

## Determination

### Vodafone New Zealand Limited and TelstraClear Limited [2012] NZCC 33

- The Commission:** Dr Mark Berry  
Sue Begg  
Anita Mazzoleni
- Summary of application:** The application by Vodafone New Zealand Limited seeking clearance to acquire up to 100% of the shares and/or assets of TelstraClear Limited.
- Determination:** Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission gives clearance for Vodafone New Zealand Limited or any interconnected body corporate thereof to acquire up to 100% of the shares and/or assets of TelstraClear Limited.
- Date of determination:** 29 October 2012

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## The proposal

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 17 July 2012. The Notice sought clearance for Vodafone New Zealand Limited or any of its interconnected bodies corporate (together Vodafone or the applicant) to acquire up to 100% of the shares and/or assets of TelstraClear Limited (TelstraClear).

## Procedure

2. Section 66(3) of the Act requires the Commission to either clear or decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and Vodafone. Accordingly, a decision on the application was required by 30 October 2012.
3. The Commission's approach to analysing the competition effects of the proposed acquisition is based on the principles set out in its Mergers and Acquisitions Guidelines.<sup>1</sup>

## Statutory framework

4. Any person who proposes to acquire the assets or shares of a business and considers that the acquisition may breach s 47 of the Act can apply for clearance under s 66.
5. If the Commission is satisfied under s 66(3)(a) of the Act that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, the Commission must give clearance for the proposed acquisition.
6. The Court of Appeal in *Port Nelson v Commerce Commission*<sup>2</sup> held that for something to be "likely" it must be "above mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen."
7. The High Court in *Woolworths & Ors v Commerce Commission*<sup>3</sup> observed that "...a substantial lessening of competition is one that is "real or of substance" as distinct from ephemeral or nominal. Accordingly a substantial lessening of competition occurs if it is likely that there will be a reduction in competition that is real or of substance."
8. If the Commission is not satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening competition in a market, or it is "in doubt" as to whether that is the case, it must decline the application under s 66(3)(b) of the Act.<sup>4</sup>

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<sup>1</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

<sup>2</sup> *Port Nelson v Commerce Commission* [1996] 3 NZLR 554 at 562-563.

<sup>3</sup> *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

<sup>4</sup> *Commerce Commission v Woolworths Ltd* (2008) 8 NZBLC 102,336 (CA) at [207].

9. The burden of proof lies with Vodafone as the applicant, to satisfy the Commission on the balance of probabilities that the acquisition is not likely to substantially lessen competition.<sup>5</sup> The decision to grant or refuse clearance is to be made on the basis of all the evidence.<sup>6</sup> The Commission will sometimes have before it conflicting evidence from different market participants and must determine what weight to give to the evidence of each party.<sup>7</sup>

### Analytical framework

10. The Commission's analytical framework for assessing whether an acquisition is likely to result in a substantial lessening of competition is described in the Commission's Mergers and Acquisitions Guidelines. The application of the guidelines depends on the facts in each case. In any assessment, the determination of the relevant market or markets may be an important tool. To define markets, the Commission identifies the areas of overlap between the businesses of the acquirer and the target, and then considers what, if any, products and geographic regions constitute relevant close substitutes from both a customer's and a supplier's point of view.
11. The Commission uses a forward-looking analysis to assess whether a substantial lessening of competition is likely. This exercise "requires a comparison of the likely state of competition if the acquisition proceeds (the factual) against the likely state of competition if it does not (the counterfactual)."<sup>8</sup> That assessment depends on the facts revealed during the Commission's investigation of the application.
12. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.<sup>9</sup>
13. The High Court in *Air New Zealand v Commerce Commission (No.6)*<sup>10</sup> accepted that an absence of market power would suggest there had been no substantial lessening of competition in a market, but did not see this as a reason to forsake an analysis of the counterfactual as well as the factual. Justice Rodney Hansen stated that "...a comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, that is, dominance has been attained."
14. In addition to considering existing competitors, the assessment may include an analysis of potential competitors. Potential competitors can act as a constraint on a business or businesses that might otherwise be able to exert market power. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from actual, or threatened, market entry.

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<sup>5</sup> *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths Ltd* (CA) above n 4 at [97].

<sup>6</sup> *Commerce Commission v Woolworths Ltd* (CA) above n 4 at [101].

<sup>7</sup> *Brambles New Zealand Ltd v Commerce Commission* (2003) 10 TCLR 868 at [64].

<sup>8</sup> *Commerce Commission v Woolworths Ltd* (CA) above n 4 at [63].

<sup>9</sup> New Zealand Electricity Market (Commerce Commission Decision 277, 30 January 1996) at 16.

<sup>10</sup> *Air New Zealand v Commerce Commission (No.6)* (2004) 11 TCLR 347 at [42].

15. If entry is to act as an antidote to what otherwise might be a substantial lessening of competition in a market, that entry must be likely, timely and of sufficient extent to constrain market participants. The central question is whether or not a merged firm would be constrained in a timely way by likely market entry (or expansion) in the event that it increased prices or reduced services or quality.

## **Parties**

### *Vodafone New Zealand Limited (Vodafone)*

16. Vodafone is the largest mobile network operator in New Zealand both in terms of revenues and customers. In terms of infrastructure, its mobile network has a similar size and geographic reach to that of Telecom's, providing coverage for around 97% of the population. It also has some fixed-line infrastructure.
17. Vodafone uses its network to serve mobile retail customers nationwide and also wholesales mobile services to other providers. In addition, Vodafone offers a range of fixed-line services to residential and business customers.
18. Vodafone is owned by Vodafone Group Plc, a UK based multi-national provider of mostly mobile telecommunications services.

### *TelstraClear Limited (TelstraClear)*

19. TelstraClear is the second largest fixed network operator in New Zealand with its own telephone and cable TV network covering most of the suburbs of Wellington and Christchurch. It also has a fibre network in the CBDs of all the major cities connected to a nationwide fibre backbone.
20. TelstraClear offers a range of fixed-line services to residential and business customers throughout New Zealand. In addition to its fixed-line products, TelstraClear offers cable TV, mobile phone services (through a wholesale agreement with Vodafone) and data backhaul services.
21. TelstraClear is owned by Telstra Corporation, an Australian based provider of telecommunications services.

### *Telecom New Zealand Limited (Telecom)*

22. Telecom is New Zealand's largest retailer of telecommunications services but no longer owns a fixed-line access network, which was transferred to Chorus in November 2011 following structural separation mandated under Part 2 of the Telecommunications Act 2001. It has retained ownership of its nationwide backhaul network and mobile network.
23. Telecom provides retail fixed-line voice, broadband and data services as well as mobile services throughout the country to residential and business customers of all sizes. It also provides a range of fixed-line and mobile wholesale services, sometimes in conjunction with Chorus.

*Chorus New Zealand Limited (Chorus)*

24. Chorus is the owner of New Zealand's only nationwide fixed-line copper access network. It also has a fibre backhaul network and is in the process of building a fibre access network.
25. Chorus wholesales access to its networks to a range of providers, and also acts as an agent for Telecom in the provision of some telecommunications services.

*Two Degrees Mobile Limited (2Degrees)*

26. 2Degrees is a recent entrant to the mobile services market having commenced operations in 2009. Its mobile network now covers most New Zealand cities. Outside these areas 2Degrees provides coverage via Vodafone's mobile network.
27. 2Degrees offers both pre and post pay mobile services to residential and business customers.

*Orcon Limited (Orcon)*

28. Orcon is a fixed-line service provider offering a range of fixed-line voice, broadband and data services to both consumers and businesses.

*CallPlus Limited (CallPlus)*

29. CallPlus supplies business customers with a range of fixed-line and mobile telecommunications services including broadband, calling, and managed solutions. Its residential brand, Slingshot, supplies the residential market with a similar range of services.

**The Telecommunications Regulatory Regime**

30. The Telecommunications Act 2001 provides for the regulation of wholesale telecommunications services to promote competition for the long term benefit of end-users. Regulated services are listed in Schedule 1 of the Telecommunications Act. Under the Telecommunications Act, the Commission can issue a determination that sets out the terms and conditions for accessing a regulated service, including prices for designated services.
31. The Commission can also investigate and recommend that a new telecommunications service should be regulated, or that an amendment be made to how an existing service is regulated. The Minister responsible for telecommunications has to approve such a recommendation before it can be implemented.
32. There are a number of regulated services relevant to this decision. The most basic regulated service is voice interconnection which is connecting a phone call from one network to another. The network on which the call is initiated usually pays a termination charge to the network who delivers the call to the final recipient. Although fixed interconnection (that is, interconnection between two fixed-line networks) is a regulated service, there is no Commission determination in force as

the operators reached agreement (at one cent per minute) just as the Commission was about to set a similar price.

33. Mobile voice and text interconnection (that is, a mobile-to-mobile and fixed-to-mobile termination access service referred to as 'MTAS') is regulated and the Commission issued a determination in 2011.<sup>11</sup>
34. Wholesale access to retail services offered over a fixed telecommunications network is also regulated. While a number of telecommunication companies provide retail services, the regulation currently applies to Telecom and, at this time, no determination is in force. [ ]].
35. Unbundled Bitstream Access (UBA),<sup>12</sup> Unbundled Copper Local Loop (UCLL)<sup>13</sup> and associated co-location and backhaul services are all regulated services with determinations in place.

## Overview of telecommunications services

36. The supply of fixed-line, broadband and mobile services to retail customers is provided through a range of telecommunications services and networks. The key services relevant to this determination are outlined below.

### Standard terms

#### *Public switched telephone network (PSTN)*

37. PSTN is the traditional, publicly available telephone network that delivers analogue voice services (sometimes referred to as POTS - plain old telephone service).

#### *Local loop*

38. Local loop is the term used to describe the pair of copper telephone wires that connect a premise to the local telephone exchange.

#### *Broadband*

39. Broadband is a generic term for a data service giving higher speed, always on, access to the internet, typically any data service faster than a dial-up modem.

#### *Digital subscriber line (DSL)*

40. DSL is a type of technology that allows data (that is downloaded and uploaded material such as accessing websites, e-mails and voice over internet protocol (VoIP) – see below) to be transmitted over a copper line while still allowing conventional

<sup>11</sup> See <http://www.comcom.govt.nz/assets/Telecommunications/STD/MTAS/Final-MTAS-STD/Final-MTAS-STD-Decision-Document-5-May-2011-Public-version.pdf>

<sup>12</sup> As discussed further below, UBA is wholesale access (through the local loop) to either a broadband and voice service to a customer premise or a naked broadband service.

<sup>13</sup> As discussed further below, UCLL is the term used to describe the situation where Chorus leases local loops to retail providers that have their own equipment (co-located in an existing exchange) to provide DSL broadband and, often, a POTS voice service.

analogue voice signals to be transmitted simultaneously. This is the usual technology used to deliver fixed-line broadband to residences and small businesses.

### *Backhaul*

41. Backhaul is a generic term used to describe the transport of data between regional and national data aggregation points. Backhaul generally involves carriage of signals by fibre optic cables rather than by copper cables; although it can also be provided by microwave radio.
42. Regional backhaul is the carriage of users' voice and data signals to and from aggregation points located in about 600 local exchanges throughout New Zealand (for example Karori) to and from the 30 major exchanges (for example Wellington) and other aggregation points in the same region. National backhaul is the longer distance carriage of such signals between individual major exchanges and other aggregation points, and from these points to the two Auckland international gateways.
43. Backhaul is also required by mobile network operators to carry their voice and data traffic from their cell phone towers to national mobile switches and from there onto the internet if necessary.
44. The national and regional backhaul required for UBA and UCLL services (these services are described at paragraphs 50-52) is regulated for those links where the Commission considers there is limited competition. Access-seekers can buy backhaul from any provider on a commercial basis or from Chorus at a regulated price if necessary.

### *VoIP*

45. Rather than being transmitted over a dedicated copper wire as an analogue signal, voice can be converted into digital form and transmitted as data. If VoIP is used in conjunction with a broadband connection, a traditional voice connection can be dispensed with. When broadband is in place but without a traditional voice connection, this is typically called 'naked broadband'.
46. Where both the sending and receiving parties are using compatible VoIP systems then there are no separate call charges, just the consumption of data from the users' contracted data allocation. If the access line to a premise is fibre only, then any voice service has to be VoIP based.

### *On network/off network pricing*

47. On network/off network (on-net/off-net) pricing refers to a fixed or mobile network operator charging differential rates to its retail customers for terminating a call or text, depending on whether the call/text is terminated on its own, or another operator's network. A low or nil termination charge to end-users for on-net traffic can be seen as a means to encourage customers to contact phones on the same network. Mobile-to-mobile on-net/off-net differential pricing is currently being



monitored by the Commission. Fixed-to-mobile differential pricing is not currently monitored by the Commission.

48. Closed User Group (CUG) differential pricing is when calls (or texts) to selected numbers, like all those within a single business, do not attract a variable charge. This could be mobile-to-mobile calls, fixed-to-fixed calls, fixed-to-mobile calls or all three types of calls.

#### *Bundling*

49. Retail service providers (RSPs) often bundle services together, offering a discount relative to the price at which the services would cost separately (some services are now sometimes offered only in a bundle). There are three main categories of telecommunications service bundles presently offered by providers: voice and broadband; voice, broadband and pay TV (triple play); and voice, broadband, pay TV and mobile (quad play).

#### *Unbundled bitstream access (UBA)*

50. Bitstream access is wholesale access (through the local loop to a customer premise) to a broadband service that is sold together with a voice service or by itself as a naked broadband service. In particular, UBA is wholesale access to Chorus' DSL service delivered over its copper network. The UBA service has a regulated price (under the provisions of the Telecommunications Act 2001) which is currently based on a discount to the Telecom retail price for broadband.<sup>14</sup> This discount provides a wholesale margin available to any retail service provider. The regulated prices currently charged to retail service providers are \$41.30 for naked broadband in urban areas and \$55.82 for broadband plus a voice service per line per month in Wellington and Christchurch. Prices elsewhere are about \$7 more. However, these prices will move from being based on a discount to Telecom's retail prices to being cost-based in 2014.
51. The UBA price does not include the necessary backhaul which must be arranged separately by the retailer.

#### *Unbundled copper local loop (UCLL)*

52. UCLL is the term used to describe the situation where Chorus leases local loops to retail providers that have their own equipment (co-located in an existing exchange) to provide DSL broadband and often a POTS voice service. The UCLL service has a regulated price, which is based on cost. Currently there is a two tiered urban and non-urban price but, from 2014 onwards, the Commission must set a geographically averaged price. The current urban, non-urban, and average prices are respectively \$19.84, \$36.63, and \$24.46 per line per month. It is noteworthy that the UCLL regulated price (urban) is well under the UBA price and this gives the retail provider a potential return on its investment in the necessary equipment. Overall, the margin available to a retail provider is larger from UCLL than UBA, providing sufficient numbers of users can be connected to each exchange the retailer has 'unbundled'.

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<sup>14</sup> This access price was determined prior to the separation of Telecom and Chorus.

Vodafone, Orcon, CallPlus and TelstraClear have all unbundled numerous exchanges throughout the country; although the largest concentration of unbundled exchanges is in the Auckland metropolitan area.

#### *Hybrid fibre-coaxial (HFC)*

53. Coaxial cable is essentially TV aerial cable with a centre of copper wire surrounded by insulation and a further sheath of copper wires outside. The TelstraClear network that uses this technology covers much of residential Wellington and Christchurch. When this network was rolled out, a conventional copper PSTN network was also installed alongside the HFC cables. The term 'hybrid' is used because TelstraClear's network is part coaxial until a neighbourhood roadside distribution cabinet is reached, after which the network becomes fibre optic. TelstraClear is able to offer broadband, a conventional phone service, and pay TV (retransmitted Sky), over its cable network.

#### *Ultra-fast broadband (UFB)*

54. UFB is the name given to the Government's initiative to provide a fibre optic cable connection to 75% of all premises (residential and business) in the country so the occupants will have the option of purchasing high speed broadband services. The initiative is concentrated during its first six years on priority broadband users such as businesses, schools and health services. New subdivisions and certain residential areas will also be included.
55. Those parties rolling out UFB such as Chorus, Enable (in Christchurch), Northpower (in Whangarei) are wholesalers who sell the UFB service to RSPs who then supply the UFB service to end-users.

#### *Business data services*

56. Larger businesses typically have a need for dedicated data connections to, for example, connect and transmit data between computers in different physical locations, and to connect to the internet. Dedicated data connections used to be provided over copper lines (leased lines) but now they are generally provided over fibre.

#### *3G*

57. 3G is the term used to describe third generation cellular mobile technology. In addition to facilitating voice and text messaging services, it allows a device connecting to the 3G mobile network to provide a broadband service. While in theory 3G mobile broadband can be as fast as fixed-line broadband, it is a resource shared among all the users of a cell site so in practice generally provides a considerably slower broadband service than a fixed-line (2G was designed to provide only voice and text messaging, although in the final stages of its evolution it could provide very slow internet access. Only Vodafone and 2degrees currently provide a 2G service).

*Long term evolution (LTE)*

58. To avoid use of the term 4G for the next generation of mobile technology after 3G, the industry has named the next mobile technological development 'long term evolution'. It provides significantly faster mobile broadband, and also treats voice as data which improves sound quality and allows for more efficient network operation.

**Market definition**

59. The Commission finds that the relevant markets for the consideration of potential horizontal effects in relation to this application for clearance are the national retail markets for:
- 59.1 residential fixed-line voice services;
  - 59.2 residential fixed-line broadband services;
  - 59.3 business fixed-line data services (including voice); and
  - 59.4 mobile phone services (for residential and business consumers).
60. In respect of the residential fixed-line voice services and fixed-line broadband services markets, in this decision the Commission analyses the potential competitive effects in these markets collectively, differentiating them only where there are specific competition issues relating to one or other of the products.
61. The Commission finds that the additional relevant markets for the consideration of potential vertical effects in relation to this application for clearance are:
- 61.1 national backhaul transmission services; and
  - 61.2 wireless spectrum management rights suitable for mobile phone services.

**Commission's approach to market definition**

62. The Act defines a market as:<sup>15</sup>
- a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
63. In general, the more closely substitutable two products or sources of supply are, the closer the competition and the greater the competitive constraint between those products or sources of supply.
64. As part of defining the relevant markets, the Commission looks to evidence of commercial practice, and is aided by the internationally accepted SSNIP test as an analytical tool.
65. The SSNIP test assesses substitutability by identifying the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not

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<sup>15</sup> Section 3(1A) of the Act.

constrained by the threat of entry could impose at least a small yet significant and non-transitory increase in price (SSNIP), assuming all other terms of sale remain constant. Under the SSNIP test, the smallest space in which such market power may be exercised is considered to be the relevant market.<sup>16</sup>

66. The SSNIP test is generally applied using a hypothetical 5-10% price increase applied over a one year period.

#### **Vodafone's view of the relevant markets**

67. Vodafone submitted that the relevant markets in this instance are the national retail markets for:
- 67.1 fixed voice services (including fixed-line local access and calling services);<sup>17</sup>
  - 67.2 fixed-line toll/fixed-to-mobile services;
  - 67.3 fixed-line broadband services; and
  - 67.4 mobile services.
68. Vodafone's application also considered wholesale access markets in certain geographic areas. Vodafone submitted that it is also appropriate to consider the effects of this merger on the individual local exchange areas where both Vodafone and TelstraClear have unbundled the local exchange. That is, each of these areas can be considered as a separate geographic market. This results in overlap in [ ] exchanges ([ ] in Auckland, [ ] in Wellington, and [ ] in Christchurch).

#### **The Commission's view of the relevant markets**

69. There are a range of wholesale and retail markets in which TelstraClear and Vodafone operate. Many of these markets have been defined previously in various reviews of the telecommunications services regulated under the Telecommunications Act 2001. However, markets defined for the purposes of determining the likely competitive effects of a merger may not necessarily coincide with previous market definitions.
70. The High Court has described market definition for the purposes of determining the likely competitive effects of a merger as follows:

It is intended to reveal the effective constraints upon a firm's business behaviour... Accordingly, it should focus on the real competition issue in the case, while recognising potential substitutability and constraints from products or services that may fall outside the chosen market definition.<sup>18</sup>

<sup>16</sup> Commerce Commission Mergers and Acquisitions Guidelines, page 29.

<sup>17</sup> This includes phone line rental and local calling services.

<sup>18</sup> *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

71. Market definition is therefore a flexible tool, and how it is applied depends on the facts of each case and the theories of harm under consideration. It is not an end in itself and markets may not have to be defined, or precisely defined, in order to assess the constraints acting on the merged entity.
72. The usual approach for determining relevant competition markets is to start with at least one of the products supplied by the merging parties, and then incorporate into the market any relevant substitutes.

### **Retail markets for residential fixed-line voice (local and toll) and broadband services**

73. As set out below, the Commission considers that for the purposes of assessing this application, there are separate national retail markets for residential fixed-line voice and for residential fixed-line broadband. However, as discussed more fully in paragraphs 125 – 127, the Commission analyses the potential competitive effects in these markets collectively, differentiating them only where there are specific competition issues relating to one or other of the products.
74. In arriving at this finding, the Commission considered the role of local calls versus toll calls, whether fixed-line voice and broadband services are in the same market, and whether fixed-line voice and broadband services for businesses are in the same market as residential services.

#### *Local access versus toll calling*

75. Fixed-line voice services typically include local access (line rental) and local calling, as well as national, international and fixed-to-mobile toll calling. Consumers can purchase these products separately, such as by purchasing toll-only packages or by bypassing their local access provider when making toll calls.
76. Local access and local calling is a distinct product from toll calling, in that consumers would be unlikely to substitute one for the other if the price of one of them increased.
77. On the supply side, however, it is likely that a supplier of local access and calling services could switch readily to provide toll calls in the face of a price increase. On the other hand, some toll call providers do not provide local access services. As Vodafone submits, 'there are even more options for customers making national, international and fixed-to-mobile calls including calling cards and VoIP'.<sup>19 20</sup>
78. While local access and toll services may well be separate markets, for the purposes of this application we consider that it is sufficient to assess them as one fixed-line voice services market. Local access has fewer players and the market is more concentrated; as such, if there are no competition concerns in that market, it is unlikely that there is a concern in the less concentrated toll services market.

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<sup>19</sup> As discussed above, VoIP calls are calls made via an internet connection.

<sup>20</sup> Vodafone application for clearance, page 42.

*Fixed-line voice and broadband services*

79. Previously, the Commission defined separate fixed-line voice and broadband services,<sup>21</sup> at least for the purposes of wholesale market analysis. However, there is information that suggests many consumers prefer to purchase these products as a bundle.
80. Despite a large proportion of consumers purchasing these services together in a bundle, we find that fixed-line voice and broadband services are best considered as discrete product markets for the purpose of assessing this application. Fixed voice services and fixed broadband services are distinct products in that consumers would be unlikely to substitute one for the other if the price of one increased.<sup>22</sup>
81. The respective proportions of customers that purchase a fixed voice/broadband package are:
- 81.1 [ ]% of Vodafone’s customers purchase a fixed/broadband package;
- 81.2 [ ]% of TelstraClear’s customers have bundles that include fixed calling and broadband (some bundles may also include pay TV); and<sup>23</sup>
- 81.3 [ ]% of Telecom’s customers purchase fixed voice and broadband either as a bundle or buy both from Telecom separately.<sup>24</sup>
82. There continues, however, to be a considerable number of consumers who purchase fixed voice services or fixed broadband services on their own, or who purchase both products but not in a bundle. For instance, the uptake of naked broadband (that is, as noted above, broadband supplied without a traditional phone line) has been increasing significantly in the last three years, albeit off a small base.<sup>25</sup> Vodafone has submitted that [ ]% of its customers currently purchase naked broadband.<sup>26</sup>
83. Furthermore, some firms have a relatively larger presence in fixed voice services – such as Telecom, which has a market share of [ ]% of fixed voice connections, compared to [ ]% of broadband connections.<sup>27</sup> Others have a stronger relative presence in broadband, such as Orcon, which has an estimated [ ]% in fixed voice and [ ]% in broadband connections.<sup>28</sup>
84. The Commission therefore considers, as noted above, that fixed-line voice and broadband services are discrete product markets for the purpose of assessing this

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<sup>21</sup> For example, Commerce Commission, Final Report on whether the Resale Services should be omitted from Schedule 1 of the Telecommunications Act 2001

<sup>22</sup> The Commission notes that there is some suggestion that VOIP services are a substitute for fixed voice services. However, the Commission does not consider that such substitutability is sufficient for these products to be considered to be in the same relevant market.

<sup>23</sup> Submission from TelstraClear, 24 August 2012, page 6.

<sup>24</sup> Submission from Telecom, 29 August 2012, page 2.

<sup>25</sup> Naked broadband connections have increased from about [ ] in 2010, to [ ], to [ ] in 2012.

<sup>26</sup> Submission from Vodafone, 22 August 2012, page 7.

<sup>27</sup> Vodafone application for clearance, 12 July 2012, pp 37 and 44.

<sup>28</sup> *ibid.*

application. The distinction between a bundled market and separate relevant markets for fixed voice and fixed broadband is not, however, critical to the Commission's analysis.

85. In relation to the geographic scope of fixed-line voice and broadband markets, while consumers purchase fixed-line products specifically for their own geographic location, the markets can generally be characterised as national due to the ability of suppliers to supply on a national basis. Retail suppliers often purchase the requisite inputs, which is generally access to lines and fibres (as discussed in the industry background above) from infrastructure providers. Using this access infrastructure, retail suppliers can supply products in all geographic locations, and often offer prices on a national basis.
86. There are, however, multiple exceptions to the depiction of a national market. In many more densely populated areas suppliers have unbundled local exchanges, lowering their costs of supply for fixed voice and broadband together.<sup>29</sup> Similarly, TelstraClear has its own cable network running past a large portion of residences in Wellington and Christchurch. The consequence of this is that in some local areas the nature of competition for fixed voice and broadband is very different as suppliers use different inputs, and therefore have different costs. As a consequence some suppliers have introduced geographic price differentials as well as 'below-the-line' pricing (that is, discounts below the advertised price to customers in some local areas).
87. The Commission considers that these local areas could be considered as discrete local geographic markets, given the propensity for some suppliers to engage in geographic price discrimination. However, for the purposes of this application, the Commission considers that the appropriate geographic dimension of the fixed voice and broadband markets is national. Any differences in the competitive dynamic in different local areas are considered as part of the competition assessment.

#### *Small office/home office*

88. There is also a question as to whether residential fixed-line products are in the same market as products supplied to business customers. Standard residential services are often used by businesses operating from home and small businesses having their own premises. These customers are often referred to as SOHO (small office/home office) by the telecommunications industry. We find that this set of business customers are best considered as part of the residential market as the product they purchase is typically equivalent to that purchased by residential customers.

#### **Retail market for business fixed-line services**

89. Typically, larger businesses have a need for customised fixed-line services and/or managed data services.<sup>30</sup> Often the sophistication and complexity of the product

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<sup>29</sup> It appears as though the investment required for unbundling is too much to justify providing only fixed voice services to residential consumers.

<sup>30</sup> These services include traditional and IP voice services, internet access networks, data centre services, data security and other data communications services.

offering increases with the size of the business customer as the number and type of connections, security requirements and volume of data to be managed increases.

90. Generally, the industry segments business customers into three broad categories:
- 90.1 small enterprises (1-49 employees);
  - 90.2 medium enterprises (50-199 employees); and
  - 90.3 corporate and government customers (200+ employees).
91. For the purposes of assessing this application, it is not necessary to form a conclusive view as to whether fixed-line services to small, medium and larger (corporate and government) enterprises are in separate markets, or whether they are segments within a larger differentiated market. In the competition analysis below we examine the business fixed-line services market, although within that market we separately consider the small and medium enterprise segments (collectively, the SME section), and the corporate and government enterprises segment.

#### **Wholesale local access markets**

92. Potentially, there are several wholesale markets under the consumer fixed-line voice and broadband services umbrella, including residential local access and broadband services. However, unlike Telecom and Chorus, TelstraClear and Vodafone do not generally operate in the wholesale market for residential fixed-line services. TelstraClear does not wholesale any of the services it supplies over the cable network that it operates in Wellington and Christchurch. Vodafone has an agreement to wholesale to CallPlus the UCLL services it provides from some Auckland exchanges. However, CallPlus has moved to unbundle most of these exchanges itself [ ].
93. As discussed in the retail market analysis, larger businesses have a need for customised phone services and/or managed data services. Retailers who provide these customised services generally purchase at least some of the required inputs from infrastructure providers, although some of them self-supply some of their inputs.
94. TelstraClear, Telecom, Chorus and FX Networks are the main providers of these inputs but there are also a number of other regional providers. Vodafone does not currently own the requisite infrastructure assets to provide such inputs.
95. Furthermore, no concerns have been raised with the Commission regarding fixed-line wholesale inputs. Wholesale markets for business fixed-line services are not considered further as there is no business overlap between the merging parties, and because there are no potential vertical effect concerns.
96. In the Commission's view, the wholesale markets for consumer fixed-line and broadband services would not be impacted by the merger; therefore we have not considered these markets further.



### **Retail market for mobile phones**

97. The Commission has previously considered mobile phone services to be in a separate retail market to fixed-line services. In its 2010 Final Report for Resale Services the Commission noted:

Due to the different characteristics of fixed and mobile services, at present, end-users appear to purchase these services in conjunction with, rather than as substitutes for, one another. In light of this, the Commission considers that mobile services are not sufficiently close substitutes to be included in the same market.<sup>31</sup>

98. The Commission notes that there is some evidence of increased switching away from fixed-line services to mobile.
99. The mobile market could conceivably be separated further, such as into pre-pay and post-pay products, or by residential and business customers. However, we do not consider that for the purposes of assessing this application such further separation is required. As such, the Commission considers the relevant retail market is for mobile phone services. This includes both residential and business customers.

### **Market for the provision of backhaul transmission services to mobile networks**

100. TelstraClear currently provides backhaul transmission services throughout New Zealand. Vodafone stated that as it does not operate in this market, it did not consider the market further in its application.
101. However, potential competition concerns in this market have been raised with the Commission. The concern is that Vodafone, given its large downstream retail presence, could potentially have an incentive to increase the price of backhaul services to rivals post merger. This issue is considered in the competition assessment.
102. The Commission has previously defined a national market for the provision of backbone transmission services.<sup>32</sup> The Commission considers that for the purposes of this application the appropriate market is the national market for backhaul services.

### **Spectrum management rights for mobile phone services**

103. Concerns have been raised with the Commission in respect of the acquisition of the management rights for spectrum used in the provision of mobile phone services.
104. Mobile phone service operators transmit data across radio spectrum. Spectrum management rights are sold in a range of frequencies. Some of these frequencies are more suitable for providing mobile services. The use for a particular spectrum frequency depends on the terrain, population density and other factors.
105. The Ministry of Business, Innovation and Employment (MBIE) regulates the maximum individual holdings for some of the spectrum frequencies.

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<sup>31</sup> Commerce Commission, Final Report for Resale Services, 2010

<sup>32</sup> Telstra Corporation Limited and Clear Communications limited (Commerce Commission Decision 447, 7 December 2001).

106. There is a question as to whether spectrum frequencies constitute individual product markets, or comprise a broader differentiated market. For the purposes of assessing this application, we do not consider it necessary to reach a firm conclusion on the market for the management rights of spectrum. In the competition assessment below we have analysed the management rights for spectrum frequencies individually where required.

*Conclusion on market definition*

107. The Commission considers that for the purposes of assessing the competition effects of the proposed acquisition, the relevant markets are the national markets for:
- 107.1 residential fixed-line voice services;
  - 107.2 residential fixed-line broadband services;
  - 107.3 business fixed-line data services (including voice);
  - 107.4 mobile phone services (for residential and business customers);
  - 107.5 backhaul transmission services; and
  - 107.6 wireless spectrum management rights suitable for mobile phone services.

**Factual and counterfactual**

**Factual**

108. In the factual Vodafone would acquire up to 100% of the shares and/or assets of TelstraClear.

*Spectrum management rights*

109. Both Vodafone and TelstraClear own management rights for a number of radio spectrum frequency bands. Not all of TelstraClear's spectrum holdings will be acquired by Vodafone under the sale and purchase agreement. Instead, Vodafone, TelstraClear, and Telstra will swap some of their respective spectrum holdings as follows.

*Spectrum for mobile telephony purposes*

110. Vodafone will increase its 1800MHz FDD band spectrum holdings from 2x15MHz to 2x25MHz. TelstraClear currently owns management rights to 2x25MHz of 1800MHz band radio spectrum. Immediately prior to the acquisition, TelstraClear will transfer 2x15MHz of 1800MHz band radio spectrum to another Telstra entity, meaning that Vodafone will acquire 2x10MHz of 1800MHz band radio spectrum initially. It will migrate its mobile traffic to this new spectrum over a period of 90 days.
111. At the end of the 90 day period, Vodafone and Telstra Corporation will carry out a swap under which Vodafone will transfer its pre-existing 2x15MHz of 1800MHz band radio spectrum to Telstra Corporation in return for Telstra Corporation transferring its 2x15MHz of 1800MHz band radio spectrum to Vodafone. This swap will occur

pursuant to a binding agreement entered into as part of the main transaction. Telstra Corporation will be free to sell the remaining 2x15MHz of 1800MHz band radio spectrum at its discretion.

112. Vodafone will increase its 2100MHz FDD band spectrum holdings from 2x15MHz to 2x25MHz by acquiring 2x10MHz of 2100MHz band radio spectrum. Immediately prior to the acquisition, TelstraClear will transfer 2x5MHz of 2100MHz band radio spectrum to another Telstra entity, and Telstra Corporation will be free to sell the spectrum. This structure ensures that Vodafone will not exceed the 2x25MHz cap imposed by the MBIE on holdings of spectrum in the 2100MHz band.

*Other spectrum*

113. Vodafone will increase its holding of 2100MHz TDD radio spectrum from 5MHz to 10MHz and will acquire TelstraClear's 2x28MHz microwave spectrum in the 2GHz band (where it currently has no licences).
114. Vodafone will increase its 3.5GHz band spectrum holdings to 2x28MHz by acquiring TelstraClear's current 2x21MHz.

[ ]

115. [

]

116. The Commission considers that it is likely that in the factual, [ ]

*Potential entry by Telstra*

117. Included in the sale and purchase agreement entered into between Vodafone and Telstra is a restraint of trade deed [

]. Telstra

informed the Commission that [

]. Therefore, the

Commission considers that with the acquisition, Telstra [ ].

118. The Commission considers that the restraint of trade deed precludes the potential re-entry of Telstra into New Zealand telecommunications markets. However, the Commission notes that the global nature of telecommunications investment and the potential (and existing) investment by other overseas entities in the New Zealand telecommunications industry minimises any potential loss of future competition or investment from Telstra.

*Conclusion on the factual*

119. The Commission considers that with the acquisition, Vodafone will acquire up to 100% of the shares and/or assets of TelstraClear. In regards to spectrum, Telstra will retain 2 x 15 MHz of 1800 MHz spectrum and 2 x 5 MHz of 2100 MHz spectrum which it [ ]. Further, the Commission considers that in the factual, these [ ].

**Counterfactual**

120. Vodafone submitted that without the acquisition it would continue to own and operate the Vodafone business, and to identify opportunities for growth either organically or through acquisition. In addition, Vodafone submitted that [ ].
121. Telstra submitted that without the acquisition, it would continue to own and operate the TelstraClear business. [ ].
122. The Commission accepts that without the acquisition, both Vodafone and TelstraClear would continue to operate in all the relevant markets; the counterfactual is the status quo.

**Competition analysis**

123. We have considered the potential competition concerns that could arise from the acquisition in a number of areas, which are:
- 123.1 horizontal effects in the:
- 123.1.1 residential fixed voice and broadband markets;
  - 123.1.2 business data services market; and
  - 123.1.3 mobile phone services.
- 123.2 vertical effects in respect of:
- 123.2.1 national backhaul for mobile services; and
  - 123.2.2 spectrum for mobile services.
- 123.3 conglomerate effects, including:
- 123.3.1 on-net/off-net fixed-to-mobile pricing; and
  - 123.3.2 fixed/mobile bundling.
- 123.4 coordinated effects.

## Horizontal effects

124. Competition concerns could arise from a loss of existing competition between Vodafone and TelstraClear if the acquisition allowed the merged entity to:
- 124.1 unilaterally raise its prices; or
  - 124.2 prevent prices from otherwise declining or declining as significantly or as rapidly as they otherwise would have; or
  - 124.3 otherwise negatively affect product features and services valued by consumers.
125. The acquisition would result in overlap between those parts of the businesses of Vodafone and TelstraClear that currently provide:
- 125.1 fixed-line voice<sup>33</sup> and broadband services to residential consumers;
  - 125.2 fixed-line data services to businesses consumers;<sup>34</sup> and
  - 125.3 mobile phone services to all consumers.
126. In order to determine whether or not there is likely to be a substantial lessening of competition in these markets, the Commission assesses:
- 126.1 the current level of competition between providers in these markets;
  - 126.2 the extent to which this competition will be lessened with the acquisition; and
  - 126.3 whether the remaining (or new entrant) providers will be able to constrain the actions of the merged entity to such an extent that any lessening of competition is not substantial.

## Fixed-line voice and broadband services for residential consumers

127. As discussed in the market definition section, fixed-line voice and broadband services are distinct product markets despite the fact that many residential consumers now purchase their fixed-line voice and broadband products together as a bundle. The Commission, however, assesses the likely competitive effects of the sale of these two products together, differentiating them only where there are specific competition issues relating to one or other of the products.
128. The Commission does this because:
- 128.1 the market participants are largely the same (although market share for these participants differs across the two relevant product markets); and

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<sup>33</sup> Including access and calling services.

<sup>34</sup> Including voice, broadband and managed data services. Managed data includes the provision of local area networks, wide area networks, SIP, internet access, data storage and contact centre services.

- 128.2 the available evidence suggests that the degree of competitiveness for broadband products, or broadband packages, is somewhat greater than in voice (this is supported by greater product differentiation and greater price variation).
129. If the acquisition proceeds, overlaps between Vodafone and TelstraClear would occur in:
- 129.1 [ ] local exchange service areas<sup>35</sup> where Vodafone and TelstraClear have installed their own equipment to unbundle exchanges to provide services via UCLL to consumers;
- 129.2 [ ] local areas where Vodafone provides services via UCLL or UBA (with or without POTS) to consumers in exchange service areas which are contiguous with TelstraClear's HFC network; and
- 129.3 local exchange service areas in which both Vodafone and TelstraClear provide services (usually with POTS) via UBA (about [ ] exchange areas, covering the rest of New Zealand).

#### *Vodafone's submissions*

130. Vodafone submitted that post acquisition, Telecom will remain as the major participant in all relevant markets and would offer a strong brand and competitive prices. In addition, there would be other providers, including Orcon and Slingshot (Slingshot is CallPlus' residential brand), which would compete by unbundling, by offering broadband via UBA, and by offering naked broadband plus VoIP telephone services. In general, Vodafone claims that both Telecom and the smaller providers would constrain the merged entity.
131. Vodafone noted that, the merged entity would remain less than half the size of Telecom, with the other smaller competitors continuing to compete vigorously in the market. It further claimed that Orcon and Slingshot have demonstrated a strong competitive presence by both unbundling and reselling wholesale UBA products.
132. In all the areas of overlap between the services provided by TelstraClear and Vodafone, Vodafone submitted that other consumers of Chorus' UBA services, in particular Telecom, remain as competitors. Vodafone additionally noted that there are competing unbundlers in all but two exchange service areas. In those two areas, entry by other unbundlers or by UFB providers will constrain the merged entity.
133. Vodafone's levels of fixed-line churn are approximately [ ]% per annum for residential products and [ ]% for business products. According to Vodafone, this demonstrates the competitive nature of the market as levels of churn are driven by new offers made by its competitors.

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<sup>35</sup> There are about 600 exchanges owned by Telecom and Chorus. About 160 are unbundled by various retail service providers. Of this number only [ ] have been unbundled by both of the merging parties (and others). Of those [ ], Vodafone and TelstraClear are the only unbundlers in [ ] exchange service areas.

### Market Shares

134. Table 1 below shows the Commission's estimates of national market shares for residential voice and broadband products for 2011.

**Table 1: Residential fixed-line voice market shares (includes calling charges); Residential fixed-line broadband market shares (2011).**

<b>Fixed-line provider</b>	<b>Residential voice revenue (\$million)</b>	<b>Residential voice market share</b>	<b>Residential broadband revenue (\$million)</b>	<b>Residential broadband market share</b>
Vodafone	[ ]	[ ]%	[ ]	[ ]%
TelstraClear	[ ]	[ ]%	[ ]	[ ]%
<b>Merged Entity</b>	<b>[ ]</b>	<b>[ ]%</b>	<b>[ ]</b>	<b>[ ]%</b>
Telecom	[ ]	[ ]%	[ ]	[ ]%
CallPlus/ Slingshot	[ ]	[ ]%	[ ]	[ ]%
Orcon	[ ]	[ ]%	[ ]	[ ]%
Other providers <sup>36</sup>	[ ]	[ ]%	[ ]	[ ]%
<b>Total</b>	<b>[ ]</b>	<b>100%</b>	<b>[ ]</b>	<b>100%</b>

Source: Commerce Commission annual industry survey as at June 2011

135. Table 1 shows that post acquisition, Telecom will remain the largest competitor in fixed voice and broadband with a market share of [ ]% in fixed voice and [ ]% in fixed broadband. The merged entity will be the next largest competitor in these markets with market shares of [ ]% and [ ]% respectively.
136. Ordinarily, post acquisition market shares of this size are unlikely to raise significant competition concerns, given the presence of a large incumbent competitor and a number of smaller competitors at the fringe.
137. However, while a static snapshot of market shares can be suggestive of relative degrees of competition, we do not depend on them to fully reflect the extent and nature of competition in this market. It is important to establish which providers drive competition in the market. If Vodafone and TelstraClear are the main drivers of competition, then the loss of this rivalry post acquisition may result in a substantial lessening of competition.
138. In assessing the current state of competition in this market, the Commission has examined:
- 138.1 the pricing and product offerings of the different providers;
  - 138.2 the level of price competition between providers; and
  - 138.3 the extent of customer switching between providers.

<sup>36</sup> Compass Communications, World Exchange, TrustPower Kinect, Woosh and Bay City.

### *Pricing and product features*

139. Pricing of broadband and voice bundles can depend on a number of product attributes, such as the volume of data included and calling features offered with the fixed-line (eg, call waiting). Each bundle can include a range of other features such as free local calls, free calls to a select group of numbers or discount on other products (such as Sky Network Television (Sky TV)).
140. As such, price comparisons are difficult because very few, if any, packages from different providers have the exact same features. Moreover, as discussed there is sometimes metropolitan versus non-metropolitan pricing (such as discounts in Auckland, Wellington and Christchurch) as well as “below the line pricing”.
141. Some providers also offer pay TV services which can be purchased in conjunction with their fixed voice and broadband packages (discussed in further detail at paragraphs 218 – 223):
- 141.1 Vodafone resells Sky TV nationally to about [ ] of its voice and broadband customers and offers discounts over Sky TV’s prices for either high definition video recorders or Sky sports channels for purchasers of its more expensive broadband bundles;
- 141.2 TelstraClear retransmits Sky TV and other video content through its own set-top box to about [ ] of its customers who purchase voice and broadband packages and are connected to its HFC network; and
- 141.3 Telecom resells the Sky TV basic package to about [ ] of its voice and broadband customers.<sup>37</sup>
142. All providers, other than Orcon, offer stand-alone fixed voice products (ie, without broadband). Telecom has by far the greatest proportion of fixed voice only customers.
143. All the providers, except Telecom, offer naked broadband products. Telecom has the capacity to provide naked broadband, but it is not currently part of its offerings.
144. As can be seen from the above array of product attributes, broadband-voice bundles can be, and are, differentiated in a number of ways. Nonetheless, the Commission has tabulated (see Table 2 and Table 3 below) for the purposes of illustration, residential voice and broadband bundles currently provided by the main retail service providers for medium users of data and high users. The product offerings and associated promotions change regularly, but a comparison of bundles helps to illustrate the competitive positioning of various providers.

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<sup>37</sup> Although this is a legacy product which Telecom no longer makes available to non-legacy customers.



**Table 2: Benchmarking table of medium usage fixed-line voice and broadband bundles – as at 26 October 2012<sup>38</sup>**

	Vodafone	TelstraClear	Telecom	Orcon <sup>39</sup>	Slingshot
Data allowance	30GB	60GB <sup>40</sup>	30GB <sup>41</sup>	30GB	20GB
Price per month	\$75	\$82	\$75	\$75	\$72 <sup>42</sup> /\$73 <sup>43</sup> /\$82 <sup>44</sup>

Source: Individual company web sites as at 26/10/12.

**Table 3: Benchmarking table of high usage fixed-line voice and broadband bundles – as at 26 October 2012<sup>45</sup>**

	Vodafone	TelstraClear	Telecom	Orcon	Slingshot
Data allowance	160GB <sup>46</sup>	150GB <sup>47</sup>	150GB	Unlimited data	Unlimited data
Price per month	\$125 <sup>48</sup>	\$105	\$99 <sup>49</sup> /\$109 <sup>50</sup>	\$99	\$111 <sup>51</sup> / \$112 <sup>52</sup> / \$121 <sup>53</sup>

Source: Individual company web sites as at 26/10/12.

145. Table 3 and Table 4, which has retail prices for comparable packages of the five largest retail service providers, shows similarity of retail pricing between competitors. Moreover, RSPs can and regularly do reposition their packages by adding features, changing data caps or adjusting price.

<sup>38</sup> This table shows advertised national pricing and does not reflect any “below the line” pricing.

<sup>39</sup> The Orcon products provide naked broadband and a VoIP voice service.

<sup>40</sup> This is a current special offer giving 60GB of data for the 10GB price for one year.

<sup>41</sup> This is a current special offer giving 30GB of data for the 5GB price until the end of 2013.

<sup>42</sup> This is for unbundled exchange areas only.

<sup>43</sup> This is for non-unbundled exchanges in Auckland, Wellington, and Christchurch.

<sup>44</sup> This is for the rest of New Zealand.

<sup>45</sup> This table shows advertised national pricing and does not reflect any “below the line” pricing.

<sup>46</sup> This is the 80GB Mega package with an additional \$30 for the “double your data” add on

<sup>47</sup> This is a current special offer giving 150GB of data for the 40GB price for one year.

<sup>48</sup> This is a promotional 12 month price.

<sup>49</sup> This is for Auckland, Wellington and Christchurch.

<sup>50</sup> This is for the rest of New Zealand.

<sup>51</sup> This is for unbundled exchange areas only.

<sup>52</sup> This is for non-unbundled exchanges in Auckland, Wellington, and Christchurch.

<sup>53</sup> This is for the rest of New Zealand.

146. The Commission notes that the tables above represent a snapshot of current offers and promotions in the market. These offers change regularly and TelstraClear in particular tends to price competitively via promotional offers that provide a discounted price for 12 months only. Moreover, it is difficult to tell from this static picture which RSPs are driving competition and which are merely responding. This is assessed further below.

*Product/price offers in certain geographic areas*

147. Providers often offer different prices for certain geographic regions. For instance, some providers offer a \$10 discount in areas where they provide broadband via UCLL. However, in recent months there has been a move by some providers such as Vodafone to cease offering geographic pricing and introduce new products that have one national price.
148. The Commission notes that the majority of premises in New Zealand are located in areas that have been unbundled by at least one provider. Slingshot estimates that it can currently reach about [ ]% of lines via UCLL and estimates that the merged entity would be able to reach about [ ]% of lines. This does not mean that this many customers are serviced via UCLL, just that UCLL provided products are available for this proportion of customers.
149. The evidence shows that in general, RSPs that provide fixed voice and broadband via UCLL have lower costs than if the equivalent product is sold via UBA. TelstraClear internal documents state that “[ ]”.<sup>54</sup>
150. Under the terms of the Telecom-Chorus separation agreement, Telecom is unable to unbundle until 2014. This means that providers who are able to unbundle, can offer broadband through UCLL at a lower cost than Telecom is able to offer via UBA. Evidence obtained by the Commission indicates that [ ].
151. However, in Wellington, Auckland and Christchurch, Telecom offers a \$5-10 discount on broadband bundles even though it provides the broadband service via UBA. Telecom [ ].<sup>55</sup> This discounting in Auckland, Wellington and Christchurch suggests that Telecom remains vigorously competitive in these areas, despite its inability to unbundle.
152. Telecom’s higher relative costs in these areas may prevent it from being a price leader. RSPs that have unbundled would seem to have the ability to price at a point lower than Telecom in these areas.
153. There are also some further below the line discounts; that is, discounts below the advertised rate. For example, Telecom has an additional \$10 per month one year loyalty discount which may be offered to consumers who contact Telecom about

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<sup>54</sup> TelstraClear [ ].

<sup>55</sup> Telecom submission, 28 August 2012.

their current plans. Telecom has stated [ ]<sup>56</sup>

154. TelstraClear advised that it conducts “below the line” promotions through direct marketing campaigns, such as its “Sunshine” campaign run in December 2011 in certain unbundled areas which offered customers additional data. Slingshot advised that it targets customers door-to-door in areas that it has unbundled, [ ]<sup>57</sup>
155. The Commission considers that generally, all providers of residential voice and broadband services offer similar products at similar price points, largely regardless of geographic location. There are distinct points of difference between different providers however: Orcon offers its Genius VoIP product as its key differentiator; Slingshot targets being the price leader; and Telecom focuses on customer service.

#### *How RSPs determine price*

156. The Commission has assessed how RSPs price and which RSPs currently drive price competition. The evidence below has been compiled from industry parties. While it does not necessarily provide a direct answer to which RSPs drive competition, and to whom RSPs look to when setting their own prices, it does help to build a picture of the current level of price competition in the market.
157. There is evidence to suggest that Orcon and Slingshot are currently price leaders in the fixed voice and broadband market.
158. [ ] has stated that over the last five years, price-led competitive responses have always been initiated by the tier-two or new entrant operators.<sup>58</sup>
159. [ ] stated that [ ] was seen as the price leader in the consumer fixed-line and broadband market. It further noted that there was also a shift to [ ]<sup>59</sup>.
160. Internal documents from [ ] and [ ] support this view and describe [ ] as a “price fighter”<sup>59</sup>, and having a “price led marketing strategy...targeting budget conscious customers”.<sup>60</sup> [ ] further describes [ ] as having moved from a “premium market positioning” to “price led innovation”.<sup>61</sup>
161. Telecom does not see itself as [ ]. It has the largest customer base but does not [ ].<sup>62</sup> Telecom sees its strength in customer service. In

<sup>56</sup> Telecom submission, 28 October 2012.

<sup>57</sup> Slingshot interview, 14 August 2012.

<sup>58</sup> [ ].

<sup>59</sup> [ ].

<sup>60</sup> [ ].

<sup>61</sup> [ ].

<sup>62</sup> Interview with Telecom, 7 August 2012.

Telecom's view, [ ]].<sup>63</sup>

162. TelstraClear's role in the market is less clear. A number of parties cited TelstraClear's \$75 a month bundle as a key move in the market, with [ ] stating that the offer "moved the goalpost" in the market and now represents the expected price point for a voice and broadband bundle.<sup>64</sup> [ ] further submitted that TelstraClear's \$75 promotion significantly increased [ ] churn. [ ] submitted that it sees aggressive competition between Vodafone and TelstraClear in the residential market. Prior to TelstraClear's \$75 offer, [ ] noted that TelstraClear had been more of a direct competitor to [ ] but the offer has repositioned them down to the lower price end of the market and competing with the traditional price leaders such as Vodafone.<sup>65</sup>
163. Telecom stated that Vodafone is predominantly strong in the upper part of the North Island where it has been active in unbundling and offering differentiated pricing between unbundled/non-unbundled areas.<sup>66</sup> However, Vodafone is increasingly [ ].<sup>67</sup>
164. The Commission considers that the pricing behaviour of competitors in this market positions them along a spectrum, with Slingshot and Orcon at the price-leading end of the market, Telecom possibly at the opposite end of the spectrum with its premium brand (although its recent pricing appears sharper), and TelstraClear and Vodafone perhaps positioned somewhere between. TelstraClear and Vodafone have both driven price offerings in the market, and elicited significant competitor responses.

#### *Customer switching*

165. To assist in determining the current state of competition in the residential fixed broadband and voice markets, the Commission has considered information on consumers' switching decisions. The Commission has obtained churn data from Vodafone, TelstraClear and Telecom, and porting data from the Telecommunications Carriers Forum (TCF).
166. TelstraClear submitted that its residential customer churn for the year ended 30 June 2012 was [ ]%. TelstraClear, however, was [ ]%.
167. Vodafone submitted that its annualised monthly churn for residential products is approximately [ ]% but on occasion this rises to between [ ]% and [ ]% when competitors launch new products and plans. It, however, [ ]%.

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<sup>63</sup> Ibid.

<sup>64</sup> [ ]].

<sup>65</sup> [ ]].

<sup>66</sup> Interview with Telecom, 7 August 2012.

<sup>67</sup> Telecom submission, 12 September 2012.

168. Telecom submitted that its churn rates range from between [ ]% and [ ]%, increasing in response to offers from competitors (for example the \$75/month package offered by TelstraClear).<sup>68</sup>
169. The above data on customer churn from the three largest providers indicates that many consumers are willing to switch providers. However, it is difficult to identify with any certainty which providers are the beneficiaries of this switching. Telecom noted that its customers [ ].<sup>69</sup>
170. Any loss of competition for these customers is relevant, but a loss of a provider that competes for those customers that are less likely to switch is also important. The relevant question is, but for the merger, would prices decline more in order to convince those customers who are less likely to switch to in fact change service providers?
171. To help assess to which provider customers switch, the Commission examined porting data collected by the Telecommunications Carriers Forum. Porting data generally captures the instances of consumers switching fixed-line providers, provided the underlying carrier also changes.<sup>70</sup> It provides data on those who move to another provider but keep their fixed-line telephone number. As we go on to explain, the data is suggestive of the extent and nature of competition, but has its limits.
172. The two figures below show the destinations of consumers porting away from both Vodafone and TelstraClear from September 2010 to September 2012.

**Figure 1: Monthly porting away from Vodafone from September 2010 to September 2012**  
[ ]

Source: Telecommunications Carriers Forum

**Figure 2: Monthly porting away from TelstraClear from September 2010 to September 2012**  
[ ]

Source: Telecommunications Carriers Forum

173. The porting data suggest that Telecom is a prominent competitor to both Vodafone and TelstraClear. Moreover, the porting data are consistent with the evidence outlined at paragraphs 185 – 195 in respect of Telecom, that the company is becoming a more vigorous competitor following separation. [ ].
174. The two charts above indicate that, at times, [ ]<sup>71</sup> [ ]<sup>72</sup>

<sup>68</sup> Telecom response to Commission information request, 28 August 2012.

<sup>69</sup> Interview with Telecom, 7 August 2012.

<sup>70</sup> When a customer switches providers the underlying “carrier” does not necessarily change. For instance, when a product is supplied by UBA, then Chorus provides the infrastructure to supply that service over.

<sup>71</sup> [ ].

[  
 ]. While this has not shown through in [  
 ], this is perhaps  
 due to the competitive response from Vodafone and TelstraClear. Orcon and  
 Slingshot's likely constraint on the merged entity in the factual is considered further  
 at paragraphs 199 – 215.

175. Moreover, if the RSPs which customers switched to are an indication of existing  
 competition in the fixed-line market, the porting data indicate [  
 ].

176. However, there are reasons why the porting evidence should be used cautiously and  
 perhaps given limited weight. The data do not usually capture instances of switching  
 at the retail level when the underlying carrier is not also changed since voice services  
 are often purchased by the RSP from Telecom who would be considered the  
 "carrier". This suggests the porting data are more representative of unbundled local  
 exchange areas than other local areas. As noted above, unbundled local exchange  
 areas are generally more competitive, in that they are more likely to be  
 characterised by below the line pricing and other price concessions, than those  
 exchanges that have not been unbundled.

177. Vodafone has also raised concerns about the cogency of porting data as an indication  
 of consumer switching patterns. Vodafone noted that:

177.1 porting data does not capture switching for services delivered over UBA;

177.2 customers that switch from a fixed/mobile package to naked broadband are  
 not captured as they do not have a phone number to port; and

177.3 porting of multiple lines can sometimes be recorded as a single line.

178. Taking these reservations into account, the Commission considers the porting  
 evidence to be suggestive and useful, but not determinative. The data are indicative  
 of to whom customers switch, rather than the overall level of switching.<sup>73 74</sup>

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<sup>72</sup> [  
 ].

<sup>73</sup> The relative proportion of switching to Slingshot and Orcon and other smaller unbundlers is probably  
 overstated: since these RSPs compete more vigorously in exchange areas where they have unbundled,  
 the porting data will likely overstate their importance in the market overall (the corollary of this is that  
 the relative proportion of switching to Telecom is likely overstated relative to the market overall).

<sup>74</sup> The relative proportion of switching to Telecom is probably overstated since the porting data do not  
 include switching by naked broadband users: the porting data only capture switching when the switch  
 includes a fixed-voice component (either on its own or as part of a bundle). Since it does not include  
 switching by naked broadband users and because Telecom is the only RSP that does not offer a naked  
 broadband product, the relative proportion of switching across all other RSPs is generally understated  
 (meaning the relative proportion of switching to Telecom is generally overstated). The impact of the

*Conclusion on current state of competition*

179. The Commission considers that, generally, all providers of fixed voice and broadband services supply similar products, with some variations in terms of data allowances, speed, and quality of service.
180. Pricing too appears to be reasonably uniform although, as discussed, it is difficult to draw parallels between different providers as they all offer subtly different packages and not all seek to lead the market on price.
181. The switching data examined by the Commission suggests that Vodafone and TelstraClear do compete aggressively for market share.
182. Overall, the Commission considers that it is difficult to determine with precision which providers are the key drivers of competition in fixed voice and broadband markets. Orcon, for instance, is described as a price-leading and innovative competitor but has experienced publicity as to problems with customer service and product quality, as discussed further at paragraphs 199 – 215. Conversely, Telecom has traditionally been the most expensive of the providers but had [ ].<sup>75</sup> More recently, there is evidence that Telecom has become a more vigorous competitor post separation, discussed further at paragraphs 187 – 197 below.
183. What is clear is that Vodafone and TelstraClear compete to provide fixed voice and broadband services to residential customers and this competition between them will be lost with the acquisition.

*Will existing competitors constrain the merged entity?*

184. While the Commission notes that it is difficult to reach a firm conclusion on the extent to which Vodafone and TelstraClear are key drivers of competition in fixed voice and broadband markets, we nonetheless examine the extent that other competitors in the market will likely act as a competitive constraint on the merged entity.

*Telecom*

185. As outlined above, Telecom has a market share of [ ]% across the fixed voice and broadband market. While this market share is large, it has been declining over recent years. However, the Commission notes that this loss of market share has arisen, at least in part, from structural and regulatory changes in the industry including:
- 185.1 regulation of Telecom's wholesale bitstream price commencing in 2004 as a result of an application to the Commission by TelstraClear (this service is now provided by Chorus at a regulated price);

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exclusion of naked broadband switching is not likely to be large, however, since it accounts for less than [ ]% of the market.

<sup>75</sup> Interview with Telecom, 7 August 2012.

185.2 the 2006 Government decision to permit unbundling of Telecom's exchanges with the subsequent provision of the first UCLL service by Orcon in March 2008, leading to about 10% of lines currently being provided via UCLL; and

185.3 the separation of Telecom and Chorus on 1 December 2011.

186. The Commission notes that these regulatory steps were taken to enhance competition, and evidence suggests that this has occurred, with the Commission's Annual Telecommunications Monitoring Reports noting decreased retail market concentration each year. The Commission considers that apart from the prohibition on Telecom being able to unbundle until 2014, which is discussed further below, the current regulation does not appear to impede Telecom from being an effective competitor.

*Telecom post separation with Chorus*

187. Telecom's continued loss of market share [ ]<sup>76</sup> is a possible indication that Telecom may not provide a significant degree of competitive constraint on the merged entity. In addition, Telecom appears to be a follower in the market, rather than a driver of competition through price leadership.
188. Telecom informed the Commission that it does [ ]. While it has the largest customer base, it does not want [ ]. Telecom stated that it sees its strength in customer service and [ ].<sup>77</sup>
189. However, Telecom has signalled a desire to be more competitive as a non-vertically integrated competitor than it was before separation from Chorus. Telecom's new chief executive, Mr Simon Moutter recently stated that its loss of market share was as a result of the "many challenging years the company spent grappling with regulations before its split with network arm Chorus. This made it difficult for the company to focus on the market. So with an inward rather than outward focus some of the necessary connection with its customers and the country had waned".<sup>78</sup>
190. Mr Moutter stated that "I'm very pleased to have played a part in an early decision to draw a bit more of a line in the sand around broadband market share and compete more aggressively - not giving reasons for customers to leave us on such a simple lever as price. So we will be playing a more competitive role in the market."<sup>79</sup>
191. Vodafone submitted that Telecom has historically relied on being an incumbent provider and has not "led the market on price or innovation". Vodafone further submitted that this has led to a material increase in customers switching away from Telecom. Vodafone asserted that Telecom is determined to compete aggressively on price in order to protect and win back its market share.<sup>80</sup>

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<sup>76</sup> Vodafone [ ].

<sup>77</sup> Interview with Telecom, 7 August 2012.

<sup>78</sup> Speech to Telecom Annual General Meeting, 28 September 2012.

<sup>79</sup> Telecom 2012 earnings conference call to market analysts, 23 August 2012.

<sup>80</sup> Submission from Vodafone, 26 October 2012.



192. Vodafone's internal strategy documents also [ ]. In its 2011 Mid-Term Strategy Review<sup>81</sup> Vodafone stated that [ ].
193. This can be contrasted with Vodafone's comments on a pre-separation Telecom: [ ].<sup>82</sup> Vodafone also noted [ ].<sup>83</sup>
194. The Commission notes that Telecom has taken some steps towards becoming a more vigorous competitor since its separation from Chorus. In its recent new retail product offering<sup>84</sup> Telecom has:
- 194.1 abandoned on-net/off-net pricing for fixed-to-mobile calls and reduced some national fixed-to-fixed calling rates from 31 cents/minute to 24 cents/minute;
  - 194.2 increased its data cap for most plans; and
  - 194.3 reduced prices for larger users of broadband data to such an extent that it now undercuts some of its competitors.
195. In a July 2012 Board Update paper, Vodafone's Director of Marketing noted that [ ].
196. TelstraClear's internal strategy documents also noted that [ ].<sup>85</sup>
197. A key impediment to Telecom's competitive position in fixed voice and broadband markets is its inability to unbundle local exchanges until 2014, under the terms of the Telecom-Chorus separation agreement. Until that time, it faces [ ] for providing fixed voice and broadband compared to RSPs that provide those services via UCLL.

*Conclusion on likely constraint by Telecom*

198. Taking into account the evidence outlined above, the Commission finds that, on balance, Telecom is likely to provide a competitive constraint on the merged entity in providing fixed voice and broadband services to residential customers.

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<sup>81</sup> [ ].

<sup>82</sup> Vodafone [ ].

<sup>83</sup> [ ].

<sup>84</sup> Initial introduction of this product range was on 1 October 2012.

<sup>85</sup> TelstraClear Strategy[ ].

199. The proposed acquisition will create a vertically integrated merged entity with a significant fixed customer base. Post acquisition, Vodafone will be ideally placed to compete 'head to head' with Telecom.
200. Post separation, Telecom is a wholly retail-focused business which is unable to rely on significant wholesale revenue to offset a declining retail market share. Under such circumstances, the Commission does not expect that Telecom will sit dormant and allow the merged entity to [ ], without responding. Telecom is a well resourced competitor with the institutional frameworks in place to aggressively target residential voice and broadband customers.

#### *Orcon / Slingshot*

201. Orcon and Slingshot are the next largest fixed-line competitors after Telecom, Vodafone and TelstraClear. Orcon's market share of total retail connections (including residential and business) has increased from [ ]% in 2005/06 to [ ]% in 2010/11. Slingshot's market share has increased from [ ]% in 2005/06 to [ ]% in 2010/11.
202. As discussed below, the Commission considers that Orcon and Slingshot play a more vigorous role in terms of driving competition than their market shares alone would indicate.
203. These two companies have been very active in unbundling exchanges. Table 4 below outlines the total number of lines and exchanges unbundled by respective providers.

**Table 4: Number of lines and exchanges unbundled per provider**

	<b>Total number of residential lines supplied by UCLL product</b>	<b>Total number of exchanges unbundled</b>
Vodafone	[ ]	[ ]
TelstraClear	[ ] <sup>86</sup>	[ ]
Orcon	[ ]	[ ]
CallPlus/Slingshot	[ ]	[ ]
Compass Communications	[ ]	

Source: Chorus

204. Table 4 shows that Orcon has unbundled [ ] Vodafone and TelstraClear but that CallPlus/Slingshot has unbundled [ ]. Other evidence obtained by the Commission indicates that while other RSPs appear to have reached the end of their unbundling programmes, [ ].

<sup>86</sup> This does not include customers on TelstraClear's HFC network.

205. The level of unbundling undertaken by Orcon and CallPlus/Slingshot indicates that they are well placed in terms of underlying investment in capacity to increase their market share and drive competition over time. Slingshot's continued investment in unbundling is an indication that it has confidence that it will grow over time. Orcon has advised that [ ].<sup>87</sup> It further stated that [ ].<sup>88</sup>
206. Despite Orcon's early and Slingshot's significant investment in unbundling, [ ]. [ ] per unbundled exchange out of all the main RSPs. Unbundling is just part of the investment required to service fixed voice and broadband customers. Marketing, branding, customer service and other technological capacities are also required. These aspects are discussed further below.
- Price and product offers*
207. Evidence before the Commission indicates that Orcon is seen in the market as an innovative competitor. Orcon was the first provider to unbundle an exchange following the release of the Commission's 2008 Standard Terms Determination which allowed unbundling. Also, on 20 July 2011, Orcon introduced Genius, a new competitively priced (\$75 per month) naked broadband and VoIP service.<sup>89</sup> Orcon's Chief Executive indicated that customer numbers have shown strong growth since Genius was launched.<sup>90</sup>
208. Vodafone submitted that Orcon, with the launch of Genius, was the first company to introduce a mass-market VoIP service. Vodafone further submitted that Orcon, "[ ]."<sup>91</sup> In September 2012, Orcon launched a further Genius plan with unlimited broadband consumption bundled with an attractive calling package.<sup>92</sup> These Genius plans were price leaders.
209. The introduction of the initial Genius package stimulated an immediate response from other competitors in the market. TelstraClear began offering a similar package, but with a conventional phone line in October 2011. This was followed with similar packages from Vodafone and Telecom. The \$75 package plus a varying volume of broadband data is currently the industry entry level for broadband and phone packages.<sup>93</sup> Orcon has also advised that [ ].<sup>94</sup>
210. Slingshot is also an innovative price leader. For example, in response to TelstraClear's \$75 fixed-line broadband and phone offer, Slingshot introduced a \$69 fixed calling

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<sup>87</sup> Orcon interview, 24 October 2012.

<sup>88</sup> Orcon interview, 24 October 2012.

<sup>89</sup> \$75 naked broadband with 30GB data cap.

<sup>90</sup> [http://www.orcon.net.nz/about/article/new\\_call\\_centre](http://www.orcon.net.nz/about/article/new_call_centre)

<sup>91</sup> Submission from Vodafone, 26 October 2012.

<sup>92</sup> \$99 naked broadband plus unlimited free national calling.

<sup>93</sup> Most RSPs offer a package around the \$75 price point currently, however some offer significantly lower data caps (2-3GBs) for this price.

<sup>94</sup> Interview with Orcon, 24 October 2012.

and broadband plan. Recently it was the first provider to introduce a plan under which the consumer can roll over unused data. Earlier, Slingshot was the first provider to introduce a competitively priced 100 GB broadband product aimed at larger data users.<sup>95</sup> Its associated company, Flip has offered the first ‘free’ broadband product (5GB data cap but with the ability to purchase more data if required) with the purchase of a phone line from Flip.<sup>96</sup>

*Quality and brand perception*

211. There is some evidence to suggest that Orcon and Slingshot may in the past have experienced poor public perception of their customer service and product quality, which affected their brands, and which they may now be overcoming.
212. Slingshot’s customer satisfaction in the Consumer Magazine surveys declined significantly between 2008 and 2011. [ ]<sup>97</sup>
- Nevertheless, the Commission notes that Truenet reported that Slingshot recorded a good result in its broadband quality testing for September 2012. This resulted from significant investment in bandwidth and caching according to its Chief Technology Officer, Adrian Dick.<sup>98</sup>
213. Research carried out by Consumer Magazine, which surveys customer satisfaction levels across the five largest providers, indicates that Orcon has generally enjoyed favourable consumer perceptions, with a noticeable drop in 2011.<sup>99</sup> The Commission understands that this was after its successful launch of its Genius product which led to a dramatic uptake from consumers [ ]<sup>100</sup> [ ]<sup>101</sup> [ ]<sup>102</sup>
214. Slingshot and Orcon have taken time to build their brand while trying to maintain consumer perceptions about quality. It is apparent that this is not an easy market to enter and succeed immediately. The Commission considers that Slingshot and Orcon (and to some extent others, such as Compass) have already done much of the hard work required to establish themselves in the market. They continue to build their networks, brand and customer bases.
215. The Commission considers that both CallPlus/Slingshot and Orcon are well resourced and experienced competitors in this market. They have taken the time to establish

<sup>95</sup> This was a \$50/\$60 broadband only product to which the price of the phone line was added. The lower price was available to those consumers who also purchased their phone line from Slingshot.

<sup>96</sup> This product is \$49.95 per month and includes 5GB of data, free local calling, and a low price rate for calls to mobiles and many overseas landlines.

<sup>97</sup> [ ]

<sup>98</sup> <http://www.truenet.co.nz/articles/september-2012-report>.

<sup>99</sup> Consumer Magazine editions #486, 499, 510 and 520.

<sup>100</sup> Interview with [ ]

<sup>101</sup> Ibid.

<sup>102</sup> Ibid.

sizeable networks and they will likely play a more important role in driving competition in the future.

216. Orcon has stated that:

[

].<sup>103</sup>

217. CallPlus/Slingshot and Orcon's [ ] perhaps evidence that they will remain fringe competitors in the future. Orcon noted that, [

].<sup>104</sup>

218. The Commission notes that the recent announcement by Orcon that it is integrating its operations with those of its parent company, Kordia, is likely to provide additional efficiencies to the business and enable it to be more competitive.<sup>105</sup>

#### *Conclusion on Slingshot and Orcon*

219. The Commission considers that, post acquisition, Orcon and Slingshot will continue to act as aggressive, price leading competitors in the market. While they lack the scale of Telecom or the merged entity, they are able to compete effectively, especially in areas where they have unbundled (where Vodafone's fixed network is largest). The Commission considers that, post acquisition, Orcon and Slingshot will provide competitive constraint on the merged entity.

#### *Triple play*

220. As indicated earlier, Vodafone and TelstraClear are the only two RSPs that currently offer Sky TV as an add-on for new customers. As such, the Commission has considered this separately within its assessment of the markets for fixed voice and broadband services to residential customers.

221. As noted, Vodafone and TelstraClear (and Telecom to its legacy customers only) provide a triple play product that includes Sky TV bundled with phone and broadband. TelstraClear currently offers its triple play product only to consumers connected to its HFC network (ie, Kapiti, Wellington and Christchurch). Vodafone offers its triple play product nation-wide, without geographic price differentials. Vodafone offers discounts to the usual price of certain Sky TV add-ons with certain triple play bundles, including a free high-definition 'MySky' recorder (saving \$15 per month) or half-price Sky Sports channels (saving \$13.17 per month).

222. As noted, Telecom currently has some existing triple play customers purchasing the basic Sky TV package from it. However, Telecom does not offer this to new

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<sup>103</sup> Interview with Orcon, 8 August 2012.

<sup>104</sup> Ibid.

<sup>105</sup> Orcon media release, 25 October 2012.

customers and cannot at present upgrade its customers to higher-value Sky TV packages.

223. The aggregation of triple play package offers in Kapiti Coast, Wellington and Christchurch may not raise competition issues. Most consumers purchase pay TV directly from Sky TV (more than 800,000 consumers) and independently purchase their telecommunications services from another provider. Moreover, Vodafone offers the same triple play offer nationwide, regardless of whether or not TelstraClear competes in that a particular region, indicating that the removal of TelstraClear as a constraint in Wellington, Kapiti and Christchurch is unlikely to lead to an increase in the price of Vodafone's triple play packages.
224. Vodafone has stated that in offering these bundles Vodafone endeavours [ ].<sup>106</sup>
225. The Commission considers that while the proposed acquisition will result in the loss of triple play competition between Vodafone and TelstraClear, it does not consider that this loss will be substantial. Only TelstraClear's HFC customers can purchase its triple play offer. Those customers able to access the offer are therefore confined to most suburbs of Wellington and Christchurch. As a consequence, the actual level of overlap between Vodafone's and TelstraClear's triple play offerings is small; therefore the competition being lost through the merger will be minimal.

#### *The effect of UFB*

226. UFB will be provided by Chorus and three other local fibre companies on an open access, non discriminatory basis. Crown Fibre Holdings information shows that by the end of 2014, UFB will pass 450,000 premises and this number will increase to over 600,000 by the end of 2015.<sup>107</sup>
227. However, in its "High speed broadband services demand side study final report June 2012", the Commission noted that:
- 227.1 the costs related to connecting to the network, and using high speed broadband services appear to be significant and are likely to reduce the initial uptake of high speed broadband services for both consumers and SMEs; and
- 227.2 while video content is likely to be the primary driver of consumers' uptake of high speed broadband services over the next few years and the rate of uptake is likely to be higher if there is a diverse range of video on demand options available to consumers, currently there are limited online video on demand services in New Zealand compared with many other comparable countries.
228. However, if Chorus's 20% uptake target<sup>108</sup> is met that would imply 90,000 UFB consumers by 2014 and 120,000 UFB consumers by 2015. While it is not yet certain that these numbers will in fact be achieved or what proportion will be business and

<sup>106</sup> Vodafone submission, 31 August 2012.

<sup>107</sup> There are currently about 1.8 million fixed voice lines in New Zealand.

<sup>108</sup> Provided for in the contract between Crown Fibre Holdings and Chorus.

residential, Vodafone has argued that customers will benefit from ongoing competition in the future between providers using UFB and providers that have unbundled local exchanges.<sup>109</sup>

229. Vodafone has argued that such enhanced competition from UFB is analogous to the current situation in regions where TelstraClear has its HFC networks, which gives it “a competitive advantage in those regions where it is offered”.<sup>110</sup>
230. In particular, Vodafone argued that the roll-out of UFB, while it will occur in both the factual and the counterfactual, will lead to RSPs being able to compete more vigorously in the future. This enhanced prospect of competition could potentially arise if:
- 230.1 UFB would provide some constraint to the merged entity’s prices for products provided via UBA;
  - 230.2 it allows other retail service providers to be more competitive with the merged entity’s UCLL pricing and product offering;
  - 230.3 non-discriminatory access to UFB, in a similar manner, allows other retail service providers to be more competitive with the merged entity’s HFC pricing and product offering; and
  - 230.4 these constraints begin to bite by 2014/2015 as the number of premises passed by UFB ramps up.
231. On the other hand, the majority of UFB customers in the next two years are likely to be made up of schools, hospitals and businesses, which are the priority in the early years of the roll-out. It is unlikely that there will be a significant number of residential customers by 2014/15. For example, Orcon stated [ ].<sup>111</sup>
232. Moreover, UFB is being rolled out predominantly in metropolitan areas. Generally, these areas have already been unbundled or are serviced by TelstraClear’s HFC network. As such, UFB provided products appear irrelevant in terms of constraining the merged entity’s UBA provided products as it simply will not be available in the majority of those areas.
233. Within unbundled areas, the merged entity and other UCLL providers would have less of an incentive to sell UFB to new customers or to migrate existing HFC or UCLL customers to UFB given the likely lower margins available through the higher cost UFB. Although there will likely be a proportion of residential customers who demand the higher download speeds available from UFB and are prepared to pay a higher price.

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<sup>109</sup> Vodafone application for clearance, 12 July 2012.

<sup>110</sup> Ibid.

<sup>111</sup> Interview with Orcon, 25 October 2012.

234. In any case, even if UFB was being rolled-out to residential customers in all areas, and even if there was evidence to suggest that there would be strong uptake (given the lack of clarity around prices and connection costs), UFB simply provides another delivery mechanism to provide the products; it does not alter the players in the market or their position within those markets.

*Conclusion on fixed-line voice and broadband for residential consumers*

235. The Commission considers that currently, Vodafone and TelstraClear play a role in stimulating competition for residential fixed voice and broadband products. Historically, this role has been limited to some extent to their respective home territories (Wellington and Christchurch for TelstraClear, and Auckland for Vodafone).
236. In the last year, TelstraClear has introduced new packages which ‘shifted the goalpost’ in terms of pricing and made them a more direct competitor to Vodafone. TelstraClear and Vodafone are strong competitors, both of each other, and of other competitors in the market. As such, post acquisition there will be a loss of competition. However, the Commission finds that the remaining competitors will likely act as a constraint on the merged entity, such that this loss of competition is not likely to be substantial.
237. The Commission considers that Telecom, as a large, experienced, and well resourced competitor will provide a strong degree of competitive constraint on the merged entity. Post-separation, Telecom is akin to a new company, with new leadership and an expressed intention to be a vigorous competitor with the goal of arresting its declining market share. The Commission notes that Telecom has introduced new residential voice and broadband plans which support this intention.
238. Further, the Commission considers that smaller providers, especially Orcon and Slingshot, play a greater role in driving competition than their market shares suggest. Both Orcon and Slingshot have made significant and ongoing investment in unbundling and new technology and the Commission considers that they will continue to grow and constrain the larger players.
239. The Commission considers that, on balance, existing competitors in the residential fixed voice and broadband markets will likely provide sufficient constraint on the merged entity such that there is unlikely to be a substantial lessening of competition in these markets.

**Fixed-line services for businesses**

240. The Commission has defined a market for business fixed-line services, including voice and broadband/data services. As noted above, business customers can be split into three broad categories:



240.1 small enterprises (1-49 employees);<sup>112</sup>

240.2 medium enterprises (50-199 employees); and

240.3 corporate and government customers (200+ employees).

241. Although, as outlined below, these categorisations are by no means industry norms and different firms use their own customer categories.

*Vodafone's submissions*

242. Vodafone submitted that small businesses' fixed voice and broadband requirements are little different to the requirements of residential customers and the products provided are effectively the same. Larger businesses, however, require more complex solutions including wider area networks solutions to connect computer networks and phone systems between multiple office locations.

243. Vodafone submitted that while TelstraClear has strong capability in providing fixed-line solutions to all sizes of businesses, Vodafone has limited ability as it currently only has products to supply [ ] to business customers. According to Vodafone, the limited business customer overlap between the merging parties occurs only in the very small business segment (including, but not limited to SOHO customers) where there are largely the same competition considerations that apply to residential customers.<sup>113</sup>

244. Vodafone submitted that the acquisition will make Vodafone a more effective competitor to Telecom/Gen-i for business customers who wish to have a single source for all their telecommunications and data management products. Indeed, Vodafone's internal documents indicate that [

]".<sup>114</sup>

245. There is no business data network infrastructure overlap as Vodafone does not own any CBD fibre networks. A range of other providers own such networks.

*Other parties' submissions*

246. In the course of its investigation of the acquisition, the Commission received a number of submissions expressing a lack of competition concerns with the merger, combined with a view that the acquisition could have pro-competitive effects in the business market.

246.1 [

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<sup>112</sup> Note that those below 10 are generally characterised as SOHO and so are included in the residential section. We note again, however, that this is a very loose distinction and in reality the differentiation between customer types is not so clearly demarcated. In fact, some of the evidence and data discussed below also applies to many SOHO customers.

<sup>113</sup> Vodafone application for Clearance, 12 July 2012.

<sup>114</sup> Vodafone [ ].

] submitted that overall the merger would be pro-competitive as Vodafone would achieve a scale that would allow it to directly compete with Telecom.

246.2 [ ], who is a competitor in some niche markets, saw no issue with the proposed acquisition, particularly as Vodafone has indicated a desire to grow its business by integrating TelstraClear's services into its offerings. [

]

We note that as a competitor, [ ] would stand to gain from any reduction in competition and consequent higher prices in the market.

246.3 [ ] which offers managed communication services to clients, considers that the merger will increase competition in the market because it will create a stronger competitor to Telecom, currently the only fully vertically integrated provider of managed information and communications technology and telecommunications services.

246.4 [ ] is in favour of the merger because the two parties will complement each other and provide better competition to Telecom.

246.5 [ ] had no concerns over the acquisition and hoped that the TelstraClear influence would see better corporate account management from Vodafone. As a result of the merger, there would be an overall stronger competitor to Telecom.

247. The Commission has taken these submissions into account, most of which have been made by large consumers of telecommunication services or by suppliers of such services to these businesses. The submissions point to the acquisition generally having a pro-competitive effect for large businesses.

248. There is no current overlap between Vodafone and TelstraClear for the large corporate and government segment in the market, so the large business segment is the least likely to exhibit competition concerns. The area of overlap and possible competition concern is for small and medium businesses.

#### *Vodafone's position in the fixed data business market*

249. The Commission has considered what Vodafone currently offers in the business market and Vodafone's plans for expansion in that market.

250. Unlike TelstraClear, Vodafone does not have a large market presence providing fixed-line products to large and medium sized businesses. It currently offers only two small business fixed-line business products – "Small Office" and "Easy Office." Small Office provides one landline and Easy Office provides two VoIP voice lines and one service line. Both packages include small amounts of data with calling add-ons charged additionally.

251. Vodafone's internal documents reveal it had about \$[ ] million of fixed-line revenue from SME<sup>115</sup> in 2012.<sup>116</sup> Vodafone estimated that its share was about [ ]% of this \$[ ] million SME segment.<sup>117</sup>
252. [ ] stated that Vodafone currently lacks credibility in the business market, although that is predominantly a branding issue rather than a capability issue.<sup>118</sup>

*Vodafone's likely future plans in the counterfactual*

253. Vodafone stated that it was introducing two new business products which would cater to larger businesses.<sup>119</sup> Vodafone has subsequently advised the Commission<sup>120</sup> that, [ ].
254. Vodafone's internal strategic documents outline [ ].  
Vodafone stated that [ ].<sup>121</sup> And further, [ ]<sup>122</sup>
255. In respect of key challenges facing Vodafone's growth in the business segment, Vodafone's internal documents stated the following:

[

] <sup>123</sup>

256. The above shows the conflicting evidence on Vodafone's position in the business market. On the one hand, Vodafone currently has [ ] of the small and medium enterprise segments and [ ] in the larger enterprise segment. There is little evidence that Vodafone is currently a significant driver of competition in the business market. On the other hand, Vodafone is the third largest competitor in the market and it has [ ]. The proposed acquisition would thwart this nascent competition.

*TelstraClear's position in the fixed data business market*

257. TelstraClear has a large market presence providing services to major businesses such as banks, government departments, universities, trans-Tasman businesses and retail chains. TelstraClear uses its CBD fibre networks laid throughout New Zealand cities to offer a full suite of business products including managed network solutions,

<sup>115</sup> Defined as organisations with 10-199 FTEs.

<sup>116</sup> Vodafone [ ]

<sup>117</sup> [ ]

<sup>118</sup> [ ].

<sup>119</sup> Vodafone's Application for Clearance, 12 July 2012.

<sup>120</sup> Email from Bell Gully, 12 October 2012.

<sup>121</sup> Vodafone [ ].

<sup>122</sup> Vodafone [ ].

<sup>123</sup> Vodafone [ ].

business voice and broadband, data storage and management, and unified communication solutions.

258. Table 5 shows the breakdown of TelstraClear's business revenue for 2012. The Commission notes that TelstraClear's breakdown of customer types differs from Vodafone, and that the table below includes SOHO customers that we have considered as part of the residential markets above.

**Table 5: TelstraClear business revenue by customer type for 2012**

Customer type	Revenue (\$million)	Revenue share
Small enterprise (0-49FTEs)	[ ]	[ ]%
Medium enterprise (50-499FTEs)	[ ]	[ ]%
Large corporate and government (500+FTEs)	[ ]	[ ]%
Total	[ ]	100%

Source: Submission from TelstraClear

259. According to TelstraClear's internal documents, it has a much larger share ([ ]%) of the total number of smaller medium enterprises (defined as 50-199 FTEs) than its share of ([ ]%) of the larger medium enterprises (defined as 200-499 FTEs).

#### *Market shares*

260. Vodafone submitted that any competition effects arising from the aggregation of its market share with that of TelstraClear, in supplying fixed voice and broadband to small businesses, should be analysed in a manner similar to that for residential fixed-line services. As already discussed, we have included the smallest business customers (SOHO) as part of the residential analysis, although noting that these customer distinctions are not clearly distinguished. However, the combined market share of the merged entity is significantly greater in the business market than it is in the residential market. This is particularly true for the small business segment. Moreover, if Vodafone were to successfully pursue its strategy of [ ] in the counterfactual, as discussed below, there is the potential for its market share across all business segments to increase.
261. Table 6 below shows the estimated national market shares for business fixed-line voice and broadband products for 2011.
262. The Commission has not been able to collect data that allows it to estimate shares for specific segments of the market, such as small and medium enterprises where the largest overlap between the merging parties is evident.

**Table 6: 1. Business fixed-line voice market shares (includes calling charges) in 2011; 2. Business fixed-line broadband market shares in 2011; and 3. Total business voice and broadband market shares in 2011.**

Fixed-line provider	Business voice revenue (\$million)	Business voice market share	Business broadband revenue (\$million)	Business broadband market share	Total business fixed-line revenue (\$million)	Total business fixed-line market share
Vodafone	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
TelstraClear	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
<b>Merged Entity</b>	<b>[ ]</b>	<b>[ ]%</b>	<b>[ ]</b>	<b>[ ]%</b>	<b>[ ]</b>	<b>[ ]%</b>
Telecom	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
CallPlus	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Orcon	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Other providers	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
<b>Total</b>	<b>513</b>	<b>100%</b>	<b>106</b>	<b>100%</b>	<b>619</b>	<b>100%</b>

Source: Commerce Commission annual industry survey as at June 2011

*Constraints on the merged entity in fixed-line business markets*

263. The predominant overlap in the business market, or likely overlap in the future, is strongest in the small and medium enterprise segments of the market. The Commission's analysis below therefore focuses on these segments in particular.

264. The main competitor to the merged entity in the factual would be Telecom. Vodafone stated that [

].<sup>124</sup>

265. Vodafone's internal documents also stated in relation to Telecom:

[

].<sup>125</sup>

266. [ ] stated that Telecom struggles with SOHO, small and medium enterprise customers.<sup>126</sup>

267. TelstraClear's internal documents stated [

].<sup>127</sup>

However, TelstraClear stated that [ ] are the main competitors in the

<sup>124</sup> Vodafone [ ] .

<sup>125</sup> Vodafone [ ] .

<sup>126</sup> Interview with [ ] .

<sup>127</sup> TelstraClear [ ] .

medium enterprise space (50-499 FTEs) and that the small business competitive landscape is very similar to residential sector, driven by mostly price concerns and the ability to offer a mobile product is an important part of this.<sup>128</sup>

268. The above evidence suggests that Telecom is perhaps a more aggressive competitor, and more of a driver of competition in the business market than in the residential market, particularly for larger businesses.
269. Other competitors in this market include CallPlus and Orcon, as well as other smaller providers. These providers have a smaller combined market share in business ([ ]%) than for residential broadband ([ ]%). These businesses are offering some innovative solutions to medium sized business by replacing expensive PABX analogue voice systems with digital voice solutions provided over a data connection. Orcon advised the Commission that [ ]<sup>129</sup>
270. In terms of bundling business product together, TelstraClear provided the Commission with a break-down of multiple product purchases by small and medium enterprise customers. This table shows that, at least for TelstraClear, bundling mobile phones with fixed-line business packages is not required to be a successful supplier in this market.

**Table 8: Take-up of multiple products by small and medium enterprise TelstraClear customers**

	Small enterprise	Medium enterprise
Customers with voice, internet and mobile	[ ]%	[ ]%
Customers with voice and internet (no mobile)	[ ]%	[ ]%
Customers with standalone products	[ ]%	[ ]%

Source: Submission from TelstraClear

271. [ ] advised the Commission that it competes head on with Gen-I (Telecom).<sup>130</sup> In general, [ ] seemed to view the proposed acquisition as being pro-competitive in the business market, indicating the merged entity will be a more effective competitor, making the market more challenging for [ ]<sup>131</sup>
272. This suggests that Vodafone looks to Telecom and TelstraClear, more than others, as its main competitors. Although Vodafone did also note that “[ ]”<sup>132</sup>

<sup>128</sup> Interview with TelstraClear, 7 August 2012.

<sup>129</sup> Interview with Orcon, 8 August 2012.

<sup>130</sup> Interview with [ ].

<sup>131</sup> Ibid.

<sup>132</sup> [ ].

273. The above evidence suggests that the smaller providers may play less of a role in the business market than the residential market. There is little evidence that they drive competition in this market to the same extent as they do with their price-leading packages in the residential markets.

#### *Impact of UFB*

274. The UFB roll-out will have a greater affect in business markets than that in residential markets. Retail service providers' costs to access UCLL or UBA plus POTS to supply each business customer rises in proportion to the number of lines supplied. In contrast, UFB costs are essentially fixed as the number of lines supplied increases. This means that providers of UFB to businesses gain larger cost savings as the number of lines supplied increases.<sup>133</sup>
275. These cost savings are available to all retail service providers, who can develop appropriate products, as UFB is provided by Chorus on an open access basis. However, many businesses in metropolitan areas, where UFB is being rolled out first, are already provided by fibre, so it is less evident that there will be costs savings for the RSPs servicing these businesses.
276. Vodafone has argued that UFB may allow smaller providers to compete more vigorously than in the past as UFB can be accessed by providers on a non-discriminatory basis, meaning that smaller providers will perhaps have lower relative costs than in the past for serving multi-line businesses.
277. The Commission notes that UBA and other wholesale access services are already available on a non-discriminatory basis. There is no evidence from RSPs to suggest the discriminatory access currently matters in those areas where UFB is being rolled out. Moreover, UFB simply provides a new delivery method, but, similar to the argument in the residential market it does not alter the competitors in the market or their position within that market. Moreover, the roll-out of UFB is the same in the factual and the counterfactual.

#### *Conclusion on business market*

278. The Commission considers that this merger could be characterised as a reduction from three to two in terms of main suppliers of fixed-line services to small and medium enterprises. However, while this results in the loss of competition from the third competitor, the merger has the offsetting effect of creating a more efficient competitor that would be better able to compete with Telecom.
279. The evidence suggests that the main area of overlap between TelstraClear and Vodafone is in the small and medium enterprise segments. Vodafone at present plays a less significant role in this market than it does in the residential market. [ ]].
280. Vodafone is [ ] in this segment of the market, and its position may be somewhat enhanced by its ability to cross sell its mobile services. Moreover, there is

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<sup>133</sup> [ ]].

evidence to suggest that it was planning [ ] of the business market. The other smaller providers do not appear to be targeting this market or play the price leading role that they do in the residential market. However, smaller providers are active in this market and will continue to provide some measure of competition post acquisition.

281. On balance, the Commission considers that competition in this market appears to be driven by Telecom and TelstraClear, although Vodafone has made some advances in this market recently. The Commission considers that post acquisition, Telecom will likely constrain the merged entity.

### Mobile phone services

282. Vodafone is the largest supplier of mobile phone services in New Zealand. TelstraClear is amongst the smallest providers of mobile phone services. It does not have its own mobile phone network assets, rather it supplies about [ ] customers as a “mobile virtual network operator” (MVNO). This means it purchases mobile phone services from Vodafone at wholesale and resells them under its TelstraClear brand.<sup>134</sup>
283. Mobile market shares are shown in Table 9.

**Table 9: Mobile phone market shares for year ending June 2011**

Mobile phone provider	Retail revenue \$ million	Market share by revenue	Number of connections	Market share by connections
Vodafone	[ ]	[ ]%	[ ]	[ ]%
TelstraClear	[ ]	[ ]%	[ ]	[ ]%
<b>Merged Entity</b>	<b>[ ]</b>	<b>[ ]%</b>	<b>[ ]</b>	<b>[ ]%</b>
Telecom	[ ]	[ ]%	[ ]	[ ]%
2degrees	[ ]	[ ]%	[ ]	[ ]%
Other MVNOs	[ ]	[ ]%	[ ]	[ ]%
<b>Total</b>	<b>2,142</b>	<b>100</b>	<b>4,826,850</b>	<b>100</b>

Source: Commerce Commission annual industry survey as at June 2011

284. It can be seen that on both revenue and number of connections bases the increases of market shares between the factual and the counterfactual are only [ ]% and [ ]% respectively. The Commission considers that any resulting increase in market power would not result in a substantial lessening of competition.
285. This would be especially so in this case because under the MVNO arrangement, Vodafone, as a wholesale provider of mobile services, has the ability to set the margin available within which MVNOs using its network may compete with it. For example, [ ]

<sup>134</sup> Compass Communications and CallPlus, and Digital Island are other MVNOs; they are supplied by Telecom. Orcon is also a MVNO and is supplied by Vodafone. The MVNOs collectively have a very small market presence.



] In the Commission's view TelstraClear, as a MVNO, is unlikely to currently constrain Vodafone's mobile prices.

### **Vertical effects**

286. The proposed merger of Vodafone and TelstraClear is at least in part a vertical merger, as it includes the acquisition of upstream infrastructure assets such as spectrum, a fibre network and backhaul infrastructure.
287. A vertical merger between an upstream input provider (TelstraClear in this case) and a downstream producer of a final product (Vodafone in this case) can potentially lead to the merged firm increasing the price it charges for the input to rival downstream producers, making it harder for the rival to compete effectively by increasing its costs. This access concern is often described as partial input foreclosure. Alternatively, the merged firm could stop supplying the input to its rivals altogether. This could lead to higher input prices for downstream rivals or foreclose their access to the relevant input altogether, which can have the effect of reducing competition in the input market.
288. The Commission assesses below the vertical aspects of this merger in relation to:
- 288.1 the purchase of backhaul services by rival mobile operators; and
- 288.2 the availability of spectrum for mobile phone services.

### **Analysis of backhaul competition issues**

289. As discussed further below, [
- ].
290. In assessing these vertical effects, in relation to national backhaul, the Commission has considered whether the merged entity could increase the price of backhaul to rival mobile operators. Such an increase in its rivals' national backhaul costs could reduce their competitiveness in mobile phone markets, leading to a substantial lessening of competition.
291. For the reasons outlined below, the Commission considers that Vodafone's acquisition of backhaul assets is unlikely to give it either the ability or incentive to cause partial input foreclosure to rival mobile operators in mobile phone markets post acquisition. As a result there is unlikely to be a substantial lessening of competition in the market for the provision of backhaul services.

### *Background*

292. [
- ].

293. Regional (or intra-city) backhaul is the carriage of users' voice and data traffic between the many local exchanges in the city centres and suburbs of New Zealand and their nearest major exchange (of which there are 30 nationally) or other aggregation points. An example would be traffic between the Lower Hutt exchange and the Wellington major exchange.
294. National (or inter-city) backhaul is the longer distance transmission of voice and data traffic between individual major exchanges (or other aggregation points), and between major exchanges (or other aggregation points) and two Auckland-based international gateways. Backhaul almost always involves the carriage of traffic by fibre optic cable.
295. At present, the providers of longer distance national backhaul are Telecom, TelstraClear and FX Networks.<sup>135</sup> In addition, under the Telecom/Chorus separation agreement (the separation agreement), Chorus obtained approximately half the unused national backhaul fibre formerly owned by Telecom.
296. Providers of regional backhaul are outlined in Table 10:

**Table 10: providers of regional backhaul**

<b>Provider</b>	<b>Areas Active</b>
Chorus	Nationwide
TelstraClear	Wellington & Christchurch
Vector	Auckland
Counties Power	South Auckland
Metro Network	Tauranga
Unison	Napier
Data Talk	New Plymouth
Inspire	Manawatu & Southern Hawke's Bay
Citylink	Wellington
Smartlinx	Lower Hutt
The link	Blenheim & Nelson
Enable	Christchurch

<sup>135</sup> FX Networks owns and operates a national inter-city fibre optic network providing backhaul services from 35 "points of presence" and 58 locations throughout the country.

Provider	Areas Active
Electricity Ashburton	Ashburton
Invernet	Invercargill

297. A subset of regional and national backhaul is the carriage of voice and data traffic between individual mobile phone cell sites and national mobile switching centres and then either to fixed and mobile networks for termination, or to the internet. The fibre links to Telecom and [ ] cell towers are, in most instances, currently provided by Telecom, which manages the backhaul service for itself and [ ] using fibre optic cables owned by Telecom and Chorus. [ ] manages its backhaul services using fibre optic cables owned by [ ].

298. The Commission currently regulates Chorus' prices for backhaul services required for UBA and UCLL access, but only on those links where the Commission considers that competition is limited. In its most recent review of the designated backhaul services released on 5 October 2012, the Commission noted that "The review shows a marked increase in the number of backhaul links that are now subject to competition and therefore no longer need to be regulated. 95% of all regional backhaul links are now competitive, and around 75% of the relevant local backhaul links."

[ ]

299. [ ].

299.1 The market for national backhaul services in New Zealand is highly concentrated with Telecom, TelstraClear and FX Networks being the only three providers that run comprehensive national backhaul services over their fibre networks.

299.2 [

].

299.3 [

].

299.4 [

].

299.5 [

].

299.6 [

].

299.7 [

].

299.8 [

].

#### *Vodafone's submissions*

300. Vodafone's submissions are summarised below.

300.1 [

].

300.2 TelstraClear's total wholesale revenue is \$[ ]. Vodafone submits that it will require that revenue to be maintained or increased as it also provides a large justification for the acquisition of TelstraClear. Vodafone's business case for the transaction [ ]. Vodafone submits that [

].

300.3 Vodafone asserts that Chorus will continue to operate over all relevant backhaul links. Vodafone submits that the structural separation of Telecom in December 2011 has left Telecom as Chorus's competitor on most of those links. If post-merger Vodafone restricted access to the links it obtains from TelstraClear, it would simply lose revenue to Chorus, Telecom or FX Networks.

#### *The Commission's view*

301. The Commission has analysed whether Vodafone would have the ability and incentive to foreclose rival mobile operators post-acquisition.

302. Telecom, Vodafone and 2degrees are the three firms providing mobile phone services. Presently, Telecom is the only vertically integrated provider of national backhaul services with respect to mobile phone services.

303. [ ] has expressed concerns that post-acquisition the current competition between Telecom, TelstraClear and FX Networks in the provision of national backhaul would be reduced. Vodafone would become vertically integrated through its acquisition of TelstraClear's backhaul assets, [ ].

304. [ ]  
[ ]

305. To be of concern, [ ] lead to reduced competition in mobile markets, thereby allowing Vodafone and Telecom to recover any lost revenue in the backhaul market by increasing prices in the mobile market.

*Ability of Vodafone to foreclose rival mobile operators*

306. The Commission considers that in the factual, Vodafone would not have the ability to foreclose rival mobile operators through refusing to supply national backhaul services, or by only providing access on disadvantageous terms. This is because access to the necessary backhaul would still be available through FX Networks and Telecom (also potentially Chorus should it enter the market). Moreover, the Commission is of the view that as backhaul [ ]

].

307. Vodafone advised the Commission that national backhaul is [ ].<sup>136</sup> It is likely that to affect [ ] there would need to be a substantial increase in national backhaul prices.

308. Further, the Commission considers that in order for such a strategy to be successful, Vodafone would require the other vertically integrated provider of national backhaul services (Telecom) to also adopt such a strategy. Otherwise, [ ]

309. Currently, the majority of Vodafone's backhaul is [ ]

].

310. The Commission considers that such coordinated behaviour (tacit or otherwise) is unlikely, given the presence of FX Networks as an effective competitor and the potential entry of Chorus.

311. While Chorus does not currently provide national backhaul services, as part of its separation from Telecom, it has obtained the network assets and infrastructure to do so. [ ]

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<sup>136</sup> Vodafone submission dated 16 August 2012.

]. Moreover, a strategy that increases the price of backhaul would make entry by Chorus that much more appealing. Vodafone agrees. It submitted that it has no ability to “block access to backhaul because Chorus is always present.”

*Incentive of Vodafone to foreclose rival mobile operators*

312. Vodafone would only have the incentive to foreclose rival mobile operators if it could make a net gain from such a strategy. To do so it would have to increase rival’s costs in mobile phone markets therefore weakening competition, which may result in an increase in prices in the mobile market, to such an extent that the cost of lost backhaul revenue would be offset.
313. Vodafone submitted that the lack of any incentive to foreclose national backhaul is demonstrated by the fact that the [ ].
314. The Commission considers that theoretically, Vodafone may have a limited incentive to raise rivals input costs by foreclosing access to backhaul as the possibly increased revenues it could gain in mobile markets could offset any loss of revenues from backhaul. Conversely, the Commission considers that Vodafone would also be incentivised to maximise the return on the TelstraClear assets being acquired.
315. However, as outlined above, both Vodafone and Telecom would have to act to foreclose [ ]. The Commission does not consider this type of coordinated behaviour likely, given the [ ] and the potential threat of entry by Chorus.

*Potential entry of Chorus into national backhaul*

316. Notwithstanding the conclusions above, the Commission has considered in greater detail if there are any likely entrants into backhaul markets, in the event that Vodafone and/or Telecom were to attempt to foreclose rival operator’s access to national backhaul.
317. Entry or expansion in response to a price increase or other manifestation of market power must be Likely, sufficient in Extent and Timely (the LET test) in order to provide a sufficient constraint on the merged entity.
318. The most obvious potential entrant is Chorus, given its ownership (or right of use) of 50% of Telecom’s national fibre network. At present, Chorus does not offer a national backhaul service [ ]

].

319. Chorus stated that [ ]].
320. In Chorus's view, [ ]].
321. Chorus noted that while mobile backhaul, [ ], is slightly more complicated than providing, for example, UBA and UCLL backhaul, there is no technical reason why Chorus would not be able to provide a mobile backhaul service [ ]].
322. Chorus informed the Commission that [ ]].
323. On the evidence provided by Chorus, the Commission considers that Chorus [ ]]. The Commission considers that, should the price of backhaul increase for any reason, including a decision by the merged entity and Telecom both deciding to stop selling such services, the appeal of entry by Chorus would be enhanced.

*Conclusion on national backhaul issues*

324. The Commission considers that in the factual, Vodafone would not have the ability to foreclose rival mobile operators access to national backhaul services. In order for such a strategy to be successful, Vodafone would require the accommodating response of Telecom so that the choice of backhaul service providers would be reduced to one, and the backhaul prices would need to increase significantly before they would impact on a rival's ability to act as a competitive constraint in downstream mobile markets.
325. The Commission also notes that Chorus [ ]].
326. Therefore, the Commission considers that Vodafone is unlikely to have the ability to foreclose rival operators in mobile phone markets post acquisition, and there is unlikely to be a substantial lessening of competition in the mobile phone market as a result.

### Acquisition of spectrum management rights for mobile phone services

327. [

].

328. In assessing the vertical effects in relation to spectrum management rights for mobile phone services, the Commission has considered whether Vodafone could increase the price of spectrum management rights to rival mobile operators in the future, thereby reducing its rivals' competitiveness in mobile phone markets.

329. For the reasons outlined below, the Commission considers that Vodafone's acquisition of spectrum management rights is unlikely to give it either the ability or incentive to foreclose rival operators in mobile phone markets and that there is unlikely to be a substantial lessening of competition as a result.

#### *The availability of spectrum management rights for mobile phone services*

330. In order to offer a mobile phone service, an operator must be able to transmit data across radio frequency spectrum. Various bandwidths are used for mobile phone communications with differing properties in terms of their suitability for voice, text messaging and internet services, and for urban and rural services. The ownership of management rights to spectrum is regulated by MBIE with usage and ownership regulations differing across the bandwidths.

331. Telecom, Vodafone, 2degrees, and TelstraClear currently own management rights to different spectra including those that can be used to provide mobile phone services. TelstraClear does not currently use any of the spectrum for which it owns the management rights. Post acquisition, Vodafone would increase the number of spectrum bandwidths to which it has management rights, and Telstra would obtain some management rights [

].

332. For spectrum that can be used for mobile phone services, post acquisition, Vodafone would increase its holdings to the equivalent of Telecom in one bandwidth [

], and that it would also increase its holdings to the regulated limit imposed by MBIE in another bandwidth. In addition, Vodafone would increase its holdings in bandwidths that are not presently used but which could be used for mobile phone or other wireless services in the future.

333. [

]. This appears to be an expression of an input foreclosure theory of harm whereby [

].

334. The provision and management of management rights for the use of radio spectrum is administered by the Radio Spectrum Management Group of MBIE. The Commission consulted with MBIE regarding the spectrum transactions and the aggregation that would occur as a result of this merger. MBIE advised the Commission that it does not consider that the aggregation of spectrum would give



rise to any concerns in respect of the allocation and management of spectrum in New Zealand.

*1800MHz FDD spectrum*

335. In this spectrum band, Vodafone would increase its holdings from 2 x 15MHz to 2 x 25MHz by way of a swap between Vodafone and Telstra/TelstraClear of their respective holdings. Post acquisition, Telstra would hold 2 x 15MHz of 1800MHz spectrum. Telstra has [ ]

336. There is no statutory cap on the amount of 1800MHz spectrum that any one party is able to hold. The pre and post-acquisition holdings of spectrum in this band are outlined in Table 11.

**Table 11: Post-acquisition spectrum holdings in the 1800MHz band**

Holder	Pre-acquisition holdings	Post-acquisition holdings
Vodafone	2 x 15MHz	2 x 25MHz
Telecom	2 x 25MHz	2 x 25MHz
[ ]	[ ]	[ ]

337. Table 11 shows that post-acquisition, [ ] of 1800MHz spectrum licences.

338. TelstraClear has owned its spectrum licences for a number of years. [ ]

339. Without the acquisition, it is [ ]

340. The Commission considers that the spectrum transfer arrangements outlined above are not likely to result in a substantial lessening of competition. Rather, the Commission considers that the transfer of spectrum is likely to be pro-competitive as it will free up 2 x 15MHz of 1800MHz spectrum which will be able to be purchased by a third party.

341. [ ]

*2100MHz FDD spectrum*

342. In the 2100MHz spectrum band, Vodafone would increase its holdings from 2 x 15MHz to 2 x 25MHz. Post acquisition, Telstra would hold 2 x 5MHz of 2100MHz spectrum which it would be free to sell.
343. The holding of spectrum in the 2100MHz bandwidth is currently subject to a regulatory cap. Vodafone's acquisition of this spectrum would not exceed this cap. The pre and post acquisition holdings of spectrum in the 2100 MHz bandwidth are outlined in Table 12.

**Table 12: Pre and post-acquisition spectrum holdings in the 2100MHz band**

Holder	Pre-acquisition holdings	Post-acquisition holdings
Vodafone	2 x 15MHz	2 x 25MHz
Telecom	2 x 15MHz	2 x 15MHz
TelstraClear/Telstra	2 x 15MHz	2 x 5MHz
2degrees	2 x 15MHz	2 x 15MHz

344. Table 12 shows that post acquisition, Vodafone would increase its holdings in the 2100 MHz spectrum band from 2 x 15MHz to 2 x 25MHz. In addition, Telstra would hold 2 x 5MHz of spectrum.
345. Telstra informed the Commission that it [ ]].
346. The majority of mobile phone use in New Zealand currently utilises either second or third generation (2G & 3G) technology. The next generation of mobile technology (known as long term evolution (LTE or 4G)) will provide much faster transmission of data and voice.
347. While the majority of LTE transmission is expected to be carried on the sub 1GHz bandwidths, the higher bandwidths (such as 2100MHz) are necessary as they enable the transmission of data over longer distances. The pending switch-off of the analogue TV signal (carried on the 700MHz) band will free this band up to be allocated for the use of LTE technology.
348. [ ] has expressed concerns that the acquisition of spectrum would give Vodafone a 'first mover advantage' as it will be in a better position to take advantage of technological advances such as LTE due to Vodafone's increased spectrum holdings.

349. The Commission understands that [

].

350. The Commission considers that the acquisition by Vodafone of an additional 2 x 10 MHz of 2100 MHz spectrum is unlikely to raise any competition concerns. Both of the remaining mobile operators hold significant spectrum rights in this bandwidth and [

].

351. [

].

352. Further, while the 2100 MHz spectrum is valuable in terms of its suitability for LTE technology, the freeing up of the 700 MHz spectrum will provide a large amount of additional spectrum for mobile operators to roll out LTE networks.

#### *Spectrum for non-mobile use*

353. A number of parties have expressed concern about the number and range of non-mobile specific higher frequency spectrum licences Vodafone would have post-acquisition. A key concern is that such a banking of spectrum could potentially foreclose competitors from accessing spectrum in these higher bands. The parties argued that this would enable Vodafone to offer services if and when commercialisation of these bands occurs.

354. The non-mobile specific spectrum bands in which Vodafone would increase its holdings post-acquisition are outlined in Table 14:

**Table 14: Vodafone's pre and post acquisition holdings in non mobile specific spectrum bandwidths**

<b>Band</b>	<b>Vodafone's holdings pre acquisition</b>	<b>Vodafone's holdings post acquisition</b>
2100 TDD	1 x 5MHz	1 x 10 MHz
2 GHz microwave link band	0 MHz	2 x 28 MHz
3.5 GHz (FDD)	2 x 7 MHz	2 x 28 MHz

355. As outlined in Table 14, Vodafone does not currently have any holdings in the 2 GHz Microwave link band so there would be no aggregation of spectrum in this band as a result of the acquisition.

356. Furthermore, Vodafone submitted that [

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357. The Commission considers that currently, there is limited commercialisation of spectrum holdings in these higher bandwidth areas and that such commercialisation may be a number of years away. Further, Telecom, CallPlus, Woosh, and Kordia all hold management rights to spectrum in these bandwidths.
358. Therefore, the Commission considers that the aggregation of spectrum in the non-mobile specific bands is unlikely to raise any competition concerns.

### **Conglomerate effects**

359. A conglomerate merger involves the acquisition of a complementary good or business, or the acquisition of a firm that trades in a separate but closely related market. Conglomerate acquisitions are often associated with efficiencies. However, in some instances, they may give rise to competition concerns.
360. The Applicant stated:
- The acquisition of TelstraClear by Vodafone will combine two complementary businesses with limited overlap. Vodafone's network and expertise is centred primarily on mobile services, while TelstraClear's network and experience is based on fixed-line services.
361. However, some interested parties have raised concerns about the combination of Vodafone's largely mobile business with TelstraClear's related largely fixed-line business. Specifically, the Commission has received submissions expressing concerns in relation to:
- 361.1 anti-competitive on-network / off-network pricing for fixed-line- to-mobile phone calls; and
- 361.2 the bundling of fixed-line services with mobile services.
362. These issues are addressed separately below.

### **Fixed-to-mobile on-net / off-net pricing**

363. For the reasons outlined below, the Commission considers that Vodafone's acquisition of TelstraClear is unlikely to give it either the ability or the incentive to foreclose rival mobile operators through fixed-to-mobile on-net/off-net pricing, and as a result there is unlikely to be a substantial lessening of competition.

[ ]

364. [ ]

365. On-net/off-net pricing is when a supplier charges lower prices for calls to customers contacting other users on its own network (on-net) and higher prices for calls when they are contacting users on competitors' networks (off-net).

366. [ ].<sup>137</sup> That is, if fixed-to-mobile off-net prices are sufficiently high, fixed-line consumers may be dissuaded from calling people on other mobile networks. As consumers are likely to obtain value from receiving calls, a significantly reduced number of calls from a fixed network to alternative mobile networks may result in consumers placing less value on these alternative mobile networks and a higher value on the integrated fixed and mobile network.<sup>138</sup>

367. [ ]<sup>139</sup>

367.1 [ ];<sup>140</sup> and

367.2 [ ].<sup>141</sup>

368. In respect of the extent of higher off-net prices, [

]."<sup>142</sup>

369. [

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370. This is because the resulting effect of higher fixed-to-mobile off-net prices would be to make the alternate mobile network less attractive to consumers. Any slackening of competition in that market will be enjoyed by the integrated network to a greater extent if it has a larger market share in that mobile market.

371. [

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<sup>137</sup> [

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<sup>138</sup> Ibid.

<sup>139</sup> [

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<sup>140</sup>

This is because of 'monetary externalities' that arise from a firm internalising termination charges and 'consumption externalities' that arise from a network accounting for the benefits of its mobile customers receiving a call from its fixed-line customers. [ ].

<sup>141</sup>

This is because an integrated network will take account of the alternative network's mobile customers enjoying a benefit from receiving a call from the integrated network's fixed-line customers. This benefit arising to a competitor essentially increases the marginal cost of the integrated network providing the fixed-to-mobile service. [ ] describes this as a "competitive externality". As the competitive externality increases marginal costs for off-net calls, the integrated network charges higher off-net prices. A non-integrated fixed-line supplier does not have the incentive to charge higher off-net prices as it is indifferent to competition in the mobile market. [ ].

<sup>142</sup>

[ ].

*How might fixed-to-mobile on-net/off-net prices lessen competition?*

372. [

]. As discussed in the legal framework section above, the Commission needs to consider whether this acquisition will likely result in a substantial lessening of competition. Meanwhile, the relevant test in the Telecommunications Act is different to that of the Commerce Act. The Telecommunications Act's purpose is to "promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand".<sup>143</sup>

373. Moreover, as discussed below, there are several factual differences between the mobile-to-mobile and fixed-to-mobile markets. As such, previous regulation in the mobile-to-mobile and fixed-to-mobile market would not necessarily be indicative that the proposed merger would result in a substantial lessening of competition from increased on-net/off-net price differentials.

374. In respect of the proposed acquisition, the Commission considers that fixed-to-mobile on-net/off-net pricing would only result in a substantial lessening of competition if Vodafone could foreclose mobile phone competitors by denying them sufficient numbers of customers so that they could no longer operate at a competitive scale. Fixed-to-mobile on-net/off-net pricing without foreclosure that stems from this type of customer denial would not be likely to cause a substantial lessening of competition.

375. Therefore, to be of concern, the merged entity would need to gain both the ability and the incentive to foreclose its rivals through fixed-to-mobile on-net/ off-net pricing. On-net/off-net pricing can be efficiency enhancing which may have an exclusionary effect arising from a superior competitive performance. An additional requirement before fixed-to-mobile on-net/off-net pricing would become a concern is that foreclosure would need to have the effect of substantially lessening competition due to a post-foreclosure increase in prices.<sup>144</sup>

376. In order for anti-competitive foreclosure to be likely as a result of fixed-to-mobile on-net/off-net pricing, we require:

376.1 fixed-to-mobile calling rates to be important to mobile consumers so they are likely to make their mobile phone package decisions on the basis of prices for such calls;

376.2 consumers' fixed-to-mobile calling patterns to be informed by their knowledge of whether they are making an on-net or off-net call, which could then impact on consumers' choice of mobile network;

<sup>143</sup> Telecommunications Act, section 18.

<sup>144</sup> The Commission notes that in its Mobile Termination Access Service Standard Terms Determination published on 5 May 2011, the Commission determined that mobile-to-mobile, on-net/off-net price differentiation represented a barrier to efficient expansion and in relation to fixed-to-mobile that above cost termination rates are likely to limit competition, especially for non integrated operators.

376.3 the merger making foreclosure more likely than what is currently possible, given that Vodafone and Telecom are already able to offer fixed-to-mobile on-net/off-net pricing; and

376.4 any resulting foreclosure must be because rival mobile phone operators have been rendered less competitively effective by no longer being able to achieve competitive scale.

377. These issues are addressed below.

*How important are fixed-to-mobile calling rates to mobile customers' network choice?*

378. As outlined below, the evidence suggests that fixed-to-mobile on-net/off-net pricing is unlikely to be an important factor in relation to consumers' choice of network and, in any event, is difficult to commercially exploit.

379. In the Commission's view, the influence of fixed-to-mobile price differentials on consumers' choice of mobile network is likely to be determined in part by the proportion of fixed-to-mobile calls made. As outlined below, the proportion of fixed-to-mobile traffic is significantly lower than the proportion of fixed-to-fixed or mobile-to-mobile traffic.<sup>145</sup>

379.1 Fixed-to-mobile calls accounted for about [ ]% of total fixed network total calling volumes in the year ended 30 June 2011.<sup>146</sup> This proportion is small compared to domestic fixed-to-fixed calling which makes up [ ]% of fixed-line calls ([ ]% local and [ ]% national), or mobile-to-mobile calling which makes up [ ]% of mobile calling.

379.2 While fixed-to-mobile calls are more common for business customers, evidence from [ ] shows such traffic amounts to only [ ]% of the total volume of fixed-line traffic.

379.3 Vodafone's evidence shows that of the calling made by its fixed-line residential customers, [ ]% was calling to Vodafone mobiles and [ ]% was calling to mobiles on other networks.<sup>147</sup>

379.4 Vodafone's evidence shows that of the calling made by its fixed-line business customers, [ ]% of calling was to Vodafone mobiles and [ ]% was to mobiles on other networks.<sup>148</sup>

379.5 Vodafone submitted that only [ ]% of Vodafone mobile customers' received calls were from fixed-line phones.<sup>149</sup>

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<sup>145</sup> [

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<sup>146</sup> Commerce Commission 2011 Telecommunications Industry Questionnaire Results.

<sup>147</sup> Submission from Vodafone, 19 September 2012, page 5.

<sup>148</sup> *ibid*, page 6.

<sup>149</sup> Submission from Vodafone, 27 September 2012.

380. [ ] that the volume of fixed-to-mobile calls is currently very low relative to fixed-to-fixed calls because of the high prices currently being charged for off-net fixed-to-mobile calls. However, the fact that [ ]% of calls from Vodafone’s residential fixed-line network and [ ]% of calls from Vodafone’s business fixed-line network are to Vodafone’s mobile network indicates that even [ ] high off-net fixed-to-mobile charges, the proportion of fixed-to-mobile calls form a limited part of the market.
381. This evidence suggests that fixed-to-mobile on-net/off-net price differentials are currently unlikely to influence consumers’ choice of mobile network to any significant degree, as relatively few calls are received from the fixed network.

*Do price differences impact fixed-to-mobile off-net calling patterns?*

382. The degree to which fixed-line consumers adjust their calling patterns depending on the price of off-net calls is likely to impact on consumers’ choice of mobile network. As such, we need to consider if fixed-line consumers make fewer off-net calls as the price increases.
383. It is difficult to determine the impact that high off-net prices would have on calling patterns. [ ]<sup>150</sup>
384. Telecom has advised that its residential fixed-to-mobile on-net/off-net pricing [ ]. Furthermore, the advent of number portability has meant that consumers do not necessarily know which network they are calling.<sup>151</sup> Telecom advised that consumers are generally willing to [ ].<sup>152</sup> As a result of this, Telecom launched new residential plans in October 2012 that do not contain on-net/off-net price differentials for fixed-to-mobile calling.<sup>153</sup>
385. Telecom’s business calling plans, however, generally do offer on-net/off-net price differentials.<sup>154</sup> Business customers are more likely to enjoy lower on-net offers as a larger proportion of their calls are often fixed-to-mobile within the business, and as such, business users have greater visibility of the network they are calling. However, it is common for business plans to offer ‘free’ calling between all the phones used by a business.
386. Vodafone also submitted that if it were to substantially increase the off-net fixed-to-mobile call prices, [ ]<sup>155</sup>  
[ ].

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<sup>150</sup> [ ].

<sup>151</sup> Submission from Telecom, 28 August 2012, page 12.

<sup>152</sup> *ibid.*

<sup>153</sup> Submission from Telecom, 12 September 2012, page 4.

<sup>154</sup> *ibid.*

<sup>155</sup> Submission from Vodafone, 27 September 2012.



*What impact does the merger have on the likelihood of foreclosure?*

387. As noted above, Vodafone and Telecom already have sizeable fixed networks and large mobile networks.
388. Vodafone submitted that on-net pricing for fixed services is not currently a common feature of the fixed-line telecommunications market, and is becoming less widespread in the mobile market as well.<sup>156</sup> Vodafone's residential on-net/off-net pricing differentials have generally been restricted to "closed user groups", rather than across the board price differences. Vodafone submitted that the move away from on-net deals is exemplified by its BestMates for Home Phone offer which was launched in June 2012. BestMates for Home Phone is a fixed-line calling product, where the customer can nominate five mobile or fixed lines on any network to call without additional charge for up to two hours.<sup>157</sup>
389. This compares to Vodafone's similar, now legacy, Talk0 offer, which allowed consumers to only nominate Vodafone numbers.<sup>158</sup> Vodafone submitted that customer preference, lower termination rates, mobile number portability and the size of Vodafone's competitors' customer base all created the incentive to ensure that BestMates for Home Phone is an any-net product.<sup>159</sup>
390. Vodafone submitted that [ ]<sup>160</sup>
391. Vodafone submitted that Telecom has had a major share of both the fixed-line market and the mobile market for a long time, providing it with the ability to use discriminatory on-net/off-net pricing should that have been advantageous. However, as discussed above, Telecom has [ ]
392. For business customers, Telecom still offers on-net/off-net price differentials. As discussed above, businesses make a larger proportion of calls to mobiles and to mobiles within an organisation, which therefore leads to greater consumer benefit in on-net deals.<sup>161</sup>
393. The Commission also considers that the merger is unlikely to make foreclosure any more likely than currently. [ ] that it is the size of the mobile network that is the critical factor. While Vodafone has a large mobile network, the merger would not substantially increase Vodafone's ability to take advantage of fixed-to-mobile on-net/off-net prices, as its mobile network would not increase significantly. As Vodafone submits, a post-merger market share increase from [ ]% to [ ]% of the

<sup>156</sup> Submission from Vodafone, 16 August 2012, page 2.

<sup>157</sup> Submission from Vodafone, 19 September 2012, page 4.

<sup>158</sup> *ibid.*

<sup>159</sup> *ibid.*

<sup>160</sup> *ibid.*, page 2.

<sup>161</sup> Submission from Telecom, 29 August 2012.

mobile market<sup>162</sup> would have minimal impact on the attractiveness of fixed-to-mobile on-net calling for Vodafone's customers.<sup>163</sup>

394. The Commission considers that the lack of foreclosure to date from fixed-to-mobile on-net/off-net pricing suggest that foreclosure is unlikely to occur post-merger.

*Would rival mobile operators be denied scale to compete?*

395. As noted above, a large fraction of customer demand would not be impacted by any attempted on-net/off-net foreclosure strategy, and as such it would be unlikely to impact the competitiveness of other suppliers. On this basis alone, the Commission does not find that anti-competitive foreclosure is likely.

396. Moreover, the Commission considers that competitors may have counter-strategies available to them that would offset any risk of possible foreclosure. Vodafone submitted that competitors' counter-strategies would allow them to match any of its on-net/off-net offers if these did turn out to be important competitive offerings in the future.<sup>164</sup> Vodafone submitted that given the low costs of call termination on fixed or mobile networks, any competitor could replicate its "closed user group" offers, such as its BestMates for Home Phone product.<sup>165</sup>

397. The potential counter-strategies include entering into arrangements or joint undertakings with related fixed or mobile partners, or entering directly into the related market. That is, rival mobile operators would be able to either partner with one or more RSPs or, become a fixed-line provider itself by unbundling exchanges or reselling UFB. [

].<sup>166</sup>

398. We also note that the merger may well lead to efficiencies. Lower pricing could be advantageous for consumers in general. If contrary to the above conclusions, foreclosure did occur, a substantial lessening of competition would be unlikely to occur if merger related efficiencies resulted in an enhanced Vodafone product offering

399. [ ], lower on-net pricing may result from the integration of a fixed and mobile network. That would occur, in part, because the integrated network would take account of its own internal margins when setting prices. In essence, the removal of any pre-merger double-marginalisation could lead to lower post-merger prices. Any anti-competitive foreclosure, if found, would have needed to have been weighed against any pro-competitive efficiencies.

<sup>162</sup> As a result of Vodafone's acquisition of TelstraClear's [ ] mobile customers.

<sup>163</sup> Submission from Vodafone, 16 August 2012, page 2.

<sup>164</sup> *ibid*, page 3.

<sup>165</sup> Submission from Vodafone, 19 September 2012.

<sup>166</sup> [ ].

400. However, as already noted, regardless of the extent of any efficiencies, the Commission considers that it is unlikely that any foreclosure attempt would have an anti-competitive effect.

### *Conclusion*

401. The Commission considers that the above evidence suggests that, post-acquisition, Vodafone would not have an enhanced ability or incentive to foreclose rival mobile services providers by engaging in fixed-to-mobile on-net/off-net pricing. Fixed-to-mobile calling does not appear to be a major driver of consumers' choice of mobile network. Vodafone and Telecom both have extensive mobile networks already, and the proposed acquisition would do little to alter the competitive landscape in this regard.

### *Potential for regulatory intervention*

402. Under Schedule 3 of the Telecommunications Act 2001, the Commission can investigate whether a particular telecommunications service should be regulated. Notwithstanding the Commission's conclusions outlined above, were the merged entity (or any other provider) to engage in aggressive fixed-to-mobile price discrimination, the Commission could investigate whether fixed-to-mobile termination rates should be further regulated.
403. If this investigation identified that fixed-to-mobile termination rates were acting as an impediment to competition, the Commission considers that regulatory intervention would be likely. This threat of regulatory intervention is likely to act as a significant constraint on the behaviour of the merged entity in the factual.

### **Bundling**

404. For the reasons outlined below, the Commission considers that Vodafone's acquisition of TelstraClear is unlikely to give it the ability or incentive to foreclose rival operators in mobile phone markets by fixed/mobile bundling, and there is unlikely to be a substantial lessening of competition as a result.
405. Some parties, in particular [ ], have raised concerns that post-merger Vodafone would be able to offer consumers a fixed and mobile bundle and could potentially foreclose other providers through the provision of that bundle.
406. For instance, [ ].<sup>167</sup> [ ] advised that about [ ]% of SME customers purchase their fixed and mobile services from the same provider, although this would not necessarily be part of a hard bundle.<sup>168</sup> <sup>169</sup> [ ] that the incidence of fixed/mobile bundling is going to increase in the future and [ ]

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<sup>167</sup> [ ].

<sup>168</sup> A 'hard bundle' is where two products – being mobile and fixed services, in this instance – have to be purchased together as one product bundle in order to, for instance, receive a product discount. This compares to a 'soft bundle' where two products do not have to be purchased together.

<sup>169</sup> [ ].

].<sup>170</sup>

407. [

].<sup>171</sup>

408. Bundling of telecommunication products is a common practice that generally has no anti-competitive purpose or effect. However, it could raise competition concerns if bundling prevented rivals obtaining sufficient scale to be viable. Alternatively, bundling might take the form of predatory pricing. It would also have to be likely that following any foreclosure, Vodafone would be well positioned to exercise enhanced market power, such as increasing prices, resulting in a substantial lessening of competition.

409. Bundling may be a concern in this case if the merged entity acquired the *ability* and *incentive* to foreclose its rivals. We note that pro-competitive bundling can also have an exclusionary effect as a result of superior competitive performance. An additional requirement before bundling becomes a concern, therefore, is that foreclosure would need to have the *effect* of substantially lessening competition.

#### *Ability*

410. On the basis of the information before us, the Commission considers that it is unlikely that the merged entity would have the ability to foreclose its rivals by the use of fixed/mobile bundles.

411. If there was a large segment of customers that bought both fixed and mobile products from the same provider, then a strategy to foreclosure competitors via the use of bundling would be possible. Alternatively, if there were insufficient customers who purchased single products from individual firms, single product suppliers, such as [ ] may not be able to compete against a bundle.

412. However, joint purchasing of fixed and mobile services does not currently appear to be the norm. For residential customers, Vodafone and Telecom advised that fixed-line purchase decisions are generally made at the household level, while mobile phone purchasing decisions are generally made at the individual level. On the other hand, [ ] evidence suggested that many consumers wish to enjoy the advantages of bundling their mobile and fixed services (discussed further below).

413. However, other evidence obtained from interested parties suggests that fixed/mobile bundles are not currently attractive to consumers.

413.1 Telecom provided the following information.

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<sup>170</sup> [ ]  
<sup>171</sup> [ ]

413.1.1 About [ ] of its [ ] fixed customers purchase mobile as part of a hard mobile bundle, and that [ ] purchase mobile as part of a soft bundle.<sup>172</sup> However, the Commission notes that there is the potential for Telecom to increase mobile-fixed bundling by leveraging off its large fixed base.<sup>173</sup>

413.1.2 [ ] of its [ ] business customers had fixed/mobile bundles, although a number of Gen-i customers also take fixed and mobile together but not as a pre-defined bundle.

413.2 Vodafone provided the following information.

413.2.1 Vodafone currently only offers fixed/mobile bundles to customers that purchase naked broadband and mobile services. About [ ]% of Vodafone's fixed customers have a bundle that includes a mobile service.<sup>174</sup>

413.2.2 Although, [ ]<sup>175</sup> [ ]<sup>176</sup>

413.2.3 [ ]  
].

413.3 TelstraClear provided the following information.

413.3.1 [ ]  
] <sup>177</sup>  
[ ]<sup>178</sup>

413.3.2 [ ]% of TelstraClear's small business customers and [ ]% of its large business customers have a fixed/mobile package.

413.3.3 [ ]  
].<sup>179</sup>

<sup>172</sup> Submission from Telecom, 7 September 2012, page 4.

<sup>173</sup> [ ].

<sup>174</sup> Submission from Vodafone, 15 August 2012, page 8.

<sup>175</sup> For example, [ ].

<sup>176</sup> Vodafone internal document, [ ].

<sup>177</sup> Submission from TelstraClear, 24 August 2012, page 6.

<sup>178</sup> *ibid.*

<sup>179</sup> *ibid.*

414. In merger assessments such as this, customer surveys are often useful evidence of consumer preferences. A Roy Morgan study conducted on behalf of the Commerce Commission in 2011 showed that of those surveyed, 5.9% of mobile customers who switched away from Vodafone listed “in order to bundle/package with other services” as one of their reasons for switching.<sup>180</sup> For Telecom the number was 5.4%.<sup>181</sup>
415. As shown below, international experience in relation to the prevalence of fixed/mobile bundling is mixed. While some customers do enjoy the advantages of fixed/mobile bundles, the majority of consumers are likely to purchase their fixed-line and mobile services on an individual basis.
- 415.1 Vodafone stated that adding mobile to a consumer fixed-line bundle is unproven globally.<sup>182</sup>
- 415.2 Telstra’s fixed/mobile packages in Australia were popular, [ ]<sup>183</sup>
- 415.3 TelstraClear provided an excerpt from a European Commission report that showed 9% of households in the EU purchase a bundle including fixed and mobile services.<sup>184</sup>
416. On this basis, it is apparent that demand for non-bundled services is unlikely to be significantly impacted by a strategy from the merged entity to target fixed/mobile bundles. As noted, fixed/mobile bundles are not currently pervasive in the market, and on the evidence before the Commission they are unlikely to become so in the near future. Even in the business markets/segments, where bundling is more common, the norm appears to be for customers to not purchase fixed and mobile services together as a bundle (although they may purchase them from the same provider). Consumers have several alternatives available for single products. The merged entity would account for about [ ]% in the residential fixed voice market, [ ]% in the residential fixed broadband market and about [ ]% in the mobile market.
417. Again, counter strategies may exist. Telecom already provides some bundles, [ ]<sup>185</sup> [ ]. Other RSPs such as Orcon and Slingshot also provide mobile phone services as MVNOs. Conceivably those parties could also offer bundles. As discussed earlier, mobile services providers, [ ]

<sup>180</sup> Roy Morgan, Consumer Switching Behaviour in Telecommunications Markets, 2011, page 25.

<sup>181</sup> *ibid.*

<sup>182</sup> Interview with Vodafone, 8 August 2012.

<sup>183</sup> Submission from TelstraClear, 24 August 2012.

<sup>184</sup> *ibid.*

<sup>185</sup> [ ].

*Incentive*

418. On the basis of the information before us, we consider that it is unlikely that the merged entity would have the incentive to foreclose its rivals via anti-competitive bundling as it would not be profitable to do so.
419. As discussed above, most consumers do not combine their purchases of fixed and mobile purchases. While bundling is employed by suppliers and preferred by a segment of consumers, in the Commission's view there is little evidence to suggest that reducing the price of either fixed or mobile services and bundling these products on a wider scale would achieve significant gains for the merged entity. The costs of an anti-competitive strategy, in the form of (temporary) discounts on the sale of the bundled product would likely outweigh any benefits.

*Effect*

420. On the basis of the information before us, we consider that even if the merged entity did have the ability and incentive to foreclose its rivals via bundling fixed and mobile services, it is unlikely that this would lead to a substantial lessening of competition. To have the effect of substantially lessening competition, a firm would need to have the ability to raise prices after competitors have been (partially) foreclosed from the market.
421. The Commission also notes that the effect of conglomerate mergers can often lead to an increase in output if the merged entity takes into account the increased demand for a complementary product when it sets the price of the other product.<sup>186</sup> As such, bundling is often pro-competitive and can lead to lower prices for consumers.
422. In any case, the majority of customers in New Zealand appear to prefer non-bundled fixed/mobile, and as such any bundling would be unlikely to foreclose rivals as sufficient demand would remain for single service suppliers.
423. The Commission notes that for there to be a substantially lessening of competition as a result of anti-competitive foreclosure via bundling, the conditions of entry would need to be such that an exercise of market power by Vodafone post foreclosure would not attract price disciplining entry or expansion. As outlined above, we do not consider foreclosure likely, and as such we have not needed to form a view as to the conditions of entry into the mobile market in this instance.

**Coordinated effects**

424. There may be an additional concern of enhanced coordination between the merged entity and Telecom. The possibility for coordination could be enhanced by the increase in symmetry between Vodafone and Telecom post-merger.

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<sup>186</sup> Church, J., (2004), "The Impact of Vertical and Conglomerate Mergers on Competition", prepared for Directorate General for Competition Directorate B, Merger Task Force European Commission.

425. As in the vertical and conglomerate effects theories where the merged entity may have the unilateral incentive to increase prices, we consider that foreclosure would likely be required before there could be a substantial lessening of competition in relation to coordinated effects. This is because there are other competitors that currently compete with the merged entity and Telecom, and which may thwart any potential for coordination if they are still in the market acting as vigorous competitors. Therefore based on the conclusions above that there is unlikely to be foreclosure due to the merger we do not consider that there will be enhanced coordination between the merged entity and Telecom post acquisition.



**Determination on notice of clearance**

- 426. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition.
- 427. Pursuant to section 66(3)(a), the Commission gives clearance for Vodafone New Zealand Limited or any of its interconnected bodies corporate, to acquire up to 100% of the shares and/or assets of TelstraClear Limited.

Dated this 29<sup>th</sup> day of October 2012

Dr Mark Berry

Chair