



Vodafone New Zealand Limited
20 Viaduct Harbour Avenue
Private Bag 92161
Auckland, New Zealand

Reception +64-9-355 2000
Facsimile +64-9-355 2006

Monday 3rd May 2010

Dr Ross Patterson
Telecommunications Commissioner
Commerce Commission
Wellington

By email: ross.patterson@comcom.govt.nz

PUBLIC INFORMATION VERSION

Dear Ross,

MTAS investigation – invitation regarding new retail plans

This letter is Vodafone's response to your letter of 27 April in which you invited further information about Vodafone's current and future retail offers.

From the Commission's previous work, your letter of 30 April, and the 2degrees' correspondence, we understand that the Commission is interested in recently released or upcoming retail offers for mobile voice, their impact on average on-net calling rates, and on other firms' ability to compete with those offers.

In this letter I cover these issues, starting with a brief explanation of our retail strategy. I also provide an indication of some offers that we expect to launch beyond the early June timeframe indicated.

As we said in our letter to the Minister, the changes we are making to our prepay offers should not change the Commission's recommendation that the Minister accept the MTAS undertakings. They are not material to that recommendation, since the net effect of our offers is to increase on-net prices in prepay, in line with the Commission's wishes. Our competitors can copy or improve on these offers if they wish to. They are in no way anti-competitive.

The best course of action remains for the Commission to again recommend the Minister accept the undertakings.

Marketing strategy

You will have noted from our letter to the Minister that our mobile pricing strategy is designed to encourage customers to talk more, and particularly to use their mobile phone in preference to a fixed line. The Talk add-on is the most recent step in our pricing strategy first formulated back in 2006 with Bestmate, TXT2000, \$2 for 2 hours off-peak, the introduction of Family in 2008, and continuing international calling offers.

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.¹ 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 wait until they get to a landline to make a call that lasts for five minutes or more. Unsurprisingly, the price of calling is one key barrier we need to address.

Talk is constructed to move voice calling from fixed lines to mobile. A lot of the comment on Talk focuses on cheaper on-net calling rates. Even the Commission has erred in publicly describing Talk as on-net only in its press release about the Ministerial correspondence. For our customers, though, the innovation is actually low cost calling from a prepay mobile to a landline. Customers who want just on-net calling can take our On Account You Choose add-on that allows 200 on-net only minutes for \$12, which has been in the market for some years with no comment from the Commission.

Our strategy has already substantially decreased the cost of mobile calling, and increased mobile usage. In the four years to March 2009, SMS usage per Vodafone customer quadrupled and average prices per text fell to around 25% of their previous level. Voice usage by Vodafone customers has doubled as average prices per minute have come down 15% a year.

The mobile market is very competitive, with 2degrees particularly taking prepay customers from Vodafone. As we stated in our letter to the Minister, as of 31 March 2010 Vodafone mobile customers had received calls or texts from []VNZAPI unique 2degrees customers, giving 2degrees a prepay market share of at least []VNZAPI% since its August launch.²

Recent and upcoming offers

There are []VNZCOI recent and upcoming changes to our 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.
- []

¹ Note that this includes an allocation of other voice revenues, including from Bestmate, so it is not directly comparable with the []VNZCOI minute figure.

² 2degrees may also have customers who have made no calls and sent no texts to Vodafone customers. This would make 2degrees prepay market share higher than []VNZAPI%.

]VNZCOI

Impacts – on-net average prices

Based on our business case, we expect Talk to []³VNZCOI Our plan is for []VNZCOI customers to sign up to Talk in its first year. This is a very bold estimate, given that we have fewer than []VNZRI customers signed up to Bestmate after almost four years. We have forecast an average bundle utilisation of []VNZCOI%, i.e., the average customer will use []VNZCOI minutes of the 200 minute bundle, and note that the Talk bundle, in line with Supa Prepay more generally, is rounded minute plus minute. Even if we are wildly successful with Talk, a majority of our prepay customers will still have no bundles, and all prepay customers can change networks at any time.

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³ All estimates of average on-net impacts in this letter are based on modelling using data for the year ending June 2009 – the last time period for which we gave the Commission survey data.

]VNZCOI

We conclude that none of these offers are material in the sense that they should cause the Commission to change its MTAS recommendation. As you can see, the overall impact of our changes is expected to be increased average on-net rates in prepay this year. [

]VNZCOI

Impacts – competition

Our competitors can copy any of our innovations if they wish to. None of these offers are anti-competitive in any way.

Clearly either Telecom or 2degrees can copy the Talk add-on: they both have access to all New Zealand fixed-network customers and large customer communities of their own. We expect they would increase their prepay ARPU by replicating Talk. [

]VNZCOI

A direct comparison between the rate of six cents for Talk and the prevailing mobile termination rate is not helpful. All mobile operators have offers in the market today with headline prices or average rates well below prevailing termination rates. Three examples are:

- Telecom offers business customers calling from a Telecom fixed line to a Telecom mobile on its BusinessTime offer for sixty minutes for no more than a dollar, excluding GST. If calls are long this could easily generate an average price below the relevant MTR.
- Vodafone’s Bestmate offer gives effectively unlimited calling to up to one number for \$6 a month. Again, high usage would mean a low average rate.
- 2degrees offers its customers text messaging to any other 2degrees’ customer for 2 cents a text. Under our interconnection agreement, we now pay []VNZAPI cents to text a 2degrees customer.

The fact that such offers are so well-established in the market means that the Commission has effectively already considered the impact of pricing of this nature in its MTAS final report. None of the initiatives that we outline to you in this letter will change this status quo in any significant manner.

MTR “cross-check”

The regulatory interest in Talk is primarily motivated by the Commission’s “cross-check” on MTRs against average on-net retail prices.

This “cross-check” was designed to protect 2degrees from termination outpayments on the theory that 2degrees would be net senders of traffic and therefore exposed to termination rates in a way that might affect its ability to compete.⁴

[

]VNZAPI

The MTR “cross-check” is now contaminating retail mobile competition. Although we have provided the information in this letter in accordance with your invitation, I remain gravely concerned about Commission intervention in retail pricing, something for which 2degrees continues to lobby. Certainly we should not be required to seek Commission approval of new retail offers, which is one way to view what is happening with Talk.

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

Conclusion

There is nothing in our recent or upcoming retail offers that should cause the Commission to change its recommendation to the Minister on MTAS. Our offers are not material to the Commission’s recommendation since, once all relevant changes are taken into account, our average on-net rates in prepay will go up. And, all our offers are replicable by our competitors. They are in no way anti-competitive.

If the Commission concludes that one or more of our retail offers will alter the Commission’s MTAS recommendation, which is not our view, then we request the opportunity to alter our retail plans in a way that would change the Commission’s MTAS recommendation back. In particular, if Talk needs to be taken from the market, changed in some way, or increased in price, then please communicate to us what you would like us to change.

The standard set in the MTAS Final Report was clear enough: ensuring that average on-net prices did not fall more than 5% a year. We are complying with that standard.

I also want to extend again the invitation to meet with you to discuss our upcoming retail plans once this process is completed.

⁴ In para 230 of the MTAS Final Report the Commission says “[T]he headline off-net pricing offered by 2degrees, relative to that offered by Vodafone and Telecom, indicates that significant traffic imbalances in favour of the established operators could be expected. Where the MTRs that apply to this traffic are significantly above cost, such traffic imbalances will lead to a substantial transfer of resources from the small entrant to the larger mobile networks, thereby limiting the ability of 2degrees to compete in the mobile market.”

I am told that the Commission has robust systems for managing confidential information. But I note that there have been some, thankfully minor, disclosures of confidential information by the Commission recently, to add to those that have happened on occasion in the offices of operators in the past. I would urge you to take the greatest possible care with the information in this letter. To my knowledge we have never before disclosed future retail plans in writing to the Commission or any other government body. The harm to our commercial interests could be immediate and substantial were the confidential information in this letter to be disclosed other than in accordance with the strictest possible interpretation of the Commission's confidentiality order.

Please feel free to contact me either by email on hayden.glass@vodafone.com or by phone on 021 689 176 should you wish to discuss the issues raised in this letter further.

Yours sincerely,

A handwritten signature in blue ink, consisting of the letters 'H' and 'G' followed by a long, sweeping flourish that ends in a small dot.

Hayden Glass

Public Policy

Vodafone New Zealand Limited