Appendix 3

Price Squeeze and Commerce Act issues

1. NZC submits that the proposed pricing in Schedule 3A could create large price squeezes which would normally be in breach of the Commerce Act. The price squeezes would also mean that the §18 objectives in the Telecommunications Act would not be met.

2. Applying a statement from a recent decision "….*an efficient downstream competitor… is forced to exit the downstream market or is unable to compete effectively [or a potential new entrant will not enter the market]"*

3. Additionally, there may be other breaches of the Commerce Act (for example, not only price squeeze under Section 36 but other breaches, such as under Section 27).

4. For these reasons, the Vodafone draft undertaking should not be accepted.

5. NZC submits that the Commission should undertake imputation tests when considering the Schedule 3A Undertaking.

6. In relation to the Commerce Act, Clause 9 of Schedule 3A provides:

7. Part 2 [the competition provisions] of the Commerce Act 1986 does not apply in respect of

   (a) a registered undertaking; and

   (b) any matter necessary for giving effect to a registered undertaking.

8. The Commission has yet to resolve the inter-relationship between the two Acts in light of this provision, following its April 2007 Discussion Paper[1] . Additionally, there will be some uncertainty as to how the Courts would approach this issue, whatever the Commission concludes.

9. It is appropriate for the Commission to assume that a Schedule 3A undertaking would either preclude or limit a Commerce Act price squeeze (or other) remedy. In any event, a price squeeze frequently will mean that Section 18 objectives are not achieved. So this is a relevant consideration anyway.

10. The Commission appears to agree that a comparison of upstream roaming prices and downstream Vodafone retail prices is appropriate: see Para 395 of the draft mobile services report.

11. NZC cannot undertake a full price squeeze imputation test, as it does not have full data at this stage, such as what is comprised in the Vodafone retail bundles (for example, the actual SMS, data, and voice traffic which are components of bundles).

12. However, from published information, there is strong evidence that an imputation test, conducted by either of the 2 methods referred to below, would fail substantially, and that there would be a breach of Section 36.

13. As the effect of accepting the Undertaking would be to inflict a price squeeze on new entrants, leaving them with the prospect of no (or reduced) ability to challenge the price squeeze, the undertaking should not be accepted.[2]

---

[1] The Interrelationship between Part 2 of the Commerce Act 1986 and the Telecommunications Act 2001

[2] In any event Section 18 objectives would not be met.

14. Price squeeze is based on the difference between the upstream wholesale input price charged by the incumbent and the incumbent downstream retail price

15. Price squeeze (also called margin squeeze) has been described recently[3] by the UK Competition Appeal Tribunal:

> "*… a margin squeeze typically arises where a vertically integrated undertaking that is dominant in the supply of an important input in downstream market sets such a low margin between its input price … and the price it sets in the downstream market … that an efficient downstream competitor… is forced to exit the downstream market or is unable to compete effectively …*".

16. There are two imputation tests for price squeeze. These are outlined in the ACCC paper *Assessing Vertical Price Squeezes for ADSL Services: An ACCC Information Paper* . There is a useful summary of the two tests in Albion[4]:

> "*Those tests are either (a) that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company; or (b) that the margin between the price charged to competitors in the downstream market for the input product and the price which the dominant firm charges in the downstream market is insufficient to allow a reasonably efficient downstream operation to earn a normal profit*."

17. Based on either test there is strong evidence already that the there would be a very large failure price squeeze.

18. As the Commission notes in its draft report at Para 395:

19. "…the Commission notes that the price for SMS is 5.1 cpm per leg rising to 16 cpm per leg. The Commission considers this to be high when compared to prices being offered by Vodafone such as the TXT2000 service which is currently being offered to Vodafone retail customers for $10 a month for 2000 SMS messages."

20. Taking SMS in isolation, the imbalance between the upstream wholesale input price and the downstream incumbent retail price is massive, even if it is assumed that average usage by users is considerably short of the 2000 maximum number of messages.

21. SMS messaging is particularly critical to a new entrant entering a saturated market, and there is likely to be an imbalance in traffic in any event. This in itself may be enough to have the outcome noted in Albion. *"an efficient downstream competitor… is forced to exit the downstream market or is unable to compete effectively".*

22. Here it may mean that the potential new entrant simply can't enter the market.

23. Turning to mobile data, Vodafone propose 30.2 cents per Megabyte. Their current retail offerings are at http://www.vodafone.co.nz/personal/plans-services/plans/3G-broadband-and-data/3g-broadband-plans.jsp. Every plan shows a massive difference between the upstream wholesale pricing and the downstream retail pricing.

---

[3], *Albion Water Ltd v. Water Services Regulation Authority* [2006] CAT 36 (18 December 2006) Para 285

[4] At Para 292

24. Take a mid-range option as an example: 1GB per month plus a $10 top-up. If we use the "No Term" option, total cost per month is $69.95 incl. GST for 2GB of data. This equates to 3.04 cents per MB (excl GST). Even if the bundle is adjusted for usage considerably less than full usage up the cap (2GB), there would still be a massive difference between the upstream wholesale price and the downstream retail price.

25. Vodafone propose an average voice roaming rate of 14 cpm **per leg**.

26. Vodafone has, for example, 15 cpm (13.3 cents excluding GST) voice pricing for business customers, and a variety of other plans that also indicate that there is a substantial price squeeze in relation to voice roaming as well. For example there is there are better calling options available for heavy users, such as . "TalkZone Zero". For a monthly fee of $44 the customer gets and other benefits in the bundle as well.

27. Even if only the wholesale roaming prices were being compared with the retail price, the imputation test would fail on all of SMS, data and voice. This indicates that there is a considerably worse position when all costs are taken into account in properly undertaking the imputation tests.

28. It also indicates that there would be substantial failures of imputation tests even taking into account the any impact of and adjustments for bundles.

29. NZC submits that the Commission should undertake imputation tests when considering the Schedule 3A Undertaking.