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16 December 2009

Dr Ross Patterson
Telecommunications Commissioner
Commerce Commission
WELLINGTON

Dear Ross,

Re: Process for the final stage of the MTAS investigation

Thank you for your letter of 3 December 2009, in which you invited Vodafone to lodge any final revised undertakings for MTAS.

Revised undertaking

Please find attached a revised undertaking from Vodafone for MTAS.

The Commission has encouraged us to align with Telecom and 2degrees as far as possible. In our revised undertaking, we have adopted the price terms for both voice and SMS as set out in Telecom's letter to the Commission of 28 October, but with a start date of 1 October 2010. We have aligned the material non-price terms as set out in the appendix to the Telecom/Vodafone joint letter of 23 November and as were discussed between Telecom, Vodafone and 2degrees. We understand that Telecom is submitting an undertaking that is the same on all material terms but with an earlier start date of 1 April 2010.

As we have previously submitted, we do not think it is critical that 2degrees aligns its position with Vodafone and Telecom.

Benefits

This undertaking has a number of important benefits:

- It means reduced MTRs more quickly and with increased certainty versus regulation. Cuts in rates begin on 1 October 2010 compared with the 1 January 2011 assumption for regulation, and continue over five years.
- Voice MTRs will eventually reduce by two thirds from their current level. In a year's time they will be 46% lower than they are today and the average decline is 20% a year for 4 years... This brings voice rates in line with the Commission's guidance from its letter of 3 December.
- We have also moved further on SMS to a bill and keep regime, in line with the Commission's preferences. Charges for SMS termination will fall straight to zero from the current 9.5 cents per text, assuming traffic is in balance. The hybrid bill

and keep model means that there is encouragement to keep traffic broadly in balance and some protection from unwanted SPAM.

- Fixed to mobile access seekers benefit from a 35% cut in voice headline rates in 2010, with further steep declines over time. Their concerns on international-originating calls, on VOIP, and on second plus second rounding have also all been addressed.
- MTM rates for 2degrees will continue to fall sharply over time. 2degrees is protected by the terms of its interconnection agreement with Vodafone. If our undertaking were to be registered, 2degrees has the choice whether to stay on the terms of our interconnection agreement or move to the undertaking rates at any time.
- The more measured reduction in rates via a glidepath gives operators a greater chance to adjust to losses in critical revenue streams than the one-off cut the Commission contemplates under regulation. It also moderates concerns about the impacts on mobile customers from too rapid cuts in inbound revenues.
- Since our further price reductions as compared to the MTR deed start from 1 October 2010 with Telecom reducing from 1 April 2010, there will be a period of asymmetry in rates at the beginning of the undertaking period. We do not view this as significant in the context of a five year undertaking. Perfect alignment in terms between operators is not required to generate benefits to end-users.
- The industry and the Commission are able to concentrate their resources on issues of more importance to the future of New Zealand such as the Government's ultra fast broadband initiative.

In order to deliver these substantially lower voice and SMS rates over time a 1 October 2010 start date is required. This means a more measured introduction to the new lower rates, but still means an immediate and ongoing reduction of \$50m on our revenues next year relative to current rates. In an increasingly competitive market, with flat or declining industry revenues, and continuing demand for high levels of investment, we view a short additional adjustment period as reasonable.

Comments

The fact that we are submitting a revised undertaking should not be taken to mean that we necessarily accept or agree with the Commission's approach in the MTAS investigation or with its conclusions. We are submitting this undertaking because we have concluded that, if it were to be accepted and run for its five-year term, an undertaking would have the least detrimental impact on Vodafone, its shareholder, and ultimately its customers.

The Commission's letter of 3 December was extremely helpful in setting out clearly the Commission's views on what it considers an acceptable outcome. We certainly appreciate the Commission's efforts to secure industry agreement to an undertaking-based solution, and particularly the extension of time the Commission granted yesterday.

Even with clarity on the Commission's views, we have reservations about submitting this undertaking. Our two main concerns are:

- We do not know how long this undertaking will remain in force, if it is accepted. The Commission retains the ability to reopen this issue at any time.
- We remain concerned about the Commission's methodology for estimating costs.

I briefly deal with these two points in turn.

Length of undertaking

The revised undertaking is structured such that Vodafone offers significant reductions to MTRs upfront, but it is only the rates in later years that make this approach less detrimental than regulation for Vodafone. If this undertaking will not run for a substantial period, our shareholder and our mobile customers would be better off if we were to continue through the regulatory process, with a higher termination rate for both voice and SMS in 2010.

To that end, we would greatly appreciate assurances from the Commission that it intends that this undertaking, if accepted, will last until the end of its term. If the Commission cannot offer assurances that this undertaking will last for its term, it would be helpful if it could specify as precisely as it can what conditions would cause it to reinvestigate MTRs again.

Clear guidance would be a strong signal that commercial alternatives to regulation can mitigate regulatory uncertainty. This would be a useful message to give to regulated firms, and entirely consistent with both the Commission's typical preference for commercial outcomes over regulation and international best practice.

In our view, it is in the best long-term interests of end-users for the Commission to be able to offer certainty to operators so that they can make multi-year commitments with confidence.

Commission cost estimates

Our views on the Commission's approach to benchmarking have been well canvassed throughout the MTAS investigation. We remain concerned the Commission's approach is inappropriate, out of line with other regulators, and very different to its own previous practice across its telecommunications regulatory responsibilities. We are also concerned about the changes in the methodology as the investigation has progressed. In essence, we think the Commission's benchmarking process is unlikely to generate a reasonable estimate of the cost of MTAS in New Zealand in 2009, which risks undermining the aims of the investigation.

The nature of this undertaking process is that there is less scope for review of the Commission's work. Consequently, I want to record here that these issues are still live from our point of view. Our submission of this undertaking should not be taken to indicate that we agree with the Commission's cost estimates or its benchmarking process.

Concluding remarks

When the MTR issue was first opened up, voice termination rates in New Zealand were at 28cpm. We have offered to bring them down 79%. We have also offered to bring SMS termination rates down 100% (subject only to the out of balance provision). It will soon be cheaper to terminate SMS on another party's network than on our own.

I would encourage the Commission to recommend acceptance of Vodafone's undertaking. This would put an end to a 6 year process which has consumed inordinate resources across the industry, the Commission and other stakeholders.

I look forward to the Commission's Final Report.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'T. Chignell', with a stylized flourish at the end.

Tom Chignell
General Manager, Corporate Affairs
Vodafone New Zealand Limited