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Statement of Preliminary Issues

Connexa and 2degrees

26 January 2023

Introduction

1. On 17 December 2022, the Commerce Commission registered an application (the Application) from Connexa Limited (Connexa) seeking clearance to acquire certain passive mobile telecommunications infrastructure assets of Two Degrees Networks Limited and Two Degrees Mobile Limited (2degrees) (the Proposed Acquisition).[1]

2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **13 February 2023**.

5. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

6. Connexa is owned 70% by the Ontario Teachers' Pension Plan Board (OTPP) and 30% by Spark New Zealand Trading Limited (Spark). Following an acquisition in October 2022, Connexa owns almost all of the passive mobile telecommunications assets previously owned by Spark. Connexa now provides passive infrastructure services to Spark under a long-term contract.[3]

7. 2degrees is a New Zealand telecommunications service provider and, along with Spark and Vodafone, is one of three mobile network operators (MNOs) in New Zealand. It is ultimately owned by Macquarie Asset Management and Aware Super Pty Ltd, as trustee for Aware Super.[4]

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[1] A public version of the Application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

[2] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

[3] The Application at [2] and [23]-[24].

[4] The Application at [40].

8. With the Proposed Acquisition:[5]

   8.1 Connexa would acquire assets including leases, licences and other property rights, as well as infrastructure located on 2degrees' sites such as towers, masts, poles and fences;

   8.2 Connexa and 2degrees would enter into a long-term agreement under which Connexa would provide infrastructure services to 2degrees;[6] and

   8.3 Spark's ownership stake in Connexa will reduce to 17% and OTPP's stake will increase to 83%.

Our framework

9. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[7] As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

10. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[8] This allows us to assess the degree by which an acquisition might lessen competition.

11. If the lessening of competition as a result of an acquisition is likely to be substantial, we will not give clearance.

Relevant background

12. The Proposed Acquisition is part of a trend in New Zealand and overseas for MNOs to sell their passive mobile telecommunications infrastructure assets to specialist asset/mobile tower management companies (often referred to as TowerCos).[9] In 2022 in New Zealand:[10]

    12.1 Spark sold a majority stake in its passive infrastructure assets to OTPP (creating Connexa); and

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[5] The Application at [3] and [19]-[20].

[6] Connexa and 2degrees would enter into this long-term infrastructure services agreement in connection with the Proposed Acquisition, should the Commission grant clearance for the Proposed Acquisition. In assessing the Proposed Acquisition, we will consider the likely impact of this services agreement (and any other agreements) that Connexa and 2degrees would enter into in connection with the Proposed Acquisition. However, we note that Connexa and 2degrees are not seeking clearance or authorisation for this services agreement (or any other agreement entered into with the Proposed Acquisition). Any clearance that the Commission may give would be for the acquisition of the subject assets (being the passive mobile telecommunications infrastructure assets) only.

[7] Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019.

[8] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

[9] The Application at [4].

[10] The Application at [4] and [91]-[92].

12.2 Vodafone New Zealand Limited (Vodafone) sold a majority stake in its passive infrastructure assets to two parties, InfraRed Capital Partners and Northleaf Capital Partners, creating Aotearoa Towers Group LP (trading as FortySouth).

13. As part of the sale of their passive infrastructure assets, Spark and Vodafone each entered into long-term service agreements under which Connexa and FortySouth provide passive mobile infrastructure services to Spark and Vodafone respectively.

14. 'Passive' mobile telecommunications infrastructure comprises the structures capable of hosting 'active' telecommunications assets. Such assets can include underlying land interests, as well as physical structures such as towers, poles and fencing, as well as power systems and electricity connections. In contrast, 'active' infrastructure is the infrastructure on which MNOs run their mobile networks including antennae, cabinets, radio units, backhaul electronics and electricity meters.[11]

15. TowerCos like Connexa and FortySouth own, manage and invest in passive mobile telecommunications infrastructure assets, providing MNOs and other parties with access to those assets.[12] In addition to Connexa and FortySouth, other organisations in New Zealand also own infrastructure that is, or can be used as, passive mobile telecommunications infrastructure.[13]

16. Connexa and FortySouth each have long-term agreements with MNOs to provide infrastructure services (referred to by Connexa as MISAs). Specifically:[14]

16.1 Spark and Connexa have entered into a long-term Master (or Mobile) Infrastructure Services Agreement (MISA) for an initial period of 15 years;

16.2 Vodafone and FortySouth have entered into a long-term master services agreement for an initial period of 20 years; and

16.3 with the Proposed Acquisition, 2degrees and Connexa would enter into a long-term MISA for an initial period of 20 years.

17. After completion of the Proposed Acquisition, Connexa would own passive mobile telecommunications infrastructure assets at approximately 2,367 sites (being 1,243 existing sites acquired from Spark and 1,124 sites of 2degrees), compared to the estimated 1,484 sites of FortySouth.[15]

Market definition

18. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately

[11] The Application at [55] and [57].
[12] The Application at [48].
[13] The Application at [104].
[14] The Application at [19.1], [24] and [92].
[15] The Application at Appendix 7 and NERA Report (for Connexa) at Table 3.1.

determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[16]

19. Connexa submits that the markets relevant to our assessment of the Proposed Acquisition are:[17]

19.1 in terms of passive mobile telecommunications infrastructure services provided by TowerCos, wholesale markets for:

19.1.1 the national supply of MISAs to MNOs;

19.1.2 the local supply of sites not covered by MISAs with MNOs (ie, MNOs excess demand); and

19.1.3 the national supply of passive mobile infrastructure services to non-MNO customers;[18] and

19.2 the national market for the retail supply of mobile services.

20. We will consider whether these are the appropriate markets for assessing the competition effects of the Proposed Acquisition.

Without the Proposed Acquisition

21. Connexa submits that, absent the Proposed Acquisition, there is a real chance that 2degrees would sell its passive mobile telecommunications infrastructure assets to an independent third party. In such a counterfactual, Connexa submits that the assets of all three MNOs in New Zealand (Spark, Vodafone and 2degrees) would be majority owned by parties with no involvement in downstream market for the retail supply of mobile services.[19]

22. We will consider what 2degrees would do if the Proposed Acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or something other than the status quo.

Preliminary issues

23. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in any relevant markets by assessing whether any horizontal unilateral, vertical or coordinated effects might result from the Proposed Acquisition. The questions that we will be focusing on are:

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16 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

17 The Application at [10] and [115]-[151].

18 Non-MNO customers generally comprise of organisations that require access coverage and capacity for their services or internal needs. They use passive mobile telecommunications infrastructure to host their own communications equipment. Non-MNO customers comprise government entities, broadcasters and private entities. The Application at [151] and NERA Report at [41].

19 The Application at [7]-[8], [111] and [113].

23.1 unilateral effects: would any loss of competition with the Proposed Acquisition enable the merged entity to profitably raise prices or reduce quality or innovation by itself?[20]

23.2 vertical effects: would the Proposed Acquisition give the merged entity or Spark (as a shareholder of Connexa) the ability and incentive to foreclose rivals?

23.3 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

24. This assessment is forward-looking. It will recognise that the state and conditions of competition now may not be reflective of conditions in the future. We note that the timeframe for our assessment in this case may be longer than two years, given the length of contracts that the MNOs have entered into, or propose to enter into, with TowerCos.

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

25. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged entity can profitably increase price above the level that would prevail without the merger or acquisition without the profitability of that increase being thwarted by rival firms' competitive responses.[21]

26. Connexa submits that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects. It submits that:[22]

26.1 FortySouth will remain an alternative available for Spark and 2degrees with the Proposed Acquisition and Connexa will remain an alternative for Vodafone;

26.2 the pricing outcomes where two TowerCos compete (which would result with the Proposed Acquisition) are unlikely to be materially different from the outcomes where three TowerCos are competing in the counterfactual;

26.3 Connexa is incentivised to maximise co-location of equipment on assets,[23] by offering competitive pricing and services to all customers (including existing MNOs and new entrant MNOs);

26.4 each of the MNOs will have a long-term agreement in place with a TowerCo (which they have negotiated from a position of significant bargaining leverage) that will protect them as customers. However, each MNO retains an

[20] For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition (ie, it could increase quality-adjusted prices).

[21] Commerce Commission, *Mergers and Acquisitions Guidelines*, above n7 at [3.62].

[22] The Application at [10.2]-[10.5], [153], [155]-[157], [218], [220], [238] and [241] and NERA Report at [76].

[23] Co-location is the practice of placing more than one tenant's active infrastructure on a single passive site.

ability to bypass supply of a site from its contracted TowerCo by contracting another TowerCo (including a new entrant) for some sites or self-supplying some sites, which gives MNOs significant countervailing bargaining power to ensure competitive terms for all sites;

26.5 non-MNO customers are unlikely to be impacted by the Proposed Acquisition, as they have a broader set of options for their infrastructure needs;

26.6 there are limited barriers to entry or expansion, and other TowerCos can easily expand or enter the market; and

26.7 competition to supply passive mobile telecommunications infrastructure services has no material impact on downstream competition for the retail supply of mobile services.

27. Connexa further submits that rather than substantially lessening competition, the Proposed Acquisition would, by consolidating the assets and requirements of Spark and 2degrees, enhance the efficiency benefits of independent TowerCos and is likely to be pro-competitive due to the potential for increased co-location.[24]

28. We will consider:

28.1 closeness of competition: the degree of constraint that Connexa and 2degrees (or any third-party owner of 2degrees' assets in the counterfactual) impose, or would impose, upon one another. To the extent that any constraint is, or would be, material, we will assess whether competition lost with the Proposed Acquisition could be replaced by rival competitors;

28.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;

28.3 entry and expansion: how easily rivals could enter and/or expand; and

28.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

Vertical effects: ability and incentive to foreclose rivals

29. A merger or acquisition between parties who operate in related markets can result in a substantial lessening of competition due to vertical effects. This can occur where a merger or acquisition gives the merged entity (or a related entity) a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as 'foreclosing rivals').[25]

30. Connexa submits that the Proposed Acquisition would not be likely to substantially lessen competition due to vertical effects. It submits that Spark's limited shareholding in Connexa would not provide it with the ability or incentive to foreclose competitive

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[24] The Application at [153].

[25] Commerce Commission, *Mergers and Acquisitions Guidelines*, above n7 at [5.1]-[5.5].

access to passive mobile telecommunications infrastructure by other MNOs, noting that passive mobile telecommunications infrastructure costs are a small input cost for MNOs.[26]

31. We will consider whether the Proposed Acquisition would give the merged entity or Spark (as a shareholder of Connexa) the ability and incentive to foreclose rivals from accessing passive mobile telecommunications infrastructure, and the likely effect of any foreclosure.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

32. A merger or acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[27]

33. Connexa submits that the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects. It submits that the relevant markets for passive mobile telecommunications infrastructure services in which TowerCos operate are not vulnerable to coordination and this would not change as a result of the Proposed Acquisition. It further submits that Spark's limited stake in Connexa would not provide opportunities for coordinated conduct with 2degrees in any downstream market for the retail supply of mobile services.[28]

34. We will assess whether any relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in any relevant markets so that coordination is more likely, more complete or more sustainable.

Next steps in our investigation

35. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **7 March 2023**. However, this date may change as our investigation progresses.[29] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

36. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

[26] The Application at [10.1] and [168]-[173].
[27] Commerce Commission, *Mergers and Acquisitions Guidelines*, above n7 at [3.84].
[28] The Application at [10.6] and [266]-[271].
[29] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.

Making a submission

37. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Connexa/2degrees" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **13 February 2023**.

38. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website. If you make a submission and we do not acknowledge receipt of that submission within two working days, you should resubmit your submission.

39. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.