Cross-submission to the Commission by Trustpower following the LOUI

23 November 2016

Public version (there is no confidential version)

Trustpower Limited welcomes the opportunity to provide this cross-submission to the Commerce Commission in relation to the clearance application by Vodafone and Sky.

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1. Introduction and Summary

Applicants do not address evidence as to future market and technology changes

1.1 The applicants' submissions expand on their approach of relying on evidence from what is happening in the current markets to derive conclusions as to the market and technology conditions in the future. Submissions and evidence by opposing parties as to likely future market and technology circumstances are mostly not addressed in the applicants' submissions to the Commission.

1.2 Additionally, that approach of relying on the status quo to predict the future, is contrary to the applicants' approach in other material such as in the Explanatory Memorandum for Sky shareholders and board on the merger decision, the Vodafone Group 2016 annual report, and statements to other regulators. Similarly, it is contrary to the Grant Samuel independent report on the merger.

1.3 Ultimately the issue before the Commission is about the merged entity's *ability* and *incentive*, giving rise to potential substantial lessening of competition (SLC). There is a *"real chance"* (or *"real and substantial risk")* of SLC, which is how the courts frame the test.

1.4 That there would be a *"real chance"* of SLC is demonstrated by what the applicants have said elsewhere when directly addressing further market and technology conditions. It is also demonstrated by the fact that the applicant, Vodafone Europe BV, is providing some of the services overseas, in circumstances which do not appear to be distinguishable, that their submissions indicate would not happen here.

1.5 In summary, the most relevant material for assessing the factual and the counterfactual is in the material available from the applicants is in the documents noted above.

SLC in all contended counterfactuals

1.6 The debate continues between whether one counterfactual or another applies, with the applicants continuing to contend that the counterfactual entails wholesaling at ECPR rates. We submit, however, that this debate should not submerge the point that, in all counterfactuals, whether put forward by the applicants or opposing parties, there is a real chance of SLC, comparing the factual with those counterfactuals.

Other points

1.7 We address other issues arising from the applicants' submissions, and conclude:

a) Fibre unbundling in 2020 is not relevant;

b) Foreclosure does not need to force a competitor, or competitors, to exit the market to have the effect of SLC;

c) We address margin squeeze and related issues, from both price and non-price perspectives;

d) We also address the "like for like" issue that has been raised.

1.8 We note that:

a) Link Economics address issues relating to competition in the telecommunications markets and as to scale;

b) A number of legal issues are dealt with in the Wigley & Company memorandum;

c) We understand that InternetNZ are addressing the merged entity's ability and incentive to leverage Sky content into the mobile market.

2. A pragmatic overview

2.1 In their 11 November submissions, the applicants have gone substantially further in relying on the status quo circumstances to show what the future will be. NERA also continues to rely on the status quo, such as current market experience of Vodafone and Sky, as shown by market surveys and Vodafone's customers' current data use.

2.2 Submissions by other parties that raise well known points as to major changing market and technology circumstances, making the status quo largely immaterial for the assessment, are not answered by the applicants or their expert, NERA. That includes straightforward points such as that a bundle of standalone satellite content, separate from fixed line and mobile,[1] is largely irrelevant to assessing market conditions where new transmission channels (such as UFB) become central. For that reason, integrated and seamless bundles over the same transmission path become central. Because the Sky service is currently delivered by satellite (with some limited online functionality) and the other services are delivered over different telecommunications paths, that is a substantially different proposition from the delivery paths going forward.

2.3 For example, a clear point is that the current levers to compete as to Sky and Vodafone bundles are limited largely to price, as the components in the bundle are largely standalone. However, the integrated and seamless bundles of the future enable multiple ways of differentiating, including by non-price levers.

2.4 All that is well known. Such convergence paths are dominating the discussions here and internationally. But there are many more relevant market changes besides, such as declining Sky customer numbers.

2.5 One would have little idea of the above – such as the major market and technology changes during the factual and counterfactual periods – from reading what is in the applicants' submissions, apart from relatively brief mention in the original applications as to some market changing conditions.

2.6 However, one would know it though from reading what the applicants say to each of their groups of shareholders, from what Grant Samuel, Sky's expert, tells the market, and from what Vodafone tells other regulators.

3. Illustration of the problem as to focus on the status quo

What Vodafone said to the Commission

3.1 We will give an example of that problem where what Vodafone stated to the Commission appears to be irreconcilable with its statements elsewhere. The applicant, Vodafone Europe BV, Vodafone Group's main holding company for trading companies such as Vodafone NZ, states in its 11 November submission to the Commission:[2]

> "…the merged entity will not be able to leverage SKY content to switch substantial numbers of customers to the merged entity's broadband."

[1] This does not apply to the limited HFC footprint
[2] Vodafone 11 November submission at Para 1.6

[Because online uptake to date of SKY is very small] "...the evidence strongly suggests that SKY content is unlikely to increase in importance as a driver of broadband uptake in the future."

What Vodafone said to its shareholders

3.2 But the Vodafone Group 2016 annual report appears to state to the contrary,[3] in addressing global operations including New Zealand:

> "Television and content, when bundled with broadband, are becoming increasingly important drivers of customer demand."
>
> "We're aiming to expand our TV services, to support the take up of broadband. We already have TV services in seven markets."

3.3 The Vodafone Group annual report of what it is doing internationally presents a different world across the board around where content and telecommunications services are headed generally, from what the applicants are submitting, and the NERA reports are addressing.

What Vodafone said to other regulators

3.4 As an example of what Vodafone has said to other regulators, Vodafone stated to Ofcom what it is submitted is the contrary of what Vodafone is saying to the Commission as quoted above that is happening when Vodafone is seeking the opposite outcome from what it seeks here., In a passage that is directly applicable here, despite Vodafone's earlier assertions to the contrary (highlighting added):[4]

> "The advent of new fibre networks also means that the technology does not define the service a customer receives any more. Instead services such as pay TV can be provided over a variety of platforms whether satellite, cable, fixed or mobile broadband. **As consumers are increasingly attracted to bundled offers of TV, broadband, fixed and mobile voice services, the control of that exclusive content will increasingly steer their overall purchasing decisions.** Therefore, exclusive 'must have' content is no longer just a TV issue, but impacts across the whole of the £43bn telecommunications and TV market… **Ignoring the effects of 'key content' across wider and traditionally unrelated markets, such as mobile or broadband only customers, will have an enduring and irreversible effect, as the focus moves to TV bundled competition."**

What Vodafone and Sky say to Sky shareholders

3.5 In its Explanatory Memorandum (EM) to shareholders, Sky (and Vodafone, for as they say, Vodafone has legal obligations to ensure accuracy and validity in the EM[5]) appear to present a substantially different world from that outlined to the Commission in the applicants' submissions and the NERA report, with their strong focus on the status quo continuing.

3.6 In the EM, there is much focus on the major changes, opportunities and challenges in the future, such as UFB opportunities/threats, integrated and seamless bundles across content, mobile and fixed line, etc.

[3] Vodafone Group PLC, Annual Report 2016 (17 May 2016) at page 12
[4] Vodafone response to Ofcom's consultation: Strategic Review of Digital Communications discussion document (8 October 2015) (https://www.ofcom.org.uk/__data/assets/pdf_file/0025/45934/vodafone.pdf) at pp 2-3, 8-9
[5] Vodafone 11 November submission at Para 17.4

What Grant Samuel says to Sky shareholders

3.7 The Grant Samuel report and the summary letter dated 10 June 2016 do likewise, with extensive reference to the future market conditions and technologies, and the associated opportunities and threats if the merger goes ahead and if it does not. There appears to be a difference between what the applicants are telling the Commission (where they are firmly rooted in submitting that the future for factual and counterfactual purposes is to be assessed based mostly on the status quo).

3.8 For example, as Grant Samuel note in their summary letter to shareholders dated 10 June 2016:

> "The Proposed Transaction is a response to a fundamental deterioration in Sky TV's strategic position"
>
> **"The Proposed Transaction will be transformational for Sky TV.**
>
> Globally, technological developments have driven a growing convergence of the telecommunications and video entertainment sectors. In response to both the competitive threats and the opportunities resulting from this convergence, sector participants have generally sought to build capabilities to deliver a broader suite of telecommunications, internet and video services, whether organically, through acquisitions or by alliance. The Proposed Transaction will in a single step transform Sky TV's competitive position in the New Zealand market. The Combined Group will be the only participant with meaningful positions across all relevant market sectors. It will have market leading positions in the mobile telephony and video entertainment sectors and strong fixed line broadband and telephony businesses. [It will hold] the leading portfolio of video content (including rights to all the most popular New Zealand sports)… It will be well positioned to take advantage of the opportunities afforded by the roll-out of the ultra fast broadband ("UFB") network across New Zealand.

3.9 And, in a passage from the same summary letter which also points firmly away from the relevance of the status quo, Grant Samuel say:

> "The Combined Group will be able to sell bundled fixed line and mobile, pay television and internet packages more effectively than either business under the existing alliance arrangements. Subscribers for these bundled packages are typically much "stickier" than subscribers to a single product (e.g. pay television or mobile phone)…"

3.10 In conclusion, the most relevant material for assessing the factual and the counterfactual, in the material available from the applicants is in the documents noted above.

4. Margin Squeeze and related issues

4.1 The applicants submit that a price increase in standalone Sky is unlikely to occur, which would have the effect of encouraging uptake of the merged entity's bundles. ECPR pricing likely follows retail pricing, dependent on treatment of bundle pricing.

4.2 Focussing first on the price dimension, a vertical margin squeeze (a better descriptor than price squeeze for the same concept) relates not to the absolute price points as between wholesale and retail, but rather the *difference* between the price points.[6] The squeeze can be

[6] *Albion v. Water Services Regulation Authority and Dŵr Cymru* [2006] CAT 36

achieved by moving any of the price points (wholesale, standalone retail and/or retail bundle prices).

4.3 Particularly significant in this instance is the ability to create a squeeze or other anti-competitive outcome by way of non-price levers, as has been submitted. The merged entity can supply a substantially different service to its own customers, with all the emerging opportunities including over the integrated paths, from what it supplies at wholesale. Or the retail bundle can include non-price benefits that are not in the standalone retail product. A simple example is having HD in one service and SD in another retail or wholesale service (although the HD/SD split is a relatively rudimentary example of what can be differentiated going forward).

5. Market exit is not required for substantial lessening of competition

5.1 In its 11 November report, NERA said when claiming that an increase in marginal cost is not sufficient to create competitive harm, and that only exiting the market will do:[7]

> Regarding the sub-scale issue, the literature actually says that the rivals would need to be pushed out of the market. For example, Carlton Greenlee and Waldman (2008, 618 – 619) state:
>
> > It is not enough to show that the rival firm was "foreclosed" from some customers or that it was foreclosed from a substantial share of them. The key to establishing competitive harm is showing the foreclosed business left insufficient scale for the firm to remain in business…

5.2 The above conclusion is the basis, for example, for the NERA submission on sunk cost being irrelevant to exit decisions.

5.3 However, that selection of a quoted passage from Carlton et al is contrary to the overall approach in their article, and also directly contrary to the words immediately before and after that quote. Those words are added in bold around the quote used by NERA above and show that, contrary to the NERA contention, market exit is not a required condition:

> **"Thus, this instruction is consistent with our approach only if "substantially foreclose" is interpreted to mean something like "deny enough of the market to drive the competitor out of business or raise its marginal cost."** It is not enough to show that the rival firm was "foreclosed" from some customers, or that it was foreclosed from a substantial share of them. The key to establishing competitive harm is showing that the foreclosed business left insufficient scale for the firm to remain in business **(or the denied scale led to increased marginal cost)."**

5.4 The conclusion is also inconsistent with the Commission's Merger and Acquisitions Guidelines (highlighting added):[8]

> 5.9 The ultimate question is whether the competition lost from potentially foreclosed competitors is sufficient to have the likely effect of substantially lessening competition in light of the remaining competitive constraints.
>
> 5.10 A substantial lessening of competition may arise where foreclosure makes entry and expansion more difficult, or otherwise reduces a competitor's (or competitors') ability to provide a competitive constraint. **Foreclosure does not**

[7] NERA Report 11 November at Para 16
[8] Footnote omitted

need to force a competitor, or competitors, to exit the market to have this effect.

6. Fibre unbundling

6.1 The applicants and NERA refer to fibre unbundling in 2020 as a main concern of the Commission in relation to this application.

6.2 That seems unlikely for three reasons (even though there have been information requests on fibre unbundling):

a) The point is not mentioned in the LOUI nor can it be inferred;

b) 2020 is well outside the relevant period for counterfactual analysis. As the Commission's Merger and Acquisitions guidelines confirm, that is normally around 2 years (extended to 3 years in *NZ Bus*);

c) This is a good example of why the analysis does not extend so far. Market conditions in 2020 are too speculative and uncertain to predict for multiple reasons, one of which is that fibre unbundling is dependent on regulatory decisions on pricing for which neither Act nor Commission determination are in place. That is a controversial issue.

7. "Like for like" bundles

7.1 NERA raises the concern that the LOUI refers to the objective of homogenous bundles ("like for like" in the words of the LOUI) being available from competitors in the counterfactual, when that would not happen in the factual.

7.2 They rightly point out that heterogenous offerings (i.e. differentiated offerings), not "like for like", should be the objective.

7.3 It is submitted that the appropriate way to address this issue is, instead, that Sky's premium content is a key input into service offerings by competitors, who can choose to use that key input as part of differentiated (or the same) service offerings.