Submission on Vocus and 2degrees merger clearance application

15 February 2022

CHORUS

Vocus and 2degrees

Summary

If the Proposed Merger proceeds, vertically integrated fixed/mobile operators would account for more than 80% of the retail broadband market which creates some challenges for the open access wholesale model.

There are steps the Commission can take to ensure that all elements of its telecommunications regulatory toolkit remain fit for purpose to continue to best protect the interests of end-users:

- Be clear that non-discrimination obligations do not impede vigorous competition by wholesale fixed access providers with alternative network operators who are also customers;
- Ensure low barriers to entry for new retail service providers by removing or limiting wholesale business line restrictions; and
- Establishing strict rules for, and oversight of, marketing of fixed wireless access services to ensure end users can make informed choices about broadband services.

Our position

1. Thank you for the opportunity to comment on the proposed merger of Vocus Group Limited (**Vocus**) and Two Degrees Group Limited (**2degrees**) (**the Proposed Merger**).
2. Chorus does not express a view on whether or not the Commission should grant clearance for the Proposed Merger.
3. Rather, we make some observations about the likely implications of the Proposed Merger for telecommunications markets and steps the Commission could take in its capacity as a telecommunications regulator to ensure that the interests of end-users remain protected.

Implications of Proposed Merger

4. New Zealand has very high uptake of fixed-wireless access (**FWA**) services when compared with other OECD countries. As at 30 June 2020, New Zealand ranked third highest out of the OECD countries for fixed wireless broadband connections with 4.5 subscriptions per 100 population, behind the Czech Republic at 14.9 and the Slovak Republic at 7.9.[1]

[1] Commerce Commission, *Annual Telecommunications Monitoring Report 2020 Key facts*, 16 March 2021 – version 2, page 8

5. This is surprising given the widespread availability of superior quality fibre-to-the-premises access (**fibre**) services at comparable prices.

6. It suggests that vertically integrated fixed/mobile network operators are taking opportunities created by the regulatory framework for fixed networks to maximise margin by pushing FWA service (the telecommunications branch of the Commission has recognised this issue).

7. This trend is likely to continue by combining the only pure fixed operator with scale, with a nationwide mobile network operator. If the Proposed Merger proceeds, the market share of integrated fixed/mobile retail service providers (**RSPs**) would increase from 68% to 81%.[2]

8. The existing telecommunications regulatory framework is predicated on the idea that wholesale access to fixed (fibre or copper) networks is required to compete in retail fixed-line broadband and voice markets. The separation of Telecom New Zealand was intended to remove Telecom's advantage from vertical integration and create a level playing field for RSPs. The rise of vertically integrated fixed/mobile operators and services creates a challenge to this model.

Protecting end-users

9. A high concentration of retail market share in vertically integrated, unregulated fixed/mobile network operators, together with the complex regulatory framework applying to wholesale fixed network operators, creates some risks for end-users.

10. To continue to best protect the interests of end-users, the Commission must ensure that all elements of its telecommunications regulatory toolkit remain fit for purpose:

Non-discrimination

11. The non-discrimination obligations which apply to Chorus and other local fibre companies (**LFCs**) were intended to ensure a level playing field for all RSPs and promote competition. At the time these obligations were conceived the level of network competition which currently exists was not anticipated.

12. Current market dynamics mean that these obligations are open to gaming by large, vertically integrated RSPs who can use their status as wholesale customers to impede competition from wholesale fixed networks. They can do this by claiming discrimination when wholesale providers act to compete with the networks they own.

13. The Commission should make clear that:

    13.1 non-discrimination applies to RSPs in their capacity as wholesale customers - their activities as participants in other telecommunications markets (e.g. mobile services) is not a relevant consideration;

    13.2 the fact that an offer or service might be less attractive to some RSPs due to their status as vertically integrated operators of competing networks cannot amount to a 'difference in treatment' where that offer or service is available to all RSPs on the same terms; and

[2] Merger parties, *Application for clearance*, 4 January 2022, paragraph 122

13.3 Chorus/LFCs are free to engage in vigorous competition with alternative networks even where they are owned by customers.

Barriers to entry

14. Low barriers to entry in retail broadband markets will be vital to constrain the fixed/mobile integrated operators and ensure consumers have easy access to wholesale only fixed networks.

15. The merger parties stress the low barriers to entry resulting from the open access wholesale networks run by Chorus and LFCs[3]. While we agree that open access networks facilitate entry, there are features of the regulatory framework that currently act as impediments.

16. In particular, business line restrictions preventing Chorus from providing services above Layer 2, and prohibiting end-to-end services, together operate to prevent Chorus building and offering turn-key RSP solutions. This type of service would allow new RSPs to enter the market without significant at-risk network investment.

17. Currently, business line restrictions mean telecommunications network investment is required to start an RSP. This investment is risky and, even if capital can be accessed, a prospective RSP must be confident of achieving scale in order to recover the initial outlay. We have seen even large utility providers and established corporates decline to make this investment de novo and look for other ways to enter the retail fixed broadband market (e.g. Sky Network Television buys a solution through Vocus; Mercury NZ is acquiring Trustpower; 2Degrees acquired Snap; StuffFibre partnered with a third party (Devoli) to build the retail service for it).

18. End-users would benefit from removal of these restrictions which would allow Chorus to build products that lower barriers to entry – as a wholesale only provider we have the incentive to do so. This is increasingly important where, post-Merger, vertically integrated fixed/mobile operators would account for more than 80% of the retail broadband market.

Marketing and retail quality regulation

19. While the open-access wholesale regime is intended to provide a level competitive playing field, consumers can only access wholesale fixed networks through third-party RSPs.

20. In circumstances where all the largest RSPs also operate mobile networks, they have strong incentives to keep customers on those mobile networks. The merger parties state:[4]

> *The combination of fixed and mobile infrastructure assets should also enable the merged entity to compete with Spark and Vodafone more effectively for the provision of fixed wireless broadband services. An increased customer base, through combining the migration opportunity of 2degrees' and Vocus NZ's customers from copper to a fixed wireless solution, will offer the merged entity economies of scale, allowing it to provide more competitive services to customers. Fixed wireless broadband increases the overall utilisation of the mobile network, improves return on investment and supports future capital investment. A larger*

[3] Merger parties, *Application for clearance*, 4 January 2022, paragraph 52
[4] Merger parties, *Application for clearance*, 4 January 2022, paragraph 34

customer base will also reduce the forecasting risk with fixed wireless broadband, which is important for network planning.

21. It is concerning the parties do not acknowledge that end-users have a choice of alternative services as the copper network winds down and that many will want to move to fibre rather than be "migrated" to fixed wireless.

22. It is imperative that marketing and retail service quality regulation ensure RSPs give consumers clear, accurate and complete information about their broadband choices.

23. The Commission is working on this, but the Proposed Merger highlights the need for, and importance of, retail quality regulation particularly regarding the marketing of FWA services.

Market definition

Understanding telecommunications markets

24. There is a lot of regulatory activity occurring in these highly dynamic telecommunications markets, all of it proceeding in the absence of a clear framework for assessing relevant markets and competitive dynamics.

25. Though likely not required for the purposes of assessing the competition effects of the Proposed Merger, we reiterate the importance of the telecommunications branch undertaking a comprehensive assessment of relevant wholesale and retail markets and competitive dynamics before proceeding with regulatory interventions.

26. The interests of end-users will be best served where regulation takes place based on a sophisticated understanding of market dynamics.

Markets relevant to this merger

27. The merger parties propose two relevant markets at a national level:

    27.1 A retail fixed-line broadband and voice services market which includes both consumer and small business customers; and

    27.2 A retail market for mobile phone services.

28. We agree FWA should be recognised as in the same product market as fixed-line broadband and voice services (including both copper and fibre technologies).

29. Wholesale markets for fixed-line broadband and voice services currently contain multiple operators competing on an uneven playing field. The Proposed Merger will affect competition in wholesale fixed-line broadband and voice services markets since there will be a third large vertically integrated, unregulated fixed/mobile operator who will have a strong incentive to move customers onto its own network. The parties themselves acknowledge this incentive.[5] Further, the merged entity will not face the same prescriptive regulation that Chorus and other LFCs are subject to.

[5] As above, Merger parties, *Application for clearance*, 4 January 2022, paragraph 34