



Submission by Blue Reach to Commerce
Commission as to Vodafone and Sky clearance
application

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1. Summary

Introduction

- 1.1 We endorse the reasons given in the Trustpower submission as to wholesaling content, leading to the conclusion that there will be substantial lessening of competition if the merger goes ahead, due to the control in the merged company over “must have” content. We do not repeat those points below.
- 1.2 Instead we show that there are additional effects in terms of substantial lessening of competition if the merger goes ahead.

Blue Reach and its owners

- 1.3 Blue Reach is establishing a national network for fixed wireless and mobile services. It would be the 4th MNO and also provide competition to fixed line providers and other FWA suppliers. In both fixed and mobile it can provide strong competition.
- 1.4 The network is wholesale only, and open access. Therefore, by necessity, it must encourage multiple providers such as MVNOs, regional operators, etc. That provides enhanced competition and innovation.
- 1.5 Malcolm Dick owns Blue Reach. Malcolm has started a number of telco businesses (e.g. as co-founder and owner of CallPlus, now merged into Vocus) that have successfully brought competition and disruption. He has 45% of the investment in the forthcoming Hawaiki submarine cable between Australasia and the US: the cable has synergies with the Blue Reach network.
- 1.6 We deal below with why disruptive providers are important in the promotion of competition and innovation, relying in particular on a March 2016 econometric analysis by Ofcom of mobile retail pricing in 25 countries, including New Zealand.

Mobile

- 1.7 There are strong signs that there is market failure in mobile. For example, the Commission’s latest Annual Telecommunications Monitoring Report confirms that, in the OECD, as at February 2016, New Zealand ranks 28th and 33rd out of 34 countries, for 1.5GB and 6GB retail mobile data packages respectively.¹
- 1.8 High prices for larger mobile data packages are of particular concern, as triple and quad plays move to data-intensive uses such as Pay TV.

Fixed line/fixed location

- 1.9 Over fixed line, the same Commission report also notes high fixed line retail data costs as at March 2016. It noted that:²

There is also a familiar pattern: the more data included in the basket, the more the New Zealand price is above the international average.

- 1.10 Again, as data consumption increases rapidly, this pricing issue becomes more acute.

¹ Commerce Commission, Annual Telecommunications Monitoring Report 2015, at page 40

² At page 24

1.11 That also reflects the observation by the Commission in that report,³ that:

Looking at the bigger picture, wholesale broadband prices are \$4 lower than 18 months ago, but the most popular voice and broadband retail bundles are generally a little more expensive, albeit with higher data caps.

1.12 In other words, the competitive landscape is such that retail prices have gone up, despite the drop in wholesale input prices of \$4 per month. In a competitive market, a drop in wholesale input prices should be largely passed through in reduced retail prices. That has not happened, implying that the market is too concentrated. The diagram at Appendix A shows why. The market players have shrunk over time by acquisitions, etc, from around 60 to 3 major players in fixed line (Spark/Vodafone/Vocus) and 3 major players in mobile (Spark/Vodafone/2degrees), controlling around 95% of the market. This overlaps with the highly concentrated Pay TV market, relative to other countries.

1.13 As a standalone FWA provider, Blue Reach can compete without paying fixed line input costs.

3 not 4 MNOs is a substantial problem

1.14 These poor outcomes, reflected also in the nearly non-existent MVNO market with only 20,000 subscribers, indicate that having only 3 MNOs is a key source of the problems. The European Commission has been firm on that issue, when opposing 4 to 3 mergers of MNOs, unless a strong MVNO is put in place to create an effective 4th operator.

Another NZ MNO potentially drops prices by around 19% - Ofcom

1.15 A March 2016 Ofcom report, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing*,⁴ analyses the position in 25 developed countries, including New Zealand. It concludes that retail prices for mobile services:⁵

... are between 17.2% and 20.5% lower on average in countries where there is one additional mobile operator [above 3 operators] AND a disruptive firm is in the market.

1.16 The report notes that there can be improved services for customers as well.

Blue Reach is a significant disruptor

1.17 Blue Reach is a substantially more significant potential disruptor than 2degrees for a number of reasons, including:

- (a) Malcolm Dick has a strong track history in Australia and New Zealand of disruption in the telco sector.
- (b) Blue Reach is a wholesale only network. It is also open access. By necessity, it must have multiple RSPs on its network, essentially forcing

³ At page 25

⁴ Ofcom, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing* (March 2016) (http://stakeholders.ofcom.org.uk/binaries/research/cross-media/disruptive-firms-econometrics/research_document.pdf)

⁵ At page 17

the equivalent of growing the MVNO market. That magnifies the competition.

- (c) 2degrees has had, and continues to have, substantial constraints in getting wider traction in the market.
- (d) Blue Reach takes the competition from 3 MNOs to 4 MNOs, with the implications reported by Ofcom of 4 competing instead of 3.
- (e) Blue Reach targets not only mobile: it also targets fixed location access, where it can be a major disrupter as well.

Where Blue Reach fits

- 1.18 Blue Reach, with its substantial disruptive strengths, can be that 4th MNO, bringing all those advantages. Plus, it adds more as it can be another network servicing fixed locations, competing against fixed line providers, and bringing greater competition.

But....

- 1.19 If this merger goes ahead, the merged company gets bottleneck control in the markets via, for example, triple and quad plays incorporating “must have” Pay TV content. The markets are inevitably heading to such triple and quad plays.
- 1.20 That puts our business case in jeopardy as, in turn, the business cases and operations of potential RSP customers over the networks become weaker and unviable.
- 1.21 Without the merger, Sky is likely to wholesale to RSPs on terms that encourage uptake (and in turn, encourage using our network).
- 1.22 That difference is one of the key reasons why the merger will lead to substantial lessening of competition.

Other reasons why there is substantial lessening of competition

- 1.23 We and other parties submit that there is SLC for a number of reasons. We are highlighting that SLC has wider implications on the market, as above.

Inaccuracies in the applications

- 1.24 The applicants each state in their applications that:⁶

[P]ay-TV offerings do not drive substantial changes in broadband share.

- 1.25 This is contrary to numerous statements made by Vodafone (to which the applications make no reference despite verifying under the Commerce Act that the applications are correct). It is contrary to how Sky operates its business. And it would be surprising if it is consistent with how each of the parties assess the transaction internally, reflected in the parties’ internal documents such as business cases and financial modelling. One of the key drivers for the transaction – and probably the key driver – is, contrary to the applicants’ statement, to “drive substantial changes in broadband share”.

⁶ At [11.13]

1.26 That is one example of the concerns about the application. There are others.

1.27 Much is at stake, as Vodafone itself confirms in one of the many statements contrary to what it says in the application (highlighting added):⁷

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.

1.28 This in our submission points to solutions. The Commission should:

- (a) Check points made in application, including and beyond the above issue, by obtaining internal documents and interviews (quite possibly on oath in the circumstances);
- (b) Apply caution before accepting submissions by the applicants on likely future market trends (particularly as to new competitive threats such as OTT). The history is against the applicants, in relation to what has happened following prior decisions involving Sky; and
- (c) Arrange a conference on this matter which involves "enduring and irreversible effect" in multiple key markets. While conferences do not happen often, the statutory provision implies they are to be held from time to time, and it is hard to imagine a more appropriate matter for that to happen.

Structure of this submission

1.29 We have set out our submissions in the following order:

- (a) Overview of Blue Reach and its owners;
- (b) We deal with inaccuracies in Vodafone's and Sky's applications, and make some proposals for how the Commission might deal with the applicants in light of that, including a conference;
- (c) Market definition;
- (d) We then draw conclusions as to implications of the wholesaling of content in the factual;
- (e) We then overview the mobile wholesale market, as well as the mobile retail market;
- (f) In that context we deal with the experience as to 3 v 4 MNOs in Europe, including Ofcom's report on 3 v 4 MNOs;
- (g) Finally, we address our role as FWA provider to fixed locations, and as competitor to fixed line/FWA providers, on top of our mobile services.

⁷ Vodafone response to Ofcom's consultation: Strategic Review of Digital Communications discussion document (8 October 2015), at pages 8-9 (http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Vodafone.pdf)

2. Blue Reach and its owners – an overview

- 2.1 Blue Reach is establishing a national network for fixed wireless and mobile services. The network is operating, but at early stages. As a fixed wireless provider, it supplies services to fixed locations, as to copper, fibre and cable/HFC based services, and other fixed wireless (FWA) services such as Spark's and Vodafone's.
- 2.2 As the Commission's latest Annual Telecommunications Monitoring Report confirms:⁸

Fixed wireless technology starts to offer real substitute for copper.

Blue Reach's owner and track history

- 2.3 As the impact of disruptive operators in markets is substantial, as Ofcom explain, we set out some of the history behind Blue Reach.
- 2.4 The company is owned by Malcolm Dick. Malcolm has started a number of very successful telco businesses in Australia and New Zealand, as a serial entrepreneur. Following telecommunications deregulation in 1993, he and Annette Presley set up Call Australia and other RSPs: the business went from zero to over \$100M annual revenue in 3 years.
- 2.5 Having sold that business and returned to New Zealand, they set up the CallPlus, i4free, Slingshot, 2Talk and Flip businesses from 1997 onward, growing revenues to over \$250M per annum and making it the 3rd largest fixed line telco. The business was sold to Australian telco, M2, and then last year by M2 to Vocus. Malcolm retained the spectrum referred to below and that was excluded from the sale.
- 2.6 CallPlus and the related brands and businesses had a disruptive approach to the market, for example, as a price leader to lower prices, and also as the largest unbundler in New Zealand, which was a substantial investment and competitive influence.
- 2.7 Malcolm is also a 45% investor in the Hawaiki submarine cable linking Australasia and the States, and there are synergies between that cable and Blue Reach, as the Blue Reach network can integrate with Hawaiki services.

Blue Reach

- 2.8 Blue Reach is a pure wholesale business and is encouraging regional and other businesses to enter the fixed line replacement/mobile MVNO business on an open access basis, with pass-through pricing for the core incumbent-provided services such as fixed/mobile/0800 interconnect, number ranges, porting, roaming, regulatory obligations, and connectivity to LFCs. The reason we are doing this is because it is difficult, costly and time consuming for regional players and smaller national players to do this individually.
- 2.9 Blue Reach's commercial proposition will be to provide one-stop white label billing and operational support systems to enable retail businesses to concentrate on collecting customers, providing them with high quality local support and adding value by incorporating other services into their offering.

⁸ Commerce Commission, Annual Telecommunications Monitoring Report 2015, at page 10

- 2.10 Blue Reach is also providing fixed line replacement services to a number of 2nd Tier Telcos.
- 2.11 Blue Reach will move to new 5G technologies which provide even greater FWA and mobile speeds than current technology, 4G, and greater throughput as well, so that contention is less of an issue.
- 2.12 Blue Reach's model is to have voice and SMS carried over data rather than the current voice/SMS technologies used by existing data providers. That is a further reason why mobile data pricing at wholesale is important for new mobile entrants. We expand on that below.
- 2.13 The spectrum we have is primarily 30 MHz of LTE spectrum in the 2.5GHz band.
- 2.14 We also have 20 MHz of 1800 spectrum (the old guard band which is now usable), 5MHz of 2.0MHz and 14 MHz of 3.5MHz LTE spectrum. In addition, we are actively seeking additional spectrum as we do not have enough in the long term. We expect to get that spectrum.

Summary: Core features of the Blue Reach network

- 2.15 The network is wholesale only and open access. It is a competitor to mobile networks as well as to fixed line networks.
- 2.16 This means that we must wholesale to and encourage RSPs to use our platform. As to mobile we will host MVNOs, but the offering is likely to be taken up on a mixed mobile and fixed location basis by RSPs.
- 2.17 The network is to be a national network and that means that access to national roaming is required while the network is being built out.

3. Inaccuracies in Vodafone's and Sky's applications

- 3.1 There are multiple statements in each of the applications, verified to be true and correct by directors as required by the Commerce Act, which appear to be inaccurate and claim a different and more favourable position than in fact is the case.
- 3.2 The merger, if it goes ahead, will have considerable impact on the media and telecommunications sectors, and upon businesses and consumers. For example, in a statement of position, to which Vodafone has not drawn the Commission's attention, and which is contrary to the applications, the impact of the use of Pay TV as proposed by Vodafone and Sky, on broadband, mobile and other markets is "*enduring and irreversible*".⁹
- 3.3 We submit that it will be particularly important for the Commission to obtain documents and other evidence from the applicants to verify the position of the applicants, and not accept the claims in the applications at face value. That extends beyond the examples that we and others give. Therefore, it will be

⁹ In a 2015 submission to Ofcom, Vodafone sought the continuation of an obligation that BskyB be required to provide its content on reasonable terms to other providers because it is "key content" (http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Vodafone.pdf) at pages 8-9.

Vodafone said: "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."

important to review the source documents, and to interview applicants' staff. We submit that the failings in the application, and the implications for the New Zealand economy, are too great to do otherwise.

- 3.4 Overlapping with this is our submission that the Commission should take particular caution before concluding that conditions will develop after a notional merger that remove what would otherwise be SLC. This is a fast moving area, and past experience (such as past assumptions in Commission decisions) often shows that competitive pressures do not emerge as predicted. Particular caution is appropriate as to predictions by the applicants.
- 3.5 There is of course the standard test for SLC and doubt: the Commission's Mergers and Acquisitions Guidelines¹⁰ adopts the judgment of the Court of Appeal in *Commerce Commission v Woolworths*:¹¹

[I]f the Commission is "in doubt" it should decline a clearance... For the present purposes, the existence of a "doubt" corresponds to a failure to exclude a real chance of a substantial lessening of competition.

Example of inaccuracies

- 3.6 The applicants each state in their applications:¹²

[P]ay-TV offerings do not drive substantial changes in broadband share.

- 3.7 Further, they say in their applications:¹³

[T]he Combined Group would not have the ability or incentive to engage in any foreclosure strategy - even putting aside that it will continue to make inputs available on a wholesale basis.

- 3.8 Such statements are directly contrary to the multiple statements that the Vodafone Group has made internationally about the harm that Pay TV causes in the hands of those who control the content. For example, Vodafone said in October 2015:¹⁴

Key content is by its nature exclusive, or put simply a monopoly input, which in any other scenario would be subject to appropriate regulation

- 3.9 Then Vodafone Group states in its 2016 annual report:¹⁵

In several markets, incumbents have sought to gain exclusive access to key content rights. ... We will also encourage regulators to prevent incumbents from using content – in addition to their dominance in fixed access markets – as a lever to reduce competition.

¹⁰ At [2.43]

¹¹ (2008) 12 TCLR 194 at [98]

¹² At [11.13]

¹³ At page 3

¹⁴ Vodafone response to Ofcom's consultation: Strategic Review of Digital Communications discussion document (8 October 2015), at page 8

(http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Vodafone.pdf)

¹⁵ Vodafone Group, Annual Report 2016, at page 12

(http://www.vodafone.com/content/annualreport/annual_report16/downloads/vodafone-full-annual-report-2016.pdf)

- 3.10 And in a 2015 submission to Ofcom, Vodafone sought the continuation of an obligation that BskyB be required to provide its content on reasonable terms to other providers because it is “key content”:¹⁶

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.

- 3.11 While driving “substantial changes in broadband share” (the contrary of what is quoted above from the applications) is apparent from the above Vodafone statements, this from the same Vodafone submission is explicit:¹⁷

[S]ervices 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.

- 3.12 It is apparent that Vodafone’s position and understanding does not accord with its claims in the applications, quoted above. Moreover, there is ample evidence, well known to the applicants that the reverse of what the applicants have stated applies. The actual position is that “Pay TV does... drive substantial changes in broadband share” (and in a way that, as Vodafone repeatedly confirms internationally, is anti-competitive).
- 3.13 Additionally, it is clear that Sky’s strategy for many years has been to discourage wholesaling competition and favour selling to its retail customers. What it does can only be explained that way, and it can be expected that internal material will confirm this, as indeed it did in 2013 when on the basis of internal documents, the Commission did not accept Sky’s assertions to the contrary.

The real world

- 3.14 Just as the Commission established Sky’s true motives on its 2013 review of the Sky and ISP contracts, which were contrary to assertions, so too we submit that should happen here, by the Commission examining Vodafone and Sky internal documents, and by interviewing relevant managers, under oath under the powers the Commission has.
- 3.15 It is implausible that Sky and Vodafone have not done their business cases and projections, such as those that are presented to the board for assessment of the possible merger, without modelling the contrary of what they assert in their applications. The modelling can be expected to show the benefits of bundling content (the must have service) in retail packages, such that market share is gained beyond Vodafone’s and Sky’s current retail footprint (let alone that churn from its existing customer base is substantially reduced).
- 3.16 That is just an example, and firmly implies that the Commission should carefully check all of the applicants’ assertions in this manner.

¹⁶ Vodafone response to Ofcom’s consultation: Strategic Review of Digital Communications discussion document (8 October 2015), at pages 8-9

¹⁷ At pages 2-3

- 3.17 Given that these inaccuracies are plain to see, there is concern as to what lies under the bonnet.

Conference

- 3.18 It is unusual for the Commission to hold conferences on clearance applications, but that there is provision for conferences in the Act means that it is intended by the Act they are sometimes held.
- 3.19 It is hard to think of a situation that is more appropriate for a conference. We submit that this is a clearance where applying the Act calls for a conference. This will provide much help to the Commission in its decision making.
- 3.20 As Vodafone rightly points out, this decision will have “enduring and irreversible effect” in multiple markets of considerable size and impact on the NZ economy and consumers (in the digital economy, moreover, which is of such importance). There is much at stake.
- 3.21 Of significance is the difficulties of predicting where markets will go, against the background of the inaccuracies in the application.
- 3.22 We join with others in seeking a conference.

4. Market definition

- 4.1 We do not address all market definition issues, given the focus on certain points in this submission.
- 4.2 We have two preliminary points before turning to specific market definition.

Horizontal platform effects

- 4.3 The applicants claim that there are few if any horizontal effects. However, that fails to recognise the overlapping transmission paths by which content is delivered to consumers. For example, the acquisition would combine, in the same company, transmission by HFC/cable in Wellington, Christchurch and Kapiti, with transmission by competing satellite. In addition, satellite transmission is combined with fixed line and mobile transmission in many areas (urban and otherwise).

Rural

- 4.4 In the RBI footprint, satellite and RBI – which is an FWA service provided by Vodafone - are often the only actual or potential competitors for transmission of TV content. Particularly significant is that Vodafone’s wholesale obligations (which are in the form of contract and deed,¹⁸ not regulation) are limited to the relatively low sub-HD speed 5 Mb/s service.¹⁹ Vodafone is able to offer its retail customers a higher speed and quality service over its RBI-funded infrastructure, more suited to HD and other higher end TV services, without having to wholesale to other RSPs. Therefore, in much of the rural footprint, competition is removed or substantially reduced, as to higher speed transmissions.

¹⁸ Vodafone’s deed of undertaking, dated 22 September 2011

¹⁹ This is the “Enhanced RBI Broadband Service”, as defined in [4] of the Rural Broadband Agreement between the Crown and Vodafone (as cross-referenced in the deed of undertaking). That enhanced service is the same as the basic service, with higher throughput and latency metrics.

Rural markets

- 4.5 For the reasons in the above paragraph, geographic dimensions beyond national markets call for different geographic markets. For example, there are markets in the rural footprint (or, possibly, the RBI footprint) for the retail provision of pay TV services, the wholesale provision of pay TV services, for retail of broadband services (divided also into fixed and mobile), and the provision of services for the transmission of pay TV.

Fixed location not fixed line markets

- 4.6 Because FWA is a path to a fixed location, just as fixed line (copper, HFC and fibre are) is, a more correct and technology neutral approach is to describe markets where there are services to a fixed location as being broadband markets for servicing such fixed locations, not, for example, fixed line markets.

Broadband services retail markets

- 4.7 The applicants incorrectly maintain that there is only a relevant market for provision of fixed line broadband services (a market which should extend to any fixed location broadband service such as FWA). As the applications make clear, mobile services, quad plays, etc, are central to the applicants' proposed services.
- 4.8 In addition to the market for retail fixed broadband services, relevant markets include retail of mobile broadband, a broader market for all broadband, and markets on a similar basis for the rural or RBI footprint.

Wholesale pay TV services

- 4.9 Also for the reasons in the last section of this submission, there are markets (including a rural market) for wholesaling pay TV services.

Content acquisition markets

- 4.10 We have not addressed these in detail as we expect that other parties that are content acquirers will provide evidence. What is apparent is that these markets are relevant and impact downstream markets.

5. Conclusion as to content and Pay TV

- 5.1 We now draw conclusions, based on the evidence and submissions provided by Trustpower.
- 5.2 The merged entity in the factual has it leveraging its key content rights (or "must carry" content) into adjacent markets by, for example, bundling that content with fixed and mobile services. That content is unlikely to be wholesaled on reasonable price and non-price terms. The merged entity has the incentive and the ability to foreclose.
- 5.3 Additionally, because key content is not available, other content providers such as Netflix and Lightbox are unlikely to be an effective constraint (and in any event are not substitutes).
- 5.4 This leads to the failure of competition, investment and consumer choice, including due to lowered UFB uptake.

- 5.5 In the counterfactual, it is likely that Sky will wholesale on terms encouraging RSP uptake, in order to expand its footprint, given that retail subscribers and revenues are declining. UFB uptake will also increase.
- 5.6 Therefore, the factual relative to the counterfactual entails a substantial lessening of competition.

Negative implications for rolling out a 4th MNO network and FWA network

- 5.7 If the merger proceeds (in the factual), there will be substantially fewer RSP customers (than in the counterfactual) willing to take or continue to take services from the Blue Reach network. That applies to both fixed and mobile potential RSP customers of Blue Reach.
- 5.8 This conclusion is based upon developments internationally in relation to the strong trend towards triple and quad play packages, where Pay TV is a key service. With the merged entity having bottleneck control of this, the business case for new RSPs is weak if not unviable. That in turn puts our business case for rolling out the network in jeopardy.
- 5.9 As we outline below, a 4th mobile network, which is also an FWA network competing against fixed line and other FWA providers, brings substantial competition and benefits to consumers.
- 5.10 We now turn to why that is so, starting with an overview of the mobile wholesale market.

6. Mobile wholesale market – overview

- 6.1 While there are 3 mobile network operators (MNOs), 2degrees has more limited national coverage over its own network (and its 4G coverage is only around 70% of the population, compared to Spark and Vodafone each at 90%).²⁰
- 6.2 2degrees relies on a commercially negotiated roaming agreement with Vodafone, which is understood to contain relatively poor price and non-price terms, such as providing only 3G coverage even though 4G is available from Vodafone over the same footprint.
- 6.3 The commercial negotiations between Vodafone and 2degrees have occurred in an environment of minimal regulatory backstop pressure, as getting a regulated roaming service by way of price and non-price determination would be over 2 years away.
- 6.4 There is little incentive on Vodafone or Spark to compete down the roaming terms offered to 2degrees because (a) they are in duopoly conditions, and (b) discouraging more effective competition from 2degrees outweighs revenues from the roaming agreement.

MVNOs – the current position

- 6.5 This environment also negatively impacts 2degrees' ability to offer good MVNO terms in what is already a low number of competing MNOs that can offer MVNO terms. This moves the potential wholesalers of MVNO services to more like a duopoly (Spark and Vodafone), although even having 3 fully functioning MNOs leads to retail and wholesale market failure, as we outline below.

²⁰ Commerce Commission, Annual Telecommunications Monitoring Report 2015, at page 28

- 6.6 For similar reasons, the MNOs have low incentives to compete the price and non-price terms on MVNO services downwards. To the contrary, they have greater incentives to keep MVNOs out of the market, and to minimise the prospect of MVNOs taking away their retail customer base and competing down retail prices.
- 6.7 Therefore, as the Commission’s latest Annual Telecommunications Report confirms,²¹ there is only a “handful” of MVNOs (around 6), with MVNO subscribers being under 20,000 as at June 2015 (an immaterial number compared to total MNO subscribers).
- 6.8 That lack of market impact follows from the too restrictive terms which MVNOs are offered – both price and non-price. This is marked, for example, by offerings such as MVNO services based on retail minus and the MNO’s own retail constructs, etc (so called “thin” MVNOs). It also shows that Telcos of sufficient scale to build subscriber numbers have not been able to do so. That there are only 20,000 customers demonstrates this.
- 6.9 This nearly non-existent MVNO market is an international outlier by a substantial margin.
- 6.10 This is not a factor of the small size of the New Zealand market, as other small countries have a significantly larger and more effective MVNO sector, and they have a substantial portion of mobile retail revenues over MVNO on top of MNO. The main factor, given there is no MVNO regulation, is that there are only 3 MNOs, of which 1 has limited ability to offer MVNOs.

7. Mobile data and pricing

- 7.1 There is a clear trend of expanding mobile data usage, as more and more content is sent wirelessly, and with the move toward integrated mobile and content bundles, including quad plays with fixed line broadband. This is outlined above. Thus, mobile data is a key service for new entrant mobile operators, whether MNO or MVNO.
- 7.2 That is particularly so for Blue Reach, because its voice and SMS services will be provided by way of data streams. For its roaming agreements, it wishes to acquire airtime or similar (essentially a bucket of airtime/data).

High mobile retail data pricing

- 7.3 The data used by the Commission, and summarised in this section, is from February 2016.²² This table is from that report:²³

Table 4: Results of mobile broadband benchmarking

Mobile phone services basket	NZ rank	Dec 2015 price (NZD PPP)			NZ % price var. from	
		NZ	Australia	Average	Australia	Average
1.5GB GST included	28/34	30	10	20	191%	46%
6GB GST included	33/34	70	40	36	74%	95%

Source: Teligen

²¹ Commerce Commission, Annual Telecommunications Monitoring Report 2015, at page 28

²² Commerce Commission, Annual Telecommunications Monitoring Report 2015, at page 38

²³ At page 40

- 7.4 Given the trend toward much larger mobile data use, of particular concern is that mobile data retail pricing is higher than nearly all other OECD countries.²⁴ The 1.5GB and 6GB data services referred to in the Commission's report are around 50% and 100% higher than the OECD averages respectively. New Zealand ranks 28th and 33rd out of 34 countries, for the 1.5GB and 6GB packages respectively.
- 7.5 This demonstrates that consumers are paying too much – and often considerably too much – for their mobile data services. It also demonstrates, as does the weak and almost non-existent MVNO market, that the combination of 3 MNOs – one of which has a limited footprint, with only 70% at 4G speeds – is leading to substantial market failure.

8. The European experience

- 8.1 In the EU there has been a number of attempts – mostly successful – to get clearances to mergers between 2 MNOs, thereby reducing 4 MNOs down to 3. The Commission has concluded that the remaining 3 MNOs after the merger would not facilitate sufficient competition between the networks. Therefore, the Commission has generally not permitted the merger until the merging networks have entered into a contract with a third party MVNO, to supply MVNO inputs on reasonable price and non-price terms. The MVNO terms are at the so-called “thick” end of the spectrum, that is, the MVNO obtains airtime and data, and itself undertakes most of the other services as part of its retail offering. New Zealand's current MVNOs are “thin” MVNOs (that is, they are close to replicating the retail constructs of the wholesaling MVNO and that restricts pricing and product differentiation options).
- 8.2 By means of the mandated thick MVNO, the European Commission has retained competition between 4 networks, with the MVNO being comparable in competitive effect to a full MNO.
- 8.3 In relation to the most recent clearance application – to enable Hutchison and O2 to merge in the UK, reducing 4 MNOs to 3 – the European Commission in 2016 refused to clear the merger because the proffered MVNO terms were not acceptable. Other 4 to 3 MNO mergers were cleared, such as the 2016 clearance of the merger in Belgium of MNOs, BASE and Liberty Global, on the basis that thick MVNOs were established so there is an effective 4th operator.

Relevance to New Zealand

- 8.4 This generally supports the conclusion that 3 MNOs do not provide for sufficient competition. This is reflected in NZ by facts such as mobile data retail pricing which is almost the highest in the OECD, and the lack of effective MVNOs.

9. Another NZ MNO potentially drops prices by around 19% – Ofcom

- 9.1 A March 2016 Ofcom report, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing*,²⁵ analyses the position in 25 developed

²⁴ At page 40

²⁵ Ofcom, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing* (March 2016) (http://stakeholders.ofcom.org.uk/binaries/research/cross-media/disruptive-firms-econometrics/research_document.pdf)

countries including New Zealand. It concludes that retail prices for mobile services:²⁶

... are between 17.2% and 20.5% lower on average in countries where there is one additional mobile operator [above 3 operators] AND a disruptive firm is in the market.

9.2 As we explain below, Blue Reach is such a “disruptive firm”.

9.3 Ofcom’s conclusion is based on the difference between 3 and 4 mobile operators in the market as the report was prepared in the context of the European Commission’s review of the abovementioned proposed merger in the UK between MNOs, H3G and O2, which would take the number of operators from 4 to 3.

9.4 Ofcom concluded:²⁷

Combining the two sets of confidence intervals indicates that prices could be between 17.2% and 20.5% lower on average in countries where there are four or more mobile operators AND a disruptive firm is in the market. By implication, this may suggest that removing a disruptive player from a four player market (as is proposed in the H3G/O2 merger in the UK) could increase prices by between 17.2% and 20.5% on average, all else being equal.

9.5 As to be expected, the Ofcom report concludes as well that less than 4 MNOs, and without a disruptive operator, can take the form of product quality being kept low, as well as higher prices:²⁸

Consumer harm in concentrated markets can arise even without a single dominant company or companies engaging in overt collusion. It may take the form of prices being substantially above costs or product quality being low.

Implications for New Zealand

9.6 Of course, New Zealand already has only 3 MNOs, and therefore the econometric analysis across 25 countries including New Zealand firmly supports the conclusion that consumers may well be paying too much and/or receiving lower quality services.

9.7 Blue Reach is able to be the 4th MNO, as well as being a FWA provider, competing against fixed line and other FWA providers. Blue Reach is also a disruptive provider, as we note below.

Ofcom explains why disruption AND another operator are important

9.8 The Ofcom report explains why market disruption is important in this context:²⁹

Generally, disruptive players (that do not follow the crowd and actively disturb existing market dynamics) have been seen by regulatory authorities as having a positive effect on markets for their ability to increase competition, with policies to encourage disruptive entry

²⁶ At page 17

²⁷ At page 17

²⁸ At “About this document”

²⁹ At pages 2-3

commonly explored. In addition, competition authorities have sometimes paid particular attention to disruptive players or “maverick” competitors in their decisions, for example, on mergers.

We are interested in market disruption because of the effect it can have on competitive intensity in a market. Under certain conditions, markets may reach undesirable outcomes where prices are substantially above costs and/or product quality is low, even without a single dominant firm or players engaging in overtly collusive behaviour. This may be the case in markets with relatively few large competing firms, a market structure that is prevalent in the communications sector. Disruption, or even the threat of disruption, can disturb these market dynamics and promote competitive rivalry amongst players, ultimately to the benefit of consumers.

We consider that market disruption can arise for a number of reasons..... National regulatory authorities can create the right conditions for it to emerge or continue through merger control, removing entry barriers, preventing strategic responses from incumbents etc. but these are all things we would do anyway to promote competition more generally.

Who are disruptive operators?

9.9 Ofcom explain this as follows:³⁰

Disruption is a strategic choice made by firms and is something that happens exogenously. However, once it emerges, we are keen to protect disruption to retain the consumer benefits associated with it. These benefits may take the form of lower retail prices or improved product offerings.

Ultimately, our view is that a level of disruption which encourages firms to invest and remain competitive in the market is likely to maximise the benefits to consumers in the long term.

Blue Reach is a stronger disruptive operator than 2degrees

9.10 As noted above, Ofcom concludes that 2degrees is a disruptor (and therefore the entry of a 4th MNO such as Blue Reach will have incremental impact as the market moves beyond 3 MNOs).

9.11 However, Blue Reach is a substantially more significant disruptor than 2degrees for a number of reasons, including:

- (a) Malcolm Dick has a strong track history in Australia and New Zealand of disruption in the telco sector.
- (b) Blue Reach is a wholesale only network. It is also open access. By necessity, it must have multiple RSPs on its network, essentially forcing the equivalent of growing the MVNO market. That magnifies the competition.

³⁰ At page 3

- (c) 2degrees has had, and continues to have, substantial constraints in getting wider traction in the market, particularly:
 - (i) beyond pre-pay customers (which means that its revenues are considerably lower on average per customer than Vodafone and Spark);³¹
 - (ii) it has had little traction in the business retail market;
 - (iii) it is held back by unfavourable roaming terms with Vodafone; and
 - (iv) it is suffering from issues relating to being a later entrant against two strongly established incumbents, when the cost of rolling out networks was much higher than it is now.
- (d) Blue Reach takes the competition from 3 MNOs to 4 MNOs, with the implications reported by Ofcom of 4 competing instead of 3.
- (e) Blue Reach targets not only mobile: it also targets fixed location access, where it can be a major disrupter as well. We turn to that now.

10. Fixed Wireless/fixed line/fixed location markets

10.1 Blue Reach's service, in addition to mobile, is an FWA service, providing competition in the fixed location, fixed line space.

10.2 Fixed line data usage is increasing exponentially. For example, the Commission's latest monitoring report shows³² that each fixed line subscriber on average "hit 48 Gb per month in 2015, well up from the 32Gb recorded for 2014". That is just the start, given the trends with Pay TV, etc.

10.3 However, as to New Zealand fixed line retail pricing, as at March 2016, the Commission observed that pricing is generally above the OECD average. It noted that:³³

There is also a familiar pattern: the more data included in the basket, the more the New Zealand price is above the international average.

10.4 As data consumption increases rapidly, this pricing issue becomes more acute.

10.5 That also reflects the observation by the Commission in the report,³⁴ that:

Looking at the bigger picture, wholesale broadband prices are \$4 lower than 18 months ago, but the most popular voice and broadband retail bundles are generally a little more expensive, albeit with higher data caps.

10.6 In other words, the competitive landscape is such that retail prices have gone up, despite the drop in wholesale input prices of \$4 per month. In a competitive market, a drop in wholesale input prices should be largely passed through in reduced retail prices.

³¹ See Commission's 2015 Annual Telecommunications Monitoring Report

³² At page 22

³³ At page 24

³⁴ At page 25

- 10.7 But that has not happened, indicating the value of additional competition as to fixed line/FWA services. This implies that current market structures, where there are three RSPs much larger than the rest, do not produce conditions by which price drops in wholesale inputs are competed away.
- 10.8 Additionally, the parties offering FWA (Spark and Vodafone in particular) are also major fixed line providers over copper and fibre. Thus, they are largely not a competitive constraint on fixed line providers generally, for they do not have incentives to use FWA to compete down their pricing including over fibre and copper.
- 10.9 Blue Reach however is solely an FWA provider in relation to services to fixed location customers. It also does not have to pay Chorus and LFC input costs for local access via copper or fibre. It, and its wholesale customer RSPs, are well placed to compete and bring benefits to consumers.

Conclusion

- 10.10 If the merger proceeds, the roll out of our 4th MNO network and FWA network (or of anyone else's network of similar nature) is put at jeopardy, due to reduced entry and expansion by customer RSPs.

Appendix A.

