

Determination

Vocus Communications Limited and M2 Group Limited [2015] NZCC 33

The Commission: Dr Mark Berry
Sue Begg
Pat Duignan
Dr Jill Walker

Summary of application: An application under s 66(3)(a) of the Commerce Act 1986, for Vocus Communications Limited (or an interconnected body corporate of Vocus) to acquire up to 100% of the shares and/or assets in M2 Group Limited (or any interconnected bodies corporate of M2).

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

Date of determination: 03 December 2015

Confidential material in this report has been removed. Its location in the document is denoted by [].

The proposed acquisition

Summary of the proposed acquisition

1. On 09 October 2015, the Commerce Commission (the Commission) registered an application under s 66(3)(a) of the Commerce Act 1986, for Vocus Communications Limited (or an interconnected body corporate of Vocus) to acquire up to 100% of the shares and/or assets in M2 Group Limited (or any interconnected bodies corporate of M2) (the application).

Our decision

2. The Commission gives clearance to the proposed acquisition, as it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

3. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.¹

The substantial lessening of competition test

4. As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.
5. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
6. We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the acquisition based on the information we obtain through our investigation and taking into account factors including market growth and technological changes.
7. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),³ or reduce non-price factors such as quality or service below competitive levels.
8. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.
9. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ Or below competitive levels in a merger between buyers.

define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.⁴

When a lessening of competition is substantial

10. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.⁵ Some courts have used the word ‘material’ to describe a lessening of competition that is substantial.⁶
11. There is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

The clearance test

12. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁷ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.⁸

Key parties

Vocus Communications Limited (Vocus)

13. Vocus is an Australian based provider of telecommunications services. In New Zealand, Vocus owns and operates a 4,200 km fibre-optic network and provides broadband, data and voice services. In its application, Vocus states that it is primarily focused on the provision of national and international backhaul services to large organisations and other telecommunication providers.⁹
14. In addition to its wholesale backhaul services, Vocus also provides consumer broadband services through the Maxnet and FYX brands, and business fixed line services to corporate and government customers.

M2 Group (M2)

15. M2 provides residential and commercial telecommunications services through the Slingshot, Orcon, 2talk, Flip and CallPlus brands. M2 provides business and

⁴ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁵ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁶ *Ibid* at [129].

⁷ Commerce Act 1986, section 66(1).

⁸ In *Commerce Commission v Woolworths Limited (CA)*, above n 2 at [98], the Court held that “the existence of a ‘doubt’ corresponds to a failure to exclude a real chance of a substantial lessening of competition”. However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

⁹ Backhaul is the term used to describe the transport of data between regional and national data aggregation points (such as telephone exchanges), and to the international gateways. Backhaul generally (but not always) involves the use of fibre optic cables.

residential internet and voice services, managed data services, and mobile phone services. M2 also provides wholesale telecommunications services.

With and without scenarios

16. To assess whether competition is likely to be substantially lessened in any market, we compare the likely state of competition with the acquisition to the likely state of competition without the acquisition.¹⁰

With the acquisition

17. With the acquisition, Vocus will acquire up to 100% of the shares and/or assets of M2. As a result, Vocus will become a vertically integrated company offering national and international backhaul services, residential and commercial fixed-line voice and broadband services, wholesale telecommunications services, and mobile phone services.

Without the acquisition

18. Absent the acquisition, we consider that the status quo would likely prevail.

Market definition

Our approach to market definition

19. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.
20. We define markets in the way that best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

Vocus' view of the relevant markets

21. In its application, Vocus has relied on the Commission's view of telecommunications markets in *Vodafone New Zealand Limited and TelstraClear Limited*.¹¹ In particular, Vocus has focused on the New Zealand markets for:¹²

21.1 business fixed-line services (including voice);

21.2 national backhaul services; and

¹⁰ Mergers and Acquisitions Guidelines above n 1 at [2.29]; *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

¹¹ Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33, available at <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/760>.

¹² Application, at [16] – [22].

21.3 international backhaul services.

The Commission's view of the relevant markets

22. The Commission last considered telecommunications markets in a merger context in *Vodafone New Zealand Limited and TelstraClear Limited* which cleared Vodafone New Zealand to acquire the shares and assets in TelstraClear Limited.
23. We consider that the markets identified in *Vodafone New Zealand Limited and TelstraClear Limited* remain relevant and are appropriate for considering the competitive effects of this proposed merger. We have not identified any significant changes in the telecommunications industry that would alter our assessment of the relevant markets.
24. In addition to the markets identified above, the Commission has also considered the impact of the merger on the supply of residential fixed line services (encompassing both broadband and voice services), and the supply of wholesale telecommunications services.

Residential fixed-line voice and broadband services

25. M2 is a significant provider of residential voice and broadband services through its Orcon and Slingshot brands. Vocus offers a residential voice and broadband service through its FYX and Maxnet brands. However, Vocus' residential market share is minimal, estimated to be around [] of residential connections.¹³ Accordingly, due to the minimal amount of aggregation, the Commission has not considered the residential voice and broadband market further.

Commercial fixed-line voice and broadband services

26. In *Vodafone New Zealand Limited and TelstraClear Limited*, the Commission did not come to a firm conclusion on whether business fixed line services should be delineated into separate markets for SMEs and large businesses, nor whether the individual services within the "business fixed line" banner should be further defined into separate markets.
27. In this case, if we were to segregate business fixed line markets into individual services, or by customer type, it would not capture all the overlap between Vocus and M2. We have therefore considered the impact of the merger on a broader, business fixed-line service market and focussed on the closeness of competition between Vocus and M2.

Wholesale telecommunications services

28. Both Vocus and M2 are active participants in the wholesaling of telecommunication services to internet service providers (ISPs) and other resellers.

¹³ Ibid at [11.5(b)].

29. Vocus, with its nationwide fibre backhaul network, predominantly offers national data transport to ISPs and large businesses. Vocus also offers data tails (local access connections between fibre and copper networks).
30. M2 focuses on the supply of wholesale voice and wide area network (WAN) services. M2 has an extensive network of unbundled exchanges throughout the country. In addition to its voice and WAN services, M2 resells some national backhaul and also offers a data tails product.
31. There is therefore potential overlap between the parties in the supply of wholesale data-tails and backhaul products.
32. Vocus has submitted that it is appropriate to consider each of the products offered at the wholesale level as forming a discrete market. We have not reached a firm conclusion on whether wholesale markets should be defined in this way; instead, we have focussed on those services where there is actual (or potential) overlap, namely in the supply of national backhaul, and the supply of data tails.

Conclusion on market definition

33. The Commission considers that the relevant markets are the New Zealand markets for the supply of:
 - 33.1 business fixed-line (including voice) services;
 - 33.2 national backhaul services; and
 - 33.3 data tails.

Competition analysis

How the acquisition could substantially lessen competition

34. There are two questions that we have focussed on when assessing whether the proposed acquisition is likely to substantially lessen competition in the relevant markets.
 - 34.1 Would the merged entity be able to raise prices or reduce quality in respect of the supply of business fixed-line (including voice) services, national and international backhaul, and data tails?
 - 34.2 Would the merged entity be able to raise its rivals' costs so as to render them less effective competitors?

The supply of fixed-line services to commercial customers

35. Table 1 outlines the market shares of those party's active in the supply of business fixed-line services, based on the number of connections.

Table 1: Business fixed-line service market share estimates

Party	Estimated number of connections to business premises	Estimated market share
Vocus	[]	[]
M2	[]	[]
Merged Entity	[]	[]
Spark	[]	[]
Vodafone	[]	[]
Other	[]	[]
Total	[]	100%

Source: Application.

36. Post-acquisition, the merged entity will have around [] of the total business fixed line services market. Vocus has submitted that it is focused on the provision of bespoke, enterprise solutions to large commercial and government customers, whereas M2 has a SME focus, providing “off the shelf” products to small and medium businesses.

Market feedback

[]

37. [] stated that it regularly comes up against Vocus in the large enterprise space and that they are a key competitor in that area. However, [] does not consider that Vocus is active in the supply of business fixed-line services to SME customers. [] also stated that while it sees M2 as a key competitor for residential and SME customers, they do not see them as a competitor to Vocus (or []) for large commercial/government customers.

38. [] considers that the two customer groups have quite different requirements.

38.1 Large commercial enterprises require bespoke, tailored solutions to a customer, often working in tandem with integrators and IT companies. Long sales cycle (6 – 18 months) including RFPs and tender processes. Customer will have an account manager dedicated to them.

38.2 SME – commodity products which are packaged and bundled to be simple and one size fits all. Sizeable customer management infrastructure (call centre, marketing etc) is required and branding is key.

[]

39. [] advised us that M2 provides very strong constraint in the SME and residential space but has limited impact in the large enterprise or government area. Like [] splits its residential/SME business from its enterprise business due to the differences in providing those products.

[]

40. [], a provider of business fixed line services, stated that it comes up against Vocus regularly in the large enterprise/government space and sees M2 as one of its key competitors in the consumer space. [] stated that it does not ever come across both of them at the same time.

Other parties

41. [], a large commercial customer of business fixed-line services, uses Vocus for the majority of its services and does not consider that M2 is a viable option for the services that [] requires.
42. [], another large commercial customer, agrees with Vocus' submission that Vocus and M2 are not close competitors in the business space, and considers that M2 and Vocus provide very different services.
43. [], a reseller of telecommunications products to commercial customers, stated that it does not see Vocus and M2 competing against each other for the same customers, as they offer completely different products.

Conclusion on business fixed-line services

44. We consider that Vocus and M2 are not close competitors for the provision of business fixed line services. They have different customer focuses and offer different services. Vocus focuses on the provision of backhaul and data network products to large corporate and government customers, while M2 is a voice focused business and targets SME customers.
45. Vocus does not have any plans to expand into providing business fixed-line services to SME customers, nor does M2 have plans to move towards supplying these services to large commercial or government customers.
46. Even assuming that Vocus and M2 do (or could) compete across both voice and network products, and across the SME and enterprise customer groups, they would continue to face strong competition from Vodafone and Spark, which together account for more than []% of the market, along with a number of smaller competitors.
47. We therefore do not consider that a substantial lessening of competition is likely in this market as a result of the merger.

Wholesale supply of fixed line services

48. The Commission's investigation has identified a number of parties who are active in the supply of wholesale telecommunications services generally, and in the supply of national and international backhaul, and data tails.
49. The key competitors active in this area are Spark, Vodafone, 2Degrees, Chorus, Kordia and Solarix, who (along with a number of other parties) supply a wide range of wholesale services. For the supply of backhaul services, Spark, Vodafone and Chorus (with the three largest backhaul networks) will continue to provide strong competition to the merged entity. For the supply of data tails, and other wholesale services, Spark and Vodafone are the largest competitors and will continue to constrain the merged entity.
50. The Commission does not consider that the proposed acquisition is likely to result in a substantial lessening of competition for the supply of wholesale fixed-line services.

Data tails

51. No party has raised concerns regarding any overlap between Vocus and M2 in the wider wholesale space, nor specifically in the supply of data tails. [], a medium sized reseller of a broad range of telecommunications products considered that while there is some technical overlap between the data tails product supplied by the parties, they are not close competitors in this area.
52. [] currently buys its data tails from M2, and other wholesale services from Vocus. [] considered that with the acquisition it would be able to source these products from Vodafone, Spark, and 2Degrees (among others). [] does not consider that the wholesale services provided by either Vocus or M2 are unique or innovative and was not concerned about the aggregation in this area.
53. We consider that while there is overlap between the parties in the supply of these wholesale services, we consider that sufficient competition will remain in the market such that a substantial lessening of completion is not likely to occur.

Supply of national backhaul – horizontal overlap

54. As a result of the merger, Vocus will join Spark and Vodafone as fully vertically integrated providers owning both backhaul and retail operations. M2 currently has no backhaul infrastructure and purchases approximately [] of its backhaul needs from Vocus. Chorus, and to a lesser extent Kordia, will be the other providers of national backhaul services.
55. Table 2 outlines the estimated network length of the current backhaul networks.

Table 2: National fibre backhaul providers

Supplier	Length of backhaul network
Chorus	>8,000km
Spark	>8,000km
Vodafone	7,500km
Vocus	4,200km
Kordia	[]

Source: Vocus Communications Limited and M2 Group Limited Application.

56. M2 is active in backhaul as both a purchaser and a reseller. This means that there is some horizontal overlap between the two parties for the supply of national backhaul. However, M2's revenue for backhaul is only [] (approximately) per annum as compared to Vocus' [].
57. No party we interviewed considered M2 to be a viable competitor for the sale of backhaul. Further, the merged entity will continue to face strong competition from Vodafone, Spark and Chorus for the sale of backhaul capacity.
58. Accordingly, we do not consider that the proposed merger is likely to result in a substantial lessening of competition in the markets for national and international backhaul.

Supply of national backhaul – vertical foreclosure

59. We have considered whether the merged entity would have the ability or incentive to raise the price of national backhaul input services to downstream residential and/or business fixed-line broadband service providers or to refuse access to such inputs. To do so, the merged entity would need market power in the upstream market that it could use to gain or enhance market power at downstream levels (which it would have an incentive to gain post-merger because it would be vertically integrated into that market).
60. At the upstream backhaul level, Vodafone and Spark will continue to be the major providers of backhaul services and all parties we have spoken to have noted that the backhaul market is very competitive. The Vocus network is also shorter in length, and has fewer points of presence than Vodafone and Spark's network. [] has also noted that of the four main providers "all the holes are on the Vocus network".
61. [] considers that the current state of the backhaul market is very competitive and that the proposed acquisition is likely to have limited impact on competition in this area.
[]

62. The Commission considers that the merged entity will continue to face a significant degree of competition for the supply of national backhaul and as such is unlikely to have market power in the provision of national backhaul services. As such, foreclosure is not likely.
63. The Commission also notes that Chorus will remain as a non-vertically integrated provider of national backhaul services.

Conclusion on supply of national backhaul

64. We consider that the proposed acquisition will result in limited horizontal overlap in any of the relevant markets. The merged entity will continue to face strong competition from a number of parties including Vodafone, Spark and Chorus.
65. We do not consider that the proposed acquisition will result in the merged entity gaining market power in the supply of backhaul services and that vertical foreclosure is not likely.

Overall conclusion

66. The Commission 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.

Determination on notice of clearance

67. The Commission 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.
68. Under s 66(3)(a) of the Commerce Act 1986, the Commission gives clearance to Vocus Communications Limited (or an interconnected body corporate of Vocus) to acquire up to 100% of the shares and/or assets in M2 Group Limited (or any interconnected bodies corporate of M2).

Dated this 3rd day of December 2015

Dr Mark Berry

Chairman