COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Statement of Preliminary Issues

Vocus Communications Limited / M2 Group Limited

05 November 2015

Introduction

1. Vocus Communications Limited (Vocus) is proposing to acquire 100% of the shares and/or assets in M2 Group Limited (M2). On 09 October 2015, the Commerce Commission registered an application from Vocus seeking clearance for the proposed acquisition.

2. The public version of the application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/873

3. The Commission will give clearance if 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.

4. This Statement of Preliminary Issues outlines the key competition issues we currently consider to be important in deciding whether or not to grant clearance.

5. 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 November 2015**.

The parties

6. Vocus is an Australia 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.[1]

7. 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 large customers.

8. M2 provides residential and commercial telecommunications services through the Slingshot, Orcon, 2talk, Flip and CallPlus brands. M2 provides business and residential internet and voice services, managed data services, and mobile phone services. M2 also provides wholesale services to smaller ISPs.

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

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.[2] 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).[3]

11. We define markets in the way that we consider best isolates the key competition issues that arise from the acquisition. In many cases this may not require us to precisely 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 common sense.[4]

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

    12.1 existing competition – the degree to which existing competitors compete;

    12.2 potential competition – the extent to which existing competitors would expand their sales or new competitors would enter the market and compete effectively if prices were increased; and

    12.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert substantial influence on negotiations.

Preliminary issues

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

    13.1 Would the merged entity be able to raise prices or reduce quality by itself?

    13.2 Would the merged entity be able to raise its rivals' costs so as to render them less able to compete?

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

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

4 Section 3(1A).

Would the merged entity be able to raise prices by itself?

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

15. In its application, Vocus submits that it does not compete closely with M2 in any of the relevant markets as the two companies focus on offering different services. To the extent that they do offer the same services, the two companies submit that they do so to different customer groups, and so there is little competitive overlap. Vocus considers that it is focused on the provision of broadband and voice service to large commercial and government customers which require complex, bespoke solutions. In contrast, Vocus submits that M2 focusses on providing a range of "off the shelf" broadband and voice services to SME's.

16. We will consider the extent to which Vocus and M2 compete for the provision of fixed line voice and broadband to both residential and commercial customers and the degree of competitive constraint other providers in the market would provide on the merged entity. We will also consider whether in the absence of the acquisition, either Vocus or M2 would be likely to expand their offering in the near future (either their targeted customer groups and/or the type of services offered), and whether any competitive constraint from this would be lost as a result of the proposed acquisition.

Would the merged entity be able to raise its rivals' costs?

17. Like many networked industries, the telecommunications industry is characterised by competitors that are vertically integrated (ie, they operate at different levels of the supply chain). As such, certain competitors in the output markets rely on each other for the provision of services in the input markets.

18. The proposed merger will combine the owner of an upstream input supplier, in this case Vocus and its fibre optic backhaul network, and a purchaser of this input (M2). We will consider whether the proposed merger would change the merged entity's incentive to worsen terms for backhaul inputs to those buyers that compete with the merged entity in downstream markets, in particular residential and commercial broadband and voice services. This in turn could result in a substantial lessening of competition in those downstream markets.

19. We will consider the following issues:

    19.1 whether the merged entity has market power in the sale of backhaul services in any relevant market; and

    19.2 whether the merged entity would have the incentive and ability to worsen the input terms to its rivals (including denying access).

Next steps in our investigation

20. The Commission is currently aiming to make a final decision on whether or not to give clearance to the merger by **04 December 2015.** However, this date may change as our investigation progresses.[5]

21. 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

22. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Vocus/M2 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 **13 November 2015**. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version, if applicable.

23. 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.

5 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.