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Dear Mr Sugl

Kumul Consolidated Holdings (KCH) application for clearance and authorisation for the proposed acquisition of shares in PNG DataCo Ltd (DataCo) by Telikom PNG Ltd (TPNG)

This submission is made on behalf of Digicel Asia Pacific (**Digicel**). It responds to the matters raised by the Independent Consumer and Competition Commission's (ICCC) letter of 10 April 2017 regarding TPNG's proposed acquisition of shares in DataCo (**the DataCo Acquisition**).¹

While this submission focuses on the DataCo Acquisition, some matters raised are equally relevant to TPNG's proposed acquisition of shares in Bemobile Ltd (**Bemobile**) (**the Bemobile Acquisition**). Given that TPNG is acquiring both DataCo and Bemobile, which is likely to give rise to competition issues at various levels in the supply chain for telecommunications services, Digicel submits both transactions should be considered together. These matters also emphasise the need for the ICCC to undertake careful scrutiny of both transactions.

Specifically, Digicel submits that the ICCC should focus on the increased level of vertical integration in telecommunications markets post-merger, including the integration of wholesale transmission services (both domestic and international) and retail fixed and mobile voice and data services. In addition, the DataCo Acquisition will reduce the number of suppliers of wholesale transmission services from three to two and remove the only non-vertically integrated supplier from the market. It will also reduce the number of mobile

¹ Digicel acknowledges that TPNG intends to change its name to Kumul Telikom Holdings (**KTH**) but, for consistency, refers to that entity as TPNG throughout this submission.

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network operators from three to two. Collectively, these changes have the potential to substantially lessen competition in retail and wholesale telecommunication markets by increasing barriers to entry and reducing the level of price and service level competition.

These submissions principally relate to the merger clearance aspect of the DataCo Acquisition and the Bemobile Acquisition. Digicel requests the opportunity to make further submissions on the applications for authorisation should either acquisition not be cleared by the ICCC.

1 Market definition

Neither of the notices seeking clearance and authorisation of the DataCo Acquisition and the Bemobile Acquisition dated 3 April 2017 (the **DataCo Application** and **Bemobile Application** respectively, together **the applications**) make any attempt to define the relevant markets for the purposes of a competition analysis, with multiple references to a PNG telecommunications market. Digicel submits that there is no sound basis for concluding that there is a single national telecommunications market. Retail services are not substitutes for wholesale services and fixed line services will not generally be substitutes for mobile services. Data services may (or may not) not be substitutable for voice services and wireless transmission will not always be a substitute for fibre. This suggests the existence of separate markets for wholesale and retail services, potentially defined by the delivery technology. There are also likely to be a number of narrower markets defined by geography, particular in respect of transmission capacity where specific routes may be markets in themselves.

This calls into question much of the market share data provided by Kumul Consolidated Holdings (**KCH**) and TPNG in support of their applications.

2 Background and concerns regarding the KCH and TPNG applications

The proposed transaction would see TPNG (a wholly owned subsidiary of KCH) acquire 100% of the shares in DataCo and Bemobile. While this will not change the ultimate ownership of any of TPNG, DataCo and Bemobile by KCH, Digicel understands from the applications lodged with the ICCC that, as a consequence of the proposed transactions, TPNG, DataCo and Bemobile will no longer operate as three stand-alone businesses, but rather on an integrated basis.

As a consequence, there will be a reduction in the number of retail mobile providers in PNG from three to two and a reduction of the number of wholesale transmission providers from three to two. The horizontal integration issues arising from the proposed transactions are discussed in detail in section 3. In addition, the new vertically integrated operator (KTH) will be the only provider of inter-island and international undersea cable services. The vertical integration issues arising from the proposed transactions are discussed in detail in section 4.

The applications assert (without substantiating the claim) that, despite what is described as 'formal' reductions in the number of competitors, competition will be enhanced because, if the transaction goes ahead, a vertically integrated business will be better able to challenge

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the alleged (and again unsubstantiated) dominance of Digicel. This analysis is flawed in a number of respects which are considered in the context of retail mobile and wholesale services below.

2.1 Wholesale services

First, for the reasons outlined in section 1 above, there are real questions in relation to the reliability of the market share data that has been provided by KCH and TPNG.

Second, the application suggests that the DataCo Acquisition will allow KTH to develop a competitive national backhaul operation with lower prices.² However, Digicel is not aware of any commitment to reduce prices post-merger and the application provides no clear explanation of why competition will be more effective with two competitors in the market than it is under the status quo (ie three competitors). Indeed, there seems to be a suggestion that overall transmission capacity may be reduced, thereby limiting incentives to discount services, as the application notes that there is significant duplication between the TPNG and DataCo networks.³

Third, there are significant proposals for investment in inter-island and international submarine networks by DataCo that are canvassed in the applications⁴ but which do not feature at all in the analysis of the state of competition with and without the proposed transaction (discussed in more detail in section 3).

Fourth, the application states that DataCo is not currently a sustainable, vigorous or effective competitor and its departure from the market as a separate entity will have no effect.⁵ This is presumably because of the lack of redundancy in its network and limited links it operates⁶, although the reasons for the conclusion are somewhat unclear. Ultimately, there appear to be a range of solutions to DataCo's reliability problems that are not canvassed in the application, for example acquiring redundant paths from a third party to increase service reliability, which would likely result in DataCo becoming a more effective competitor (especially when combined with the investment discussed above). In addition, DataCo is a relatively new transmission provider (created in 2014) and there is no reason to assume that its effectiveness as a competitor will not increase over time. None of these issues are addressed by the application.

2.2 Retail services

The Bemobile Application repeatedly refers to Digicel's alleged dominance in mobile voice and SMS markets that allows it to charge between two and five times the rate of its competitors without losing market share.⁷ This argument is made to support the proposition that vertical integration is required to compete with Digicel. This assertion is problematic for a number of reasons.

² DataCo Application, page 4.

³ DataCo Application, page 3.

⁴ DataCo Application, page 3.

⁵ DataCo Application, page 7.

⁶ DataCo Application, page 3.

⁷ Bemobile Application, pages 2, 5 and 6.

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First, if Digicel, TPNG and Bemobile are offering the same services at different price points and Digicel's substantially higher pricing is not resulting in a loss of market share, the service offerings of TPNG and Bemobile must be of inferior quality, for example because customer service is poor or the services offered are unreliable. These are issues that can be addressed by TPNG and Bemobile internally and do not require structural change to the industry to remedy.

Second, the application alleges that Digicel is extracting monopoly rents in remote areas where it does not face competition (charging K0.60 per minute) compared with K0.25 per minute in other areas.⁸ However, this conclusion contradicts the preceding acknowledgement that the costs of deployment outside of urban areas are high.⁹ Digicel strongly denies the assertion made by KCH and TPNG and submits that the higher charges outside urban areas are solely the result of higher installation and operation costs.

Third, the application indicates that TPNG is currently rolling out a 3G/4G network.¹⁰ Digicel separately understands that it is substantially increasing the number of its towers during calendar year 2017 with an additional 120 4G and 120 LTE sites planned. The application asserts that TPNG does not have the resources to become a significant competitor to Digicel. However, given that Digicel's network is primarily a 2G network and TPNG clearly has the wherewithal to upgrade its own network, it is difficult to understand how this assertion could be correct.

Fourth, KCH and TPNG's assertions regarding vertical integration are addressed in more detail below.

3 Horizontal issues

As noted above, the DataCo and Bemobile Acquisitions will have the effect of reducing the number of suppliers from three to two of wholesale transmission and retail mobile services respectively.

The DataCo Application contends that this will allow TPNG to 'develop a competitive national backhaul operation which will lower prices'.¹¹ However, no evidence is provided to substantiate how this will be achieved. Digicel submits that the reduction in the number of competitors in the wholesale transmission services market will lead to higher prices in markets for wholesale transmission and retail telecommunications services, to the detriment of PNG consumers. The DataCo Acquisition, if cleared, will increase TPNG's market power and reduce the ability of Digicel to gain access to transmission services on reasonable terms.

Furthermore, Digicel submits that DataCo's position in the market is much stronger than that portrayed in the DataCo Application. It is disingenuous to suggest that DataCo is so insignificant that there are 'in effect, only two market participants at the moment, Digicel

⁸ Bemobile Application, pages 2-3.

⁹ Bemobile Application, page 2.

¹⁰ Bemobile Application, page 4.

¹¹ DataCo Application, page 3.

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and TPNG'.¹² To the contrary, DataCo has invested significantly in its National Transmission Network, including the aerial fibre optic connection between the Highlands region to Madang and Lae. DataCo also has to build the PNG National Submarine Fibre Cable Network which aims to connect all coastal and island provinces with affordable high capacity Submarine fibre optic cables.¹³ While it may be true that these projects 'are yet to have final approval to proceed', the ICCC is not entitled to disregard them if there is a real chance that they will go ahead. It is likely that DataCo's current and anticipated network assets will give it a much stronger position in the wholesale transmission market. Digicel is particularly concerned that TPNG is currently a monopoly provider of international undersea cable connectivity and that inter-island connectivity is generally only available via satellite. In these circumstances the acquisition of DataCo by TPNG is almost certain to eliminate any incentive to invest in these additional links and foreclose future competition.

4 Vertical integration

Digicel does not consider that vertical integration in and of itself is a bad thing. To the contrary, it can confer significant benefits to consumers through greater efficiency and lower prices. As set out in DataCo Application, the new ownership structure will produce a vertically integrated business, with TPNG obtaining control over DataCo's supply of wholesale telecommunications transmission services, in addition to its current offering of retail voice (both fixed and mobile) and broadband services. The Bemobile Acquisition will further expand TPNG's mobile voice and internet service offerings.

However, vertical integration can have anticompetitive effects including by incentivising the merged entity to foreclose competition, leading to increased market power and potentially higher prices. In the case of vertical integration of state owned enterprises (SOEs) these incentives will likely be combined with a lower cost of capital which may further facilitate foreclosure.

It is therefore essential that, if these transactions are to proceed, adequate regulatory constraints are in place to ensure that competition is not diminished and the efficiency gains and benefits of lower prices flow through to both wholesale and retail customers.

Digicel is particularly concerned by the possibility that the wholesale parts of the merged business including DataCo may favour its retail operations (TPNG and Bemobile) in the supply of transmission and other services. This could lead to the substantial lessening of competition substantial lessening of competition in downstream markets. This concern is based on the fact that transmission services are a fundamental input in the supply of retail telecommunications services and the underlying infrastructure supporting those services is both costly and time consuming to construct, particularly where government assistance is not forthcoming. This in turn makes denial of access to reasonably priced transmission capacity a significant barrier to entry for providers of retail fixed and mobile telecommunication services. It also has the potential to increase the cost of supply (or

¹² DataCo Application, page 6.

¹³ DataCo website, 'NTN New Project' (24 April 2017) <https://www.pngdataco.com/index.php/ntn>.

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reduce quality of service) for existing competitors such as Digicel. This is ultimately to the detriment of PNG consumers.

The proposed transactions will likely increase the incentive for TPNG to foreclose new entry by non-integrated competitors at the retail layer for fixed and mobile telecommunications services.

If TPNG were to discriminate against other retail competitors (that is, not provide transmission services to its competitors at all or on terms that are substantially less favourable) this would be likely to substantially lessen competition in the relevant retail markets for telecommunications services (including both fixed and mobile voice and internet services) in Papua New Guinea. The likely consequences of this include:

- **raising barriers to entry** as new retail market entrants may be reluctant to enter into a market where they will need to rely on their vertically integrated competitors for wholesale transmission services. The significant cost of infrastructure required to provide transmission services, and the incentive for the merged entity to undercut a new entrants' prices, is likely to discourage new entrants from investing in such infrastructure.
- **foreclosing competition** given that there are limited substitutable transmission service providers. The DataCo Application identifies only two satellite providers that offer substitutable transmission services. However, these services are significantly more costly than transmission services over the undersea cable currently linking Madang and Kimbe and Rabaul and Kavieng. This is likely to lead to increased costs being passed to end-users. Furthermore, the DataCo and Bemobile Acquisitions will lead to a further consolidation of infrastructure assets (including 400 Bemobile towers and thousands of kilometres of fibre optic cable across Papua New Guinea) thereby expanding the scope of potential foreclosure.

The potential for subtle discrimination on service levels and non-price terms is both hard to identify and difficult to monitor. However, the ICCC must ascertain the extent to which these possibilities are created as a result of the transactions. The ICCC must also consider how the DataCo and Bemobile Acquisitions would:

- create incentives for TPNG to offer lower transmission service prices to the retail part of its business, whilst recovering any loss by charging higher prices from third parties and how that may impact on competition; and
- facilitate a vertical price squeeze.

In order to mitigate the risk of a substantial lessening of competition in any of the relevant markets, Digicel considers it imperative that TPNG be put in a position to provide an access undertaking by way of a Reference Interconnection Offer (RIO) pursuant to the *National Information and Communications Technology Authority Act 2009*, as discussed below.

5 With and without test

The merger parties assert that the DataCo and Bemobile Acquisitions will have pro-competitive effects, which primarily relate to the merged entities increased ability to effectively compete with Digicel. However, in addition to being largely unsubstantiated, these assertions do not take into account the likely anti-competitive effects discussed above if clearance is granted; in particular, the reduced incentive for further investment in network infrastructure and the negative effects on potential new entrants. Furthermore, the applications do not consider the competitive state of the relevant markets were the DataCo and Bemobile Acquisitions not to proceed. Potential remedies for the competition concerns raised by the applications are considered below.

6 Remedies

Digicel submits that the particular competition concerns identified above may be partially addressed by means of regulated access; namely, by way of declaration of the relevant services pursuant to the process set out in the *National Information and Communications Technology Act 2009 (NICTA Act)* and the provision of an RIO.

In particular, the ICCC should encourage NICTA to conduct public inquiries into whether particular wholesale services should be designated as 'declared services' by the Minister. It should also engage with the NICTA to determine what price and non-price terms would appropriately address the competition concerns arising from the DataCo and Bemobile Acquisitions as discussed above.

This Declaration, together with an RIO, would provide greater certainty, both for existing retail service providers and potential new entrants, that they will be able to access necessary inputs and as to the terms and conditions for that access. The NICTA is specifically empowered by the NICTA Act to consult with the ICCC in preparing its report on whether particular services should be declared.¹⁴ By engaging with the NICTA, the ICCC would be promoting a consistent approach to economic regulation within PNG.

7 Further information required

7.1 Market definition

There is a lack of clarity in the DataCo Application as to what markets are likely to be impacted by the DataCo Acquisition. The DataCo Application makes various references to the 'telecommunications market', 'national backhaul market' and 'small sub-markets', but does not clearly set out what it considers to be the relevant markets.

Digicel considers it imperative for the ICCC to consider all markets that may be affected by the DataCo Acquisition. Digicel submits that there is, at the very least, a separate retail (including separate markets for fixed and mobile services) and wholesale services market. Digicel submits that the effects of the DataCo and Bemobile Acquisitions on each market should be considered separately. This is especially necessary in relation to the retail

¹⁴ NICTA Act, section 129(4).

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markets, given the adverse impact on competition that is likely to arise from vertical integration.

7.2 Lower prices

ICCC needs to undertake a thorough investigation of how prices would be impacted should the DataCo Acquisition proceed. Digicel submits that the ICCC should request further and detailed particulars on how the DataCo Acquisition will allow TPNG to develop a competitive backhaul network and how that will lead to lower prices and improved services. The DataCo Application assumes that this will be the outcome but does not substantiate the basis upon which TPNG anticipates that this will occur.

Similarly, the DataCo Application asserts that 'the world's major telecommunications companies are vertically integrated and provide a more sustainable and robust path to success, and leads to greater innovation'¹⁵ without substantiating or identifying specific instances of where and how this has occurred. This is somewhat ironic given that a central plank of the telecommunications regulatory policy of Papua New Guinea's close neighbour, Australia, is the structural separation of the dominant fixed line and mobile carrier Telstra.

7.3 Internal inconsistencies

The DataCo Application suggests that the relevant markets are both competitive and uncompetitive. For example, it provides that 'the market' is 'currently not competitive, to the detriment of consumers'¹⁶ and 'currently uncompetitive market'¹⁷, whilst also stating that DataCo and TPNG operate in a 'competitive environment'.¹⁸ It appears that this has been done on a selective basis according to the position that best supports the particular contention being made. Digicel submits that the ICCC should treat these assertions with a degree of scepticism.

We thank you for the opportunity to provide submissions on the DataCo and Bemobile Acquisitions.

Yours faithfully

Corrs Chambers Westgarth



Thomas Jones
Partner

¹⁵ DataCo Application, page 5.

¹⁶ DataCo Application, page 2

¹⁷ DataCo Application, page 6.

¹⁸ DataCo Application, page 5.