans would not create the barrier to entry and expansion in the retail mobile market that can result from on-net discounts.⁴⁷

Table 1: Talk Plan and Pre-existing On-net Calling Plans

| Vodafone Plan | Price | includes | other comments |
|-------------------|--------------|--|---------------------|
| Talk Add-on | \$12/month | 200 minutes to any VF mobile or to any landline | prepay; min+min |
| Best Mates Add-on | \$6/month | unlimited calls, SMS, MMS anytime to 1 nominated VF mobile | prepay and contract |
| \$2 for 2 hours | \$2 per call | up to 2 hours to a VF mobile off-peak | prepay |

⁴⁴ Letter from Vodafone to Minister of Telecommunications, 26 April 2010.

⁴⁵ Subscribers can have up to 3 Best Mates (at a monthly price of \$6 for each Best Mate).

⁴⁶ [Table 1](#) only includes plans with on-net calling (as opposed to on-net SMS only plans, such as TXT2000), as the new Talk Add-on only includes calling.

⁴⁷ In the absence of on-net/off-net differentials, calling patterns between mobile networks would be expected to be balanced. The termination costs on outgoing off-net traffic would cancel out the termination revenue earned on incoming off-net traffic. As a result, a small entrant should be able to replicate any-network plans offered by the larger operators (such as Telecom's XT plans), even where the MTR exceeds the retail price.

| | | | |
|-------------------------------|----------------|--|-------------------------------|
| Mega 20 | \$39.95/month | 20 minutes to any NZ mobile, 200 minutes to any VF mobile, 2000 txts to any VF mobile, 1 Best Mate | contract (12 months), min+sec |
| Talker 60 | \$39.95/month | 60 minutes to any NZ mobile, free off-peak calls to VF mobiles, 1 Best Mate | contract (24 months), min+sec |
| Talker 120 | \$59.95/month | 120 minutes to any NZ mobile, free off-peak calls to VF mobiles, 1 Best Mate | contract (24 months), min+sec |
| Talker 250 | \$109.95/month | 250 minutes to any NZ mobile, free off-peak calls to VF mobiles, 1 Best Mate | contract (24 months), min+sec |
| Talker 600 | \$224.95/month | 600 minutes to any NZ mobile, free off-peak calls to VF mobiles, 1 Best Mate | contract (24 months), min+sec |
| Talker 1100 | \$369.95/month | 1100 minutes to any NZ mobile, free off-peak calls to VF mobiles, 1 Best Mate | contract (24 months), min+sec |
| Family Add-on | \$20/month | unlimited calls and texts between 4 VF mobiles | contract |
| YouChoose YourTime 200 Add-on | \$11.95/month | 200 off-peak minutes to VF mobiles | contract |
| Motormouth | \$39.95/month | 200 minutes to any VF mobile, 200 SMS to any VF mobile | contract, min+sec |
| | | | |
| Telecom Plan | | | |
| | | | |
| My Favourites | \$6/month | unlimited calls to 1 nominated Telecom mobile or landline | prepay and contract |
| | | | |
| Freetime 125 | \$20/month | 100 off-peak minutes to Telecom mobile or landline, 25 off-peak minutes to other NZ mobiles | contract |
| Freetime 300 | \$30/month | 250 off-peak minutes to Telecom mobile or landline, 50 off-peak minutes to other NZ mobiles | contract |
| Freetime 600 | \$40/month | 500 off-peak minutes to Telecom mobile or landline, 100 off-peak minutes to other NZ mobiles | contract |
| | | | |

90. [Table 2](#) summarises the key features of the on-net plans listed in [Table 1](#), including the number of on-net minutes included in each plan (and any limitations on these minutes, such as off-peak usage), and any limitations on the number of on-net mobiles that can be called.

Table 2: Key features of On-net Calling Plans

| Vodafone Plan | # on-net minutes | # on-net mobiles | |
|----------------------------------|-------------------------|-------------------------|---------------------|
| Talk Add-on | 200 anytime | unlimited | prepay |
| \$2 for 2 hours | <120 off-peak | unlimited | prepay |
| Best Mates Add-on | unlimited anytime | 1 | prepay and contract |
| Mega 20 | 200 anytime | unlimited | contract |
| Talker 60 | unlimited off-peak | unlimited | contract |
| Talker 120 | unlimited off-peak | unlimited | contract |
| Talker 250 | unlimited off-peak | unlimited | contract |
| Talker 600 | unlimited off-peak | unlimited | contract |
| Talker 1100 | unlimited off-peak | unlimited | contract |
| Family Add-on | unlimited anytime | 4 | contract |
| YouChoose YourTime 200 Add-on | 200 off-peak | unlimited | contract |
| Motormouth | 200 anytime | unlimited | contract |
| Telecom Plan | | | |
| My Favourites | unlimited anytime | 1 | prepay and contract |
| Freetime 125 | 100 off-peak | unlimited | contract |
| Freetime 300 | 250 off-peak | unlimited | contract |
| Freetime 600 | 500 off-peak | unlimited | contract |

91. The above tables provide some indication of the similarities and differences between the new Talk Add-on plan and the on-net calling plans that were being offered at the time of the Final MTAS Report.
92. While a number of pre-existing Vodafone plans, such as the Mega 20, YourTime 200 Add-on, and Motormouth plans offer the same number of on-net MTM minutes to all Vodafone mobile numbers, these plans are contract plans, whereas the Talk Add-on plan is a prepay plan and is therefore available to a significantly larger proportion of customers in what Vodafone consider to be the key retail prepay market.⁴⁸ According to 2degrees, the Vodafone Talk plan is available to around 70% of Vodafone's customer base.⁴⁹ In the Commission's annual monitoring report for 2009, the Commission noted that approximately two-thirds of New Zealand mobile subscribers are prepay.⁵⁰
93. Of the other on-net plans that are available in the prepay segment, the Best Mates and My Favourites plans offer unlimited on-net calls, but only to one nominated on-net subscriber.

⁴⁸ Vodafone letter to the Minister of Telecommunications, 26 April 2010, page 3.

⁴⁹ 2degrees letter to Telecommunications Commissioner, 3 May 2010, page 9.

⁵⁰ Commerce Commission, *Annual Telecommunications Monitoring Report 2009*, April 2010, page 56.

94. The Commission also notes that most pre-existing plans, including the Your Time 200 Add-on, restrict the usage of the on-net minutes to off-peak times only.
95. The Commission's preliminary view is that the introduction by Vodafone of the new Talk Add-on plan represents a significant new development in the retail market. The new plan introduces into the prepay market segment on-net calling to an unlimited number of Vodafone mobiles. Such a plan is likely to be particularly attractive to end users, and is also likely to increase the difficulty for an entrant to compete, as discussed in more detail below,⁵¹ which the Commission's recommendation that the Final Undertakings be accepted was designed to address.
96. Consequently, the Commission has in its assessment had regard to the specific features and impacts of the Talk Add-on plan both in the context of the effect of that plan alone on competition in the MTM market and on the weighted average on-net price considered by the Commission in the Final MTAS Report.

Analysis of new Talk Add-on plan

97. In this section, the Commission analyses the new Talk Add-on plan and its implications for competition, and specifically whether the new plan retains a barrier to expansion for a small entrant. In order to analyse the Talk Add-on retail price, including a comparison of the Talk Add-on retail price with the average on-net retail price contained in the Final MTAS Report and the wholesale MTRs in the Final Undertakings, the Commission considers that adjustments should be made for the following:
- the retail price of \$12 per month includes GST. GST should be excluded;
 - the minutes available under the plan are based on minute plus minute rounding (in accordance with the Supa Prepay terms and conditions). In order to determine the equivalent price on a second plus second basis (to ensure comparability with the average price used in the Final Report, and the MTRs contained in the Final Undertakings), the number of minutes available under the Talk plan needs to be adjusted. In the Final MTAS Report, the Commission converted minute plus second rates to second plus second rates using a factor of 1.23. As a greater proportion of calls will be rounded up under a minute plus minute billing arrangement, the Commission considers that a higher scaling factor is appropriate, and has used a factor of 1.30 in the analysis below;
 - some of the allocated minutes may not be used by subscribers. The Commission notes that Vodafone expects []VNZCOI% of minutes to be used.⁵² Given that the marginal cost per minute is zero up until the threshold is reached, the Commission considers that a high level of utilisation is likely, and has used a figure of 90%;
 - the split of usage between mobile-to-fixed (MTF) and mobile-to-mobile (MTM) calling is also likely to be relevant. While this split will not affect the average retail

⁵¹ As noted in paragraph 126 below, Vodafone's economic expert, Covec, has noted the implications of such a plan in terms of competition by a small entrant.

⁵² Vodafone letter to Telecommunications Commissioner, 3 May 2010.

price per minute,⁵³ it will be relevant to the margins earned on such a plan, as MTF calls are terminated at a lower termination rate than MTM calls.⁵⁴

98. In [Table 3](#) below, the average retail on-net price per minute is estimated for the Talk Add-on plan. The average price depends on the proportion of the assumed utilised minutes that are used under the plan. If 90% of the minutes available under the plan are used, the average retail price per minute is 7.7cpm. If only 70% of minutes are used, the average retail price per minute increases to 9.9cpm. Vodafone's assumption that [] VNZCOI % of minutes would be used implies an average retail price of [] VNZCOI cpm.⁵⁵

Table 3: Estimated Talk Add-on Average Retail Price per Minute

| | |
|--|---------|
| | |
| Retail price per month (incl GST) | \$12.00 |
| Retail price per month (excl GST) | \$10.67 |
| Maximum available minutes (min+min) | 200 |
| Maximum available minutes (sec+sec, @1.30) | 154 |
| Minutes used (sec+sec, @90%) | 138 |
| | |
| Average Retail Price per Minute | 7.7cpm |
| | |

99. Even after the adjustments discussed above, the Talk Add-on plan offers retail calling prices that are significantly lower than the average on-net price used in the Final MTAS Report (which in turn was used to assist in informing the Commission's evaluation of the MTRs in the Final Undertakings). Allowing for the annual price reduction of -5% assumed in the Final Report, the 2008 average retail on-net MTM price of [] CRI cpm corresponds to a 2010 average retail on-net MTM price of [] CRI cpm. The average retail price of 7.7cpm⁵⁶ under the Talk plan is significantly below the 2010 average assumed in the Final MTAS Report.
100. If the Talk Add-on plan is considered in isolation, the wholesale MTR would have to be 3.2cpm in order to allow a small entrant to compete with the effective retail prices summarised in [Table 3](#).⁵⁷ This compares to the MTRs provided in the Final Undertakings, which were 10.0cpm in 2011, falling to 9.0cpm in 2012, 8.0cpm in 2013 and 6.0cpm in 2014.
101. The analysis summarised in [Table 3](#) above estimates the retail price per on-net MTM minute. The Commission notes that under the Talk Add-on plan, the available minutes can

⁵³ As shown in [Table 4](#) below, the retail revenue is allocated according to the proportion of MTF and MTM minutes i.e. usage. This follows the methodology used in the Final MTAS Report. See Final MTAS Report, first bullet paragraph 594.

⁵⁴ Data supplied by Vodafone during the MTAS Investigation indicates that the volume of on-net MTM minutes in 2008 was between [] CRI and [] CRI times higher than the volume of MTF minutes. These proportions could suggest that the majority of the allocated minutes in the Talk Add-on plan are likely to be used for on-net MTM calls.

⁵⁵ This implied average retail price has been derived using VNZCOI and is therefore classified as VNZCOI.

⁵⁶ [] VNZCOI cpm if the Vodafone assumption of [] VNZCOI % call usage is used.

⁵⁷ For example, given a retail price of 7.7 cpm, deducting 18% for retail costs, and allocating 50% to call termination, results in a termination component of 3.2cpm.

be used for either on-net MTM calls and/or for any-network MTF calls.⁵⁸ While Vodafone suggests the innovation of the Talk Add-on plan “is actually cheap calling to landlines from a prepay mobile”,⁵⁹ the unrestricted cheap calling to Vodafone mobiles is also a new feature in the prepay mobile segment. This is consistent with Vodafone’s advertising campaign for the Talk Add-on plan under the “Lets Talk” slogan.⁶⁰

“Let’s talk like we used to. Way back before emailing and texting, we loved nothing better than a good old chat. So let’s get New Zealand talking like we used to from just 6 cents a minute.”

102. The Commission has extended the above analysis of the Talk Add-on plan to take into account the inclusion of both MTF and MTM calls, including the different termination rates that apply to MTF and MTM calls.
103. In the following analysis, the Commission has considered the ability of a small entrant such as 2degrees, when faced with a fixed termination rate of 1cpm and a MTR as contained in the Final Undertakings, to compete with the Talk Add-on plan. As was assumed in the Final MTAS Report, the new entrant would have to offer any-network calling at prices that are competitive with the on-net calling prices of larger established networks such as Vodafone. This is because if the small entrant offered a similar plan that was restricted to MTM calling to other subscribers on the entrant’s network, such a plan is unlikely to be attractive due to the small customer base of the entrant. In the New Zealand context, a 2degrees on-net plan, offering on-net calling to just over 200,000 mobile subscribers, is unlikely to be as attractive as the Vodafone Talk plan, which offers on-net calling to an estimated 2.4 million mobile subscribers. In order to compete, 2degrees is likely to have to offer a retail plan that provides for calls to subscribers on other networks at a price that is competitive with Vodafone Talk’s on-net price.
104. Vodafone has submitted that there is only a weak relationship between MTRs and retail prices.⁶¹ The Commission noted in the Final MTAS Report that when combined with on-net discounting, high MTRs represent a barrier to expansion by a small network, and will consequently constrain competition in the downstream market. A reduction in the MTR towards cost is therefore likely to promote downstream competition, and in doing so will result in lower retail prices.⁶² In this regard, the Commission also notes that Vodafone agreed that TSLRIC-based MTRs would result in efficient and competitive outcomes for end-users in all relevant markets.⁶³ The implication of this is that a reduction in MTR towards TSLRIC will promote competition and result in lower retail pricing for end users.
105. Vodafone has also submitted that the Commission’s use of the on-net retail price⁶⁴

“... was designed to protect 2degrees from termination outpayments on the theory that 2degrees would be net senders of traffic and therefore exposed to termination rates in a way that might affect its ability to compete.

⁵⁸ MTF calls fell outside the scope of the MTAS Investigation and are not directly relevant to the Commission’s draft recommendation in this Draft Reconsideration Report.

⁵⁹ Vodafone letter to Minister, 26 April 2010, page 2.

⁶⁰ <http://www.vodafone.co.nz/plans/prepay/cheap-talk.jsp>.

⁶¹ See, for example, Vodafone letter to Minister of Telecommunications, 26 April 2010, page 3.

⁶² Final MTAS Report, paragraph 646.

⁶³ Final MTAS Report, paragraph 137.

⁶⁴ Vodafone letter to Telecommunications Commissioner, 3 May 2010, page 5.

[

] VNZAPI'

106. Despite Vodafone's observations regarding current traffic imbalances in paragraph 105, the Commission considers the new Talk Add-on plan is likely to result in a potentially significant net traffic outflow from 2degrees. This is because, as noted in paragraph 103, 2degrees is likely to have to offer any-network calling at a price that is competitive with Vodafone Talk's on-net calling price. This could involve an average retail calling price as low as 6cpm for off-net MTM calls, compared to Vodafone's standard any-network calling price of 89cpm. This level of relative prices for off-net calls is likely to result in Vodafone subscribers making a relatively low volume of calls to 2degrees subscribers, and 2degrees' subscribers making a relatively high volume of calls to Vodafone subscribers. As noted in the Final MTAS Report, the European Commission and ERG have raised similar concerns over the competitive implications arising from asymmetric traffic flows.⁶⁵
107. During the MTAS Investigation, Vodafone provided the Commission with information on the volume of traffic on Vodafone's network. This included volumes of MTF and on-net MTM traffic. In 2008, Vodafone's volume of on-net MTM minutes was approximately []CRI% of Vodafone's combined volume of on-net MTM and MTF minutes. Given Vodafone's objective to encourage customers to use their mobile phone in preference to a fixed line, the Commission has used a higher proportion of MTF minutes than that implied from the 2008 Vodafone data from Vodafone. The Commission has assumed that 30% of the minutes available under the Talk plan are used for MTF calls (with a fixed termination rate of 1cpm), and 70% of minutes are used for MTM calls.
108. Of the MTM calls made by the entrant's subscribers under such a plan, any calls that are on-net (i.e. to other subscribers of the entrant) would be terminated at the entrant's actual termination cost. The off-net MTM calls would be terminated at the wholesale MTR. The Commission has assumed that a relatively low proportion of the entrant's subscribers' MTM calls would be on-net, given the small size of the entrant's on-net customer base. Specifically, the Commission has assumed the following:
- of the MTM minutes, 20% are on-net and 80% are off-net;
 - the on-net MTM minutes are terminated at a cost of 5.56cpm, which is based on the October 2009 undertaking submitted by 2degrees. In its October 2009 undertaking, 2degrees offered an MTR of 5.56cpm for 2010, which the Commission has assumed would at least recover the actual cost for a small entrant such as 2degrees to terminate calls on its network; and
 - the off-net MTM minutes are terminated at a wholesale MTR of 10cpm.⁶⁶
109. The Commission has also included non-termination costs, including an allowance for retail-related costs of 18% of the retail price⁶⁷, and call origination costs for the entrant of

⁶⁵ Final MTAS Report, paragraphs 282 and 283.

⁶⁶ Based on the 2011 MTR contained in the Final Undertakings.

⁶⁷ As noted in the Final MTAS Report (paragraph 599), the 18% retail cost margin is based on a benchmarked retail avoided cost margin used in previous Standard Terms Determinations.

5.56cpm (based on call origination involving the same network elements as call termination).

110. Based on the above, the estimated monthly margin per call-type that would be earned by 2degrees in offering a competitive plan to the Talk plan is summarised in [Table 4](#). The margins shown represent the difference between the retail price and the costs of supplying a retail call, including retail costs and the costs of originating and terminating MTF and MTM calls.

Table 4: Entrant margins on Talk plan

| | | | |
|--|----------------|-----------------|-----------------|
| monthly price (incl GST) | \$12.00 | | |
| monthly price (excl GST) | \$10.67 | | |
| total minutes available (min+min) | 200 | | |
| total minutes available (sec+sec, @1.30) | 154 | | |
| total minutes used (sec+sec, @90%) | 138 | | |
| | | | |
| | MTF | MTM | |
| % minutes | 30% | 70% | |
| | | <i>on-net</i> | <i>off-net</i> |
| | | 20% | 80% |
| allocated revenue per month | \$3.20 | \$1.49 | \$5.97 |
| # minutes used | 42 | 19 | 78 |
| retail cpm (sec+sec) | 7.70cpm | 7.70cpm | 7.70cpm |
| | | | |
| <i>less costs of supply</i> | | | |
| - retail costs (@18% of retail price) | 1.39cpm | 1.39cpm | 1.39cpm |
| - origination costs | 5.56cpm | 5.56cpm | 5.56cpm |
| - termination rate | 1.00cpm | 5.56cpm | 10.00cpm |
| cost of supply | 7.95cpm | 12.51cpm | 16.95cpm |
| | | | |
| margin per minute | -0.24cpm | -4.80cpm | -9.24cpm |
| margin per month | -\$0.10 | -\$0.93 | -\$7.17 |
| | | | |
| overall margin per month | -\$8.20 | | |
| | | | |

111. [Table 4](#) indicates that a small entrant would make a loss of -\$8.20 per month per subscriber in supplying an any-network retail plan to match the Talk plan.⁶⁸ This is a significant loss, given the retail price of \$12 per month.
112. The Commission has included a number of sensitivities in Appendix 2, indicating how the above margin varies with utilisation (90% and 70%) and the distribution of call minutes.
113. In respect of the above analysis, the Commission notes that the outgoing off-net calls made by the entrant's subscribers on this plan are likely to generate some incoming off-net calls

⁶⁸ If instead Vodafone's assumption of [] VNZCOI % utilisation is used, the entrant's loss would be [] VNZCOI per month per subscriber.

in response, on which the entrant would earn termination revenues (as well as incurring the cost of terminating such calls). However, the volume of such incoming calls may be expected to be relatively low. While the outgoing minutes are made at an average calling price of 7.7cpm, incoming FTM calls and MTM calls are likely to be made at a considerably higher price (the average retail FTM price in 2008 is estimated to be approximately 30cpm, while the average retail off-net MTM price in 2008 was approximately [] CRI cpm). These relatively high retail prices for incoming off-net calls are likely to result in a lower number of incoming calls.

114. In the Commission's preliminary view, the above analysis shows that a small entrant, when faced with the MTRs contained in the Final Undertakings, is unlikely to be able to compete with the retail pricing of Vodafone's Talk Add-on plan. Given the disparity in on-net customer bases between the entrant (such as 2degrees) and the established operators, the entrant is likely to have to offer any-network calling under such a plan, in order to attract subscribers from the larger networks. In doing so, the entrant is likely to incur a significant monthly loss per subscriber, and as shown in the sensitivities in Appendix 2, such a loss is likely to remain even if subscribers only utilised 70% of the available minutes (or the [] VNZCOI % usage assumed by Vodafone).
115. The alternative to sustaining such large losses would be for the entrant to increase its monthly retail price, or restrict the volume of minutes to on-net mobile numbers. Either of these alternatives will reduce the competitiveness of the entrant's offer, and hence limit its ability to compete in the retail mobile market.

Talk plan and barriers to efficient expansion

116. In the Final MTAS Report, the Commission had regard to the level of retail prices for on-net MTM calls in relation to the wholesale MTR. The Commission emphasised that the wholesale MTR must be at a level that would allow a small entrant to compete with the retail prices of the larger established mobile operators for on-net MTM calls. By ensuring that the wholesale MTR is set at an appropriate level relative to retail on-net prices, a small entrant should be able to compete as the barrier to expansion represented by on-net discounting and high MTRs would have been removed.
117. Commissioners Patterson and Pickering concluded in the Final MTAS Report that the MTRs contained in the Final Undertakings would (absent other factors and behaviour by established operators) allow a small entrant to compete with the on-net retail prices that were expected, and would thereby address the barrier to expansion identified during the MTAS Investigation.⁶⁹ The Commission noted that if the barrier to efficient entry and expansion in the retail mobile services market re-emerged, for example in the form of steeper reductions in on-net retail prices, the Commission would consider whether further regulatory attention is warranted.⁷⁰ Commissioner Mazzoleni considered steeper reductions possible, and therefore recommended regulation.⁷¹
118. The recent introduction of the Talk Add-on plan by Vodafone offers relatively low retail on-net MTM calling prices. Based on the Commission's analysis of the new Talk plan as set out in this Draft Reconsideration Report, the average retail price per minute could be as

⁶⁹ As discussed at paragraph 64.

⁷⁰ Final MTAS Report, paragraph 880.

⁷¹ Final MTAS Report, paragraph lxvi.

low as 7.7cpm. This represents a significant reduction, and a significant widening of the differential between on-net and off-net prices. Given the low retail price, the absence of restrictions on the use of the available minutes, and the availability of the new plan to the broader and important prepay segment of the retail market, the Commission's preliminary view is that such a plan is likely to have a significant impact, both in terms of penetration in the retail market, and in terms of competition.

119. As noted by Vodafone's economic advisors during the MTAS Investigation, blanket flat-rate plans that offer calls to anyone on-net will make it significantly more difficult for a small entrant to compete:⁷²

"The task would be very much tougher for a new entrant if these voice plans were available to **anyone** on-net. Under the current structure of prices, it is not necessary for an entrant to offer low any-net pricing to compete with the existing on-net pricing."

120. This is consistent with the Commission's preliminary view, that the new Talk plan, which is an example of a voice plan offering blanket on-net discounts to any Vodafone mobile, is likely to raise barriers to expansion for a small entrant such as 2degrees, as it provides subscribers with the ability to call the entire on-net customer base of Vodafone.

121. Vodafone submitted that 2degrees could replicate the Talk Add-on, as it has a large "customer community" on its own network.⁷³ According to Vodafone:

"... as of 31 March 2010 Vodafone mobile customers had received calls or texts from []VNZAPI unique 2degrees customers, giving 2degrees a prepay market share of at least []VNZAPI% since its August launch."

122. The Commission considers that Vodafone's estimate of 2degrees' market share is excessive, as it is based on the number of 2degrees' customers who have called or texted Vodafone mobile customers since 2degrees launched its network in August 2009. This will include customers who tried out the 2degrees network using the promotional SIM cards distributed by 2degrees at launch, and is also likely to include temporary overseas visitors roaming on the 2degrees network. The Commission considers that the 2degrees figure of 206,000 customers⁷⁴, which is based on the number of customers who had used their mobile phone within the last 30 days, is a more reliable indicator of 2degrees market share. This 'customer community' of 206,000 mobile subscribers is significantly less than Vodafone's estimated 2.4 million subscribers that can be contacted under the Talk Add-on plan.

123. In order to be able to compete with the new plan, 2degrees may be forced to offer off-net calling at a retail price as low as 7.7cpm (or lower if utilisation is higher than the level assumed in this Draft Reconsideration Report). Given the wholesale MTRs contained in the Final Undertakings, which remain above the Talk retail price until 2014, and the fact that the entrant will incur other costs that would also need to be recovered from the retail price (such as the costs of call origination and marketing), the Commission's preliminary view is that if the Final Undertakings are accepted, the new Talk plan will re-establish the barrier to expansion that the Commission was seeking to address during the MTAS Investigation.

⁷² Covec, *Comments on the MTAS Conference 'Whiteboard' Examples*, 9 October 2009, paragraph 17.

⁷³ Vodafone letter to Telecommunications Commissioner, 3 May 2010, page 4.

⁷⁴ Final MTAS Report, paragraph 189.

Potential Impact of the new Talk plan on the weighted average on-net price

124. In the Commission's preliminary view, the new Talk plan makes it likely that the weighted average retail on-net price will fall more steeply than the annual reduction assumed in the Final MTAS Report, for the following reasons.
125. First, a number of features of the new Talk Add-on plan may be particularly attractive. As noted in paragraph 99, the new Talk Add-on plan offers calls at a relatively low retail price per minute. Vodafone promotes the Talk plan as offering a retail price of 6 cents a minute to Vodafone mobiles and landlines in New Zealand.
126. In addition to offering low retail calling prices, the Talk Add-on plan is unlimited in terms of the number of Vodafone mobile subscribers that can be contacted. This is likely to increase its attractiveness to customers. As has been noted by Covec in a submission on behalf of Vodafone (arguing that Vodafone's existing small calling group plans were unlikely to have an anti-competitive effect), this may also make it significantly more difficult for a smaller entrant to compete.⁷⁵
127. The on-net minutes included in the Talk Add-on plan can be used any time, rather than being restricted to off-peak times. As shown in [Table 2](#), most of the pre-existing plans that offer on-net calls to the entire on-net customer base only provide for off-peak calling.
128. The Talk Add-on plan is also available to any Vodafone Supa Prepay customer.⁷⁶ While Vodafone has prepay customers on other plans, these have been grandfathered, and according to Vodafone, Supa Prepay is Vodafone's most popular prepay plan.⁷⁷ The new plan will therefore be available to a relatively large proportion of Vodafone's customers who are on prepay plans. Vodafone has noted that the prepay market is the key retail market for Vodafone.⁷⁸ The prepay segment is also the only market segment in which the new entrant, 2degrees, currently participates.
129. The low price, the ability to call **any** Vodafone mobile subscriber at any time, and the availability to the broader prepay customer segment suggests that the new Talk Add-on plan is likely to be attractive to a very significant customer base. This is supported by subscription levels that Vodafone expects for the new plan. According to Vodafone, its business case for the Talk plan involves [] VNZCOI customers signing up for the plan within the first year.⁷⁹ This level of take-up compares to less than [] VNZRI Best Mates achieved after almost four years.
130. The Commission requested additional information from Vodafone regarding the You Choose Your Time add-on, which Vodafone imply is comparable to the Talk Add-on in stating:⁸⁰

⁷⁵ See paragraph 119.

⁷⁶ A number of pre-existing on-net plans are contract plans. For example, Vodafone's On Account You Choose plan has a Your Time 200 add-on, which allows 200 on-net minutes (off-peak) for \$11.95 per month. Vodafone's On Account Mega 20 plan includes 20 any-network minutes, 200 on-net minutes, 2000 on-net texts, and 1 Best Mate for \$39.95 per month.

⁷⁷ Letter from Vodafone to Minister of Telecommunications, 26 April 2010.

⁷⁸ Letter from Vodafone to Minister of Telecommunications, 26 April 2010.

⁷⁹ Letter from Vodafone to Telecommunications Commissioner, 3 May 2010, page 3.

⁸⁰ Letter from Vodafone to Telecommunications Commissioner, 3 May 2010, page 2.

“Talk is constructed to move voice calling from fixed lines to mobile. A lot of the comment on Talk focuses on cheaper on-net calling rates. ... For our customers, though, the innovation is actually low cost calling from a prepay mobile to a landline. Customers who want just on-net calling can take our **On Account You Choose add-on that allows 200 on-net only minutes for \$12**, which has been in the market for some years with no comment from the Commission.” (emphasis added)

131. The Commission understands that the Your Time 200 add-on is available only to on account customers and not to prepay customers, and that the on-net minutes referred to are able to be used off-peak only ie between 7pm and 7am on weekdays and all day on weekends.⁸¹ The Commission’s preliminary view is Your Time 200 add-on is not comparable to the Talk Add-on due to these differences.
132. The Commission also notes that there has been [] VNZRI take-up of the Your Time 200 add-on plan, at approximately [] VNZRI of all You Choose customers, based on the [] VNZRI You Choose customers that had the Your Time 200 add-on, compared to the [] VNZCOI customers expected to sign up for the Talk Add-on plan within the first year.
133. Second, for any given level of customer take-up, the new Talk Add-on plan is likely to have a disproportionate impact on the weighted average retail on-net price. This is due to the allocation of minutes under the new plan being considerably greater than the average level of usage across on-net plans.
134. Subscribers to the Talk Add-on plan can use up to 200 on-net MTM minutes per month. This is considerably higher than the current average volume of on-net minutes per subscriber. For example, Vodafone reported billed on-net MTM minutes of [] VNZRI minutes in 2008, and 2,422,371 subscribers, implying an average volume of on-net MTM minutes per subscriber of [] VNZRI minutes per month. Under the Talk Add-on plan, subscribers can use up to 200 minutes per month. Even allowing for the Talk Add-on plan being based on a minute plus minute billing arrangement, and allowing for some of the monthly minutes to be used for MTF calls, the volume of on-net MTM minutes under the Talk Add-on may be substantially higher than the average. As noted in paragraph 101, this is consistent with Vodafone’s advertising campaign for the Talk Add-on plan.
135. The impact of the Talk Add-on minute allocation could be even more significant, as the average volume of on-net MTM minutes per subscriber of [] VNZRI minutes per month is likely to be driven by plans such as Best Mates. According to Vodafone:⁸²
- “At present, our average prepay customer (who is not using Bestmate of Family) talks for only [] VNZCOI minutes a month.”
136. As a result, subscribers to the Talk Add-on plan are likely to have a relatively high level of on-net usage. This suggests that for any given level of take-up, the Talk Add-on plan will have a disproportionate impact on the average retail on-net price.
137. Vodafone has submitted that the introduction of the new Talk Add-on plan is expected to [] VNZCOI⁸³. Vodafone has not

⁸¹ This understanding is based on information on Vodafone’s website at <http://www.vodafone.co.nz/plans/you-choose/youchoose.jsp>.

⁸² Letter from Vodafone to Minister of Telecommunications, 26 April 2010.

⁸³ Letter from Vodafone to Telecommunications Commissioner, 3 May 2010, page 3.

submitted the modelling underlying these estimates. However, the Commission notes the following:

- any attempt to estimate the forward-looking impact of a new retail offer is likely to be subject to considerable uncertainty, for example around the level of penetration of such a plan, the extent of customer churn from other plans, and the nature of the competitive response from other operators such as Telecom;
- the weighted average on-net price used in the Final MTAS Report is confidential, being calculated by reference to Telecom and Vodafone revenue and volume information. Accordingly, Vodafone can at best only estimate what the weighted average on-net price will be;
- the average will also be affected by Telecom’s response to the new Vodafone offer. If Telecom responds with its own on-net offer, the weighted average will be driven even lower. As noted in paragraph 73, Telecom have advised that while they remained “committed to {their} “One Rate” approach, and have no plans to change this prior to June at present {they} will however continue to monitor competitor and market activity and develop commercial pricing plans accordingly.”;
- Vodafone has assumed that [] VNZCOI% of available minutes under the Talk plan will be used by subscribers. As discussed earlier, the Commission considers that this level of utilisation is likely to be understated, and a consequence of this is that the implied average retail price per minute used by Vodafone for the Talk plan will be too high;
- as discussed in paragraphs 131 to 136 above, the Talk plan is likely to generate a relatively high volume of minutes per subscriber, compared to Vodafone’s average volume of on-net MTM minutes per subscriber. For any given level of take-up, the Talk plan is likely to have a disproportionate impact on the average on-net price (which is defined as on-net revenues/on-net minutes), due to the relatively high level of usage.

138. Vodafone has also submitted that [

] VNZCOI⁸⁴

139. The Commission notes that even if [] VNCOI, it would not address the competition concerns with the Talk Add-on plan identified in this Draft Reconsideration Report. The Commission also considers that any attempt to quantify the forward-looking impact of such a change is likely to be subject to considerable uncertainty.

140. Vodafone claim that the Commission’s use of average retail on-net prices as a “cross-check” on MTRs is now “contaminating” retail mobile competition, and that Vodafone is gravely concerned about the Commission’s intervention in retail pricing:⁸⁵

⁸⁴ Vodafone letter to Telecommunications Commissioner, 3 May 2010, pages 3 and 4.

⁸⁵ Vodafone letter to Telecommunications Commissioner, 3 May 2010, pages 4 and 5.

“... The Commission’s “cross-check” is our motivation to put up prices for on-net calling this year through [] VNZCOI. The Commission should reconsider its approach to the “cross-check” as a matter of urgency.”

141. Importantly the average on-net retail price calculation was used by the Commission in the Final MTAS Report to assist in informing the evaluation of whether the barrier to expansion was likely to be removed by the MTRs contained in the Final Undertakings. It was not intended to be a “bright-line standard” which by itself created a safe-harbour for retail pricing, as is clear from the words emphasised in the extracts from the Final Report at paragraphs 64 and 68 above.
142. Where wholesale prices are reflective of cost and barriers to efficient entry and expansion are addressed, retail pricing is a matter for commercial operators. The Commission’s concern has always been whether there are barriers to efficient entry and/or expansion in the retail mobile market, and specifically emphasised throughout the Final MTAS Report the *relationship* between retail on-net pricing and wholesale MTRs. In the Final MTAS Report, the Commission had regard to average retail on-net prices in order to test whether this relationship was likely to result in a barrier to efficient expansion by a small entrant.
143. In summary, the Talk Add-on plan offers very low retail on-net calling prices, and is offered to the broader prepaid segment, with no restrictions (as to the time of day, or the number of called parties) on the use of the allocated on-net minutes. Given the relatively large allocation of monthly on-net minutes under the Talk Add-on, and the lack of restrictions on the use of those minutes, the Commission’s preliminary view is that such a plan is likely to cause the average retail on-net price to fall more steeply than the -5% annual reduction on which the recommendations in the Final MTAS Report that the Final Undertakings be accepted was based.

Conclusion

144. The Commission’s preliminary view in this Draft Reconsideration Report is that the MTRs contained in the Final Undertakings will not address the competition concerns identified by the Commission during the MTAS Investigation. As discussed above, the new retail pricing offered by Vodafone since the Final MTAS Report maintains the barrier to expansion that the Final Undertakings were designed to remove.
145. The Commission’s preliminary view is that the market behaviour demonstrated by Vodafone in launching a significant new plan with the characteristics of the Talk Add-on plan is such that, even if Vodafone were to withdraw the Talk Add-on plan, it would still retain the discretion, and have the incentive, over the 5-year period of the Final Undertakings to introduce retail pricing which would cause the barrier to re-emerge by reference to the agreed MTRs in the Final Undertakings during that period.
146. As a result, in the Commission’s preliminary view, cost-based MTRs will better promote competition in the retail mobile market, when compared to the Final Undertakings, and would therefore be in the best long-term interests of end-users in accordance with section 18 of the Act.
147. The Commission’s concern is to ensure that wholesale MTRs are set at an appropriate level in relation to the retail on-net prices that are set by the mobile operators. As discussed in this Draft Reconsideration Report, the Commission’s preliminary view is that this will be achieved by setting the wholesale MTR at a level that reflects the efficient costs of

supplying the MTAS in New Zealand. The Commission notes that the parties during the MTAS investigation agreed that cost-based MTRs will result in efficient and competitive outcomes.⁸⁶ Having determined cost-based wholesale MTRs, the Commission would expect all mobile operators to be able to compete for subscribers and to provide competitive and innovative calling, SMS, and other services to those subscribers.

⁸⁶ See for example, Final MTAS Report, paragraph 137.

APPENDIX ONE: DETAILS OF FINAL UNDERTAKINGS AND COMMERCIAL INTERCONNECTION AGREEMENT

148. The price terms of the Final Undertakings that the Commission assessed in the Final MTAS Report, and that the Commission has considered in this Draft Reconsideration Report, are set out in [Table 5](#) below.

Table 5: The Final Undertakings

| | Telecom Undertaking | | Vodafone Undertaking | |
|---------------------------|---------------------------|---|---------------------------|---|
| | MTM/FTM (cpm, sec+sec) | SMS (cpSMS) | MTM/FTM (cpm, sec+sec) | SMS (cpSMS) |
| to 31 Mar 2010 | 18.45 | 9.5 | 18.45 | 9.5 |
| 1 Apr 2010 – 30 Sept 2010 | 17.71 | 9.5 | 17.71 | 9.5 |
| 1 Oct 2010 – 31 Dec 2010 | 12.00 | 0.0 for 100%-107% 2.0 for 107%-112% 4.0 for 112%+ | 12.00 | 0.0 for 100%-107% 2.0 for 107%-112% 4.0 for 112%+ |
| 2011 | 10.00 | as above | 10.00 | as above |
| 2012 | 9.00 | as above | 9.00 | as above |
| 2013 | 8.00 | as above | 8.00 | as above |
| 2014 | 6.00 | as above | 6.00 | as above |

149. In the Final MTAS Report, the Commission also considered the terms of a commercial interconnection agreement between 2degrees and Vodafone (**2degrees/Vodafone ICA**). [

] **VAP / 2AP**. The FTM and
MTM MTRs that Vodafone pay 2degrees to terminate calls on 2degrees' network under the 2degrees/Vodafone ICA are [

] **VAP / 2AP**. The rates that Vodafone pay
2degrees to terminate SMS on 2degrees' network under the 2degrees/Vodafone ICA [

] **VAP / 2AP**.

APPENDIX TWO: ENTRANT MARGIN SENSITIVITIES

150. In this Draft Reconsideration Report, the Commission has examined the margins that a small entrant would earn when supplying a retail plan in competition with Vodafone's Talk plan. In this analysis, the Commission has assumed that 90% of minutes available under such a plan would be utilised by subscribers, and that 20% of the MTM minutes would be on-net and 80% of the MTM minutes would be off-net. The entrant would make a loss of -\$8.20 per month per subscriber, as shown in [Table 4](#) of this Draft Reconsideration Report.
151. [Table 6](#) below summarises how the entrant's margins change, as the distribution of traffic is varied, given the assumption that 90% of available minutes are used by subscribers. Where the entrant makes a loss on such a plan, the margin is shown in red. For example,
- if 30% of minutes are MTF, and of the MTM minutes, 20% are on-net, the entrant would lose -\$8.20 per month per subscriber (as per [Table 4](#));
 - if 30% of minutes are MTF, and 50% of the MTM minutes are on-net, the entrant would lose -\$6.91 per month per subscriber (i.e. the entrant's losses are reduced, as a higher proportion of MTM minutes are on-net and hence terminated at cost rather than at the higher wholesale MTR).

Table 6: Margin Sensitivities (at 90% utilisation)

| MTF % | %MTM on-net | | | | | | | | | | |
|-------|-------------|----------|----------|----------|----------|---------|---------|---------|---------|---------|---------|
| | 0% | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% | 90% | 100% |
| 0% | -\$12.80 | -\$12.18 | -\$11.57 | -\$10.95 | -\$10.34 | -\$9.72 | -\$9.11 | -\$8.49 | -\$7.88 | -\$7.27 | -\$6.65 |
| 10% | -\$11.55 | -\$11.00 | -\$10.45 | -\$9.89 | -\$9.34 | -\$8.79 | -\$8.23 | -\$7.68 | -\$7.13 | -\$6.57 | -\$6.02 |
| 20% | -\$10.31 | -\$9.81 | -\$9.32 | -\$8.83 | -\$8.34 | -\$7.85 | -\$7.35 | -\$6.86 | -\$6.37 | -\$5.88 | -\$5.39 |
| 30% | -\$9.06 | -\$8.63 | -\$8.20 | -\$7.77 | -\$7.34 | -\$6.91 | -\$6.48 | -\$6.05 | -\$5.62 | -\$5.19 | -\$4.76 |
| 40% | -\$7.81 | -\$7.44 | -\$7.08 | -\$6.71 | -\$6.34 | -\$5.97 | -\$5.60 | -\$5.23 | -\$4.86 | -\$4.49 | -\$4.12 |
| 50% | -\$6.57 | -\$6.26 | -\$5.95 | -\$5.65 | -\$5.34 | -\$5.03 | -\$4.72 | -\$4.42 | -\$4.11 | -\$3.80 | -\$3.49 |
| 60% | -\$5.32 | -\$5.08 | -\$4.83 | -\$4.58 | -\$4.34 | -\$4.09 | -\$3.85 | -\$3.60 | -\$3.35 | -\$3.11 | -\$2.86 |
| 70% | -\$4.07 | -\$3.89 | -\$3.71 | -\$3.52 | -\$3.34 | -\$3.15 | -\$2.97 | -\$2.78 | -\$2.60 | -\$2.41 | -\$2.23 |
| 80% | -\$2.83 | -\$2.71 | -\$2.58 | -\$2.46 | -\$2.34 | -\$2.21 | -\$2.09 | -\$1.97 | -\$1.85 | -\$1.72 | -\$1.60 |
| 90% | -\$1.58 | -\$1.52 | -\$1.46 | -\$1.40 | -\$1.34 | -\$1.28 | -\$1.21 | -\$1.15 | -\$1.09 | -\$1.03 | -\$0.97 |
| 100% | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 | -\$0.34 |

152. Table 7 below summarises how the entrant's margins change, as the distribution of traffic is varied, given the assumption that a lower proportion (70%) of available minutes are used by subscribers. For example,
- if 30% of minutes are MTF, and of the MTM minutes, 20% are on-net, the entrant would lose -\$4.43 per month per subscriber;
 - if 30% of minutes are MTF, and 50% of the MTM minutes are on-net, the entrant would lose -\$3.43 per month per subscriber.

