ISBN 978-1-869459-81-9

Statement of Preliminary Issues

Vocus and 2degrees

28 January 2022

Introduction

1. On 5 January 2022, the Commerce Commission registered an application (the Application) for clearance in relation to a transaction that would result in the merger of the New Zealand operations of Vocus Group Limited (Vocus) and Two Degrees Group Limited (2degrees) (the Proposed Merger).

2. The Proposed Merger involves a newly incorporated Vocus company, Voyage Digital (NZ) Limited (Voyage, the Applicant), acquiring all of the shares of Orcon Holdings Limited (Orcon, formerly known as Vocus (New Zealand) Holdings Limited (Vocus NZ)) and then acquiring all of the shares in 2degrees from its shareholders, Trilogy International New Zealand LLC and Tesbrit B.V.. Voyage seeks clearance from the Commission to acquire 100% of the shares in each of Orcon and 2degrees.[1]

3. The Commission will give clearance if it is satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

4. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

5. We invite interested parties to provide comments on the likely competitive effects of the Proposed Merger. We request that parties who wish to make a submission do so by **15 February 2022**.

6. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

7. Vocus and 2degrees are both telecommunications providers that primarily supply retail fixed and mobile services to consumers and small business customers.

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1 A public version of the Application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

2 The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

8. Orcon (formerly Vocus NZ) is the New Zealand subsidiary of Vocus. It owns and operates a national fibre telecommunications network, which it uses to supply fixed-line and other telecommunications services (on both a wholesale and retail basis). It retails telecommunication services to residential, business and government customers under brands that include Orcon, Slingshot, Flip and Vocus. It also retails energy to residential customers, bundled with telecommunications services. It does not own any mobile network infrastructure, and instead operates as a mobile virtual network operator.

9. 2degrees owns and operates a national mobile telecommunications network. It retails fixed, mobile and other telecommunications services to residential, business and government customers. It also provides wholesale services, including for fixed-line and mobile.

Our framework

10. Our approach to analysing the competition effects of the Proposed Merger is based on the principles set out in our Mergers and Acquisitions Guidelines.[3] As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

11. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[4] This allows us to assess the degree by which an acquisition might lessen competition.

12. We assess whether horizontal unilateral, coordinated or vertical/conglomerate effects might result from an acquisition or merger.

    12.1 Unilateral effects arise when a firm acquires or merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that a merged entity can profitably increase price above the level (or reduce quality or innovation below the level) that would prevail without the acquisition without the profitability of that increase (or reduction) being thwarted by rival firms' competitive responses.[5]

    12.2 An acquisition can substantially lessen competition if it increases the potential for a merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a

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3 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019.

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

5 For ease of reference, we only refer to the ability of a merged entity to "raise prices" from this point on. This should be taken to include the possibility that a merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition (ie, it could increase quality-adjusted prices).

substantial lessening of competition which can arise from a merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.

12.3 A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives a merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.

13. If the lessening of competition as a result of an acquisition is likely to be substantial, we will not give clearance.

Market definition

14. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[6]

15. In the Application, the Applicant submitted that the markets relevant to our assessment of the Proposed Merger are national markets for the:[7]

15.1 retail supply of fixed-line voice and broadband services to consumers and small business customers; and

15.2 retail supply of mobile phone services.

16. We will consider whether these are the appropriate retail markets for assessing the competition effects of the Proposed Merger.

17. In addition, we will consider whether it is appropriate for us to define any wholesale markets as part of our assessment of the competition effects of the Proposed Merger.

Without the Proposed Merger

18. The Applicant submitted that absent the Proposed Merger, Vocus NZ and 2degrees are likely to proceed with separate initial public offerings.[8]

19. We will consider what the parties would do if the Proposed Merger did not go ahead. We will consider the evidence on whether the without-the-merger scenario is best characterised by the status quo, or something other than the status quo.

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[6] Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

[7] The Application at [120].

[8] The Application at [39].

The competitive effects of the Proposed Merger

20. We will investigate whether the Proposed Merger would be likely to substantially lessen competition in any relevant markets by assessing whether any horizontal unilateral, coordinated or vertical/conglomerate effects might result from the Proposed Merger. The questions that we will be focusing on are:

    20.1 unilateral effects: would the loss of competition between Vocus NZ and 2degrees enable the merged entity to profitably raise prices by itself?

    20.2 coordinated effects: would the Proposed Merger change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

    20.3 vertical or conglomerate effects: would the Proposed Merger give the merged entity the ability and incentive to foreclose rivals?

The Applicant's submissions

21. In the Application, the Applicant submitted that the Proposed Merger would not be likely to substantially lessen competition in any relevant markets due to unilateral, coordinated or vertical/conglomerate effects. The Applicant submitted that:[9]

    21.1 Vocus NZ and 2degrees are not each other's closest competitors;

    21.2 the Proposed Merger would only result in limited to minimal aggregation in each relevant market;

    21.3 a range of existing competitors would remain in the relevant markets to constrain the merged entity;[10]

    21.4 the relevant markets do not appear vulnerable to coordination and the Proposed Merger would not enhance the ability for the merged entity and other competitors to coordinate their behaviour; and

    21.5 the merged entity would not have the ability or incentive to foreclose competitors in respect of access to wholesale services or customers by bundling energy, broadband and mobile services.

22. Relevant to our assessment, the Applicant further submitted that the Proposed Merger would have pro-competitive effects because it would:[11]

    22.1 create an integrated fixed-line and mobile business of scale, with the ability to provide better services to customers (both in terms of enhanced choice, as well as complete solutions and new bundles of services);

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[9] The Application at [11]-[15], [137], [167]-[168] and [170]-[171].

[10] The Applicant submitted that further constraint would be provided by potential competition in one market, as barriers to entry and expansion in the retail supply of broadband services are not significant.

[11] The Application at [7]-[9] and [29]-[35].

22.2 enhance competition in the relevant markets by leveraging the existing positions of Orcon and 2degrees (and combined scale) to create a stronger number-three player and stronger challenger to compete with its largest competitors, Spark and Vodafone; and

22.3 create a merged entity with the scale required to enable further investment in network capacity and sustain the anticipated network investment required for 5G, as well as sufficient capital to accelerate investment in 5G.

Current focus of our investigation

23. In assessing whether the Proposed Merger would be likely to substantially lessen competition, we will consider, and are interested in industry participants' views on:

23.1 closeness of competition: the degree of constraint that Vocus NZ and 2degrees impose upon one another, and that would be lost with the Proposed Merger;

23.2 the degree of constraint that existing competitors would impose on the merged entity;

23.3 how easily rivals can enter and/or expand;

23.4 whether the Proposed Merger is likely to result in reduced price, quality or innovation in the relevant retail markets, noting that both merger parties have in the past been drivers of such differentiation;

23.5 whether the Proposed Merger is likely to impact on competition in any relevant wholesale markets, including on the merged entity's incentives to compete for wholesale customers in the future and the wholesale supply options that would remain available to access seekers (in both fixed-line voice and broadband services, as well as mobile); and

23.6 whether any of the relevant retail or wholesale markets are vulnerable to coordination, and whether the Proposed Merger would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable. In particular, whether the Proposed Merger may make coordination between mobile network owners around the provision of wholesale access to MVNOs more likely,[12] given that they only make up 1.4% of all mobile connections[13] and that the Proposed Merger will result in the vertical integration of the largest MVNO, Vocus, with a mobile network owner (2degrees).

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12 Mobile Virtual Network Operator – an operator that provides mobile phone services but does not generally have its own licensed frequency allocation of radio spectrum or much of the infrastructure required to provide mobile telephone service. It therefore relies on buying services from an operator with a full mobile network. The amount of control it has over the services it offers will vary according to the nature of its agreement

13 Commerce Commission, *Annual Telecommunications Monitoring Report 2020 at*26.

Next steps in our investigation

24. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Merger by **15 March 2022**. However, this date may change as our investigation progresses.[14] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

25. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

26. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Vocus/2degrees" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **15 February 2022**.

27. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

28. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

[14] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.