Vodafone/SKY – Vodafone's response to the third party submissions on the Letter of Unresolved Issues

1. **Introduction and Summary**

1.1 Vodafone responds to the public versions of the third party submissions on the Commission's letter of unresolved issues (the **LOUI**) regarding the proposed merger of Vodafone and SKY in New Zealand (the **Proposed Transaction**) below.

1.2 In general, the submissions opposing the Proposed Transaction (of which all bar one are from competitors) contain no reliable evidence to support the assertions made. In particular, the opposing submitters:

(a) do not evidence how the merged entity will be able to switch a large number of customers to the merged entity. Their general references to "convergence" (with reference to the New Zealand market) and isolated overseas examples of triple/quad play uptake do not provide a valid basis on which to assess the *competitive effects* of the Proposed Transaction;

(b) do not provide any new evidence to underpin their assertions that in the counterfactual SKY will become an "enthusiastic wholesaler" of content (now described by some as a "genuine wholesaler") – a matter the Commission has scrutinised in great detail and dismissed on the evidence. Relabeling this counterfactual scenario does not make it any more likely to occur;

(c) provide no valid grounds for asserting the merged entity will change its standalone prices or change the position on wholesaling SKY content; and

(d) do not, for the most part, engage in how the alleged reduction in rivals' scale or foreclosure of access to SKY will affect their ability to compete in the relevant fixed or mobile telecommunications markets. Not only do they not show how their ability to compete will be impacted, they provide no evidence as to how the merged entity would be able to subsequently raise prices / decrease quality as a result. *Both are fundamental to the underlying issue of whether there is likely to be an SLC for Commerce Act purposes*. Where opposing submitters have touched on this issue, they do so without reference to any substantive evidence.

1.3 In contrast, the applicants' have provided extensive and detailed evidence as to why the Commission can be satisfied that the Proposed Transaction will not substantially lessen competition in a market. In summary, they have provided detailed evidence that:

(a) New Zealand telecommunications markets are highly competitive and resilient, as evidenced by:

(i) the 90+ broadband suppliers competing vigorously on price, service, quality, marketing and bundles of additional goods or services (such as Spark's Lightbox and Trustpower's electricity bundle); and

(ii) three, substantial mobile providers with high quality mobile networks offering sharply priced bundles of texts, calls and data along with add-ons such as Spark's Spotify and Lightbox offerings, together with MVNO operators such as Vocus and Warehouse Mobile who operate on a national basis;

(b) bundling SKY content with telecommunications services will **[REDACTED]**. This is evidenced by:

(i) Vodafone currently being the only provider bundling broadband with SKY (and offering deep promotions from time to time), without any increase in its market share as a result. For example, Vodafone's offer earlier this year of 12 months free SKY sport is 34% cheaper than purchasing an equivalent bundle[1] with Spark and 16% cheaper than an equivalent bundle with Voyager (who offers the cheapest 100mbs unlimited fibre as per www.broadbandcompare.co.nz).[2] This applies for the entire 12 month term of the Vodafone contract. However, despite this significant discount, **[REDACTED]**;

(ii) the continuously growing availability of content that consumers value as evidenced by the increasing availability of alternative content sources (including the recently reported entry of AmazonPrime[3]) and *actual* consumer behaviour in respect of both broadband and mobile, revealing that SKY is becoming relatively less important as a source of content. Rather, content providers are increasingly delivering, and consumers are increasingly consuming, content over the top (**OTT**), allowing all TSPs to compete to provide the internet service through which the consumers access the content. This means it is wrong to say that in the future the ability to bundle telecommunications and SKY will cause a substantial market shift when it **[REDACTED]**. This is consistent with the Grant Samuel independent report on the Proposed Transaction, which references the increasing churn for SKY as a result of OTT competition (see Vodafone's LOUI response at 8.12);

(iii) **[REDACTED]**, despite Vodafone currently being the only TSP offering SKY bundles,;

(iv) Vodafone's own data, which shows that customers value **[REDACTED]** and that promotions involving discounted bundles of SKY content **[REDACTED]**;

(v) the parties' forward looking synergy forecasts (which do, in fact, take into account discounts); and

(vi) trends showing that the growth in customer numbers taking Pay TV and broadband bundles **[REDACTED]** in recent years;

(c) the merged entity will continue to be strongly incentivised to offer standalone SKY services on attractive terms and wholesale SKY services to resellers. To do otherwise would be contrary to explicit statements in the investor materials (see Vodafone's LOUI response at 17.4); and

(d) even if rival telecommunications providers were to reduce in scale (which is denied) this would not affect their ability to compete in the short or long term or amount to an SLC in a relevant telecommunications market. As NERA has set out in detail in its report in response to the LOUI, most of the costs referred to in the LOUI are either sunk (and therefore of no relevance to how a rival is able to compete), common across several products (and therefore affected to a minimal degree by scale in the relevant broadband market) or so small as to be immaterial. Third parties have not engaged on this important point in any meaningful way. Indeed, given the strong competition being exhibited by the smaller RSPs (such as Trustpower and 2degrees) it is not credible to argue that a reduction in scale inhibits competition. Put simply, rivals will not retrench in the face of a more competitive offer, but will come out fighting.

1.4 The arguments made by the applicants are supported by two independent third party submissions, being those from Perpetual and B Howell/P Potgieter. These independent submissions provide additional evidence and well-reasoned arguments supporting clearance and are referred to further below.

1.5 Vodafone responds below to those assertions made in opposing submissions that are relevant to the potential theory of harm that the Commission is assessing. Various additional assertions and

[1] 100mbs unlimited fibre + basic package, standalone SKY sports and MY SKY.

[2] Based on prices as at 23 November 2016. If SKY HD access ticket is included in each bundle then Vodafone's bundle is 32% cheaper than Spark and 15% cheaper than Voyager.

[3] http://www.stuff.co.nz/business/industries/86673441/amazon-prime-video-adds-more-colour-to-the-internet-tv-jungle

allegations (for example in relation to zero rating, use of FTA channels and so forth) that are unconnected to matters contained in the LOUI are not addressed in this response.

2. **The competitive context of the transaction**

2.1 For the most part, the third party submissions do not oppose the commonly accepted characterisation of the New Zealand telecommunications markets as highly competitive (and as set out at section 6 below, no submitter has offered a cogent theory as to how this will change).

2.2 However, in its response to the LOUI, Trustpower, cites a "lack of competition in fixed and mobile telecommunications markets" at the present time. This is directly contrary to the facts and the Commission's own analysis. For example:

(a) Trustpower's own considerable growth since entry is a prime example of the highly competitive nature of the broadband market. For example, it recently said it was "potentially the fastest growing" telecommunications provider and has grown nearly three-fold in the period October 2014 – September 2016 (18,000 to over 60,000) through bundling broadband, power and gas (see also para 6.17 below).[4] That Trustpower has achieved this growth from a standing start evidences both low barriers to entry and the extent to which the merged entity will continue to face competition from existing and new market participants;

(b) the existence of over 90 competitors in the broadband market of all different size and scale; and

(c) the Commission's reports on the state of the telecommunications market in New Zealand stating that "Mobile pricing continues to be competitive across all bundle sizes"[5] and describing the telecommunications market as "a fast-moving competitive market"[6].

2.3 For further evidence of the competitive nature of the telecommunications markets refer to paragraphs [4.2] – [4.11] of Vodafone's response to third party submissions on 11 September and Part B of Vodafone's response to the LOUI.

3. **The factual and counterfactual**

3.1 Many of the opposing submitters (for example 2degrees and InternetNZ) continue to assert that the Proposed Transaction should be assessed against what amounts to an "enthusiastic wholesaler" counterfactual (although this is described in various ways). This counterfactual is predicated on SKY substantially changing the way it wholesales to third parties.

3.2 However, none of these submitters provide any evidence (or at least, any new evidence) for this assertion. By contrast, the Commission has undertaken a detailed review of the evidence provided by the applicants and third parties and dismissed the "enthusiastic wholesaler" counterfactual. Based on the absence of any new evidence we do not expect the Commission to revisit its earlier conclusion. However, in the unlikely event it is contemplating doing so then Vodafone requests that it is notified and given the opportunity to respond.

3.3 Other parties have argued (see Fetch TV at page 1) that in the counterfactual SKY will itself become a broadband provider (which is itself inconsistent with the "enthusiastic wholesaler" counterfactual theories posited by others). Even if this were the case, the Proposed Transaction does not result in a competition issue given the highly competitive nature of the broadband market.

[4] Interim results investor briefing, 7 November 2016.

[5] 2015 report.

[6] 2014 report.

4. **SKY content will not cause substantial switching to the merged entity**

4.1 The Commission is continuing to explore whether, by making SKY/telecommunications bundles relatively more attractive than standalone or wholesale SKY packages, the merged entity will be able to switch a substantial portion of rival TSPs' customers to its own products. It is also investigating whether such customers would be more likely to be "high ARPU" customers.

4.2 Opposing submitters argue that if:

(a) they are denied access to SKY products on "reasonable terms" (which many argue are better than the terms SKY currently offers, despite Vodafone reselling on these terms for some time)[7]; and

(b) the merged entity makes the bundled offer relatively more attractive to consumers,

then the bundles offered by the merged entity cannot be replicated, making rivals' offerings significantly less attractive. This, they argue, will result in a significant number of consumers (indeed some claim all SKY Sport consumers) switching to the merged entity's products (despite the fact that such a bundle is available today and has not led to substantial switching).

4.3 In essence, their arguments hinge on references to general trends in "convergence", selected overseas examples of selected TSPs selling triple/quad play bundles overseas and their belief that there will be a sea change in New Zealand consumer preferences in the near future. This is despite the fact that bundled telecommunication and content offerings are not currently a major feature in New Zealand markets and content is in no way seen as an essential *input* into providing a telecommunications service.

Content not a key input

4.4 Third parties' attempt to characterise the merged entity as a vertically integrated operator (between content and broadband) does not stand scrutiny. This is borne out by Howell & Potgieter's submission:

> the Commission's analysis of the proposed merger as a linear production and value chain, with an upstream content market and a downstream internet access and content distribution market with consumers as passive recipients of take-it or leave-it bundles of content and internet access does not reflect the current and future reality of competition…

4.5 Vodafone agrees that such a characterisation by the Commission would be inappropriate. It is not the case that "turning off the tap" of content to TSPs (none of whom acquire it today as an input) will all of a sudden disrupt their sale of telecommunications services, whether standalone or in bundles (let alone actually give rise to a substantial lessening of *competition* (as a process) in a market). Competitors currently, and will continue to, market their offerings on the basis of a whole range of other factors.

4.6 However, such a characterisation of this "linear production and value chain" as criticised by Howell and Potgieter is at the heart of many of the opposing submitters' assertions. For example, this is clear from Spark's comparison to the *Waste Management* case where the two products (waste collection and landfill services) are inextricably vertically linked (a waste disposal network requires landfill services as an input, whereas landfills need waste disposal customers in order to effectively operate). Any suggestion the current situation is even remotely similar is plainly wrong: Spark is competing without using SKY as an input (or, to use their analogy, successfully producing waste without anywhere to put it).

[7] Some parties have argued that Vodafone can only make its wholesale deal with SKY work because of its HFC cable network. Indeed, Russell McVeagh points to **[REDACTED]** The third parties point to no evidence for their assertion, which simply cannot be made out.

4.7 To the contrary, such an analysis has no relevance to the relationship between broadband and content bundles in New Zealand (where content is by no means a necessary input into telecommunications services) and the dynamics of competition in the telecommunications industry in New Zealand. Indeed, even as regards the digital distribution of content, the vast majority of the content that consumers watch is delivered "OTT", entirely separately from, and regardless of, their choice of TSP. This means customers remain free to choose their fixed and mobile TSPs independently of their choice of which content to access. For instance, anyone can subscribe to Netflix, AppleTV, Amazon Prime or Fanpass, irrespective of which TSP a customer takes its broadband from. Nothing is stopping OTT operators from offering content directly to customers including large sports events evidenced by Twitter directly broadcasting NFL games.[8]

References to overseas "convergence"

4.8 Many of the opposing submitters refer to convergence trends in other jurisdictions or, more frequently, in relation to one or two TSPs in an overseas jurisdiction. However, even these carefully selected examples contradict the opposing submitters' own assertions that customers who acquire SKY Sport will be "entirely foreclosed" to rival TSPs.[9] For example:

(a) Spark points to the "significant success" of Telenet's quad play bundle in Belgium but fails to point out that Telenet's quad play penetration has reached only 23% of its cable customer base. This is not at a level that would raise competition concern (and indeed is not vastly different to the proportion of SKY customers already purchasing a SKY/Vodafone bundle). If this proportion of customers was transposed on the SKY Sport customer base, it would equate to less than **[REDACTED]** of consumer broadband connections. The conclusion is similar in respect of the SFR quad play bundle in France – the customers attracted to the quad play bundle represent a proportion of their subscriber base, which in turn represents a proportion of the overall consumer broadband market (which in itself represents only a proportion of overall fixed telecommunications revenues).

(b) Similarly, 2degrees points to convergence trends in overseas countries.[10] Its data indicates that in most countries, consumer uptake of "quad play" bundles is in single figure percentages. The few countries (Belgium, France and Spain) where the figure is above 20% (with the highest being only 27%), have had these offerings available for several years. In the case of Spain, the uptake resulted from the incumbent TSP offering very deep discounts, which Vodafone has demonstrated would not be economically viable in this case.

4.9 This supports Vodafone's view that, irrespective of the nature and pace of convergence trends, New Zealand is not, with or without the Proposed Transaction, about to experience a "sea change" that will greatly increase the importance of quad play bundles to all or most consumers. If anything, the sea change has already occurred, with consumers accessing more and more content online from a wide variety of sources (including leading SVOD offerings such as Netflix and Lightbox). This uptake is expected to continue in a similar fashion with or without the Proposed Transaction. This can be seen in the third party report data provided in Vodafone's response to the LOUI, which shows consumers increasingly using a range of competing SVOD, user generated video and New Zealand on demand services.

4.10 To satisfy this demand, content aggregators and creators are increasingly making their content available online, such as TVNZ OnDemand, 3NOW On Demand. These apps are typically also available on TV home screens, with many of these apps set as a default on televisions. Vodafone does not expect any substantial shift in this trend.

4.11 By contrast to the broad assertions set out in the third party submissions, Vodafone has provided detailed evidence based on New Zealand consumer survey data *and actual market behaviour* that SKY content is not a significant driver of broadband uptake. There is no bundled offer that the

[8] See Vodafone Clearance Application at 7.8

[9] See Spark at [10].

[10] 2degrees [7.3].

merged entity could credibly offer that would cause sufficient switching for competition concerns to arise. The evidence provided to date demonstrates that SKY content in New Zealand is not a must have in telecommunications markets today, and nor is it likely to become a must have in future.

Overseas cases

4.12 Spark and Dot.Econ (on behalf of Spark) endeavour to draw broad parallels between overseas cases and the Proposed Transaction. As set out in the report prepared by Frontier Economics, none of the claims in the Dot.Econ report stand up to scrutiny. The factual basis of these cases is quite different. Equally, the separate overseas cases referred to by Spark have no relevance to New Zealand market conditions (and indeed Spark does not apply these cases to the New Zealand market or the Proposed Transaction).

4.13 Indeed, Dot.Econ on behalf of Spark proffers the *Vodafone/Liberty Global (Netherlands)* case as an example of why the Proposed Transaction should be blocked. However, it omits any reference to the key point relevant to this case, being that the European Commission did carry out a detailed assessment of the potential for non-horizontal concerns as a result of anti-competitive bundling in the Vodafone/Liberty merger and found no concerns. Indeed, the European Commission found that "[a]s regards the sale of bundles at a discount, the Commission considers this to be in the interest of consumers" and that this was "unlikely to lead to the marginalisation" of standalone rivals. (See Frontier at 5 to 14 for further details.)

5. Incentive of merged entity to retain attractive standalone offer and wholesale to rivals on competitive terms

5.1 The third party submissions (2degrees and Spark in particular) assert that in the factual the Merged Entity will:

(a) not provide wholesale access to SKY content on reasonable terms to allow competitors to compete effectively; and

(b) increase the standalone price of SKY relative to the bundled price.

5.2 As "evidence" of this, the third parties rely upon:

(a) their belief that SKY's incentives will change post transaction as the incentives of a vertically integrated operator are different to those of a non-vertically integrated operator; and

(b) the assertion that SKY does not currently provide wholesale supply of its content to TSPs on reasonable terms (despite Vodafone successfully reselling SKY for some time on comparable terms, the vast majority of which as a reseller and not pursuant to the retransmission agreement).

5.3 We address the mischaracterisation of content being part of a vertical production chain for telecommunications services above at 4. Vodafone has provided ample evidence that **[REDACTED]**.

5.4 Further, Part F of Vodafone's LOUI response provides substantial evidence illustrating that the merged entity will continue to be incentivised to provide wholesale access on reasonable terms to rival TSPs and provide standalone SKY on similar terms as exist today. SKY has offered to wholesale its content for many years, yet Vodafone is the only TSP out of 90+ nationwide to opt to resell SKY in recent years. None of the opposing submitters offer evidence of why the merged entity will not wholesale, except as to say that they do not find the SKY terms attractive currently. (While they endeavour to argue that this will change in the counterfactual, as above, none have provided substantial evidence as to why this will occur.)

5.5 Regarding the assertion that the absence of wholesaling is because there is insufficient margin, the terms offered by SKY are comparable to the terms offered by **[REDACTED]**. As previously submitted to the Commission, Spark is the exclusive reseller of Spotify and gives this away to its mobile customers at no additional charge – at a significant cost to itself. This is in addition to its Lightbox offering, for which it also incurs substantial costs. If reselling SKY services was as important to Spark as it claims, it would offer a SKY bundle now as doing so would entail comparable or lower costs than the bundles it currently offers.

5.6 In Vodafone's view, third parties do not currently resell SKY content because:

(a) their customers do not see it as a must-have add-on to the telecoms services they are buying; and

(b) they do not find it beneficial to do so compared to the range of other offers they have in the market.

5.7 Regarding the assertions about the merged entity's incentives to wholesale, Vodafone has shown that it is a highly effective wholesaler. It has a separate wholesale division today selling around **[REDACTED]** of telecommunications products and services to around **[REDACTED]** small and large competitors. This division reports to the CEO to ensure independence from Vodafone's retail arm and in the new organisation is expected to report to the CEO or CFO to ensure the same independence. Vodafone's wholesale arm achieves a high level of customer satisfaction (higher than its other divisions).

5.8 Significant examples of wholesale deals with competitors include:

(a) resigning a 5 year national roaming deal with 2degrees which offered an approximate **[REDACTED]** saving compared to its previous terms. In May 2015 Vodafone proactively wrote to inform 2degrees that **[REDACTED]**;

(b) **[REDACTED]**;

(c) **[REDACTED]**;

(d) **[REDACTED]**;

(e) 13 retailers take wholesale rural broadband products from Vodafone, an offering that was set up as part of the Government's Rural Broadband Initiative (RBI) program. Until recently, Vodafone's wholesale RBI customers have achieved greater volumes on the RBI network than Vodafone retail. Vodafone has moved well beyond the original 3G wholesale requirements we agreed with the government and now offers better bundles and 4G services.

5.9 As the examples above demonstrate, Vodafone has an experienced and successful wholesale operation in telecommunications services that competes in the market to provide services its customer's value. Its intention would be to apply this experience to content offerings and skills so that it can wholesale into the wider market. This is consistent with the statements in the Explanatory Memorandum. In particular, Vodafone will look to:

(a) sell wholesale offerings similar to the inputs Vodafone buys from SKY today and has shown to support a successful retail offering strategy. Indeed, Vodafone is encouraged by the expressions of interest by Spark, 2 degrees and Trustpower through their submissions;

(b) work with rival TSPs to allow them to resell SKY's OTT offerings such as NEON and FANPASS. This can be done with very limited technical integration and will benefit Vodafone by broadening the reach of these packages to more viewers. Vodafone would be in competition with a number of other OTT providers in this respect, including Netflix, Spotify, Amazon Prime and many more as the global market continues to evolve; and

(c) based on Vodafone's success in the rural segment with its RBI offerings, where it has 13 retailers, it sees a good opportunity to grow its content revenue by reselling to as many as possible of the 90+ small TSPs who see value in offering a SKY content bundle.

5.10 In summary, the merged entity is incentivised to, and will, wholesale content on a commercial basis post-transaction. Refusing to wholesale content will have, at best, a negligible effect on the merged entity's market share in relevant telecommunications markets. On the other hand, wholesaling content will allow it to increase the number of subscribers and therefore its revenue base. A "foreclosure" strategy would simply not be profitable.

6. The Proposed Transaction will not hinder rivals' ability to compete

6.1 The LOUI records that the Commission is continuing to explore:

(a) the impact on Vodafone's competitors in the event that they were to lose scale as a result of the Proposed Transaction; and

(b) whether this could result in higher prices with the Proposed Transaction compared to the counterfactual (and therefore whether there could be said to be a substantial lessening of competition).

6.2 These are critical to a theory of harm based on alleged incentives to foreclose content to rival RSPs. Without this there can be no substantial lessening of competition for Commerce Act purposes. In light of this, it is telling how little third parties have submitted about any potential effects on the ability of rivals to compete in telecommunications markets. Rivals who are genuinely concerned about their ability to compete post-merger should be in a position to submit evidence as to the impact of reduced scale *on their ability to compete effectively*. If such evidence stood up to scrutiny, they should have every incentive to make it available to the Commission, and yet they have not done so. (If they have, then it is important that Vodafone or its external advisers be able to test that.)

6.3 In Vodafone's view, this is because (given market conditions in New Zealand, underpinned by the regulatory framework), just as is the case today, rivals will continue to be competitive in the relevant telecommunications markets irrespective of:

(a) scale (which is unlikely to be substantially affected by the Proposed Transaction); and

(b) whether they include SKY in their bundles (which none do today).

The limited arguments to the contrary have no substance for the reasons set out below.

6.4 Concerns that the Proposed Transaction will reduce competition between competing bundles containing SKY content are dealt with above in relation to the counterfactual and in NERA's report on the LOUI. Simply put, consumers are all different and attracted to different features (with price being the primary feature for most consumers). Competition in the relevant telecommunications markets in New Zealand is not driven to a large extent by availability of content bundles, but by a very broad range of features. This will continue in the future.

Perpetual

6.5 Vodafone agrees with Perpetual, which states in its submission that "[w]e believe [the Proposed Transaction] will be additive to innovation/competition of both content and delivery ultimately benefitting the New Zealand consumer who will experience a broader set of differentiated and tailored options. With the proliferation of content and platforms, combined with increasing network availability, the companies who do this best will win."

B Howell and P Potgieter

Vodafone agrees with Howell and Potgieter that the Proposed Transaction will not foreclose competitors, regardless of their scale. If that were possible it would have already occurred.

> "If foreclosure due to the compelling price advantages of the content and internet bundle was inevitable, then it would be expected that all rational Sky customers who also purchase broadband internet access would already be customers of Vodafone fixed line broadband. That is, foreclosure in fixed line broadband access markets would have already occurred. "

2degrees

6.6 The 2degrees submission is notably silent on this aspect of the LOUI (putting aside its arguments on the "enthusiastic wholesaler counterfactual" which we refer to above). This is consistent with Vodafone's arguments in response to the LOUI that any loss of scale (which is denied) would not affect 2degrees' competitiveness. It is also consistent with the statements in the 2degrees investor materials, as described in Vodafone's response to the LOUI (see section 24) including:

> "Access to the fixed market, with massive headroom to grow share"
>
> "Low CAPEX investment due to government-supported infrastructure enables opportunity to scale across the country"
>
> "AQX / Trilogy believe that each of 2degrees and NuevaTel occupy favorable positions within their respective markets. Each operates in an attractive, stable three player market; has meaningful market share; is poised to benefit from the switch from voice to data usage; has the opportunity to grow through ancillary businesses; has demonstrated significant profitability; is benefitting from recent capital investments; and owns its own infrastructure.
>
> "Trilogy management believes both its New Zealand and Bolivian subsidiaries will deliver substantial growth over the coming years. In New Zealand, this growth is expected to come from (i) continued market share and post-paid subscriber growth, (ii) expanded bundled solutions to target the previously underserved business segment, and (iii) cross-selling fixed solutions to the existing mobile subscriber base."

6.7 AQX/Trilogy has made these statements in the full knowledge of the Proposed Transaction, and will have been fully substantiated according to strict legal requirements not to mislead the market. AQX/Trilogy's expectation of substantial market share growth is directly contrary to any foreclosure theory of harm.

Fetch TV

6.8 Fetch TV (at page 1) notes that the merged entity's bundled offer will be "highly attractive to the consumer […], will drive customers to the merged entity and which will result in a substantial lessening of competition in the market for residential fixed line broadband services and by extension, mobile services." Providing attractive products in an attempt to win customers is the very essence of competition. Competition law exists to protect the competitive process, not individual competitors. Fetch TV does not provide a cogent argument why offering a more attractive offering to consumers would give rise to an SLC.[11]

Internet NZ

6.9 Internet NZ does not engage on the Commission's analysis of the effect of the Proposed Transaction on competitors' scale. Rather, it sets out its view that "innovative uses of UFB and RBI are less likely" as a result of the Proposed Transaction. As Vodafone has previously submitted to the Commission, the aim of the Proposed Transaction is completely the opposite. Vodafone expects its use of technology to further drive competition and innovation.

[11] Vodafone also refers to its response to the third party submissions in relation to the issues that Fetch raised in that context that it is "re-emphasising" in this submission.

Spark

6.10 Spark makes a number of claims in the Executive Summary of its submission that the Proposed Transaction will:

(a) weaken effective competitors, cause fledgling competitors to lose scale and likely exit and reduce innovation, investment and dynamic efficiency (para 7); and

(b) reduce competitors' ability to invest in assets and services that will provide a competitive constraint over the merged entity (para 8).

6.11 However, these statements are not substantiated at all in the body of its submission, either through provision of evidence or substantive engagement in the issues. To the extent that these issues are (obliquely) referred to in the overseas materials and New Zealand cases that Spark refers to, there is no attempt to apply this to the situation in the New Zealand market. For instance, it does not submit at all on the key features of the New Zealand market such as structural separation.

6.12 The failure to engage on this point is telling. In Vodafone's view, this is likely because Spark is unable to evidence this critical aspect of the theory of potential competitive harm can be made out with reference to specific conditions that exist in downstream telecommunication markets in New Zealand.

6.13 Spark is the largest telecommunications provider in New Zealand. As recently as 4 November 2016 Spark has described the substantial investments it continues to make in infrastructure, with its Chairman stating:

> "Operationally we have continued to invest in data network and digital service leadership, expanding our 4G mobile network, commencing a new international cable build, investing in data and Cloud advantages and completing a major upgrade of customer IT systems. At the same time we have rapidly expanded the availability of our music, video and big data analytics services, with very strong customer uptake."

6.14 Spark explains nowhere how it would be inhibited from continuing to make such investments in the future should the Proposed Transaction proceed. Indeed, this is at odds with statements by Spark CEO, Simon Moutter that Spark is well placed has to compete with the merged entity. During an earnings conference call of 17 August[12], Mr Moutter stated:

> "we have been competing with Vodafone and Sky operating as a pretty tight team. They might not be married yet but certainly living in sin. And we are holding our own. So we feel like we're in good shape."

6.15 Given the substantial market share advantage that Spark currently enjoys in broadband, together with revenues and fixed connections that substantially exceed Vodafone's, there is no credible basis upon which to argue that the merger will have any impact on Spark's ability to continue competing against the merged entity.

Trustpower

6.16 Trustpower notes that "to establish an ISP that has the ability to operate at the scale required to be able to compete with incumbents requires a multi-million dollar up-front investment" and that the "merged entity will make these scale problems substantially worse, if not fatal for RSPs, and deter new entry." Trustpower fails to provide any evidence of how the merged entity will make the alleged "scale problems" substantially worse. In contrast, NERA sets out why sunk costs (which have already been made by a large number of competitors) do not affect their competitiveness and that the Proposed Transaction could not affect rivals' marginal costs in any material way. Trustpower, like other third parties, does not engage on these critical distinctions.

6.17 Furthermore, Trustpower's own experience in the broadband market is contrary to its assertions of these "scale problems". Trustpower recently boasted it was "potentially the fastest growing"

[12] From Seeking Alpha, automated transcript of Earnings Conference Call, August 17.

telecommunications provider despite only having approximately 50,000 customers.[13] It has grown from approximately 18,000 broadband connections in October 2014 to over 60,000 in September 2016 through profitably bundling broadband, power and gas.[14] Trustpower's broadband presence enables it to reduce churn and target high value customers. There is no indication that growth is stagnating.[15]

6.18 Unlike the other opposing submitters, Trustpower does seek to describe certain categories of costs that it considers would be more challenging to cover if it were to lose scale. However, as above, it has started out at much smaller scale than it is now and yet has managed to incur these costs and profitably grow. When the specific cost measures are assessed, it is clear that scale is not a relevant issue for the likes of Trustpower or other TSPs.

(a) **Marketing costs:** as set out in Vodafone's response to the LOUI (para 20.3), marketing costs are readily scalable and can be targeted at specific groups/demographics of consumers or geographic areas. Furthermore, like many other broadband suppliers who also supply other products, Trustpower's marketing costs are shared to a large extent between its different businesses.

(b) **Acquisition costs (including modems/routers):** these costs are entirely scalable by customer number (while some efficiencies may accrue for bulk purchases, these will not be material).

(c) **Operations and Business Support Systems:** like marketing costs, these costs are scalable. Indeed, the fact that there are 90+ RSPs of different scale and each of which will require such systems, it is clear that such costs are not a disproportionate burden on smaller providers. In any event, like other multi-product providers, Trustpower would have many of the key components (such as customer and billing platforms) as part of their electricity business.

(d) **Aggregation network infrastructure:** Vodafone understands that Trustpower is referring to infrastructure associated with copper unbundling. Again, this is scalable, represents a very small proportion of overall cost and is of limited relevance to competition going forward.

TVNZ

6.19 TVNZ does not address the Proposed Transaction's effect on competitors' scale. It instead focuses on claims that the Merged Entity will damage the FTA and Pay TV markets. These issues are not relevant to the Proposed Transaction.

7. Arguments of switching by "high ARPU customers"

7.1 Associated with the previous two issues (customer switching and scale) is the argument that the customers that the merged entity would expect to switch are "high ARPU" customers. Opposing submitters claim that, as a result, the effect of customer losses will be compounded due to a disproportionally high loss of revenue from these departing customers.

7.2 Once again, these claims are made without any evidence. In fact, the evidence shows they are without foundation:

(a) no third parties have offered evidence that the SKY customers who are expected to switch to the merged entity's broadband products are "high ARPU" customers. The claim appears to be premised on nothing more than claiming (without evidence) that if you subscribe to SKY you will also consume a lot of telecommunication services;

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[13] Trustpower submission to the Commission on the Section 30 Review of the UBA Standard Terms Determination, May 2016. .

[14] Interim results investor briefing, 7 November 2016.

[15] Interim results investor briefing, 7 November 2016.

(b) even if this was the case, a high ARPU customer is not necessarily the same as a highly profitable customer. A high ARPU customer is one who takes a higher value service, which is likely to cost more to produce; and

(c) in any event, the analysis in the NERA report, based on actual consumer data, directly contradicts this assertion.

7.3 Finally, as noted by Howell & Potgieter, consumer telecommunications products make up only a proportion of the markets. The graph below shows that a large proportion **[REDACTED]** of telecommunications revenue is attributable to revenue from enterprise customers and could not be affected by the Merged Entity's ability to bundle SKY/telecommunications products to consumers.

[REDACTED]

8. **Submissions of Wigley & Co, Russell McVeagh, Minter Ellison and Covec**

8.1 Third parties' counsel and economic consultants have prepared submissions following their review of information confidential to the parties. These submissions set out a number of assertions, including that **[REDACTED]**. These assertions are baseless. The Commission has access to all relevant information and can assess this for itself.

8.2 Accordingly, Vodafone does not seek to address each of these assertions, but rather two central themes of these submissions relating to:

(a) the accuracy of NERA's statement that "The Covec report builds up its counterfactual from an assumption that Sky gain most revenue synergies through "upselling" Sky to Vodafone's existing customer base. However, this is not correct..."; and

(b) the level of market share uplift anticipated by the parties in the synergies documents.

8.3 In relation to the former, NERA's statement is correct. **[REDACTED]**

8.4 In relation to the latter, third parties initially based their submissions on assertions that the expected revenue synergies could not be achieved without foreclosure of rivals. For example, Spark in its 12 August submission stated: "Spark does not have access to Sky and Vodafone's internal data, its expectation is that a significant proportion of the $435m in claimed merger revenue synergies will arise from pursuing an input foreclosure strategy. Spark cannot see where else an additional $435m of revenue could come from in the context of the pay TV market, where Sky is already leveraging its market power to the greatest extent permissible, and the broadband / mobile markets, which are currently highly competitive with low margins." Having seen the synergy workings, the advisors of these third parties now **[REDACTED]**

8.5 **[REDACTED]** Vodafone has provided extensive evidence of the rigorous process behind the synergies calculations, which formed part of the investor materials. Calling into question the outcome of this process **[REDACTED]**.

9. **Other matters**

9.1 Third party submitters have raised a range of other matters that Vodafone views as not having any material bearing on its Clearance Application, but to which it responds for the record. If the Commission is minded to place any weight on the other matters raised by third parties for the purposes of assessing Vodafone's Clearance Application, we request the Commission advise the parties of this so that we may understand, and adequately respond to, the Commission's concern(s).