COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Statement of Preliminary Issues

Spark New Zealand Trading Limited and TeamTalk Limited

31 March 2017

Introduction

1. On 20 March 2017, the Commerce Commission registered an application (the Application) from Spark New Zealand Trading Limited (Spark) seeking clearance to acquire, either directly or indirectly, up to 100% of the shares of TeamTalk Limited (TeamTalk).[1]

2. The Commission will give clearance if it is satisfied that the proposed merger 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 merger. We request that parties who wish to make a submission do so by **14 April 2017**.

The parties

5. Spark is a wholly owned subsidiary of Spark New Zealand Limited. Spark New Zealand Limited is a company listed on both the New Zealand and Australian stock exchanges. Spark is a telecommunications company offering fixed and mobile telecommunications services in New Zealand. Spark also provides information and communication services to businesses.

6. TeamTalk is listed on the New Zealand stock exchange. It is a telecommunications company whose services include delivering access to fibre networks for larger organisations and businesses in the main centres, digital mobile radio and internet and voice services to hard-to-reach areas. TeamTalk's subsidiaries include Farmside and CityLink. According to the Application, the TeamTalk business comprises the following parts:

    6.1 Through CityLink, TeamTalk:

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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.

6.1.1 owns fibre network assets in the Wellington and Auckland CBDs, which are used to offer wholesale local access to RSPs and managed data services;

6.1.2 offers a free-WiFi service in the Wellington CBD, subsidised by the Wellington City Council;

6.1.3 owns data centres (in Wellington and Auckland), operated under the SiteNet brand where customers can rent rack space on a co-location basis (according to the Application, SiteNet does not offer outsourcing services from these data centres); and

6.1.4 provides peering exchange services through ExchangeNET where ISPs, large enterprises, and content providers can interconnect to exchange information. ExchangeNET has exchanges in Auckland, Hamilton, Wellington, Christchurch, and Dunedin.

6.2 TeamTalk provides trunked mobile radio (TMR) used, for example, by taxi companies and emergency services.

6.3 TeamTalk provides point-to-point digital microwave radio (DMR), used either: to link remote locations where other forms of broadband are not viable; or to organisations that require a mix of telecommunication services so can remain operational in the event of an emergency.

6.4 Through Farmside, TeamTalk provides broadband to rural customers across New Zealand. Farmside also provides mobile services via an MVNO arrangement with Vodafone.

Our framework

7. Our approach to analysing the competition effects of the proposed merger are based on the principles set out in our Merger and Acquisition Guidelines.[3] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

8. We determine whether a merger 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).[4]

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

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

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

define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial sense.[5]

10. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening of competition is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:

    10.1 constraint from existing competitors – the extent to which current competitors compete and the degree they would expand their sales if prices increase;

    10.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    10.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Preliminary issues

11. The questions that we will be focusing on when assessing whether the proposed merger is likely to substantially lessen competition in the relevant markets are:

    11.1 would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?

    11.2 would the merged entity be able to engage in behaviour that forecloses rivals and renders them less able to compete?

Would the merger reduce competition through eliminating the competitive constraint between the two parties?

12. Where two suppliers compete in the same market, a merger would remove a competitor that would otherwise act as a competitive constraint, potentially allowing the merged entity to raise prices. A merger could also reduce competition if one of the merging firms was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm.

13. The Application submits that there is only limited competitive overlap between Spark and TeamTalk.[6] According to the Application:

    13.1 Spark does not own any fixed local access fibre network infrastructure and so no overlap occurs with TeamTalk's local networks in Wellington and Auckland;

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

6 The Application at [8.2].

13.2 both Spark and TeamTalk provide managed data services; however, TeamTalk has a *de minimis* presence and only offers these services over its own local access fibre networks;

13.3 both Spark and TeamTalk provide data centre services, however TeamTalk's participation in data centre services provisions is limited to small co-location facilities in Wellington and Auckland and the market is highly competitive with a large number of vigorous competitors;

13.4 both TeamTalk and Spark provide WiFi in the Wellington CBD, however, Spark only offers its free WiFi hotspots around its payphone sites to Spark customers and there are low barriers for other RSPs to offer an equivalent service;

13.5 Spark does not provide mobile radio services, or own a digital radio network, and so no overlap occurs with TeamTalk's TMR service;

13.6 both Spark and TeamTalk have DMR assets; however, Spark only uses those assets for its own backhaul services and so does not currently compete with TeamTalk's DMR services. To the extent that Spark has a customer that requires DMR services it is confined to reselling using third party infrastructure;

13.7 both Spark and TeamTalk provide broadband and mobile, however Teamtalk's participation is *de minimis*, focusing on rural customers (Farmside);

13.8 Spark does not own any peering exchanges and so there is no overlap with TeamTalk's service. Spark does, however, offer "local peering" services where ISPs can interconnect with Spark's network and exchange internet traffic within that designated coverage area between ISP's end users and Spark's broadband users.

14. Our investigation will:

14.1 verify the extent of overlap that the Applicant has identified;

14.2 where overlap occurs, assess the impact the merger would have on competition compared to without the merger; and

14.3 where no overlap occurs, assess the extent to which the parties would become closer competitors without the merger and the impact the loss of that competition would have on competition.

15. The counterfactual in a merger is often the status quo. However, in this case Vodafone has made an offer to buy part of TeamTalk's subsidiary Farmside.[7] If the

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[7] Vodafone "Vodafone New Zealand to acquire 70 per cent stake in TeamTalk's Farmside for $10 million in cash" (press release, 24 March 2017).

merger does proceed, the counterfactual may not be the status quo, but rather a scenario in which Vodafone owns part of Farmside.

Would the merged entity be able to foreclose rivals?

16. A merger between suppliers can result in a substantial lessening in competition due to vertical or conglomerate effects. The proposed merger raises potential vertical and conglomerate effects.

Vertical effects

17. A vertical merger is a merger between firms operating at different levels of a supply chain (eg. a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by refusing to deal with competitors completely (total foreclosure), or by raising prices it charges competitors (partial foreclosure). This merger has a vertical dimension because it may create scenarios where Spark will provide services that rival RSPs use to compete with Spark in a downstream market. This includes (but may not be limited to) the following examples:

    17.1 TeamTalk owns fibre network assets in Wellington and Auckland CBDs. RSPs may use these services to offer broadband services that compete with those of Spark.

    17.2 TeamTalk owns DMR assets that provide point-to-point broadband connections to customers, which is an alternative for broadband provided via cable. If RSPs purchase a service from TeamTalk in order to provide broadband services to rural customers, they may compete with Spark's broadband services.

    17.3 TeamTalk owns peer exchanges in the main centres, which RSPs may use as an input for broadband services that compete with that of Spark's.

18. The Applicant submits that in the market for peer exchange services there is no prospect of the merged entity pursuing a credible foreclosure strategy that substantially lessens competition. [8] This is because:

    18.1 customers can switch to other providers of peer exchanges;

    18.2 an attempt to foreclose downstream competitors would not have a material effect as the costs from peer exchanges are small; and

    18.3 it would pose a risk to local access fibre revenues by damaging relationships with customers, who also purchase peering exchange services.

19. In considering whether it could be profitable for the merged entity to foreclose rivals due to vertical effects, we will consider:

[8] The Application at [8.7.1].

19.1 whether the merger would increase the merged entity's ability and/or incentive to foreclose competitors; and

19.2 whether that conduct is likely to have the effect of substantially lessening competition in a relevant market.

Conglomerate effects

20. A conglomerate merger is a merger between firms supplying products that may be complementary. Such mergers may, in certain situations, increase a merged firm's ability and/or incentive to foreclose competitors by, for example, bundling together complementary products, or by refusing to sell those services to customers unless they also buy a second service from it (tying).

21. We will consider whether any of the services that Spark and TeamTalk provide could be complementary and therefore used to foreclose rivals. For example, the merged entity could bundle radio and cellular services to customers.

22. In considering whether it could be profitable for the merged entity to foreclose rivals due to conglomerate effects, we will consider:

22.1 whether the merger would increase the merged entity's ability and/or incentive to foreclose competitors, such as through bundling discounts or by tying to a range of services; and

22.2 whether that conduct is likely to have the effect of substantially lessening competition in a relevant market.

Next steps in our investigation

23. The Commission is currently scheduled to make a decision on whether or not to give clearance to the merger by **22 May 2017.** However, this date may change as our investigation progresses.[9] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

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

Making a submission

25. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Spark / TeamTalk 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 **14 April 2017**.

[9] 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.

26. 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.

27. 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, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.