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COMMERCE COMMISSION

# Decision No. 573

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

**SKY NETWORK TELEVISION LIMITED**

**and**

**PRIME TELEVISON NEW ZEALAND LIMITED**

**The Commission:** Paula Rebstock
David Caygill
Denese Bates QC

**Summary of Application:** The acquisition by SKY Network Television Limited of the television broadcasting business of Prime Television New Zealand Limited.

**Determination:** Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.

**Date of Determination:** 8 February 2006

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# EXECUTIVE SUMMARY

## The Proposal

1. A notice pursuant to s 66(1) of the Commerce Act 1986 was registered on 25 November 2005. The notice sought clearance for the acquisition by SKY Network Television Limited (SKY) of the various assets, rights and benefits comprising the television broadcasting business of Prime Television New Zealand Limited (Prime).

## Relevant Markets

2. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national markets for:

   - retail pay-TV broadcasting services (the Pay-TV Broadcasting Market);
   - retail free-to-air (FTA) television broadcasting services (the FTA Broadcasting Market);
   - pay-TV advertising services (the Pay-TV Advertising Market);
   - FTA television advertising services (the FTA Advertising Market); and
   - the wholesale acquisition of live sport rights (the Sports Rights Market);
   - the wholesale acquisition of movie rights for pay television (the Pay-TV Movies Market);
   - the wholesale acquisition of movie rights for FTA television (the FTA Television Movies Market); and
   - the wholesale acquisition of first-run television series rights (the First-run Series Market).

## Counterfactual and Factual

3. The Commission considers that, in the factual scenario, the combined entity would continue to operate Prime as an FTA broadcaster.

4. The Commission considers that, in the counterfactual scenario, Prime would continue to operate as an FTA broadcaster, either as it is, or owned by another party not already competing in the affected markets.

## Competition Analysis

*The Pay-TV Advertising and FTA Advertising Markets*

5. The proposed acquisition would not result in any aggregation in either the Pay-TV advertising market or the FTA advertising market.

*The Pay-TV Broadcasting Market*

6. As Prime is not currently a pay-TV broadcaster, the proposed acquisition would not result in any aggregation in the pay-TV market. However, the Commission has analysed the extent to which the acquisition would lead to an increase in the market power of SKY in the pay-TV market, by way of a lessening of the competitive constraint exerted by FTA broadcasters on the pay-TV broadcasting market.

7. Currently, SKY is the only provider of a digital broadcast service, which it supplies through its satellite service. Industry participants advised the Commission that New Zealand will follow other countries and have an FTA digital service introduced, or 'rolled-out', to replace the existing FTA analogue service. The Commission has analysed the extent to which SKY could delay or prevent such an FTA digital roll-out in order to strengthen its position in the pay-TV market, or to ward off any future competition from FTA broadcasters on SKY.

8. The Commission considered the implications of the proposed acquisition on the establishment of an alternative digital service to the one currently offered by SKY. TVNZ stated that it was essential to have all FTA broadcasters involved in the establishment of an FTA digital platform as substantial investment is required. TVNZ submitted that the attractiveness of an FTA digital platform would be reduced if Prime's premium content was removed.

9. The Commission considers that other industry participants (broadcasters and government bodies) would be more important to the establishment of a digital service than Prime. Further, the Commission understands that the Government is still considering its options and has not yet committed itself to any investment. Accordingly, the Commission does not consider that Prime is an essential participant in any proposed FTA digital platform.

10. The Commission considers that the acquisition would be unlikely to have an effect on the success or otherwise of an alternative digital platform that, potentially, would be able to compete more effectively with pay-TV.

11. Therefore, the Commission is of the view that the proposed acquisition is unlikely to result in a substantial lessening of competition in the pay-TV market.

*The FTA Broadcasting Market*

12. The main competitors in the FTA market are TVNZ, with two channels, CanWest, with two channels, and Prime, with one channel. As SKY is not currently an FTA broadcaster, the proposed acquisition would not result in any aggregation in the FTA broadcasting market.

13. However, the Commission has analysed whether the acquisition would have an effect in the upstream markets for the acquisition of content rights. Industry participants stated that the ability to acquire suitable content rights is essential for the success of a broadcaster. The Commission considers that any lessening of competition in the upstream markets for the acquisition of rights may, by vertical linkages, create competition concerns in the downstream retail markets.

*The Wholesale Acquisition Markets*

14. The Commission considers that the main competitors in the sports rights market are SKY, TVNZ and CanWest. SKY holds the rights to the majority of live sports events in New Zealand. The Commission understands that SKY is under no obligation to on-sell delayed rights to FTA operators. CanWest and TVNZ have successfully bid against SKY for live sports rights for events such as the Rugby World Cup, and international and domestic netball.

15. Accordingly, the Commission considers there would be only a minimal effect on the acquisition of sports rights as a result of the proposed acquisition.

16. With regards to the pay-TV and FTA television movie markets, the Commission considers that the combined entity may be able to successfully bundle pay-TV and FTA movie rights. While the Commission understands that the proposed acquisition and the ability to bundle would give the combined entity a competitive advantage in comparison to the other purchasers of FTA movies, the Commission does not consider that this competitive advantage would result in SKY having market power for the purchase of either FTA television movies or pay-TV movies. Given the countervailing power of the studios, the requirement for the combined entity to purchase 'hot titles' and the presence of existing competitors for the purchase of FTA movies, the Commission is satisfied that the proposed acquisition would not result in SKY having market power in the markets for the purchase of pay-TV movies or FTA television movies.

17. The Commission also assessed the extent to which the combined entity could adopt a predatory strategy by attempting to 'buy up' all premium content relating to first-run series, to the detriment of other competitors. The Commission considers that the combined entity would be unable to purchase all premium content available. Premium content is not restricted to the large American studios, and it would not be financially viable for the combined entity to purchase all available first-run series. The Commission also understands that TVNZ and CanWest have current output deals with the prominent American production studios.

18. The Commission considers that, in the factual scenario, the combined entity would be unlikely to have the ability to successfully adopt a predatory strategy by overbidding for all first-run series premium content, eliminating all other FTA broadcasters, and subsequently recouping its losses.

19. Therefore, the Commission does not consider that the combined entity would be in a position to substantially lessen competition in any of the four purchasing markets. Therefore, the combined entity could not leverage its position as a purchaser of content in the upstream markets, by vertical linkages, to impact on the downstream broadcasting markets.

20. Accordingly, the Commission considers that the acquisition would not be likely to result in a substantial lessening of competition in the FTA television broadcasting market.

**Overall Conclusion and Determination**

21. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

22. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by SKY Network Television Limited of the various assets, rights and benefits comprising the television broadcasting business of Prime Television New Zealand Limited.

## THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 25 November 2005. The notice sought clearance for the acquisition by SKY Network Television Limited (SKY) of the various assets, rights and benefits comprising the television broadcasting business of Prime Television New Zealand Limited (Prime).

## PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 8 February 2006.

3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1] In investigating an Application, the Commission considers the Applicant's submissions, conducts an investigation to test these submissions and considers the views of interested third parties, before reaching its own conclusions, based on these principles.

## STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal will have, or would be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely, if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v* Commerce *Commission,* where the Court held:

> We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.

> conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.[3]

7. In determining whether there is a change along the spectrum that is significant, the Commission must identify a real lessening of competition that is not minimal.[4] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years, or over such other time frame as may be appropriate in any given case.

9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition, such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or other such other time frame as may be appropriate.

## ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

    - with the acquisition in question (the factual); and
    - in the absence of the acquisition (the counterfactual).

11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:

    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or suppliers.

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[3] *Air New Zealand & Qantas Airways Ltd v Commerce Commission,* unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

[4] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

## THE PARTIES

### SKY Network Television Limited

12. SKY is a pay television (pay-TV) broadcaster, which began operating in 1990. SKY broadcasts on two separate formats, a digital satellite service, which offers up to 80 channels, and an analogue UHF service, with five channels. Currently, SKY has a total subscriber base of approximately 600,000 households.

13. SKY is a publicly-listed company and currently its largest shareholder is Nationwide News Pty Limited (NNL). NNL is a limited liability company registered in Australia, and is a wholly-owned subsidiary of News Corporation. News Corporation is an international media and entertainment company with operations in films, television, magazines, book publishing and other media. SKY is News Corporation's only interest in the New Zealand broadcasting industry.

### Prime Television New Zealand Limited

14. Prime is a free-to-air (FTA) television broadcaster, which began operating in New Zealand in 1998. Prime broadcasts a single channel on a set of analogue terrestrial UHF frequencies. Prime offers a broad mix of general entertainment, lifestyle, drama and comedy programming primarily sourced from overseas providers.

15. Prime is wholly-owned by Prime Television (Holdings) Pty Limited, an Australian limited liability company wholly-owned by Prime Television Limited, which is registered in Australia. The Prime group of companies operates 12 television broadcasting stations in Australia, in addition to Prime in New Zealand.

## OTHER RELEVANT PARTIES

### Television New Zealand Limited (TVNZ)

16. TVNZ is an FTA television broadcaster. TVNZ broadcasts two channels, TV ONE and TV2, on a set of analogue terrestrial VHF frequencies. TVNZ also holds a set of UHF licences and a number of individual licences (through two subsidiaries, Horizon Pacific Television Limited and Freesat Television Limited).

17. TVNZ is a commercial broadcaster, although it has a number of public broadcasting objectives that are set out in the TVNZ Charter. The Charter outlines TVNZ's role and responsibilities and was implemented by the Government in 2003. Currently, approximately 10% of TVNZ's revenues are from public sources, which include both New Zealand on Air funding and specific Charter funding.

18. TVNZ's two channels are targeted at slightly different audiences: TV ONE targets a more mature audience, with a broad range of programming, while TV2 focuses on youth and family entertainment.

19. The Commission received a request for a conference from TVNZ. The Commission considered the request and declined it. At the time, the Commission considered that the issues raised and the information received from interested parties could be adequately tested in the course of the investigation.

The Commission did not consider that holding a conference would assist it in making its determination under s 66. TVNZ subsequently issued proceedings challenging the Commission's decision not to hold a conference. These were withdrawn the same day.

**CanWest MediaWorks (NZ) Limited (CanWest)**

20. CanWest is an FTA television broadcaster and radio station operator. CanWest broadcasts two channels, TV3 and C4, on a set of analogue terrestrial VHF frequencies. CanWest's TV3 targets a mainstream audience while C4 is predominantly a music television channel.

**Ministry of Culture and Heritage (MCH)**

21. MCH provides advice to the government on culture and heritage matters, including the provision of cultural resources and the promotion of New Zealand's history and heritage.

22. MCH is responsible to a number of ministers, including the Minister of Broadcasting, and provides advice on the use of non-commercial broadcasting spectrum. MCH recently commissioned a cost-benefit study into launching an FTA digital broadcasting service in New Zealand. This study is expected to be completed in April this year.

**Ministry of Economic Development (MED)**

23. MED provides advice to the government on the use of radio frequencies in broadcasting, including the allocation of spectrum and licensing functions.

24. MED administers management rights for a range of frequencies dedicated to television broadcasting, and also grants spectrum licences to certain frequencies, including most radio and television broadcasting bands. Typically, these are allocated through a public auction or tender.

**Content Providers**

25. Television broadcasters purchase programming and other content from suppliers. For sport, broadcasters typically purchase specific rights to events from sport's governing bodies. For movies, television dramas and comedies, broadcasters purchase programming from production studios. Currently, the main studios supplying New Zealand are:

- American production studios, such as The Walt Disney Company (Disney), Twentieth Century Fox and Warner Bros. Inc.;
- other international studios, such as Atlantis Alliance Communications from Canada and Granada from the United Kingdom; and
- local production houses, such as South Pacific Pictures and The Gibson Group.

## INDUSTRY BACKGROUND

26. Historically, television broadcasting in New Zealand was controlled by the government, which was responsible for the introduction of New Zealand's first television channel in 1960. This was followed by a second state-owned channel in 1975.

27. The industry was deregulated in the late 1980s, which saw the State broadcaster transformed into a state-owned enterprise and additional television frequencies auctioned off to private enterprise. This auction process subsequently led to the formation of commercial broadcasters in New Zealand.

28. TV3 was launched in 1989 as the first FTA, privately-owned broadcaster. It subsequently launched another FTA channel in 1997.

29. SKY was launched in 1990 as New Zealand's first pay-TV broadcaster. It initially offered three subscription channels on a set of UHF frequencies. In 1998, SKY was the first broadcaster to introduce a digital satellite service in New Zealand, which increased substantially the number of channels it could provide to subscribers.

30. Also in 1998, Prime launched an FTA channel, which increased the number of national broadcasters from three to four, with three FTA broadcasters - TVNZ, CanWest and Prime - and one pay-TV broadcaster, SKY.

31. Other FTA television channels have also been established, although these have tended to be specialised channels focusing on particular audiences. These have had a minimal impact on the broadcasters mentioned above. For example, the TAB broadcasts horse racing and greyhound racing on its 'Trackside' channel, and more recently a Maori television channel has been launched. Further, regional broadcasters have also been established, such as in Invercargill and Dunedin, which tend to focus on local issues and hence gain relatively small audiences.

## PREVIOUS DECISIONS

### New Zealand Commerce Commission Decisions

32. The Commission previously considered television broadcasting in Decision 276*: Telecom Corporation of New Zealand / HKP Partnership of New Zealand,* 26 September 1995 (the Telecom Decision).

33. In analysing the competitive implications of the proposed acquisition, the Commission divided broadcasting into markets corresponding to the main components necessary to provide a broadcasting service. These markets were:

    - the television transmission vehicle market, as a broadcaster requires access to a transmission 'vehicle', such as radio spectrum, cable or satellite;
    - the television transmission services market, which incorporates the service of sending the television signals between transmission points; and
    - the retail television broadcasting market, as broadcasters in effect 'retail' services to either advertisers or subscribers/viewers. The Commission then went on to consider the supply of television programmes when analysing entry conditions within this market.

34. In the Telecom Decision, the Commission considered whether FTA television and pay-TV were in the same market. The Commission received data that suggested that substitution was occurring between FTA television and pay-TV, although the Commission noted that this data was limited. Further, the Commission received disconnection information from SKY, which supported a substitution hypothesis, but noted the difficulty in comparing cross-price

elasticities in this industry because one set of channels is free and the other is available at a price (through a subscription charge).

35. The Commission considered that FTA television and pay-TV place competitive constraints on each other in programming, viewing and, to a limited degree, advertising, with the two services competing for programming and using their programming mixes to compete for viewers.

36. The Commission also noted that there was only a limited amount of overseas discussion on the substitutability of FTA television and pay-TV, and that future technological advances might change the nature of the industry and of the market definitions.

37. Given these considerations, the Commission considered in the Telecom Decision that, on balance, and for the purposes of that decision, FTA television and pay-TV were in the same market.

**Overseas Authorities**

38. Overseas jurisdictions have analysed broadcasting and media industries in recent times. The cases of most relevance to the present Application are:

- Bertelsmann/Kirch/Premiere, Germany (European Commission merger case No IV/M.993; decision dated 27 May 1998)[5];
- TPS, France (European Commission antitrust case No IV/36.237; decision dated 3 March 1999)[6];
- British Interactive Broadcasting/Open, United Kingdom (European Commission antitrust case No IV/36.539; decision dated 15 September 1999)[7];
- British Sky Broadcasting Group Plc / Manchester United Plc (A report on the proposed merger, Competition Commission, April 1999)[8];
- NTL Incorporated and Cable / Wireless Communications Plc (A report on the proposed acquisition, Competition Commission, March 2000)[9];
- Newscorp/Telepiù, Italy (European Commission merger case No COMP/M.2876; decision dated 2 April 2003)[10]; and
- BSkyB Broadband Services Limited/Easynet Group plc, United Kingdom (Office of Fair Trading merger case; decision dated 30 December 2005).[11]

## MARKET DEFINITION

39. The Act defines a market as:

> "… a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."[12]

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[5] http://europa.eu.int/comm/competition/mergers/cases/decisions/m993_19980527_610_en.pdf.
[6] http://europa.eu.int/eur-lex/pri/en/oj/dat/1999/l_090/l_09019990402en00060022.pdf.
[7] http://europa.eu.int/eur-lex/pri/en/oj/dat/1999/l_312/l_31219991206en00010037.pdf.
[8] http://www.competition-commission.org.uk/rep_pub/reports/1999/426sky.htm#full.
[9] http://www.competition-commission.org.uk/rep_pub/reports/2000/437ntl.htm#full.
[10] http://europa.eu.int/comm/competition/mergers/cases/decisions/m2876_en.pdf.
[11] http://www.oft.gov.uk/NR/rdonlyres/7BBDAD13-F766-4730-856A-C2AFD2DC64CD/0/BskyB.pdf.

40. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

**Product Market**

41. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.

42. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

43. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

44. The Applicant submitted markets that were consistent with the Commission's previous investigation into the broadcasting industry from the Telecom Decision, namely:

- television transmission vehicles;
- television transmission services; and
- retail television broadcasting.

45. As previously noted, the Commission considered in the Telecom Decision that future technological advances might change the nature of the industry and the market definitions. Also, significant developments have occurred in the industry since 1995, as indicated in the Industry Background section above. The Commission has revisited its previous assessment of the relevant product markets in the context of the current Application.

**Television Transmission Vehicles**

46. Television transmission vehicles are the means by which television signals are transmitted to viewers. In the Telecom Decision, the Commission included a number of mechanisms for transmitting television signals within one market. These mechanisms included radio spectrum, microwave multi-point distribution service frequencies and satellite signals. The Commission also considered the possibility of using telephone lines as a transmission option.

47. Currently, New Zealand broadcasters transmit their television signals in two different ways. Either the signal is transmitted terrestrially via radio spectrum or the signal is transmitted via a satellite.

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[12] s 3(1A) of the Commerce Act 1986.

48. Radio spectrum used for television transmission is either on a VHF band or a UHF band. VHF bands have been the preferred bandwidth for television signals because they are more suitable for New Zealand's hilly terrain. For example, VHF waves can 'bend' around obstacles and can be received over relatively long distances. Currently, TVNZ and CanWest are the only holders of management rights for VHF bands, and the Commission understands that there are no more rights available for this type of band.

49. UHF bands are higher on the radio spectrum and are not as well suited to transmitting over hilly terrain, and require more energy to transmit over a given range, in comparison to the VHF frequencies. Currently, both the Applicant and Prime have management rights for UHF bands.

50. SKY also transmits a satellite service, introduced in 1998, which now accounts for approximately 85% of its subscribers[13].

51. Prime currently has management rights for one nationwide UHF band. Under the present proposal, SKY would purchase Prime's management rights for this signal. Currently, SKY has four UHF bands and it has an arrangement with the New Zealand Racing Board (Racing Board) to share the Board's UHF band[14]. Other than the Applicant and Prime, the holders of management rights to nationwide spectrum include:

- TVNZ, with two VHF bands and several (currently unused) UHF bands;
- CanWest, with two VHF bands;
- the Maori Television Service, owned by the Crown with a nationwide UHF band; and
- the Racing Board with a nationwide UHF band.

52. The proposed acquisition does not include any of the nationwide VHF bands, which are typically considered the most significant because of the better signal quality and coverage in New Zealand. The VHF bands are currently held by TVNZ and CanWest.

53. The Applicant submitted that the acquisition would give rise to minimal aggregation in respect of the spectrum rights held by SKY. Industry participants agreed with that assessment. The Commission also agrees with this assessment. The acquisition would result in SKY obtaining the management rights to one nationwide UHF band. For the purposes of this Application, the Commission did not consider this market further.

*Analogue and Digital Broadcasting Services*

54. TVNZ submitted that there is a separate market for the provision of digital broadcasting services.

55. Currently, all broadcasters that transmit on either a VHF band or a UHF band provide an 'analogue' signal to viewers. Analogue is the traditional format on which television signals are broadcast, and is also used for other technologies such as radio or first-generation mobile phones.

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[13] SKY's Annual Report 2005.

[14] The Racing Board broadcasts the TAB's Trackside channel, which televises horse and greyhound racing. SKY has a contractual relationship with the Racing Board such that SKY transmits one of its channels to its UHF subscribers when Trackside is not on air.

56. However, SKY's satellite service broadcasts a 'digital' signal to viewers. Digital signals are broken down into a binary format and can be stored and transferred more easily than analogue signals. Industry participants advised that 'digital' signals provide better quality picture and sound as well as for interactive services and multi-channelling[15]. Industry participants noted that currently, most televisions in New Zealand convert any digital signal into analogue form for screening on an analogue television set.

57. The Commission notes that all industry participants advised that analogue broadcasting will eventually be superseded by digital broadcasting, although there was much debate on when this 'switch' would occur.

58. As stated above, TVNZ submitted that there is a separate market for the provision of digital broadcasting services. It considered that digital services are superior to analogue, and are not substitutable. TVNZ submitted that the introduction of an FTA digital service would enable FTA operators to compete more closely with SKY digital, as they would be able to offer many more channels and a variety of other features, similar to that offered by pay-TV.

59. The Commission understands that analogue and digital refer to the technological means of transmission. In this regard, the Commission is of the view that there is unlikely to be separate markets for analogue and digital transmissions.

**Television Transmission Services**

60. Television transmission services concern the sending of television signals between transmission points to the viewer. Historically, this service has been provided by Broadcast Communications Limited (BCL)[16], which has numerous repeaters located through the country. Presently, all broadcasters use BCL to transmit, or deliver, their television channels to viewers. Typically, a broadcaster will sign a long-term contract with BCL to provide these services. SKY also uses SingTel Optus Pty Limited[17] to provide its satellite service.

61. SKY and Prime are purchasers of transmission services and any aggregation would occur in the purchase of these services from BCL. The Applicant submitted that this aggregation would be minimal, and that the two principal suppliers of transmission services, BCL and SingTel Optus, would both have substantial countervailing power over the combined entity. Industry participants agreed with this assessment. The Commission also agrees with this assessment. For the purposes of this Application, the Commission did not consider this market further.

**Retail Television Broadcasting and Advertising**

62. In the Telecom Decision, the Commission defined a single market for retail television broadcasting, which included both FTA television and pay-TV. In that decision, the Commission drew the following conclusions about market characteristics:

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[15] Industry participants advised that digital signals use less 'space', or bandwidth, than analogue signals. It is commonly accepted that five digital channels can be accommodated in the same space as one analogue signal.

[16] BCL is a wholly-owned subsidiary of Transmission Holdings Limited, a state-owned enterprise.

[17] SingTel Optus Pty Limited is a telecommunications provider based in the Asia Pacific region.

- FTA television and pay-TV were substitutes, with evidence that suggested that the two were used as alternatives;
- price increases for pay-TV at the time had led to increased disconnections (or churn); and
- there was some substitution on the supply-side.

63. Further, the Commission noted:

> FTA and pay-TV place competitive constraints on each other in programming, viewing, and, to a limited degree, advertising … the two services compete for programming, and use their programme mixes to compete for viewers. SKY attempts to attract new viewers by emphasising the benefits of limited advertising and uninterrupted movies. Restrictions placed on the nature of SKY advertising by the FTA broadcasters indicate competition for viewers between the two forms of service.[18]

64. In its current investigation, most industry participants, with the notable exception of the Applicant, considered it valid to distinguish between pay-TV and FTA television broadcasters, and that separate markets are justified for these two services.

65. The Commission also considered the approach taken by other jurisdictions when analysing this industry[19]. It found that other jurisdictions conclude that, generally, FTA television and pay-TV are in separate product markets[20].

66. Industry participants advised the Commission that the main differences between FTA television and pay-TV in New Zealand are:

- subscribers to pay-TV pay fees for the service;
- subscribers are willing to pay for the services despite the availability of FTA services. Currently, 40% of New Zealand households subscribe to SKY;
- pay-TV has multiple channels with specialised programming, such as for sports, food, movies, and news (i.e. special interest channels). FTA channels are typically focused on attracting mass audiences through a single channel (i.e. general interest channels); and
- a pay-TV broadcaster seeks to maximise subscription revenue by providing appealing programming targeted at specific audiences. FTA broadcasters seek to maximise advertising revenue, typically by screening programmes with mass appeal.

67. Industry participants advised that the main difference between FTA and pay-TV broadcasters is their contrasting business models, namely:

- FTA broadcasting revenues are derived from selling advertising services, where audience (or viewer share) and advertising rates are the key parameters, and the end user is the viewer; and

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[18] The Telecom Decision, para 96.

[19] See Overseas Authorities Decisions in the Previous Decisions section above.

[20] For example, see: European Commission, *Case No. IV/M.993, Bertelsmann/Kirch/Premiere*, May 1998; Australian Competition & Consumer Commission, *Declaration of an analogue subscription television broadcast carriage service*, October 1999; and the UK Competition Commission, *NTL Incorporated and Cable & Wireless Communications plc., 'A report on the proposed merger'*, March 2000.

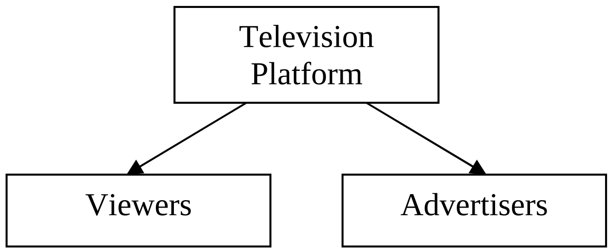
- pay-TV broadcasting revenues are derived from selling subscriptions on a contractual basis, where the number of subscribers and subscription rates are the key parameters, and the end user is the subscriber.

68. The Commission has gone on to consider whether there are separate markets for pay-TV and FTA television.

*Two-sided Platform Characteristics*

69. Industry participants advised the Commission that from an FTA broadcaster's perspective, there are two economic agents – advertisers and viewers. This reflects the presence of a two-sided platform where, on the one side, viewers are the consumers of the television service and, on the other side, advertisers are the buyers of the television advertising service. Therefore, viewers and advertisers could both be regarded as an FTA broadcaster's 'customers'.

**Figure 1: The Two-sided Platform for Television**




70. Recently, there have been advances in the economic literature that have shed new light on how such related activities should be analysed. This literature suggests that FTA television is an example of a business model called a "two-sided platform" or "multi-sided market"[21]. With advertising-supported media, the platform supplies content at a zero price to attract viewers, and the viewership is then used as the basis to attract advertisers. There is a clear indirect network effect between the two sides of the business, since advertisers value platforms that have a large viewership, and it is the advertising revenues that pay for the service. Viewers contribute nothing directly to the business's revenues.

71. Although two-sided platforms pose some challenges for the Commission's *Mergers and Acquisitions Guidelines*, the Commission believes that they can be analysed with the frameworks in the Guidelines, providing the appropriate adjustments are made. In particular, neither "side" of the two-sided platform[22] can be analysed in isolation from the other, yet regard must be had to

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[21] See David Evans "The Antitrust Economics of Multi-Sided Platform Markets" (2003) 20 *Yale J on Regulation* 325-381; Jean-Charles Rochet, and Jean Tirole (2002) "Cooperation among Competitors: Some Economics of Payment Card Associations," *The RAND Journal of Economics*, 33(4): 1-22; Jean-Charles Rochet and Jean Tirole (2003) "Platform Competition in Two-Sided Markets," *Journal of the European Economic Association*, 1(4): 990-1029; Richard Schmalensee (2002) "Payment Systems and Interchange Fees," *Journal of Industrial Economics*, 50(2): 103-122; David S Evans., and Richard Schmalensee (2005) "The Industrial Organization of Markets with Two-Sided Platforms," *NBER Working Paper Series*, No. 11603, September.

[22] Evans defines three conditions necessary for two-sided markets: (1) Two distinct groups of customers; (2) The marginal utility or value of one group of customers increases as the number of the other group of customers increase; and (3) An intermediary is necessary to internalise the externalities of each group.

competitive conditions, barriers to entry, pricing, output and quality decisions, etc on each side of the platform.

72. The Commission has recently considered media markets noting that, although there is a degree of interplay between the different types of advertising media such as print, radio and television, each type of advertising is distinct and likely to form a discrete market[23].

73. Further, the Commission notes that the two-sided mechanism relates to FTA television services, but less so to pay-TV services, as the pay-TV format restricts a broadcaster's ability to advertise. For example, SKY submitted that only 5% of its revenues are derived from advertising[24].

74. The Commission has considered both the demand-side and supply-side substitutability for both sides of the platform - television broadcasting services and television advertising services.

*Television Broadcasting Services*

75. Industry participants advised the Commission that there is a degree of competitive tension between FTA and pay-TV broadcasters, but there was disagreement over how strong this is. The Commission analysed the extent of this tension, and whether the level of competition between FTA and pay-TV broadcasters is sufficiently close to justify a single market for these two types of services.

Demand-side substitutability

76. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so.

77. The Commission received anecdotal evidence to suggest that the quality of programming on FTA channels can constrain the uptake of pay-TV subscriptions. For example, if an FTA broadcaster has a high-quality content on offer to viewers, there is less incentive for viewers to purchase, or switch to, pay-TV services. Nevertheless, this proposition is not supported by evidence. SKY has steadily increased its subscription base since it was first introduced, which may indicate that its subscriptions are not greatly affected by the FTA networks' programming and choice of channels.

78. Further, SKY stated that its current churn rate is at an all-time low of approximately 15% per year and compares favourably with other international pay-TV broadcasters. It advised that this low churn rate is due to the favourable economic status of its customers rather than its subscribers switching to the FTA alternative.

79. In the face of a SSNIP imposed by a pay-TV broadcaster, industry participants stated that any switching (or disconnection) would likely be the result of a value-added judgement by subscribers to the additional subscription charge. Industry participants advised the Commission that although some marginal SKY customers would switch (or disconnect) in the face of a 5% price increase, for

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[23] See *Decision 557: CanWest Radioworks / Radio FM Licenses in Northland, 31 August 2005* and *Decision 561: Fairfax New Zealand / Times Media Group, 14 October 2005*.

[24] SKY also advised that although there are some opportunities to screen advertisements on its existing channels, such as between programmes and during breaks in live sport broadcasts, any increase in advertising would alienate its subscribers and lead to greater churn.

the majority of customers there would be no substitute for pay-TV. Industry participants noted that this is particularly true for fans of live sport.

80. The Commission has also considered the likely components of the utility functions of viewers for both pay-TV and FTA television services. From a viewer's perspective, the demand for television broadcasting services is based on the utility received from the consumption of the service and the cost (or disutility if there are other non-price factors to be considered) it creates. The Commission's utility function analysis appears in the Appendix.

81. This analysis suggests that the relevant parameters for FTA broadcasting services and for pay-TV broadcasting services may be sufficiently different to suggest that the two services fall into different markets.

82. Given this and other evidence, the Commission is of the view that, from a demand-side perspective, FTA and pay-TV broadcasting services are unlikely to be in the same product market.

Supply-side substitutability

83. Close substitute products on the supply-side are those between which suppliers can shift production easily and in the short-run, when given a profit incentive to do so.

84. Industry participants stated that an existing pay-TV broadcaster contemplating switching to provide FTA services would need to make significant investment. A new FTA broadcaster would need to be able to attract mass audiences to be viable. SKY advised that it could enter the FTA market by unscrambling one of its existing UHF channels, but said that it would require considerable investment to enable it to reach a sufficient number of viewers. It noted that Prime had incurred substantial losses, in the order of $70 million, in establishing an FTA service.

85. The Commission also considered the likely components in the profit function of suppliers of pay-TV and FTA television services, to assess if there is a substantial difference in the profit function for each service. The Commission's profit function analysis appears in the Appendix.

86. Given these profit functions and the limited degree of substitutability, the Commission is of the view that, on the supply-side, FTA and pay-TV broadcasting services are unlikely to be in the same product market.

Conclusion on Pay-TV and FTA Television Broadcasting Services

87. The Commission considers that although there are similarities between FTA television broadcasting services and pay-TV broadcasting services, there are also a number of significant differences. These differences suggest that the scope for substitutability between FTA and pay-TV broadcasting, both on the demand and supply-side, may be limited.

88. Accordingly, for the purposes of the present Application, the Commission considers that there are separate product markets for pay-TV broadcasting services and for FTA television broadcasting services.

*Television Advertising Services*

89. Advertising revenue is essential for the operation of an FTA broadcasting service. By offering television services on one side of the platform and

attracting mass audiences, the television broadcaster is able to attract advertisers on the other side of the platform. It is the advertising revenues that cover the costs of the broadcasting service. This is particularly true for an FTA broadcaster.

90. On the demand-side, any advertiser contemplating switching from an FTA broadcaster to a pay-TV broadcaster would need to consider the ability of the broadcaster to reach potential consumers. FTA broadcasters offer mass audiences, whereas pay-TV audiences are diluted over a number of different channels.

91. In the face of a SSNIP imposed by an FTA broadcaster, industry participants stated that some advertisers could switch to SKY, but this is unlikely on a significant scale, due to the limited amount of advertising time available and the smaller audience. FTA advertising has the attraction of being able to access mass audiences.

92. Given the limited degree of substitutability between advertising services on the two types of television services, the Commission is of the view that FTA and pay-TV advertising services are unlikely to be in the same product market.

<u>Conclusion on Pay-TV and FTA Television Advertising Services</u>

93. The Commission considers that although there may be some degree of substitutability between FTA advertising services and pay-TV advertising services, this level of substitution is not sufficient to justify a single TV advertising market.

94. Accordingly, for the purposes of the present Application, the Commission considers that there are separate product markets for pay-TV advertising services and for FTA television advertising services.

**Programming Rights**

95. Industry participants advised the Commission that one of the key competitive factors for broadcasters is the purchasing of television programming, or content. Broadcasters then screen this content in order to attract viewers or subscribers. Broadly, television programming falls into two categories, general content and premium content.

96. General content is a term used to describe standard programming that has only a limited ability to attract viewers, and does little to drive a broadcaster’s market share. Industry participants did not have any concerns in regard to the purchasing of general content. Essentially, interested parties considered that a broadcaster airs general content to ‘fill in the gaps’ between screening the all-important premium content. Accordingly, the Commission does not intend to discuss general content further.

97. All industry participants agreed that the screening of premium content is what attracts audiences, and therefore advertisers or subscribers. Premium content is, typically, characterised by programmes that are screened in ‘prime-time’. No mainstream broadcaster could survive long term without access to premium content.

98. Industry participants advised that, in New Zealand, premium content falls into three distinct categories:

- live sport, with the most in demand sports being international and domestic rugby, rugby league and cricket;
- blockbuster movies, which are typically purchased from the main Hollywood studios after their theatrical release; and
- first-run television series, such as comedy or drama series. Current examples of premium series include ‘Desperate Housewives’, the ‘CSI’ series or traditional favourites such as Coronation Street.

99. The degree of substitutability between the different categories of premium content is unclear. All broadcasters purchase a range of premium content although the mix differs between each broadcaster. For instance, pay-TV broadcasters have typically focused on live sport, FTA broadcasters have focused on first-run series, while both types of broadcasters purchase a range of movie titles. However, on the supply-side, the rights holders and content suppliers are typically different for each of the categories listed above[25].

100. While acknowledging that it may be possible to consider that all the types of premium content are substitutable for one another, the Commission has, as a starting point, considered each of the categories listed above separately. As such, if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

101. Accordingly, the Commission has considered each category separately and whether there is a distinction made based on whether the broadcaster is either an FTA operator or a pay-TV operator.

*Premium content – Live Sport*

102. Industry participants stated that the nature of live sport, such as its uniqueness or its unpredictability, sets it apart from other programming such that a premium is charged for the rights to live sporting events. By screening the event in a delayed format or in an edited form, the uniqueness (and therefore its value) is reduced as the outcome of the event may already be known to the viewer.

103. The Commission understands that broadcasters acquire ‘rights’ to particular live sporting events from the sports governing body, or an associated organisation[26]. Typically, these rights are sold to the highest bidder.

104. Although the Commission is aware that some rights holders may, at their discretion, sell separate pay-TV and FTA rights[27], industry participants advised the Commission this is the exception rather than the rule. Also, pay-TV and FTA broadcasters have at certain times partnered together and submitted joint bids to rights holders. Again, the Commission considers this to be an exception.

105. Some other countries, such as Australia, have anti-siphoning legislation, which requires certain culturally significant sporting events to be broadcast on an FTA network. However, anti-siphoning legislation does not exist in New Zealand.

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[25] The Commission notes that some movie studios also supply first-run television series

[26] The Commission notes that some rights are obtained from third parties, such as brokers, who wholesale rights to particular countries.

[27] For example, the Applicant advised that, recently, both Prime and SKY had co-rights to Wimbledon tennis where Prime had the live FTA rights and Sky had the live pay-TV rights.

106. During the course of its investigation, the Commission received submissions stating that any purchasing markets should include the acquisition of delayed rights. For example, SKY has historically sold the rights to replay certain sporting events to FTA broadcasters.

107. However, the Commission notes that there is no obligation or requirement for SKY to sub-license, or on-sell, any of the rights it has acquired to a third party. For example, SKY has acquired the rights to broadcast all international and domestic rugby in New Zealand through its contract with SANZAR[28]. The Commission understands that SKY makes the commercial decision to on-sell some of its content to an FTA broadcaster. The FTA broadcaster has then broadcast certain games in a delayed format.

108. SKY has also negotiated certain deals with FTA broadcasters for other sporting events that it has acquired the rights for, such as international cricket and rugby league. However, the Commission understands that no broadcaster, regardless of its status as either a pay-TV or an FTA broadcaster, is restricted in its ability to bid for any live sport rights. Other notable sporting events have been acquired by an FTA broadcaster. For example, CanWest has acquired the rights to the next Rugby World Cup and TVNZ has the rights to live international and domestic netball.

109. Although some industry participants considered it relevant to distinguish between the acquisition of live sporting rights by pay-TV and FTA broadcasters, the Commission understands that typically rights are sold to the purchaser/broadcaster with the highest bid, regardless of whether the purchaser is an FTA or a pay-TV operator.

110. Accordingly, the Commission considers there is no distinction between the acquisition of live sport content rights by FTA and pay-TV broadcasters.

111. Therefore, the Commission is of the view that for the purposes of the present application there is a product market for the acquisition of live sport rights by television broadcasters.

*Premium content – 'Blockbuster' movies*

112. Premium movies are those movies initially released in cinemas before making their way onto the 'small screen' of television[29].

113. Movie studios typically release their movies under 'windows' or 'pay-periods' that aim to maximise the revenue from any one particular movie. As movies move through each window, a new set of purchasers become available. The sequence is set out in Table 1 below:

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[28] South African New Zealand Australia Rugby (SANZAR) is the administrative body that represents professional rugby in all three member countries.

[29] The Commission understands that, due to New Zealand's smaller size, not every movie released overseas is released into cinemas here although they may be released under other windows.

**Table 1: Timeframes for the Release of Movies**

| Succession | 'Window' | Average Length |
|---|---|---|
| 1st | Theatre | 3 months |
| 2nd | DVD/video sales/rental | 6 months |
| 3rd | Pay-per-view | 3 months |
| 4th | pay-TV | 12 months |
| 5th | FTA | 5+ years |

Source: Industry participants

114. The Commission understands that the "windows format" is a standard industry practice. By offering separate rights for each of these windows, the movie studios can accumulate revenue throughout a movie's 'life cycle' without sacrificing revenue from neighbouring windows.

115. Generally, SKY is the only purchaser of premium movies in the 'pay-per-view' and 'pay-TV' windows. TVNZ, CanWest and Prime are the purchasers of premium movies in the 'FTA' window. Although the Commission is aware of certain instances where FTA broadcasters have purchased sole rights (for both pay-TV and FTA) to movies, these are typically for individual movies, or one-off deals, which fall outside the main studio deals.

116. The Commission understands that the length of time a movie remains in each particular window (as described in Table 1) is negotiable. However, the length in each window affects the purchase price. Typically, the earlier a movie is released from an existing window, the higher the purchase price for the new window. Further, the windows themselves are a product of technology developments. For example, the 'pay-per-view' window is a result of the increase in functionality of SKY's satellite service.

117. The current application involves the acquisition of movie rights sold to television broadcasters. The relevant windows are therefore:

- the pay-TV window[30]; and
- the FTA window.

118. The Commission considers that due to the window system, imposed by movie studios and producers, each window falls into separate product markets. A purchaser of movie rights in one window, such as pay-TV, cannot then screen those movies in another window, such as on FTA television.

119. The Commission is of the view that for the purposes of the present application the relevant product markets are:

- the acquisition of premium movies by pay-TV broadcasters; and
- the acquisition of premium movies by FTA broadcasters.

[30] The Commission notes that as SKY is the only purchaser of both 'pay-per-view' and 'Pay-TV' windows, it is appropriate, for the purposes of the present application, to combine these two windows into one pay television market.

*Premium rights – First-run television series*

120. Premium first-run television series are included in the output deals that broadcasters acquire from the main television studios. These studios include Disney, Warner Bros., and Twentieth Century Fox.

121. These output deals relate to first-run series and subsequent reruns. Typically, these deals are an ‘all-or-nothing’ scenario whereby a broadcaster is not able to cherry-pick the best shows without having to purchase the remaining shows in a studio’s portfolio. Output deals are generally for between two to five years and may include rights of renewal, although it is not uncommon for studios to switch between networks[31].

122. Industry participants advised the Commission that some broadcasters will negotiate ‘right of series’ deals with a studio such that the broadcaster would retain rights to a particular series, for its lifetime, even if the broadcaster no longer has an output deal with that studio. In this scenario, the broadcaster would typically pay a premium for these rights.

123. Industry participants stated that there is a preference by the studios to maximise exposure for their programmes and this is achieved by selling to the mass audience delivered by FTA broadcasters. Further, a television show’s length and design are geared around the advertising breaks of the FTA broadcasters. In this regard, first-run-series have almost exclusively been shown by the three national FTA broadcasters, TVNZ, CanWest and Prime[32].

124. Typically, an FTA broadcaster values the rights to first-run series higher than a pay-TV broadcaster, because of the value of advertising these series attract. As a result, FTA broadcasters are willing to pay more than pay-TV broadcasters for the same rights.

125. The Applicant advised the Commission that the drivers for subscriptions in New Zealand are live sport and premium movies, and that it could not justify paying the price that an FTA broadcaster is prepared to pay for one of the main output deals. This is because it could not recoup the purchase price for the series through selling advertising. SKY stated that it has previously bid for a number of television series, but it has been consistently outbid by the existing FTA broadcasters. Further, industry participants advised that the television series acquired by SKY are typically series for which FTA broadcasters have declined to purchase.

126. The Commission understands that, although historically the rights to first-run television series have been held by FTA broadcasters, there is nothing to stop pay-TV purchasers from bidding for these rights. Each purchaser makes an assessment of the value of these rights and the rights are typically sold to the highest bidder. Accordingly, the Commission considers there is no distinction between first-run series television rights for FTA television and pay-TV.

127. The Commission is of the view that, for the purposes of the present application, there is a market for the acquisition of first-run television series.

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[31] For example, two years ago, TVNZ acquired the output deal with Disney, which had previously been held by CanWest.

[32] The Commission understands that, in overseas markets, it is not uncommon for first-run series to be aired by pay-TV broadcasters.

*Conclusions on Programming Rights*

128. The Commission has defined four separate product markets for the acquisition of premium content. For the acquisition of movies rights, the rights fall into distinct windows based on the status of the acquirer in the downstream market. However, for the acquisition of live sports rights and first-run series rights, the Commission has not made a similar distinction. For these rights, all broadcasters, whether a pay-TV or an FTA broadcaster, compete to acquire the same types of premium content in the upstream markets.

129. The Commission notes that some types of content are more important for FTA broadcasters while other types are essential for pay-TV broadcasters. Thus, the mix of programming shown in the downstream FTA and pay-TV markets tends to differ. In New Zealand, pay-TV focuses on sports, movies and special interest channels, while FTA has a wide-ranging programme menu, encompassing local programming, first run comedies and dramas, older movies, and more limited sports coverage. However, for the demand-side and supply-side reasons outlined above, the Commission considers that pay-TV and FTA broadcasters are in separate downstream markets.

130. Defining the appropriate market is not a precise science. Market definition provides a reference point from which the Commission can undertake a competition assessment. For the purposes of assessing whether or not to grant a clearance, the Commission will define a relevant market in a way that best assists the analysis of the competitive impact of a proposed acquisition[33].

131. All mainstream broadcasters acquire premium content although some broadcasters considered that certain content is more important than other types. In this regard, the Commission notes that it may be possible to define a single market for premium content. However, the Commission has not undertaken a full analysis of the degree of substitutability between the different types of premium content.

132. In the circumstances, the Commission has taken a conservative approach and adopted narrower markets for the four main types of premium content. The Commission does not consider that its conclusions on the competition effects of the proposed Acquisition would be any different under a single premium content market as those conclusions outlined below in regard to the four acquisition markets defined by the Commission.

## Conclusions on Product Markets

133. The Commission concludes for the purposes of assessing the competition implications of the proposed acquisition the appropriate product markets are:

- pay-TV broadcasting services;
- FTA television broadcasting services;
- pay-TV advertising services;
- FTA television advertising services;

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[33] Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association*, above note 10; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 {reversed on other grounds}.

- the acquisition of live sport television rights;
- the acquisition of premium movie television rights by FTA broadcasters;
- the acquisition of premium movie television rights by pay-TV broadcasters; and
- the acquisition of first-run television series rights.

**Functional Markets**

134. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

135. With regard to pay-TV and FTA television broadcasting services, all broadcasters supply their services to viewers (these are 'subscribers' in the context of pay-TV services), who are the end consumers. With regard to pay-TV and FTA television advertising services, all broadcasters supply their services to advertisers, who are the end-customers. Accordingly, the Commission considers the relevant functional level for these four product markets to be the retail level.

136. With regard to the television rights for live sport, premium movies for pay-TV, premium movies for FTA television and first-run television series, broadcasters purchase these rights from content providers. Broadcasters then package these rights into a format to be televised on their own channels or services. Accordingly, the Commission considers the relevant functional level for these four product markets to be the wholesale acquisition level.

**Geographic Markets**

137. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

138. Content rights are purchased for exclusive broadcast in New Zealand. Further, the majority of broadcasters provide a national service[34]. Accordingly, the Commission considers that the geographic market is national for all of the relevant markets.

**Conclusion on Market Definition**

139. The Commission concludes that for the purposes of assessing the competition implications of the proposed acquisition, the relevant markets are national markets for:

- retail pay-television broadcasting services (the Pay-TV Broadcasting Market);
- retail FTA television broadcasting services (the FTA Broadcasting Market);
- pay-TV advertising services (the Pay-TV Advertising Market);

[34] There are some small regional operators who broadcast to a given region (e.g. Dunedin).

- FTA television advertising services (the FTA Advertising Market);
- the wholesale acquisition of live sport rights (the Sports Rights Market);
- the wholesale acquisition of movie rights for pay television (the Pay-TV Movies Market);
- the wholesale acquisition of movie rights for FTA television (the FTA Television Movies Market); and
- the wholesale acquisition of first-run television series rights (the First-run Series Market).

## COUNTERFACTUAL AND FACTUAL

140. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).[35] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

### Factual

141. In the factual scenario, the Applicant submitted that Prime would continue to operate as an FTA broadcaster. The acquisition of an FTA network would allow it to diversify its revenue base, and provide it with greater advertising revenue.

142. The Applicant submitted that it could improve the value of its overall business by providing both a pay-TV service and an FTA service. While SKY is primarily focused on growing its subscription base, it stated that overseas evidence has shown that FTA broadcasting is sustainable, regardless of the number of households with access to pay-TV. In this regard, SKY considered that ownership of an FTA channel would not lead to cannibalisation of its pay-TV business.

143. Further, SKY submitted that its rationale for the acquisition is:

- to compete more effectively with FTA broadcasters for studio output deals for first-run television series. SKY considers it would be able to recover, through the advertising revenues from Prime, any investment it would make in acquiring a studio output deal;
- [

  ]; and
- [

[35] *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No 6),* unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

].

144. Further, the Applicant submitted that there would be a number of other benefits created by the acquisition, which would include operational savings, programming synergies and increased "tune-in" benefits that SKY programming could bring to Prime.

145. The Commission considers that in the factual, SKY would attempt to increase the value of Prime as an FTA channel, as well as using Prime as a vehicle to enhance SKY's current business.

146. Accordingly, the Commission considers that, in the factual scenario, the combined entity would continue to operate Prime as an FTA broadcaster.

**Counterfactual**

147. The Applicant submitted a number of likely counterfactual scenarios, namely:

- the status quo, with Prime continuing to operate as an FTA broadcaster. However, the Applicant noted that [ ]; or
- the purchase of Prime by an existing competitor in the FTA market, namely TVNZ or CanWest; or
- the purchase of Prime by an overseas acquirer.

148. Prime submitted that it has consistently been a loss-making operation in New Zealand and, absent the acquisition, it would continue to be severely inhibited in its ability to compete with other broadcasters to acquire premium content.

149. Further, Prime submitted that, until recently, it had an agreement with Channel Nine in Australia to provide Prime with subsidised programming, marketing and managerial support. This agreement has now been terminated[36]. Prime stated that [ ].

150. Nevertheless, Prime has [ ]. Accordingly, absent the proposed acquisition, Prime considered it would be unlikely to withdraw from the market [ ].

151. The Commission understands that [ ].

152. The Commission considers that although Prime has made losses since its entry into New Zealand, in the counterfactual it would continue to operate in the short-term, until such time as a suitable purchaser for the business was identified.

[36] Prime stated the termination was unrelated to the proposed acquisition.

153. Accordingly, the Commission considers that, in the counterfactual scenario, Prime would continue to operate as an FTA broadcaster, either as it is, or owned by another party not already competing in the affected markets.

## COMPETITION ANALYSIS

### Existing Competition

154. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

155. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

156. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of 40% share; or
- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

157. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

### The Pay-TV Advertising and the FTA Advertising Markets

158. As discussed in the market definition section above, the Commission considers that pay-TV and FTA advertising services fall into separate markets. Therefore, the proposed acquisition would not result in any aggregation in either the pay-TV advertising market or the FTA advertising market.

159. Accordingly, the Commission does not consider these markets further.

### The Pay-TV Broadcasting Market

160. Currently, the main operator in the pay-TV market is SKY. SKY has a combined total of 600,000 subscribers on its satellite and UHF platforms. This equates to approximately 40% of New Zealand households.

161. TelstraClear Limited (TelstraClear) is the only other operator in the pay-TV broadcasting market, launching a cable pay-TV service in the Wellington, Christchurch and Kapiti Coast regions. Industry participants advised the

Commission that TelstraClear exerts limited competitive constraint on SKY as its pay-TV services are typically sold in a package with other TelstraClear services, such as broadband internet. Further, the vast majority of the TelstraClear services are channels from the SKY portfolio, which TelstraClear has a contract to rebroadcast. Taking all of the above factors into account, the Commission does not consider TelstraClear to be a competitive constraint on SKY.

162. Prime does not operate in the pay-TV broadcasting market. Accordingly, the acquisition would not result in any aggregation in the provision of pay-TV broadcasting services.

163. However, as discussed in the market definition section, although pay-TV and FTA broadcasting services are in separate markets, the two services exert a degree of competitive constraint on one another. The Commission has analysed the extent to which the acquisition would lead to an increase in the market power of SKY in the pay-TV broadcasting market, by way of a lessening of the competitive constraint exerted on SKY by FTA broadcasters.

164. In opposition to the proposed acquisition, TVNZ submitted that there is a separate market for digital broadcasting services. However, as noted previously, the Commission does not consider it appropriate to distinguish between analogue and digital signals. Nevertheless, the Commission understands the significance of digital technology to the entire broadcasting industry and was advised by industry participants that, eventually, all existing analogue services will become obsolete and be replaced with digital services.

*Digital 'Roll-Out'*

165. All industry participants stated that New Zealand will follow other countries and have an FTA digital service introduced, or 'rolled-out', to replace the existing FTA analogue service. The Commission has analysed the extent to which SKY could delay or prevent such an FTA digital roll-out in order to strengthen its position in the pay-TV market, and to ward off any future competition that could be exerted from FTA broadcasters on SKY.

166. TVNZ submitted that the successful start-up of an FTA digital platform (in addition to SKY's platform) would allow FTA broadcasters to compete more aggressively with pay-TV, as they would be able to offer many more channels and a variety of other features, similar to that offered by pay-TV.

167. Currently, SKY is the only provider of a digital broadcast service, which is supplied through its satellite service[37]. All other broadcasters transmit an analogue terrestrial signal through bands on either the VHF or the UHF spectrums. This also includes SKY's analogue service.

168. Industry participants stated that digital is "the way of the future", and that it will offer significant benefits to the viewer, primarily through better picture quality and increased functionality, such as interactivity and more channels. TVNZ, SPADA[38] and MED stated that a digital FTA platform would increase the

[37] The Commission notes that, recently, TVNZ has introduced a satellite service, which it uses for its two existing channels. This service can be received with the purchase of a satellite dish and receiver.
[38] The Screen Production and Development Association of New Zealand (SPADA) represents local producers concerning independent screen production in New Zealand.

attractiveness of FTA television, and therefore could increase the competitive constraint exerted by FTA broadcasters on SKY.

169. The Commission considers that as SKY is currently the only provider of digital services, it may have the incentive to attempt to block the start-up of an alternative digital platform. Therefore, the Commission considered whether SKY would have the *ability*, as well as the incentive, to delay the introduction of an alternative digital service.

170. TVNZ submitted that, under the counterfactual, a grouping of all FTA broadcasters would advance plans to launch an FTA digital terrestrial platform. This grouping would then act as an important competitive constraint on SKY's existing digital service.

171. TVNZ considered that, in the factual scenario, this competitive constraint would be significantly weakened through SKY gaining control of a member of this FTA grouping. TVNZ suggested that SKY could influence the success of an alternative digital platform by:

- disrupting, delaying or otherwise influencing roll-out by continuing Prime's involvement with the platform; or
- by reducing the attractiveness of the platform through removing premium FTA content by withdrawing Prime from the platform.

172. However, TVNZ noted that although the combined entity would be unlikely to completely halt plans for a new digital platform, SKY could delay the launch or success of such a platform, which would allow SKY to cement its position as the major digital provider.

*Initiatives into Digital Broadcasting*

173. The Commission understands that digital broadcasting has been on the agenda for the industry for some time, and that the Government has fostered a number of initiatives[39].

174. For example, in 2003, the Government announced a way forward for digital television, involving further work by both the Government and the broadcasting industry. Jo Tyndall, Director, Digital Broadcasting Strategy, MCH, stated that it was the Government's view that further development of digital television services was likely to be best assisted if public and commercial broadcasters and related industry interests worked through a group to co-operatively resolve key issues, such as building a satisfactory business case for digital television. The Government also agreed in principle to spectrum allocation options for digital terrestrial television, and agreed to changes in the management of the spectrum used for satellite television, to increase the capacity available. Further, Jo Tyndall stated that the Government expected TVNZ, as the nation's public service broadcaster, to take the lead in the digital initiatives.

175. Currently, there are initiatives led by TVNZ, BCL and the MCH into plans for a digital terrestrial television (DTT) platform, which would eventually replace the

[39] See 'Broadcasting in New Zealand: A 2003 Stock-take' dated 21 November 2003, MCH, available at www.mch.govt.nz .

existing analogue network. TVNZ has also facilitated discussions through the New Zealand Television Broadcasters' Council (NZTBC)[40].

176. Both TVNZ and BCL recently submitted plans to the Government regarding digital TV initiatives. BCL submitted a business plan for the transmission of a new digital terrestrial platform. TVNZ submitted a 'costed strategic plan' to the Government, which set out two options for the advent of FTA digital TV:

- a satellite service; or
- a DTT service.

177. Also, MCH recently commissioned a cost-benefit study into the launch of an FTA digital broadcasting service in New Zealand. This report is expected to be finalised in April this year[41]. MCH stated that it will make a recommendation on the most appropriate digital service to the Government based on the findings of this study. This recommendation will include a request for funding. MCH advised the Commission that this funding request would be critical to any future roll-out of an FTA digital service in New Zealand.

178. MCH considered that if appropriate funding was provided, a DTT service could be provided within six months with a critical mass of viewers reached after 18 months. Alternatively, an FTA satellite service could be introduced within a shorter period, although this would be a more expensive option. MCH and MED considered that TVNZ has a preference for the DTT option, as it would clearly differentiate an FTA digital service from SKY's pay TV digital service. However, broadcasters recognise that as it is prohibitively expensive to reach 100% coverage with DTT, especially in rural areas, a satellite service is still a real possibility.

179. Although there are a number of options still to be considered, industry participants advised the Commission that the DTT option is the most likely to be implemented. However, for DTT to be implemented, significant investment would be required from broadcasters and transmission service providers. In particular, this would require a simulcast[42] of both analogue and digital signals, for a period of time [43]. Further, viewers would be required to purchase a new set-top box to receive the digital signal.

180. Ian Hutchings, Senior Policy Analyst, Radio Spectrum Policy, MED considered that the main question regarding the future success of any digital roll-out would be "who would pay?" This is because any digital service would need additional benefits, thereby incurring additional costs, to encourage viewers to purchase a specific set-top box to receive the service. MED estimated that a DTT platform would require investment of over [ ] from TVNZ alone, and it was unsure whether the Government would be willing to cover all or part of this cost.

181. Jo Tyndall, MCH also stated that TVNZ's and BCL's business plans would be likely to face a number of hurdles before receiving government approval. This would be largely related to the level of investment required.

[40] NZTBC is an industry organisation representing the non-competitive interests of FTA broadcasters and includes TVNZ, CanWest and Prime.
[41] See 'Request for Proposal, National net economic benefits of a launch and transition to free-to-air digital television' MCH, 8 December 2005.
[42] Simultaneous broadcast over two or more different systems or channels.
[43] Essentially, a simulcast would double the cost of transmission.

*Implications of the Proposed Acquisition*

182. TVNZ stated that it was essential to have all FTA broadcasters involved in the establishment of an FTA digital platform as substantial investment would be required in programming, transmission, and promotion. In addition, it would be necessary to have all FTA broadcasters involved to make the DTT package attractive enough for viewers to consider making the investment in a set-top box.

183. TVNZ submitted that the attractiveness of an FTA platform would be reduced if Prime's premium content was removed. However, this argument is premised on TVNZ's suggestion that the combined entity would be able to purchase all the available premium content. As discussed below, in relation to the upstream market for acquisition of premium content, the Commission considers that this strategy would be neither feasible nor rational.

184. The Commission notes that Prime is currently a small FTA broadcaster accounting for only a small proportion of television viewing, and is very much smaller than both TVNZ and CanWest. Both Prime and SKY stated that, in the factual, the imperative to improve Prime's financial position would compel SKY to participate in and contribute to a digital FTA platform. SKY submitted that it would have every incentive to support DTT, as this would involve the continuation of its existing analogue service, noting that MED has stated that any analogue-digital conversion would allow for all existing UHF frequencies as it is likely that the future uses of analogue signals would decrease.

185. MED advised the Commission that although TVNZ would be unlikely to make a digital investment by itself, a new digital platform would probably be successful if CanWest was involved. It considered that if TVNZ and CanWest were to establish a platform themselves, Prime and any other FTA broadcasters would be likely to follow at a later date. This situation would be similar to the uptake of the 'Freeview' digital FTA service in the United Kingdom[44].

186. Ian Hutchings, MED, stated that:

> SKY could attempt to influence the other FTA broadcasters but it would be unlikely to constrain any digital roll-out by TVNZ and CanWest. If the Government was keen on establishing a digital platform, which it is, the combined entity could not do anything to stop it.

187. Jo Tyndall, MCH stated that although Prime would add to the diversity of an FTA digital service, it would not be crucial to the service's development or success. Further, CanWest was initially cautious about any proposed DTT platform. It has become quite keen in recent months, although it has not yet made a formal commitment to a new DTT platform. [

].

188. Prime submitted that, in the counterfactual scenario, while it would wish to be carried on any potential digital platform, it considered it would only be able to offer as much as its financial constraint would allow. While it is supportive of the move to digital FTA television, and its parent in Australia has been involved with digital television, Prime's input in DTT discussions has been minimal and

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[44] 'Freeview' is a DTT service that provides up to 30 FTA channels. See www.freeview.co.nz .

it has not formally supported any specific proposal for DTT. In addition, any future financial commitment from Prime would be dependent on the specific proposal. Further, the Commission also understands that, since the announcement of the proposed acquisition, Prime has been excluded from discussions within the FTA grouping.

189. Both the MED and MCH consider that government support would be an important factor in the establishment of a DTT service, rather than the influence of Prime. Further, the Commission understands that the government is still considering its options and has not yet committed itself to any investment. Accordingly, the Commission does not consider that Prime is an essential participant in any proposed FTA digital platform.

190. Therefore, the Commission considers that the acquisition would be unlikely to have an effect on the success or otherwise of an alternative digital platform.

*Conclusion on the Pay-TV Broadcasting Market*

191. The Commission does not consider that the combined entity would have the ability to affect the establishment of an FTA digital service.

192. Accordingly, the Commission concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the market for the provision of retail pay-TV broadcasting services.

**The FTA Broadcasting Market**

193. The main competitors in the FTA broadcasting market are: TVNZ, with two channels; CanWest, with two channels; and Prime, with one channel. Other broadcasters in the market include the Maori Television Service and the Racing Board's TAB channel.

194. Table 2 shows the estimated market shares for broadcasters in the FTA broadcasting market, measured by audience share.

**Table 2: Audience Share by FTA Channel: All Viewers age 5+**

| Broadcaster | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|
| TVNZ | 70% | 69% | 67% | 65% |
| CanWest | 23% | 23% | 25% | 27% |
| Prime | 4% | 5% | 7% | 7% |
| Others | 3% | 3% | 1% | 1% |
| **Total** | **100%** | **100%** | **100%** | **100%** |

Source: AGB Nielsen Media Research, Commission estimates.

195. Table 2 indicates that TVNZ has the highest market share in the FTA broadcasting market, based on audience. TVNZ also has a significant market share if advertising revenue is used as the measurement. Since it was first launched in 1998, Prime's percentage market share has remained in the single figures. In this regard, industry participants advised that Prime has been unable to attract significant advertising revenue with which it could purchase more attractive content to entice viewers to switch from other FTA broadcasters.

196. Nevertheless, Prime had been making steady improvements to its market share. However, in attempting to further increase this market share, it made a number of programming acquisitions that have proven to be unsuccessful. Industry participants considered this was highlighted by Prime's purchase of 'The Holmes Show' from TVNZ. The ratings of this show have declined dramatically since the show switched broadcasters.

197. As previously indicated, SKY is not currently an FTA broadcaster. Accordingly, the acquisition does not result in any aggregation in the provision of retail FTA television broadcasting services.

198. However, the Commission has analysed whether the acquisition would have an effect in the upstream markets for the acquisition of rights to certain content. Industry participants stated that the acquisition of suitable content rights is essential for the success of a broadcaster. When analysing the upstream markets, the Commission has assessed:

- whether competition in any of the upstream markets would be lessened; and
- whether a lessening in competition in any of the upstream markets would, by vertical linkages, impact on the television broadcasting markets.

**The Sports Rights Market**

199. The main competitors in the market for sports rights are SKY, TVNZ, CanWest and Prime.

200. SKY advised the Commission that live sport is its main driver of subscriptions in New Zealand, and the cornerstone of its sports programming is rugby. SKY has held rights for professional rugby since its inception and recently renegotiated this agreement until 2010. Industry participants advised that the other leading sports in New Zealand are rugby league and cricket, which SKY also has the current rights to.

201. Currently, SKY spends approximately [ ] per annum on sports rights, which accounts for [ ] of SKY's total spending on all programming. This content is then broadcast on one of its four sporting channels. In comparison, Prime currently spends approximately [ ] per annum on all its programming.

202. All industry participants considered SKY to be the leading purchaser of sporting rights in New Zealand, with Prime only having a limited involvement in the purchase of premium sporting rights. The Commission notes that the sporting rights that Prime has acquired have typically been delayed packages which it has negotiated directly from SKY[45]. As stated in the market definition section, the Commission does not consider the purchase of delayed rights to be relevant to assessing the competition effects of the proposed acquisition.

203. Industry participants advised the Commission that TVNZ and CanWest have been the only significant competitors to SKY for sports rights, and have been successful in obtaining such rights. For example:

- Rugby Sevens – TVNZ has the rights to this series of international tournaments;

[45] Currently, Prime has delayed rights for rugby league and international cricket.

- Rugby World Cup – the Commission understands the CanWest outbid a joint bid from both SKY and TVNZ for the rights to the next Rugby World Cup. The rights to the previous tournament were held by TVNZ; and
- International and domestic netball – the Commission understands that TVNZ outbid SKY for these rights.

204. TVNZ also has the rights to a number of popular one-off events such as the America's Cup, the Olympics and the Commonwealth Games.

205. Apart from these examples, which tend to be one-off events, the majority of sports rights are currently held by SKY. However, given the limited involvement of Prime in the acquisition of sports rights, the Commission considers that, in comparison between the factual and counterfactual scenarios, the number of bidders for sports would remain the same. Therefore, the Commission considers there would be only a minimal effect on the sports rights market as a result of the proposed acquisition.

*Conclusions on the Sports Right Market*

206. The Commission is of the view that the proposed acquisition is unlikely to result in a substantial lessening of competition in the factual scenario compared to the counterfactual scenario, in the sports rights market.

**The Pay-TV and the FTA Television Movies Markets**

207. The Commission defined separate wholesale markets for the acquisition of movie rights for pay-TV and for FTA television.

208. Currently, the only operator in the pay-TV movies market is SKY. Prime does not purchase any movies in this market and therefore, the acquisition does not result in any aggregation in the pay-TV movies market.

209. The main competitors in the FTA television movies market are TVNZ and CanWest and, to a lesser extent, Prime. In the counterfactual, SKY is not a competitor and has no incentive to purchase content in the FTA television market as, typically, it has already acquired the rights to the same movies, albeit in the pay-TV movie window. Therefore, the acquisition does not result in any aggregation in the FTA television movies market.

210. However, TVNZ and SPADA raised concerns that the acquisition would allow SKY to use its position, as the only purchaser in the pay-TV movies market, to lessen competition in the FTA television movies market. In the factual, the combined entity would be the only purchaser interested in, and able to acquire, both sets of movie rights.

211. For example, TVNZ submitted that the acquisition of Prime would allow SKY to purchase both FTA television and pay-TV movie rights, as these rights are supplied by the same production studios. This ability to 'bundle' would place SKY at a competitive advantage and reduce competition in respect of all television movie rights. For instance, the combined entity could refuse to purchase certain content if it is not granted both sets of rights. Alternatively, if any other broadcaster purchased combined rights it would be forced to supply the pay-TV rights to SKY, as SKY is currently the only existing competitor in the pay-TV movies market.

212. The Commission notes that the supply of the content in both movie rights markets is controlled by the studios. The movie ‘windows’ are implemented by the studios to extract the maximum amount of revenue from each market. Industry participants advised that a studio would only sell ‘bundled’ rights to the combined entity if the purchase price exceeded the price it could receive by selling those rights separately.

213. [ ] Buena Vista International, Disney stated that while it may seem that SKY is in a bargaining position as the only New Zealand purchaser of pay-TV movies, producers such as itself are also in a strong bargaining position as they supply content that is valuable to television broadcasters. Further, it is essential for SKY to purchase popular blockbuster movies to maintain its movie channels and movie channel subscribers. Disney stated that movie producers are in a particularly strong bargaining position at times of year when they have produced ‘hot titles’ that are in high demand.

214. In this regard, the Commission considers the production studios would hold a degree of bargaining power in relation to any acquirer, such as the combined entity[46]. This relationship would be unaffected by the acquisition. Further, the Commission considers that certain movie rights are necessary for SKY as a pay-TV broadcaster, and it would be unlikely to be in a position to voluntarily foreclose the purchase of any movie rights.

215. While the Commission understands that the acquisition would give the combined entity a competitive advantage in comparison to the other competitors in the FTA television movies market, the Commission does not consider that this competitive advantage would result in SKY having market power in either the FTA television movies market or the pay-TV movies market.

216. Accordingly, given the countervailing power of the studios, the requirement for the combined entity to purchase ‘hot titles’ and the presence of existing competitors in the FTA television movies market, the Commission is satisfied that there is unlikely to be a substantial lessening of competition in either of the two purchasing markets for television movies.

*Conclusions on the Pay-TV and the FTA Television Movies Markets*

217. The Commission is of the view that the proposed acquisition is unlikely to result in a substantial lessening of competition in the factual scenario compared to the counterfactual scenario in the markets for:

- the wholesale acquisition of movie rights for FTA television; and
- the wholesale acquisition of movie rights for pay-TV television.

**The First-run Series Market**

218. The two main competitors in the first-run series market are TVNZ and CanWest, with Prime and SKY also competing for programming rights.

219. Typically, a broadcaster will align itself with a production studio, via an output deal, to provide it with sufficient television series to attract viewers. In New Zealand, broadcasters will generally negotiate deals with a number of studios,

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[46] The Commission notes that this was also the conclusion in the Telecom Decision.

which increases the range of programming at their disposal and increases their chances of acquiring the most ‘popular’ content.

220. Currently, TVNZ has negotiated deals with Disney, Warner Bros., and Granada. Although these are the most prominent deals, TVNZ also has a relationship with a number of other studios including Channel 4 in the United Kingdom and Southern Star in Australia. CanWest has negotiated deals with Twentieth Century Fox, Universal Studios and Alliance Atlantis.

221. Industry participants advised the Commission that a large proportion of the content in the first-run series market originates from the main North American studios. Industry participants stated that, historically, this is the only content that has consistently attracted audiences.

222. Accordingly, output deals with the large American studios such as Disney, Warner Bros., and Twentieth Century Fox are the most sought after by broadcasters. For example, industry participants advised that there is a wide amount of speculation about TVNZ’s existing deal with Disney as this contract is known to be the next major contract up for re-negotiation. CanWest previously held the Disney contract before it was acquired by TVNZ. [ ].

223. However, the Commission does not consider that competition in this market is limited to the most prominent American studios. Industry participants stated that premium content also comes from other smaller studios from the United Kingdom and Australia. In addition, an increasing proportion of local New Zealand content is becoming ‘premium’, highlighted by the success of television shows such as ‘Shortland Street’ and ‘Brotown’.

224. Prime does not have an output deal with a production studio equivalent to those of TVNZ and CanWest. Prime previously had a management agreement with the Channel Nine network in Australia, which provided a significant proportion of Prime’s programming. Prime stated that this resulted in the perception that the Prime channel had become ‘too Australian’ for New Zealand audiences. This management agreement has recently been withdrawn. Industry participants stated that other attempts to acquire premium content have been unsuccessful, noting the high purchase price of ‘The Holmes Show’ and the subsequent ratings decline for that show.

225. SKY currently purchases a number of television series although it does not have a specific output deal with a studio. SKY submitted that approximately 90% of the television series it purchases are ‘second-run’ products that have been previously aired on other television channels. For instance, SKY has acquired rights to several of the Alliance Atlantis shows that have previously been aired by CanWest. SKY stated that the remaining 10% are shows have been turned down by other broadcasters.

226. SKY advised that it has previously bid for a number of output deals with the main studios but has been unsuccessful in these acquisitions. SKY submitted that without the advertising revenue stream offered by a FTA channel it can not justify paying the equivalent price bid by the existing FTA broadcasters. However, post-acquisition, it would be in a better position to negotiate deals, which is one of the main rationales for the acquisition.

227. The Commission notes that the acquisition does not involve any of the first run series or output deals that industry participants consider important for broadcasters. In this regard, there is minimal aggregation as a result of the aggregation. However, the acquisition would reduce the number of potential bidders for output deals in the future and several industry participants raised concerns on the implications of the acquisition.

228. TVNZ submitted that, post-acquisition, the combined entity would be able to out-bid other broadcasters for television rights by paying more for the rights than their economic value. It argued that SKY would have the ability to do this because it could cross-subsidise any inflated purchase price through monopoly rents it generates in the pay-TV broadcasting market. TVNZ considers that the combined entity could out-bid the other FTA broadcasters on all output deals, to the extent that other FTA broadcasters could no longer acquire premium content, and therefore compete in the downstream FTA broadcasting market.

229. Although this strategy would be loss-making for the combined entity in the short term, TVNZ considers that this over-bidding strategy is rational as it would weaken the existing competitors, resulting in them withdrawing from the market and therefore giving the combined entity the ability to recoup any losses through monopoly rents in the future.

230. However, the Commission considers that, as previously indicated, the first-run series market is not limited to the most prominent American output deals. There are many other types of premium first-run series available and SKY would not be able to purchase everything in the market.

231. Further, Disney stated that the combined entity could not purchase all the output deals and premium content in the market, for two reasons:

- money – it would not make economic sense as SKY would quickly become bankrupt; and
- timing – output deals are usually for a number of years and are renewed at different times. For example, the Commission understands that some existing output deals are not due for renewal until 2010.

232. Industry participants, including Prime itself, stated that Prime has lacked the financial ability to compete with TVNZ or CanWest for the acquisition of valuable output deals and first-run series. For example, [ ]. Industry participants advised the Commission that this is the primary reason for the inability of Prime to compete successfully with TVNZ and CanWest.

233. Post-acquisition, the Commission considers that Prime would be able to submit credible bids for output deals that have traditionally only been contestable by TVNZ and CanWest. Industry participants considered that the successful acquisition of an output deal with a major studio, such as one of the deals currently held by TVNZ or CanWest, would result in Prime becoming a stronger competitor in the FTA broadcasting market.

234. The Commission considers that, in the factual scenario, the combined entity is unlikely to have the ability to successfully adopt a predatory strategy by overbidding for all premium content, eliminating all other FTA broadcasters, and subsequently recouping its losses.

*Conclusions on the First-run Series Market*

235. The Commission is of the view that the proposed acquisition is unlikely to result in a substantial lessening of competition, in the factual scenario compared to the counterfactual scenario, in the first-run series market.

**Conclusions on the FTA Broadcasting Market**

236. As SKY is not currently an FTA broadcaster, the acquisition would not result in any aggregation in the provision of retail FTA television broadcasting services, or the downstream market. However, to consider the full implications of the acquisition, the Commission has also assessed the effect on competition in the wholesale acquisition markets, or upstream markets.

237. The Commission does not consider that the combined entity would be in a position to substantial lessening of competition in any of the four wholesale acquisition markets. Therefore, the combined entity could not leverage its position as a purchaser of content in the upstream markets, by vertical linkages, to impact the downstream broadcasting markets.

238. Accordingly, the Commission considers that the acquisition would not result in a substantial lessening of competition in the provision of retail FTA television broadcasting services.

## OVERALL CONCLUSION

239. The proposed acquisition would not result in any aggregation in the FTA advertising market or the pay-TV advertising market. In addition, the acquisition would not result in any aggregation in the FTA broadcasting market or the pay-TV broadcasting market.

240. However, when assessing the pay-TV broadcasting market, the Commission considered the implications of the acquisition on the establishment of an alternative digital service to the one currently offered by SKY.

241. The Commission considers that, in the factual scenario, the combined entity would not have the ability to affect the establishment of an alternative digital service. Therefore, the Commission is of the view that the proposed acquisition is unlikely to result in a substantial lessening of competition in the pay-TV broadcasting market.

242. As SKY is not currently an FTA broadcaster, the proposed acquisition would not result in any aggregation in the FTA broadcasting market. However, to consider the full implications of the acquisition on this market, the Commission also assessed the effect on competition in the four wholesale acquisition markets and the potential downstream implications.

243. The Commission does not consider that the combined entity could successfully bundle content or adopt a predatory strategy to the detriment of other competitors. Accordingly, the Commission does not consider that the combined entity would be in a position to exercise market power, such that a substantial lessening of competition would result in any of the four upstream acquisition markets for premium content.

244. The Commission is of the view that, post-acquisition, the combined entity would be unlikely to be able to leverage its position as a purchaser of premium content

in either of the four upstream markets to substantially lessen competition in the downstream FTA broadcasting market.  Accordingly, the Commission considers that the proposed acquisition would not be likely to result in a substantial lessening of competition in the FTA broadcasting market.

245. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

**DETERMINATION ON NOTICE OF CLEARANCE**

246. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by SKY Network Television Limited of the various assets, rights and benefits comprising the television broadcasting business of Prime Television New Zealand Limited.

Dated this 8th day of February 2006

Paula Rebstock
Chair
Commerce Commission

## APPENDIX

### Demand side Functions

1. The Commission considers that a viewer's utility function for an FTA television service would look like:

$$U_F = u(T, I_F, D_F, P_F)$$

Where:

| | |
|---|---|
| $T$, $I_F$ and $D_F$ | = cost factors |
| $P_F$ | = benefit factor |
| $T$ | = cost of television set |
| $I_F$ | = initial set-up cost for an FTA television service |
| $D_F$ | = disutility (viewer's indirect cost) of advertising during the watching hours on FTA television |
| $P_F$ | = programming provided by an FTA broadcaster |

2. In contrast, the viewer's utility function for a pay-TV service would look like:

$$U_P = u(T, I_P, S_P, D_P, P_P)$$

Where:

| | |
|---|---|
| $T$, $I_P$, $S_P$ and $D_P$ | = cost factors |
| $P_P$ | = benefit factor |
| $T$ | = cost of television set |
| $I_P$ | = initial set-up cost for a pay-TV service |
| $S_P$ | = subscription-based monthly cost for a pay-TV service |
| $D_P$ | = disutility (viewer's indirect cost) of advertising during the watching hours on pay-TV |
| $P_P$ | = programming provided by a pay-TV broadcaster |

3. These two viewer's utility functions have different characteristics in respect of both the cost and benefit factors.

4. Parameter $T$ (cost of a television set) is a basic requirement for use of both types of service and it may not have to be included in the equations. Further, a television set is frequently used not only for television service but also for video and DVD screening as well as video and DVD games consumption, thus suggesting this cost factor is less important for the Commission's analysis of the relevant markets.

5. Parameters $I_F$ and $I_P$ (initial set-up cost for FTA and pay-TV service, respectively) appear to be distinct. The initial set-up cost for an FTA service is generally composed of an antenna and other accessories with possible installation costs. In contrast, the initial set-up cost for a pay-TV service is composed of a decoder, an antenna and other accessories acquisition with possible installation costs, as well as a joining fee.

6. Parameter $S_P$ (subscription-based monthly cost for a pay-TV service) is defined only in the utility function for a pay-TV service. This is a recurrent cost, the size of which is dependent on the choice of channels selected in a pay-TV package (e.g., the more channels selected equates to a higher subscription-based monthly cost).

7. Parameters $D_F$ and $D_P$ (disutility of advertising during the watching hours for FTA and pay-TV service, respectively) are valued separately due to the different volumes of advertising hours during the average television broadcasting in the two television services. The basic package for a pay-TV service includes all FTA channels and some pay-TV specific channels[47]. As a pay-TV viewer can switch from advertising-revenue-based FTA channels to subscription-revenue-based pay-TV channels, the disutility factor weighs less heavily in his/her utility function than it might be the case of an FTA viewer's utility function, where the choice is limited only to advertising-revenue-based FTA channels.
8. Parameters $P_F$ and $P_P$ (programming provided by FTA and pay-TV broadcasters, respectively) are defined separately. FTA broadcasters in New Zealand provide only a very limited number of channels[48] to viewers, while the existing pay-TV broadcaster offers more than 80 channels at any one time – the choice is far greater.
9. Further, there are also different programming characteristics between FTA and pay-TV. Typically, FTA broadcasters purchase programming that will attract a larger audience, which will in turn enable the broadcaster to generate advertising revenue. Pay-TV broadcasters purchase programming that will attract more subscribers who are willing to pay to get additional benefits of the programming.
10. Each broadcaster has characteristics specific to each service's business model and associated programming structure. For example, some types of content are more important for FTA broadcasters while other types are essential for pay-TV broadcasters. Therefore, the mix of programming between the two services tends to differ. Typically, pay-TV focuses on sports, movies and special interest channels, while FTA has a wide-ranging programme menu, encompassing local programming, first run comedies and dramas, older movies, and more limited sports coverage. This implies that the programming parameter could be valued separately in a viewer's utility functions for pay-TV and FTA services and therefore, that the programming parameters are distinct for the two viewer's utility functions.

**Supply side Functions**

11. The Commission considers that a broadcaster's profit function for an FTA television service would look like:

$$\Pi_F = R(A_F, G_F) - C(C_F, F_F)$$

Where:

| | |
|---|---|
| $R$ | = Revenue |
| $C$ | = Costs |
| $A_F$ and $G_F$ | = revenue factors |
| $C_F$ and $F_F$ | = cost factors |
| $A_F$ | = revenue from television advertising services, based on audience share |
| $G_F$ | = other revenues, such as Government funding |
| $C_F$ | = variable costs of purchasing content for FTA programming |

[47] For example, as of June 2005, SKY's basic "Start up" package offers more than 20 channels at the minimum price of $44.61 per month.
[48] There are currently five main national channels provide by three broadcasters.

$F_F$ = fixed costs of providing FTA services

12. In contrast, a broadcaster's profit function for pay-TV service would look like:

$$\Pi_P = R(I_P, S_P, A_P) - C(C_P, F_P)$$

Where:

$I_P$, $S_P$ and $A_P$ = revenue factors
$C_P$ and $F_P$ = cost factors
$I_P$ = initial set-up revenue for pay-TV services
$S_P$ = subscription-based monthly revenue for pay-TV services
$A_P$ = revenue from television advertising services, based on audience share
$C_P$ = variable costs of purchasing content for pay-TV programming
$F_P$ = fixed costs of providing pay-TV services

13. Parameter $I_P$ (initial set-up revenue for pay-TV service) is defined only in the profit function for pay-TV services. This is a one-off source of revenue, which is obtained from every new subscriber joining the pay-TV service. This revenue will reduce in importance as the household penetration increases.[49]

14. Parameter $S_P$ (subscription-based monthly revenue for pay-TV service) is defined only in the profit function for pay-TV service. This is a recurrent revenue which is dependent on the choice of channels selected in a pay-TV package (e.g., the more channels selected equates to a higher the subscription-based monthly cost).

15. Parameters $A_F$ and $A_P$ (revenue from television advertising service, based on audience share of respectively FTA and pay-TV channels) are different for the two types of broadcaster's profit function. This assumption is based on the fact that the two business models differ significantly, which is confirmed by the proportion of advertising revenue in a broadcaster's total revenue[50].

16. Parameter $G_F$ (other revenues) is defined only in the profit function for an FTA service. This revenue is associated with any local television production an FTA broadcaster through Government funding or subsidies. This revenue will actually reduce the level of variable costs in the FTA broadcaster's profit function ($C_F$).

17. Parameters $C_F$ and $C_P$ (variable costs of purchasing content for FTA and pay-TV programming, respectively) appear to be distinct. These costs are based on the acquisition of broadcasting rights for content produced externally and/or the financial participation in television content production. The Commission understands that FTA broadcasters typically finance New Zealand's local production although in many cases local production may be subsidised by the Government through 'NZ On Air' funding[51]. The Commission considers that these variable costs are significant and do not exist in the pay-TV broadcaster's budget line. Besides the local production variable costs, pay-TV and FTA

[49] Currently, the pay-TV service has been adopted by approximately 40% of New Zealand households.
[50] For 2005, average advertising revenue for three main FTA broadcasters (TVNZ, CanWest and Prime New Zealand) amounted to 84% of their total revenue while it amount to less than 8% of SKY's total revenue.
[51] For example, the local production subsidies totalled $60 million for 2005.

variable cost structures differ to a certain extent, in the acquisition cost of broadcasting rights. Film studios use ‘windows’ pricing structures to charge different prices to different buyers. It is common practice for film studios to charge more for the pay-TV window than for the FTA window, hence impacting on pay-TV and FTA broadcasters’ budget lines in a different way.

18. Parameters $F_F$ and $F_P$ (fixed costs of providing FTA and pay-TV services, respectively) are also distinct. The two services are based on different transmission technologies, terrestrial hertzian analogue transmission mode for all three main FTA broadcasters (TVNZ[52], CanWest and Prime) and satellite digital transmission mode for the pay-TV broadcaster (SKY[53]). The Commission also found significant differences in studio equipment costs booked under the fixed assets accounting line between the two types of broadcaster[54].

[52] Under property, plant and equipment section of company’s accounting line in TVNZ’s 2005 annual report, TVNZ booked the total cost value for the transmission equipment corresponding to 8.9% of the total cost in the section.

[53] Under fixed assets section of company’s accounting line in SKY’s 2005 annual report, SKY booked the total cost value for the satellite transponders, decoders and associated equipment corresponding to 46.4% of the total cost in the section.

[54] For the financial year 2005, the proportion of studio equipment costs in other fixed assets costs is 37.4% for TVNZ and 2.9% for SKY. These proportions suggest that the FTA broadcaster invests more in local television production than the pay-TV broadcaster does.