

## Vodafone/SKY – Vodafone’s Response to Letter of Unresolved Issues

### 1. Introduction and Summary

- 1.1 This submission comprises Vodafone’s response to the Commission’s letter of unresolved issues sent to Vodafone and dated 31 October 2016 (the **LOUI**) regarding the clearance applications from Vodafone Europe BV and SKY Network TV Limited in respect of the proposed merger of Vodafone and SKY in New Zealand (the **Proposed Transaction**).
- 1.2 This response provides detailed evidence demonstrating that the potential theory of harm as set out in the LOUI is unfounded. As detailed below, this is because:
- (a) New Zealand’s telecommunications markets are highly competitive and resilient;
  - (b) SKY content, while valuable, does not demonstrably drive substantial uptake in broadband or mobile services in New Zealand;
  - (c) even if this were the case, the merged entity will (and will be incentivised to) offer wholesale SKY and retail standalone SKY;
  - (d) existing and potential market participants will not, in any case, be driven below competitive scale. The market will remain as competitive as ever.

#### *Telecommunications markets are highly competitive*

- 1.3 New Zealand’s broadband and mobile markets are highly competitive. In the broadband market, structural separation drives minimal barriers to entry resulting in 90+<sup>1</sup> competitors of varying sizes competing across a range of service, value and bundle competition. In mobile, the three providers continue to invest in their networks and compete through sharply priced bundles of texts, calls and data, along with add-ons such as Spark’s Spotify and Lightbox offers.
- 1.4 Within the telecommunications market, Vodafone is a substantial operator, but is not the largest. Its mobile share (at **[REDACTED]** to that of Spark’s **[REDACTED]** while its broadband share (**[REDACTED]**) is **[REDACTED]**). A recent investor presentation in relation to 2degrees reveals the strong growth of 2degrees, such that it now accounts for around 23% of mobile connections and a growing share of broadband.
- 1.5 Against this background, the Proposed Transaction would need to result in a monumental change in telecommunications markets to risk substantially lessening competition. For the reasons below, there is no prospect of this occurring. Rather, the Proposed Transaction is aimed at increasing innovation and choice.

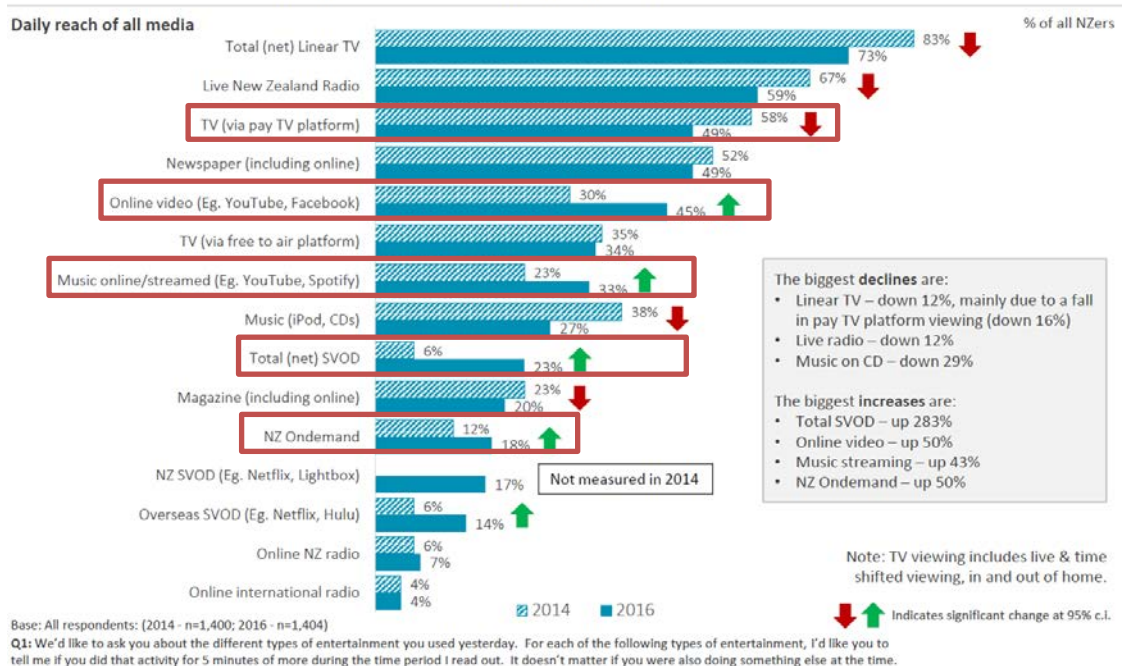
#### *SKY content does not drive substantial uptake of broadband or mobile products in New Zealand*

- 1.6 SKY content is not a “must have” for rival telecommunications service providers (**TSPs**) to compete in the New Zealand market. SKY content is valuable to some consumers, but there is a wealth of other content available. Furthermore, **[REDACTED]**. Accordingly, the merged entity will not be able to leverage SKY content to switch substantial numbers of customers to the merged entity’s broadband. Evidence of this includes the following.
- (a) Rival TSPs have not to date seen the ability to provide a SKY bundle as critical to attract customers (despite the availability of commercial terms). This reflects the fact that competition takes place across a multitude of factors and the competitors have simply decided to focus on other ‘levers’ to pull to attract consumer demand.

<sup>1</sup> See IDC “To 1 GBps and Beyond: The New Zealand Telco Story”

- (b) Recent, independent survey data shows consumers increasing usage of digital media from a wide variety of sources, while decreasing their usage of Pay TV. There is no trend towards consumers valuing SKY content more highly (and if anything the opposite is the case).

Linear TV (73% daily reach) and radio (59%) remain the most popular media among New Zealanders. However audiences for nearly all traditional media have declined since 2014 whereas nearly all online media have grown significantly.



- (c) Research commissioned by Vodafone to guide its internal business decisions demonstrates that the addition of SKY content in a broadband bundle is a [REDACTED].

- (d) consistent with the customer research business cases for, and results of, deep discount promotions of SKY content by Vodafone demonstrate that such promotions are expected to drive [REDACTED]. The chart below reveals that, [REDACTED]

(i) [REDACTED]

(ii) [REDACTED]

[REDACTED]

- (e) More generally, the [REDACTED], indicating that [REDACTED].

- (f) Market data and existing business plans corroborate the estimates of [REDACTED] (consumer broadband [REDACTED] to accrue by 2020) in the forward looking synergies workings.

1.7 The relationship between SKY content and sale of mobile services is even more remote. Contrary to the Commission's potential concern, the merged entity will not be able to foreclose access to SKY content to competing mobile providers or their customers in order to reduce their scale.

1.8 Network data shows that SKY [REDACTED]. In particular, premium live sport is the content least likely to be consumed over mobile networks on mobile devices on the go compared to the likes of YouTube (SKY accounts for approximately [REDACTED]), Facebook and SVOD services – a fact borne out by the data. This is also consistent with the parties' forward-looking synergies calculations.

- 1.9 The information summarised above and detailed below provides concrete evidence that the merged entity will not be able to leverage SKY content to switch substantial numbers of customers to the merged entity's telecommunication products. By contrast, third parties have failed to provide any evidential support.

*Merged entity will continue to wholesale and offer standalone SKY*

- 1.10 The merged entity will not be incentivised to raise the standalone SKY price or wholesale prices to rival TSPs compared to the scenario absent the Proposed Transaction.
- (a) As set out above, consumers are increasingly consuming a wide range of competing digital content and reducing their consumption of Pay TV. Increasing the price of standalone SKY would cause a substantial loss of customers and revenue, not offset by any increase in comparatively low margin telecommunications customers and revenues in a highly competitive telecommunications market. As above, **[REDACTED]**.
- (b) Similarly, the Commission has accepted that it is in the merged entity's interests to continue to wholesale SKY services to rival TSPs as this drives revenue. If the merged entity sought to wholesale on worse terms than a standalone SKY would absent the Proposed Transaction, it would not attract any reseller customers and would gain no revenue. This loss of revenue would not be offset by an increase in broadband or mobile revenue because rivals do not need SKY content in order to compete in the relevant telecommunications markets in New Zealand. Such a strategy would also be contrary to explicit statements in SKY's investor materials relating to the Proposed Transaction.

*Competitors will not be driven below competitive scale*

- 1.11 Even if rivals lost scale as a result of the Proposed Transaction, this would not adversely affect the competitiveness of rivals (either in the short or long term) such that a substantial lessening of competition could result.
- 1.12 In relation to broadband:
- (a) the New Zealand market is amongst the most competitive in the world. This is driven by structural separation, government funding of fibre networks and a regulatory regime that ensures a level playing field for all TSPs;
- (b) there are no barriers to entry evidenced by the fact that there are 90+ suppliers; and
- (c) small to medium sized competitors such as 2degrees (Snap) and Trustpower have demonstrated that they can be highly competitive and increase market share despite starting from a low base.
- 1.13 In this environment it is simply not feasible that competition will be weakened, let alone substantially lessened, as a result of the merger even if it did reduce the scale of competitors.
- 1.14 Longer term, the Proposed Transaction will not affect the ability of rivals to make investments in their networks, such as by way of fibre unbundling, should they see value in doing so.
- (a) Unbundling is naturally scalable as it can be done exchange by exchange, with the equipment scaled for the number of connections. Indeed, entities now owned by Vocus were amongst the more active unbundlers in the copper context, which proves that smaller firms can and will unbundle in the event they see value in doing so.
- (b) In any event, whether a TSP unbundles an exchange would have a minimal impact on its ability to successfully compete in the market. The moment a TSP unbundles an exchange it triggers competition between that TSP and the fibre access provider. This benefits all TSPs (and consumers) regardless of whether they have unbundled themselves. TSPs will continue (as is the case today in relation to copper) to unbundle where they see value and

buy from the incumbent where they do not. In relation to the latter, unbundling of itself is likely to drive innovation and better terms from the incumbents benefitting those TSPs who chose not to unbundle.

1.15 In relation to mobile:

- (a) the New Zealand market is highly competitive with competitive prices and amongst the best 4G speeds in the world; and
- (b) Spark and 2degrees are aggressive competitors to Vodafone. 2degrees has recently announced to investors (as part of a proposed listing) that it is an “established and highly competitive challenger with strong momentum” and that the New Zealand market exhibits “attractive industry drivers, with 2degrees well positioned to benefit”.

1.16 Most of the mobile network operators’ (**MNOs**) investments into their 4G networks have now been made, and these networks are characterised by low variable costs. Any reduction in scale would increase available capacity, thus resulting in more aggressive market behaviour and more competition, not less.

1.17 Longer term, the Proposed Transaction will not affect the ability of rivals to make investments in their networks. Each MNO’s 4G network is largely complete, with no other substantial network investments expected within the next five years.

1.18 At some point 5G services may be rolled out, although all aspects of this are subject to considerable uncertainty. Vodafone expects that, much like 4G, all MNOs will eventually introduce 5G technology. Even if some parties’ rollouts are delayed (which is highly unlikely to arise as a result of the Proposed Transaction), this will in no way adversely affect competition in the market. (in practice such roll-outs are staged over time, with larger cities done first.) Vodafone was the only provider of 4G services for a period **[REDACTED]**. When it arrives, 5G will simply be one of many competitive differentiators with other factors such as price and data allowances continuing to be critical to customer purchasing decisions.

**PART A: THE TEST FOR CLEARANCE****2. The test for clearance**

- 2.1 The Commission must satisfy itself “that it is more likely than not that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market.”<sup>2</sup> The court equates the standard of proof for ‘satisfied’ to the balance of probabilities.<sup>3</sup>
- 2.2 The Commission must undertake a forward looking analysis and so there is always a degree of uncertainty when predicting the future states of the world. However, those future states must not be speculative, they must be evidence based and amount to a “real and substantial prospect”.<sup>4</sup>
- 2.3 The Commission’s Mergers and Acquisitions Guidelines and the Commission’s 2016 *Spark New Zealand/Craig Wireless New Zealand/Woosh Wireless Holdings* clearance decision provide insight as to how the Commission approaches establishing the counterfactual:

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.

- 2.4 The position is therefore that an evidence based assessment is required in order to differentiate between a ‘real and substantial’ prospect and mere possibilities.
- 2.5 For the reasons set out below, all evidence on the record strongly contradicts the theories of harm being tested by the Commission. There is no evidence to support a “real and substantial prospect” that the Proposed Transaction will give rise to an SLC.

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<sup>2</sup> *Commerce Commission v Woolworths Limited* at [97].

<sup>3</sup> *Commerce Commission v Woolworths Limited* ([2008] NZCA 276).

<sup>4</sup> At [135].

**PART B: THE COMPETITIVE CONTEXT OF THE TRANSACTION**

- 2.6 We address below the specific aspects of the Commission's theory of harm. However, before doing so, we set out the broader market context of this transaction.
- 2.7 New Zealand's broadband and mobile markets are highly competitive. In the broadband market, structural separation drives minimal barriers to entry resulting in 90+ competitors of varying sizes competing across a range of service, value and bundle competition. In mobile, the three providers continue to invest in their networks and compete through sharply priced bundles of texts, calls and data, along with add-ons such as Spark's Spotify and Lightbox offers.
- 2.8 Within the telecommunications market, Vodafone is a substantial operator, but is not the largest. Its mobile share (at [REDACTED]) is similar to that of Spark's [REDACTED] and its broadband share ([REDACTED]). At [REDACTED]. It has also shown limited growth over recent years, particularly when compared to its smaller competitors. A recent investor presentation in relation to 2degrees reveals the strong growth of 2degrees, such that it now accounts for around 23% of mobile connections and a growing share of broadband. Against this background, the Proposed Transaction would need to result in a monumental change in telecommunications markets to risk substantially lessening competition. The NERA report provides further information in this regard.<sup>5</sup>
- 2.9 Rivals have not "retrenched" in the past in the face of major market developments (e.g. local loop unbundling, introduction of 3G and 4G technology, structural separation of Telecom and UFB roll out, RBI, Commission decision on copper pricing, Netflix launch, etc.<sup>6</sup>). Rather, telecommunications markets have become more competitive every year as competitors innovate and differentiate their offerings in a myriad of ways in order to win business, prompting other competitors to react with initiatives of their own, and so on.
- 2.10 Indeed, this is precisely what we observe in the market at present. Since the date the merger was announced, some of the competitive responses have included:
- (a) Spark has continued to make Lightbox available at no cost to all of its ~ 680,000+ residential subscribers and has also made Lightbox free as part of pay monthly mobile plans. It has also announced substantial (50%) increases in data caps for its broadband users and increased mobile data caps. Most recently, it has begun a summer promotion of three months free unlimited broadband on a 12 month contract. This is in addition to leveraging its nationwide footprint of 1000+ payphones (which it secured as part of Telecom's separation) to offer over 1,000 free wi-fi zones to Spark customers and offering free Spotify.
  - (b) Vocus has recently offered Orcon customers a free Xbox One S when they sign up for a 24 month 1GBps fibre plan and is currently offering limited edition designer series modems on all of its plans.
  - (c) 2degrees recently decreased its prices for plans offering unlimited NZ & Australia calls and texts and 4.5GB of carryover data by \$10 to \$49.95, a decrease of 17%.
  - (d) Trustpower has continued aggressively to market its heavily discounted broadband offer, bundled with electricity, which has continued to gain in market share.
  - (e) MyRepublic is offering half price unlimited fibre broadband for the first 6 months of a 24 month contract.
  - (f) Stuff Fibre has entered the broadband market. (That Stuff entered post-announcement is consistent with the parties' view that the merger will not alter the existing intensity of competition in telecommunications markets.)

<sup>5</sup> Nera Report "Sky/Vodafone – response to LOUI", 11 November 2016.

<sup>6</sup> [REDACTED]

2.11 These developments are hugely beneficial to consumers and Vodafone expects that they will only intensify following the Proposed Transaction.

**PART C: FACTUAL AND COUNTERFACTUAL****3. With the merger (the factual)**

- 3.1 For the most part, Vodafone agrees with the Commission's assessment of the factual set out in paragraph 14 of the letter. It does expect the merged entity to offer differentiated bundles and content to customers and cross-sell products to consumers. Indeed, it expects the Merged Entity will innovate to develop new products that are currently not offered in market.
- 3.2 These actions will directly benefit consumers and provide the underlying rationale for the proposed acquisition. The dynamic efficiencies delivered by innovation and differentiation (which have and will prompt competitive responses from other firms) are precisely the kind of outcomes which competition law should foster.
- 3.3 Vodafone also agrees that the Merged Entity will make SKY services available for resale and retransmission. Such products will be sold on terms that allow rival RSPs to compete with the Merged Entity because:
  - (a) the purpose of wholesaling is to gain more revenue from customers consuming content (a point made in the investor materials), which would not be achieved if content was not wholesaled on sufficiently attractive terms; and
  - (b) even if the Merged Entity did not wholesale, this would not have any effect on rivals' competitiveness.
- 3.4 Both of these issues are addressed in more detail below.

**4. Without the merger (the counterfactual)**

- 4.1 Vodafone considers that the Commission's assessment of the counterfactual in the LOUI provides a reasonable basis against which to assess the competitive effects of the Proposed Transaction.



**PART D: THE COMMISSION'S THEORY OF HARM****5. The theory of harm**

- 5.1 The Commission's stated concern is that while consumers *may* initially benefit from lower prices, rival broadband and mobile providers *could* lose or fail to achieve scale and become less competitively effective. *Over time* this *could* reduce competition in these markets and *potentially* enable the merged entity to raise prices or lower the quality of service beyond what it would be able to do without the merger occurring. [Emphasis added]
- 5.2 The theory of harm the Commission is exploring relies on five cumulative conditions being met. If any one condition is not met then the theory of harm does not hold. The following table sets out the conditions and why the theory of harm should be dismissed on the basis of the available evidence.

Element of theory of harm	Vodafone's response
The merged entity has substantial market power in the supply of certain premium content, particularly live sports.	Whether the merged entity has substantial market power in content (which is denied) is not the relevant question. It is whether this content is "must have" for TSPs to successfully compete, which it is not.  Even if SKY content was a "must have", the majority of these rights are temporary and contestable when they come up for renewal within the next 4 to 5 years.
The merged entity will make buying premium content on a standalone basis comparatively less attractive for consumers than buying a bundle including such content from the merged entity.	Consumers are decreasingly attracted to SKY services due to the increase in OTT competitors. Increasing the price of standalone SKY products would cause a substantial loss of customers and revenue, not offset by any increase in comparatively low margin telecommunications customers and revenues in a highly competitive telecommunications market.
The merged entity will set wholesale terms for key content that would not allow rival TSPs to compete against the merged entity's bundle.	Such an approach would not be rational as it would sacrifice wholesale revenue, which would not be offset by any increase in broadband share or revenue. It would be tantamount to a decision not to wholesale, which would be contrary to statements made in the investor materials.
The Merged Entity's behaviour will cause consumers to switch to its services to such an extent that one or more rival TSPs will lose scale in fixed broadband and/or mobile markets. That reduction in scale will have a meaningful impact on their ability to constrain the merged entity.	SKY content is not a significant driver of broadband uptake, even when substantially discounted. The link with mobile is even more remote. There is no bundled offer that the merged entity could rationally provide that would cause sufficient switching for its rivals to lose scale.
The merged entity subsequently increases prices / decreases quality such that an SLC in a <u>market overall</u> results.	As a result of structural separation, the broadband market is highly competitive with 90+ players. Even if rivals lost share this would not render them uncompetitive now or in the

	future. In the mobile market, any reduction in a rival's scale (which is even more remote) would not reduce competitive intensity given the three extensive networks that exist, each with low variable costs. Equally, a reduction in scale would not prevent future network investment such that an SLC would result.
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- 5.3 These conditions are interrelated. If the merged entity does not have market power in content and/or its content is not a "must have" input into telecommunications services then offering bundles of such content will not have the effect of substantially increasing the merged entity's market share. We address these issues in Part E below.
- 5.4 We address the incentives of the merged entity to raise the standalone price of SKY and its incentives to wholesale together at Part F below.
- 5.5 Finally, we address the lack of competitive harm that would arise even if rivals lost market share at Part G below.

**PART E: SKY CONTENT WILL NOT CAUSE SUBSTANTIAL SWITCHING TO THE MERGED ENTITY****6. Summary of evidence in this section**

- 6.1 The Commission is concerned that SKY has “substantial market power” in content markets. It attributes this primarily to the rights that SKY holds to sports content. Vodafone acknowledges that SKY content rights are valuable for bundling with its own services as a key retention tool so to enjoy longer customer relationships (but notes they are just one of many tools which achieve this purpose).
- 6.2 However, the Commission’s theory of harm relies on the merged entity being able to use this content to switch a substantial number of rivals’ customers to its broadband and/or mobile services, which is an altogether different assessment. The critical point is whether that content is a “must have” for competing TSPs to continue to compete in telecommunications markets in New Zealand. It is not.
- 6.3 The evidence set out in this section shows that SKY content is not a must have today, and nor is it likely to become a must have in the future.
- (a) Rival TSPs have not to date seen the ability to provide a SKY bundle as critical to attract customers. Commercial terms have been available to them but, unlike Vodafone, they have not taken this up.
  - (b) Recent, independent survey data shows that consumers are increasing their usage of free and subscription digital media from a wide variety of sources, while decreasing their usage of Pay TV. This addresses the Commission’s concern that there may be a trend towards more users valuing SKY content.
  - (c) Research commissioned by Vodafone to guide its internal business decisions demonstrates that **[REDACTED]**.
  - (d) Business cases for, and results of, deep discount promotions of SKY content by Vodafone demonstrate **[REDACTED]**.
  - (e) More generally, **[REDACTED]**, indicating that it **[REDACTED]**.
  - (f) Market data and existing business plans corroborate the estimates of **[REDACTED]** in the *forward looking* synergies workings.
  - (g) The relationship between SKY content and sale of mobile services is even more remote. Network data shows that SKY content is not, and **[REDACTED]**. This is also consistent with the parties’ forward-looking synergies calculations.
- 6.4 We address each of these points in more detail below. Overall, Vodafone considers that the evidence on the record makes clear that the Merged Entity will not be able to use SKY content to drive sufficient switching of customers to the Merged Entity to raise a competition concern.

**7. Rival TSPs do not see SKY as critical to compete in telecommunications markets**

- 7.1 Experience from the past 8 years demonstrates that TSP’s do not need SKY content to compete effectively in telecommunications markets, and nor is there any evidence on the record to suggest that will change in the future. No other TSP currently resells or retransmits SKY (albeit Vodafone understands the merger has prompted some to commence negotiations with SKY) and those that have in the past have stopped and concentrated on other offers (including competing OTT content offers). This has not resulted in Vodafone’s market share increasing or its rivals’ decreasing. In fact, Vodafone’s share has decreased.

7.2 Decisions by other TSPs not to enter wholesale arrangements with SKY are not due to the SKY terms being “uncommercial” as claimed by third parties. Vodafone is able to resell SKY on a commercial basis and does not receive preferential terms.

7.3 The SKY submission will address third-party interactions in more detail. From Vodafone’s perspective the appropriate conclusion from the fact that other competitors haven’t entered into wholesale arrangements with SKY is because they have taken the view that reselling SKY is merely one of a multitude of ways to attract and retain customers.

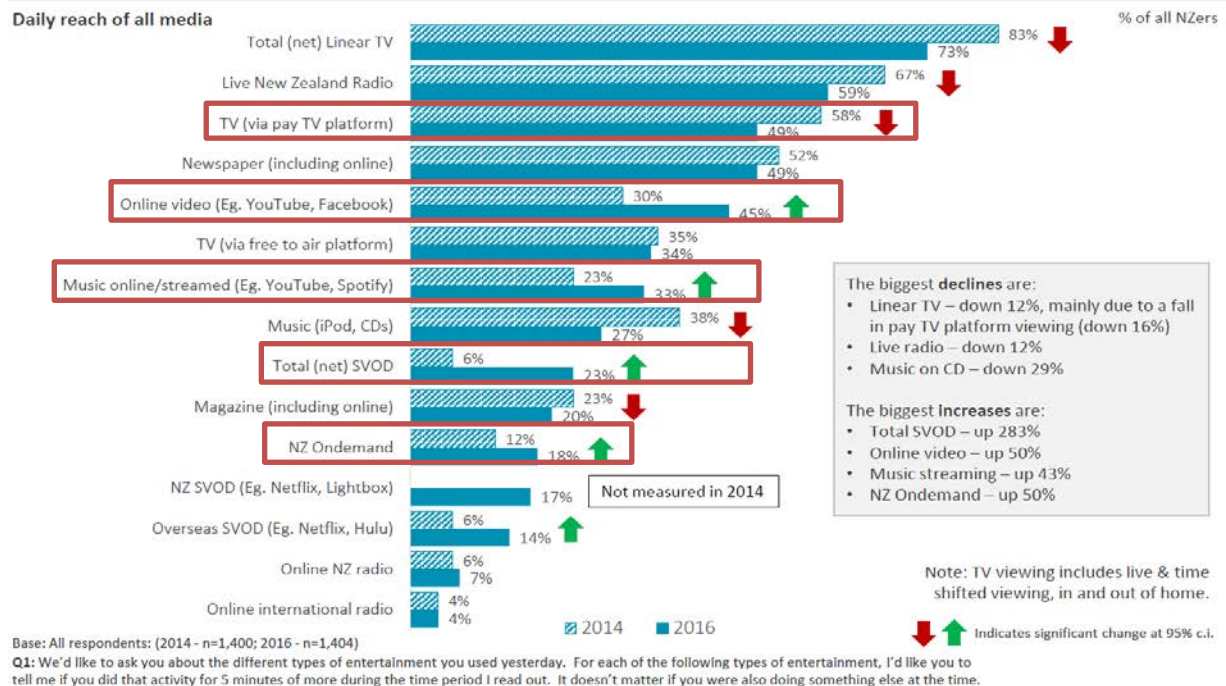
## 8. **Consumers value a wide variety of content other than pay-TV**

8.1 A range of recent, publicly available survey data provides ample evidence that consumers are increasingly consuming a much wider variety of content, with a substantial increase in consumption of free online video and subscription video on demand (**SVOD**) content. This reveals there is no basis to conclude that SKY content has become *more* important to consumers (and in theory TSPs). If anything, the opposite is the case.

8.2 The recently released NZ On Air Audience Report 2016 is based on consumer interviews conducted in April and May of this year. It reports that audiences for nearly all traditional media have declined since 2014, whereas nearly all online media have grown “significantly”. Survey participants were asked to review a list of different entertainment and indicate whether they had used any of the media listed for 5 minutes or more during the previous day. The results of this survey indicate that use of pay-TV has decreased 16% whilst online video (including via YouTube and Facebook) has increased by 50% (and is now almost as popular as pay TV). The relevant extract of this report is set out below. Evidence of this nature is important given the critical need to answer the underlying question, which is whether *SKY content* is or will become a must have to compete in the relevant markets in New Zealand.

8.3 As above, pay TV platform viewing decreased by 16%, while the biggest increases were total SVOD (up 283%), online video (up 50%), music streaming (up 43%) and NZ OnDemand (up 50%). Given the clear direction of these trends, the evidence strongly suggests that SKY content is unlikely to increase in importance as a driver of broadband uptake in the future.

Linear TV (73% daily reach) and radio (59%) remain the most popular media among New Zealanders. However audiences for nearly all traditional media have declined since 2014 whereas nearly all online media have grown significantly.



#### 8.4 Rather, consumers are increasingly valuing a range of other content. As reported by NZ On Air:<sup>7</sup>

- Online video via sites like YouTube and Facebook now reach more than six in ten New Zealanders each week.
- Music via YouTube and Spotify reaches five in ten and two in ten New Zealanders respectively.
- NZ Ondemand sites now reach four in ten New Zealanders each week.
- Online NZ radio now reaches nearly two in ten New Zealanders.

#### 8.5 The NZ On Air report also demonstrates the comparative importance to consumers of various TV channels and websites.

<sup>7</sup> NZ On Air "Where are the audiences?" 2016 Report.

The biggest daily audience concentrations on single channels, stations or sites are on TV ONE, YouTube, TV3, Facebook, and TV2.



- 8.6 The report shows that three times as many respondents used YouTube and more than two times as many used online video on Facebook the previous day than used a SKY sports channel. The numbers of respondents using SKY Sports channels decreased around 14% over the last two years from 14% of users to only 12% of users in 2016. It is now only marginally higher than TVNZ Ondemand.
- 8.7 This evidence strongly indicates that SKY TV is not a critical part of a broadband bundle in New Zealand. It is consistent with what we observe in the broadband and mobile markets today. Critically though, this evidence reveals that, if anything, SKY content is not likely to become *more* important in the future.
- 8.8 Specifically in relation to music, the NZ On Air report suggests YouTube, Spotify and other music streaming platforms are increasingly important; reporting a “sea change” in terms of music consumption – although less so in terms of radio listening. More New Zealanders now consume music via streaming each day (33%) compared to 2014 (at only 23%). (This trend is more prominent among younger New Zealanders.) In Vodafone’s view, such content is likely to be a much more natural fit with mobile services than the likes of SKY sport.
- 8.9 The Nielsen “Connected Consumer” data provides a similar perspective. It finds that consumers access a wide variety of content using internet television, with sport accessed by comparatively few New Zealanders.

[REDACTED]

- 8.10 Regarding the performance of SKY online content over time, there is [REDACTED]

[REDACTED]

- 8.11 Vodafone does not have the capability to measure and provide a breakdown of SKY services on its fixed network to compare against other video services. However, as for mobile, it considers

that SKY data would [REDACTED]. As advised in its response to third party submissions, on Vodafone's fixed network:

- (a) YouTube accounts for around [REDACTED] of data traffic;
- (b) Netflix accounts for around [REDACTED] of data traffic; and
- (c) content delivered through Akamai accounts for [REDACTED] of data traffic. Of this, traffic, Vodafone estimates that [REDACTED] is accounted for by SKY online services (the other services delivered by Akamai include Lightbox, TV3, TV One, Apple TV, Facebook and others).

8.12 The network data and independent survey data is consistent with the view set out in the independent adviser's report on the merits of the Proposed Transaction prepared by Grant Samuel, as required under the New Zealand Takeovers Code. This report states:<sup>8</sup>

“The growing popularity of Over-the-Top (“OTT”) services delivering video on demand via high speed broadband internet has fundamentally changed the competitive position of pay television operators around the world. The effect for SKY TV has been increasing rates of subscriber churn and a flattening of revenue growth. At the same time, heightened global competition for content has driven up programming costs, resulting in a projected fall in SKY TV's earnings across the FY16 and FY17 financial years.”

9. **Vodafone internal data on SKY content as a driver of broadband uptake**

9.1 The independent data sources summarised above are consistent with Vodafone's own survey data, [REDACTED]. Key drivers include price, service and network speed/reliability.

[REDACTED]

9.2 Recent survey data from Vodafone's testing of various customer propositions from August 2016 demonstrates [REDACTED].

[REDACTED]

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<sup>8</sup> Grant Samuel “Proposed Acquisition of Vodafone New Zealand Limited: Summary of our Independent Adviser's Report and Appraisal Report.”

**[REDACTED]**

- 9.3 Vodafone uses this information internally to guide it as to the likely uptake of promotional offers, a point expanded upon in section 10 below, which provides data on Vodafone's bundle performance over time and **[REDACTED]** in causing customers to switch to its broadband products.
- 9.4 The Commission is concerned that bundling by the merged entity will cause significant numbers of non-Vodafone customers to switch to the merged entity, therefore reducing rivals' scale. However, as demonstrated above, other propositions are more highly valued by consumers.
- 10. Evidence of ability of discounted SKY content to drive broadband uptake**
- 10.1 Consistent with the findings above, actual market evidence shows that **[REDACTED]** in New Zealand and is not expected to be in the future. Vodafone has been reselling SKY services for some time, without experiencing any growth in its broadband share. The Commission has raised a concern that this may change if Vodafone was to deeply discount its bundles.
- 10.2 As Vodafone has previously submitted to the Commission, a strategy of deeply discounting bundles of broadband and pay TV (beyond short term promotions) is not likely to be profitable for Vodafone. SKY content is expensive and sacrificing pay TV revenue in an attempt to gain broadband share (where margins are small) is not a rational business strategy as it needs to attract a massive number of broadband customers to make up for the significant revenue loss.
- 10.3 This is reinforced by Vodafone's previous experience in providing discounted SKY offers in an attempt to gain customers. Despite substantial discounts on SKY products, often over the entire term of a contract (e.g. 12 months' free SKY Sport or Movies on a 12 month broadband contract, including free installation and free MySky for eligible customers), Vodafone generally forecasts that these promotions will drive additional subscriber numbers equivalent to **[REDACTED]** More specifically within the last two years Vodafone has offered the following promotions:
- (a) Vodafone assessed a 2 month offer of 12 months free SKY Sports or Movies when a customer signs up to an unlimited broadband plan with home phone for a 12 month term. It anticipated adding **[REDACTED]** incremental customers as a result of this offer **[REDACTED]**. This promotion was first offered in May of 2015 (and was ultimately extended until the end of November 2015);
  - (b) Vodafone assessed an offer of 6 months free SKY Sports or Movies when a customer signs up to an unlimited broadband plan for a 12 month term. It anticipated adding **[REDACTED]** incremental customers as a result of this offer **[REDACTED]**. This promotion ran from July to October 2015;
  - (c) Vodafone assessed an offer of 6 months free NEON on 80GB broadband plans with a 12 month term. It anticipated adding **[REDACTED]** incremental customers as a result of this offer, **[REDACTED]**. This promotion ran from August to October of 2015;
  - (d) Vodafone assessed an offer for 12 months free SKY Sports or SoHo when a customer signed up to an unlimited broadband plan with home phone for a 12 month term. It anticipated adding **[REDACTED]** incremental customers as a result of this offer **[REDACTED]**. This promotion ran from January to May of 2016; and
  - (e) Vodafone assessed extending the offer referred to in (d) above. It anticipated adding **[REDACTED]** incremental customers as a result of this offer **[REDACTED]**. This promotion ultimately ran from July to October of 2016.
- 10.4 By way of comparison, Vodafone anticipated an additional **[REDACTED]** customers as a result of a May 2015 promotion involving a free 12-month speed upgrade to VDSL (when a customer signed up to Vodafone Broadband (80G or unlimited)), compared to **[REDACTED]** customers as a result of an October 2015 promotion involving free SKY-Sports and Soho with an unlimited broadband plan.



- 10.5 These initiatives reflect Vodafone's intent to compete in intensely competitive telecommunications markets characterised by a vast and constantly changing array of consumer offers. In this environment, it must react to competitor action in order to both win new customers and seek to retain existing customers.
- 10.6 As it is, the offers described above have a payback period of [REDACTED]. If Vodafone was to discount the bundle even further (i.e. beyond the free Sport, Movies and/or SoHo component plus the free MySKY) [REDACTED]. Even if such a level of discounting increased uptake 20-fold (which is highly unlikely), this would represent a market share shift of [REDACTED] - well below the level at which competitive harm could possibly occur.
- 10.7 This dynamic is reflected in the success rates of the offers described. Vodafone does not conduct formal ex post reviews of the actual uptake of these offers. However, it informally tracks success rates and uses these to guide their expectations for future offers. If the SKY promotions had been vastly more successful than anticipated, then expectations for subsequent promotions would have increased (which has not occurred).<sup>9</sup>
- 10.8 However, the impact of the SKY offers over time is starkly demonstrated by [REDACTED]. The following graph shows that the [REDACTED].

[REDACTED]

- 10.9 As the chart demonstrates, an on-going discount to customers for a broadband/SKY bundle and frequent, and deep promotions of SKY content, [REDACTED].

## 11. Overall trends in Pay TV bundles

- 11.1 We understand that the Commission is still testing whether the trend to bundling broadband and pay TV (particularly sport) is increasing or likely to increase in the future. Vodafone data demonstrates that, if anything, the bundle offer is reaching saturation. [REDACTED]

[REDACTED]

- 11.2 As the chart shows, growth of the customer numbers with a Pay TV bundle in the last two years [REDACTED]. This is despite the on-going \$15 per month discount available to bundle customers and the number of substantial promotions offered during this period (as set out above). More recently, the introduction of Netflix and Lightbox have impacted uptake.

## 12. Consistency with forward looking synergy forecasts

- 12.1 The data above in relation to the effect of promotions and bundle uptake is consistent with, and supports the veracity of, the synergies calculations previously provided to the Commission. The Parties' **forward looking** synergies analysis forecasts [REDACTED] consumer broadband [REDACTED], consumer mobile ([REDACTED]) and pay-TV ([REDACTED]) to accrue by 2020. Even after 8 years post-merger, the parties expect that around [REDACTED] SKY subscribers will have their broadband supplied by a competitor. Simply put, [REDACTED]. Vodafone has previously provided substantial detail on the rigorous process undertaken by the directors and/or senior staff of both parties in signing off the synergies due to the very serious consequences of getting this wrong.
- 12.2 The level of discount used to calculate the various synergies was considered and determined to be \$15.00. This is consistent with the current level of discount, and also consistent with the overall rationale for the transaction from Vodafone's perspective, which is to create value for consumers by providing them with an overall offering which will appeal to them, [REDACTED].
- 12.3 Given the nature of the Explanatory Memorandum process, in Vodafone's view there is no basis upon which to dismiss or underplay the weight to be placed on the synergies forecasts – which

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<sup>9</sup> [REDACTED]

were central to the entire deal – on the basis that if a different business strategy were adopted [REDACTED] then the figures would likely be different. If such a strategy were plausible then it would have been addressed in the synergies workings and the Explanatory Memorandum. Its initial post-Transaction plans and promotions are consistent with this, and little different to what the parties offer currently.

- 12.4 Finally, it is not the case that a SKY bundled offer is needed to capitalise on the opportunities created by the higher levels of customer churn during the UFB roll-out.
- (a) First, the UFB roll-out is already well-advanced.
  - (b) Second, notwithstanding Vodafone is the sole TSP offering a bundle which includes SKY content, its share of new fibre adds [REDACTED]. As indicated in the table below, IDC reports Vodafone with a market share of [REDACTED] as at June 2016. [REDACTED] overall broadband share.

[REDACTED]

### 13. SKY content and the mobile market

- 13.1 In relation to mobile, the Commission's LOUI recognises that the number of SKY subscribers represents only a small proportion of the number of mobile connections. Furthermore, its letter does not state a view that SKY content is likely to be a compelling driver of sales of mobile services. Rather, it appears to suggest that because consuming content over mobile phones and the associated data usage will become more important to Mobile Network Operators (**MNOs**) in the future, Vodafone will be able to disadvantage its rivals by foreclosing access to SKY content. Nevertheless, we address both of these issues below.
- 13.2 The evidence of actual behaviour in the mobile market demonstrates that these concerns are unfounded. Content is widely available and the biggest drivers of data usage on mobile phones [REDACTED]. Customers using data to consume video and audio content on their mobiles is important to MNOs currently. However, SKY content [REDACTED].
- 13.3 In any event, it is not clear how or why the merged entity could/would restrict its rivals' customers from accessing SKY content on their mobile devices. SKY already has developed apps such as Fanpass (where anyone can subscribe to view SKY Sports content over internet without a fixed term contract) and SKY Go (allowing SKY's satellite subscribers to access content online) that customers can use to access content online (on fixed or mobile networks). It has done this to compete with OTT rivals and ensure that its content continues to be consumed by as many paying customers as possible. To somehow restrict SKY customers from accessing content on the basis of the mobile network they choose would be wholly irrational.
- 13.4 We expand on these points below.

### 14. Drivers of mobile competition

- 14.1 Bundled content is not a major driver of sales of mobile plans. Rather, customers are driven by price, handsets and data allowances. For example, 2degrees has been very successful as a new entrant growing through strong marketing and attractive offers. 2degrees has not required access to SKY content in the past to grow and there is nothing suggesting that will change. Similarly, Spark has invested heavily in its low cost prepaid brand SKINNY. This has taken share from Vodafone and 2degrees.
- 14.2 To the extent that content is a driver of mobile uptake; this is by no means exclusive to video content. Spark also exclusively bundles music streaming service Spotify for free today. Neither 2degrees nor Vodafone have Spotify, which Spark has used effectively to gain market share. [REDACTED]

- 14.3 Indeed, while SKY Sport on mobile may be of value to some consumers in New Zealand, the fact that none of the MNOs have deployed such an offer in the highly competitive market to date demonstrates that it is not considered particularly compelling compared to other offers. In short, whilst it is attractive to some segments it is not important for most mobile consumers in New Zealand.
- 14.4 We also note that live sport has value because it is live, a point the Commission has accepted on numerous prior occasions. This means that highlights packages/interviews, etc, would be highly unlikely to drive any shift in consumer demand for mobile services.
- 14.5 Finally, the Commission has suggested that the merged entity could simply bundle mobile plans with SKY plans to drive consumers to its mobile network. The Commission has accepted that a “hard tie” is not likely (and Vodafone agrees that such a step would not be commercially rational). **[REDACTED]**.
- 14.6 In light of the above, the potential for a step change in market dynamics such that SKY content all of a sudden becomes a key part of the consumer’s mobile experience (and hence relevant to purchasing decisions in New Zealand) is, in Vodafone’s view speculative and does not satisfy the “real and substantial prospect” test.

## 15. Drivers of data consumption on mobile

- 15.1 It is true that consumption on mobile is increasing, but there is nothing to suggest that SKY content is going to become a valuable driver of mobile data consumption. The graphs below illustrate that there is **[REDACTED]** across Vodafone’s mobile network.<sup>10</sup> In the same time period total mobile data consumption has increased by **[REDACTED]**, Netflix mobile traffic by **[REDACTED]**, and Facebook video by **[REDACTED]**. YouTube has **[REDACTED]** on Vodafone’s mobile network.
- 15.2 This is consistent with the nature of SKY content, particularly live sport. By definition, sport is live and so consumers cannot simply choose to stream it when convenient (e.g. when they have spare time when commuting). By contrast, shorter video clips (such as are common on YouTube and Facebook) and SVOD delivered content (where the consumer can pick up and leave off programmes at will) are much more suited to consumption on the go over a mobile device.
- 15.3 In addition to the trends outlined below, as at October 2016 SKY accounts for approximately **[REDACTED]**.<sup>11</sup>
- 15.4 Indeed, the proposed revenue synergy relating to increased data usage driven by the merged entity was considered insufficiently certain to be included in the Explanatory Memorandum. In any event, the assumptions underlying that synergy related to **[REDACTED]** Even if the **[REDACTED]** figure was achieved by FY20/20 that would equate to only **[REDACTED]**, and that increase would come about because Vodafone mobile customers would choose to consume more content **[REDACTED]**. What this also shows is that should the merged entity somehow limit its rivals’ customers access to SKY content (which would come at a substantial cost to the merged entity) **[REDACTED]**. Given the vast array of alternative content available, it is highly likely that rivals will source alternative content to drive similar data uplift – the net result being that, if anything, the merged entity would be worse off.

<sup>10</sup> Scale of graphs is GB per month, based on Vodafone internal network data.

<sup>11</sup> **[REDACTED]**

**PART F: INCENTIVE OF MERGED ENTITY TO RETAIN ATTRACTIVE STANDALONE OFFER AND WHOLESALE TO RIVALS ON COMPETITIVE TERMS**

**16. Summary**

16.1 The Commission is still testing whether the merged entity would have the incentive to:

- (a) raise the standalone price of SKY in an attempt to switch customers to its telecommunications bundles; and
- (b) wholesale key content on less attractive terms in an attempt to switch customers to its telecommunications bundles or prevent them switching to rivals.

16.2 The evidence set out in Section E demonstrates that SKY content is not a major driver of consumers' choice of broadband or mobile provider. The evidence in Section G below sets out why, even if rivals lost scale, this would have no adverse competition effect (and therefore there would be no ability for the merged entity to raise prices above counterfactual levels in the future). This evidence alone is sufficient to demonstrate why the merged entity will remain incentivised to promote competitive standalone SKY services and offer commercially attractive wholesale packages (equivalent to what would be offered in the counterfactual). Vodafone provides more detail below on the commercial imperatives that it faces in continuing to offer these products on attractive terms.

**17. The merged entity will not increase the price of standalone SKY content services**

17.1 The evidence provided in Part E above demonstrates that consumers are increasingly attracted to a wide variety of online content. Consumers' use of SKY services is decreasing, with competitive content placing substantial pressure on its business model. In such circumstances, increasing the price of the standalone SKY product risks losing substantial numbers of customers and the associated margin gained from those customers. To be profitable, this would need to be offset by substantial increases in telecommunications customer numbers, where margins are lower than in pay TV.

17.2 However, as also evidenced in Part E, such a substantial increase in telecommunications revenues would not occur. [REDACTED]. This is consistent with the parties' detailed synergies forecasts as these are based on Vodafone's actual experience in using SKY content in order to drive market share.

17.3 The Commission has raised whether the telecommunications revenue from an additional customer may be greater if it could also capture the margin of "one or two mobile accounts". However, while Vodafone does endeavour to cross-sell mobile plans to its broadband/pay-TV customers, it is implausible that it could do so for a substantial proportion of its broadband/pay-TV customers, let alone in volumes sufficient to cause a competition issue. By way of evidence, the assumption set out in the synergies forecasts is that the merged entity is able to cross-sell mobile to [REDACTED] of SKY customers who take up a Vodafone broadband package and who are on a competitor's mobile network within two years.<sup>12</sup> While this figure is ultimately expected to [REDACTED] of those incremental customers, [REDACTED], the merged entity remains incentivised to wholesale on competitive terms

17.4 The Merged Entity will continue to wholesale SKY content in order to monetise content over the largest possible customer base. This cannot be achieved if terms are offered that do not, in fact, secure wholesale customers. Indeed, such an approach would be contrary to the explicit statements in the Explanatory Memorandum.<sup>13</sup> As noted, there are legal obligations on the parties to ensure the accuracy and validity of the statements included in the shareholders'

<sup>12</sup> [REDACTED]

<sup>13</sup> See, for example, Notice of Meeting and Explanatory Memorandum relating to the merger of the businesses and SKY and Vodafone New Zealand, 13 June 2016 at page 20: "The Combined Group will continue to sell wholesale telecommunications and content products, as each of Vodafone NZ and SKY does today, to take advantage of growth opportunities in wholesale markets."

materials, including the Explanatory Memorandum. In particular, both Vodafone and SKY, and their managers and directors, face potential liability in relation to the shareholder materials, including under the Takeovers Code, the Financial Markets Conduct Act, the NZX and ASX listing rules and the Companies Act. Put simply, there is no credible basis upon which to suggest the individuals involved would have characterised wholesaling as a strategic priority and noted it in the Explanatory Memorandum business case if there was any prospect that the wholesale terms would in fact not be offered and appeal to such customers.

- 17.5 In the counterfactual Vodafone would expect that SKY would continue to make its services available for resale by TSPs on an equivalent basis to what it offers today. Post-transaction, the merged entity will be incentivised to continue offering such terms. This is primarily because it enables the merged entity to increase its revenue to spread the cost of content acquisition. The merged entity can continue to differentiate itself on the basis of its overall customer experience without foreclosing access to SKY content. Quite simply, recoupment would not be possible.
- 17.6 More specifically, withholding SKY content to rivals in order to increase its own broadband customers will not be a commercially rational strategy for the Merged Entity. As above, Vodafone would not expect the sale of SKY/Vodafone bundles to drive substantial additional customers. In contrast, it is entirely commercially rational to seek to spread the costs of creating and acquiring content across the widest possible customer base.
- 17.7 Finally, Vodafone does not accept the Commission's concern that Vodafone would not act in a profit maximising way in the short term with a view to recouping lost revenue in the longer term. As set out below, broadband and mobile markets are highly competitive. The Proposed Transaction does not provide the ability to drive competitors below the scale necessary to remain competitive in the longer term.
18. **Wholesale [REDACTED]**
- 18.1 As part of the Proposed Transaction, the merged entity **[REDACTED]**

**PART G: COMPETITORS WILL NOT BE FORCED BELOW COMPETITIVE SCALE****19. Summary**

19.1 The following section provides evidence demonstrating that, even if rival competitors were to reduce in size as a result of the Proposed Transaction, this will not affect their ability to compete. The Commission has sought information in relation to rivals' ability to make long-term investments (such as in fibre unbundling and 5G) and we specifically address that issue below.

**20. Rival broadband competitors will not be forced below competitive scale in the short to medium term**

20.1 The New Zealand broadband market is amongst the most competitive in the world due to a number of factors. This includes structural separation, government funding of fibre networks and a regulatory regime that ensures a level playing field for all TSPs. There are no barriers to entry evidenced by the fact that there are 90+ suppliers. In this environment it is simply not feasible that competition will be weakened, let alone substantially lessened, as a result of the merger, and that the merged entity could subsequently increase prices such that an SLC would result.

20.2 As previously submitted to the Commission, vertical separation and the 90+ suppliers of all different sizes demonstrate that scale is simply not a major factor underlying the ability to compete. Specifically in relation to online television, the availability from Chorus of the "multicast" product (allowing separate TV and data streams through a fibre connection) allows effective delivery of TV through fibre for all players on an equal footing.

20.3 Vertical separation of access providers and TSPs means that the main cost (access) of providing a broadband connection is the same for all providers, from the smallest to the largest.<sup>14</sup> Other components such as national and international backhaul are provided in highly competitive markets with no need to invest in infrastructure and only very limited scale benefits. Other costs such as marketing, billing and customer care are completely scalable in line with the size of the business and the desired level of growth. This is why there are 90+ suppliers of different sizes with new entrants arriving all the time. Indeed, the likes of Trustpower and 2degrees/Snap have grown quickly off a small base. In an investor presentation earlier this month 2degrees also points to the fact that:<sup>15</sup>

"low capex investment due to government-supported infrastructure enables opportunity to scale across the country."

20.4 The NERA report contains additional commentary on the relevant assessment of costs in fixed broadband provision.

**21. Broadband competitors will not be inhibited from making long-term network investments**

21.1 Over the longer term, Vodafone understands the Commission is testing whether competitors would have sufficient scale to justify investment required to access Chorus and LFCs' unbundled fibre networks from 2020 onwards. We have described above why the Proposed Transaction will not materially affect its rivals' scale, such that it could not affect their decisions in relation to unbundling. We set out below additional evidence that:

<sup>14</sup> We are proceeding on the basis the Commission has no concern about further unbundling of Chorus' copper network, for the reason that:

- all TSPs that wish to pursue a commercial unbundling strategy have done so already. As a matter of fact, the Proposed Transaction is incapable of affecting any existing copper unbundling strategy;
- costs of prior investment in copper unbundling are sunk and we understand (for almost all TSPs) fully recovered; and
- further unbundling of the copper network is unlikely given the transition to fibre access and incentives created by relative pricing of copper and superior fibre services. Indeed, such further unbundling would be wasteful, duplicative investment in a context where fibre is the obvious future access technology.

<sup>15</sup> Trilogy International Partners "Investor Presentation", November 2016.

- (a) the decision to unbundle is not heavily dependent on scale; and
  - (b) even if the Proposed Transaction were to change rivals' decision-making in respect of unbundling, this would not result in a substantial lessening of competition.
- 21.2 Mass market unbundling (should legislation ultimately provide for it) refers to the ability of a TSP to install network equipment on fibre networks to provide its own "Layer 2" service (being the provision of the full data service). Under current regulations, only Chorus and the LFCs currently provide Layer 2 services and TSPs resell these services in competition with one another.
- 21.3 Fibre unbundling will not occur prior to 2020. It is not yet certain that regulation will allow for fibre unbundling or, if it does, the terms on which it will be offered. Given the status of fibre unbundling, it is by no means clear that a TSP's decision to do so will be driven by scale. As evidence of this:
- (a) Orcon and CallPlus (pre-merger of those providers) were the most active "unbundlers" on the copper network, despite being smaller than TelstraClear and Vodafone (Telecom was not able to unbundle);
  - (b) unbundling is scalable. A TSP can unbundle exchange by exchange (rather than having to invest in unbundling nationally). Unbundling decisions are typically made for specific areas according to whether investment costs are justified with reference to the direct cost savings that are generated;
  - (c) in addition, the equipment (and therefore cost) is scalable depending on the number of customers a TSP expects to service on the exchange. Accordingly, investments can be made at virtually any scale and incrementally over time;
  - (d) Vodafone only has around a [REDACTED] share of broadband, and at [REDACTED], an even lower share of fibre currently. The other players' share of fibre is higher than their overall broadband share. Accordingly, it is not correct to characterise Vodafone as having substantial scale benefits compared with the other players. The NERA report sets out the step-change that would be required in market shares to grow Vodafone even to the level of Spark's current market share;
  - (e) Trustpower is a very large company (NZ\$1.47b market capitalisation) that uses broadband sales to benefit other areas of its business (electricity and gas);
  - (f) Vocus is a substantial Australian business (AU\$3.5b market capitalisation) with the ability to invest in unbundling irrespective of its current scale in New Zealand; and
  - (g) Trustpower and Vocus, along with smaller competitors could join forces to unbundle, spreading any fixed costs of unbundling over greater numbers of customers. This could be done by way of joint ventures or agreements to wholesale Layer 2 services to one another. The likes of Vocus and Trustpower could unbundle and concentrate on wholesaling Layer 2 services in addition to servicing their own customers.
- 21.4 Finally, the incentives to unbundle and any benefits of scale will be affected in a material way by the regulatory regime that is put in place in respect of unbundling. Vodafone would not expect regulatory settings to be introduced that greatly favoured large scale competitors over small scale competitors if that were likely to substantially lessen competition. If that were the case, there could well be a competition concern in the counterfactual, where Spark is likely to remain the largest broadband supplier. The NERA report provides more details in this regard.
- 21.5 Even if there were a connection between the Proposed Transaction and decisions by other TSPs not to invest in fibre unbundling (which is not evident), the fact that some rivals elected not to unbundle would not substantially lessen competition in a market for the following reasons.
- (a) TSPs that choose to unbundle are likely to wholesale in order to maximise any investment. As a general indication of scope for fibre unbundling, in Singapore, which is also

characterised by structural separation, there are 12 operators wholesaling on the back of unbundled fibre. This provides choice for TSPs which in turn has driven price competition as well as innovation.

- (b) TSPs that choose not to unbundle a given exchange are still able to resell the Chorus/LFC Layer 2 product as they currently are doing. There is no reason to conclude that this Layer 2 product will not enable them to compete with a TSP that does unbundle a given exchange. Indeed, experience shows that throughout the period that copper was the sole fixed access technology, TSPs that had chosen not to invest in copper unbundling competed effectively with those that had. In reality, Vodafone expects that TSPs would pursue unbundling mainly to achieve reduced direct costs, rather than to pursue differentiation. Even so, copper unbundling experience shows that whether, or how much, a TSP has unbundled does not affect its ability to compete through differentiation. Differentiation can occur in a number of ways, including network based (e.g. technical parameters such as reduced latency) or service based (e.g. reduced installation/fix time). A TSP that did not unbundle would remain able to differentiate its offering on a service basis, or in another way. Furthermore, copper unbundling experience gives no indication that TSPs who invested in unbundling could offer a mass market service with “unmatchable differentiation”. Potential forms of product differentiation that fibre unbundling might allow (e.g. reduced latency services for video gamers) are unlikely to have mass market appeal, and certainly not appeal leading to the demand shift that the Commission suggests.
- (c) Even if a TSP competing with the Merged Entity decided not to pursue fibre unbundling themselves, the general availability of unbundling would generate substantial new competition for the supply of Layer 2 services, as those operators who have invested in unbundling look to maximise return. This enhanced wholesale competition would deliver additional innovation and differentiation possibilities to TSPs that haven’t invested themselves, i.e. they would still benefit from the general availability of unbundling via a richer range of wholesale offerings.

#### 21.6 In summary:

- (a) the Proposed Transaction will not cause a substantial change in rivals’ scale;
- (b) in any event, scale is not critical to making an unbundling business case in New Zealand; and
- (c) there is no evidence that a TSP that did not unbundle (or did not unbundle as much) would be materially less competitive in the market as a result.

## 22. Impact on mobile market in the short term

- 22.1 Vodafone also understands that the Commission is assessing whether a reduction in the number of customers on rival mobile networks could affect their ability to invest in network assets, primarily a 5G network once that technology becomes available.
- 22.2 As set out above, the link between the Proposed Transaction and a potential reduction in scale of Vodafone’s mobile competitors is, at best, remote. Furthermore, IDC expects the mobile market to **[REDACTED]**. This indicates strong growth prospects for mobile operators rather than any reduction below scale.
- 22.3 As a result, any concerns about competitors like 2degrees not achieving scale are unfounded. While 2degrees is smaller than Spark and Vodafone, it is a major player. Based on the investment presentation attached, it has 23% of all mobile connections (only a little under 2/3rds of Spark and Vodafone’s connections). It is therefore incorrect to position 2degrees as a small player who may struggle to make investments because of its size or who is particularly sensitive to small shifts in market share.



### 23. Relevant cost measures in mobile

- 23.1 It is important to differentiate between costs which affect pricing decisions, entry decisions and exit decisions. The Commission alleges that high fixed costs in mobile mean that a loss of subscribers could affect scale economies and undermine competitiveness. However, this is not consistent with a MNO's business model. Indeed, the economic incentives operate in the opposite way suggested in the LOUI.
- 23.2 While mobile network operators face high upfront fixed costs, variable costs are relatively low. Fixed costs do not affect pricing incentives or on-going competitiveness. An operator that loses scale will have capacity and will have the incentive to offer this capacity to customers on favourable terms because serving incremental customers generates low additional variable costs, and therefore large positive profit contributions towards the fixed cost of the network. This is in stark contrast to an operator operating at scale which will tend to have rising (rather than falling) variable costs meaning it starts to experience diseconomies of scale. This means the incentives of a mobile network operator to compete are, to a large extent, determined by two factors: the available network capacity and the operator's customer base.

### 24. No impact on ability to compete in short to medium term

- 24.1 In light of the above, it is clear that the Proposed Transaction could not reduce rival MNOs' ability to compete in the short to medium term. The fixed network costs have largely been expended and any reduction in customer numbers (which for the reasons above is highly unlikely to be caused by the Proposed Transaction) would result in much more aggressive market behaviour and therefore increased competition.
- 24.2 This is consistent with 2degrees' November 2016 investor presentation, which suggests it has a bullish view of the New Zealand market:
- (a) it highlights "attractive dynamics" and "significant headroom in post-paid consumer and business markets";
  - (b) it has recently announced it is to become listed on the Toronto Stock exchange;
  - (c) it does not mention the Proposed Transaction as a risk to its business (despite the strict requirements for investor documents to put forward an accurate view of future prospects);
  - (d) it achieves a strong EBITDA margin of 27% [REDACTED];
  - (e) it has grown strongly, including their recently acquired fixed line business.

A press release sets out its view of the New Zealand market:

"AQX / Trilogy believe that each of 2degrees and NuevaTel occupy favorable positions within their respective markets. Each operates in an attractive, stable three player market; has meaningful market share; is poised to benefit from the switch from voice to data usage; has the opportunity to grow through ancillary businesses; has demonstrated significant profitability; is benefitting from recent capital investments; and owns its own infrastructure.

Trilogy management believes both its New Zealand and Bolivian subsidiaries will deliver substantial growth over the coming years. In New Zealand, this growth is expected to come from (i) continued market share and post-paid subscriber growth, (ii) expanded bundled solutions to target the previously underserved business segment, and (iii) cross-selling fixed solutions to the existing mobile subscriber base."

- 24.3 Information in the slides from "Trilogy International Partners: Investor Presentations" also supports this position, as per below.

## The acquisition of Snap provides critical ability to offer bundled solutions



- Cross-sell existing mobile subscriber base
- Access to the fixed market, with massive headroom to grow share
- Government-backed network infrastructure, including Ultra-Fast Broadband ("UFB") initiative
- Low CAPEX<sup>(1)</sup> investment due to government-supported infrastructure enables opportunity to scale across the country

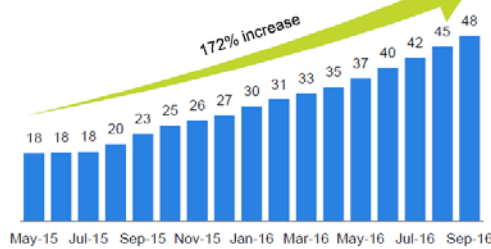


### Snap highlights

- Acquired on April 30<sup>th</sup>, 2015
- Full access to New Zealand's UFB network
- Snap founder joined 2degrees senior leadership team
- Launched small and medium-sized enterprise ("SME") fixed broadband offering in June 2016
- Launched 1Gbps to the home plans in October 2016

### Subscriber base growth since acquisition

(Ending subscribers in thousands)



Note: Q3 operating figures are preliminary.  
 (1) CAPEX includes vendor backed or capital lease financed additions and excludes spectrum purchases.

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## 2degrees highlights



- Developed economy with positive underlying fundamentals
- Attractive industry drivers with 2degrees well positioned to benefit
- Established and highly competitive challenger with strong momentum
- Transitioned into a full service provider with the acquisition of Snap
- Track record of revenue and Adjusted EBITDA growth expected to continue

25. Overall, the investor documents demonstrate that 2degrees is a strong company and competitor, which expects to continue growing despite the Proposed Transaction. New ownership and capital backing will further support its ability to grow.
26. **Impact on future investments in mobile market**
- 26.1 Notwithstanding the strong prospects of 2degrees as set out above, we understand that the Commission is assessing whether, should Vodafone's mobile competitors lose share as a result of the Proposed Transaction:
- (a) this will affect their ability to invest in network technology, such as 5G; and
  - (b) therefore one or more of them will be rendered less competitive.
- 26.2 These concerns are unfounded. For the reasons set out above, the Proposed Transaction will not cause any material shift of mobile subscribers to Vodafone's network. Even if this were to occur:
- (a) it would not prevent investment in the mobile network. Such investments are driven by competition – a more competitive Vodafone entity would likely cause its rivals to accelerate network builds if this were to drive a differentiated offer; and
  - (b) while network investment and differentiation is one driver of competition, it is far from the only driver. A competitor which did not upgrade its network as quickly would simply respond by competing on other factors. Previous experience shows that this does not prevent strong competition.
- 26.3 We understand that the Commission's primary focus is on 5G mobile technology. 4G technology is already well entrenched and all three MNOs have deployed a 4G network to a large proportion of the population. It is therefore helpful to set out some background to 5G to assist the Commission's assessment.
- (a) There is, as yet, no set definition of 5G technology, nor has a 5G technology standard been ratified. The timing for these milestones remains uncertain and it is generally expected that 5G is not expected to be commercially deployed prior to 2020, but it could be much later.
  - (b) 5G will have some advantages over 4G, primarily around increased network capacity, speed and latency, alongside increased ability to support Internet of Things (IoT) technology. However, it is not yet clear what the technology (costs, handsets, design requirements etc.) will look like.
  - (c) Given this uncertainty, [REDACTED].
- 26.4 In light of the above, it is highly uncertain when 5G will be rolled out in New Zealand and what costs will be involved in doing so. That said, there is no reason why the proposed transaction (even if it were to result in a slight reduction in 2degrees' mobile share) would impact its ability to deploy 5G services. Such roll-outs are invariably done on an incremental basis, e.g. Auckland, Wellington, Christchurch, Hamilton.
- 26.5 Even in the highly unlikely event that one of Vodafone's competitors was delayed in deploying 5G technology, this could not be said to "substantially lessen competition" in a market. The best example of this is the roll-out of 4G technology. Vodafone New Zealand rolled out 4G technology around one year earlier than its competitors in the New Zealand market. However, this had no meaningful impact on its market share as set out below. Rather, Spark's share grew materially around the same time as Vodafone introduced 4G, revealing that consumers valued other factors more highly.<sup>16</sup> Note too that the move from 3G to 4G was a greater improvement to the customer

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<sup>16</sup> Initially Vodafone sought to charge customers a premium for 4G as it was a premium product. However, this was competed away by Spark and 2degrees

experience that is likely to be the case from a move from 4G to 5G. As can be seen from the graph below.

**[REDACTED]**

- 26.6 In summary, the evidence supports Vodafone's view that the Proposed Transaction could in no way result in a substantial lessening of competition in the mobile market either in the short or long term.