Cross-Submission by 2degrees in response to submissions on the Commerce Commission Letter of Unresolved Issues

VODAFONE EUROPE B.V. AND SKY NETWORK TELEVISION LIMITED

23 November 2016

PUBLIC VERSION

1. Introduction

1.1 In this cross-submission we comment on matters raised by the Applicants in their submissions on the Commission's Letter of Unresolved Issues (**LOUI**). We do not repeat our previous submissions, except to the extent relevant.

1.2 It is apparent from the public record that the Applicants are telling two different stories – one to SKY shareholders (the **Shareholder Version**) and the other to the Commission (the **Commission Version**).

1.3 The Shareholder Version describes Sky's "*strong lock on the key sporting rights that are significant drivers of subscription attraction*", as "*a key differentiating factor for the consumer"* which provides "*a critical competitive advantage*", and that "*merging the complementary capabilities of each company will be a winning strategy to meet consumers converging communications and viewing preferences."*[1]

1.4 Sky shareholders were told that:

(a) "*telecommunications companies have been increasingly seeking to bundle services in a single package*";

(b) "*these bundled offers have become a key plank in the strategies of both telecommunications companies and pay television operators*"; and that

(c) "*the transaction will allow the Combined Group to provide fully integrated bundled quad play and multi play services.*"[2]

1.5 Sky shareholders were also told that the factors listed above would deliver revenue synergies to the Combined Group of $435 million NPV.

1.6 The Commission Version, in contrast, claims that:

(d) Sky's premium content is not a "*must have"*;

(e) Rival TSPs do not see Sky content as critical (because only Vodafone currently resells SKY);

(f) Sky content has not led to an increase in broadband market share in the past and is unlikely to increase in importance as a driver of broadband uptake in the future; and

(g) Bundling of pay TV (particularly sport) with broadband is likely reaching saturation.

1.7 The question for the Commission is not which of the Applicants' two very different descriptions of the future state of the world (the Commission Version or the Shareholder Version) is correct, but simply, whether the Shareholder Version has a real and substantial prospect of occurring.

1.8 The Commission can take comfort that the Shareholder Version is a real and substantial prospect of the future state of the world, from Vodafone's submission on the LOUI, which refers to the legal obligations on the parties to ensure the accuracy and validity of the statements included in the investor materials.[3] Vodafone stressed that both Vodafone and SKY and their managers and directors face potential liability for any misstatement, and accordingly there is no credible basis to suggest the individuals involved would have made any misleading statements.

1.9 As a consequence, the Commission Version of the future state of the world must be disregarded, and given no weight.

---

[1] Sky Network Television Limited, *Notice of Meeting and Explanatory Memorandum* (June 2016) (**Explanatory Memorandum**).
[2] Grant Samuel & Associates Limited, *Independent Adviser's Report and Appraisal Report in relation to the Proposed Acquisition of Vodafone New Zealand Limited* (June 2016) (**Grant Samuel Report**).
[3] Vodafone, *Submission on Letter of Unresolved Issues* (11 November 2016) (**Vodafone Submission**) at 17.4.

2. Vodafone's submission on the LOUI

The test for clearance

2.1 We agree with the statement of the Court of Appeal in *Commerce Commission v Woolworths Limited,* cited by Vodafone,[4] that the evidential threshold the Applicants face is the balance of probabilities. The Court said:[5]

> *It is common ground that the standard of proof in this context is on the balance of probabilities. A hypothesis is established on the balance of probabilities if it is more likely than not to be true. …If the Commission is in doubt, it should decline clearance…the existence of a 'doubt' corresponds to a failure to exclude a real chance of a substantial lessening of competition.*

2.2 Vodafone states[6], again citing *Woolworths*, that there is always uncertainty in predicting the future states of the world, and that these future states "*must not be speculative, they must be evidence based and amount to a real and substantial prospect*".

2.3 While we agree with this statement, we think it is helpful to set out the full passage from the Court of Appeal decision which Vodafone cites:[7]

> *We regard the key question on this aspect of the case as whether there is a real and substantial prospect that the Extra concept will succeed to the extent that The Warehouse is prepared to roll out more stores. This question can, in the end, only be answered as a matter of impression. Further, given the nature of the clearance process, it has always been for Woolworths and Foodstuffs to establish that there is no such real and substantial prospect.*

2.4 The Court of Appeal decision in *Woolworths* is particularly relevant because the merger applicant in that case (like the Applicants in this case), adopted a backward-looking approach to defining the counterfactual, on the basis of "*what has happened following entry, and what can be inferred from that.*"[8]

2.5 The Court of Appeal rejected this backward-looking approach, because it resulted in "*overlooking what we consider to be a real prospect of substantial competitive constraint imposed by Extra stores in one or more of the local markets in which they now operate.*"[9] In doing so, the Court had regard to market developments overseas:[10]

> *We see the foreclosure of the one-stop shop innovation before it has had a chance to prove itself a matter of concern, especially as the concept is the only realistic source of ongoing competition to Woolworths and Foodstuffs in the near future. While the competitive effect of supercentres in New Zealand markets will likely be at a considerably lower level than in the United States for the reasons outlined above, we believe there is a real chance that the concept will succeed, as it has in many other countries.*

2.6 The Court of Appeal made it clear that the competition analysis must be forward-looking, and what had happened in the past does not establish what is likely to occur in the future:[11]

> *The High Court concluded that the emergence of the Extra stores had not had a material impact on competition in the period up until October 2007. We do not differ from that assessment. But the absence of a material impact on competition associated with Extra up to 21 October 2007 does not establish such impact is not likely.*

---

[4] Vodafone Submission, above n 3 at 2.1.
[5] *Commerce Commission v Woolworths Limited* [2008] NZCA 276 at [97] and [98].
[6] Vodafone Submission, above n 3 at 2.2.
[7] *Commerce Commission v Woolworths Limited* [2008] NZCA 276 at [135].
[8] At [207(b)].
[9] At [207(b)].
[10] At [205].
[11] At [198].

2.7 Vodafone then submits[12] that "*the evidence on the record strongly contradicts the theories of harm being tested by the Commission.*"

2.8 To the contrary, we submit that the evidence before the Commission (including the statements of the Applicants in the Explanatory Memorandum, overseas developments (including Vodafone's actions and statements in overseas jurisdictions), and the Covec Reports) clearly demonstrates a real and substantial prospect that the competition concerns identified by the Commission in the LOUI are well-founded.

2.9 It is well settled that "*likely*" does not mean more likely than not. It must be more than a mere possibility, but it can be less than a probability of 50%. Likely means a real risk, a substantial risk, or something that might well happen.[13]

2.10 The Applicants have not discharged the evidential burden on them to establish, on the balance of probabilities, that the Proposed Transaction is not likely to substantially lessen competition in the relevant telecommunications markets.

The factual

2.11 Vodafone's description of the factual includes the proposition that the Merged Entity will make Sky services available for resale or retransmission "*on terms that allow rival RSPs to compete with the Merged Entity*".[14]

2.12 As we discuss in more detail below (at 2.22 -2.24, and 3.3 – 3.8) the Merged Entity intends to continue to charge ECPR prices to TSPs (and impose contractual restrictions on bundling and third party content), while self-supplying content to its telecommunications business on more favourable terms. As a consequence, there is no likelihood that rival RSPs will be able to compete with the Merged Entity.

The counterfactual

2.13 Vodafone agrees that the Commission's "status quo" counterfactual is "*a reasonable basis against which to assess the competitive effects of the proposed transaction*".[15]

2.14 We disagree for the reasons set out in our submissions to date (including what is set out in the Explanatory Memorandum), the Covec Reports, and the reasoning of the Court of Appeal in *Woolworths* set out above.

2.15 The best description of what Sky is likely to do if the transaction does not proceed is set out in the Explanatory Memorandum: SKY will:[16]

> *continue to …focus on its current businesses and investments and implement its strategy as previously announced* ***but may also consider alternative strategies to achieve some or all of the anticipated benefits of the Proposed Transaction, including strategies to broaden content distribution or to participate in other distribution networks.***

The theory of harm

2.16 Vodafone submits that for the Commission's theory of harm to hold, five cumulative conditions must be meet, and explains at 5.2 of its submission why in its view **none** of these conditions are met.

[12] Vodafone Submission, above n 3 at 2.5.
[13] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 5 NZBLC 103,762 (HC) at 432, 103,779-103,780.
[14] Vodafone Submission, above n 3 at 3.3.
[15] At 4.1.
[16] Explanatory Memorandum, above n 1 at 25, emphasis added.

2.17 We submit that not all five conditions must be met for a substantial lessening of competition to be likely. Appendix 1 to this cross submission sets out our detailed responses to Vodafone's claims about the Commission's theory of harm. In summary:

(a) All objective evidence points to the existence of Sky's substantial market power in premium sports content;

(b) The merged entity would not have to increase the price it offers for standalone Sky in order to drive uptake of its bundled offers;

(c) TSPs will not be able to match the merged entity's triple and quad play bundles because the restrictive ECPR + key commitments wholesale terms available to TSPs would be significantly less favourable than the internal transfer price available to the merged entity;

(d) Rival TSPs will lose scale as a consequence of their inability to match the merged entity's bundled offerings (if Vodafone truly believes that Sky content is not, and never will be, a significant driver of broadband uptake then why is it pursuing this merger?); and

(e) A loss of scale will raise rival TSPs' costs and significantly limit their ability to actually respond to competition (even if they are incentivised to do so).

The importance of Sky content

2.18 Vodafone submits that:

(a) SKY's premium content is not "*must have";*[17]

(b) rival TSPs do not see Sky content as critical (because only Vodafone resells SKY);[18]

(c) SKY content has not led to an increase in its broadband market share in the past and is unlikely to increase in importance as a driver of broadband uptake in the future;[19] and

(d) bundling of pay TV (particularly sport) with broadband is likely reaching saturation.[20]

2.19 As noted above, this Commission Version is completely at odds with the position described to Sky shareholders including:

- Sky's "*strong lock on the key sporting rights that are significant drivers of subscription attraction*",[21] as
- "*a key differentiating factor for the consumer",*[22] which provides
- "*a critical competitive advantage*",[23] and that
- "*merging the complementary capabilities of each company will be a winning strategy to meet consumers' converging communications and viewing preferences."*[24]

2.20 The statement to the Commission that bundled video and broadband packages are reaching saturation is at odds with the Shareholders Version, which is that

- "*telecommunications companies have been increasingly seeking to bundle services in a single package*";

[17] Vodafone Submission, above n 3 at 6.
[18] Vodafone Submission, above n 3 at 7.
[19] Vodafone Submission, above n 3 at 8.
[20] Vodafone Submission, above n 3 at 11.
[21] Explanatory Memorandum, above n 1 at 10.
[22] At 30.
[23] At 10.
[24] At 5.

- "*these bundled offers have become a key plank in the strategies of both telecommunications companies and pay television operators*",[25] and that
- "*the transaction will allow the Combined Group to provide fully integrated bundled quad play and multi play services.*"[26]

2.21 Substantial evidence demonstrating the critical importance of premium sports content to triple and quad play bundles in other jurisdictions has been provided in submissions by TSPs. This evidence is supported by numerous statements by Vodafone internationally, and, most importantly, by the statements in the investor materials. The weight of this evidence exceeds by a wide margin the "real and substantial" threshold which must be met.

Content in the mobile market

2.22 Vodafone submits that "*there is nothing to suggest that SKY content is going to become a valuable driver of mobile data consumption.*"[27]

2.23 This statement directly contradicts the Shareholder Version. Shareholders were told that there are "*significant opportunities for the Combined Group to generate additional revenue synergies through the monetisation of entertainment content on mobile devices.*"[28]

2.24 Moreover, as TVNZ explained in its submission on the LOUI, SKY wishes to prevent any of its sports video content being included in TVNZ's online news service, because "*the TVNZ programming is essentially a commercialised entertainment package that competes with Sky's own opportunities to exploit its footage*", and "*TVNZ appears to deliberately set out to compete with Sky's own programming*".[29]

2.25 The Shareholder Version clearly recognises the importance of SKY's lock on premium sports rights as a critical differentiator for both triple play and quad play bundles; SKY's court action to prevent its sports video content being shown as part of online news services simply reinforces this.

2.26 Vodafone's submission is also at odds with the considerable evidence internationally that video content, and in particular, coverage of premium sports, is the most valuable driver of mobile data consumption:

(a) "*Comcast Corp's NBCUniversal unit will air* ***live over 6,000 hours of competition on TVs and mobile devices*** *from the Rio Olympic Games and offer viewers up-to-the-minute technology to search and personalize content, Chief Executive Officer Brian Roberts said on Monday.*"[30]

(b) "*The cable and media giant will relay 1,500 hours of content on 11 of NBCUniversal's television networks such as Bravo and NBC****, in addition to 4,500 hours online on its NBC Sports Live Extra mobile app*** *and website, which will also be made available on in its X1 video service.*"[31]

(c) SportBusiness Group *Global Sports Media Consumption Report 2014* (US): Sports fan study 2014 – among fans that watch sports online, live streaming was the most popular – 38% of online sports fans watch live streaming in 2014, up from 33% in 2013. Among

---

[25] Grant Samuel Report, above n 2 at page 20.
[26] Grant Samuel Report, above n 2 at 9.1.
[27] Vodafone Submission, above n 3 at 15.1.
[28] Explanatory Memorandum, above n 1 at 16.
[29] TVNZ, *Submission on letter of unresolved issues* (11 November 2016) at 3.2.
[30] Malathi Nayak "Comcast to air over 6,000 hours of Olympics 2016 content" *Reuters* (online ed, Auckland, 16 May 2016) available at http://www.reuters.com/article/us-comcast-corp-olympics-idUSKCN0Y71TG.
[31] Ibid.

online sports users, **44% preferred apps to websites**, 39% preferred websites, and the remaining 17% used them equally.[32]

(d) "*NCAA March Madness Live, managed by Turner Sports, set all-time records with 80.7 million live video streams and 17.8 million hours of live video consumption during this year's NCAA Division I Men's Basketball Championship. This year's record-setting live video streams are up 17 percent over last year, with hours of live video consumption up 19 percent vs. 2014. Additionally, TV Everywhere usage soared during this year's tournament, recording double-digit year-over-year increases across Turner's websites* ***and apps*** *throughout the entire tournament.*"[33]

(e) "*More than one billion fans tuned in to watch the final of the 2014 FIFA World Cup Brazil™, with the competition reaching a global in-home television audience of 3.2 billion people, according to final figures from FIFA and Kantar Media*." "***An estimated 280 million people around the world watched matches online or on a mobile device, in a sign that more and more fans are embracing new technology for sports content****.*"[34]

2.27 In addition, Vodafone Ireland, which partners with Sky UK to offer a Sky Sports Mobile TV service on mobile phones,[35] has stressed the importance of access to sports events on mobile devices. According to Marcel de Groot, Consumer Director, Vodafone Ireland:[36]

> *Mobile phones are an intrinsic part of people's lives, like sport…. This exciting new partnership with Sky Sports means [customers] can now view their favourite sports as easily too.*

2.28 In our submission of 12 August 2016, in response to the Commission's Statement of Preliminary Issues, we provided an extract from a Mary Meeker Internet Trends presentation showing the future of premium live sports content across fixed broadband and 4G mobile devices. For convenience, we reproduce it below:

---

[32] SportBusiness Group *Global Sports Media Consumption Report 2014* (May 2014) available at http://sportsvideo.org/main/files/2014/06/2014-Know-the-Fan-Study_US.pdf.

[33] NCAA "NCAA March Madness Live sets record with more than 80 million streams during 2015 NCAA tournament" (7 April 2015) available at http://www.ncaa.com/news/ncaa/article/2015-04-07/ncaa-march-madness-live-sets-record-more-80-million-streams-during-2015.

[34] FIFA "2014 FIFA World Cup™ reached 3.2 billion viewers, one billion watched final" (press release, 16 December 2016) available at http://www.fifa.com/worldcup/news/y=2015/m=12/news=2014-fifa-world-cuptm-reached-3-2-billion-viewers-one-billion-watched--2745519.html.

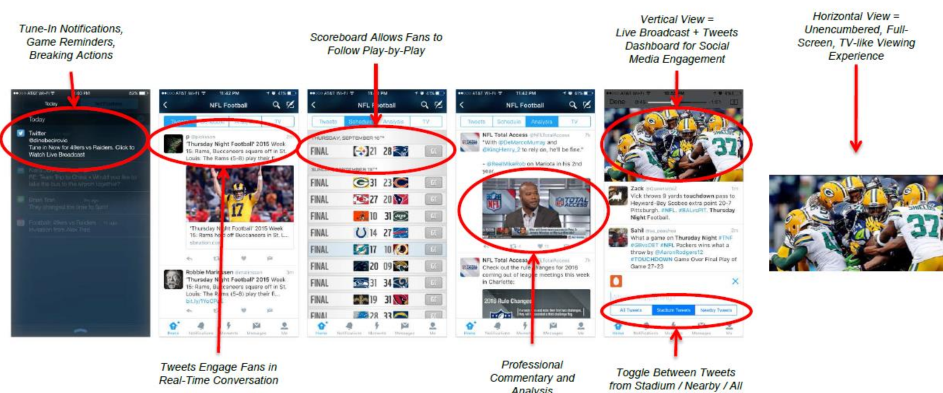
[35] https://www.vodafone.ie/red-connect/sky-sports/.

[36] "Vodafone Ireland announces new partnership with Sky Sports" (5 August 2014) available at http://irelandstechnologyblog.com/home/vodafone-ireland-announces-new-partnership-sky-sports/.

2016E = Milestone Year for 'Traditional' Live Streaming on Social Networks...
NFL Live Broadcast TV of Thursday Night Football on Twitter (Fall 2016)

Hypothetical Mock-Up

Complete Sports Viewing Platform =
Live Broadcast + Analysis + Scores + Replays + Notifications + Social Media Tools



@KPCB Source: KPCB Hypothetical Mock-Up. Design provided by Brian Tran (KPCB Edge) KPCB INTERNET TRENDS 2016 | PAGE 88

2.29 Importantly, 2degrees' negotiations with SKY described in Confidential Annexure 2 of our 12 August submission [

]

Wholesaling

2.30 Vodafone asserts that "*the Merged Entity will continue to wholesale Sky content in order to monetise content over the largest possible customer base. This cannot be achieved if terms are offered that do not, in fact, secure wholesale customers.*"[37]

2.31 Securing wholesale customers would require a dramatic change to the status quo. The evidence shows that in the past Sky's ECPR pricing has not secured wholesale customers – of the 90+ TSPs only one has chosen to take the service on that basis. TSPs who have submitted on this issue assert that ECPR pricing makes the offer uncommercial.

2.32 Faced with this lack of wholesale customer uptake over many years, SKY has not, however, chosen to change its offer to "*secure wholesale customers*", as Vodafone submits the Merged Entity would do. This is not surprising, because as NERA's summary of the Commission's *Investigation Report on SKY TV contracts* (2013) records, "*Sky calculates its wholesale price so that it is **indifferent** between whether a subscriber is a direct SKY customer or a customer via an RSP, which is the efficient component pricing rule (ECPR) approach*".[38]

2.33 [

]

2.34 Sky has previously submitted that the Merged Entity will not change that approach; the incentives to wholesale on an ECPR basis would be the same under the factual as they are currently (and would be under the counterfactual):[39]

> *That is, Sky will continue to offer wholesale access to its pay-TV services at Sky's retail price, minus avoided cost, including restrictions on bundling Sky's pay-TV services with*

[37] Vodafone Submission, above n 3 at 17.4.
[38] NERA, *Sky/Vodafone – review of economics reports* (11 September 2016) at footnote 20.
[39] Buddle Findlay, *Letter to Commerce Commission on behalf of SKY* (9 September 2016) at 23.

other pay-TV services, and restrictions on the acquisition of other content exclusive from Sky.

2.35 ECPR is by definition the maximum price a monopolist can charge for its services without risking a Commerce Act violation. Sky's stated intention to continue post-merger with ECPR pricing to TSPs while not imposing the same internal charge on its own TSP division will in and of itself have a foreclosing effect.

2.36 The critical issue is the terms on which the Merged Entity's pay television business unit supplies content to its telecommunications business unit. While the public documents are clear in relation to the price of supply to TSPs (ECPR), they have been silent on internal arrangements. If content is supplied between the Merged Entity's television and telecommunications business units at an internal transfer price that is less than ECPR, TSPs will not be able to compete effectively with the Merged Entity in telecommunications markets.

Scale – fixed broadband

2.37 Vodafone focuses on whether the Proposed Transaction will materially impact investment in fibre unbundling after 2020.

2.38 This is not relevant to the Commission's decision for a number of reasons:

(a) Access to unbundled layer 1 fibre in 2020 is one of the issues being considered as part of the current Telecommunications Act Review consultation process;

(b) If unbundled layer 1 fibre access were to be available, the terms on which it will be made available are unknown;

(c) It will be more than three years away, beyond the two to three years period relevant to the Commission's merger assessment; and

(d) The economics of fibre unbundling is in any event far different from the economics of copper unbundling (among other things the layer 2 cost proportion is far less with fibre than with copper).

2.39 As a consequence, any discussion on fibre unbundling in the context of the Proposed Transaction can be no more than speculative.

2.40 Vodafone also implies[40] that to establish a substantial lessening of competition, it is necessary to show the Merged Entity has "*the ability to drive competitors below the scale necessary to remain competitive in the longer term*."[41] This theme is continued by Vodafone's CEO: "*it's inconceivable that a strategy to bundle content and communications services could force players out of the market*".[42]

2.41 Vodafone overstates what is required to satisfy the substantial lessening of competition test. It is not necessary to show that the transaction will result in players being forced out of the market, or reduced in scale to such an extent they do not remain competitive in the long term.

2.42 As the Commission's Merger Guidelines state:[43]

> *A substantial lessening of competition may arise where foreclosure makes entry and expansion more difficult, or otherwise reduces a competitor's (or competitors') ability to provide a competitive constraint.* ***Foreclosure does not need to force a competitor, or competitors, to exit the market to have this effect.*** [emphasis added].

[40] Vodafone Submission, above n 3 at 17.7.
[41] Vodafone Submission, above n 3 at 17.1.
[42] Vodafone, *Response to letter of unresolved issues – letter from Russell Stanners, CEO Vodafone New Zealand* (11 November 2016) at 3.
[43] Commerce Commission, *Mergers and Acquisition Guidelines* (July 2013) at 5.10.

2.43 The Covec Reports previously provided to the Commission, and filed with this cross-submission, demonstrate there are ample grounds for concluding that the Proposed Transaction is likely to have the effect of substantially lessening competition in retail markets for fixed and mobile telecommunications services.

Scale – mobile broadband

2.44 Vodafone claims that the link between the Proposed Transaction and a potential reduction in 2degrees' scale is "*at best, remote*"[44], and that it is "…*incorrect to position 2degrees as a small player who may struggle to make investments because of its size or who is particularly sensitive to small shifts in market share".*[45]

2.45 Vodafone refers to an IDC report for which it has claimed confidentiality.[46] The basis for this claim is not clear. IDC is an analyst firm that produces reports on industry trends and market shares. Without the information being disclosed, we cannot provide views on whether or not the information is relevant, or subject to any limitations.

2.46 However, Vodafone's assertions in relation to scale ignore the fact that a "small shift" in the critical high ARPU customer segment can have a material impact compared to a small shift in low ARPU customers. This point is well made in the Covec Reports.

2.47 In addition, [

]

2.48 [

] The Covec Reports also explain the disproportionate impact of loss of scale on sub-scale operators.

2.49 Vodafone then states[47] that while "…*mobile network operators face high upfront fixed costs, variable costs are relatively low*", and "*fixed costs do not affect pricing incentives or on-going competitiveness*". This leads it to claim that "[*a]n operator that loses scale will have capacity and will have the incentive to offer this capacity to customers on favourable terms because serving incremental customers generates low additional variable costs, and therefore large positive profit contributions towards the fixed cost of the network.*"

2.50 It is correct that a mobile network requires a large upfront investment to build cell sites and the core network, but it also requires significant on-going capital investment in technology upgrades (for example 3G to 4G to 4.5G to 5G). While it is also correct that an operator will have an incentive to sell available capacity, including at the margin, this holds only if the operator can recover its full costs over time. If the operator has insufficient scale to cover all of its costs, it will not be able to invest in technology upgrades, and as a consequence will have further reduced ability to attract high ARPU customers in the future.

2.51 Vodafone refers to a 2degrees November 2016 investor presentation (this was in fact a "Trilogy International Partners: Investor Presentation"; Trilogy is an investor in 2degrees) and states that the presentation does not mention the Proposed Transaction as a risk to 2degrees' business[48]. The Trilogy presentation was prepared some weeks after the LOUI was published, and reflects the view that clearance for the Proposed Transaction will not be granted. The growth assumptions in the presentation similarly reflect the view that clearance will not be granted.

2.52 Vodafone then submits[49] that "…*while network investment and differentiation is one driver of competition, it is far from the only driver. A competitor which did not upgrade its network as*

[44] Vodafone Submission, above n 3 at 22.2.
[45] Vodafone Submission, above n 3 at 22.3.
[46] Vodafone Submission, above n 3 at 22.2.
[47] Vodafone Submission, above n 3 at 23.2.
[48] Vodafone Submission, above n 3 at 24.2(c).
[49] Vodafone Submission, above n 3 at 26.2(b).

quickly would simply respond by competing on other factors. Previous experience shows that this does not prevent strong competition."

2.53 Vodafone does not give details of this *"previous experience",* but 2degrees' experience has been to the contrary. [ ]

2.54 [ ]

2.55 [ ]

2.56 5G technology is expected to deliver new services including driverless cars, faster MBB and Internet of Things technology, and to enhance the delivery of content, particularly live sport and related products. 5G investment should therefore be viewed as interrelated, and contingent on quad play content bundles and high ARPU customers, not an uncertain and optional future technological development.

3. SKY submission on LOUI

The legal test

3.1 2degrees agrees with Sky that "*the Commerce Act is not directed at protecting any individual rival of the parties to the transaction.*"[50] However, the LOUI has correctly considered the impact of the Proposed Transaction on competition as a whole. The lessening of competition effects are clearly articulated in the Covec Reports.

3.2 Contrary to SKY's assertion,[51] and as we set out at 2.7 of our submission on the LOUI, the two criteria listed in *Bluescope Steel/Pacific Steel*[52] are met in this case. The evidence clearly establishes that:

[50] Sky, *Submission in response to letter of unresolved issues* (11 November 2016) at 10.
[51] At 12.

(a) there are no good, cost-effective alternatives to SKY's premium exclusive sports content; and

(b) competitors in telecommunications markets will be rendered less competitively effective as a consequence of SKY's "*strong lock on the key sporting rights.*"

Undermining standalone SKY would be too risky

3.3 SKY argues "*there is no real chance that the merged entity could pursue a strategy of making standalone SKY less attractive than purchasing SKY in a bundle from the merged entity so that enough SKY subscribers are driven to purchase the bundle to reduce the scale of rival telecommunications providers to the extent of preventing them from providing an effective competitive constraint*".[53]

3.4 SKY's submission cannot be reconciled with the evidence. The Applicants have stated on the public record that the Merged Entity intends to provide "*fully integrated bundled quad play and multi play services*", and "*create attractive packages for customers*".

Incentives to wholesale

3.5 2degrees agrees with SKY that "*if the merged entity offers wholesale terms that are priced so there is no possibility of rival telecommunications providers offering bundles that can compete with those offered by the merged entity, those potential wholesale partners will simply walk away.*"[54]

3.6 That is however exactly what has happened to date; Sky's ECPR pricing is so unattractive to TSPs that only one of more than 90+ TSPs has taken up the offer – the others have, in SKY's words, "*walked away.*"

3.7 This position will only worsen under the factual, as the merged entity has made clear it will continue to offer the same unattractive ECPR prices to TSPs (together with contractual restrictions on bundling and third party content) while providing content to its telecommunications business on more attractive terms, so that it is able to offer "*attractive packages for customers.*"

Differentiation

3.8 Sky refers to "*a number of different types of offerings in telecommunications markets that do not include Sky services.*"[55] With the sole exception of Spark's offer to its broadband customers of free subscriptions to Lightbox, none of the listed offers contains video content.

3.9 As the Applicants are aware, the relevant future competitive playing field is triple and quad play bundles and, by definition, triple and quad play bundles include a pay television element (i.e. video content). Accordingly, any current bundled offering that does not include video content is not relevant for the purposes of a forward-looking competition assessment of triple and quad play bundles.

3.10 Sky refers to NERA's report which points out that consumer preferences are not heterogeneous,[56] a fact which is both obvious and not disputed. Sky goes on to identify a multitude of bundled offerings currently in the market place that do not include video content as evidence of the fact that bundles that do not include Sky services have been, and would continue to be, an effective competition constraint on bundles supplied by the merged entity.

3.11 This is incorrect. As stated above, bundled offerings that do not contain video content are not relevant for the purposes of a competition assessment of triple and quad play bundles. Sky's

[52] *Bluescope Steel (NZ) Limited and Pacific Steel Group* [2014] NZCC 8.
[53] Sky, *Submission in response to letter of unresolved issues* (11 November 2016) at 17.
[54] Sky, *Submission in response to letter of unresolved issues* (11 November 2016) at 38.
[55] At 44.
[56] At 46(a).

lengthy description of the success of Trustpower's bundles of telecommunications services with electricity and gas[57] is a red herring.

3.12 Furthermore, as we noted in our cross submission of 6 October 2016, "*a high value customer would be unlikely to consider a bundled offer including a music streaming service or electricity as substitutable for a bundled offering including premium broadcast content"*.[58]

3.13 The relevant question is whether Sky's premium live sport content is highly valued for a significant group of customers within telecommunications markets such that any triple or quad play offering which did not include that content would not be a competitive proposition for those customers.

3.14 Sky's claim that any "extra" products developed by the merged entity (including sports replay, highlight and interview packages) would never be *"sufficiently popular or compelling to drive such material changes in consumer numbers as to result in a substantial lessening of competition"*[59] is surprising in the context of Sky's current copyright infringement litigation which shows that Sky obviously sees the value in offering sports content over mobile devices.

Fibre unbundling

3.15 SKY discusses, at length, the impact of the proposed transaction on fibre unbundling (which may be available from 1 January 2020), despite there being no reference to fibre unbundling in the LOUI.

3.16 We refer to our submission at 8 above in relation to similar submissions by Vodafone.

Content over mobile

3.17 Sky submits, as did Vodafone, that sports content consumed on mobile devices is not significant and that "*although consumer preferences are changing, those changes in preferences do not support a large increase in the consumption of live sports over mobile networks and devices*".[60]

3.18 As we discuss in section 6 above, the international evidence is clear that live sport content is as important to mobile broadband bundles as it is to fixed broadband.

[57] At 48 and 49.
[58] 2degrees, *Additional submission on Vodafone / Sky merger* (6 October 2016) at 3.23.
[59] Sky, *Submission in response to letter of unresolved issues* (11 November 2016) at 54.
[60] At 69.

APPENDIX 1

Vodafone states that the Commission's theory of harm is based on five cumulative conditions which are not met for the reasons set out in the table below (copied below from para 5.2 of Vodafone's submission). 2degrees responds to Vodafone's claims in the third column.

Element of Theory of Harm	Vodafone's response	2degrees' response
The merged entity has substantial market power in the supply of premium content, particularly live sports.	Whether the merged entity has SMP in content (which is denied) is not the relevant question. It is whether this content is a "must have" for TSPs to successfully compete, which it is not. Even if Sky content was a "must have", the majority of these rights are temporary and contestable when they come up for renewal within the next 4-5 years.	**Sky's market power in premium sports content** The question of whether Sky currently has (and the merged entity will have) substantial market power in premium live sports content is *highly relevant* in the context of its proposed vertical integration into telecommunications markets. All objective evidence points to the existence of Sky's market power. Sky holds the exclusive rights to *all* premium sports that are important to New Zealand viewers including rugby, rugby league, cricket and netball. Sky's own statements to its shareholders that Sky is "*the only pay television operator in New Zealand of any significance*"[61]*,* it "*has a strong lock on the key sporting rights that are significant drivers of subscriber attraction and retention*"[62] and that those sports rights, *"provide a critical competitive advantage"*[63] prove that the Applicants' repeated denials of the existence of market power to the Commission are completely disingenuous. Sky's ECPR pricing + restrictions wholesale terms are also compelling evidence of its market power. If the relevant market for inputs (premium content) were competitive, ECPR pricing would not survive. **Sky's monopolised premium sports content is a "must have" component of competitive triple/quad play bundles** The "must-have" nature of Sky's premium sports content has been fully explained in Covec's first and second reports. In summary: • while viewer preferences are undoubtedly not homogenous, for a

[61] Grant Samuel Report, above n 2 at 10.
[62] Ibid.
[63] Ibid.

		significant proportion of consumers in telecommunications markets, Sky's premium sport content is highly valuable or a "must-have"; and • in the relevant future competitive playing field of triple and quad play bundles *it is extremely important for competition that all RSPs have access to premium broadcast content on equivalent terms.* Sky's exclusive rights for premium live sports content endure until at least 2020 which is well beyond the relevant period for the Commission's competition assessment of the proposed merger. The fact that those rights may become contestable in 4-5 years' time is therefore irrelevant.
The merged entity will make buying premium content on a standalone basis comparatively less attractive for consumers than buying a bundle including such content from the merged entity.	Consumers are decreasingly attracted to Sky services due to the increase in OTT competitors. Increasing the price of standalone Sky products would cause a substantial loss of customers and revenue, not offset by any increase in comparatively low margin telecommunications customers and revenues in a highly competitive telecommunications market.	Vodafone has assumed that making standalone Sky products relatively less attractive to the merged entity's triple and quad play bundles could only occur by increasing the price of standalone Sky products. This is incorrect. The merged entity could continue to offer standalone Sky on the same basis that it does today while simultaneously making its triple and quad play bundles more attractive.
The merged entity will set wholesale terms for key content that would not allow rival TSPs to compete against the merged entity's bundle.	Such an approach would not be rational as it would sacrifice wholesale revenue, which would not be offset by any increase in broadband share or revenue. It would be tantamount to a decision not to wholesale which would be contrary to statements made in the	Vodafone conveniently ignores the critical point that all third party TSPs will be subject to restrictive wholesale terms while the merged entity's own TSP division will not be. Sky has repeatedly stated that its incentives (and its wholesale terms) would be the same under the factual, counterfactual and the status quo. In all possible scenarios Sky will *"continue to offer wholesale access to its pay-TV services at Sky's retail price minus avoided cost, including restrictions*

	investor materials.	*on bundling Sky's pay-TV services with other pay-TV services, and restrictions on the acquisition of other content exclusive from Sky.'*[64] These restrictive wholesale terms are clear evidence that Sky has been willing to sacrifice wholesale revenue (Vodafone is the only one of 90+ RSPs currently reselling Sky services) in order to preserve its monopoly rents in the retail pay-TV market. Sky's stated intention to continue ECPR pricing (a pricing construct only available to monopolists) if the merger proceeds demonstrates that not only has Sky been willing to sacrifice wholesale revenue in the past, it intends to continue to do so in the future. Vodafone's use of the words "*tantamount to a decision not to wholesale*" is surprising given that Sky currently wholesales to only one of a potential 90+ customers. The fact that only one, of a potential 90+, wholesale customers, has accepted Sky's terms is not evidence that the terms are commercial, and is more likely to indicate that Sky's wholesale terms are unduly restrictive. The statement in the Explanatory Memorandum to Sky shareholders that the merged entity will "*take advantage of growth opportunities in wholesale markets"* is entirely inconsistent with the Applicants' statements to the Commission that the merged entity will continue to adopt an ECPR + key commitments wholesale construct and that a genuine wholesaler counterfactual is fanciful.

[64] Buddle Findlay, *Letter to Commerce Commission on behalf of SKY* (9 September 2016) at 23.

The merged entity's behaviour will cause consumers to switch to its services to such an extent that one or more rival TSPs will lose scale in fixed broadband and/or mobile markets. That reduction in scale will have a meaningful impact on their ability to constrain the merged entity.	Sky content is not a significant driver of broadband uptake, even when substantially discounted. The link with mobile is even more remote. There is no bundled offer that the merged entity could rationally provide that would cause sufficient switching for its rivals to lose scale.	Two obvious questions arise here: • If Sky content is *not a significant driver of broadband uptake*, why has Vodafone opted to resell Sky services for the past 8 years; and more importantly • why is Vodafone now pursuing a merger with Sky (a content monopolist)? Vodafone's claims are entirely inconsistent with statements made in the Explanatory Memorandum to Sky shareholders including, *"the Combined Group will be able to cross-sell a much broader range of services across the Sky TV and Vodafone NZ subscriber bases,* ***reduce subscriber churn through bundled service offerings****…'*[65]
The merged entity subsequently increases prices / decreases quality such that an SLC in a market overall results	As a result of structural separation the broadband market is highly competitive with 90+ players. Even if rivals lost share this would not render them uncompetitive now or in the future. In the mobile market, any reduction in a rival's scale (which is even more remote) would not reduce competitive intensity given the three extensive networks that exist, each with low variable costs. Equally, a reduction in scale would not prevent future network investment such that an SLC would result.	The Applicants' repeated references to 90+ players in the broadband market must be qualified by acknowledging that the three largest market participants account for more than 90% of broadband connections (Spark with 48%, Vodafone with 29% and Vocus with 15%). As the Link Economics report correctly highlights: • the three firm concentration ratio for fixed broadband in NZ is 92%, compared with 69% in Australia and 74% in the UK; • this corresponds to a subscriber share HHI of > 3370, well above the 2,500 threshold usually denoting a highly concentrated market; • more than half of ISPs have fewer than 1000 subscribers. Vodafone's claim that '*any reduction in scale would increase available capacity*' and result in '*more aggressive market behaviour and more competition*' ignores the fact that for smaller competitors a loss of scale raises their costs and significantly limits their ability to actually respond to competition (even if they are incentivised to do so in order to get back down the average cost curve). This is why depriving competitors of scale is so effective.

[65] Grant Samuel Report, above n 2 at 10.1.