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# Statement of Preliminary Issues

## Vodafone Europe B.V. and Sky Network Television Limited

**14 July 2016**

## Introduction

1. On 29 June 2016 the Commerce Commission received applications for clearance concerning a proposed merger between Vodafone New Zealand Limited (Vodafone) and Sky Network Television Limited (Sky):[1]

   1.1 an application from Sky seeking clearance to acquire up to 100% of the assets and/or shares of Vodafone from Vodafone Europe B.V.; and

   1.2 a separate application from Vodafone Europe B.V. seeking clearance to acquire up to 51% of the shares in Sky.

2. While we have received two separate applications for clearance (for the two separate acquisitions), the Commission is considering the applications together.

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

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

5. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties wishing to make a submission do so by **Thursday 28 July 2016**.

## The parties

6. Vodafone Europe B.V. is a wholly owned subsidiary of Vodafone Group plc (a company listed on the UK stock exchange). Vodafone Europe B.V. is the current owner of Vodafone New Zealand Limited (Vodafone). Vodafone is a telecommunications company offering fixed and mobile telecommunications services in New Zealand, including fixed and mobile broadband internet to consumer and business customers. It is also a reseller of Sky services, where consumers are invoiced by Vodafone for the provision of a Sky decoder and Sky services.

[1] Public versions of the two applications are available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

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

7. Sky is listed on both the New Zealand and Australian stock exchanges. Sky's principal business is supplying pay-TV services (including news, sport, movies and general entertainment) to its subscriber base. It mainly offers it services via satellite but also has online services including: Sky Go (a service that enables satellite subscribers to view programming over the internet); Fan Pass (a service providing access to certain events on a pay-per-view basis); and Neon (a subscription video on-demand service).

## Our framework

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

9. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[4]

10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[5]

11. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:

    11.1 constraint from existing competitors – the degree to which existing competitors currently compete and the extent to which they would expand their sales if prices were increased;

    11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete effectively if prices were increased; and

    11.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by a buyer's ability to exert substantial influence on negotiations.[6]

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3 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

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

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

6 Countervailing power is more than a customer's ability to switch from buying products from the merged entity to buying products from a competitor. Similarly, a customer's size and commercial importance is not sufficient in itself to amount to countervailing power.

## Market definition

12. In their applications, Vodafone and Sky submitted that the key markets potentially affected by the proposed merger are:[7]

    12.1 the national retail market for the provision of residential fixed-line broadband services; and

    12.2 the national market for the retail provision of pay-TV services.

13. As part of our investigation, we will consider whether these are the only relevant product markets or whether there may be other affected markets (eg, markets for mobile broadband and/or fixed wireless services, markets for the purchase of the broadcasting rights to content). We will also consider whether there may be other affected functional markets (eg, a wholesale market for the provision of pay-TV services in which Sky wholesales its services to Vodafone and other parties).

14. In terms of the geographic dimension of the markets, we will also consider whether differences in the choices available to consumers mean that it may be appropriate to define narrower geographic markets (eg, in rural areas where broadband services are poorer or data caps are more restrictive such that internet-based pay-TV services may not be a viable alternative to Sky).

## Preliminary issues

15. We will investigate whether the proposed merger is likely to substantially lessen competition in the relevant markets by looking at the unilateral, vertical and conglomerate effects that might result from the merger. The questions that we will be focusing on are:

    15.1 unilateral effects: would the merged entity be able to raise prices or reduce quality by itself?

    15.2 vertical and conglomerate effects: would the merged entity be able to engage in behaviour that either forecloses rivals or otherwise renders them less able to compete?

16. The second of these issues will be the main focus of our investigation.

### Unilateral effects: would the merged entity be able to raise prices by itself?

17. A merger between competing suppliers can have the likely effect of substantially lessening competition through unilateral effects.[8]

18. Where two suppliers compete in the same market, a merger could remove a competitor that would otherwise provide a competitive constraint, allowing the merged entity to raise prices. A merger could also reduce competition if the target

[7] Vodafone Europe B.V. Clearance Application (29 June 2016) and Sky Network Television Limited Clearance Application (together, the Applications) at [6.1].

[8] Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at [3.61].

was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm, meaning higher prices compared to the scenario without the merger.

19. In their applications, Vodafone and Sky submitted that there is no meaningful competitive overlap between Vodafone and Sky currently.[9]

20. Although this appears to be the case, we will consider whether the parties would become more meaningful competitors without the merger. For example, we will consider whether, without the merger, Vodafone might start providing content on a stand-alone basis (ie, not in conjunction with Sky) which would compete with one of Sky's offers. We will also consider whether, without the merger, Sky might start providing telecommunications services on a stand-alone basis (ie, not in conjunction with Vodafone). If such expansion would be likely without the merger, then any potential competitive constraint from this would be lost as a result of the proposed merger. This could result in higher prices or decreased service levels relative to the without the merger scenario.

21. To assess whether the loss of potential competition is likely to materially affect competition, we will assess:

    21.1 whether Vodafone or Sky would be likely, without the merger, to launch any services that would be in competition with one another;

    21.2 whether existing competition in the markets in which any new Vodafone or Sky services would be launched without the merger is currently weak (such that potential competition would impose an important constraint);[10] and

    21.3 whether Vodafone or Sky are uniquely positioned to be the potential entrant that would impose constraint on incumbents in the relevant markets without the merger.[11]

22. We note that many of the factors mentioned above are also relevant to vertical and conglomerate effects, which we discuss below.

**Vertical and conglomerate effects: would the merged entity be able to foreclose rivals?**

23. A merger between suppliers who are not direct competitors and operate in related markets is less likely to result in unilateral effects. However, such a merger can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.[12] [13]

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9 The Applications at [8.2].

10 In the Applications, the parties submitted that telecommunications markets are highly competitive. They also submitted that the pay-TV market is increasingly competitive, with a growing number of suppliers delivering content via the internet. The Applications at [11.10] and [12.2].

11 In the Applications, the parties submitted that there is ease of entry into the relevant markets, suggesting that other firms that could impose the same constraint as Vodafone and Sky. The Applications at 3.

12 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013 at [5.2].

23.1 A vertical merger is a merger between firms operating at different levels of a supply chain (eg, a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability or incentive to foreclose its competitors. Foreclosure can either be:

23.1.1 input foreclosure – where the merged entity refuses to supply an input to a downstream competitor or raises the price of the input; or

23.1.2 customer foreclosure – where the merged entity disadvantages an upstream competitor in the sale of that competitor's products by limiting access to customers.

23.2 A conglomerate merger is a merger between firms that supply products that may relate to each other (eg, complementary products). Foreclosure can arise in the case of conglomerate mergers due to:

23.2.1 bundling – where the merged entity provides bundled discounts to customers that buy the merging parties' products together rather than separately; or

23.2.2 tying – where the merged entity refuses to sell one of the merging parties' products unless customers also buy the other parties' product.

24. In investigating the vertical or conglomerate effects of a merger, we consider whether any foreclosure is likely to have the effect of substantially lessening competition in a market in light of remaining competitive constraints.

*Foreclosure generally*

25. Like networked industries, the telecommunications and broadcasting industries are characterised by competitors that are vertically integrated (ie, they operate at different levels of the supply chain). This means that competitors in output markets may find themselves using inputs provided by their rivals. For example, suppliers of pay-TV services via the internet may use telecommunications services supplied by vertically-integrated suppliers that also sell pay-TV services (eg, Netflix is made available to end-users via telecommunication service providers, some of which also own pay-TV services).

26. The proposed merger would combine New Zealand's largest pay-TV supplier (which, among other content rights, holds the broadcasting rights to some significant sports content) with one of New Zealand's major suppliers of telecommunications services. The proposed merger raises both vertical and conglomerate effects.

27. We will consider whether the proposed merger would give the merged entity the ability and incentive to engage in behaviour that might foreclose rivals (in pay-TV and/or telecommunications services) or otherwise render them less competitively effective and result in a substantial lessening of competition in a relevant market.

[13] When we refer to foreclosure, this includes behavior that both forecloses rivals or otherwise renders a competitor less competitively effective.

28. In their applications, Vodafone and Sky submitted that there is no prospect of the merged entity pursuing a credible foreclosure strategy that reduces competition.[14] They argue that this is because:

    28.1 the merged entity would not supply "must-have" inputs that competitors require to participate in telecommunications or pay-TV markets;

    28.2 the merged entity would not have the ability or incentive to engage in any foreclosure strategy;

    28.3 Sky currently makes its pay-TV services available to other parties (on a wholesale basis) and would continue to do so; and

    28.4 the merged entity would be strongly incentivised to sell pay-TV and telecommunications services to consumers on an unbundled basis.

29. The merger could give the merged entity the ability to foreclose rivals if the combination of Vodafone and Sky allows the merged entity to leverage market power in the supply of pay-TV or telecommunications services (eg, because Sky holds the broadcasting rights to important sports content and the addition of Vodafone's customer base allows it to profitably tie Sky to Vodafone's telecommunications offering). We will therefore consider whether the merged entity would, in fact, supply any "must-have" content to rivals outside of a bundle with Vodafone. As part of this, we will consider the nature of rights to broadcasting content and how delivery of that content is evolving (eg, over the internet as opposed to via satellite and directly rather than via a content aggregator).

*Vertical effects*

30. In considering whether it could be profitable for the merged entity to foreclose rivals due to vertical effects, we will consider whether the merged entity could profitably discriminate against other online content providers (eg, Lightbox, Netflix) by preventing Vodafone customers' ability to access this content (eg, by blocking website access) or by reducing the quality of this content (eg, by deciding not to host rival content providers on Vodafone's network).

31. This vertical issue could adversely affect other suppliers of pay-TV services and content, as they could lose scale and become less competitive (ie, affect Sky's current and potential future competitors).

*Conglomerate effects*

32. In considering whether it could be profitable for the merged entity to foreclose rivals due to conglomerate effects, we will consider:

    32.1 whether the merged entity could profitably make Sky content only available to Vodafone customers (eg, by only selling Sky's pay-TV services bundled with Vodafone's telecommunications services); and

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[14] The Applications at [11.1].

32.2 whether the merged entity would make Sky content available to Vodafone customers at a predatory price (eg, via a bundled Sky/Vodafone package).

33. These conglomerate issues could adversely affect competing suppliers of telecommunications services, which could lose scale and become less competitive (ie, affect Vodafone's current and potential future competitors).

34. In addition to the above, we are interested in parties' views on any other sources of market power that the merged entity may have and be able to leverage post-merger (eg, in bidding for the rights to broadcasting content, in filming sports content, in sponsoring major sporting events).

## Next steps in our investigation

35. The Commission is currently scheduled to make a decision on whether or not to give clearance to the merger by 11 November 2016. However, this date may change as our investigation progresses.[15]

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

### Making a submission

37. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Vodafone/Sky in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **Thursday 28 July 2016**.

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

39. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.

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