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COMMERCE COMMISSION

DECISION NO. 325

Determination pursuant to the Commerce Act 1986, in the matter of an application for clearance of a business acquisition involving:

TELECOM CORPORATION OF NEW ZEALAND LIMITED

and

CELLNET MOBILE SERVICES LIMITED

The Commission: P C Allport
T G Stapleton
R N Taylor

Commission Staff: Andrew Brice
Richard Adam
Vimla Rani

Summary of

Proposed Acquisition: The acquisition by Telecom Corporation of New Zealand Limited or one of its interconnected bodies corporate of the assets and business of Cellnet Mobile Services Limited from Cellnet and its subsidiaries.

Working Day 10: 30 April 1998

Working Day 21: 15 May 1998 (as the result of an extension of time agreed between the Commission and Telecom).

Determination: Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commission determines to give a clearance for the proposed acquisition.

Date of Determination: 15 May 1998

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BRACKETS**

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THE PROPOSAL

- 1 On 16 April 1998, the Commission registered a notice pursuant to s 66(1) of the Commerce Act 1986 (“the Act”) seeking a clearance for the acquisition by Telecom Corporation of New Zealand Limited (“Telecom”) of the assets and business of Cellnet Mobile Services Limited (“Cellnet”) from Cellnet and its subsidiaries.

PROCEDURES

- 2 Section 66 of the Act requires the Commission to make a determination in respect of the notice within 10 working days after the date of registration of the notice, or such longer period as the Commission and the person who gave the notice agree. In order to undertake a satisfactory investigation of the proposal and to be able to consult with industry participants, the Commission, in terms of s 66(3) of the Act sought an extension of the period. Telecom agreed to an extension until 15 May 1998.
- 3 Telecom initially sought confidentiality for the fact of the proposal until such time as the outcome of its bid was known. In part, this was because of the concern of the parties to the proposed acquisition to meet their obligations to inform the New Zealand Stock Exchange and Cellnet staff before the matter became public. The Commission informed Telecom that it considered that it would not be possible to investigate the application satisfactorily while it was the subject of a fact confidentiality order.
- 4 Subsequently, Telecom agreed that it would not require a confidentiality order for the fact of the proposal, once Cellnet informed its staff of the proposal, and the New Zealand Stock Exchange was advised. A public announcement of the proposal was made on 28 April 1998.
- 5 Telecom sought a confidentiality order for certain information contained in the notice seeking clearance because of the commercial sensitivity of the information. The Commission made a confidentiality order on 27 April 1998 prohibiting the publication or communication of certain of the information given by Telecom for a period of 20 working days from the Commission’s determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act will apply to that information.
- 6 The Commission sought the views of interested parties and made available a copy of the public version of the application to them.

- 7 Counsel from Clear Communications Limited (“Clear”) and BellSouth New Zealand (“BellSouth”) requested the release to them and to independent experts of the information subject to the confidentiality order from the Commission. They offered to sign confidentiality undertakings in respect of the information. After careful consideration, the Commission declined their request. It was pointed out to the counsel that it is not usual practice for the Commission to make confidential information available in this way, unless it was necessary for the proper consideration by the Commission of the proposal and a conference was being held to consider the proposal. Neither circumstance applied in this instance.
- 8 The two counsel also requested the Commission hold a conference as part of its process in considering and determining the notice seeking clearance. The Commission declined the request and informed the counsel that, in its view, the matter could be properly considered and determined without a conference.
- 9 This report concludes that staff are satisfied that the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market. Accordingly, it is recommended that in terms of s66(3)(a) of the Act, the Commission give clearance for the proposal.

THE INVESTIGATION

- 10 Staff interviewed the following parties in person during the investigation:
 - Telecom Corporation of New Zealand Limited
 - Cellnet Mobile Services Limited
 - BellSouth New Zealand
 - Telstra New Zealand Limited (“Telstra”)
 - Clear Communications Limited
 - Fisher and Paykel Limited (“Fisher and Paykel”)
 - Rocom Communications Limited
 - Comworth Systems Limited.
- 11 Staff conducted telephone interviews with the following parties during the investigation:
 - Telecommunications Users Association of New Zealand (“TUANZ”)
 - Saturn Communications Limited (“Saturn”)
 - Blue Star Holdings Limited
 - The Business Centre
 - The Hill and Stewart Retail Group
 - Goodman Fielder Group
 - Caltex New Zealand Limited
 - Federated Farmers of NZ Incorporated

- Coca Cola Amatil (NZ) Limited
- New Zealand Post Limited
- Bank of New Zealand
- Repco Auto Parts

12 The Commission received written submissions from:

- BellSouth
- Clear
- TUANZ
- Wizkid Internet Limited

THE PARTIES

Telecom Corporation of New Zealand Limited

13 Telecom is a full service provider of telecommunications, providing local, national, and international telephone services, including cellular and other mobile services, directories, leased circuits and data communications. Telecom is also a distributor of certain telecommunications equipment and is a provider of internet services.

14 The principal operating subsidiaries of Telecom, as at 31 March 1997, are listed on page 69 of Telecom's 1997 Annual Report. Since that time, MCS Cellular Services Limited has been incorporated.

15 The interconnected bodies corporate of Telecom involved in the sale of cellular air time and connections are:

- Telecom New Zealand Limited which, in addition to its own operations, acquired the cellular air time business of Ericsson Cellular Limited ("Ericsson") in 1997;
- MCS Cellular Services Limited which acquired the cellular airtime business of Motorola New Zealand Limited ("Motorola") in 1997.

16 Telecom provides additional cellular services including cellular secretary, a directory service, voice activated dialling, three way conferencing, international roaming, data transmission, mobile radio, paging services, and personal communications services. It provides numeric and alpha-numeric paging services, available to 95% of the population, and simple tone and private paging systems. Telecom also operates a two-way mobile radio system called Fleetlink, a trunked dispatch system, providing coverage to 95% of New Zealand's populated area, through a network of 190 repeater sites.

- 17 Telecom's principal shareholder is Bell Atlantic Holdings Limited with 24.5% of the shares. Ameritech Holdings Limited, which until recently held 24.5% of shares in Telecom, is in the process of completing a sell-down of its shares in Telecom by way of a global offering.

Cellnet Mobile Services Ltd

- 18 Cellnet is a wholly-owned subsidiary of Fisher & Paykel Industries Ltd. Its sole business is the sale of cellular equipment, and cellular connections to, and air time on, the Telecom cellular network. Cellnet's rights to sell cellular connections and air time is governed by an agreement between Telecom and Cellnet dated 8 November 1990, and amended on 25 June 1997. It is a Telecom Accredited Service Provider (a "TASP").

- 19 Cellnet has three subsidiaries:

- Cellnet Paging Services Limited
- Cellular Communications Limited
- Modern Communications Limited

- 20 Following the acquisition by Telecom of the cellular air time businesses of Motorola and Ericsson within the last year, Cellnet is the only remaining independent TASP. During the interviews Cellnet indicated that it, and its parent company, had terminated its involvement in the sale of network equipment.

Other Market Participants

BellSouth New Zealand

- 21 BellSouth is a partnership between BellSouth Corporation with a 65% interest, one of the world's top five telecommunications companies, and Singapore Technologies with 35% interest.
- 22 The company offers mobile communications, voice, data and advanced applications and value-added services. It operates the second of the two cellular networks in New Zealand which it commenced in the Auckland area in July 1993 and in Wellington in late 1994. BellSouth's network is fully GSM.
- 23 There has been speculation in the media recently about a possible sale of BellSouth. However at this time there is no certainty as to whether BellSouth is for sale, whom the potential buyer may be, or if it is, what the new buyer will do with the company. It is considered that possible changes to BellSouth are too uncertain to affect the analysis of the relevant markets in this report.

Telstra New Zealand Limited

- 24 Telstra is a wholly owned subsidiary of Telstra Corporation Limited of Australia and provides customers with direct connections into Australia, Asia Pacific and worldwide.
- 25 In 1993 Telstra acquired rights to spectrum which would have allowed it to operate another GSM network. However in December last year it reached an agreement with BellSouth whereby the spectrum rights were passed to BellSouth and Telstra negotiated access to BellSouth's network.
- 26 Telstra is currently implementing a programme with the announced aim of becoming a full service provider of telecommunications, providing local, national, and international telephone services, including cellular and other mobile services. It commenced offering a cellular service under the name of "MobileNet" on 1 May 1998 and using the 029 access code.

Clear Communications Limited

- 27 Clear is a New Zealand based and managed company with four corporate shareholders, British Telecom, MCI Communications, Todd Corporation and Television New Zealand. Each shareholder has a 25% share in the company. Clear has operated primarily in the local toll, and international toll service areas, and has a local loop service within the Auckland and Wellington central CBD areas, and internet access service.
- 28 At this point in time, Clear does not have a presence in the cellular market although it has indicated a wish to enter the market.

Saturn Communications Limited

- 29 Saturn is a Wellington based communications company which is 65% owned by UIH Asia/Pacific, a subsidiary of the United States based cable company United International Holdings of Denver, which operates entirely out of the United States in 24 countries, and 35% by SaskTel Holding Corporation. Saturn has a cable television network in the Wellington region and earlier this month began using that network to provide telecommunications services to the Hutt Valley. At present, Saturn does not operate in the cellular telecommunications market but has indicated a wish to expand in this area.

Background to TASPS

- 30 In its application Telecom has stated:

"Telecom's cellular business was launched in the same period in which the privatisation of the company occurred. For the first year of operation, Telecom did

not use the TASP structure. Rather Telecom sold direct to the public through dealers.

At the end of the first year of operation it was decided to introduce the TASP structure. Telecom appointed its five major dealers as TASPs. At that time Telecom was interested in using the TASP model to assist with the marketing and distribution of cellular services as Telecom did not consider that it had a suitable infrastructure in place to interact efficiently with the market place. The TASP role was to facilitate the marketing and distribution of cellular services. There were marked efficiencies to be gained at the time through the use of the TASP structure but subsequent development of the market and of Telecom infrastructure has resulted in a recognition that TASPs no longer provide the most efficient means of participating and competing in the market for cellular services.

Up until recently, Motorola and Ericsson provided similar services to that of Cellnet. Telecom itself continues to provide, inter alia, the same services offered by Cellnet. TASP agreements between Telecom and each TASP provided the same margin on any particular services for all TASPs. The TASP agreement between Telecom and Cellnet continues in this form. TASPs have an existence only by virtue of these contracts created by Telecom. In effect, the TASPs are simply commission agents of Telecom for the distribution of a service.”

THE MARKET

Introduction

- 31 Consideration of the proposal requires markets to be defined which best allow the Commission to consider the competitive impact of Cellnet, whose core business is the sale of cellular connections to, and air time on, the Telecom cellular network, being acquired by Telecom which is a full service supplier of telecommunications services, including those services undertaken by Cellnet.
- 32 In its *Business Acquisition Guidelines*¹, the Commission notes that it will seek to define relevant markets in terms of:
 - the goods or services supplied and purchased (the product/service dimension);
 - the geographic area from which the goods or services are obtained or within which the goods or services are supplied (the geographic dimension); and
 - the level in the distribution chain (the functional dimension).

- 33 In its application, Telecom has submitted the product/service dimension of the market is that for the bundle of intermediate services and hardware which a customer receives when purchasing mobile telephone services, including the handset, access to a cellular network, access to the PSTN and billing. Telecom has submitted that the geographic extent of the market is New Zealand wide, and that the functional dimension incorporates all elements involved in the delivery of cellular services.

The Product Dimension

- 34 It has been suggested in the past that cellular services are sufficiently substitutable for fixed services that the two should fall within the one product market for the purpose of competition analysis. Telecom does not agree with this view. Nor does BellSouth. Telecom has said in the application:

‘The price and functionality of fixed services (principally non-portability) are so different from mobile telephony that they should continue to be regarded as being in a different product market. The differences are narrowing, and the evolving technology for providing mobile services integrated with fixed (eg. PCS) may change the market definition in the future.’

- 35 This view accords with the conclusion reached by the Commission when it considered Telecom’s acquisition of Ericsson in October last year. It is also broadly in line with the view of the High Court and the Court of Appeal in the AMPS-A case² (albeit prices and technology have changed markedly since that case).
- 36 There has been nothing raised in the course of the current investigation which would support the conclusion that there is one product market.

The Geographic Dimension

- 37 The distribution of cellular services appears to have common features throughout the country. A “national” market is considered appropriate.

The Functional Dimension

- 38 In its analysis of the Ericsson acquisition, the Commission focussed on the distribution functional market and the retail functional market. This was despite Telecom’s view that there was sufficient integration of the supply of cellular services to place all activities involved in the supply in the one functional market.
- 39 In the present application, Telecom has provided extensive additional argument on this point and has also included a paper from Dr John Yeabsley, Senior Research Economist

at NZIER, who supports its argument. Telecom has again argued that there should not be a distinction made in functional level in this case.

- 40 Staff have given careful consideration to the argument but remain of the view that the distribution market is the most appropriate functional market to use to analyse the competitive impact of the proposal.
- 41 It is acknowledged that both Telecom and BellSouth are fully vertically integrated from network operations to retail level. Both own and operate their networks, undertake the full range of distribution functions and have a small number of retail outlets they own themselves. Further, when distribution of Telecom's cellular service goes outside Telecom's vertically integrated chain, the various outside parties concerned often undertake what appear to be quite similar functions. For instance, in respect of the different functions undertaken when the distribution chain involves Cellnet:
- the shape of the "package" being offered for sale is influenced strongly by Telecom but can be varied by both Cellnet and the dealers;
 - the purchase of hardware (principally the handset) is undertaken by dealers;
 - both Telecom and Cellnet have an influence in determining retail prices (discussed further below);
 - product promotion is undertaken by Telecom, Cellnet and the dealers;
 - organising connections involves all three parties;
 - customer support involves all three parties;
 - billing is a function of Cellnet alone;
 - credit risk lies with Cellnet.
- 42 Further, the precise roles of the parties have changed over time. For instance Cellnet was previously the major supplier of handsets to its dealers, but it recently withdrew from this role when it became apparent that this task could be performed more efficiently by another party.
- 43 The extent that network operators, distributors and dealers are capable of performing similar functions provides some support for the argument that all fall within the one market. Nevertheless there are also important differences at the different functional levels. In particular, the number of firms and entry conditions are significantly different at the different levels.
- 44 In any event, as has been stated in the past, the purpose of defining markets is to assist the analysis of any change in competition/market power from the acquisition in question. As the High Court said in AMPS-A³ :

“If we ask what functional divisions are appropriate in any market definition exercise the answer, plainly enough, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers.”

- 45 Staff consider that the competitive impact of the proposal can best be considered by using what Telecom may regard as a narrow market definition – that for the distribution of cellular services. It is in this area that market aggregation occurs. The market excludes dealers but includes Telecom, Cellnet, BellSouth and, from the beginning of May 1998, Telstra. Defining the market this way will not prevent full regard being given to the competitive constraint on Telecom coming from parties (such as dealers) who fall outside the defined market.

Conclusion on Market Definition

- 46 Staff conclude that the market of primary relevance to the consideration of the proposal is the market for the distribution of cellular services in New Zealand (“the distribution market”).

CELLULAR NETWORKS

Introduction

- 47 There are two cellular networks in New Zealand at present. Telecom has an analogue/digital system which commenced in 1987, while BellSouth began operating its GSM digital system in 1993.
- 48 There has been considerable dispute between the two companies over the relative coverage of the two networks. It is probably safe to say that Telecom’s network has the wider coverage and its analogue reach is considerably greater than its digital reach. Beyond that lies a field of conflict. However, it is apparent that both networks have near complete coverage of the major population centres. Telecom has advised the Commission that its network reaches 96% of the population, while BellSouth has said that its network reaches 92%. Both firms are adding new cell sites to extend their coverage.
- 49 As might be expected, both firms claim advantages for its network over that of its competitor. It is staff’s perception that Telecom’s strongest selling point is its reach, while BellSouth’s is the additional features it can offer.

Connections to Each Network

50 No doubt at least partly because it has been in the market for the longer time, Telecom has significantly more connections to its network than BellSouth has to its network. However, BellSouth's percentage of total connections is increasing quite rapidly, and in recent months it has achieved more new connections than Telecom. This is demonstrated in the confidential tables in Appendix A and Appendix B to this report.

51 It is recognised that not all connections are of equal value as some subscribers make greater use of the network than others. In order to assess the value of the connections to the two networks, staff have attempted to assess the cellular revenue generated by the two networks. Our assessment, based on material received from Telecom and BellSouth (shown in the confidential table below), indicates that the average spend per BellSouth subscriber is greater than that per Telecom subscriber. This accords with information provided to the Commission at the time of the Ericsson acquisition:

REVENUE FROM CELLULAR SERVICES

For year ended 31 December 1997

Party	Revenue \$m	Revenue \$m	Percent
BellSouth		[]	[]
Telecom	[]		
Cellnet margin	[]		
Ericsson margin	[]		
Motorola margin	[]		
Total Revenue from Telecom network		[]	[]
Total Cellular Revenue		[]	

Source: Confidential information provided by Telecom and BellSouth

52 The information also indicates that for the first quarter of 1998, BellSouth's share of total cellular revenue was [] while Telecom's (including Cellnet's) was [].

Potential for a new cellular network

53 In the AMPS-A decision, the High Court considered that the number of cellular networks which could be established was severely constrained by the availability of spectrum. This concern has now been met to some extent by additional frequency rights being made available by the Government. For instance, rights to the 2 GHz range of the spectrum are being auctioned later this year, and could be used for additional cellular networks.

- 54 More important constraints on a new network being established are likely to be the size of New Zealand's population, and the cost of building a new network. It has been suggested to the Commission previously that a new network could cost between \$150 million and \$200 million to establish although this may reduce with future technological developments. Telstra, which had earlier acquired the rights to the TACS-B band with the intention of developing its own network, has recently passed those rights to BellSouth under an arrangement which gives Telstra access to BellSouth's network.
- 55 Staff conclude that a new entrant at the cellular network operator level is unlikely in the near future.

THE MARKET FOR THE DISTRIBUTION OF CELLULAR SERVICES IN NEW ZEALAND

Introduction

- 56 Telecom previously distributed cellular services through several TASP's, including one in which it had an ownership interest. Over the last year, Telecom acquired Motorola and Ericsson, and Cellnet is now the only independently-owned TASP. Telecom now distributes the majority of its cellular services itself.
- 57 Telecom has stated that its intention in wishing to acquire Cellnet and integrate it with its other cellular operations is to:
- “reduce the cost to consumers of obtaining new cellular connections;
 - reduce Telecom brand fragmentation;
 - reduce costs of supporting existing Telecom cellular customers;
 - improve the service and benefits offered by Telecom and extending them to a wider range of customers; and
 - increase the speed at which new products and services can be brought to the market.”

Current Market Shares

- 58 The application notes that Cellnet had an estimated market share of [] of all connections to Telecom's network as at 31 March 1997. As at February 1998 this had fallen to []. Telecom's share of all cellular connections is shown in the following table:

CONNECTIONS FOR CELLULAR SERVICES

As at 31 March 1998

Party	Connections	Share of Total Connections
Telecom	[]	[]
Cellnet	[]	[]
	[]	[]
BellSouth	[]	[]
Total	[]	100.0%

Source: Confidential information provided by Telecom and BellSouth

59 Because it has concentrated on the corporate sector, Cellnet's share of the market by revenue is higher than its share by connections. As discussed earlier, BellSouth's share of total revenue is also higher than its share of connections.

Entry Conditions and the Likelihood of New Entry

60 The key to entry into this market is an agreement with a cellular network operator for the use of its network. There are no other elements about the distribution of cellular services which would be likely to deter entry given normal profit incentives. The necessary technical knowledge, materials and capital appear to be readily available.

61 As discussed above, Telecom in the past chose to distribute its services through a small number of TASP's but has increasingly taken over that function itself. Cellnet is currently the only outside distributor of Telecom cellular services. Given the views Telecom has expressed above about the advantages of handling its own distribution, staff consider it unlikely that Telecom will enter into any new TASP agreements in the future.

62 BellSouth has opted to distribute its own cellular services and there is no indication that it will agree to independent distributors undertaking this function in the near future.

63 The one example of new entry in this market has been Telstra. As noted earlier, Telstra has reached an agreement with BellSouth whereby it will offer its own cellular service using BellSouth's network. Thus Telstra has now entered all the functional markets apart from that of network operations. Like BellSouth, it has chosen not to use independent distributors to distribute its services.

64 Other telecommunications companies (Clear and, at some time in the future, Saturn) have indicated a wish to add cellular services to their range of telecommunications services. It is anticipated that they would do this by using one of the existing networks to

provide their own branded service (in the way Telstra has). [

] Staff consider that new entry of this nature is a real possibility. From the network owner's perspective, such a proposal may be an attractive and profitable way of utilising the network's unused capacity.

- 65 Another form of new entry which could occur would arise from existing cellular dealers increasing the extent to which they undertake tasks which can be regarded as being part of the distribution function. For instance, independent Telecom dealers who focus on the corporate market often have account managers and provide the type of customer support (often in conjunction with Telecom) which Cellnet also provides. They also promote particular products and services in a similar way to Cellnet, and have the discretion to vary the mix of products (usually handsets) and services they offer to a limited extent. These dealers may increase their "distributor" role. However, having regard to their dependent relationship with the network owners and the comprehensive nature of the existing dealer contracts, it is likely that any substantial change in the existing dealer role would only occur at the discretion of the network owners.
- 66 It is staff's view that the most likely new entry into the distribution market will come from firms wishing to add cellular to their existing range of telecommunications services by reselling time on an existing network. Telstra is an example of such a new entrant, and Clear and, to a lesser extent, Saturn have also indicated an interest in this type of entry.

Dominance

- 67 In terms of s 3(9) of the Act, a person is in a dominant position in a market if:
- "... that person as a supplier or an acquirer, ..., of goods or services, is ... in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ..."
- 68 In determining whether a person is in a position to exercise such a dominant influence, regard shall be had to:
- “(a) The share of the market, the technical knowledge, the access to materials or capital of that person ...,
- (b) The extent to which that person is, ..., constrained by the conduct of competitors or potential competitors in that market;
- (c) The extent to which that person is, ..., constrained by the conduct of suppliers or acquirers of goods or services in that market.”

- 69 In considering these and other relevant factors, staff have noted indications of strong competition in the supply of cellular services. The rivalry between Telecom and BellSouth is intense, substantial amounts are spent by each firm on comparative advertising, and the increase in the number of new connections on each network has been similar in the past year. BellSouth's success with its Prepay plan appears to have forced Telecom to develop a similar plan to try to prevent a further loss of its share of connections. Prices have reduced and the level of service has increased.
- 70 At the distribution functional level, additional competition has arisen. Telstra's entry into cellular on 1 May 1998 has the goal of improving the company's position with the corporate sector by allowing it to offer a full range of voice and data products and services. Telstra is also proposing to supply other sectors of the market. Telstra launched as a full entity in New Zealand in 1996, has invested \$30 million to date, and has announced that it will spend \$60 million over the next three years to establish a major presence in the country. In the cellular market, Telstra will be promoting its own brand with its own features, and does not consider itself constrained by its agreement with BellSouth for the use of BellSouth's network.
- 71 Staff consider that entry conditions allow for further new entry. The key to entry is an agreement with a network operator for the use of its network. The recent entry of Telstra indicates that such agreements are possible and would appear to provide an effective way for a network owner to utilise unused capacity on its network.
- 72 In considering the cellular product market as a whole, staff recognise that there remain impediments to fully effective competition at all functional levels. For instance, the lack of number portability increases the cost of subscribers switching networks costs at all functional levels, while Telecom's control of the PSTN gives it the ability to act adversely to its competitors in most telecommunications markets.
- 73 In the distribution functional market, however, staff consider that the existing indications of strong competition, the success of BellSouth in increasing its market share, the lack of substantial entry barriers and the recent entry of a strong and committed competitor in Telstra, means that Telecom is not currently dominant in the distribution market.

Competition from Cellnet and the Impact of its Removal from the Market

- 74 In the application, Telecom has submitted that Cellnet currently provides little if any real competitive pressure on either Telecom or in the market generally. It states:

“A practical examination of the behaviour of TASPs and the other market participants (Telecom and BellSouth) demonstrates that the TASPs have an insignificant competitive effect in the market. What might at first appear to have been competition between TASPs was, in fact, driven not by normal market dynamics but by the TASP agreements each had with Telecom. The TASPs act not as independent wholesalers or distributors, but rather as contractual agents of Telecom in the provision of cellular services. This is reflected in the lack of significant service or pricing initiatives coming from the TASPs and their reluctance in adopting Telecom initiatives. These attitudes and behaviour reflect the TASPs reliance on the TASP agreement to suggest that they need do no more or less than that set out in the strict terms of the TASP agreements.”

75 Elsewhere in the application, Telecom states:

“TASPs have an existence only by virtue of those contracts created by Telecom. In effect the TASPs are simply commission agents of Telecom for a distribution of a service.”

76 In its submission on the application, BellSouth disagrees with Telecom’s submissions. BellSouth has stated:

“The reality is that the three TASPs (ie. Cellnet, Ericsson and Motorola) have never been mere ‘commission agents’. Instead they have provided superior service standards and innovative pricing packages, won business at the expense of Telecom’s own vertically integrated distributor, and as at June 1997 they had respectively 11%, 19% and 20% of the market.”

77 Further, BellSouth states:

“Moreover, as BellSouth understands the position, Cellnet has always been the most independent and innovative of the TASPs. BellSouth believes that this is in part due to the customer contacts which were available to it through the Fisher & Paykel network, and partly because Cellnet carried out all accounting functions in-house ..., whereas the other TASPs relied on Telecom to provide the accounting function for them. This has resulted in a greater degree of independence for Cellnet, and in particular meant that Telecom has no access to information about Cellnet retail customers. BellSouth also believes that it is this facility which has enabled Cellnet to package and price its products in a more innovative way than the other TASPs.”

- 78 To assess whether Cellnet has a competitive influence in the market independent of Telecom, staff have considered both the impact of its formal agreement with Telecom and also the practical relationship between the two in the past.

The Agreement between Telecom and Cellnet

- 79 The agreement (known as the TASP agreement) places various obligations on the two parties. These include obligations on Telecom:

- []
- []
- []
- []

- 80 The agreement also places various obligations on Cellnet, including obligations to provide the distribution service to subscribers in a proper and efficient manner and not to market the services of any other mobile network operator. Cellnet is also required to meet specified performance criteria.

- 81 The Schedule to the agreement sets out recommended retail charges and the base percentage discounts off those recommended retail charges. []

- 82 Other provisions in the agreement include:

- []
- []
- []
- []

- 83 The original agreement dated 8 November 1990 was amended in part by an agreement dated 25 June 1997. The amendment []

- 84 Staff are of the view that while the agreement, in itself, does not prevent Cellnet from competing vigorously in the distribution market, the provisions which provide for co-operation on promotion are not suggestive of a strongly competitive relationship between Telecom and Cellnet.

Competition between Telecom and Cellnet in Practice

- 85 A number of industry participants whom staff have spoken to have emphasised the independent nature of Cellnet. It has developed its own market niche – the corporate sector – and, it has been suggested, has guarded its customers jealously from Telecom. Unlike the other TASP's, it has developed its own billing system and has promoted the special features this brings.

- 86 Cellnet has emphasised its independent role in the past. As recently as 22 April 1998, Cellnet stated in an advertisement in *The Dominion*:

“UNTIL TODAY CELLULAR TECHNOLOGY HAS SHRUNK EVERY-
THING EXCEPT FOR THE BILL

Thanks to Cellnet talk just got cheaper. For more information about these
great rates, contact your nearest Cellnet dealer.”

- 87 The advertisement then itemises the various base price plans on offer.
- 88 Notwithstanding the above, staff consider that competition between Cellnet and Telecom has been severely restrained in practice. For example, the base price plans are developed by Telecom and are the basis on which distributors and dealers determine their prices. The plans and prices available from Cellnet dealers which feature in the above advertisement are similar to those introduced through Telecom's dealers.
- 89 In respect of competition for large corporate business, Telecom has claimed that in most cases it does not compete against Cellnet. It has provided instances where it has refused to bid for major contracts, but rather has supported Cellnet's bid. Telecom has claimed that in any year only approximately [] of its top 600 customers may switch between Cellnet and Telecom. Cellnet has confirmed this, although it has noted that there was an increase in this number (perhaps an additional []) when Ericsson and Motorola businesses were acquired by Telecom last year.

90 Telecom further claims that it [

]

91 Staff have checked some, but not all, of these claims. However, all are consistent with the view that Telecom would have an economic incentive to maximise the use of its network at the expense of BellSouth's network. In these circumstances it is unlikely that Telecom would wish to undermine an important distributor of its services which it helped establish in the first place.

92 Notwithstanding the above, it is recognised by staff that Cellnet does have some competitive influence on Telecom. This is inevitable as Cellnet provides a choice for consumers who are connected to Telecom's network. These consumers do not have to face the cost of switching networks if they become dissatisfied with Telecom's distribution service. Rather they can change to Cellnet. Without the ability to switch to Cellnet, a competitive discipline on Telecom is removed.

93 It is staff's view that the competition lost from Telecom's acquisition of Cellnet would be small, and far less than would occur if Cellnet was independent of Telecom. Cellnet is essentially a creature of Telecom, it is actively supported by Telecom, and it relies on Telecom for its long term survival. As a TASP, Cellnet is not in a position to provide more than weak competition to Telecom.

94 While Cellnet has an important customer base, it does not have the ability to provide effective competition in the market independent of Telecom, and staff conclude that it is appropriate to view Cellnet as one element of Telecom's competition with the distributors of other services.

Conclusion

95 Staff conclude that Telecom is not currently dominant in the market for the distribution of cellular services in New Zealand.

96 Further, staff conclude that the proposal would not materially change the present level of competition in the distribution market, and not such as to result in Telecom acquiring dominance. Post-acquisition, Telecom would continue to face effective competition from BellSouth, while it is anticipated that Telstra will become an additional significant player in the distribution market in the near future.

ABILITY OF TELECOM TO LEVERAGE ITS MARKET POWER

97 In its submission on the proposal, BellSouth states:

“Telecom will, by obtaining direct access to the Cellnet customer base, be able to extend its conduct of anti-competitive leveraging of its monopoly landline services through its various exclusive discount pricing plans, which are currently subject to litigation in the High Court. Telecom currently does not have the ability to deploy this strategy in relation to Ericsson or Motorola customers until it acquired those businesses.”

98 BellSouth notes that it has consistently argued that Telecom breaches the Commerce Act with its practice of contracting with customers to provide discounts across all services on the condition that the customer uses Telecom exclusively. It submits that Cellnet’s corporate customers are at risk of being subject to anti-competitive pricing practices if Telecom acquires Cellnet. It further submits that the Commission must ask whether the acquisition of Cellnet will increase in a way that is more than slight or insignificant Telecom’s ability to exercise its market power in any market.

99 In response to BellSouth’s submissions, staff note that the relevant issue to be addressed in considering the proposal is not whether the proposal might result in conduct by Telecom which BellSouth might allege was anti-competitive (such allegations would be considered and determined in accordance with the provisions of Part II of the Act), but whether the proposal would result, or would be likely to result, in Telecom acquiring or strengthening a dominant position in a market.

100 As noted, the proposal would not result, and would not be likely to result, in Telecom acquiring a dominant position in the distribution market. Moreover, staff conclude that the proposal would not result, and would not be likely to result, in Telecom strengthening its dominant position in the market for the provision of fixed telephony services in New Zealand.

CONCLUSION

101 Staff have considered the impact of the proposal in the market for the distribution of cellular services in New Zealand.

102 Staff conclude that Telecom is not currently dominant in the market for the distribution of cellular services in New Zealand and that the proposal would not result, and would not

be likely to result, in any person acquiring or strengthening a dominant position in this market.

- 103 Having regard to the factors set out in s 3(9) of the Act and all the other relevant factors, staff conclude that the proposal would not result, and would not be likely to result, in Telecom or any other person acquiring or strengthening a dominant position in a market.

RECOMMENDATION

- 104 Staff recommend that, in terms of s 66(3)(a) of the Act, the Commission give clearance for the proposed acquisition.

Richard Adam
Analyst

Vimla Rani
Investigator

Andrew Brice
Chief Investigator

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DETERMINATION ON NOTICE OF CLEARANCE

TELECOM CORPORATION OF NEW ZEALAND LTD/CELLNET MOBILE SERVICES LTD

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3) of the Commerce Act 1986, we hereby give/decline to give clearance for the acquisition by Telecom Corporation of New Zealand Limited or one of its interconnected bodies corporate of the assets and business of Cellnet Mobile Services Limited ("Cellnet") from Cellnet and its subsidiaries.

Dated this 15th day of May 1998

P C Allport
Chairman

T G Stapleton
Deputy Chairman

R N Taylor
Member

APPENDIX A: GROWTH IN CELLULAR CONNECTIONS BY NETWORK OPERATOR

Quarter	Total	Telecom	BellSouth	% BellSouth
June 1995	[]	[]	[]	[]
September 1995	[]	[]	[]	[]
December 1995	[]	[]	[]	[]
March 1996	[]	[]	[]	[]
June 1996	[]	[]	[]	[]
September 1996	[]	[]	[]	[]
December 1996	[]	[]	[]	[]
March 1997	[]	[]	[]	[]
June 1997	[]	[]	[]	[]
September 1997	[]	[]	[]	[]
December 1997	[]	[]	[]	[]
March 1998	[]	[]	[]	[]

Source: Confidential information provided by Telecom and BellSouth

For the year end 31 March 1998, the total cellular connections grew by [], comprising Telecom by [] and BellSouth by [].

APPENDIX B: TOTAL CELLULAR CONNECTIONS BY NETWORK OPERATOR

Quarter Ending	Telecom	Telecom's share of Total	BellSouth	BellSouth's Share of Total	Total	Growth in Total Connection per Quarter
March 1995	[]	[]	[]	[]	[]	
June 1995	[]	[]	[]	[]	[]	[]
September 1995	[]	[]	[]	[]	[]	[]
December 1995	[]	[]	[]	[]	[]	[]
March 1996	[]	[]	[]	[]	[]	[]
June 1996	[]	[]	[]	[]	[]	[]
September 1996	[]	[]	[]	[]	[]	[]
December 1996	[]	[]	[]	[]	[]	[]
March 1997	[]	[]	[]	[]	[]	[]
June 1997	[]	[]	[]	[]	[]	[]
September 1997	[]	[]	[]	[]	[]	[]
December 1997	[]	[]	[]	[]	[]	[]
March 1998	[]	[]	[]	[]	[]	[]

Source: Confidential information provided by Telecom and BellSouth

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- ¹ Business Acquisitions Guidelines, 1996
- ² *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, and *Telecom Corporation of NZ Limited v Commerce Commission* (1992) 3 NZLR 429
- ³ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502

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