COMMERCE COMMISSION

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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

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

The Commission: Dr Ross Patterson
Anita Mazzoleni
Gowan Pickering

Recommendation of the Commission:

For the reasons set out in this 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 28 (the **proposed regulatory change**) and the Final Undertakings should not be accepted under Schedule 3A of the Telecommunications Act 2001 as an alternative to the proposed regulatory change.

Date of Reconsideration Report: 16 June 2010

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS

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**), pursuant to the Commerce Act 1986, section 100, as applied by the Telecommunications Act 2001, section 15(i).

The Reconsideration Confidentiality Order can be viewed on the Commission's website at www.comcom.govt.nz/mobiletomobiletermination/.

Confidential information cited in this 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 Reconsideration Report.

Restricted information is labelled as follows: Vodafone Restricted Information is labelled VNZRI, and Commission Restricted Information is labelled CRI.

Additional protection information, which is subject to the additional conditions set out in the Commission's letter of 17 May 2010[1], is labelled as follows: Vodafone and 2degrees additional protection information related to the commercial interconnection agreement between those parties is labelled VNZAPI1 / 2dAPI1.

Commission only information is labelled as follows: Vodafone's Commission only information is labelled VNZCOI and 2degrees' Commission only information is labelled 2dCOI.

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.

All documents referred to in this Reconsideration Report are available on the Commission's website at www.comcom.govt.nz/mobiletomobiletermination/.

[1] Commerce Commission, *Classification of information about domestic commercial interconnection agreements and domestic national roaming agreements under the MTAS Reconsideration Confidentiality Order*, 17 May 2010.

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EXECUTIVE SUMMARY[2]

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**).[3] As part of the MTAS Investigation, the Commission also considered whether the Final Undertakings submitted by Telecom and Vodafone[4] should be recommended for acceptance as an alternative to regulation.

Recommendation and views in Final MTAS Report

2. In the Final MTAS Report[5], the Commission undertook an analysis of whether regulation or the outcomes that would likely occur without regulation would best or be 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. The Commission also had regard to efficiencies, as it is required to do under section 18(2) of the Act. The Commission concluded that there were grounds to regulate MTAS, as cost-based MTRs were likely to remove a barrier to efficient entry and expansion that would otherwise exist.

3. Having concluded that there are grounds to recommend regulation, the Commission then assessed whether regulation or the Final Undertakings offered by Telecom and Vodafone, as an alternative to regulation, would best or be 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.

4. The recommendation of the Telecommunications Commissioner in the Commission's Final MTAS Report[6] 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"

5. Associate Commissioner Pickering concurred with the recommendations of the Telecommunications Commissioner.[7] Commissioner Mazzoleni's view was that the

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[2] For the avoidance of doubt this Executive Summary forms part of the Commission's Reconsideration Report.
[3] 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.
[4] Telecom's Undertaking of 11 February 2010 and Vodafone's Undertaking of 16 February 2010, collectively referred to as the **Final Undertakings**. The MTRs provided for under the Final Undertakings are summarised at paragraphs 783 to 835 and Table 31 of the Final MTAS Report, and in Appendix One of this Reconsideration Report.
[5] 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**).
[6] Final MTAS Report, page 15, paragraph xxix.
[7] Final MTAS Report, page 19, paragraph lv.

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.[8]

6. In coming to this conclusion, Commissioners Patterson and Pickering made a number of assumptions about incumbent future pricing behaviour, including that the introduction of new aggressive on net discounting plans was very unlikely in the current market. Commissioner Mazzoleni on the other hand considered such pricing possible given the conditions in the current NZ market.

Requirement to reconsider recommendation

7. On 13 April 2010, Vodafone New Zealand launched a new Talk Add-on product, which was marketed as providing Vodafone's prepay customers up to 200 minutes to Vodafone New Zealand mobiles and landlines for $12 a month, and was promoted on Vodafone's website as offering calls for 'just 6 cents a minute to Vodafone NZ mobiles and landlines in New Zealand'.[9]

8. 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.[10]

9. The Minister requested comment on whether or not the Commission considered that this was the case.

10. On 19 April 2010, the Commission advised the Minister that its:[11]

> "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."

11. 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 **reconsideration request**).[12] 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

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[8] Final MTAS Report, pages 20-23, paragraphs lvi-lxxi.
[9] Information on the Talk Add-on, including this quote, was available on Vodafone's website at http://www.vodafone.co.nz/plans/prepay/cheap-talk.jsp. This page has subsequently been updated to reflect the withdrawal of the Talk Add-on from the market.
[10] Letter from Minister to the Commission, 19 April 2010.
[11] 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.
[12] Letter from the Minister to the Commission, *Mobile Termination Access Services*, 26 April 2010.

- 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."

Focus of reconsideration

12. In its reconsideration, the Commission has, in accordance with the scope of the reconsideration request in paragraph 11, considered only 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 release of this Reconsideration Report[13] (**relevant retail offers**). Information about the relevant retail offers is summarised in Appendix Five, including Vodafone's now withdrawn Talk Add-on offer.[14]

13. The central issue for the Commission in its reconsideration is whether the relevant retail offers, or the potential for future retail offers, raise any competition concerns under the Act which the Commission (other than Commissioner Mazzoleni) had considered in the Final MTAS Report[15] would be addressed by the Final Undertakings and, if any such competition concerns were raised, whether those concerns have implications for the Commission's recommendation in the Final MTAS Report that the Final Undertakings be accepted as an alternative to regulation.

14. Having regard to the nature of the relevant retail offers, 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.

Conclusions of the Commission

15. Vodafone's Talk Add-on plan offered relatively low retail on-net MTM calling prices. It introduced into the prepay market segment on-net calling to an unlimited number of Vodafone mobiles, as well as mobile calls to any fixed line. While Vodafone has suggested that the innovation of the Talk Add-on plan was the provision of cheap mobile to fixed (**MTF**) calls,[16] the provision for cheap calling to Vodafone mobiles, without restriction on the number of Vodafone mobiles that could be called or the times when these calls can be made, was also a new feature in the prepay mobile segment.

16. Vodafone withdrew the Talk Add-on plan after the release of the Commission's Draft Reconsideration Report. The Commission considers however that the potential for the introduction by an established operator of flat-rate retail on-net plans such as the Talk plan has heightened the competition concerns related to a small entrant having to compete with such plans while incurring the MTRs in the Final Undertakings.[17] Flat-rate retail plans

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[13] The Commission indicated to interested parties that this Reconsideration Report was due to be released in early June and sought information on plans that would be released before that date.

[14] Vodafone's Talk Add-on offer provided up to 200 minutes per month to any Vodafone mobile or any fixed line for $12 per month. Further details on this offer are contained in Appendix Five.

[15] Summarised in the Executive Summary to Commerce Commission, Final MTAS Report, page 10, paras xi, xii and xiv.

[16] Vodafone letter to Minister, 26 April 2010, page 2.

[17] As noted in paragraphs 74 and 75 below, both Vodafone's economic expert and Vodafone itself have noted the implications of such a plan in terms of the difficulties that a small entrant may face in competing.

such as the Talk Add-on plan, providing calls to the entire on-net customer base in the important pre-pay market segment, would be likely to have a significant impact, both in terms of penetration in the retail market, and in terms of competition. While such retail plans were not widely available at the time of the MTAS Investigation, the Talk Add-on plan introduced such an on-net tariff, and in doing so demonstrated the type of behaviour that could limit the competitive constraint that the entrant could impose on the incumbents.

17. A small entrant that faced such retail pricing by mobile operators with a large established customer base, and had to pay the wholesale MTRs contained in the Final Undertakings (as well as the costs of call origination and marketing), would be unlikely to be able to vigorously compete because it would incur significant losses. To avoid such losses, the entrant would have to either increase its monthly retail price, or restrict the volume of minutes to its on-net mobile numbers. Either of these alternatives would limit its ability to compete in the retail mobile market.

18. As a result, the Commission's view is that if the Final Undertakings are accepted, the potential remains that a plan such as the Talk Add-on plan could be introduced, and consequently the barrier to expansion that the Commission was seeking to address during the MTAS Investigation would not have been removed.

19. While low retail prices arising from such plans would benefit end users on the larger network(s) in the short-term, the Commission's view is that there are likely to be longer term detrimental effects on competition in the mobile services market. The competition issue being considered during this reconsideration (and throughout the MTAS Investigation) is not the level of retail pricing *per se;* the competition concern arises from the relationship between the wholesale MTR and the retail on-net price, and the extent to which the combination of low retail on-net prices and above-cost wholesale MTRs creates or maintains a barrier to efficient expansion by a new entrant. The Commission has consistently stated that if such a barrier exists or re-emerges, then it would recommend a move to cost-based pricing of the MTAS on the basis that this would best promote competition.

20. Under the factual of cost-based regulation of MTRs, the Commission would expect retail on-net discounting to continue. However, by setting the wholesale MTR at a level that reflects the efficient costs of supplying the MTAS in New Zealand, a small entrant should be able to compete with the retail on-net pricing of the larger mobile operators. The Commission notes that the parties during the MTAS investigation, including both Vodafone and Telecom, agreed that cost-based MTRs will result in efficient and competitive outcomes.[18] 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.

21. In the Commission's view, the introduction of a retail plan such as the Talk Add-on plan, notwithstanding its subsequent withdrawal, and the potential for the future introduction of similar plans, is evidence that the assumptions on which Commissioners Patterson and Pickering relied in concluding that "the competition concerns identified by the Commission would be addressed in a timely manner by acceptance of the Final Undertakings" have

[18] See for example, Final MTAS Report, paragraph 137.

been undermined, and their recommendation that the Final Undertaking be accepted, which was based on those assumptions, cannot survive.[19]

22. In light of this, and market developments since the Final MTAS Report, the Commission's view is that 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.

23. Parties submitted that a Standard Terms Determination (**STD**) process would be complex, timely, costly and contentious. The Commission considers that if an STD were to be undertaken, then the STD could be progressed in a timely manner, given that many issues that would need to be considered in an STD have been identified and explored during the MTAS Investigation. The Commission considers that an STD process would be not lengthy, costly and complex, and that dealing with reciprocity would not be necessarily complex, given the work that was undertaken to reach the reciprocal terms in the Final Undertakings.

24. Parties also submitted that the Commission should accept the Final Undertakings and rely on monitoring to identify any future issues with on-net discounting. The Commission considers that monitoring the mobile services market would not be an adequate response to the potential for similar offers to the Talk Add-on to occur in the future, re-creating the competition concerns that the MTAS Investigation and this reconsideration process aim to address. If the Final Undertakings were accepted and a similar competition concern arose in the future, then yet another investigation under Schedule 3 of the Act would be required. Should the MTAS be regulated following a subsequent Schedule 3 investigation, then there would be a corresponding delay before the benefits of regulation would be realised.

Commission's Recommendations

Framework for recommendation

25. 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.[20] 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.

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

27. This 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. 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. Additionally, given the reciprocity requirements and symmetric price terms

[19] Appendix Four provides Commissioners Patterson and Pickering's additional views on the reasons that their assumptions about future pricing behaviour in the Final MTAS Report are no longer appropriate.

[20] See sections 18 and 19 of the Act.

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.[21]

Reconsideration recommendation

28. Based on the analysis set out in this Reconsideration Report, the Commission's reconsideration recommendation[22] 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**);[23]

Mobile termination access services (MTAS)	
Description of service:	Termination (and its associated functions) on a cellular mobile telephone network of: ▪ 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. 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, 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:	Benchmarking against the costs of providing similar services in comparable countries that result from the application of –

[21] See Final MTAS Report, pages 192-195, paragraphs 836-850.

[22] Commissioner Mazzoleni and Associate Commissioner Pickering concur with this Reconsideration Report and the reconsideration recommendation in paragraph 28.

[23] The proposed regulatory change is the same as that assessed by the Commission in the Final MTAS Report, with the exception of the following change. The final row "Additional matters that must be considered regarding the application of section 18" has been added to the proposed regulatory change for consistency with other regulated services. This row had been accidentally omitted from earlier versions of the proposed regulatory change. The Commission considers that this is not a material change, as it is not proposed that any additional matters need to be considered. The Commission notes for the avoidance of doubt that in interpreting the proposed regulatory change the singular can be read as the plural, for example the singular "service" can be read as the plural "services" and vice versa, as the context requires.

	(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: (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:	Either – (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: (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
Additional matters that must be considered regarding the application of section 18	Nil

and

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

(the **reconsideration recommendation**).

DATED this 16th day of June 2010

Dr Ross Patterson
Telecommunications Commissioner

SECTION I: BACKGROUND TO RECONSIDERATION PROCESS

Introduction

29. This section outlines the process and framework for the reconsideration process. Further detail on the process and framework, including addressing submissions on these matters, is contained in Appendix Two. This section also outlines the structure of the remainder of this Reconsideration Report.

30. 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

31. The recommendation of the Telecommunications Commissioner in the Commission's Final MTAS Report[24] 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"

32. Associate Commissioner Pickering concurred with the recommendations of the Telecommunications Commissioner.[25] 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.[26]

Request for reconsideration

33. 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.[27]

34. The Minister requested comment on whether or not the Commission considered that this was the case.

35. On 19 April 2010, the Commission advised that Minister that its:[28]

> "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

[24] Final MTAS Report, page 15, paragraph xxix.
[25] Final MTAS Report, page 19, paragraph lv.
[26] Final MTAS Report, pages 20-23, paragraphs lvi-lxxi.
[27] Letter from Minister to the Commission, 19 April 2010.
[28] 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.

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."

36. 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:[29]

"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."

Legislative framework, statutory purpose and other relevant considerations

37. In carrying out its assessment for the purposes of and making its recommendations in this 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.[30]

Scope of issues considered in this Reconsideration Report

38. In a letter dated 27 April 2010, the Commission set out an indicative process and timeline for the reconsideration. The Commission noted that:[31]

"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."

39. This reconsideration is focused on the Commission's recommendation in the Recommendations and Reasons section of the Final MTAS Report, and is limited to the aspect noted in paragraph 33 above in accordance with the reconsideration request, including all required considerations pursuant to the Act. Other sections of the Final MTAS Report (including findings on market definition, the benchmark set, the factual and counter-factuals, and qualitative and quantitative analysis) are not the subject of the reconsideration and those findings of the Commission remain unchanged.

40. 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.

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

[30] The statutory considerations that the Commission is required to consider are summarised in Appendix Two of this Final Reconsideration Report at paragraphs 92-97. See also, pages 30-33, paragraphs 25-41, and page 34, paragraphs 44-46 in the Final MTAS Report.

[31] Letter from Commerce Commission to interested parties, *Mobile termination access services investigation – indicative process and timeline for reconsideration*, 27 April 2010, page 2.

Structure of this Reconsideration Report

41. The remainder of this Reconsideration Report is structured as follows:

- Section II summarises the competition concerns under the Act that the Commission has considered in this Reconsideration Report;
- Section III analyses the relevant retail offers considered in this Reconsideration Report and considers whether these offers have any implications for the Commission's recommendation in the Final MTAS Report;
- Appendix One summarises the price terms of the Final Undertakings;
- Appendix Two summarises the process that the Commission has followed in responding to the reconsideration request, and summarises submissions relating to that process and the framework the Commission has used in this Reconsideration Report;
- Appendix Three summarises and comments on high level general submissions on the Commission's draft recommendation from the Draft Reconsideration Report, sets out the proposed regulatory change considered in this Reconsideration Report and addresses submissions on the proposed regulatory change;
- Appendix Four provides Commissioners Patterson and Pickering's additional views on the reasons that their assumptions about future pricing behaviour in the Final MTAS Report are no longer appropriate;
- Appendix Five summarises information provided by interested parties about relevant retail plans; and
- Appendix Six summarises the Commission's assessment of Vodafone's (now withdrawn) Talk Add-on plan, including submissions related to the Commission's assessment of the Talk Add-on plan, and provides a sensitivity analysis in relation to the estimated margins that a small entrant could have earned if supplying a retail plan in competition with Vodafone's Talk Add-on (had it not been withdrawn). Appendix Six also addresses submissions that the Commission is engaging in retail price control, and relating to interconnection traffic volumes.

SECTION II: COMPETITION CONCERNS IN MTAS INVESTIGATION AND RECONSIDERATION

42. Section II summarises the competition concerns under the Act that the Commission has considered in this Reconsideration Report.

Reconsideration of barriers to efficient entry and expansion

43. The Commission has considered whether the ability of incumbent operators to introduce new retail plans such as those introduced 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.

44. The Commission notes that while the 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).

Summary of the competition concerns in the Final MTAS Report

45. 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:[32]

> "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."

46. The Final MTAS Report concluded that on-net discounting at the retail level would make subscription to a larger network more attractive 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.[33]

47. 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

[32] Final MTAS Report, paragraphs 306-307.
[33] Final MTAS Report, paragraph 276.

outflow would result in the entrant incurring a loss on such traffic. As noted in the Final MTAS Report:[34]

> "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."

48. 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 estimated weighted average retail on-net prices to the wholesale MTR. In making this comparison, the Commission estimated the weighted average retail on-net price for MTM and SMS for 2008.

49. 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.[35] The Commission had regard to the resulting implied on-net termination rates to:[36]

> "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)

50. While concurring with the analysis in the Final MTAS Report,[37] Commissioner Mazzoleni expressed concern with the outcome if the large network operators responded with more aggressive on-net pricing than was assumed in the Final MTAS Report.[38] Commissioner Mazzoleni considered that a steeper fall in retail on-net prices was possible in the current New Zealand market, and that regard should be had to the likely response from each large network rather than simply a weighted average response.

51. In considering the MTRs contained in the Final Undertakings submitted by Vodafone and Telecom, the Commission (other than Commissioner Mazzoleni) concluded that the MTRs should (absent other factors and 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.[39]

52. In the Final MTAS Report, the Commission also noted that:[40]

> "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

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[34] Final MTAS Report, paragraph 584.
[35] This imputation involved the deduction on non-termination costs from the retail price, such as the costs of retailing and call origination.
[36] Final MTAS Report, paragraph 626.
[37] Final MTAS Report, paragraph lvi.
[38] Final MTAS Report, paragraph lxvi.
[39] Final MTAS Report, paragraph 823.
[40] Final MTAS Report, paragraph 880.

> mobile services market could re-emerge to the extent that a small {mobile network operator} 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)

53. 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 or re-emergence 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 Reconsideration Report

54. In this Reconsideration Report, the Commission has considered whether the introduction of new retail plans since the Final MTAS Report is likely to result in the continuation of the barriers to expansion in the retail mobile services market that were identified in the Final MTAS Report, and the Commission's recommendation in the Final MTAS Report that the Final Undertakings would address this situation.

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

55. Section III analyses whether the information provided by interested parties about relevant retail plans raises competition concerns and the effect (if any) of such concerns on the Commission's recommendation in the Final MTAS Report. Further consideration of issues raised in submissions is contained in Appendix Six.

New retail plans since the Final MTAS Report

56. In the Draft Reconsideration Report, the Commission noted that it was aware of two retail offers that had been released since the Commission provided the Final MTAS Report to the Minister on 22 February 2010. These two new retail plans were 2degrees' 2 cents per text to 2degrees mobiles top-up offer, and Vodafone's Talk Add-on plan.[41]

57. Following the release of the Draft Reconsideration Report, Vodafone announced that it was withdrawing the Talk Add-on plan.[42]

58. Since the Draft Reconsideration Report, a number of new mobile plans have been launched in New Zealand. The Commission is aware that a number of further mobile plans may be offered by the time the Commission finalises its reconsideration recommendation.

59. The new mobile plans that have been considered by the Commission as part of this reconsideration process are listed below, along with a brief summary of the key features of each plan:

- 2degrees 2 cents per on-net text: when customers top-up their prepay service, texts to other 2degrees customers are 2 cents per text after they have used up their allocated free texts. This offer is valid for a month after the top-up;
- 2degrees $10 Text Pack: 500 texts to any network for $10 per month;
- 2degrees $6 Data Pack: 50MB of data for $6 per month;
- 2degrees Everyone100 plan: 100 minutes to any network (to be used within 30 days), for $30;
- Vodafone Talk Add-on (subsequently withdrawn): 200 minutes to any Vodafone mobile and to any fixed line, for $12 per month;
- Vodafone BestMates1000: 1,000 minutes and 1,000 texts to 1 nominated Vodafone mobile for $6 per month;[43]
- Vodafone Simply Prepay: calls to any network at 49 cpm, and texts to any network at 12 cents per text;

[41] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 79.
[42] Vodafone cross-submission, 26 May 2010, page 2.
[43] Vodafone also offers BestMates2000 for 2 Best Mates, at $12 per month, and BestMates3000 for 3 Best Mates, at $18 per month.

- Vodafone talkZoneZero Plus: provides business customers with options for calling, from $36 per month per user for free calls within their calling group, up to $136 per month per user for free calls to any New Zealand landline or mobile (including voicemail and the provision of a local number associated with each mobile);

- Telecom Talk&Text 300: 300 off-peak minutes to any network, 300 texts to any network, and 20 peak minutes to any network, for $29.95 per month;

- Telecom Text Anyone 2500 (until 31 July 2011): 2,500 texts to any network, for $12;

- Telecom One Bill: calls to any network at 59 cpm, 200 texts to any network, and one bill for mobile and homeline, for $10 per month.

60. [

] **VNZCOI**

Commission's analysis of new plans

Potential competition implications of the new plans

61. In the Commission's view, the new 2degrees 2 cents per on-net text pricing is not likely 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 is above the average termination rates for texts under the Final Undertakings that the Commission referred to in the Final Report.[44]

62. A number of the new plans referred to in paragraph 59 above are any network plans. These include the 2degrees Text Pack, the 2degrees Everyone100 plan, Vodafone Simply Prepay, and the new Telecom plans. These plans do not feature discounted on-net prices, and therefore do not create a competitive advantage for the larger networks. As a result, the combination of the retail prices in these plans, and high MTRs, is unlikely to create a barrier to entry or expansion for a small mobile network.

63. Vodafone's BestMates1000 introduces a monthly cap for prepay subscribers of 1,000 minutes and 1,000 texts to each nominated Vodafone mobile.

64. Vodafone's new talkZoneZero Plus plans include various options for business customers, starting with a fixed monthly charge of $36 per user providing unlimited calls within the calling group, and with progressively higher monthly charges to include unlimited calls to any New Zealand landline, to any Vodafone mobile, and to any New Zealand mobile. The option providing unlimited calls to any Vodafone mobile has the potential to lead to competition concerns for a small entrant, although such concerns need to be seen in the context of the other features of the new plans. In particular, the entrant is likely to be able to compete with the base plan offering unlimited calls between nominated users within the business, as the entrant should be able to target the business customer. The options

[44] 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.

providing for unlimited calls to any landline, and to any mobile, are any network features, and as discussed above, these are unlikely to create competition issues in the retail mobile market.

65. [

] **VNZCOI**

66. In the Draft Reconsideration Report, the Commission concluded that the introduction of the Talk Add-on plan by Vodafone represented a significant new development in the retail mobile market,[45] and that if the Final Undertakings were to be accepted, plans such as Talk are likely to result in the re-emergence of barriers to expansion that would constrain the ability of a small entrant to compete, and of the kind that the Commission was seeking to address during the MTAS Investigation.[46]

67. In commenting on the Commission's conclusions in the Draft Reconsideration Report, Vodafone submitted that it has made a number of changes at the retail level in responses to Commission concerns. Vodafone submitted that while there is some uncertainty over what the Commission now regards as being acceptable on-net pricing, the Commission can be reassured that Vodafone will exercise caution to ensure that its offers do not result in barriers to entry or expansion. According to Vodafone, the assumptions that the Commission says underlay its initial recommendation continue to be valid and will not be undermined.[47]

68. Vodafone claims that it withdrew Talk in response to Commission concerns that the plan was anti-competitive[48] (and that it introduced the cap on the BestMates plan in response to Commission concerns[49]). The Commission has never required Vodafone (or any other mobile operator) to amend its retail mobile offers. The competition issue being considered during this reconsideration (and throughout the MTAS Investigation) is not the level of retail pricing *per se*, but rather the relationship between retail prices and the wholesale MTR, 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. The Commission has consistently stated that if such a barrier exists or re-emerges, then it would recommend a move to cost-based pricing of the MTAS on the basis that this would best promote competition. The Commission agrees with Vodafone that the regulatory framework set out in Part 2 of the Act is focussed on determining the price of wholesale inputs rather than retail prices, and has therefore focused on ensuring that wholesale MTRs are at an appropriate level that removes the barrier identified above.

69. While the Talk Add-on plan has been withdrawn by Vodafone, its offer into the market demonstrates the kind of behaviour that a large incumbent can undertake as long as MTRs

[45] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 95.
[46] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 123.
[47] Vodafone cross-submission, 26 May 2010, page 2.
[48] Vodafone submission, 19 May 2010, page 1.
[49] Vodafone submission, 19 May 2010, page 7.

remain at a level contained in the Final Undertakings. As TUANZ has noted in relation to the Talk plan:[50]

> "If both Telecom and Vodafone were to proliferate on-net/off-net differential pricing on such a large scale ... they could completely close out competition from any other carrier which lacks the scale to make on-net only calling marketable to its small cluster of customers."

70. 2degrees has also argued that what is important is future market conduct, rather than a detailed analysis of the Talk plan:[51]

> "The Commission's assumptions concerning future market conduct were not limited to a single retail plan or plans; they were assumptions about future market conduct generally. The issue for reconsideration is whether those assumptions were sound and the Commission is right to conclude they were not."

71. Although Vodafone withdrew the Talk Add-on plan after the release of the Commission's Draft Reconsideration Report, the Commission considers that the potential for the introduction by an established operator of flat-rate retail on-net plans such as the Talk plan has heightened the competition concerns related to a small entrant having to incur the MTRs in the Final Undertakings. Were the Final Undertakings to be accepted, and a similar retail on-net plan introduced, such concerns could only be addressed through a further investigation under Schedule 3 of the Act and then either through a recommendation to regulate or to accept any new undertakings that might be offered.

72. Although the Commission has placed less emphasis on the Talk plan *per se* in this Reconsideration Report, the Commission's view is that a plan of the nature of the Talk plan would, if introduced, be likely to prevent or limit the ability of a small entrant to compete and expand in the mobile service market. For example, in Appendix Six, the Commission has analysed the margins that a small entrant could potentially earn if it had to compete with a retail plan such as the Talk Add-on, and this shows that the entrant would likely earn significant losses. Appendix Six also includes the Commission's consideration of submissions on the Talk analysis that was contained in the Draft Reconsideration Report.

73. Both Telecom[52] and Vodafone argued that the Commission had inappropriately focussed on the Talk Add-on plan. For example, according to Vodafone, the Commission's focus has been on whether 2degrees can compete with Talk, rather than whether the undertakings or regulation will best promote competition. Vodafone submitted that in focusing on Talk, the Commission had ignored other plans (or planned changes to existing plans), such as the introduction of a hard cap on the volume of calls that can be made under the Best Mates plan (recently set at 1,000 minutes per month). According to Vodafone, such a cap will more than off-set the impact of the Talk plan on the average on-net revenue per minute.[53]

74. The Commission has previously noted that retail mobile plans that offer a relatively high volume of on-net MTM minutes to any on-net mobile number for a fixed monthly fee, may have a significant impact on the ability of a small entrant to compete.[54] Covec, on behalf of Vodafone, also submitted during the MTAS Investigation that such blanket retail plans offering calls to any on-net number would make it much more difficult for a small entrant

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[50] TUANZ letter to Telecommunications Commissioner, 3 May 2010, page 2.
[51] 2degrees cross-submission, 26 May 2010, page 3.
[52] Telecom cross-submission, 26 May 2010, paragraph 6.
[53] Vodafone submission, 19 May 2010, page 7.
[54] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 118.

to compete than plans such as BestMates, which are restricted to relatively small calling circles:[55]

> "since low on-net prices are driven by closed user group pricing, it does not follow that the average price to call *anyone* on-net is low. Low prices are only available for calls to small groups. 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."

75. In submitting on the Draft Reconsideration Report, 2degrees also referred to Vodafone's own statement on the potential impact of plans offering on-net access during the MTAS Investigation:[56]

> "But even more, or at least as significant as that, those customers who have on-net tariffs are not getting on-net access to the entire customer base of Vodafone, particularly in the case of voice pricing ... It would be a different argument if there were widespread use of on-net tariffs where the on-net community extended to the entire customer base of the large operators, but that is not the position, not the facts that we see in New Zealand today."

76. In its submission on the Draft Reconsideration Report, Covec noted that the Talk plan includes calls to any landline (MTF), and that as such calls are terminated at a fixed termination rate of 1cpm, considerable margins are available on such calls. In addition, Covec argued that Talk subscribers had to commit to a monthly spend of $12, and that the Talk plan did not offer a low per-minute price from the first minute of usage. Finally, Covec noted that the Talk plan was limited to voice and did not include other services such as SMS.

77. In considering the potential competitive impact of a plan such as Talk, the Commission has taken into account the fact that the plan included MTF minutes, and that such minutes would be terminated at a relatively low rate of 1cpm.[57] Despite the relatively high margin that could be earned on such MTF calls, the Commission has found that for reasonable calling patterns (such as the level of utilisation, and the distribution of calls between MTF, on-net MTM, and off-net MTM), the entrant was likely to incur substantial losses in trying to compete with an incumbent's retail plan such as Talk.[58]

78. The Commission has also taken into account the likelihood that only a proportion of available minutes would be used,[59] and that the resulting average price per minute will depend on this proportion. The Commission discusses the significance of potential revenues from other services (such as SMS) in Appendix Six.

79. Covec caveats its earlier comments made during the MTAS Investigation on the potential impact of blanket on-net plans on the ability of a small entrant to compete. According to Covec:[60]

> "Talk is quite different to a simple offer of, say, 10 cents per minute for all on-net calls (from the first minute) versus, say, $1 per minute for all off-net calls including to fixed lines. Such a plan is what we had in mind when we made our earlier statements about the competitive implications of on-net pricing.

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[55] Covec, *Comments on the MTAS Conference 'Whiteboard' Examples*, 9 October 2009, paragraph 17.
[56] 2degrees submission, 19 May 2010, page 2.
[57] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraphs 102 and 103.
[58] As shown in Appendix Six, such losses would continue to be incurred across a wide range of scenarios.
[59] As discussed further in Appendix Six.
[60] Covec submission, 19 May 2010, paragraphs 17 and 18.

> Compared with Talk, this type of pricing would likely have much broader appeal, and would make a larger mobile network more attractive than a smaller one, everything else equal.
>
> In contrast, Talk is an offer targeted at a subset of a segment of the mobile market, and is not restricted only to on-net calling. We therefore do not consider that our earlier comments about the ability of an entrant to compete with on-net offers translate into the strong conclusions the Commission has reached about Talk in the Draft Reconsideration Report."

80. The Commission considers that the likely competitive impact of a metered on-net plan (offering the example of a simple on-net calling rate of 10cpm) would be similar to that of a plan such as Talk (offering a bucket of minutes for a fixed monthly fee), unless the utilisation of the bucket was very low (or the volume of minutes contained in the bucket was low). In the Commission's view, it is reasonable to expect that consumers paying a fixed monthly fee for a volume of minutes will use a high proportion of those minutes. The Commission noted in the Draft Reconsideration Report that the monthly volume of minutes available under the Talk plan was relatively high, and that Vodafone's promotion of the plan focused on stimulating calling volumes.[61] Vodafone's submission on the Draft Reconsideration Report states that the Talk Add-on was designed to increase mobile voice usage.[62] Under these circumstances, it is reasonable to expect that the average price to call *anyone* on-net will be low under a flat-rate plan such as Talk, giving rise to the scenario in which Covec expressed competition concerns during the MTAS Investigation.[63]

81. This is supported by Vodafone's own statement at the MTAS conference (referred to at paragraph 74 above), where it acknowledged that retail plans offering access to the entire customer base of the larger operators would create difficulties for a small entrant. Both a metered plan of the kind referred to by Covec, and a flat-rate plan such as the Talk Add-on, offer access to the entire Vodafone customer base. While such retail plans were not widely available at the time of the MTAS Investigation, the Talk plan introduced such an on-net tariff, and in doing so demonstrated the type of behaviour that could limit the competitive constraint of the entrant. According to Vodafone, it had expected [ ] **VNZCOI** customers signing up for the Talk plan within the first year. This level of expected first-year take-up, which compares to less than [ ] **VNZRI** Best Mates achieved after almost four years, was consistent with the Commission's view in the Draft Reconsideration Report that a plan such as Talk would be particularly attractive to end users and could have a potentially significant impact on the ability of a small entrant to compete, given the MTRs contained in the Final Undertakings.[64]

82. Telecom submitted that the Commission would continue to have leverage over mobile operators in the event that the Final Undertakings were accepted. Telecom noted that if the operators were to engage in contentious on/off-net price differentiation in the retail mass market over the life of the undertakings, the Commission could respond by recommending regulation of MTRs.[65] However, the Commission notes that such a recommendation would have to be based on a new Schedule 3 investigation, leading to a further deferral of benefits for end users.

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[61] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 134.
[62] Vodafone submission, 19 May 2010, page 1.
[63] as per Covec's statement quoted at paragraph 74 above.
[64] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 95.
[65] Telecom submission, 19 May 2010, paragraph 15.

83. Finally, the Commission notes Vodafone's submission that the introduction of BestMates1000 is likely to offset the impact of the Talk plan on Vodafone's average on-net price.[66] In the Commission's view, while the introduction of a BestMates cap may have the effect of increasing Vodafone's average retail on-net price per minute, to the extent that the usage of some customers is moderated by the cap, the BestMates cap is unlikely to offset the competitive impact of a plan such as Talk. This is because the BestMates plan is limited to a small number of on-net numbers, whereas plans (such as Talk) that offer access to Vodafone's entire on-net customer base would make it much more difficult for a small entrant to compete.

Conclusion

84. In summary, the Commission considers that the introduction of the Talk Add-on plan by Vodafone (despite its subsequent withdrawal following the Commission's draft recommendation to regulate the MTAS) demonstrates the type of behaviour that could emerge under a counterfactual based on the Final Undertakings. The Commission stated in the Draft Reconsideration Report that even if Vodafone were to withdraw the Talk plan (which it has subsequently done), Vodafone would still retain the discretion, and have the incentive, to introduce retail pricing that could again give rise to barriers to expansion for a small entrant mobile operator, given the MTRs in the Final Undertakings.

85. When faced with such retail pricing by mobile operators with a large established customer base, and having to pay the wholesale MTRs contained in the Final Undertakings, a small entrant is unlikely to be able to vigorously compete because it would incur significant losses.[67] To avoid such losses, the entrant would have to either increase its monthly retail price, or restrict the volume of minutes to on-net mobile numbers. Either of these alternatives will limit its ability to compete in the retail mobile market.

86. Under the factual of cost-based regulation of MTRs, retail on-net discounting is expected to continue. However, by setting the wholesale MTR at a level that reflects the efficient costs of supplying the MTAS in New Zealand, a small entrant should be able to compete with the retail on-net pricing of the larger mobile operators. The Commission notes that the parties during the MTAS investigation agreed that cost-based MTRs will result in efficient and competitive outcomes.[68] 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.

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[66] Vodafone submission, 19 May 2010, page 2.
[67] As shown in Appendix Six.
[68] See for example, Final MTAS Report, paragraph 137.

APPENDIX ONE: DETAILS OF FINAL UNDERTAKINGS

87. The price terms of the Final Undertakings that the Commission assessed in the Final MTAS Report, and that the Commission has considered in this Reconsideration Report, are set out in Table 1 below.

Table 1: 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

APPENDIX TWO: RECONSIDERATION PROCESS AND FRAMEWORK FOR ASSESSMENT

88. Appendix Two summarises the process that the Commission has followed in the reconsideration.

Reconsideration process

89. 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**:**[69]

> "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."

90. On 27 April 2010, the Commission notified interested parties of its indicative process and timeline for the reconsideration process.[70]

Draft Reconsideration Report and submissions

91. On 12 May 2010, the Commission released its Draft Reconsideration Report.[71] Submissions were due on 19 May 2010 and cross-submissions were due on 26 May 2010.[72] Submissions were received from nine interested parties and cross-submissions were received from five interested parties.

Legislative framework, statutory purpose and other relevant considerations for Commission's reconsideration recommendation

92. Schedule 3 of the Act contains the procedure for altering regulated services. Under Part 1 of Schedule 3, the Commission may undertake an investigation into a proposed alteration to Schedule 1 of the Act, and recommend to the Minister whether or not the proposed alteration should be made.[73]

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

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

[71] Commission, *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*, 12 May 2010 (**Draft Reconsideration Report**).

[72] An extension to the deadline for submissions was granted to Business NZ until 24 May 2010, and the deadline for cross-submissions on Business NZ's submission was extended until 31 May 2010.

[73] See the Final MTAS Report, pages 30-33, paragraphs 25-41 for details of the requirements for the MTAS Investigation process and Appendix 1 for details of the *Process of MTAS Investigation.*

93. Clause 6(2)(b) of Schedule 3 of the Act sets out the Minister's power to require a reconsideration of the Commission's recommendation in the Final MTAS Report:

> "**6 Decision by Minister on Commission's recommendations**
>
> (2) The Minister may— …
>
> (b) require the Commission to reconsider, for any reasons specified by the Minister,—
>
> (i) any set of related recommendations or any aspect of that set of related recommendations:
>
> (ii) any of the other recommendations or any aspect of those other recommendations."

94. As noted in paragraph 33, the Minister made the reconsideration request to the Commission under clause 6(2)(b) on 26 April 2010.

95. Section 18 of the Act describes the purpose of Schedule 3 as follows:

> **'18 Purpose**
>
> (1) The purpose of this {Part 2} and Schedules 1 to 3 is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers.
>
> (2) In determining whether or not, or the extent to which, any act or omission will result, or will be likely to result, in competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand, the efficiencies that will result, or will be likely to result, from that act or omission must be considered.
>
> (3) Except as otherwise expressly provided, nothing in this Act limits the applications of this section.
>
> (4) Subsection (3) is for the avoidance of doubt.'

96. Section 19 of the Act provides as follows:

> **'19 Commission and Minister must consider purpose set out in section 18 and additional matters**
>
> If the Commission or the Minister (as the case may be) is required under this {Part 2} or any of Schedules 1, 3, and 3A to make a recommendation, determination, or a decision, the Commission or the Minister must—
>
> (a) consider the purpose set out in section 18; and
>
> (b) if applicable, consider the additional matters set out in Schedule 1 regarding the application of section 18; and
>
> (c) make the recommendation, determination, or decision that the Commission or Minister considers best gives, or is likely to best give, effect to the purpose set out in section 18.'

97. In carrying out its assessment for the purposes of and making its recommendations in this 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. The Commission has also had regard to the economic policies of Government transmitted under s19A of the Act in relation to the reconsideration recommendation in this Reconsideration Report, and notes that there were no additional matters that required changes to the view set out in the MTAS Final Report regarding the economic policy statement.[74]

[74] MTAS Final Report, page 34, paragraphs 44-46.

Submissions on the analysis framework in the Draft Reconsideration Report

98. The New Zealand Business Roundtable (the **Business Roundtable**) submitted that:

- the draft recommendation does not demonstrate a clear national interest in favour of regulation[75], the benefits of regulation are minimal[76] and the benefit of protecting a new entrant is not a valid one[77] (and is not made out);[78] and

- dynamic efficiency and protection of property rights require a presumption against regulation.[79]

99. Telecom cross-submitted that it supported the "fundamental philosophical concept underpinning the Business Round Table submission", stating that:[80]

> "regulation should only be imposed where it can be demonstrated with a reasonable degree of certainty that there is a clear overall benefit to be gained through regulation. In this case regulation would come at a cost for businesses but it is by no means clear that it would provide a better solution to concerns in relation to on/off net pricing than the undertakings and it is also by no means clear that it would result in lower prices for consumers."

100. Business New Zealand (Business NZ) submitted that reviews of this nature could in the future be conducted by the Productivity Commission and that the Productivity Commission should review the wider issues associated with business incentives associated with MTAS decisions, including associated effects on other industries.[81]

Commission views on submissions on the analysis framework in the Draft Reconsideration Report

101. In this Reconsideration Report the Commission has applied the statutory test under sections 18 and 19 of the Act in reaching its reconsideration recommendation. The Commission has had regard to the submissions in paragraphs 98 to 100 to the extent that they relate to the application of the statutory tests in the context of this reconsideration. However, other aspects of those submissions are outside the limited scope of the issues considered in this Reconsideration Report. The Commission does, however, make the following comments in response to these submissions.

102. The Commission's recommendations in the Final MTAS Report were based on judgments regarding likely future behaviour in the mobile markets, in particular relating to on-net pricing. During this reconsideration, the Commission has considered whether those judgments remain valid in light of retail plans introduced since the Final MTAS Report. For the reasons set out in this Reconsideration Report, the Commission's view is that the assumptions upon which the recommendation in the Final MTAS Report was based have been undermined, and that acceptance of the Final Undertakings is likely to result in the continuation or re-emergence of the barriers to entry and expansion that the Commission has been seeking to address through the MTAS Investigation. Such barriers would reduce

[75] Business Roundtable, *Submission on the Commerce Commission's Draft Reconsideration Report on Mobile Termination Services*, May 2010 (**Business Roundtable, *Draft Reconsideration Report Submission***), pages 3-5, paras 3.1-3.8.
[76] Ibid, page 3, para 3.2.
[77] Ibid, page 7, para 6.1.
[78] Ibid, pages 4-5, paras 3.7-3.8 and 4.1.
[79] Ibid, page 7, para 6.3.
[80] Telecom, *Draft Reconsideration Report Cross-submission*, page 6, para 25.
[81] Business NZ, *Re: Draft Reconsideration Report*, 24 May 2010, pages 2-3.

competition in the retail mobile service market, compared to the scenario in which cost-based MTRs were available. As noted by both Vodafone and Telecom, cost-based MTRs are likely to result in efficient and competitive outcomes in the relevant downstream markets.

103. Given the limited scope of the issues considered in this Reconsideration Report, the Commission does not think a reassessment of the cost-benefit analysis in the Final MTAS Report, as proposed by the Business Roundtable, is required. The Commission considers that a focus in this Reconsideration Report on whether regulation is justified or not, based on the Commission's judgments regarding future market behaviour, is appropriate.

104. The Commission considers that the Business Roundtable submission also appears to focus on dynamic efficiencies arising only from the established incumbent operators and the protection of incumbents property rights, and does not take into account the dynamic efficiency gains that can arise from a new entrant, especially where the entrant is entering a concentrated market, as is the case in relation to 2degrees entry into the New Zealand mobile services markets.[82] In this Reconsideration Report the Commission has weighed the benefits of dynamic efficiency from entrants against the impacts on incumbents in reaching a view of whether the long term benefits of end users are best met or are likely to be best met by regulation or acceptance of the Final Undertakings. The Commission considers that this is the correct application of the statutory tests that it is required to apply.

[82] See the Final MTAS Report, pages 61-62, paras 189-190 and pages 64-65, paras 195-198 regarding the currently concentrated nature of the New Zealand mobile services markets.

APPENDIX THREE: PROPOSED REGULATORY CHANGE

105. Appendix Three summarises and comments on high level general submissions on the Commission's draft recommendation from the Draft Reconsideration Report. .

Submissions on the Commission's draft reconsideration recommendation

106. The Commission's draft reconsideration recommendation to the Minister, under clause 6(2)(b) of the Act, was that:[83]

- the proposed regulatory change should be made; and
- the Minister should not accept the Final Undertakings offered by Telecom and Vodafone under Schedule 3A of the Act.

Submissions on the Commission's draft reconsideration recommendation

107. Telecom[84] and Vodafone[85] both submitted that they considered that the Final Undertakings should still be accepted, as the Final Undertakings still offer benefits compared to regulation of:

- certainty or the avoidance of uncertainty;[86]
- simplicity, including regarding avoiding having to further deal with reciprocity, which has been addressed in the Final Undertakings but would need to be revisited under regulation;[87]
- lower mobile termination rates faster;[88]
- avoidance of lengthy, costly, complex and contentious STD process;[89] and
- avoidance of potential challenges to the Commission's analysis.[90]

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[83] Commerce Commission, Draft Reconsideration Report, 12 May 2010, pages 8-10, para 23.

[84] Telecom, *Submission on the Commerce Commission's Draft Reconsideration Report on Mobile Termination and Access Services*, 19 May 2010 (**Telecom, *Draft Reconsideration Report Submission***), page 3, para 7(c), and Telecom, Cross Submission on the Commerce Commission's Draft Reconsideration Report on Mobile Termination and Access Services, 26 May 2010 (**Telecom, *Draft Reconsideration Report Cross-Submission***), page 2, paras 1-3.

[85] Vodafone, *MTAS investigation – comments on draft reconsideration report*, 19 May 2010 (**Vodafone, *Draft Reconsideration Report Submission***), page 10 and Vodafone, *Cross-submission on MTAS*, 26 May 2010 (**Vodafone, *Draft Reconsideration Report Cross-Submission***), pages 1 and 6.

[86] Telecom, *Draft Reconsideration Report Submission*, page 3, para 7(c), page 5, para 19 and page 7, paras 29-31, Vodafone, *Draft Reconsideration Report Submission*, page 8, Telecom, *Draft Reconsideration Report Cross-Submission*, page 6, paras 22-24, and Vodafone, *Draft Reconsideration Report Cross-Submission*, page 3.

[87] Telecom, *Draft Reconsideration Report Submission*, page 3, para 7(c) and page 5, para 19, Vodafone, *Draft Reconsideration Report Submission*, page 10, and Vodafone, *Draft Reconsideration Report Cross-Submission*, pages 3 and 4.

[88] Telecom, *Draft Reconsideration Report Submission*, page 2, para 5, page 3, para 7(c) and page 7, para 31, Vodafone, *Draft Reconsideration Report Submission*, pages 8 and 10, and Vodafone, *Draft Reconsideration Report Cross-Submission*, pages 4 and 6.

[89] Telecom, *Draft Reconsideration Report Submission*, page 2, para 3, page 3, para 7(c) and pages 6-7, paras 23-26, Telecom, *Draft Reconsideration Report Cross-Submission*, page 6, para 24, and Vodafone, *Draft Reconsideration Report Cross-Submission*, pages 1 and 3-4.

[90] Telecom, *Draft Reconsideration Report Submission*, page 7, para 29(b) and Vodafone, *Draft Reconsideration Report Cross-Submission*, pages 3-4.

108. Telecom and Vodafone propose that monitoring will be adequate to address future concerns or prevent future inappropriate behaviour[91], with Telecom submitting that:[92]

> "the potential threat of replacing the undertakings with regulation is a lever available to the Commission to ensure appropriate conduct. The undertakings are thus a better means of achieving the Commission's ends than regulation."

109. The Business Roundtable submitted, as noted in paragraph 98 that the Commission:[93]

> "should either provide a compelling national interest case in its final reconsideration report for recommending regulation, or change its recommendation."

110. While Business NZ did not explicitly state that they disagreed with the Commission's draft recommendation, this is inferred in Business NZ's submission that:[94]

> "The current reconsideration report adds another chapter to the process which we believe will have long-term negative consequences for investment not only by the major players in the industry, but also for other industries where major business investment is required."

111. A member of Business NZ, Carter Holt Harvey, and an Associate Industry Group member of Business NZ, the New Zealand Council for Infrastructure Development (NZCID), both cross-submitted that they did not fully support Business NZ's submission. Carter Holt Harvey submitted that:[95]

> "We believe that regulation is required to correct what can only be described as market failure in the area of MTR."

112. NZCID submitted that it considered that:[96]

> "… in the absence of any further commitments by Telecom and Vodafone to speed up the implementation of cost-based MTRs, regulation of MTRs would be in the best long term interests of end-users in accordance with the Act."

113. 2degrees, Drop the Rate, Mate!, TUANZ and Gary Stevens supported the Commission's draft recommendation.[97] In addition:

- 2degrees and TelstraClear submitted that a prompt resolution of the MTAS process, including any STD, is important;[98]

- 2degrees, TelstraClear, Drop the rate, Mate! and TUANZ submitted that they supported cost-based MTAS rates;[99] and

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[91] Telecom, *Draft Reconsideration Report Submission*, page 2, paras 5-6, pages 4-5, paras 12-16, Vodafone, *Draft Reconsideration Report Submission*, page 10, Telecom, *Draft Reconsideration Report Cross-Submission*, page 2, para 4(b) and (c), and Vodafone, *Draft Reconsideration Report Cross-Submission*, page 6.
[92] Telecom, *Draft Reconsideration Report Submission*, page 3, para 7(b).
[93] Business Roundtable, *Draft Reconsideration Report Submission*, page 6, para 6.1.
[94] Business NZ, *Re: Draft Reconsideration Report*, 24 May 2010, page 1.
[95] Carter Holt Harvey, *Business New Zealand MTR letter 24th May 2010*, 31 May 2010.
[96] NZCID, *Re: Telecommunications Act 2001: Schedule 3 Investigation into Regulation of Mobile Termination*, 30 May 2010.
[97] 2degrees, *Submission on Draft Reconsideration Report*, 19 May 2010 (**2degrees, *Submission on Draft Reconsideration Report***), page 1, Gary Stevens, *Re Mobile Termination*, 17 May 2010.
[98] 2degrees, *Submission on Draft Reconsideration Report*, page 3, and TelstraClear, *Commerce Commission Draft Mobile Termination Reconsideration Report Recommendation to regulate Mobile Termination Access Service ('Draft Reconsideration Report')*, 19 May 2010 (**TelstraClear, *Submission on Draft Reconsideration Report***), page 1, para 2.

- TelstraClear expressed qualified support for the Commission's Draft Recommendation, submitting that, if regulation is the only way to ensure MTAS prices move to reflect cost over the longer term and the Commission no longer has confidence in the ability of undertakings to address competitive concerns, then the MTAS should be regulated.[100]

114. Telecom cross-submitted that:[101]

> "Many of the parties who are advocating for regulation (such as those referred to in the Drop The Rate Mate poll) are doing so in the expectation that regulation will lower mobile retail prices for consumers. Given that there is in reality no indication that regulation will directly or indirectly deliver lower mobile prices to consumers than the undertakings, this support for regulation is misplaced."

115. Telecom went on detail a number of concerns with methodology of the Drop the Rate, Mate poll[102], and concluded that:[103]

> "a logical market consequence of lower MTR rates (at least below those set out in the undertakings) is not so much a net reduction in retail prices as a shift in benefits from one category of user to another. As noted previously we do not regard a mere transfer in benefit from one consumer group to another to be an economic benefit of regulation."

Commission's views on submissions on the Commission's draft reconsideration recommendation

116. The Commission has considered the claimed benefits of the Final Undertakings, as discussed in Telecom and Vodafone's submissions in paragraph 107, and Telecom's cross-submissions in paragraphs 114 and 115, and considers that regulation of MTAS on the basis of the proposed regulatory change set out in paragraph 28 will provide greater long term benefits to end users than accepting the Final Undertakings for the reasons set out in Section III in particular.

117. The Commission considers that, if the Commission's reconsideration recommendation is accepted and an STD is initiated, then an STD could be progressed in a timely manner, given that many issues that would need to be considered in an STD have been identified and explored during the MTAS Investigation. The Commission does not agree that the STD process would be lengthy, costly and complex, or that dealing with reciprocity would be necessarily complex, given the process that occurred to reach the reciprocal terms in the Final Undertakings and the process that would occur for the development of an STD.[104] The Commission is confident that an STD process can address all issues raised by Telecom and Vodafone, including in relation to reciprocity.

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[99] 2degrees, *Submission on Draft Reconsideration Report*, page 1 (subject to 2degrees comments on what the appropriate cost methodology is, discussed at paragraphs 121 and 123), TelstraClear, *Submission on Draft Reconsideration Report*, page 1, para 3.
[100] TelstraClear, *Submission on Draft Reconsideration Report*, page 1, para 2 and page 2, para 9.
[101] Telecom, *Draft Reconsideration Report Cross-Submission*, page 4, para 9.
[102] Telecom, *Draft Reconsideration Report Cross-Submission*, pages 4-5, paras 11-17. Vodafone also indicated that they had concerns with the methodology of the Drop the Rate, Mate poll – see Vodafone, *Draft Reconsideration Report Cross-Submission*, page 6.
[103] Telecom, *Draft Reconsideration Report Cross-Submission*, page 6, para 21.
[104] During the development of an STD the Act provides for a scoping workshop to be held, followed by the submission of a standard terms proposal, which parties can then make submissions proposing specific changes and the reasons for those changes, prior to the Commission issuing a draft STD. Parties also have the opportunity to make submissions on a draft STD before the Commission determines the final terms of the STD.

118. The Commission also considers that monitoring the mobile services market would not be an adequate response to the potential for similar offers to the Talk Add-on to occur in the future, re-creating the competition concerns that the MTAS Investigation and this reconsideration process aim to address. If the Final Undertakings were accepted and a similar competition concern arose in the future, then a subsequent Schedule 3 investigation would be required to address those competition concerns. Should the MTAS be regulated following a subsequent Schedule 3 investigation, then there would be a corresponding delay before the benefits of regulation would be realised.

119. The Commission acknowledges the concerns raised by Telecom and Vodafone in relation to the Drop the Rate, Mate poll and has given the results of that poll no weight due to the concerns about the reliability of the poll.

Proposed Regulatory Change in the Draft Reconsideration Report

120. In the Draft Reconsideration Report, the Commission's draft reconsideration recommendation to the Minister, under clause 6(2)(b) of the Act, included the proposed regulatory change, which involved adding the services detailed in paragraph 28 to Part 2, Subpart 1 of Schedule 1 to the Act.[105]

Summary of submissions on the proposed regulatory change

121. 2degrees proposed the addition of long-run-incremental-cost (**LRIC**) to the proposed regulatory change as pricing option for the final pricing principle (**FPP**).[106] 2degrees submitted that:[107]

> "Given recent and widespread reconsideration of whether TSLRIC, LRIC or BAK pricing best addresses the harm caused by above cost MTRs it is important that the Commission does not rule out any particular pricing methodology at this stage. We recommend that LRIC be included in the proposed regulatory change as an alternative FPP in the event that the Commission considers (consistent with developments in Europe) that TSLRIC or BAK pricing do not best give effect to the purpose set out in section 18 of the Act."

122. Telecom and Vodafone both cross-submitted that they did not agree with the inclusion of LRIC as part of the FPP. Telecom submitted that this would create too much uncertainty and that there is no reason based on the relevant retail offers to change the FPP that the Commission had previously been considering.[108] Vodafone questioned whether pricing at LRIC is consistent with section 18 and noted their previous submissions that if MTAS were to be regulated then TSLRIC is the appropriate pricing principle.[109]

123. 2degrees also submitted that retail non-discrimination rules needed to be provided for, stating that:[110]

> "cost-based termination will not of itself address current market distortions.
>
> …

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[105] Commerce Commission, Draft Reconsideration Report, 12 May 2010, pages 8 – 9, para 23. The proposed regulatory change in the Draft Reconsideration Report was the same as that assessed by the Commission in the Final MTAS Report.
[106] 2degrees, *Draft Reconsideration Report Submission*, pages 1-2 and 4.
[107] Ibid, page 2.
[108] Telecom, *Draft Reconsideration Report Cross-submission*, page 7, para 31.
[109] Vodafone, *Draft Reconsideration Report Cross-submission*, pages 1 and 4.
[110] 2degrees, *Draft Reconsideration Report Submission*, pages 2-3.

> Wholesale regulation may allow new entrants to offer plans that have comparable outbound calling utility to Vodafone's Talk Add-on or similar products. However, if incumbent operators are able to penalise their own customers with excessive off-net retail prices that choke off cross-network calls and SMS, new entrants will remain severely limited in their ability to compete as their customers suffer from severely restricted inbound call utility.
>
> … The Commission should require retail non-discrimination because the Commerce Act does not adequately address barriers to entry and expansion. There can be no doubt that discriminatory pricing is a significant barrier to entry in its own right."

124. Vodafone cross-submitted that retail non-discrimination rules were inappropriate.[111] Vodafone stated that:[112]

> "Removal or significant restriction on on-net pricing would impact negatively on competition in New Zealand, including 2degrees and almost every other operator, and would not be in either the short-term or long-term interests of end users."

125. In its submission on the Draft Reconsideration Report, Vodafone referred to the "real uncertainty" around what the regulator would make of its retail offerings,[113] and that the Commission's use of on-net prices as a cross-check involves setting retail mobile prices to some extent (or at least establishes a floor for retail prices, given any level of wholesale MTR), which in its view does not seem appropriate under the Telecommunications Act.[114]

126. In its cross-submission, Vodafone argued that the Commission should be cautious about trying to control retail mobile prices, either directly or through the MTAS process. Vodafone questioned whether the Commission is best placed to determine the best mobile pricing model for consumers. According to Vodafone, the Act does not contemplate the Commission intervening in retail pricing.[115] Vodafone again submitted that the uncertainty over the Commission's position on retail pricing was making it difficult for Vodafone to compete, and that further clarity would be valuable.[116]

127. According to Telecom, the appropriate mechanism for addressing any anti-competitive on-net pricing differentials is the Commerce Act.[117]

128. Business New Zealand expressed a concern that the Commission could inadvertently become a "clearing house" for future retail plans, given the uncertainty that appears to exist.[118] According to Business New Zealand, such an outcome would be undesirable, would involve considerable resourcing and would dampen competition.

129. 2degrees argued that Vodafone's claims that the Commission has prescribed retail pricing are without foundation:[119]

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[111] Vodafone, *Draft Reconsideration Report Cross-submission*, pages 1 and 2-3, supported by Covec, *Comments on Some Aspects of Mobile Competition*, 26 May 2010.
[112] Vodafone, *Draft Reconsideration Report Cross-submission*, page 3.
[113] Vodafone submission, 19 May 2010, page 8.
[114] Vodafone submission, 19 May 2010, page 11.
[115] Vodafone cross-submission, 26 May 2010, page 2.
[116] Vodafone cross-submission, 26 May 2010, page 3.
[117] Telecom submission, 19 May 2010, paragraph 11.
[118] Business New Zealand submission, 26 May 2010.
[119] 2degrees cross-submission, 26 May 2010, page 3.

"Nowhere in the Final Report did the Commission dictate how operators should set their retail prices. Quite the opposite, the Commission's assessment in its Final Report was focused on whether regulating *wholesale* MTAS would best promote competition in retail markets ..."

130. Vodafone disagrees with the Commission's inclusion of internationally originated (**IO**) calls or SMS in the proposed regulatory change, stating that:[120]

> "While Vodafone was willing to include {IO SMS and calls} in its undertaking as part of the overall package, we do not believe that there is any justification for regulating those services. Regulation of {IO SMS and call} rates does not provide long-term benefits to end-users in New Zealand, and there has never been any competitive problem demonstrated in relation to SMS services."

131. Telecom also disagrees with the inclusion of IO SMS in the proposed regulatory change[121] (but are silent on IO calls). Telecom state that including IO SMS could disadvantage NZ operators, if they do not get reciprocal terms, and submit that the Commission would need to:[122]

> "take precautions to ensure that Access Providers are not unfairly disadvantaged by having to give offshore network operators regulated terms for SMS termination but not receiving reciprocal terms from those network operators for outbound SMS from New Zealand. Such precautions would include a requirement that any foreign mobile network operator who wants to become an Access Seeker for the purposes of SMS termination:
>
> (a) Hand over of SMS traffic in New Zealand in the same manner as a domestic Access Seeker does, and
>
> (b) Offers Telecom and other Access Providers a reciprocal SMS termination service on the same terms including pricing."

132. Vodafone raise a concern that the proposed regulatory change provides for benchmarking to be against the costs of providing similar services rather than MTAS prices and submit that:[123]

> "This formulation seems to give weight to arguments expressed in the MTAS investigation that the Commission's cost benchmarking approach was not then consistent with the initial pricing principle."

133. Vodafone also raise a concern re benchmarking is no longer against networks that are similar to the access providers' networks. Vodafone state that the reasons for this change are unclear.[124]

Commission's views

134. The Commission does not consider that any material changes to the service description in the proposed regulatory change are appropriate, it considers that retail non-discrimination rules are out of scope[125], and notes that no substantive new issues have been raised by submissions. The issues raised regarding the proposed regulatory change were considered

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[120] Vodafone, *Draft Reconsideration Report Submission*, page 10.
[121] Telecom, *Draft Reconsideration Report Submission*, pages 3-4, para 7(f) and page 9-10, paras 43-49.
[122] Ibid, page 10, para 49.
[123] Vodafone, *Draft Reconsideration Report Submission*, page 10.
[124] Ibid.
[125] In relation to Telecom's comment regarding the Commerce Act, the Commission notes that this Reconsideration Report is under the Telecommunications Act, rather than the application of the Commerce Act and that such issues are relevant under the Telecommunications Act for the reasons set out in paragraphs 19 and 134-140.

extensively during the MTAS Investigation and the reasons for the Commission's views were set out in the Final MTAS Report.[126] The Commission is aware of the Ofcom draft recommendation referred to by 2degrees[127], but does not consider it appropriate to change its view from the MTAS Report, that LRIC should not be included in the FPP, at the present time.

135. In relation to submissions regarding the impact of the Commission's decision on retail price setting, the Commission reiterates the view it set out in the Draft Reconsideration Report, that the competition issue being considered during this reconsideration is not the level of retail pricing *per se*, but rather the relationship between retail prices and the wholesale MTR, 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. The Commission agrees with Vodafone that the regulatory framework set out in Part 2 of the Act (and associated Schedules) is largely focussed on determining the price of wholesale inputs rather than retail prices.

136. However, in assessing MTRs throughout this investigation, and in particular whether regulation or an undertaking would best promote competition for the long-term benefits of end-users, the Commission has had regard to the level of retail on-net pricing of the larger mobile operators. If retail on-net prices are too low in relation to the wholesale MTR, a small entrant is unlikely to be able to compete and expand in the retail mobile market. While one possible solution may be to increase retail prices (as Vodafone claims it has done in response to concerns raised by the Commission in the Draft Reconsideration Report), an alternative is to lower the wholesale MTR to a cost-based level. Given the retail on-net pricing prevailing throughout the MTAS Investigation, the latter option resulted in Vodafone and Telecom offering to progressively lower MTRs through their proposed undertakings, although the MTRs in the Final Undertakings remained above the Commission's cost benchmarks.

137. As discussed in Section III, the Commission considers that the ability and incentive of the larger operators to introduce on-net retail plans such as Talk highlights the importance of setting wholesale MTRs at a level that enables an entrant operator, with a smaller on-net customer base, to compete with such plans. The Commission considers that an MTR that reflects the efficient costs of supplying the MTAS in New Zealand will result in efficient and competitive outcomes in the relevant downstream markets. As noted in the Draft Reconsideration Report, both Telecom and Vodafone have previously agreed that TSLRIC is the pricing principle for the MTAS that best promotes competition and efficiency in all relevant markets.[128]

138. The setting of cost-based MTRs should allay the concerns raised by Vodafone, Telecom and Business New Zealand over the uncertainty for the mobile operators surrounding regulatory intervention in retail pricing. The monitoring of on-net retail pricing referred to in the Final MTAS Report was only required in the context of accepting the Final Undertakings, as the undertakings contained MTRs that were above the likely cost of

[126] See Commerce Commission, *Final MTAS Report*, at pages 95-97, paras 353 – 361 in relation to the reasons why LRIC pricing was not included in the FPP, pages 200-201, paras 875-880 in relation to the discussion of retail non-discrimination rules, pages 202-203, paras 889 – 896 in relation to the discussion of the inclusion of IO calls or SMS in the proposed regulatory change and page 97, para 365 in relation to the form of cost-based benchmarking to be applied in the proposed regulatory change.
[127] 2degrees, *Draft Reconsideration Report Submission*, page 2.
[128] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 147.

supplying the MTAS in New Zealand. In the event that the MTAS becomes regulated and a cost-based MTR is determined, then it would not be necessary to monitor on-net retail prices along the lines envisaged in the Final MTAS Report.

139. In relation to Telecom's proposal that, were IO SMS to be covered by the proposed regulatory change, then precautions would be needed to ensure that handover occurred in NZ and reciprocal pricing arrangements were provided for, the Commission considers that provisions of this kind would be appropriate to ensure that IO SMS are treated consistently with domestically-originated SMS. This approach was reflected in the Commission's comments in the Final MTAS Report that it considered the costs of these services should be broadly the same.[129]

140. In relation to the omission from the description of the benchmarking approach of the requirement that this be against networks that are similar to the access provider's network, the Commission notes that if an STD were to be initiated, it is likely that under an STD there would be multiple access providers, and considers that it is more appropriate to undertake benchmarking against the costs of an efficient access provider.

Conclusion on proposed regulatory change

141. For the reasons set out in paragraphs 134 to 140 above, the Commission concludes that the proposed regulatory change as set out in the Draft Reconsideration Report is appropriate for the assessment in this Reconsideration Report.[130]

[129] Commerce Commission, *Final MTAS Report*, page 203, para 895.
[130] Subject to the comments in footnote 23.

APPENDIX FOUR: ASSUMPTIONS ABOUT FUTURE PRICING BEHAVIOUR

142. Appendix Four provides Commissioners Patterson and Pickering's additional views on the reasons that their assumptions about future pricing behaviour in the Final MTAS Report are no longer appropriate.

143. 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.[131]

144. 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 a significant risk in the current New Zealand market.[132]

145. 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 years[133], 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 stringent top up conditions for pre-pay customers, reducing handset subsidies, reducing investment, and delaying the introduction of innovative new services.[134]

- 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

[131] Final MTAS Report para lxvi.
[132] Final MTAS Report para xli.
[133] 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.
[134] MTAS Final Report - Appendix 5, page 285, paras 41 and 42.

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.

146. 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.

147. 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 question we had described in paragraph xxxix of the Final Report had been answered.

148. After reconsideration, our 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.

149. 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 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.

APPENDIX FIVE: RETAIL OFFERS CONSIDERED IN THIS RECONSIDERATION REPORT

150. Appendix Five summarises information provided by interested parties about relevant retail plans.

Information Request

151. 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 Reconsideration Report in early June, that parties wish the Commission to consider before issuing its Draft Reconsideration Report."[135]

Information provided in response to Commission's information request

152. 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.

153. Telecom advised that they had:[136]

> "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."

154. 2degrees provided the following summary of their current plan:[137]

> "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."

155. 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.

156. 2degrees also advised in relation to future pricing plans that [

] **2dCOI**.[138]

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[135] Above note 31, page 2

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

[137] 2degrees, *MTAS – Your Letter regarding Indicative Process & Timeline for Reconsideration*, 3 May 2010, page 11.

[138] Ibid.

157. Vodafone advised that they had:[139]

> "four major recent and upcoming changes to {their} Prepay offers:
>
> - 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**
> - On the same date we will launch a new prepay pricing plan called Simply Prepay. Simply Prepay will offer domestic any-net voice calling for 49c.
> - By October we will implement a hard cap on Bestmates.
>
>   At present we operate a soft cap, where we call those customers who are well outside our acceptable use policy. By October we expect to revise the limit from what is effectively unlimited at 5,000 minutes per month to 1,000 minutes, and automate the cap to prevent customers from using more than 1,000 minutes for their $6. We expect to announce the cap in May. This is a direct response to the concerns the Commission expressed in its MTAS Final Report."

158. Vodafone subsequently provided further information on upcoming changes to retail plans:[140]

> "[
>
>]" **VNZCOI**

Information provided after responses to Commission's information request

159. In its submission on the Commission's Draft Reconsideration Report, Vodafone advised:[141]

> "we have decided to withdraw Talk from sale from Thursday 20 May in light of the Commission's recently expressed concerns.
>
> The Commission clearly has the view that Talk is a critical constraint to competition in the mobile market. In its Draft Report, the Commission was of the view that 2degrees could not compete with Talk, that it would drive our interconnection traffic with 2degrees out of balance, and that it would materially impact our average on-net prices and therefore fall foul of the Commission's "cross-check" on MTRs and lead to regulation of mobile termination rates.

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[139] Vodafone, *MTAS investigation – invitation regarding new retail plans*, 3 May 2010, pages 2-3. Note – on 24 May 2010 Vodafone provided updated versions of the information, which removed VNZCOI classification from the number of planned changes to their prepay offers, and from the information contained in the third and fourth bullet detailing those changes. As a result of these changes, only one bullet from Vodafone's original version of the information quoted in this paragraph remains classified as VNZCOI. [

] **VNZCOI**.

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

[141] Vodafone, *MTAS investigation – comments on draft reconsideration report*, 19 May 2010, page 1.

In the circumstances, although we do not agree with the Commission's views on Talk (as discussed further below), we do not wish to continue to offer a product which the regulator believes to be anti-competitive. The ongoing criticism from competitors and lobby groups generated by the Commission's commentary is also potentially damaging to our business and our brand.

For us, Talk was an add-on designed to increase mobile voice usage and ARPU for some users in the prepay segment of the market. It was one of many offers we will launch this year as we seek to compete for call minutes with landlines and deliver better mobile value for our customers.

As previously advised, we will also announce our new prepay plan on Thursday and begin advising customers about the Bestmate cap, but the **[ ] VNZCOI**."

160. On 31 May 2010, 2degrees provided additional information about new offers that it had launched following the Commission's information request. 2degrees advised that these offers, launched on 25 May 2010, provided:[142]

"**$10 Text Pack**

Our $10 Text Pack offers customers 500 texts to any network in New Zealand for $10.

Texts are valid for 30 days and the pack recurs automatically provided there is sufficient credit in the customer's prepay account.

Customers can purchase on $10 Text pack in any 30 day period, with any additional texts charged at our standard rates. Customers can cancel the $10 text Pack at anytime.

Customers continue to receive our Top-Up & Get Rewards (previously known as "Magic Top-up") which provide a free text bundle and reduced on-net calling and texting rates for 30 days every time they top-up. Top-Up and Get rewards are used before pack benefits.

We have launched our $10 Text Pack with a 'buy one get one free' offer. Customers who purchase the $10 Text Pack before 30 June 2010 will receive a $10 credit to pay for their second month. The offer is limited to one $10 credit per prepay account.

$6 Data Pack

Our $6 Data Pack provides customers with 50mb of data for use anywhere in New Zealand for $6.

Data Pack benefits are valid for 30 days with any additional use charged at our standard rates. Customers can buy as many Data Packs as they need each month. The benefits of older packs are used first.

Data usage per session is rounded up to the nearest 5Kb and a minimum usage charge per session of 20Kb applies."

161. On 2 June 2010 Telecom provided additional information about new any-net offers that it had launched following the Commission's information request, advising that it had:[143]

"released the following any-net offers since 22 February 2010:

- Talk and Text 300 - this post-paid plan is available on Telecom's XT Network and provides up to 300 any-net night and weekend minutes, 300 any-net texts, 20 any-net daytime minutes for $29.95 per month.

[142] 2degrees, *Mobile Termination Access Services – 2degrees $10 Text Pack and $6 Data Pack*, 31 May 2010, pages 1-2.

[143] Telecom, *MTAS Reconsideration – Further Information On Recent Retail Plans*, 2 June 2010.

- TXT ANYONE 2500 - this post-paid and pre-paid plan is available on Telecom's XT Network and provides up to 2500 any-net texts for $12. Text Anyone 2500 is available until 31 July 2011.
- XT One Bill – this post paid plan is available on the XT network and for a monthly fee of $10 it enables the caller to access an any-net, any-time rate of 59c for calls, receive 200 free any-net texts and receive one bill for mobile and home line calling. This plan is only available to Telecom landline customers.

We do not anticipate releasing any other relevant mass market retail plans before the Commission releases its final report on the MTAS Reconsideration."

162. On 10 June 2010 Vodafone announced[144] the release of new *talkZoneZero Plus* plans for business customers. This new plan provides a number of options for business customers with five or more connections, starting from a base plan at $36 per month per user offering the business customers free calls within their calling group (ie that business customers mobile users). Additional options offer free calling options (incrementally) to New Zealand landlines, Vodafone mobiles and other mobiles.[145] The cost per user depends on the number of Talk Zones (free calling options) that the customer selects, and ranges from $66 per month per user through to $136 per month per user.

163. On 15 June 2010 2degrees announced[146] the release of the *Everyone100 Talk Pack*. This offer provides "100 minutes to any standard landline or mobile in New Zealand"[147] for $30. The allocation of 100 minutes is valid for 30 days and 2degrees' customers can purchase as many *Everyone100 Packs* as they want within a month.

[144] Vodafone media release, *Vodafone revolutionises business calling*, 10 June 2010.
[145] In addition, voicemail is free with any of the additional Talk Zones options above the base plan, and the talkZoneZero Plus New Zealand plan at $136 per month per user also provides a local number for each mobile user, which allows for local customers to call that user on a local number, without the cost of a mobile call.
[146] 2degrees media release, *2degrees launches lowest any-network pre-pay calling rate in New Zealand*, 15 June 2010. Based on 2degrees prepay terms and conditions at http://www.2degreesmobile.co.nz/c/document_library/get_file?uuid=33022baf-e792-48ca-946b-2f18ea03f505&groupId=10128, the minutes available under the *Everyone100 Talk Pack* would appear to be used on a minute+minute basis, meaning that this offer would provide up to 100 minutes of calling time.
[147] See http://www.2degreesmobile.co.nz/everyone100.

APPENDIX SIX: ASSESSMENT OF VODAFONE'S (NOW WITHDRAWN) TALK ADD-ON PLAN

164. Appendix Six summarises the Commission's assessment of Vodafone's (now withdrawn) Talk Add-on plan, including submissions related to the Commission's assessment of the Talk Add-on plan and provides a sensitivity analysis in relation to the estimated margins that a small entrant could have earned if supplying a retail plan in competition with Vodafone's Talk Add-on (had it not been withdrawn). Appendix Six also addresses submissions that the Commission is engaging in retail price control and submissions relating to interconnection traffic volumes.

Talk Add-on plan

165. On 13 April 2010, Vodafone launched a new plan called the Talk Add-on plan. The Talk Add-on plan was available to Vodafone's Supa Prepay customers, offering up to 200 minutes of voice calling to any New Zealand landline or any Vodafone mobile for $12 a month.

166. On 20 May 2010, Vodafone announced that it was withdrawing the Talk Add-on plan.[148]

167. In the Commission's view, it is appropriate to consider the Talk Add-on plan despite its withdrawal, as such a plan demonstrates the competitive concerns that are likely to arise in the downstream retail market as long as wholesale MTRs remain above cost. The Commission has therefore had due regard to the Talk Add-on plan, based on the analysis of the plan contained in the Draft Reconsideration Report, and submissions made in response to that analysis.

Summary of analysis in the Draft Reconsideration Report

168. In the Draft Reconsideration Report, the Commission noted that the Talk Add-on plan offered up to 200 minutes of on-net MTM calling or MTF calling, at a monthly price of $12, including GST. Vodafone had promoted the Talk Add-on plan as providing for a retail calling price as low as 6cpm.[149]

169. In the Draft Reconsideration Report, the Commission analysed the new Talk Add-on plan and its implications for competition, and specifically whether the plan would retain a barrier to expansion for a small entrant. The Commission made a number of adjustments to the Talk price in order to take into account relevant features of the plan and to allow for a consistent comparison with the MTRs contained in the Final Undertakings, including:[150]

- the removal of GST;
- an adjustment for minute plus minute rounding, based on an assumption that the volume of billed minutes (under minute plus minute rounding) will be 30% higher than the volume of actual minutes (under second plus second);

[148] See http://forum.vodafone.co.nz/topic/5098-vodafone-announces-changes-to-prepay/. Customers that had subscribed to the Talk Add-on plan up to 20 May 2010 can remain on the plan for a further 3 months.
[149] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 81.
[150] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 97.

- an allowance for some of the minutes to remain unused by subscribers, with utilisation assumed to be up to 90% (with a sensitivity of 70%);

- an allowance for minutes to be used for calls to both mobile (MTM) and fixed (MTF) numbers, with MTF calling assumed to represent 30% of minutes. In addition, the Commission allowed for some of the MTM minutes to remain on-net.

170. The Commission estimated that a small entrant would incur a loss of -$8.20 per subscriber per month in supplying an any-network retail plan to match the Talk plan. The Commission included a number of sensitivities in the Appendix to the Draft Reconsideration Report.

Submissions on the Draft Reconsideration Report and Commission view

171. In its submission on the Draft Reconsideration Report, Vodafone submitted[151] that the Commission's analysis of a small entrant's ability to compete with Talk needs to be amended. Specifically, Vodafone submitted that the Commission had understated the revenues that could be earned from other services supplied to subscribers of such a plan, and had also overstated the likely utilisation rate of the plan, and overstated the proportion of calls that would be to made to subscribers on other mobile networks.

172. As noted by Vodafone, subscribers to a retail plan such as the Talk Add-on plan may purchase other services, such as off-net MTM calls, texts, and data services. Such subscribers may also generate revenues for their mobile network operator from incoming calls from other networks.

173. However, Vodafone has provided little evidence on the magnitude of such revenues. While Vodafone submitted that the Talk subscribers who joined the plan on 13 April 2010 had an average outbound ARPU of $[ ] **VNZCOI** prior to their subscription to Talk, this doesn't reveal the revenues earned from other services that are not included in the Talk plan. For example, if the ARPU of $[ ] **VNZCOI** was earned mainly from on-net MTM calls and MTF calls, the level of revenue understatement would be much lower than that claimed by Vodafone. In addition, the costs associated with supplying any other services to these customers, such as SMS and off-net MTM calls, would have to be taken into account.

174. To the extent that there are excess margins available on other services, such as SMS and off-net MTM calls, with which an entrant would effectively have to cross-subsidise any losses incurred when supplying a retail plan to match Talk, these excess margins are likely to attract the attention of Vodafone and Telecom, resulting in the erosion of such margins over time. The entrant is therefore unlikely to be able to sustain such losses. As noted in the Draft Reconsideration Report,[152] 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.

175. Vodafone submitted that the Commission erred in dismissing revenues from inbound voice minutes as being relatively low. According to Vodafone, prepay customers are more likely

[151] Vodafone, *Draft Reconsideration Report Submissions*, page 4.
[152] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 115.

to be net call recipients, and Talk was intended to stimulate call volumes, thus generating more inbound calls in return.[153]

176. While the Commission accepts that prepay customers may be net recipients of calls, the Commission noted in the Draft Reconsideration Report that the average retail price for Vodafone and Telecom customers to make off-net MTM calls ([ ] **CRI** cpm in 2008) is considerably higher than the average retail price that would be offered by the entrant (7.7cpm) when competing with a plan such as Talk.[154] Given such a large price differential, the volume of incoming calls from the other networks (on which the entrant could earn termination revenues) is likely to be relatively low.

177. In terms of utilisation, Vodafone submitted that the Commission's assumption of 90% utilisation is unsupported, and that actual utilisation rates on Vodafone plans (including for those customers who subscribed to the Talk plan) indicated that 90% utilisation was likely to be too high.

178. Telecom also commented that while the Commission's 90% utilisation assumption:[155]

> "... has a theoretical logic, it is inconsistent with our observation of consumer behavior. In our view, prepay customers generally have significant less calling than 200 minutes per month on average. Based on our understanding of consumer behaviour, consumers may well increase their calling to some extent if they are given extra minutes for the same price but they would rarely exponentially change their calling habits simply because additional calls do not have a monetary cost (especially over the short term)."

179. Telecom noted that broadband subscribers generally do not consume all of the data that is available under their plan each month,[156] and concluded that in the absence of empirical evidence, the Commission should be cautious when considering what future utilisation rates may be.

180. The Commission notes that while it used a utilisation of 90% in the Draft Reconsideration Report, it also considered sensitivities based on utilisation of 70% of minutes and Vodafone's assumption of [ ] **VNZCOI** %. At these lower levels of utilisation, the Commission noted that the entrant would continue to incur a loss in attempting to compete with the Talk Add-on plan.[157]

181. Of the actual utilisation rates submitted by Vodafone in its submission on the Draft Reconsideration Report, the Commission has previously noted that the minutes offered under the Your Time 200 plan can only be used during off-peak periods,[158] which may explain the relatively low level of utilisation of those minutes. The TXT2000 plan is a relatively high volume text plan. In the Commission's view, the usage patterns on these plans are unlikely to have much relevance for any analysis of a plan such as the Talk plan.

182. The Commission considers it likely that a relatively high proportion of minutes available under a plan such as Talk would be used by subscribers. As noted in the Draft Reconsideration Report, the marginal cost of using an additional minute under such a plan

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[153] Vodafone submission, 19 May 2010, page 5.
[154] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraph 113.
[155] Telecom submission, 19 May 2010, paragraph 38.
[156] Telecom submission, 19 May 2010, paragraph 39(b).
[157] Commerce Commission, Draft Reconsideration Report, 12 May 2010, paragraphs 111 and 112.
[158] Commerce Commission, Draft Reconsideration Report, 12 May 2010, Table 1.

is zero up until the threshold is reached, indicating that a relatively high utilisation could be expected.

183. In this Appendix, the Commission has used a utilisation assumption of 70%. This is consistent both with Vodafone's evidence of utilisation by those subscribers that signed up to the Talk plan, and is also consistent with broadband usage.[159] As shown in Table 2, which reproduces the margin sensitivity in the Draft Reconsideration Report where 70% of the available minutes are used, the small entrant is likely to incur a loss in competing against a retail plan with the features of the Talk Add-on.

Table 2: Entrant Margins (70% utilisation)

	%MTM on-net										
MTF %	0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
0%	-$8.01	-$7.53	-$7.05	-$6.58	-$6.10	-$5.62	-$5.14	-$4.66	-$4.19	-$3.71	-$3.23
10%	-$7.04	-$6.61	-$6.18	-$5.75	-$5.32	-$4.89	-$4.46	-$4.03	-$3.60	-$3.17	-$2.74
20%	-$6.07	-$5.69	-$5.31	-$4.92	-$4.54	-$4.16	-$3.78	-$3.39	-$3.01	-$2.63	-$2.25
30%	-$5.10	-$4.77	-$4.43	-$4.10	-$3.76	-$3.43	-$3.09	-$2.76	-$2.42	-$2.09	-$1.76
40%	-$4.13	-$3.85	-$3.56	-$3.27	-$2.99	-$2.70	-$2.41	-$2.13	-$1.84	-$1.55	-$1.26
50%	-$3.16	-$2.93	-$2.69	-$2.45	-$2.21	-$1.97	-$1.73	-$1.49	-$1.25	-$1.01	-$0.77
60%	-$2.19	-$2.00	-$1.81	-$1.62	-$1.43	-$1.24	-$1.05	-$0.86	-$0.66	-$0.47	-$0.28
70%	-$1.23	-$1.08	-$0.94	-$0.80	-$0.65	-$0.51	-$0.36	-$0.22	-$0.08	$0.07	$0.21
80%	-$0.26	-$0.16	-$0.07	$0.03	$0.13	$0.22	$0.32	$0.41	$0.51	$0.60	$0.70
90%	$0.71	$0.76	$0.81	$0.86	$0.90	$0.95	$1.00	$1.05	$1.10	$1.14	$1.19
100%	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68	$1.68

184. Submissions did not comment on the Commission's assumption that the minute plus minute volume is 30% higher than the second plus second volume, or that 30% of the minutes under the Talk plan would be used by subscribers for MTF calls.

185. In the Draft Reconsideration Report, the Commission assumed that of the MTM minutes originated by the entrant's subscribers under such a plan, 20% would be on-net minutes, and 80% would be off-net minutes. As shown in Table 2, the entrant would incur a loss of -$4.43 per subscriber per month, which represents 37% of the retail revenue of $12 per month.[160] Even with an on-net proportion of 50%, which Vodafone claimed is more reasonable, the resulting loss of -$3.43 per subscriber month would be significant (representing 29% of the retail revenue).

186. Given the above losses incurred by a small entrant attempting to compete with a retail plan such as the Talk Add-on plan, the entrant would have to earn substantial additional margins on other services in order to remain viable. As noted in paragraph 173, Vodafone has provided little evidence on this, referring only to the ARPU that was previously earned from those customers who subscribed to Talk on 13 April 2010 (ie prior to their subscription to the Talk Add-on). In addition, any such margins are unlikely to be sustainable over time.[161]

[159] Based on data supplied by Telecom for UBA pricing updates.

[160] At 90% utilisation, the Commission estimated that the entrant's loss would be -$8.20 per subscriber per month, representing a significant proportion of retail revenue (68%). See Draft Reconsideration Report, paragraph 111.

[161] See paragraph 174 above.

Interconnection traffic

187. Vodafone's submission on the Draft Reconsideration Report included information on the flow of MTM voice traffic between Vodafone and 2degrees. Vodafone submitted that:[162]

> "2degrees continues to be a [ ] **{VNZAPI1 / 2dAPI1}** of voice interconnection traffic from Vodafone. The Commission's theory is that this [ ] **{VNZAPI1 / 2dAPI1}**. The retail "cross-check" is based on this theory. This theory therefore seems to be [ ] **{VNZAPI1 / 2dAPI1}**.
>
> ...
>
> The Commission has set out its theory that 2degrees will be a net payer of interconnection because it will have to offer any-net calling at the same prices as our on-net calling in order to attract customers. [ ] **{VNZAPI1 / 2dAPI1}**"

188. Vodafone notes that [ ] **VNZAPI1 / 2dAPI1.**

189. The traffic flows evident in Vodafone's table also suggest that [ ] **VNZAPI1 / 2dAPI1**.

190. The Commission notes that over the period covered by Vodafone's table, Vodafone's standard Supa Prepay rate for calls to other mobile networks was 89cpm, and 2degrees' standard rate for calls to other mobile networks was 44cpm. These relative prices for off-net calls are likely to influence the relative volume of such calls. Vodafone's economic experts agreed at the MTAS conference that the probability of calling is influenced by prices.[163] The relatively low off-net price offered by 2degrees is likely to lead to a relatively high volume of calls originated by 2degrees subscribers to Vodafone subscribers.[164]

191. Given the expected relationship between off-net price and volumes, the introduction of steeper on-net discounts through plans such as the Talk Add-on plan would be expected to exacerbate the net traffic flows in favour of the larger mobile network.

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[162] Vodafone submission, 19 May 2010, page 3.

[163] MTAS Conference transcript, 3 September 2009, page 209.

[164] A similar relationship between prices and volumes was evident in the Commission's annual monitoring report, showing a relatively high average price for off-net calls and a relatively low volume of off-net calls, when compared on on-net prices and volumes. See Commerce Commission, Annual Telecommunications Monitoring Report 2009, April 2010, Figure 43.