11 November 2016

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Commerce Commission
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Wellington

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Dear Katie

Response to letter of unresolved issues

Thank you for your letter dated 31 October 2016 setting out the Commission's unresolved issues in relation to our proposed merger with SKY. This letter provides a summary of our response to the remaining issues set out in your letter, and is supported by a comprehensive submission which is attached.

At its heart, this transaction is all about increased innovation, more competition and greater choices for consumers. Bringing together Vodafone's networks and SKY's content, building on our existing partnership, will lift the game for competition in consumer communications markets; but we're under no illusion that, in this fast-moving and dynamic market, our competitors won't continue to compete hard.

Today's communications market is highly competitive, and this deal won't change that. As a result, communications markets in New Zealand are highly resilient: there's simply no path for us (or any other participant) to leverage any content (even content as compelling as SKY's live sports content) to harm competition.

That means there's no way the proposed transaction could lead to the outcomes which underpin the Commission's remaining concerns. This transaction is an outcome of the competitive pressure to find new and innovative services to meet consumer demand, not a pathway to foreclosing it.

This letter summarises our view of why our competitors, in both the fixed broadband and mobile market, will continue to vigorously compete. In short:

- SKY and Vodafone, through the plans we've shared with you, will be a more innovative creator and competitive company delivering great solutions for our customers. We will lift the game in the industry and our competitors will respond;
- as a function of New Zealand's existing market structure, our competitors have (or can achieve) any necessary scale;
- there are many dimensions to competition in the fixed broadband and mobile market, giving existing RSPs and new entrants a wide variety of paths to winning consumer demand and market share; and

- even if certain content held by the merged entity (such as live rugby) evolved into a "must have" for communications, the right incentives are in place for that content to be made available (either through standalone content, reselling arrangements, or our competitors seeking to acquire content themselves directly from content owners).

Fixed broadband market: ready and incentivised to compete

In the fixed broadband market, New Zealand benefits from significant investment in fibre broadband and the structural separation of Chorus and the LFCs. This translates to a highly competitive market with extremely low barriers to entry, and open access to the necessary infrastructure for new and existing competitors to compete effectively:

- Spark, with the largest market share in fixed broadband, continues to exercise considerable competitive pressure in the market (including through its challenger brand, Bigpipe). They've made it overwhelmingly clear to their shareholders that they're "ready to compete" and believe that the merged entity poses no "greater challenge" than our existing partnership with SKY has achieved to date;

- Vocus, the clear number three, is also well-established (and well-capitalised), pursuing a successful strategy across various sub-brands targeting various market segments;

- New entrants continue to have a significant impact, such as Trustpower (bundling electricity services and leveraging its scale in that market), MyRepublic (focusing on the fibre-only market, and demonstrating the ability of telco operators from other markets to easily enter the New Zealand market), and 2degrees (who acquired Snap and now cross-sells across mobile and fixed broadband). Also importantly, because the barriers to entry are so low in fixed broadband, the competitive reality of new entrants also show no sign of letting up (such as Stuff Fibre's recent entry to the market).

These broadband providers (and prospective new entrants) will continue to invest and innovate, exercising a continuous competitive constraint in market.

Mobile market is no less competitive than the fixed broadband market

The mobile market is no less competitive (with prices below OECD averages and some of the best 4G speeds in the world):

- Spark has successfully grown through a range of strategies, including content bundling (Spotify and Lightbox) and a low-cost MVNO (Skinny) with significant advertising and promotion investment and low prices.

- As 2degrees shareholders have recently advised investors, they are an "established and highly competitive challenger with strong momentum" which has "demonstrated significant profitability; is benefitting from recent capital investments; and owns its own infrastructure."

While there are naturally fewer mobile operators, all three operators are now well-established with the underlying infrastructure and scale necessary to compete. Mobile networks are characterised by high upfront costs and low variable costs. That means that, if market conditions (or commercial strategy) result in an operator losing customers, it will have spare capacity enabling it to compete even more aggressively. It is not a commercially realistic outcome that any of New Zealand's three mobile operators could be pushed below a minimum viable scale.

All operators can and will respond to the innovation we plan to deliver

In both fixed and mobile markets, it's inconceivable that a strategy to bundle content and communications services could force players out of the market. Our competitors are well-positioned and strongly incentivised to continue to exercise a competitive restraint.

While the rough and tumble of such a fast-moving market means, over time, there may be changes to the competitive landscape, the market as a whole is fundamentally resistant to the merged entity achieving a dominant position. That would entail unseating Spark (with 47% share of the total communications market), disrupting the strong "number 3" operators (such 2degrees in mobile and Vocus in fixed) who have significant international backing and considerable local capability, and (especially in the fixed market) resisting dynamic and growing competitive pressure from new entrants.

We expect new and existing operators will compete vigorously on the basis that:

- A wide-range of competing bundles will be offered (we know that different consumers value different types of bundles, from our own market research and the commercial reality of the market today) and other commercial strategies (such as low-cost, non-bundled services) will continue to be viable;

- Even if certain content held by the merged entity (such as live rugby) evolved into a "must have":

    - the merged entity would be incentivised to make it available on a stand-alone basis (allowing consumers to "make their own bundle") or via wholesale partners. It's simply not economically viable for the merged entity to lose paying customers for content which is very expensive to acquire;

    - the content rights held by the merged entity are not permanent and other parties will have regular opportunities to bid for content (and, rights-holders will have the discretion to sell content in new ways, to maximise their revenue, and find new ways of distributing content).

Our proposed merger with SKY will allow us to take competition in the New Zealand media and communications markets to the next level. We know our competitors will respond vigorously. We're excited about the potential for the innovative new services we believe we will be able to deliver for our Kiwi consumers when this deal is approved.

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