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Vertical mergers in the technology, media and telecom sector – Note by New Zealand

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More documents related to this discussion can be found at

http://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm

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New Zealand

1. Introduction

1. In New Zealand mergers and acquisitions are regulated under Section 47 of the Commerce Act 1986 (the Act). Section 47 prohibits the acquisition of assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition (SLC) in a New Zealand market (the SLC test). The New Zealand Commerce Commission (the Commission) enforces the Act; however there is also a right of private action.

2. The SLC test applies equally to both horizontal or vertical mergers. However, it is more common that horizontal mergers raise competition concerns than vertical mergers. This is because vertical mergers do not directly eliminate competition between firms and so are viewed as less likely to cause an SLC. For example, over the past ten years the Commission has looked at around 100 merger clearance and authorisation applications (explained below). Of these, nineteen involved vertical integration. Five of these cases were declined, all since 2017.

2. Statutory framework

3. Section 47 applies to all types of mergers. Mergers will often involve more than one dimension. For example, in *Trade Me/Limelight* (discussed below), the Commission had concerns over both horizontal effects (since Trade Me was a potential competitor to Limelight) and vertical effects (since the merged entity may have been able to leverage market power from each vertically related market into the other).

4. The Commission assesses mergers using the SLC test. This test compares the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[1] Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[2] The High Court has used the word 'material' to describe a lessening of competition that is substantial.[3] A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.[4]

5. New Zealand has a voluntary notification regime. Under section 66 of the Act parties can apply to the Commission for clearance. Clearance applications comprise the bulk of the Commission's merger review activity. The Commission will grant clearance if

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

[2] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

[3] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [129].

[4] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [111].

it is satisfied that the merger would not be likely to SLC in any market. The onus is on the parties to satisfy the Commission that there will be no SLC. If an acquisition receives clearance, section 47 is deemed not to apply to the acquisition, so long as the acquisition is completed within one year of receiving clearance. If the Commission is not satisfied – including if it is left in doubt – it must decline to clear the merger.[5] The parties to the merger can appeal the Commission's clearance decision to the New Zealand High Court.

6. Under section 67 of the Act merging firms can also apply for authorisation for an acquisition. The Commission will grant authorisation if it is satisfied that the merger will be likely to result in such a benefit to the public that it should be permitted, despite any SLC. Efficiencies are an important category of public benefit considerations under the authorisation test. Authorisation applications are quite rare. There have been only four authorisation applications in the last ten years. Only one of these involved vertical integration (*Wilson & Horton/Fairfax NZ*).

7. Merging firms can proceed with a merger without seeking clearance or authorisation. However, if the Commission considers that a merger will SLC or would be likely to, it can file High Court proceedings alleging a breach of section 47. The Commission can seek interim relief from the High Court to prevent the merger going ahead, to preserve competition until the High Court has had an opportunity to consider if the merger is likely to SLC.[6]

8. When a merger raises competition concerns, an applicant can provide an undertaking to sell certain assets or shares as a condition of clearance or authorisation to remedy those competition concerns.[7] We can only accept structural undertakings to divest assets or shares. We cannot accept behavioural undertakings.

3. The Commission's merger guidelines

9. The Commission has guidelines that set out its approach to assessing mergers.[8] The guidelines cover all types of mergers, including vertical mergers.

10. For vertical mergers, the most common concern is whether the merged entity will have the ability and incentive to foreclose rivals such that an SLC is likely to occur. To test these concerns, the Commission applies an ability and incentive assessment of whether:

- The merged entity would likely have the ability to foreclose by having market power at one or more level of the supply chain (ability).
- The merged entity would likely have the incentive to foreclose, because it would gain more through the additional margin in the target market compared to the margin it loses from foreclosed inputs or customers (incentive).

[5] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [98].

[6] For more information about the Commission's approach to mergers that complete without seeking clearance or notification see "New Zealand's submission to the OECD Roundtable on Suspensory Effects of Merger Notifications and Gun Jumping" (2018).

[7] Commerce Act 1986 (as amended), s.69A.

[8] Commerce Commission "Mergers and Acquisitions Guidelines" (July 2013). The Commission is intending to update these guidelines in 2019, including the section on vertical mergers.

11. The ultimate question is then whether the competition lost from the foreclosure would have the effect or likely effect of substantially lessening on competition (effect).

12. The nature of foreclosure could be:

- Input foreclosure.
- Customer foreclosure.
- Both combined, if the merging parties had market power in both vertically related markets.

13. The conduct the Commission is concerned about could be either an outright refusal to deal with a rival (total foreclosure) or terms that significantly raise the costs of rivals (partial foreclosure).

14. In some cases, vertical mergers can increase the likelihood of coordination. For example, if vertical integration increases pricing transparency or increases the symmetry of firms in the market, the ability and/or incentive to coordinate prices may be enhanced.

15. The Commission assesses conglomerate mergers in an analogous way to vertical mergers as both may involve the aggregation of complementary products. The main concern from conglomerate mergers is the risk of foreclosure through bundling. The Commission applies the same ability/incentive/effect framework to assess whether a conglomerate merger is likely to SLC.

16. The Commission can take account of efficiency effects arising from a vertical or conglomerate merger when deciding whether to grant clearance. A pro-competitive efficiency rationale for a merger could potentially offset the anticompetitive effects such that there is no SLC. However, the threshold for accepting efficiency arguments to eliminate concerns under the SLC test is high. The applicant must satisfy the Commission that efficiencies from the merger will be realised soon, they are merger specific and they will be passed on to customers sufficiently to prevent an SLC. It is rare that applicants can meet this standard under a clearance application. If the applicant believes there are strong efficiency benefits to the merger, they can apply for an authorisation which allows efficiencies to be assessed as a public benefit.[9] In particular, section 3A of the Act requires the Commission to have regard to any efficiencies when considering whether a merger will be likely to result in a benefit to the public.

4. Vodafone/Sky

17. In 2016 the Commission considered an application for a merger between Sky Network Television (Sky) and Vodafone New Zealand Limited (Vodafone). [10]

- Sky was the leading pay TV operator in New Zealand. Sky held the exclusive rights to broadcast almost all of New Zealand premium live sports content. A large proportion of broadband and mobile customers subscribed to Sky Sport (Sky's sports channel).

[9] *NZME Limited and Fairfax New Zealand Limited* [2017] NZCC 8 at [54] and [81].

[10] *Vodafone Europe B.V. and Sky Network Television Limited* [2017] NZCC 1 & 2.

- Vodafone was one of three major providers of telecommunication services in New Zealand. It offered fixed and mobile services to residential and business customers. It also owned a national fibre backhaul and mobile networks.

18. The Commission was concerned that the merged entity would leverage its market power over premium live sports content, foreclosing competition in the relevant broadband and mobile services markets over the medium to long term.

19. The Commission's concerns were that:

- Sky had market power due to the control of premium sports content. The Commission found that there were no good substitutes for that content.
- The merged entity could offer Sky Sport subscribers (and those thinking of subscribing to Sky Sport) bundles of pay TV, broadband and mobile services that were more attractive than rivals could offer. Although the merged entity may not outright refuse to supply the content to rivals, it might be at a price that made those rivals less effective competitors.
- Customers would switch to the merged entity. New Zealand was in the process of rolling out its ultrafast broadband (UFB) network. Many customers were switching to UFB and therefore "in play" as they considered the options available from different suppliers, which meant there were many customers that the merged entity could potentially gain. The customers interested in bundles including Sky content also tended to be higher value telecommunications customers. Once those customers had switched to a bundle, they would likely become "stickier" and harder for rivals to win back.
- Rivals could lose scale and face increased customer acquisition costs, making it harder for them to invest and innovate in the future, adversely affecting competition.

20. The parties submitted that the merger would generate efficiencies, including making it easier for the firms to supply innovative new products. However, the Commission was not satisfied that the merger would not result in an SLC. As the Commission was left in doubt, it declined to give clearance to the merger.

5. Trade Me/Limelight

21. In 2017 the Commission considered an application from Trade Me Limited (Trade Me) to acquire Limelight Software Limited, trading as Motorcentral (Motorcentral).[11]

- Trade Me operated an online motor vehicle auction and classified advertising platform under the name Trade Me Motors. It was the leading provider of such services in New Zealand. It also supplied a software tool called "DealerBase" that car dealers could use to manage inventory. Such software is known as "dealer management system" (DMS) software.
- Motorcentral was the leading provider of DMS software to independent dealers. It had also recently launched an advertising platform called Need-a-Car.

[11] *Trade Me Limited and Limelight Software Limited* [2018] NZCC 1.

22. The Commission had both vertical and horizontal concerns over the merger.

23. The Commission found that the merger was likely to SLC in the DMS market as a result of horizontal concerns. This was because, absent the merger, Trade Me was likely to have invested in DealerBase to make it a stronger competitor to Motorcentral. The Commission also considered the merger might have resulted in some loss of competition between Trade Me Motors and Need-a-Car.

24. The Commission considered that the merged entity would likely seek to protect or enhance its market power for either (or both) advertising or DMS software. An important role of DMS software is to allow car dealers to upload listings to advertising platforms. The Commission considered that the merged entity would likely have the ability and incentive to inhibit the interaction between Motorcentral and rival advertising platforms. Similarly, the merged entity would likely inhibit the interaction between Trade Me and rival DMS software. This conduct would raise the costs of those rivals and potential entrants, making them less attractive.

25. The Commission was not satisfied the merger would not be likely to result in an SLC. The Commission declined to give clearance to the acquisition.

6. Ingenico/Paymark

26. In 2018, the Commission considered an application from Ingenico Group SA (Ingenico) to acquire Paymark Limited (Paymark).[12]

- Ingenico was a firm that supplied payment terminals, which are used in stores to accept physical card payments and digital payment services that facilitate online transactions.
- Paymark was a firm that operated a "switch" that routed transactions from the terminal or online payments to the relevant financial institution.

27. The main concern that the Commission considered was whether the merged entity could foreclose rival suppliers of payment terminals by raising the cost of switching services to other terminal suppliers.[13] Paymark was the only switch operator that had links to all financial institutions. Although there were other switch operators, they did not have links to all financial institutions. They had to have an arrangement with Paymark to be able to process cards for those financial institutions they did not have links with. Switch operators provided these processing services to terminal providers, who in turn competed to supply terminal solutions to merchants.

28. The Commission considered whether the merged entity would be able to foreclose rival terminal providers by raising the price to have transactions processed (partial foreclosure) or refusing to process transactions (total foreclosure). The Commission decided that the merged entity was unlikely to have the incentive to foreclose rivals. The main reasons for this decision were that:[14]

[12] *Ingenico Group SA and Paymark Limited* [2018] NZCC 18.

[13] *Ibid.*, at [109]-[111].

[14] *Ibid.*, at [148]-[150].

- if faced with foreclosure, a rival switch could build links so that it did not rely on Paymark; and
- raising the costs of rivals would likely encourage merchants to take up alternative payment technologies that do not use switches.

29. For these reasons, the Commission decided that the merger would be unlikely to SLC. The Commission granted clearance to Ingenico to purchase Paymark.