Why the Commerce Commission cleared Vodafone's purchase of TelstraClear

The Commission has given reasons in its 73 page decision, released several weeks after the clearance was confirmed. We summarise some key points in the decision.

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Framework

We start with the framework used in the decision[1]. Then we turn to specific services and markets.

The Commission clears an acquisition if it will not have, or is not likely to have, the effect of sufficiently lessening competition (SLC) in a market. That's usually assessed on a forward-looking approach over the next two years. However, that two year limit had little focus here, and the decision deals a lot with the here and now, as opposed to close assessment of what might happen in the future due to the acquisition. Crystal ball gazing as to the future is challenging, and the here and now can be informative as to the future.

In its decision, the Commission first defines the relevant markets (e.g. retail mobile services) and then considers if there is SLC in each of those markets. It uses the standard factual/counterfactual approach, or, in other words, it assesses what will happen **with** the acquisition, compared with what will happen **without** the acquisition. The "without" or counterfactual is the status quo in this case: VF and TCL will continue to trade separately. It is the difference between the "with" and the "without" that drives the SLC analysis, and not the difference between the position following the acquisition and some sort of Nirvanian competitive model. Seen that way, retaining anti-competitive aspects in the markets does not necessarily mean there is SLC.

Markets

The markets considered by the Commission were:

Retail

- Residential fixed line voice;
- Residential fixed line broadband;
- Business fixed line data including voice;
- Mobile for business and residential.

Upstream inputs

- National backhaul transmission;
- Spectrum.

In the retail markets, the Commission compared the current level of competition against (a) the extent to which that level of competition would be lessened by the acquisition and (b) whether the remaining or new entrant providers could sufficiently constrain VF-TCL.

Turning to each market:

Residential fixed line voice and broadband

These two markets were handled together in view of overlapping issues.

The Commission said that VF and TCL are competitors in these markets, and that would be lost on the acquisition. An example is the recent $75 price-point introduced by TCL. So the Commission then handled the next question: would competitors constrain VF-TCL? Yes, said the Commission:

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- Post-separation Telecom – the largest player – would constrain VF-TCL, including because a stronger vertically integrated provider is created, able to take on Telecom (with its retail focus) "head to head";
- Orcon and CallPlus will continue as aggressive, price leading competitors, especially where they have unbundled.

The Commission looked at triple-play issues, focussing on the position today, where only TCL and VF bundle in Sky for new customers. TCL only offer Sky over HFC, so there is little overlap between the offerings by each of VF and TCL. On this basis, competition lost was said to be minimal.

The Commission concluded that UFB would not make a difference to the players in the markets or their positions in those markets. Similarly in the business markets that follow.

Fixed line services for businesses

The Commission considered that there are more issues in the SME space so it focussed on that in the analysis, ahead of business at the big end of town.

The Commission concluded that the acquisition could be "characterised as a reduction from three [Telecom, TCL and VF] to two main suppliers [where 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."

The Commission concluded:

> "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."

The analysis in this area is focussed on today's position rather than what might happen in the future under the factual and the counterfactual.

For example, little is done to explain why (a) "nascent competition" from VF's future options and/or plans (in the counterfactual) doesn't change things and (b) how "Telecom alone will likely constrain the merged entity" when it, like VF-TCL, has incentives to keep pricing higher, where competition is driven by two players.

Mobile phone services

No SLC here, given TCL's small market share and the fact that it is an MVNO, making it a price taker, with margins set by a mobile network operator (MNO), namely, VF.

Upstream inputs

Consideration of the remaining two markets (backhaul and spectrum) focusses on:

- Increased pricing charged to downstream competitors such as for backhaul owned by VF-TCL (called partial input foreclosure); and
- Cessation of supply to downstream competitors (called foreclosure).

Backhaul

The Commission addressed only supply of backhaul to rival mobile operators. It concluded there would not be SLC for national backhaul, given:

- Existing competition from FX and Telecom;
- Telecom is the only other vertically integrated operator, and VF-TCL would require an "accommodating response of Telecom so that the choice of backhaul service providers would be reduced to one".
- Chorus has, or has access to, sufficient backhaul to enter the market, and is incentivised to do so if backhaul prices are high enough.

Spectrum

First as to mobile use of spectrum, the deal will have VF-TCL with expanded 1800MHz holdings, and Telstra Corp holding 1800MHz spectrum that it can sell. The Commission decided that this is pro-competitive rather than causing SLC: spectrum is freed up for sale to a third party.

Similarly in the 2100MHz range, against the background that the Commission says that sub-1GHz spectrum will mostly be used for LTE (with 2100MHz for longer distances). 700MHz spectrum to be released by the analogue switch-off is said by the Commission to be relevant, and the other two mobile network operators have large holdings in the 2100MHz range anyway.

As to non-mobile use in the 2100MHz range, the Commission noted there was not SLC, for reasons that include the limited commercialisation of spectrum holdings in these higher bandwidth areas, and that commercialisation may be a number of years away (plus several other players hold spectrum in these bandwidths).

Conglomerate effects

This is the next level considered by the Commission, followed by coordinated effects as noted below.

A conglomerate merger involves acquisition of a firm trading in a separate but closely related market: while they often lead to efficiencies, there can be competition concerns. In this context, the Commission addressed Fixed to Mobile (FTM) on-net/off-net pricing, and the bundling of fixed line services with mobile services.

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

After an extensive review of the issues, the Commission concluded:

> 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.

Bundling fixed-line with mobile services

Bundling can be pro-competitive, but also anti-competitive too where there is, for example, said the Commission, predatory pricing, or bundling prevents rivals from gaining sufficient scale to be viable.

The Commission said that there is a concern if VF-TCL has the **ability** and **incentive** to foreclose on rivals, with the **effect** of SLC. It concluded that VF-TCL wouldn't have the **ability** to foreclose: "joint purchasing of fixed and mobile services does not currently appear to be the norm". That conclusion is supported by international experience cited by the Commission. And there are what the Commission described as counter-strategies: Telecom's ability to bundle and MVNOs' ability to bundle.

However, as the Commission in effect noted earlier in the decision, MVNOs have limited room to move and would not be effective competitors where mobile services are involved. That is not surprising: viable MVNO offerings such as those in the UK would be difficult to obtain in this limited market (where, also, one MNO does not have national coverage on its own network). That view is supported by Optus' recent announcement in Australia that it would limit supplying to MVNOs.

That leaves two fixed line and mobile-integrated operators with the ability to offer fixed and mobile bundles that are not viably available from others. Arguably, Telecom does not provide an adequate restraint in those circumstances.

Those issues, and the role of 2degrees, are not addressed, at least in the non-confidential parts of the decision. The answer may be that 2degrees can buy-in fixed line services from another carrier (or acquire a fixed line operator) and compete in that way. But can it viably do that in the 2 year window usually used on clearance applications? Those issues weren't addressed.

For overlapping and other reasons, the Commission also concluded there is no relevant **incentive** or **effect**.

Coordinated effects

The question here is whether there is the prospect of enhanced tacit or other coordination between TCL-VF and Telecom. The issues we raise above as to possible bundling incentives for Telecom and TCL-VF (where they are the only integrated fixed and mobile carriers) are an example.

Flowing from the earlier conclusions as to inability to foreclose, the Commission decided that there are no coordinated effects causing SLC:

> 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.

Where to from here?

The acquisition is done and dusted, and others don't have rights of appeal. There are undoubtedly positive outcomes of this acquisition such as the creation of a larger carrier

1. The clearance reasons are at http://www.comcom.govt.nz/assets/Uploads/NZCC-33-2012-Vodafone-TelstraClear-clearance-public-decision-29-October-2012.pdf

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