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Monday, 26 April 2010

Hon Steven Joyce
Minister of Telecommunications
Parliament Buildings
Wellington

Public Version

Dear Minister,

New prepay plans

In its correspondence with you on 19 April, the Commerce Commission stated that our new prepay add-on “may have the potential” to alter the Commission’s recommendation that you accept the MTAS undertakings from Telecom and Vodafone.

In my view our new prepay add-on has no such effect.

That said, given the media coverage and materiality of this issue to our business, I am keen to keep you informed. We have attempted to speak with the Commissioner directly and with officials at your Ministry, but neither are inclined to engage with us on this matter. This makes it difficult to understand and respond to any concerns.

In this letter I explain the strategy behind Talk and the competitive situation, and indicate what I think this means for your mobile termination rate decision.

Talk strategy

As you know, the Talk add-on gives Supa Prepay customers up to 200 minutes of calling to Vodafone mobiles and New Zealand landlines for \$12 a month. Supa Prepay is our most popular prepay plan.

Our strategy is to encourage customers to talk more, and particularly to use their mobile phone in preference to a fixed line. Talk is the most recent step in our pricing strategy first formulated back in 2006 with Bestmate, TXT2000, \$2 for 2 hours off-peak, and the introduction of Family in 2008.

At present, our average prepay customer (who is not using Bestmate or Family) talks for only [] **VNZCOI** minutes a month. Average monthly outgoing voice revenue per user across our prepay customer base is only [] **VNZCOI**. Of our prepay customers who used their phones in March, [] **VNZCOI** did not make a single voice call. Our market research says that almost three quarters of prepay customers would wait until they get to a landline to make a call that lasted for five minutes or more. Unsurprisingly, the price of calling is one key barrier. We are aiming to change this.

Talk is constructed to move voice calling from fixed lines to mobile. It is one of a number of propositions which we plan to launch in the near future. We have already introduced new international voice rates for our most popular destinations, adding to our existing \$2 for 60 minutes capped calling offer.

A lot of the comment on Talk in the media focuses on cheaper on-net calling rates. For our customers, though, the innovation is actually cheap calling to landlines from a prepay mobile. Customers who want just on-net calling can take our On Account You Choose add-on that allows 200 on-net only minutes for \$12. This has been in the market since 2006 and has caused no concerns for the Commission.

Competition

2degrees is a very successful competitor.

As of 31 March 2010, Vodafone mobile customers had received calls or texts from []VNZAPI unique 2degrees customers.¹ Using the same method of counting customers, we had []VNZCOI prepay customers as at the end of March, and we estimate Telecom had 1.41 million.

On these figures, 2degrees has a prepay market share of []%VNZAPI. In six months that makes it one of the most successful new mobile entrants anywhere in the world. 2degrees is also making remarkable strides with its branding. Only three months after launch 2degrees was [

]VNZRI. 2degrees' advertisements are highly recognised, branded and liked in the market. The key driver of brand in prepay is value.

2degrees' media posturing that this plan is somehow anti-competitive should not obscure the fact that 2degrees or Telecom can copy this offer should they wish to as both have significant customer communities. 2degrees has argued for years that it cannot compete without further regulatory concessions. Lobbying for regulatory concessions has been a continuous part of 2degrees' competitive strategy and we do not expect anything different from it for the future.

Future plans

We have several other propositions coming soon for prepay customers:

- [

¹ This is []VNZAPI than the 206,000 customers that Eric Hertz announced 2degrees had after six months operation. The difference is that Mr Hertz is choosing only to count customers who had used their phone in the last 30 days.

]VNZCOI

Relationship with MTRs

We have long argued that there is only a weak relationship between MTRs and retail pricing. The timing of our Talk announcement is a simple demonstration of this. Why would we announce this now if it risked impacting your MTAS decision? The answer is that Talk pricing has little relationship with MTRs and we need to respond to the competitive situation in prepay, which is the key retail market for Vodafone.

In its MTAS Final Report the Commission suggested a floor for industry average retail on-net prices at just under two and half times the mobile termination rate. The Commission said clearly that if industry average on-net rates fell quickly relative to MTRs, it may decide to reopen the question of what appropriate MTR benchmarks look like.

The modelled impact of Talk is to [
]VNZCOI. However, when the impact of the other changes to our prepay offers set out above are considered, we expect there to be an overall increase in our average on-net prices this year. We understand that this is what the Commission wishes to see and is in line with the Commission's assumptions regarding on-net pricing. Therefore we are at a loss as to why the Commission states, without apparently having done any meaningful investigation or even talking to us, that it "may be material".

Implications for MTAS decision

In all of this, you need to make a decision on what to do with the Commission's recommendation on mobile termination rates. Two of the choices you have are to send it back to the Commission for more work, or to accept the undertakings as recommended by the Commission.

The Commission's input to you does not seem very helpful in making this decision. The Commission has advised that its "initial view" is that Talk "may be material" and that it "may have the potential to affect the basis for the Commission's recommendation in the Final Report". It says nothing about how this can be so.

Our view, backed up by the evidence in this letter, is that it is not material. It is important that your consideration of this issue does not occur without access to relevant facts that we can provide.

We would be pleased to engage in a process led by the Minister or the Commission to clarify this issue and speedily address any issues that you or the Commission have. To date, we have had no opportunity to engage on the issues, despite several requests. Certainly I am very concerned that our offering has been singled out as somehow anti-competitive, when our view and our understanding of the Commission's own thinking on MTAS is that it cannot be. This is damaging to our reputation and brand and we are concerned that neither the Commission nor the Ministry has engaged with us to enable us to address this.

It would also be useful to us to know what has been said about the offer so that we might better understand the concerns and respond to them. I understand that 2degrees has written to you or the Ministry setting out concerns. I would be grateful if your officials would provide us with a copy of any correspondence.

I would be happy to discuss these issues at your convenience either in person, or by phone on 021 853 111. I can also provide a version of this letter suitable for public release if that would be useful. As I am sure you will appreciate, some of the information in this letter is highly commercially sensitive, and disclosure could prejudice Vodafone's commercial position.

Yours sincerely,

Russell Stanners
Chief Executive

Copy:
Dr Ross Patterson, Telecommunications Commissioner