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Investigation report on Sky TV contracts

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Glossary

DTT – Digital Terrestrial Television. The broadcasting of television signals in a digital format, rather than the analogue signals previously used. DTT has the advantage that it provides a better quality picture using less spectrum, and offers lower operating costs to broadcasters once established.

IPTV – Internet Protocol Television. Internet Protocol television a system through which television services are delivered over a packet-switched network such as the internet, instead of being delivered through traditional terrestrial, satellite signal, and cable television formats. In this document we refer to IPTV to indicate digital TV delivered both over a managed/closed network and using the open-internet / un-managed networks (also defined as Internet TV).

Linear TV – A linear service is one where the television service provider determines the schedule of programmes. This is in contrast to video-on-demand, where the television viewer picks which television programme he or she would like to view and the viewing time.

OTT – Over The Top (ie via the internet). Over the top content means on-line delivery of video and audio without the RSP being involved in the control or distribution of the content itself.

PPV – Pay Per View. A service by which a television audience can purchase events to view via private telecast. The broadcaster shows the event at the same time to everyone ordering it.

RSP – Retail Service Provider. An organisation that provides access to the internet.

VOD – Video On Demand. A system that allows users to select and watch video content on demand. It can also be used to provide audio content. IPTV technology is often used to bring video on demand to televisions and personal computers.

SVOD – Subscription Video On Demand. A type of VOD system, where the subscribers have unlimited access to specific video content for a regularly charged fee.

TVOD – Transactional Video On Demand. Video on demand where the customer pays for each individual programme.

UFB – Ultra-Fast Broadband.

Purpose

1. This report provides our assessment of whether provisions of Sky Network Television Limited's (Sky) contracts with content providers and telecommunications retail service providers (RSPs) breach section 27 or 36 of the Commerce Act 1986 (the Act).

Summary

2. Sky has resale contracts with three of the four largest RSPs in New Zealand:

   2.1 Telecom New Zealand Limited (Telecom);

   2.2 Vodafone New Zealand Limited (Vodafone); and

   2.3 CallPlus Services Limited (CallPlus).

3. Sky also had a retransmission contract that it signed with TelstraClear Limited (TelstraClear) before TelstraClear's acquisition by Vodafone. Vodafone now has a retransmission contract with Sky.[1] Together we call the resale and retransmission contracts 'the RSP contracts' in this report.

4. The RSP contracts include 'key commitment' provisions, which:

   4.1 restrict RSPs' ability, and potentially their incentive, to source and resell TV content from any party other than Sky (the 'exclusivity provision'); and

   4.2 prevent RSPs from providing assistance to other parties who provide services that compete with Sky, including internet protocol (IP) based wholesale providers (wholesale providers), and over-the-top providers (OTT providers) (the 'no assistance provision').

5. We refer to these two provisions together as the 'key commitments' – as Sky does.

6. Each RSP contract also has a provision that stops the relevant RSP from bundling Sky content with third party content, unless Sky gives its consent. We refer to these provisions as 'the prohibition on bundling'.

7. Sky also has contracts with content providers containing exclusivity provisions that potentially restrict other parties, such as RSPs, or IPTV providers, from obtaining access to content, which may be required to compete in the supply of pay TV in New Zealand.

8. The Commission opened an investigation into Sky's contracts following expressions of concern received by the Commission during its investigation of the Igloo joint

[1] Vodafone also has a 'hybrid agreement' with Sky [ ]. When we refer to RSP contracts in this document, we also refer to the hybrid agreement.

venture that access to content and Sky's contracts with RSPs may be hindering competition.[2]

9. On the basis of our investigation, we consider that:

   9.1 Sky's contracts with content providers are not likely to have breached the Commerce Act;

   9.2 key commitments in Sky's contracts with RSPs are likely to have previously breached section 27 and were at risk of breaching section 36 of the Commerce Act by hindering competition in the market for pay TV in New Zealand; and

   9.3 while their purpose likely remains unchanged, the key commitments in Sky's current contracts with RSPs appear unlikely to continue to have the effect or likely effect of substantially lessening competition, because of market developments.

10. In this case, we have decided to issue a formal warning to Sky rather than issue legal proceedings because:

   10.1 the key commitments in the current RSP contracts are, on the facts available to us, unlikely to lead to detriment in the future; and

   10.2 the public interest is not in favour of the Commission commencing court action, given the costs, risks and uncertain future benefits involved.

11. We will, however, continue to monitor Sky's existing or new contracts with RSPs and Sky's conduct in relation to those contracts. This is to ensure that the provisions remain unlikely to have an anti-competitive effect. In particular, we will closely scrutinise Sky's conduct in relation to any requests for exemptions from these provisions.

12. If we consider that there is evidence that competition is, or is likely to be, substantially lessened, we will take the necessary enforcement action to remedy the situation, and ensure that the long-term interests of consumers are protected.

Sky contracts with RSPs – key commitments

13. For the purpose of investigating Sky's RSP contracts, we have defined the relevant market as the retail supply of pay TV services in New Zealand (the pay TV market).

14. We have considered three ways that the key commitments could harm competition in the pay TV market:

   14.1 by Sky leveraging its market power, going beyond that which would be necessary to be profit-maximising absent an exclusionary effect, to prevent or

[2] See Commerce Commission Investigation Report: The joint venture between Television New Zealand Limited and Sky Network Television Limited, Igloo ('The Igloo report'), 16 May 2012.

hinder RSPs from assisting or developing rival pay TV products that may have in time become an effective competitor to Sky;

14.2 by denying rival pay TV wholesalers to Sky viable scale in New Zealand by limiting access to RSPs; and

14.3 by Sky paying RSPs not to enter into the pay TV market and/or not to support a new entrant into that market.[3]

Section 27

15. We consider that the key commitments, when taken together,[4] have previously breached section 27.

16. In particular, we consider that previously the key commitments had the purpose and, in aggregate across the RSP contracts, the effect of substantially lessening competition in the pay TV market.

17. However, while their purpose likely remains unchanged, the key commitments appear unlikely to continue to have the effect or likely effect of substantially lessening competition, because of market developments.

18. In regard to both the historical and present status of the RSP contracts, we consider that the purpose of the key commitments was, and is, to substantially lessen competition in the pay TV market. We say this because:

18.1 on their face these provisions appear aimed to hinder competition;

18.2 we consider that despite Sky's purported rationale for the key commitments, the key commitments are in themselves anti-competitive provisions; and

18.3 furthermore, Sky's internal contemporaneous documents indicate support for a conclusion that Sky's subjective purpose was to limit competition from RSPs, especially in relation to content.

19. We also consider that the key commitments have previously had the effect of substantially lessening competition in the pay TV market:

19.1 Sky is a near monopoly in the supply of pay TV in New Zealand, such that any new entry were it to occur would have significant benefits for New Zealand consumers;

19.2 [

];[5]

---

3 This is based on a discussion contained in Mark Armstrong, "Anti-Competitive Agreements Between Firms in the Pay TV Market", Regulation Initiative Discussion Paper Series, Number 24, 1999.

4 The provisions in the RSP contracts with Sky in aggregate under section 3(5).

5 See paragraphs 255 to 256 below for more details.

19.3 the RSP contracts alone (or in aggregate)[6] increased barriers to entry to the RSPs, some of the most likely entrants into the pay TV market;

19.4 TelstraClear intended to enter the pay TV market by providing exclusive content via an SVOD (subscription video on demand) service, but did not, in part because of the key commitments. TelstraClear entered the market with a reduced offering;

19.5 Sky required TelstraClear to [

]; and

19.6 Vodafone [

].

20. Put another way, the key commitments force RSPs to choose whether to supply Sky (potentially subject to a limited exemption), or to supply a rival service. Given the strength of Sky's brand and portfolio of content, RSPs have historically preferred to supply Sky. Sky is therefore likely to have limited entry into the market and harmed competition by forcing RSPs to make this binary choice, without providing the opportunity to sell both Sky and a rival service (to different customers).[7]

21. In regard to support of wholesale pay TV entry, however, there is no clear evidence that without the key commitments RSPs would have unmetered an OTT provider and there is only limited evidence that absent the key commitments RSPs may have supported the entry of a pay TV wholesaler.

22. As noted above, the evidence suggests that the effect of the key commitments was to substantially lessen competition. However, we note:

22.1 that in the presence of high barriers to entry and expansion, entry may have been unlikely with or without the key commitments such that the key commitments did not make a material difference in fact;

22.2 there is only limited evidence that RSPs were considering entry and what evidence there is suggests that such entry would have been relatively small scale such that its loss may perhaps not be considered substantial; and

---

[6] Under section 3(5), we do not need to reach any decision on the individual effect of one RSP contract.

[7] This is analogous to the US case of *Dentsply*. This is a US 3rd Court of Appeals judgment dealing with an exclusive dealing case under section 2 Sherman Act (ie, a unilateral conduct case). In the case, each retailer could terminate its supply contract at any time. The court nonetheless found a breach of section 2, as retailers were induced to stay under contract with Dentsply by its (superior) range of products – retailers were forced to choose whether to supply Dentsply or a rival competitor's products, and the vast majority chose Dentsply, and this harmed competition. http://www.ca3.uscourts.gov/opinarch/034097p.pdf

22.3 Telecom [

].

23. In regard to each of the above, we note:

    23.1 absent high barriers to entry and expansion, it is unlikely Sky would have had market power to begin with and be so well positioned so as to impose restrictive contractual terms. Moreover, as noted, all things being equal, the higher the degree of market power already existing in a market, the more likely it is that any further lessening of competition will be substantial;

    23.2 given that the key commitments were in place, it is less likely that the RSPs would have spent considerable resource in developing entry plans; and

    23.3 it is not clear whether Telecom [ ].

24. Given market developments, we consider the key commitments are unlikely to continue to have the effect or likely effect of substantially lessening competition. This is because, in no particular order:

    24.1 Telecom is not currently offering Sky's services to new customers and as such has a reduced incentive to remain with Sky [

    ];

    24.2 Telecom was recently granted an exemption to the key commitment provisions by Sky so that it can offer an alternative pay TV product;

    24.3 Vodafone has recently signed new contracts with Sky and, [

    ][8] [ ]; and

    24.4 entry by other pay TV providers is more likely than it has been in the past.

25. Nevertheless, it remains the case that the contractual restrictions are wider than we consider necessary to protect Sky's position. As such we may have concerns in the future if Sky were to sign further contracts with RSPs that include the key commitment provisions, and if Sky were to enforce the key commitments in existing or new contracts thereby restricting RSP entry into the pay TV market.

Section 36

26. We consider that Sky, in its contracts with RSPs, may have breached section 36 of the Act in imposing the key commitments.

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[8] Following the acquisition of TelstraClear by Vodafone the reference to Vodafone also reflects the position of TelstraClear.

27. We consider that Sky is likely to have a substantial degree of market power (SMP) in the pay TV market. Sky's share of the supply of the pay TV market has been close to a monopoly for a sustained period of time, and new entrants also face significant barriers to entry that they must overcome.

28. We consider that Sky may have taken advantage of its substantial market power, as there is a plausible basis for arguing that Sky would have acted differently if competing in a hypothetical workably competitive market. The basis for our view is that a comparator business in a hypothetical workably competitive market:

    28.1 would have entered into resale or retransmission contracts with RSPs to reduce customer churn and access new customers; and

    28.2 would not have included key commitments in the RSP contracts given our view that Sky's stated rationale for the key commitments does not suggest that they could be sustained in a workably competitive market.

29. If Sky were found to have taken advantage of its substantial market power, we consider there is a strong argument that Sky would also be found to have had the requisite anti-competitive purpose. We consider that this can be established from:

    29.1 a plain reading of the RSP contracts which suggests that Sky's purpose is to hinder actual or potential rivals competing;

    29.2 documents supplied by Sky, that suggest it had an anti-competitive purpose; and

    29.3 a court inferring an anti-competitive purpose if we establish that Sky had taken advantage of its SMP which had resulted in an anti-competitive effect.

Sky contracts with RSPs – prohibition on bundling

30. In our view, Sky is entitled to prevent RSPs from bundling competing TV products with Sky's to protect its brand. Sky has invested for a number of years in its brand, and sustained losses for ten years when entering. If Sky could not prevent an RSP from bundling its products with other pay TV products, the RSP could enter on the coat-tails of Sky. This may reduce incentives for firms to invest in a similar fashion in future and reduce competition.

31. We consider the prohibition on bundling provision facilitates Sky supplying its product. Therefore, we consider that these provisions are unlikely, in aggregate under section 3(5), to have the effect or likely effect of substantially lessening competition in breach of section 27.

32. Sky has also not breached section 36 by entering into the prohibition on bundling as a firm without SMP but otherwise with the same characteristics would include a similar clause.

33. We do not consider this argument applies to the assessment of the key commitments. In that case, Sky is not seeking to protect its investment, but seeking to preserve its market power in future by limiting competition from RSPs.

Sky's content acquisition contracts

34. For the purpose of investigating Sky's content contracts, we have defined the relevant markets as:

    34.1 the acquisition of premium movies in the first subscription pay TV window;

    34.2 the acquisition of premium movies in windows after the first subscription pay TV window;

    34.3 the acquisition of live sports rights; and

    34.4 the acquisition of first-run TV series.

35. We consider that Sky's content contracts, either individually or in aggregate, do not breach section 27 nor does Sky's concomitant conduct breach section 36.

36. The main theory of harm is that Sky's content contracts are exclusive, long-term and overlapping such that insufficient content may be available within a reasonable time period for a potential rival to be able to put together an appealing pay TV package.

37. The evidence does not support such a theory: sufficient content of all types appears to be available outside of Sky's exclusive contracts to enable a rival to put together an appealing pay TV package.

38. Nor, on the basis of this theory, do we consider there to be a breach of section 36. In a hypothetical workably competitive market, a business without a substantial degree of market power, but otherwise with the same characteristics as Sky, would likely have obtained contracts with content providers of similar duration, degree of exclusivity and degree of overlap. Other broadcasters in New Zealand also have contracts with similar exclusivity and duration provisions.

39. What is potentially more of a barrier for a new entrant is the price Sky pays for content, which reflects its large subscriber base. The cost of content, however, is in itself not a Part 2 Commerce Act issue.

40. We also considered a second theory of harm relating to Sky overbuying content so that it is not available for potential rivals. We have investigated this possibility, but the evidence does not support it.

Introduction

41. We first received complaints about Sky's contracts during our investigation of the joint venture between TVNZ and Sky (the Igloo joint venture). First, we received complaints that Sky's contracts with content right holders harmed competition.[9] Secondly, we received complaints that Sky's contracts with RSPs for the resale and retransmission of Sky's pay TV services harmed competition due to the inclusion of certain restrictive provisions.[10]

42. At the conclusion of our Igloo investigation, we launched an investigation into these complaints. This report sets out our assessment of whether any of the provisions (alone or in combination) of Sky's content or RSP contracts give rise to breaches of sections 27 and/or 36 of the Commerce Act.

43. Our consideration of these issues is set out as follows in this report.

    43.1 Key parties

    43.2 Summary of the legal framework

    43.3 Sky's contracts with RSPs

    43.4 Sky's content acquisition contracts

    43.5 Conclusion of assessment under sections 27 and 36

    43.6 Attachment: Industry background.

[9] For example, [ ] (1 November 2011).
[10] For example, telephone call [ ] (23 March 2012).

Key parties

Sky

44. Sky is the largest pay TV provider[11] in New Zealand. Its principal business is supplying video content to its subscriber base, mainly via satellite. As at June 2012, Sky had a total of 846,931 subscribers, representing about 49.4% of New Zealand households.[12]

45. Sky broadcasts more than a 100 channels on its digital satellite platform, offering a range of content, including news, sport, movies and general entertainment. In addition, Sky:

    45.1 owns 66% of the shares in Igloo Limited (Igloo),[13] a pay TV service which was launched in December 2012. Igloo provides 11 pay TV channels on a prepaid basis and access to live pay-per-view (PPV) sports events, movies and TV episodes, as well as access to free-to-air channels;

    45.2 operates one free-to-air TV channel, Prime Television (Prime is a business unit of Sky);

    45.3 acquires content rights from overseas and local content suppliers as well as producing its own content (eg, sports programming), for screening on its pay and free-to-air services;

    45.4 owns 100% of the shares in the outside broadcast operator Outside Broadcasting Limited;

    45.5 provides video-on-demand (VOD) services through its iSky service; and

    45.6 holds a majority shareholding in Fatso, an on-line DVD rental service in New Zealand.

46. Sky is listed on both the NZX and the ASX. Until recently, Sky's largest shareholder was Nationwide News Pty Limited, a wholly-owned subsidiary of News Corporation (News Corp). However, on 4 March 2013, News Corp announced that its New Zealand subsidiary would divest its shareholding in Sky. News Corp expected that the shares would be sold to a broad range of institutional and retail investors.[14] On 5 March 2013, News Corp announced that the sale had been completed.[15]

Retail Service Providers

47. Retail Service Providers (RSPs) are businesses which provide telecommunications services, which may include providing access to the internet. The four largest RSPs in

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[11] For the purpose of this report we define pay TV providers as any party that provides TV/video-on-demand services for a fee.

[12] http://www.skytv.co.nz/company-profile.aspx.

[13] Television New Zealand Limited owns the other 34% of the shares in Igloo.

[14] http://www.skytv.co.nz/Portals/0/data/MediaReleases/SKYNZ-press-release-4-March-2013.pdf.

[15] http://www.stuff.co.nz/business/market-data/8383515/Shares-fall-as-Sky-TV-drops.

New Zealand (Telecom, Vodafone,[16] CallPlus and Orcon) account for over 90% of the retail broadband market.[17]

48. Telecom, Vodafone and CallPlus currently have reseller contracts with Sky (RSP contracts).[18] Under these contracts, RSPs can and do offer Sky TV in conjunction with RSPs' other services, for example fixed line telephony, mobile telephony and retail broadband services. The RSP contracts generally prohibit RSPs from offering competing pay TV products, or directly assisting providers of such products. These restrictions are one of the subjects of this investigation and are discussed in detail below.

49. Only Vodafone currently has a retransmission contract with Sky. (Prior to its acquisition by Vodafone, TelstraClear had a retransmission contract with Sky).[19] Via its retransmission contract, Vodafone now provides cable TV services to customers in Wellington, Kapiti and Christchurch using its HFC cable network.[20] Its service involves the retransmission of free-to-air and Sky content together with some PPV movie content.[21]

50. Orcon does not currently offer, retransmit, or resell any pay TV services to its customers.

Content providers

51. Content providers are the parties holding the rights to show video content through various formats. Content rights holders include:

    51.1 the movie and TV production studios (eg, Disney and HBO);

    51.2 sports governing bodies (eg, the NZ Rugby Union);

    51.3 aggregators of content which acquire licence rights from various content providers and then repackage the content for resale to customers (eg, Fetch TV);[22] and

    51.4 the local and overseas production companies and commercial broadcasters which produce in-house content (eg, news and current affairs).

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16 TelstraClear was acquired by Vodafone in October 2012 following Commerce Commission clearance.

17 2012 Commerce Commission Telecommunications Monitoring Report.

18 Reseller contracts involve RSPs selling Sky set-top boxes and services to end-consumers, while Sky continues to transmit the services. Retransmission contracts involve RSPs selling their own set-top boxes and Sky's services to end-consumers and also retransmitting Sky's services.

19 We considered the Sky/TelstraClear Retransmission Agreement [ ] in our investigation.

20 Vodafone's own TV services are only available in the areas outlined, where households can connect to its HFC cable network.

21 Vodafone also has a 'hybrid agreement' with Sky [ ]. When the remainder of this report refers to RSP contracts it also refers to this agreement.

22 Fetch TV is an Australian IPTV company which provides pay TV services to its RSP partners on a wholesale basis.

Other parties

Other pay TV providers

52. In New Zealand, other pay TV providers are small relative to Sky, and do not offer the same all-inclusive package as Sky does, including linear, VOD and transactional pay TV.

    52.1 Coliseum Sports Media (Coliseum) provides English Premier League (EPL) coverage via an internet-based subscription platform. Coliseum began offering this service in August 2013. Coliseum's service is currently co-marketed with Telecom.

    52.2 Apple Inc. provides video content through a digital media receiver, Apple TV, and via its iTunes store on a transactional video-on-demand (TVOD) basis and electronic sell-through basis (ie, sale of a digital download).

    52.3 Quickflix NZ Limited (Quickflix), a wholly owned subsidiary of Quickflix Limited, started its service in March 2012 and offers film and TV series on a subscription VOD (SVOD) and TVOD basis.

    52.4 Ezyflix launched in New Zealand on 5 September 2013 offering film and TV series on a TVOD and electronic sell-through basis.

    52.5 Ziln.co.nz is an internet TV service which was launched in September 2009. Ziln currently offers free live streaming of local and overseas channels and some limited pay VOD content.

Free-to-air TV broadcasters

53. There are currently two main free-to-air TV broadcasters in New Zealand:

    53.1 Television New Zealand Limited (TVNZ), which is the largest free-to-air broadcaster with two free-to-air channels (TVONE and TV2), two digital-only channels (U and TV One plus 1), which are broadcast through Freeview and Sky platforms, and two digital Sky platform-only channels (TVNZ Heartland and TVNZ Kidzone24). TVNZ is also a part owner of Igloo; and

    53.2 MediaWorks New Zealand Limited (MediaWorks), which has two free-to-air channels (TV3 and FOUR), and TV3 Plus 1, which is broadcast through the Freeview and Sky platforms.

54. Together with Sky, TVNZ and MediaWorks are the major New Zealand purchasers of overseas and local TV content as well as the producers of their own content for screening on their respective free-to-air networks.

55. The other free-to-air broadcasters are:

    55.1 Māori Television, a public broadcaster which launched in 2004 with the objective of promoting and revitalising the Maori language. It receives the bulk of its funding from the Government; and

55.2 Prime TV, a free-to-air broadcaster operating one channel, which is wholly owned by Sky.

55.3 Sommet Sports, a free-to-air broadcaster operating one channel on the Freeview platform, which broadcasts a variety of sporting content.

56. The main source of revenue for all free-to-air broadcasters is advertising.

57. TVNZ, MediaWorks and Maori Television (together with Radio New Zealand) own and operate Freeview, a not-for-profit organisation that was set up to transition all free-to-air broadcasters from analogue transmission to digital transmission. Freeview runs a hybrid terrestrial/satellite platform, which shows all the major national free-to-air TV channels.

Summary of the legal framework

Purpose

58. This section describes the applicable legal tests under sections 27 and 36 of the Act.

Section 27 – substantial lessening of competition

59. For Sky to be in breach of section 27, we would have to satisfy a court that a provision (or provisions) of one or more of Sky's RSP contracts (or its content contracts) has the purpose, effect or likely effect of substantially lessening competition in a New Zealand market.

Substantial lessening of competition test

60. The substantial lessening of competition (SLC) test is a relative standard. It requires us to compare the likely state of competition with the provisions of the contract, arrangement or understanding (often referred to as the factual) with the likely state of competition without those provisions (often referred to as the counterfactual). We must then assess whether the provisions substantially lessen competition.

61. The key aspects of the SLC test are as follows.

    61.1 While an absence of market power suggests no SLC, this does not mean we can forgo an analysis of the counterfactual as well as the factual.[23]

    61.2 Competition means workable or effective competition.

    61.3 The lessening must be real or of substance to be captured, rather than ephemeral or nominal.[24] A SLC in a significant section of a market may be a SLC in the market.[25]

    61.4 A lessening of competition includes hindering or preventing competition.[26] A firm with market power can breach section 27 if, but for their conduct, new competition would emerge.[27]

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23 *Air New Zealand/Qantas v Commerce Commission* (No 6) (2004) 11 TCLR 347 (HC) at [42].

24 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC).

25 *Dandy Power Equipment Pty Ltd & Anor v Mercury Marine Pty Ltd* (1982) 44 ALR 173, 192, cited with approval by McGechan J in *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 (HC) at 435.

26 Section 3(2), Commerce Act. In *Commerce Commission v Port Nelson* (HC) above n 25 McGechan J noted the extended definition of the term lessening at 434: "One may or may not, normally, 'lessen' when one 'hinders'. The word 'hinder' (Shorter English Dictionary (3rd ed), vol 1, p865) covers senses which include 'do harm to' and 'prevent'; but also to 'keep back; impede, deter, obstruct', and 'delay or frustrate action, by an obstacle or impediment'. One can 'hinder' by merely delaying or obstructing for the immediate time. That, no doubt, is the extended sense intended. There would be little point, otherwise, in the extension. The inclusion of 'hindrance', in that sense accords entirely with the overall policy of the Act to remove obstacles in the way of free competition" cited with approval by Glazebrook J in *ANZCO Foods Waitara Ltd v AFFCO NZ Ltd* [2006] 3 NZLR 351 (CA) at [241].

27 *Transpower v Todd Energy* [2007] NZCA 302 at [113].

61.5 Pro-competitive efficiencies arising may be netted off against anti-competitive effects provided the pro-competitive efficiencies arise in the same market as the anti-competitive effects.[28]

61.6 The SLC test exists to protect the competitive process.[29] It is not focused on protecting individual firms.[30]

Purpose, effect and likely effect

62. It is the purpose of the provision that is relevant, not the purpose of the parties who penned the provision.[31]

63. The purpose inquiry in section 27 cases is focused on an objective assessment of a substantial purpose of the provision[32] in the contract (which may be one of several purposes).[33] Although purpose is primarily assessed objectively, evidence of a person's actual (subjective) purpose remains relevant.[34]

64. The state of the case-law on the test for purpose is otherwise unclear. The leading authority is the Court of Appeal's judgment in *ANZCO*,[35] which features the views of three different judges. The judges had different views on how to assess purpose, either objectively or subjectively, and how the effect of a provision may interplay with assessing the purpose of a provision. These views are not readily reconciled, as has been noted in the literature.[36]

65. It is sufficient for this assessment to note that the existence or not of an anti-competitive effect, or likely effect, may influence whether a court finds that a provision's purpose is anti-competitive.

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28 *Fisher & Paykel v Commerce Commission*, [1990] 2 NZLR 731, (HC) at 740. *Commerce Commission v Port Nelson* (HC) above n 25 at 433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463 (HC), at [531].

29 Competition is defined as workable or effective competition. Commerce Act 1986, s 3(1).

30 *ANZCO* (CA) above n 26 at [242].

31 *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA), at 563; *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608 (CA), at [73].

32 *ANZCO* (CA) above n 26 at [260], "I also adopt the point made by McGrath J in *Giltrap City* that anything other than an objective ascertainment of purpose does not fit in with the per se provisions, such as sections 29 and 30, which also refer to the concept of purpose. It would be contrary to the intended mischief to which those provisions are aimed if a party were able to escape liability for conduct that is prohibited absolutely on the basis of a subjective ascertainment of purpose."

33 Commerce Act 1986, section 2(5).

34 While the New Zealand authorities diverge on the approach to the analysis of anti-competitive purpose, to date the courts favour an objective assessment, taking into account any subjective evidence of the rationale for the agreement, *ANZCO* (CA) above n 26 at [255].

35 *ANZCO* (CA) above n 26 at [257].

36 Paul G Scott, "The purpose of substantially lessening competition: the divergence of New Zealand and Australian Law" (2011) 19 Waikato Law Review 168.

66. Effect is a question of fact. An effect must follow directly from the provision without an intervening cause.[37]

67. "Likely" is a real and substantial risk; it is above "possible" but not "more likely than not".[38]

All Sky's contracts (RSP and content) taken together are relevant in assessing whether a specific provision has the effect or likely effect of an SLC

68. The effect/likely effect of a provision must be assessed taking into account all the contracts to which Sky is a party.[39]

A provision which may not have had the effect or likely effect of an SLC when it was entered into and originally given effect to, may now have the effect or likely effect of an SLC

69. If giving effect to a provision gives rise to a SLC, or a likely SLC, it will breach section 27(2) even if the provision did not have that effect when entered into, or when it was previously given effect to.[40]

Section 36

70. For Sky's conduct to be in breach of section 36, we would have to satisfy the Court that:

    70.1 Sky has a substantial degree of market power in one or more markets;

    70.2 by including the key commitments or imposing the prohibition on bundling in its RSP contracts, or by entering into agreement for the acquisition of content on specific terms, Sky took advantage of its SMP; and

    70.3 in doing so, Sky's (substantial) purpose was to restrict the entry of a person into, prevent or deter a person from competing in, or eliminating a person from, any market.

Substantial degree of market power

71. A firm has market power when it is not constrained in the way in which it would be constrained in a competitive market. Any firm that is substantially unconstrained by competitive pressures has SMP.[41]

72. Market power may arise from a variety of circumstances. High market share may or may not give market power. Barriers to entry will ordinarily be vital.[42]

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37 *Commerce Commission v Bay of Plenty Electricity Ltd* HC Wellington CIV-2001-485-917, 13 December 2007 at [343].
38 *Port Nelson v Commerce Commission* (CA) above n 31 at [562-563].
39 Section 3(5), Commerce Act.
40 Section 2(3), Commerce Act.
41 *Commerce Commission v Telecom Corporation of New Zealand Limited* [2011] 1 NZLR 577 (*0867)* at [33].
42 *Boral Besser Masonry Ltd v ACCC* [2003] HCA 5, (2003) 215 CLR 374 at [137].

73. “Substantial” in this context means weighty, rather than real or of substance.[43] However, it is not necessary to show that a firm has a monopoly to have SMP, only that the firm is “substantially unconstrained”.

74. So the question is whether we consider Sky to be substantially constrained or not in the relevant markets in which it competes and why. If we do not consider Sky to be “substantially constrained”, then Sky will have SMP.

Taking advantage

75. Sky would have taken advantage of its SMP if it would not have imposed the key commitments (as drafted) as a matter of practical business or commercial judgment if it did not have SMP, ie, if Sky operated in a hypothetical workably competitive market. The same test applies in respect of the prohibition on bundling in its RSP contracts and Sky’s conduct vis-a-vis its content acquisition contracts.

76. The “hypothetical workably competitive market” must be one which genuinely denies Sky all aspects of its SMP, ie, it must be a market where the competition to Sky neutralises the SMP it enjoys in reality.[44] The hypothetical market must include Sky and at least one effective competitor.[45]

Purpose

77. Under section 36(2) it is the “purpose” of the person with SMP, in this case Sky, that is relevant, rather than the purpose of a provision as in section 27.[46] Sky’s “purpose” need only be a substantial purpose, ie, be “real or of substance”.

78. Purpose may be inferred from direct evidence, relevant conduct or circumstances, including contemporaneous documents.[47] A court may also infer from a firm’s use of SMP that its purpose was to produce the effect in fact produced.[48]

43 Gault on Commercial Law at CA36.04(1).
44 *0867* above n 41 at [36] and *Turners & Growers Ltd v Zespri Group Ltd* (2011) 13 TCLR 286 (HC) (*Zespri*) at [342].
45 *0867* above n 41 at [36] and *Zespri* above n 44 at [343].
46 *Zespri* above n 44 at [92].
47 Section 36B, Commerce Act and *Union Shipping NZ Ltd v Port Nelson Ltd* [1990] 2 NZLR 662 (HC) at 709.
48 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC).

Sky's contracts with RSPs

79. In this section, we set out:

    79.1 the key provisions of Sky's RSP contracts;

    79.2 how these provisions might harm competition (the theories of harm);

    79.3 the likely scope of the relevant markets; and

    79.4 whether the provisions of Sky's RSP contracts are likely to breach sections 27 and 36, assessing each of the theories of harm in turn.

The key provisions of Sky's RSP contracts

80. We set out below the contractual position of each RSP and the potential restrictive provisions in the RSP contracts.

Contractual position of Telecom

81. Telecom signed a reseller contract with Sky in [ ]; this contract expires in [ ].[49]

82. [ ].[50]

83. [ ].[51] [ ].[52]

84. In July 2013 Telecom announced a marketing partnership with Coliseum whereby Telecom customers receive a discount on Coliseum's EPL based product. To enable Telecom to co-market this product it obtained a specific exemption from Sky to the key commitments. This exemption is detailed further below.

Contractual position of TelstraClear

85. TelstraClear entered into a retransmission contract with Sky in [ ]. Although TelstraClear was acquired by Vodafone in October 2012 and TelstraClear's contract with Sky expired on 1 February 2013, (the contract continued to run on a month by month basis until August 2013), we have considered the historic purpose and effect of Sky's retransmission contract with TelstraClear in our investigation.

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[49] [ ].

[50] [ ].

[51] [ ].

[52] [ ].

Contractual position of Vodafone

86. Vodafone entered into a Sky reseller contract in 2008; this contract expired on 1 December 2011. [ ]; however, the contract continued to run on a month by month basis until August 2013.

87. Vodafone entered into new reseller, retransmission and hybrid contracts with Sky in August 2013. These contracts will expire in [ ].

Contractual position of CallPlus

88. CallPlus and Sky signed a reseller contract in April 2011. This contract expires in [ ].[53]

89. Since signing in 2011, CallPlus has not sold Sky services. CallPlus [ ].[54] CallPlus has entered into a reseller contract with Igloo,[55] Sky has provided a waiver to CallPlus from the key commitments to allow CallPlus to resell Igloo.[56]

Overview of potentially restrictive provisions in the RSP contracts

90. Sky's RSP contracts provide Sky's services to the RSPs on a wholesale basis, and then allow the RSPs to resell or resupply these services in conjunction with their own services (eg, mobile, fixed voice and broadband services).

91. The contracts between Sky and each of the RSPs are broadly similar in both general terms and the key provisions.

92. We have identified a number of potentially restrictive clauses (and exemptions to them), which we summarise in turn, namely:

    92.1 the key commitments (including exclusivity and no assistance clauses);

    92.2 exemptions from the key commitments;

    92.3 a prohibition on bundling.

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53 Before this, it did not have a contract with Sky.

54 [ ].

55 CallPlus (trading as Slingshot) and Igloo Limited entered into a reseller agreement on 17 January 2013.

56 Sky's letter to CallPlus (26 March 2012) in which Sky agreed to grant CallPlus a limited waiver from the key commitments. The reseller agreement remains in full force and effect subject only to the limited waiver.

Key commitments

93. In each RSP contract, the first clause of the key commitments prohibits an RSP from reselling, or making available, any pay TV service[57] other than Sky's services. We call this the 'exclusivity clause'.[58]

94. RSPs are also prohibited from providing 'special assistance' or 'direct assistance'[59] to any party providing pay TV services. We call this the 'no assistance clause'. Under this clause an RSP cannot:

94.1 [

];

94.2 [ ]; or

94.3 [

].

95. No special or direct assistance means that, for example, an RSP cannot:

95.1 [

];

95.2 [

];

57 [

].

58 [

].

59 [

].

95.3 [

]; or

95.4 [

].

96. The key commitment clauses are interlinked – the no assistance clause reinforces the exclusivity clause – so that analysing the purposes and effects of these clauses separately is often difficult. The majority of our analysis focuses on analysing the two provisions together as the 'key commitments', but where appropriate we distinguish between the exclusivity clause and the no assistance clause.

Exemptions from the key commitments

97. The RSP contracts include specific exemptions to the key commitment provisions that in effect, determine the scope of the key commitment provisions and what RSPs can and cannot offer. As set out below, the exemptions vary for the different RSPs and enable RSPs, to a limited extent, to tailor their offerings.

Telecom

98. Sky granted Telecom a limited exemption to the key commitments, [

].[60] [61] [

].

99. In July 2013 Sky agreed an exception to the key commitments with Telecom, under which Telecom is able to promote Coliseum's English Premier League product on the following basis:

99.1 [ ];

99.2 [

]; and

99.3 [ ].

TelstraClear

100. TelstraClear's contract with Sky (signed in [

60 [ ].

61 [

].

].[62]

101. [

].[63] A similar exemption to the one granted to TelstraClear is now included within the latest Vodafone contracts with Sky (discussed below).[64]

Vodafone

102. Under its 2008 reseller contract with Sky, Vodafone [

],[65] [

].

103. The exemptions to the key commitments in the new 2013 contracts[66] allow Vodafone [ ].

104. In particular, [

][67] [

]:

104.1 [ ];

104.2 [ ];

104.3 [ ]; and

104.4 [ ].

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62 [ ].

63 [

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64 [

].

65 [ ].

66 [

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67 [

].

105. As noted above, there is a specific exemption[68] in the 2013 contracts for Vodafone to [

].

106. [

].[69]

CallPlus

107. CallPlus has an exemption allowing it to [ ].[70] First, [

].[71] [ ].[72]

Requests for any other service

108. In addition, all three of the older reseller contracts state that if each RSP (ie, CallPlus, Telecom or Vodafone (2008 contract)) wish to provide any other pay TV service it can give notice to Sky and Sky will consider the RSP's request in good faith.[73] [74]

109. In addition to this general clause, Telecom's contract states that [

]:[75]

109.1 [ ]; and

109.2 [

]; and

109.3 [

].

110. As discussed above, this theme is carried over in the new 2013 contracts with Vodafone, as [

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68 [

].

69 [ ].

70 [ ].

71 [ ].

72 [ ].

73 [

].

74 [

].

75 [ ].

][76]

[ ]. Without Sky's approval, offering these products would be in breach of the key commitment provisions.

Prohibition on bundling

111. Each RSP contract has a provision that stops the relevant RSP from bundling Sky content with third party content ('non-approved bundles'), unless Sky gives its consent[77] or, under the 2013 Vodafone contracts, Sky itself is offering the same service. Each RSP contract states a non-exhaustive list of reasons why Sky may decide not to consent to bundling:

    111.1 the association of Sky's brand with the product offered in the bundle would have a detrimental effect on Sky's brand;

    111.2 the inclusion of the product in the bundle would be contrary to Sky's commercial interest; and

    111.3 the product in the bundle is provided by a direct and substantial competitor of Sky.

112. We call this the prohibition on bundling clause in the remainder of this report.[78]

Duration of the current RSP contracts

113. The duration of each contract varies. The Telecom contract has a term of [ ]. The 2013 Vodafone contracts have [ ]. The CallPlus contract has a [ ].

Termination provisions

114. [ ].

115. [ ] [79] [ ].

---

76 [ ].

77 [ ].

78 Sky has commented that this provision is not intended to be a general prohibition on bundling. Rather it views this provision as part of the role of the key commitments. However, in this report we treat this provision as a general prohibition on bundling as that is our reading of the provision.

79 [ ].

116. We do not know how many of Vodafone's customers would actually churn in the event that Vodafone could no longer resell Sky services. By way of comparison, since Telecom stopped offering Sky to new customers, Telecom reseller subscribers have [ ].[80] It should be noted however that Telecom continues to support its legacy Sky subscribers.

Theories of harm

117. We have identified three possible theories of harm that provide a framework for considering how provisions of Sky's contracts with RSPs could harm competition.

118. In each of these theories, Sky may have the incentive to enter into such provisions not only to limit downstream competition for pay TV services, but also to limit upstream competition for content acquisition. These two potential effects are interlinked, and difficult to disentangle: any entry as a purchaser upstream requires entry downstream as a pay TV provider.

119. The incentive to limit upstream competition can be explained as follows. The price Sky is willing to pay for content may be determined by how much the next highest bidder would be willing to pay. Suppose Sky offers the next highest bidder access to the content on condition that it not bid for the content in the original auction. The next highest bidder now makes some profit on that content (where it previously made none) and the amount that Sky has to pay for the content is now determined by how much the third bidder would be willing to pay. Sky may therefore be able to bid less for the content, as well as potentially gaining from the reduction in the degree of downstream competition for consumers.

Theory 1: Extending terms of resale/retransmission contracts beyond profit-maximising terms

120. This theory involves Sky including provisions in the RSP contracts that harm competition by leveraging any market power Sky has to prevent or hinder RSPs from assisting or developing rival pay TV products that may have in time become an effective competitor to Sky.

121. What raises a potential competition concern here is that while RSPs can acquire Sky's services at the wholesale level, they are restricted in what they can do when on-selling those services. They are also restricted in what they can do in relation to selling other competing products.

122. Such restrictions may go beyond what is necessary to achieve the benefits Sky obtains from wholesaling the services in the first place (eg, accessing market segments that would otherwise be difficult for Sky to access), and thereby harming competition.

123. Currently an RSP that sells Sky's content is likely to be at a competitive advantage compared to its rivals that do not. While it is possible that, eventually, without the key commitments in the Sky contracts, one or more RSPs could profitably enter and

[80] [ ].

become an effective competitor to Sky,[81] RSPs have, for the time being, chosen the benefits of selling Sky. It may be the case that this choice is affected by competition among RSPs. That is, part of the reason each individual RSP has an incentive to on-sell Sky content is to not be left as the only RSP that is slowly developing its own content transmitting service. Collectively, however, RSPs (and consumers) may be better off if RSPs entered the market in their own right.

Theory 2: Denying content wholesalers viable scale

124. This theory involves Sky including provisions in the RSP contracts that potentially harm competition as they deny rival pay TV wholesalers to Sky viable scale in New Zealand by limiting access to RSPs (distribution foreclosure).

125. As indicated above, some pay TV operators operate as content aggregators and wholesalers to RSPs, and have no direct contracts with consumers (eg, Fetch TV in Australia).

126. Certain provisions in the RSP contracts prevent RSPs from offering competing pay TV products to consumers and assisting third parties developing competing services to Sky. If such a wholesale aggregator requires access to a number of potential subscribers, and therefore RSPs, to make its business economically viable, tying up RSPs by way of the RSP contracts would have the effect of denying the wholesale aggregator the required scale to be competitively effective.

Theory 3: Paying RSPs not to enter or not supporting a new entrant

127. This theory involves Sky 'paying' RSPs not to enter into the pay TV market and/or not to support a new entrant into that market.[82] It could do this by entering into terms advantageous to RSPs, for example, a low wholesale price.

128. In essence, the theory is that Sky has an incentive to share the profits of its market power in order to foreclose competition. RSPs have the incentive to agree to such profit-sharing as long as their share of profits are greater than their expected returns from entering into the supply of pay TV themselves.

129. This could harm competition if one or both of the following apply:

    129.1 Sky paid off RSPs that would otherwise likely have entered into the pay TV market and they did not enter; and/or

    129.2 Sky paid off RSPs that would otherwise likely have supported a new entrant, they did not support a new entrant, and this new entrant did not have other effective routes to market to achieve sufficient scale.

[81] Or some risk that the RSPs could effectively help support a new entrant who has some potential to access content.

[82] This is based on a discussion contained in Mark Armstrong, "Anti-Competitive Agreements Between Firms in the Pay TV Market", Regulation Initiative Discussion Paper Series, Number 24, 1999.

130. As such, the competitive effects under this theory are akin to those under theories 1 and 2. We therefore consider this possibility as part of our consideration of theories 1 and 2 below.

Applying these theories of harm under the Commerce Act

131. The three theories of harm provide a framework for considering how the RSP contract provisions could materially raise barriers to entry into the supply of pay TV.

131.1 The first theory focuses on the impact of the provisions on the entry by RSPs themselves.

131.2 The second theory focuses on the issue of RSPs assisting or promoting TV products that are in competition with products sold by Sky.

131.3 The third theory relates to a mechanism by which Sky induces RSPs not to enter directly or support rival pay TV products.

132. Under the Act, we have therefore assessed whether Sky's inclusion of the relevant RSP contract provisions raises barriers to entry to RSPs or content wholesalers and therefore:

132.1 enhances Sky's market power such that compared to the situation without the relevant RSP contract provisions there is a SLC (section 27);[83] or

132.2 go beyond those that Sky would impose if it was acting in a profit-maximising fashion without a substantial degree of market power for an anti-competitive purpose (section 36).

Market definition

133. This investigation considers the competitive effect of contracts for the resale or retransmission of Sky's TV services by RSPs. Given the contracts being considered, we define the relevant market as the retail supply of pay TV broadcasting services in New Zealand.[84] We refer to this as the pay TV market throughout the remainder of this report.

134. In 2006, we considered Sky's acquisition of Prime Television.[85] In that decision, we considered the relevant markets were:

134.1 retail pay TV broadcasting services;

134.2 retail free-to-air TV broadcasting services;

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83 Considering the effect of the contractual provisions in the RSP contracts in aggregate (section 3(5)).

84 While the contracts between Sky and the RSPs are at the wholesale level, the key competitive issues relate to the supply of pay TV to consumers (that is, whether, absent the RSP contractual provisions, there would have been effective competitive entry into retail pay TV). We therefore define the relevant market at the retail level.

85 Sky Network Television Limited and Prime Television New Zealand Limited (Commerce Commission Decision 573, 8 February 2006).

134.3 pay TV advertising services; and

134.4 free-to-air advertising services.

135. In May 2012, we considered the Igloo joint venture between TVNZ and Sky.[86] That investigation did not require us to conclusively define the relevant market. However we adopted a similar definition to previous investigations and considered a separate market for the supply of pay TV to consumers in New Zealand. This market included linear pay TV, SVOD and TVOD services.

136. In the Igloo report we noted the spectrum of competition in the pay TV market from those services which may be closer substitutes to free-to-air services, such as the Quickflix SVOD service, through to linear pay TV services such as Sky TV.

137. In addition to this we investigated the extent to which TVOD is a substitute for subscription pay TV services. We found limited evidence of the relationship between these two products, but the evidence suggested that TVOD is more of a complement than a substitute for linear pay TV in New Zealand.[87] In any event, our conclusions in the Igloo investigation were not altered by the inclusion of TVOD within the pay TV market.

138. The approach in the Igloo report is consistent with the UK Competition Commission's (UK CC) decision on the market investigation into movies on pay TV.[88] In that decision, the UK CC defined a retail pay TV market that included linear pay TV,[89] as well as SVOD services. In addition, the UK CC found that to assess competition it did not need to conclude whether TVOD was in the relevant market. It noted that it was not clear that the availability of TVOD services influenced consumers' subscription decisions.

139. Based on investigations by the Commission and the UK CC's decision, the lack of any new contradictory evidence, and the key competitive issue in this investigation, we adopt a market for the supply of pay TV to consumers in New Zealand. For clarity that is defined, as in the case of the Igloo report, as including linear pay TV, SVOD and TVOD services.

140. This definition is consistent with the evidence we have seen from the internal documents of both Sky and the RSPs. In these documents SVOD is considered a

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86 Commerce Commission Investigation Report: The joint venture between Television New Zealand Limited and Sky Network Televisions Limited, Igloo (The Igloo report) 16 May 2012.

87 We also noted that when assessing the proposed acquisition by FOXTEL of Austar the ACCC defined one of the relevant markets as the national market for the retail supply of subscription TV services, which did not include TVOD. The ACCC have since published their public competition assessment noting that they consider TVOD services to be complementary to other types of content delivery rather than substitutes for them, as they are either being utilised at different times or places, or as a supplement. This is consistent with the limited evidence available for New Zealand as put forward in the Igloo report.

88 The UK Competition Commission Report: Movies on pay TV investigation, 2 August 2012.

89 Both bundled and stand-alone packages of linear pay TV and SVOD.

growing competitive constraint on linear pay TV. For example Sky's business plan for 2013[90] contains the following statements:

[.]

[ ].

[ ].

[90] [ ].

Sky's contracts with RSPs – Section 27

141. In this section we set out the relevant provisions of the RSP contracts. We then assess:

    141.1 whether the purpose of those provisions was to substantially lessen competition;

    141.2 whether the provisions of the RSP contracts have historically had the effect of substantially lessening competition in the pay TV market; and

    141.3 whether the provisions of the RSP contracts currently in place have the effect of substantially lessening competition in the pay TV market.

Purpose

142. As discussed above, the purpose of a provision is primarily assessed objectively, although evidence of a person's actual (subjective) purpose remains relevant.

143. We set out below our assessment of the objective purpose of the relevant RSP provisions, followed by our assessment of subjective purpose.

Objective purpose

144. We first assess the prohibition on bundling provision. It is likely that the provision has multiple purposes. In particular the non-exhaustive list of reasons why Sky may not consent to bundling (see paragraph 111 above) suggests that the objective purpose of the provision is to ensure that:

    144.1 the inclusion of any product offered as part of a bundle would not have a detrimental effect on Sky's brand or would be contrary to Sky's commercial interests;[91] and

    144.2 the RSP only resells or makes available Sky's pay TV services given that Sky can withhold consent if the further product or service is provided by a third party who is a direct or substantial competitor of Sky.

145. Taking into account the multiple purposes of the provision, we do not consider that the substantial purpose of the prohibition on bundling provision is to substantially lessen competition.[92] Sky has made considerable investments in its brand and it is reasonable it would seek to protect returns on that investment. Therefore, on its face, it appears that Sky's aim or object is to protect its brand.

146. We now assess the exclusivity and no assistance provisions within the key commitments.

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[91] Examples are set out in the Sky/Vodafone Reseller Agreement which outlines when Sky's prior consent to bundle with a third-party product or service can be withheld.

[92] *Zespri* above n 44 at [81]: "One substantial anti-competitive purpose will suffice even if the provision also has legitimate business purposes and/or reflects a unilateral rather than a joint purpose: *Tui Foods Ltd v New Zealand Milk Corporation Ltd*, *Port Nelson Ltd v Commerce Commission* and *ANZCO v AFFCO*;"

147. On a plain reading, in our view the purpose is to ensure that each RSP cannot resell or make available to any person in New Zealand any pay TV service other than Sky pay TV services, subject to certain specified exceptions.[93]

148. The exclusivity provision is reinforced by the no assistance provision. By entering into this provision, on a plain reading, the provision has the purpose of prohibiting (or at least hindering) each RSP and its affiliates from assisting or helping any other person from doing anything that the RSP cannot because of the exclusivity provision, ie, selling any pay TV service other than Sky's. In our view the provision is capable of having an anti-competitive effect and as discussed below, in our view, historically, there is sufficient evidence to say that the provision had the effect of substantially lessening competition.

149. However, exclusivity clauses by their nature stop a party undertaking particular activities and whether this affects competition requires further evidence or analysis.[94] We now turn to consider the information we have collected concerning the surrounding circumstances and the reasons why Sky included these provisions.

Sky's rationale for the key commitments

150. Sky has stated that the two main purposes of its RSP contracts are:

  150.1 to allow it to benefit from the ability of RSPs to bundle Sky services with RSPs' own services and thereby extend the pool of potential Sky customers; and

  150.2 to benefit from reduced subscriber churn for subscribers who sign as part of a triple play offering (phone, internet, and TV) compared to a standalone Sky subscriber.[95]

151. These statements are consistent with Sky's internal documents.[96]

152. Sky has stated that the purpose of the key commitments is to [ ].[97] We understand Sky's opportunity cost to be the return that Sky would have otherwise earned had it sold its services directly to those customers that have purchased through the RSPs.

153. [ ] submitted that the restrictions go significantly beyond protecting Sky's claimed business justification of protecting opportunity cost.[98] That is, the increase in

[93] The exceptions vary for each RSP.

[94] For example, in *Fisher & Paykel v Commerce Commission* [1990] 2 NZLR 731 (HC) the High Court found that Fisher & Paykel's exclusive distributive strategy, allied with investment in service and brand promotion was pro-competitive (although barriers to entry were low).

[95] Letter from Buddle Findlay (on behalf of Sky) to the Commission (01 June 2012) at [9].

[96] [ ].

[97] Letter from Buddle Findlay (on behalf of Sky) to the Commission (20 June 2012) at [13] – [15].

[98] [ ].

revenue to Sky from wholesaling, based on the high wholesale cost charged by Sky and the avoidance of cost required in servicing customers, more than compensates Sky for any opportunity cost.

154. However, Sky has submitted that the content it makes available to RSPs forms the core of its business. The key commitments provide the basis of the RSP contracts enabling Sky to calculate the margin and other financial terms that Sky is prepared to offer RSPs.

155. We agree that the concept of opportunity cost can illuminate how a business might rationally act.

156. However, we disagree with Sky's approach to its opportunity costs in this case and therefore the breadth of contractual restrictions Sky believes it needs to protect its opportunity cost. In fact, we consider Sky's approach may suggest an anti-competitive purpose.

157. Sky's opportunity cost relates to the value it would have achieved without the contract. It does not appear that Sky has taken this approach in practice.

157.1 Without the contract, Sky may have sold its services directly to some or all of the subscribers via the RSP in question. To cover this opportunity cost, Sky would be expected to charge a wholesale price, so that it would be indifferent whether a subscriber is a direct customer of Sky or is a subscriber via a RSP.[99] Sky has said that it calculates the wholesale price in this way.[100] However Sky has also said that it may need to offer a higher access fee, if it did not include the key commitments.[101]

157.2 Sky's reasoning does not explain why RSPs must be prevented from selling any competing pay TV product or assisting rival pay TV providers. Without the key commitments, RSPs could sell other pay TV services or assist Sky's rivals. Sky has argued that "in the absence of the key commitment, the other party could use Sky's services as a base from which to launch additional competing services".[102] For the reseller contracts, it is hard to see how this would be the case – the provision preventing bundling stops the RSP gaining any advantage. For the retransmission contracts, there may be some shared costs over developing a platform or infrastructure to offer IPTV. However, if Sky is charging a wholesale price so it is indifferent whether it sells or an RSP sells to a particular customer, Sky should not then

[99] For example by charging a price equal to the retail price Sky charges less its avoidable costs plus any costs of providing the service via the RSP.

[100] [ ].

[101] [ ].

[102] [ ], Sky said that [ ].

seek to prevent the development of future competition through use of the key commitments.

157.3 Sky's submissions build on its flawed contention concerning opportunity costs. For example, it explains that [

].[103] Also, when considering whether to offer an exemption to the key commitment, it considers "whether the exemption is likely to have any impact on Sky's business, positive or negative (eg, in terms of revenue, costs, profitability), and accordingly whether any agreement to adjust the commercial terms with the RSP is required or possible".[104]

157.4 This only prevents an opportunity cost to Sky in the sense that it entrenches Sky's market power by preventing or materially hindering the development of rival pay TV operators. This is not, in our view, a legitimate opportunity cost that Sky can seek to protect. Nor can it legitimately trade off this 'cost' against the costs of entering into the contracts.[105]

158. Sky has also submitted that the key commitments provide an RSP with an incentive to promote Sky's services. Sky has submitted that:[106]

> The key commitment (and any exemptions to it) is locked in early on in the discussion with the RSP because, to calculate the margin and the financial terms that Sky is prepare to offer the RSP, Sky needs to understand the RSP's incentives.
>
> It is only possible to establish the margin and the financial terms with the key commitment, and any exemptions to it, clearly defined.
>
> The key commitment protects against arrangements that would result in unquantifiable and unknown opportunity costs. This is because the key commitment incentives the RSP to promote Sky's services.

159. We disagree with how Sky links the RSP's incentives and the opportunity cost. RSPs will have an incentive to promote the Sky product if the resale of that product provides them a reasonable return. There is no link between the key commitments and the margin that the RSPs earn on resale. Moreover, it appears that Sky's RSP contracts already provide other mechanisms to give RSPs incentives to promote Sky's service, which are potentially less restrictive of competition, such as:

159.1 [ ];

159.2 [

]; and

159.3 [ ].[107]

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103 [

].

104 [ ].

105 Such as negotiating and implementing a contract with an RSP.

106 Letter from Buddle Findlay to the Commission (20 June 2012) at [13-15].

160. We therefore do not consider Sky's explanation of the purpose for the key commitments convincing.

161. As the purpose of the key commitments is not explained by Sky's submitted reasons, an alternative hypothesis is that Sky's purpose in including the key commitments was to restrict competition. We note that Sky may wish to restrict competition in the market for pay TV for two reasons which co-exist: one, to help preserve or enhance Sky's market power, and two, by having restricted competition in the pay TV market, also ensure that competition for inputs, namely the acquisition of content, is restricted so that input prices are not bid up (as discussed in the theories of harm section at paragraph 119).

162. Indeed, [ ]:

162.1 [ ];[108]

162.2 [ ];[109]

162.3 [ ];[110] and

162.4 [ ].[111]

163. Sky has also stated in correspondence with the RSPs [ ]:

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107 [ ].

108 [ ].

109 [ ].

110 [ ].

111 [ ].

163.1 [

];[112]

163.2 as noted above, [

];[113]

163.3 [

];[114] and

163.4 [

].[115]

164. The statements in the documents are particularly strong around sports content, for example: "[ ]".[116] [117]

165. The commercial value to Sky of the restriction on content acquisition is evidenced in the documents we have reviewed.

166. A document assessing the costs and benefits of the contract between Sky and [ ] includes a section on

112 [ ].
113 [ ].
114 [ ].
115 [ ].
116 [ ].
117 [

].

].

Conclusion on purpose of the key commitments

167. We do not consider that the prohibition on bundling provision has the purpose of substantially lessening competition. We consider this is a legitimate provision designed to protect Sky's brand and commercial position.

168. We consider that the purpose of the key commitments was, and is, to substantially lessen competition in the pay TV market. We say this because:

  168.1 on their face these provisions appear aimed to hinder competition;

  168.2 we consider that despite Sky's purported rationale for the key commitments, the key commitments are in themselves anti-competitive provisions; and

  168.3 furthermore, Sky's internal contemporaneous documents indicate support for a conclusion that Sky's subjective purpose was to limit competition from RSPs, especially in relation to content.

169. That said, purpose cases are rare in New Zealand, and the law as to what will amount to a purpose of substantially lessening competition is not entirely clear, particularly when any anti-competitive effect from the provision is unlikely.

Effect/likely effect of substantially lessening competition

170. To assess whether the provisions of the RSP contracts have substantially lessened competition in the pay TV market, we consider whether those provisions have hindered or delayed competition in the pay TV market by increasing barriers to entry to that market. In addition to this analysis of the historical effect of the RSP contracts, we consider their likely effect at paragraphs 247 to 257.

171. We consider that historically the RSP contracts alone (or in aggregate) increased barriers to entry to RSPs, some of the most likely entrants into the pay TV market [ ].[118]

172. In the context of Sky's near monopoly in that market and the historic difficulty in entering the pay TV market in general, we consider that the RSP contract provisions raised barriers to entry compared to the situation without the relevant RSP contract provisions, and therefore historically had the effect of substantially lessening (hindering or delaying) competition emerging in the pay TV market.

173. Our analysis below examines:

  173.1 the likely state of competition in the market with the provisions (the factual); and

[118] See paragraph 255 below for more details.

173.2 the likely state of competition in the market without the provisions (the counterfactual(s)).

174. Before analysing the factual and counterfactual, we observe that Sky is a near monopoly in the supply of pay TV in New Zealand.[119] We must assess the extent of any lessening of competition in the context of this market structure.

Entry conditions in the factual and the counterfactual

175. In both the factual and the counterfactual a new entrant would need to overcome a number of significant conditions of entry which would exist in both the factual and the counterfactual and that are unaffected by the key commitments.

176. Any new entry is likely to be via IPTV given the shortage of capacity in nationwide digital terrestrial and satellite transmission.

177. New IPTV entrants face a number of potential conditions of entry and expansion. The key barriers are the linked issues of access to content and economies of scale.

177.1 Access to content. Sky and free-to-air broadcasters acquire a significant amount of content on an exclusive basis. This, together with Sky's ability to pay significant sums of money, due to its large subscriber base, means that new entrants may not find it profitable to secure compelling (premium) content. Any entrant is therefore likely to be initially on a limited basis, and would only be in a position to expand its content offering as its subscriber base increases. To compete strongly with Sky, an entrant needs to provide new and recent content, and therefore likely needs to acquire premium rights. For example, regarding films, entry using library SVOD rights and TVOD rights as Quickflix has done is relatively straightforward. However, this type of entry may not provide significant competition to Sky. To provide closer competition to Sky, an entrant such as Quickflix may ultimately need to acquire film rights in the first pay window and be able to compete with Sky on the price it pays content rights holders.

177.2 Economies of scale. Several TV operators said it was important to achieve a sufficiently large customer base to reach profitability.[120] Without a sufficiently large subscriber base, a prospective entrant is likely to find it difficult to compete in the pay TV market profitably. In addition studios (and other content providers) often require high minimum guaranteed payments, which require a subscriber base of a sufficient size to make purchasing this content feasible. This may be exacerbated by the switching costs that customers face. For example, if they are locked into one-year / two-year contracts.

178. Two further issues raise conditions of entry for rivals.

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[119] See paragraph 293 to 294 below for more details.

[120] [

].

178.1 Partnership with RSPs. Pay TV wholesalers may need to partner with RSPs to access scale in distribution in order to achieve scale in production (and to acquire content).

178.2 Data caps / unmetering. Data caps in New Zealand have historically been small compared to many OECD countries.[121] This is relevant to an IPTV service as video contains lots of data: a high definition movie may be 2.5GB, and many data caps were less than 5GB.[122] Therefore, in the New Zealand context, a VOD service has been considerably more valuable to consumers if it is unmetered. Unmetering has therefore been important historically for OTT and other IPTV pay TV operators.[123] Indeed Netflix commented publicly in 2011 that it would not be entering in New Zealand, in part due to data caps.[124]

179. We also note that it appears that entry by OTT providers is more likely currently and in the future than it has been historically. This is in part due to increased data caps, changing technology availability, and the continued success of OTT entrants overseas.

Factual

180. Other than Telecom's selling of TiVo and TelstraClear's limited PPV offer, RSPs have not entered the pay TV market. Furthermore, there has been limited entry by other pay TV providers. We consider these issues in turn.

RSP entry

181. In this section, we briefly consider the evidence of past entry by RSPs, and then consider the prospects for RSP entry in future.

182. Both Telecom and TelstraClear have been part of entry into the pay TV market on a small scale.

183. As noted above, in early 2009 Telecom began exploring the possibility of securing the New Zealand sales and distribution rights for the TiVo personal video recorder platform.[125] Hybrid Television who owned the rights to TiVo in New Zealand and Australia offered Telecom Retail exclusive sales of the TiVo platform, initially through to March 2010.[126]

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121 For a fuller discussion of these issues, see Commerce Commission, *High-speed broadband demand side study issues paper 1: technical issues*, 19 December 2011, pages 33-40.

122 45% of broadband customers had data caps of less than 5 GB in June 2009; this figure fell to 20% in June 2011 and 19% in June 2012. Source: Statistics NZ.

123 [ ].

124 NZ Herald, Netflix turned off by low data caps, 26 November 2011.

125 TiVo is a set top box that transmits and records free to air channels and VOD services. The key difference between TiVo and Sky was that TiVo would be a hybrid of broadcast HD Freeview, plus download TV and movies.

126 The period of exclusivity to distribute and unmeter the TiVo product ultimately continued until 1 July 2010.

184. In [ ] Telecom's [

].[127] However, [

].

185. Following discussions with Sky in [ ], Sky agreed to exempt Telecom from certain provisions of the contracts[128] [

].[129]

186. The exemptions to the contracts were recorded in a letter from Sky to Telecom dated [ ].[130] The letter recorded that Telecom was permitted as an exemption to the [ ] contracts to:

186.1 [ ][131] [

];[132] and

186.2 [

].

187. However, it is explicit in the letter that [ ].

188. The TiVo initiative proved unsuccessful. Telecom decided to exit and [

].[133] It has stated that this was due to [
].[134]

189. Following the failure of TiVo, Telecom re-evaluated its strategy and decided to [
]. This resulted in the reseller contract dated [ ] which contains the key commitments.

190. Telecom agreed with Sky an exemption to co-market Coliseum's EPL services in July 2013 (see paragraph 203 below for more details).

191. [

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127 The July 2003 agreements formally ended on [ ].

128 [
].

129 [
].

130 [ ].

131 [
].

132 [ ].

133 [ ].

134 [ ].

].[135]

192. [

].[136]

193. [

].[137]

194. Another example relates to TelstraClear and Ziln. [

].[138] [

].[139]

195. Sky wrote to TelstraClear advising that:[140]

> [
>
>].

196. TelstraClear had an exemption from its retransmission contract with Sky [

]. This exemption was set out in two contracts and allowed TelstraClear to provide:

196.1 [

]; and

196.2 [

].

197. TelstraClear offered over 30 PPV movie channels for customers via TelstraClear's own set-top box on its cable network. However, TelstraClear submitted that [

]:

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135 [ ].
136 Ibid.
137 [ ].
138 [ ].
139 [ ].
140 [ ].

197.1 [

;[141]

197.2 [

]; and

197.3 [

].[142]

198. Following the acquisition of TelstraClear by Vodafone and Vodafone's signing of a retransmission contract with Sky in August 2013 Vodafone now offers its own PPV service.

199. CallPlus has not entered the pay TV market.

200. We consider that, in future, if the key commitments constrained RSPs' behaviour and RSPs had the incentive to remain with Sky (relative to an alternative where they forego Sky altogether in favour of a rival service), it is likely that RSPs would continue not to enter the pay TV market, or enter in the limited fashion allowed by Sky. As we discuss below, the key commitments are unlikely to continue to constrain entry by all RSPs and RSPs' incentives to remain with Sky may have lessened, but still exist in varying degrees (see paragraphs 242-251 below).

Entry by other pay TV providers

201. In this section, we briefly consider the limited entry by other pay TV providers, and then consider the prospects for entry in future.

202. Sky is the only linear pay TV provider in New Zealand. There has been limited entry by OTT providers such as Coliseum, Apple TV and Quickflix.

203. Coliseum entered the pay TV market in New Zealand in August 2013. Coliseum has acquired the exclusive New Zealand rights to the EPL and offers full coverage of all EPL games on an internet-based subscription platform. It has an agreement with TVNZ which allows the latter to show limited free-to-air highlights and live games.

204. Apple TV in New Zealand only provides TVOD and electronic sell-through movies. In other countries it also provides TVOD TV shows. [

].[143]

205. Quickflix has been available in New Zealand since March 2012 and provides SVOD movies and TV shows, and TVOD movies. However Quickflix's entry has been small-

141 [ ].
142 Ibid at [11].
143 [ ].

scale with less than [ ] subscribers by March 2013.[144] When Quickflix launched it was available to Orcon and CallPlus customers on an unmetered basis.

206. Turning to the likelihood of entry in the future, we have talked to [ ] as potential entrants. None of these have any firm plans for entry in the near future.

206.1 [ ].[145]

206.2 [ ].

206.3 [ ].

207. However, as noted above, further entry into the pay TV market by OTT providers may be more likely in the future than it has been historically.

Counterfactual

208. In this section, we assess whether:

208.1 Sky would enter into reseller or retransmission contracts with RSPs without the key commitments and/or a bundling provision; and

208.2 there would be materially more competition in the pay TV market without these provisions compared to the scenario with those provisions, such that there would be a substantial lessening of competition.

209. We discuss below the scenarios that may have occurred without the key commitment provisions and/or bundling provisions.

Would Sky enter into contracts with RSPs in the counterfactual?

210. In this section, we consider whether Sky would enter into contracts with RSPs that did not contain the key commitments and/or a bundling provision.

<u>Key commitments</u>

211. Sky has told us that without the key commitments it may not enter into the RSP contracts.[146]

212. However, we consider that Sky would want to enter into contracts with RSPs without the key commitments as Sky would still want to achieve the benefits identified by Sky, namely to increase demand and reduce churn.

---

144 [ ].

145 [ ].

146 For example, [ ].

213. The RSP contracts increase demand by (a) using RSPs as a channel to market with a different customer base[147] and (b) allowing them to bundle with their own complementary telecommunications services. For instance, in the period from July 2009 to June 2012, Sky's total customer base expanded by about 94,000 and subscribers via RSP contracts accounted for [ ] of this growth (ie, about [ ] of overall subscriber growth).[148] However, Sky has submitted it cannot

].[149] [

].[150] [

][151]

214. The RSP contracts reduce churn due to the bundling with telecommunications services. For example, the churn of Sky's direct customers has been between [ ] in the 21 months to March 2012.[152] In contrast, the churn of customers to which [ ] resells has been approximately [ ].[153] [ ] churn has been more volatile varying between roughly [ ], but has always been less than Sky's.

215. However, Sky have submitted that:

215.1 [

];[154] and

215.2 [

].[155] As a result it may not supply if this is the counterfactual.

---

147 Allowing for the fact that there would be some overlap between RSP customer bases and Sky customer bases, absent the arrangements. [ ].

148 [

].

149 [ ].

150 Ibid at [23].

151 Ibid at [29]. It is important context to this point that Sky's subscriber numbers are relatively flat and demand for Sky's existing services may be reaching saturation point. This may mean that Sky needs new routes to customers; alternatively, it may mean that there is little benefit to trying to sell to further customers – RSP are simply cannibalising other Sky sales. One should also bear in mind that Sky has covered fixed costs, so any further sales are likely to be highly profitable.

152 On a rolling twelve month basis. [

].

153 [ ].

154 [ ].

155 [

].

216. While the empirical evidence on point from other jurisdictions is relatively sparse, many commentators are of the view that bundling increases barriers to switching.[156]

217. As a result, we consider bundling pay TV and telecommunications service reduces churn with or without the key commitment, which is attractive to both Sky and RSPs. A contract might also be attractive to both Sky and RSPs to reduce the shared acquisition, billing and managing costs for customers.[157] Sky would want to achieve these benefits by entering into contracts with RSPs.

218. We therefore consider that Sky would be able to achieve the same benefits as it has submitted without the key commitment. It would therefore have the same incentive to supply as in the factual.[158]

219. It is worth noting that Sky [ ], with alternative contractual mechanisms to protect Sky's interests.[159]

220. We therefore consider that, without the key commitments, Sky would have entered into contracts with RSPs.

Prohibition on bundling

221. We consider that, without the provisions that prevent RSPs bundling other pay TV products with Sky's services, Sky would not enter into contracts with RSPs.

222. Sky's contracts with RSPs allow RSPs to offer Sky's services as part of bundled offerings with their own services only, such as broadband, mobile and fixed line

156 For example, OECD Working Party on Communication Infrastructures and Services Policy, Broadband Bundling: Trends and Policy Implications, (2011) at 35 states: "Bundling is often used as a tool to reduce customer churn by helping solidify barriers to switching". An FCC survey found that 39% of customers "said that having to change their current bundle of Internet, TV, and phone service was a *major* reason for keeping service", see FCC, "Broadband Decisions: What Derives Consumers to Switch – or Stick with – Their Broadband Internet Provider" (2010), Working paper.

157 We have not explored the extent of any avoided costs, but some cost savings of this kind would be likely, on the face of it. Sky has said that average acquisition costs (excluding fixed or business overhead costs and costs for installation of a STB) were [ ].

158 However, this is in the context of the upfront fixed costs of negotiation and implementation. Sky and RSPs incur fixed costs in negotiating and implementing the agreement. For example, Sky has said that the current CallPlus agreement cost Sky [ ] to implement. [ ].

159 [ ].

services, to the exclusion of all video services. Sky has allowed [

].

223. In our view, Sky is entitled to prevent RSPs from bundling competing TV products with Sky's to protect its brand. Sky has invested for a number of years in its brand, and sustained losses for ten years when entering. If it was required to allow rivals to bundle its products with other pay TV products, this may reduce incentives for firms to invest in a similar fashion in future and reduce competition.

224. [

][160]

225. We consider the prohibition on bundling facilitates Sky supplying its product, and these provisions, in aggregate under section 3(5), do not have the effect or likely effect of substantially lessening competition in breach of section 27. We consider that this analysis is substantially the same regarding the likely effect of this provision in the future, and so we do not consider this issue under section 27 any further.

Would there be materially more competition in the pay TV market, without the inclusion of the key commitments in Sky's contracts with RSPs, such that there would be a substantial lessening of competition?

226. As discussed above, we consider that Sky would have agreed less restrictive contracts with RSPs with no key commitments or similar provisions.

227. We therefore assess whether, without the key commitments, RSPs would have offered separately both Sky's products and a rival product (including one of their own).

228. We consider that the key commitments have historically increased barriers to entry, so that this may be argued to have had the effect or likely effect of substantially lessening (in the sense of hindering, delaying or restricting) competition.

229. However, we have also gone on to consider the evidence of whether RSPs may have acted differently without the key commitments:

229.1 first, whether RSPs are likely to have entered the pay TV market compared to the factual; and

229.2 secondly, whether RSPs are likely to have assisted another entrant into the pay TV market such as an OTT or wholesale provider.

[160] [ ].

230. We address these issues in turn below. The key evidence in assessing these issues is the RSPs' contemporaneous business documentation, although Sky's business documents citing the risks of RSP entry are also relevant.

RSP entry

231. We consider that, without the key commitments, at least one RSP is likely to have entered the pay TV market in a more substantial way than has occurred in the factual. This is based on evidence from RSPs' business documentation and submissions where RSPs' consider entry.

232. We also note, however, that given that the RSP contracts were in fact in place, it is not surprising that the RSPs would not have expended many resources to the consideration of entry. We discuss the evidence of entry by TelstraClear, Vodafone and Telecom in turn.

233. As discussed above,[161] TelstraClear entered the pay TV market in a limited manner: it offered non-exclusive PPV movies after Sky granted an exemption from the key commitments. However TelstraClear also stated that it always intended to independently offer a pay subscription service along with a TVOD and PPV service. At the same time, TelstraClear wished to remain an exclusive partner to Sky on linear broadcast TV services.[162] [163] [164]

234. [ ]:

[ ].[165]

[ ][166]

[ ].[167]

235. [ ].[168] [ ].

[161] See paragraphs 191-192.
[162] Email from TelstraClear to Sky (4 February 2011).
[163] [ ]
[164] [ ]
[165] [ ].
[166] [ ].
[167] [ ].

236. Turning now to evidence of entry by Vodafone, in [

].[169]

237. [

][170] [

],[171] [

].

238. Telecom has [

].[172] [

].

239. We recognise it could be argued that the evidence of potential entry by RSPs is limited:

239.1 the RSP documentation on considering entry is sparse with no detailed business plans and as such entry was not in fact likely with or without the key commitments;

239.2 RSPs could enter at the end of their RSP contracts with Sky or could 'walk away' from their contracts with Sky (or in Vodafone's case [
] and did not; and

239.3 the evidence in fact demonstrates RSPs explored entering and decided not to enter based on the conditions of entry discussed at paragraphs 175 to 178.

240. We consider each of these arguments in turn below.

241. While it appears that [

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168 [ ].

169 [
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170 [ ].

171 [
].

172 [ ].

].[173]

242. This leads to the question of why RSPs re-signed with Sky and have not 'walked away' from their contracts with Sky rather than entering themselves.

243. Most importantly, RSPs wanted to continue to supply Sky to their customers. RSPs have indicated that Sky's services are highly valued by a large proportion of customers, and it would not be attractive not to supply those services.[174] RSPs wanted to enter to supply an additional product either to those customers not wanting to purchase Sky or as an additional product to those customers already purchasing a triple play bundle.[175]

244. Historically RSPs may have had a further strong incentive to remain with Sky – an RSP may have been at a competitive disadvantage if it did not.

244.1 [ ].[176]

244.2 Any RSP which stopped selling Sky services may be at a competitive disadvantage in the short term compared to other RSPs.[177] For example, Vodafone commented[178] [ ]. This disadvantage arises from Sky's range and depth of services, brand etc compared to a different pay TV provider.[179]

245. This latter incentive may differ from RSP to RSP depending on the number of customers who purchase a triple play bundle including Sky, for example Vodafone has [ ] customers purchasing such a bundle; and Telecom [ ].[180]

246. In addition, during its term, a party could only terminate an RSP contract, [ ]. If an RSP otherwise wished to terminate its contract during its term, it may potentially have needed to pay

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173 [ ].

174 For example [ ].

175 See TelstraClear and Vodafone entry considered in paragraphs 233-237.

176 [ ].

177 [ ].

178 [ ].

179 And which a pay TV operator could not match within a reasonable time period.

180 [ ].

compensation to Sky and this would raise the cost of entry beyond any other conditions of entry.

247. However, some RSPs' incentives to remain with Sky because of the potential for competitive disadvantage may have changed recently, so that the key commitments are unlikely to continue to prevent or hinder RSP entry to such a degree.

248. Telecom may not have a strong incentive to remain with its Sky reseller contract. It is not offering Sky to new customers due to [ ], and [ ]. Therefore, if it terminated its contract with Sky, Telecom would experience little or no change in any competitive disadvantage for new customers it has compared to other RSPs who offer Sky.

249. The evidence further suggests that [ ].[181] [ ].

250. In our view Vodafone's incentive to remain with Sky has likely changed. Vodafone is the only current provider of Sky as part of a triple-play bundle to new customers (through both Vodafone and TelstraClear), due to Telecom's [ ] and CallPlus' offering the Igloo service rather than Sky. This reduces any Vodafone competitive disadvantage compared to other RSPs through not offering Sky. This also reduces the likelihood of churn for non-pay TV products following the non-renewal of the contract with Sky.

251. Therefore Vodafone's incentive to remain with Sky may have been reduced; however, we also acknowledge the other possible view point is that Vodafone now face a greater incentive to remain with Sky as they would be the sole RSP supplying Sky's services as part of a 'triple play' package. This may be evidenced by Vodafone's recent signing of new contracts with Sky.

252. Given CallPlus' resale of Igloo rather than Sky its incentives do not materially change dependant on the ability of other RSPs to resell Sky. It may however have an incentive to remain with Igloo, and we consider we could aggregate any exclusivity clause in this contract between CallPlus and Igloo under section 3(5) with the RSP contracts, as Igloo is a 51% subsidiary of Sky and therefore an interconnected body corporate with Sky for the purposes of section 27.[182] In any event, CallPlus has [ ].[183]

181 [ ].

182 Commerce Act, s 2(7). Companies Act 1993, s 5.

183 [ ].

253. In the future some RSPs' incentive to remain with Sky for 'competitive disadvantage' reasons may be diminished. As such, the key commitments may not continue to hinder entry by some RSPs. However, RSPs will retain the incentive to remain with Sky due to the superiority of its services. If in the future RSPs wish to remain with Sky and also supply their own VOD service, then the key commitments would raise barriers to entry to RSPs and substantially lessen competition in the supply of pay TV unless exemptions to the key commitments were sought and agreed.

254. While we acknowledge that any entry will need to overcome the conditions of entry outlined at paragraphs 175 to 178 above in both the situations with and without the key commitments, RSPs are likely to be able to overcome these sufficiently to enter without the key commitments on a VOD basis. In particular, RSP's technical capabilities[184] and existing customer base for other services will assist in developing a delivery method and accessing potential subscribers. Any entry might initially be small-scale, but in time would be likely to become greater.

255. [ ].

[ ][185]

[ ].[186]

[ ][187]

[ ].[188]

[ ][189]

[

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184 Broadband connections in NZ are provided mostly using ADSL2+ technology, which has a theoretical top speed of 24Mbps. Bandwidth requirements for VOD applications can be found in Table 1 of the Commission's Final Report for high speed broadband services demand side study (http://www.comcom.govt.nz/high-speed-broadband-services-demand-side-study/).

185 [ ].

186 [ ].

187 Ibid at [35].

188 [ ].

189 [ ].

].[190]

256. [

].

257. [

].[191] [

].[192]

Conclusion on entry by RSPs

258. We consider that the evidence above demonstrates that without the key commitments one or more RSPs would have been more likely to enter the pay TV market.

259. However it is less clear that in the future the key commitments will continue to constrain RSPs' behaviour given:

   259.1 Telecom is not currently offering Sky's services to new customers and as such has a reduced incentive to remain with Sky when its contract ends;

   259.2 Telecom was recently granted an exception to the key commitments by Sky so that it can offer the Coliseum pay TV product; and

   259.3 while Vodafone has recently signed new contracts with Sky, [

   ][193] [

   ].

Entry by other pay TV operators

260. We consider that without the key commitments RSPs may have supported the entry of another pay IPTV provider, in particular a pay TV wholesaler, such as Fetch TV.

261. However, the evidence supporting this is limited. For OTT providers, such as Quickflix, it is not clear that the key commitments have materially hindered their entry or expansion.

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[190] [ ].

[191] [

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[192] Ibid at [16].

[193] Following the acquisition of TelstraClear by Vodafone the reference to Vodafone also reflects the position of TelstraClear.

262. We have considered how RSPs might support a new entrant. Below we discuss the potential benefits to an IPTV provider in turn:

262.1 data caps and RSPs unmetering;

262.2 RSPs as a marketing channel for OTT providers; and

262.3 RSPs as a route to market for wholesaler providers

263. Data caps in New Zealand have historically been low compared to many OECD countries.[194] This is relevant to an IPTV service as video contains lots of data: a high definition movie may be 2.5GB, and many data caps were less than 5GB.[195] Therefore, in the New Zealand context, a VOD service has been considerably more valuable to consumers if it is unmetered. Unmetering has therefore been important historically for OTT and other IPTV pay TV operators. Indeed Netflix commented publically in 2011 that it would not be entering in New Zealand, in part due to data caps.[196]

264. However we consider that in the future data caps are unlikely to be an issue for a new pay TV entrant, as in recent years data caps have grown significantly.[197] In particular, all RSPs raised their data caps further in the second half of 2012.[198] Quickflix submitted that, while data caps were rising, a perception issue remained in the eyes of New Zealanders.[199] However, Quickflix documents [

].[200] [

].[201] Coliseum stated that [

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[194] For a fuller discussion of these issues, see Commerce Commission, *High-speed broadband demand side study issues paper 1: technical issues*, 19 December 2011, pages 34-40.

[195] 45% of broadband customers had data caps of less than 5 GB in June 2009; this figure fell to 20% in June 2011 and 19% in June 2012. Source: Stats NZ.

[196] NZ Herald, Netflix turned off by low data caps, 26 November 2011. [

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[197] Data from Statistics New Zealand shows the number of subscribers with data caps over 50GB has increased almost 800% from January to June 2012. In that same period the average amount of data consumed by subscribers has increased from 9GB to 16GB.

[198] For example, Vodafone announced an unlimited data plan on 24 September 2012. (http://www.orcon.net.nz/about/article/orcon_launches_unlimited_plans). Telecom introduced a new residential plan with a data cap of 500GB on 1 October 2012 (previously its highest data cap was 150GB). Vodafone introduced its new "Choice" and "Mega" plans with data caps 10GB higher than the old "Ideal" and "Ultimate" plans, along with a new "Chocka" plan with a 200GB data cap.

[199] [ ].

[200] [ ].

[201] [

].

].[202]

265. However, the growth in data caps cannot be assumed. For example in the US, there has been controversy regarding the payments for data usage introduced by some cable operators. It has been widely reported that the Department of Justice is investigating whether this hindered competition from OTT providers, such as Netflix, and breached competition law.[203] [204]

266. In the Telecommunication Commissioner's report on the high-speed broadband demand-side study of 29 June 2012, he said that:

> If these trends continue, data caps should not inhibit the take-up of broadband services. However, if these trends do not continue, or do not continue at sufficient pace, data caps may impact uptake of high speed broadband services, since the higher speed of these services might lead to consumer reaching their data caps sooner.[205]

267. Some evidence suggests that this is possible: CallPlus and Orcon have announced UFB plans which do not increase data caps above the levels in existing plans.[206] If data caps do not continue to increase sufficiently, then it is possible that unmetering may again become essential for IPTV operators.

268. With respect to unmetering Sky submits that the key commitments do not prevent a signatory RSP from unmetering the broadband traffic of OTT pay TV providers, if it unmeters Sky services.[207]

269. Indeed, CallPlus has unmetered Quickflix. However the requirement to unmeter Sky means that the incremental cost for an RSP (with a contract with Sky) to unmeter a rival pay TV operator differs depending on whether it has already unmetered Sky. CallPlus had already unmetered Sky, so the RSP contract effectively did not alter CallPlus' incentives for unmetering another pay TV provider.

270. Similarly, Vodafone also unmeters Sky, so it is not, and has not been, constrained.[208] However Vodafone acquired TelstraClear and so the restriction on unmetering in the no assistance clause may not constrain Vodafone anymore. It is unclear whether it will extend its unmetering of Sky to former TelstraClear customers.

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202 [ ].

203 The Sherman Act. This may reflect the vertical integration of cable operators in the US, which is not the situation in the New Zealand telecommunications marketplace.

204 Bloomberg, Justice Department Is Said to Investigate Cable Companies, 14 June 2012, available at http://www.bloomberg.com/news/2012-06-13/u-s-said-to-probe-cable-company-competition-with-online-video.html (last viewed on 17 March 2013 at 1:35pm).

205 Commission's Demand Side Study Final Report at paragraph 80.

206 http://www.orcon.net.nz/about/article/orcon_launches_unlimited_plans and http://www.slingshot.co.nz/products/fibre/fibre-pricing-plans/

207 [ ].

208 http://www.vodafone.co.nz/entertainment/tv/sky/isky/

271. So the main RSPs potentially restricted by the key commitments from unmetering have been Telecom and TelstraClear. These two RSPs represented more than 60% of broadband customers in New Zealand in 2011.[209] However, this potential restriction may not have resulted in a materially different position between the scenarios with and without the key commitments, as Telecom and TelstraClear may not have unmetered a rival pay TV product. Telecom has stated [.][210]

272. Overall we consider that going forwards data caps are unlikely to materially hinder a new pay TV entrant, and that there is not clear evidence that without the key commitments RSPs would have unmetered an OTT provider.

273. We now turn to consider whether RSPs are a key marketing channel for OTT providers, such as Quickflix.

274. Quickflix has advised us that RSPs are important for its marketing efforts. CallPlus and Orcon have each marketed Quickflix. However, due to CallPlus' obligations under the no assistance clause, Sky stated that it must give at least equal prominence to Sky's VOD services (iSky) as Quickflix in any marketing. Quickflix submitted that this made the marketing far less effective.

275. However, for Quickflix, and other OTT pay TV providers, marketing by RSPs is likely to be less a 'must-have' and more a simple competitive advantage. For example Quickflix has also used other companies to reach a wider audience, such as an email campaign with Mercury Energy.[211] Further to this, Coliseum stated that [ ][212] and international OTT pay TV providers such as Netflix and LOVEFiLM have successfully entered the UK pay TV market but have not partnered with an RSP to market their product.

276. Overall we consider that RSPs are not a required marketing channel for OTT providers and as such there is little evidence that the key commitments materially hindered greater entry by OTT providers.

277. Finally we consider whether RSPs are a key route to market for wholesale pay TV providers.

278. Pay TV wholesalers have a business model whereby they require RSPs to resell its services. [ ] has indicated that [ ].[213] For its business model, it is vital that it can partner with RSPs with a sufficient number of subscribers.

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209 In 2011, a World Internet report indicates that these two represent 65% of the market in 2011. See Commerce Commission, Telecommunications monitoring report 2011, (http://www.comcom.govt.nz/assets/Telecommunications/Market-Monitoring/2011-Annual-Telecommunications-Monitoring-Report-30-April-2012.pdf).

210 [ ].

211 [ ].

212 [ ].

213 [

279. While a pay TV wholesaler may require an RSP to enter the pay TV market in New Zealand the evidence as to whether, absent the key commitments, this entry would have taken place is mixed.

280. [ ] [214] [ ].[215]

281. [ ][216] and even when [ ].

282. Overall we consider that while pay TV wholesalers may require RSPs as a route to market there is limited evidence that absent the key commitments RSPs may have supported the entry of a pay TV wholesaler.

Conclusion on entry by other pay TV operators

283. We consider that without the key commitments RSPs may have supported the entry of another pay IPTV provider, in particular a pay TV wholesaler. However, the evidence supporting this is limited.

284. For OTT providers, such as Quickflix and Coliseum, it is not clear that the key commitments have historically materially hindered their entry or expansion. Currently, and in the future, the key commitments are unlikely to prevent further entry.

Comparison between factual and counterfactual

285. We consider that historically the key commitments (alone or in aggregate) across RSP contracts have had the effect of substantially lessening competition in the pay TV market.

285.1 Sky is a near monopoly in the supply of pay TV in New Zealand, such that any new entry were it to occur would have significant benefits for New Zealand consumers.

285.2 [ ].[217]

285.3 The RSP contracts alone (or in aggregate)[218] increased barriers to entry to the RSPs, some of the most likely entrants into the pay TV market.

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[214] [ ].
[215] [ ].
[216] [ ].
[217] See paragraphs 255 to 256 for more details.
[218] Under section 3(5), we do not need to reach any decision on the individual effect of one RSP contract.

285.4 There is some evidence to suggest that, without the key commitments, one or more RSPs would have entered the pay TV market (or entered to a greater extent in the case of TelstraClear).

285.5 While this entry may initially have been limited, given the market structure and prospects of other entry, this lessening of competition is substantial.

286. For other pay TV providers there is no clear evidence that without the key commitments RSPs would have unmetered an OTT provider and there is only limited evidence that absent the key commitments RSPs may have supported the entry of a pay TV wholesaler.

287. It is less clear that in the future the key commitments will continue to constrain RSPs' behaviour given [

].

Conclusion on whether the provisions of RSP contracts breach section 27

288. We consider that the purpose of the key commitments was, and is, to substantially lessen competition in the pay TV market.

289. We also consider that historically there is evidence suggesting that the key commitments have had the effect of substantially lessening competition in the pay TV market. We therefore consider that the key commitments of the RSP contracts have historically breached section 27.

290. Given market developments we consider the key commitments are unlikely to continue to have the effect or likely effect of substantially lessening competition. This is because, in no particular order:

290.1 Telecom is not currently offering Sky's services to new customers and as such has a reduced incentive to remain with Sky [

];

290.2 Telecom was recently granted an exemption to the key commitment provisions by Sky so that it can offer an alternative pay TV product;

290.3 Vodafone has recently signed new contracts with Sky and, [

][219] [

]; and

290.4 entry by other pay TV providers is more likely than it has been in the past.

[219] Following the acquisition of TelstraClear by Vodafone the reference to Vodafone also reflects the position of TelstraClear.

291. Nevertheless, it would remain the case that the contractual restrictions are wider than we consider would be necessary to protect Sky's position. As such we may have concerns in future if Sky were to sign further contracts with RSPs including key commitment provisions, and not provide reasonable exemptions in existing or new contracts.

Sky's contracts with RSPs – Section 36

292. Our investigation has largely focussed on section 27. However, we explain below why Sky may also have breached section 36 through its conduct in relation to the key commitments.

Substantial degree of market power

293. Largely for the reasons explained in relation to our section 27 analysis, we consider that Sky likely has a substantial degree of market power in the supply of pay TV to consumers in New Zealand.

294. We consider that Sky is substantially unconstrained by competitive pressures.

   294.1 Sky's share of the supply of pay TV to consumers in New Zealand has been close to a monopoly for a sustained period of time.

   294.2 Sky faces, and has faced, little effective existing competition for the supply of pay TV services. Apart from reseller/retransmitters of Sky service, Coliseum and Quickflix NZ have entered the pay TV market, but they currently have a relatively limited presence and are only likely to currently and in the near future provide fringe competition to Sky.[220]

   294.3 New entrants also face significant barriers to entry that they must overcome as discussed above (see paragraphs 175 to 178).

Taking advantage of market power

295. As required by the Supreme Court's comparative exercise test for taking advantage, we describe what we consider to be the features of the relevant hypothetical workably competitive market.

Hypothetical market

296. Sky's market power arises from the content under its control and the size of its subscriber base with the related economies of scale (see paragraph 177 above).

297. To strip out Sky's substantial degree of market power in the retail market for the supply of pay TV to consumers in New Zealand, we assume that there are at least two firms in effective competition with one another.[221] We call these firms Sky1 and Sky2, or S1 or S2 for short.

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220 [ ].

221 See *Telecom Corporation of New Zealand Limited v Clear Communications Limited* [1995] 1 NZLR 385 (PC); *Carter Holt Harvey Building Products Group Limited v Commerce Commission* [2006] 1 NZLR 145 (PC); *Telecom Corporation of New Zealand Limited v Commerce Commission* [2012] NZCA 278 (CA) (*Data tails*).

298. In this market, each of S1 and S2 has a sufficient range of content[222] under its control and a sufficiently large subscriber base to be an effective competitor to one another. Each of S1 and S2 has an effective method to transmit its services to consumers.

299. We assume both S1 and S2 offer a range of "tiers" of content, similar to Sky, such as a basic package, a movie package and a sports package. Both offer online catch-up services and PPV services, similar to Sky's (but only for the content under their control).

How would a business rationally act?

300. When considering how a business without substantial market power but otherwise with the same characteristics as Sky (a comparator business) would act, we have considered two questions.

    300.1 Would this business enter into contracts with RSPs?

    300.2 If it would, what restrictions would this business require in contracts with RSPs?

S1 would supply

301. Largely for the reasons identified in our section 27 analysis, we consider that a comparator business would likely want to enter into resale and retransmission contracts with RSPs. S1 and S2 would each want to achieve the benefits identified by Sky, namely increased demand and reduced churn. The reasons for this are the same as why Sky would supply without the key commitment as we explained above (see paragraphs 211 to 220).

No key commitments

302. Our view is that:

    302.1 S1 may not require a clause similar to the key commitments; but

    302.2 S1 would be likely to include a clause similar to the clause preventing bundling.

303. As noted above, our reasons for these views largely mirror our analysis for section 27 (see paragraphs 211 to 220).

304. In relation to the bundling provisions, in our view, Sky is entitled to prevent RSPs from bundling competing TV products with Sky's to protect its brand and it is therefore likely that S1 would include a similar clause.

305. In relation to the key commitments, we note that a business in a workably competitive market, such as S1, would not be able to enter into a contract which

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[222] Including premium sport, movies, documentaries etc.

more than compensated for its opportunity cost, as competitive forces would only allow it to enter into contracts that compensated its opportunity cost.[223]

306. However, for the reasons explained earlier, we do not consider that the key commitments are a means to assure that Sky's opportunity costs in supplying RSPs at the wholesale level are protected. Sky's opportunity cost relates to the value it would have achieved without the contract. It does not appear that Sky has taken this approach in practice.

307. As the key commitment is not explained by Sky's submitted reasons, S1 may not be able to impose these terms in the counterfactual market. This is because if S1 attempted to impose such terms, then an RSP would simply acquire content from S2 without these contractual restrictions. S2 would be willing to provide such services as it would be compensated for its opportunity costs in doing so.

308. As a result, S1 may therefore act in a different way in the counterfactual than Sky has in the factual. It follows from this conclusion that Sky may be taking advantage of its substantial market power by imposing the key commitments.

Anti-competitive purpose

309. We consider that when assessed objectively, Sky had the requisite anti-competitive purpose for section 36 to be breached.

310. More specifically, we consider that Sky has likely acted as it has to:

310.1 restrict the entry of RSPs into the pay TV market and the acquisition of content rights; and

310.2 prevent RSPs from engaging in competitive conduct in those markets.

311. We consider that this can be established from:

311.1 a plain reading of the RSP contracts. The contracts suggest that Sky's purpose is to hinder actual or potential rivals competing;

311.2 documents supplied by Sky that suggest it had an anti-competitive purpose; and

311.3 a court inferring an anti-competitive purpose if we establish that Sky had taken advantage of its SMP which had resulted in an anti-competitive effect – to which much of the analysis in the section 27 assessment will be relevant (see paragraphs 142 to 169).

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[223] S1 would not be able to achieve a more favourable outcome for it, as any RSP would switch to S2, who would be similarly constrained by S1.

Conclusion on whether Sky's conduct relating to the RSP contracts breaches section 36

312. We consider that:

312.1 Sky is likely to have a substantial degree of market power in the supply of pay TV to consumers in New Zealand;

312.2 Sky may have taken advantage of its substantial market power, as there is basis for arguing that Sky would have acted differently if competing in a hypothetical competitive market because a comparator business in a hypothetically competitive market:

312.2.1 would likely have entered into resale or retransmission contracts with RSPs to reduce customer churn and access new customers; and

312.2.2 would not likely have included key commitments in the RSP contracts given our view that Sky's stated rationale for the key commitments does not suggest that they could be sustained in a workably competitive market; and

312.3 if Sky were found to have taken advantage of its substantial market power and that this had resulted in an anti-competitive effect, we consider there is a strong argument that Sky would also be found to have had the requisite anti-competitive purpose.

Sky's content acquisition contracts

313. In this section, we explain:

313.1 the key provisions of Sky's content acquisition contracts;

313.2 how these provisions might harm competition (the theories of harm);

313.3 the likely scope of the relevant markets; and

313.4 our assessment of whether the provisions of Sky's content acquisition contracts are likely to breach sections 27 and 36, assessing the theories of harm in turn.

The key provisions of Sky's content acquisition contracts

314. In this section, we summarise the provisions of Sky's contracts with content providers in three categories:

314.1 pay TV movie contracts;

314.2 live sports rights; and

314.3 first-run TV series.

Sky's pay TV movie contracts

315. Sky has [ ] contracts with each of the seven major studios.[224] For each studio:

315.1 [ ]; and

315.2 [ ].[225]

316. [ ].

317. The contracts themselves last [ ] years.

318. The contracts tend to [ ]. Sky estimates the values of each of these contracts range between [ ].

[224] Disney, Columbia, Fox, MGM, Paramount, Universal, Warner's. MGM is classified as non-major studio by the UK Competition Commission but Sky has classified it as a major.

[225] [ ].

319. [

],[226] [ ][227] [ ].

Sky's contracts for live sports rights

320. [ ] of Sky's [ ] largest content contracts by value relate to sport: those for [

],[228] [

].[229] The duration of these rights varies between [ ] and [ ] years. Sky estimates the values of these contracts vary between [ ] each.

321. Typically, Sky acquires [

].[230] Each of these contracts [

].

Sky's contracts for first-run TV series

322. The other [ ] of Sky's [ ] largest contracts by value relate to first-run television series, namely the contracts with:

322.1 [

];

322.2 [ ];

322.3 [ ];

322.4 [ ]; and

322.5 [ ].

323. All of these contracts are for the acquisition of linear channels.

324. These contracts last [ ].[231]

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226 Basic pay TV refers to the basic package that is offered by pay TV broadcasters (in the case of Sky, it would be the Sky basic package).

227 Premium pay TV refers to the additional packages that can be added on to the basic package offered by a pay TV broadcaster (in the case of Sky, these would be the Sport Package, the SoHo channel, the Movies package).

228 [

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229 [ ].

230 [ ].

231 If one did not take this approach, the duration would be [ ].

325. Sky has told us that in these contracts exclusivity relates to the channel (ie, the brand), not the content itself. That is, the provider of a channel can switch content in and out at will. [ ].[232]

Theories of harm

326. In light of the complaints that we have received, we have developed two theories of harm regarding Sky's content acquisition contracts.

326.1 Do Sky contracts with content providers deny potential rival pay TV providers access to sufficient content within a reasonable time period to enter effectively?

326.2 Has Sky bought more content than it needs ('over-buying') to prevent or hinder entry effectively?

Theory 1: Do Sky contracts with content providers deny potential rival pay TV providers access to sufficient content within a reasonable time period to enter effectively?

327. This theory is the classic theory of input foreclosure by way of exclusive dealing:[233] the firm with market power has contracts for the supply of an important input that effectively deny the input to a competitor in sufficient quantity to allow that competitor to become effective.

328. In this case, the provisions of Sky's contracts with content providers may have the purpose, effect or likely effect of substantially lessening competition if those contracts are exclusive, long-term and overlapping such that within a reasonable time period insufficient content would be available for a potential rival to be able to put together an appealing pay TV package.

329. These contracts may also amount to Sky taking advantage of its SMP if Sky would not have acted in the same way without SMP.

Theory 2: Has Sky bought more content than it needs to prevent or hinder entry?

330. This theory involves Sky potentially over-buying content so that it is not available for potential rivals. This would harm competition in the same way as theory 1: for Sky to harm competition in this way, its conduct must have denied rivals' access to sufficient content that would otherwise have facilitated entry. However, this type of conduct is likely to be harder to justify in business terms.

Market definition

331. This section explains the likely scope of the relevant markets.

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[232] [ ].

[233] An example of it includes *Theatre Enterprises Inc. V. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954), as referenced in Dennis Carlton and Jeffery Perloff, Modern Industrial Organization, 1990, p. 751.

332. In the Sky/Prime decision,[234] we considered the relevant markets relating to the acquisition of *premium* content were the markets for the acquisition of:

   332.1 premium movies by pay TV broadcasters;

   332.2 premium movies by FTA broadcasters;

   332.3 live sports rights by TV broadcasters; and

   332.4 first-run TV series by TV broadcasters.

333. There are no more recent New Zealand decisions which have considered these markets.

334. When assessing the market for movies on pay TV, the UK CC considered there to be separate markets for the acquisition of movie rights in the first subscription pay TV window and the acquisition of movie rights in later windows.[235] This is consistent with the market definition we used in Sky/Prime. That is, it was based on the acquisition by pay TV of premium movie rights being for the first subscription pay TV window and the acquisition of premium movies by FTA broadcasters being for the rights in later windows.

335. Interested parties have highlighted the acquisition of premium content (including movies, sport and first-run TV series)[236] as being separate from other content. In addition, interested parties have noted the differences between the types of premium content in terms of the price paid for the content, the suppliers of the content, the way in which the content is marketed and aired on TV, and the relative importance to their pay TV and FTA TV retail offering.

336. To assess the key competitive issue in this investigation we do not need to conclusively define markets for the acquisition of different types of premium content. We adopt broadly the same markets as used in Sky/Prime, namely markets for the acquisition of:

   336.1 premium movies in the first subscription pay TV window;

   336.2 premium movies in windows after the first subscription pay TV window;

   336.3 live sports rights; and

   336.4 first-run TV series.

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[234] Sky Network Television Limited and Prime Television Limited (Commerce Commission Decision 573, 8 February 2006).

[235] United Kingdom Competition Commission Report: Movies on pay TV market investigation, 2 August 2012.

[236] We note that some content is sold packaged as channels with an associated brand, for example MTV, however this does not materially impact the market definition of premium content as these channels are aggregating this content and selling it to TV broadcasters/transmitters in a similar manner to other content suppliers such as HBO or Fox.

337. We now address whether provisions of Sky's content acquisition contracts breach sections 27 and 36, assessing the theories of harm in turn.

Do Sky contracts with content providers deny potential rival pay TV providers access to sufficient content within a reasonable time period to enter effectively?

No breach of section 27

338. Provisions of Sky's content acquisition contracts do not have the purpose, effect or likely effect of substantially lessen competition by denying potential rival pay TV providers access to sufficient content within a reasonable time period to enter effectively.

339. We do not consider that the provisions of the content contracts have an anti-competitive purpose. Such a purpose is not readily apparent on the face of the provisions of the contract.

340. In terms of evidence of Sky's purpose, we have only very limited evidence indicating that Sky may have a substantial anti-competitive purpose, and we consider that a court is unlikely to find that Sky's contracts have a substantial anti-competitive purpose. One recent Sky strategy document notes that Sky was investigating [ ].[237] In another document, Sky noted that [ ][238] This might suggest that Sky's intention was to restrict rival pay TV operators from obtaining access to sports content, or it might suggest that Sky could [ ].

341. We consider that provisions of Sky's content acquisition contracts, individually or aggregated together under section 3(5), do not have the effect and likely effect of substantially lessen competition, as the contracts are not sufficiently extensive, exclusive, long-term and overlapping to prevent rivals' developing attractive competing products.

342. This seems consistent with some, limited evidence from interested parties' views. For example, one of Telecom's internal documents states "[ ]"[239] and Coliseum stated that it [ ].[240]

343. Sky's contracts with film providers do not raise concerns under section 27 as they are unlikely to materially impede entry.

[237] [ ].

[238] [ ].

[239] [ ].

[240] [ ].

344. Our view is that an entrant would be likely to enter using library content (which is available on a non-exclusive basis) initially. The entrant may then seek to compete for one contract from a content provider such as a major or mini-major movie studio. For example, Quickflix has already entered in New Zealand using library content. [ ].[241]

345. In the UK new entrants Netflix and LOVEFiLM sought one contract for first subscription pay TV movie rights initially.[242] However the theory of harm requires a new entrant to need more than one contract, and so with the type of entry we consider to be likely it does not hold. In addition, we note that:

345.1 the exclusivity in Sky's first pay window (and other) film rights acquisition contracts does not stop others acquiring TVOD rights; and

345.2 contracts with the major film studios come up for renewal regularly. [ ].[243] [ ].[244] [ ].[245] [246]

346. Sky's contracts with sports rights providers are unlikely to prevent entry into the pay TV market in breach of section 27.

346.1 New entrants focussing on a SVOD model have told us that they do not necessarily need sport. Quickflix has entered in New Zealand and Australia without sport content. Netflix and LOVEFiLM do not show sport.

346.2 [

241 [ ].

242 Indeed, the UKCC noted in its final report at [35] that "between them, Netflix and LOVEFiLM had already signed exclusive first-pay window movies agreements with most of the large non-major studios, which suggested that there were no material barriers to the acquisition of first-pay window movies content from this group of studios." A new entrant could also compete for films in the second pay TV / FTA window. While not as recent or valuable as films in the first subscription pay TV window, these rights are typically available around 12 months after the first availability of pay TV rights, but this appears to vary between studios. LOVEFiLM in the UK acquired some of these rights in May 2012. http://www.telegraph.co.uk/technology/news/9300457/Lovefilm-signs-exclusive-film-deal-with-Universal.html

243 [ ].

244 [ ].

245 [ ].

246 [ ].

].[247]

346.3 New entrants focussing on a fuller range of service may need sport. [

].[248] Again, the theory of harm requires a new entrant to need more than one contract, and so with the type of entry we consider to be likely it does not hold, and Sky's contracts are unlikely to have the likely effect of substantially lessening competition.

347. Sky's contracts with TV series providers do not raise concerns under section 27, as sufficient content is not covered by Sky exclusivity, whether one considers programmes or channels. We consider these issues in turn.

348. Sky's contracts for programmes, in aggregate, do not prevent or hinder rivals for competing for content. Of the largest five of these, [

],[249] [ ]. Sky estimates that the value of these contracts ranges between [ ].

349. TVNZ and MediaWorks have held significant output deals with studios for programming. TVNZ has [ ].[250] MediaWorks has [ ].[251] It also acquired a substantial amount of content from CBS and NBC, although the latter expired at the end of 2012, and MediaWorks will not be renewing the rights, as it focuses more on local content.[252]

350. We have also considered the possibility of competition for channels, [

].[253] This is consistent with Sky's services in New Zealand: the vast majority of its content is channels it has bought. [ ]:

350.1 [ ];

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247 [ ].

248 [ ].

249 [

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250 [ ].

251 [

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252 Media article: MediaWorks to buy more local TV shows as CBS rights expire, NBR (1 June 2012). [

].

253 [ ].

350.2 [ ];

350.3 [ ]; and

350.4 [ ].

351. [ ].[254] [ ].[255] [ ].[256] It does not therefore appear that the contracts are sufficiently overlapping for the aggregate effect to substantially lessen competition under section 27 for channels.

352. [ ] raised a specific concern with Sky's contract with HBO. [ ] noted that this contract damages competition in particular as it prevents the sale of library content and newer TV content important to SVOD entrants. HBO has told us [ ].[257] Sky has stated that it estimated a payback period of [ ] years for the [ ]. The degree of exclusivity may be justified by Sky's investment in this new channel. Furthermore, this concern relates to one studio's content, so while the content is highly valued, rights to some other TV programmes are likely to be substitutes for it.

353. [ ] raised a concern of Sky obtaining both linear and VOD rights together. The evidence collected does not support this occurring. Indeed, a recent Sky document notes that "[ ]".[258]

No likely breach of section 36

354. As indicated above we consider that Sky has a substantial degree of market power in the supply of pay TV to consumers in New Zealand. Sky's share of the supply of the pay TV market has been close to a monopoly for a sustained period of time, and new entrants also face significant barriers to entry that they must overcome.

254 Ibid.

255 [ ].

256 [ ].

257 Telephone call with HBO (25 July 2012).

258 [ ].

355. We consider that it is unlikely that Sky has taken advantage of its substantial degree of market power by including exclusivity provisions for content.

356. In a hypothetical workably competitive market, a business without a substantial degree of market power, but otherwise with the same characteristics as Sky, would likely have obtained contracts with content providers of similar duration, degree of exclusivity and degree of overlap. Other broadcasters in New Zealand also have contracts with similar exclusivity and duration provisions.

Has Sky bought more content than it needs to prevent or hinder entry effectively?

357. Sky has not bought any non-sports content that it has not used or planned to use in the last three years.[259] It has purchased, but not aired, limited sports content where all rights to a tournament or event, such as the 2012 London Olympics, were sold together.[260]

358. We therefore consider that Sky has not breached the Commerce Act through anti-competitive overbuying.

Conclusion

359. We consider that Sky's content contracts, either individually or in aggregate, have not breached section 27 or Sky's concomitant conduct has not breached section 36.

[259] Letter from Buddle Findlay to the Commission (20 July 2012).
[260] Emails from Buddle Findlay to the Commission (18 February 2013 and 19 February 2013).

Conclusion of assessment under sections 27 and 36

360. We therefore consider, on the basis of our investigation, that:

    360.1 when taken together, the key commitments in the RSP contracts have previously breached sections 27;

    360.2 the key commitments appear unlikely to continue to have the effect or likely effect of substantially lessening competition;

    360.3 the prohibition on bundling provisions in the RSP contracts do not raise concerns under sections 27 or 36; and

    360.4 provisions of Sky's content acquisition contracts with content providers do not raise concerns under sections 27 or 36.

Decision on what action to take

361. We have decided to issue Sky with a formal warning for engaging in conduct that, in our opinion, breached the Commerce Act, rather than commencing court action. The formal warning is in relation to the key commitments being likely to have previously breached section 27 of the Commerce Act.

362. While we consider that Sky's RSP contracts appear unlikely to continue to have the effect or likely effect of substantially lessening competition, we will continue to monitor Sky's existing and new contracts with RSPs and Sky's conduct in relation to those contracts. This section explains how we decided to issue a warning letter and not commence court action against Sky.

363. We have decided not to take court action, but rather issue a warning because:

    363.1 the key commitments in the current RSP contracts are, on the facts available to us, unlikely to lead to detriment in the future; and

    363.2 the public interest is not in favour of the Commission commencing court action, given the costs, risks and uncertain future benefits involved.

364. In reaching this decision, we have considered our Enforcement Criteria, which set out how we decide whether to commence or continue enforcement action and the most appropriate response in each case.

365. Our Enforcement Criteria are:

    365.1 extent of detriment;

    365.2 seriousness of conduct; and

    365.3 public interest.

Extent of detriment

366. While the key commitments may have led to detriment in the past in the pay TV market,[261] the key commitments in the current RSP contracts are unlikely to lead to detriment in the future, in particular as Telecom's contract [ ] and its incentive to re-sign may be diminished. Any case may therefore risk being of less and less relevance to the pay TV market in the future.

Seriousness of conduct

367. While Sky may not have breached a per se provision of the Commerce Act, a breach of the Commerce Act of this kind is serious.

Public interest

368. While court action may deter future breaches of the Commerce Act, in particular sections 27 and 36, a warning letter is more likely to be in the public interest.

368.1 Any court action could be costly and risky with uncertain future benefits.

368.2 As the market develops, the arguments may appear even more historic by the time of any court hearing.

368.3 A warning letter will put Sky and others on notice of our concerns under the Commerce Act.

[261] There may also have been follow-on impacts in other, related markets, such as telecommunications, if the conduct prevented greater competition emerging through competing triple-play bundles, but we do not have direct evidence that this has been the case.

Attachment - Industry background

369. Television viewing is changing rapidly. Traditionally operators have offered channels in which programmes are available at certain times ('linear TV'). However this is increasingly supplemented by VOD, which is available at any time. This trend may continue.[262]

370. This attachment gives an overview of the pay TV industry, in particular:

 370.1 how video may be transmitted;

 370.2 linear pay TV;

 370.3 VOD; and

 370.4 content rights.

How video may be transmitted

371. Video may be transmitted by a variety of technologies, for example, analogue, digital terrestrial broadcast on UHF or VHF frequencies, satellite, cable and internet (IPTV).[263]

Linear pay TV

372. Linear pay TV providers secure rights to content (including sports, movies and premium drama) to deliver multiple channels with specialised programming. This model is funded largely from subscription revenue.

VOD

373. VOD can include free content (free VOD) and paid content (pay VOD). This in turn can be broken down into various forms, including:

 373.1 subscription VOD (SVOD), where viewers pay a monthly amount to view an unlimited amount of content – this is the model used by, for example, Netflix and Quickflix; and

 373.2 transactional VOD (TVOD) or PPV, where viewers make a one-off payment to view a particular film, game or event – this is the model adopted by, for example, iTunes.

374. VOD has the potential to allow new players to enter into the supply of low-cost pay TV,[264] which is what has been observed overseas.

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[262] TVNZ launched its VOD services in 2006 and, as noted, Quickflix entered the New Zealand market with a VOD product in March 2012.

[263] IPTV is a system through which television services are delivered using the internet protocol suite over a packet-switched network, such as the internet, instead of being delivered through traditional terrestrial, satellite signal, and cable television formats.

[264] VOD rights typically cost less than pay TV or free-to-air rights, as they are generally for library movies or second/third run TV series.

375. IPTV appears to be becoming an important alternative vehicle for the delivery of pay TV in many countries worldwide. IPTV and triple play (combining voice, broadband and video services into a single bundled package) providers are emerging globally.

376. In New Zealand, TVNZ, MediaWorks and Māori Television all offer free catch-up VOD to viewers.

377. Sky's catch-up VOD service, iSky, is free to all Sky subscribers. Sky also operates Sky Box Office, comprising 14 PPV channels. Sky also offers a pay VOD service for MY Sky and MY Sky HDi consumers. New movies are downloaded to the MY Sky hard drives each week and can be purchased on a PPV basis. Sky Box Office and the service for MY Sky and MY Sky HDi are forms of TVOD.

378. In addition, Quickflix has been available in New Zealand since March 2012 and Apple TV is also available. Both offer pay VOD services: SVOD and TVOD, and TVOD respectively.

Data caps and unmetering

379. In New Zealand RSPs offer their internet packages with varying restrictions on the amount of data a customer can use in any given month without incurring additional charges or speed restrictions. These are referred to as data caps.

380. Some RSPs exclude the use of certain websites from the data usage which counts towards a customer's data cap.[265] This is referred to as the unmetering of a website.[266]

Content rights

381. Pay and free-to-air TV providers acquire the licensing rights from content providers, aggregate the programming and show it to their viewers. Sky also wholesales the content to RSPs, who bundle the content with their own telecommunications services for retransmission or resale to their customers.

382. The way in which content rights are sold in New Zealand varies for different types of content. We explain below how rights are sold in New Zealand for:

    382.1 films;

    382.2 general entertainment TV series; and

    382.3 sport.

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[265] For example Vodafone unmeter the iSky website. http://www.vodafone.co.nz/entertainment/tv/sky/isky/, and Orcon unmeter various websites through their O-Zone promotion http://www.orcon.net.nz/home/page/o_zone.

[266] For a more comprehensive discussion on data caps and unmetering see the Commission's Demand Side Study Issues Paper 1 (http://www.comcom.govt.nz/assets/Telecommunications/Studies/UFB-Demand-Side/High-speed-broadband-technical-issues-paper-19-December-2011.pdf).

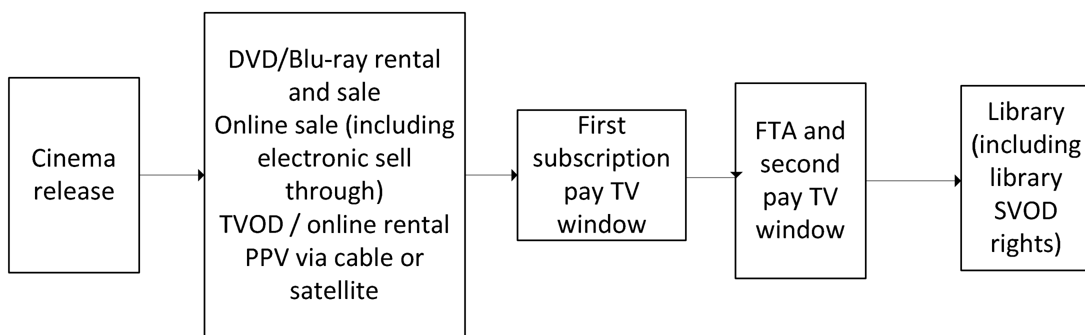
Film rights

383. Studios generally sell films through a window structure. This involves a series of discrete windows, or time periods, in which the film is available on one or more platforms/business models (eg, cinema, pay TV). These windows may be time-limited (eg, first pay TV window), or may be open-ended (eg, once a film is available for sale on DVD, it remains there).

384. With the advent of VOD, the traditional window structure is in flux. However, we consider that the window structure diagrams below are indicative of current market practice.

385. Figure 1 sets out the window structure sale for films in New Zealand.[267]

Figure 1 – Window structure for films in New Zealand



386. Rights for films in TV windows (both pay TV and free-to-air) are typically exclusive. However, there are some exceptions, particularly with the advent of VOD. We understand the following arrangements occur.

386.1 In New Zealand, there is no 'hold-back'[268] against TVOD for 'first run' movies in the pay TV window. This means that it is possible to show a new release movie on TVOD at the same time as it is being shown for the first time on Sky.[269]

386.2 TVOD rights are sometimes available at the same time as DVD/Blu-ray rental (day and date release).

386.3 Overseas, SVOD operators (eg, Netflix and LOVEFiLM) compete against pay TV operators in the first pay TV window.[270] This involves an SVOD operator competing head-to-head for content exclusivity with traditional pay TV

267 [ ].

268 Hold-back refers to when the film studio agrees not to make the content available in another window, during, and, in some instances, before the window for which the exclusivity applies.

269 [ ].

270 UK Competition Commission report – Movies on pay TV market investigation, 2 August 2012. [ ].

operators. We understand that this model has yet to be tested in New Zealand.

386.4 Library SVOD movie rights (ie, rights to movies that have passed through the windows) and TVOD movie rights tend to be non-exclusive around the world.

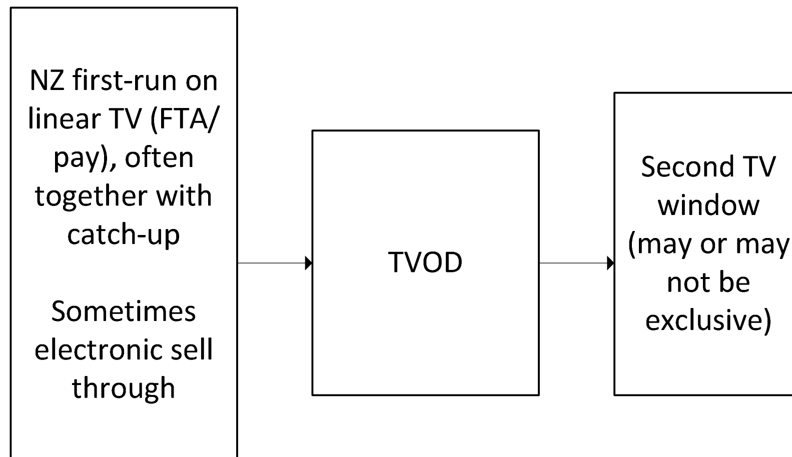
386.5 It may take up to eight years after the first cinema release of a film for the library SVOD rights to become available.

Rights to general entertainment TV series

387. General entertainment rights are also sold through a window structure. Local general entertainment shows can also be commissioned directly by TV operators.[271]

388. Figure 2 sets out the window structure for general entertainment TV series in New Zealand.

Figure 2 – Window structure for general entertainment TV series in New Zealand



Source: [ ]. It is unclear where SVOD rights would sit in this diagram, as these rights have not yet been obtained by any broadcaster in New Zealand. We consider that SVOD operators may be able to compete for these rights against traditional broadcasters in the New Zealand first-run linear TV window.

389. Historically free-to-air operators have held the majority of general entertainment TV rights.[272] TVNZ submitted that free-to-air operators currently hold [more than 90%] of these rights.[273] However, in recent years, Sky has acquired more of these rights, such as the right to show HBO series for the first time in New Zealand.[274]

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271 [ ] stated that [ ] of local programming is commissioned. [ ].

272 Sky Network Television Limited and Prime Television New Zealand Limited (Commerce Commission Decision 573, 8 February 2006) at [123] states that: "first-run series have almost exclusively been shown by the three national free-to-air broadcasters…"

273 [ ].

274 [ ].

Nonetheless, free-to-air operators continue to obtain a large majority of the first-run rights to general entertainment series.

390. First-run rights for general entertainment TV series are often exclusive and often run for several years.[275] In New Zealand, there is also typically hold-back against TVOD for first-run television series until the date when the series has completed its first run.[276]

391. First-run series are sometimes sold as part of output deals between a content rights holder and a broadcaster or other aggregator of content. These output deals typically involve the purchaser acquiring some or all of the TV series produced by the content right holder. They typically include exclusivity over the content for the length of the output deal (normally five to seven years). The rights holder's content is then subject to competition at the end of each output deal. Many overseas produced TV series are sold to New Zealand broadcasters in this way.

392. Many other first-run television series are purchased on a one-off basis and are not subject to output deals (all New Zealand produced content is sold to broadcasters in this way). For these series, the exclusivity only lasts until the end of the individual series broadcast.

393. As well as acquiring rights to content, TV operators can acquire certain channels. These channels may also be exclusive to one platform. For example, Sky has exclusive rights to some channels in New Zealand [

].[277] [

].[278] In Australia, Fetch TV said that it has set up SVOD "channels" [

]. For example, it has 25 BBC documentaries available as VOD under the "BBC Earth" banner.[279]

394. We have been told that, in general, only library rights for pay TV are non-exclusive.[280]

Sport

395. Sports rights are not sold through windows, reflecting the value to viewers of live or recent sport events over historic sporting events. Rights are often sold on an exclusive basis to maximise the value obtained by the owner of the rights (such as the sports body in question).

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275 Sky's largest [ ] content acquisition agreements vary in length from [ ], but in some cases have been extended beyond that period. Sky stated that these agreements typically last [ ]. [ ]. TVNZ's largest [ ] content acquisition agreements vary in length from [ ].

276 Meeting with Sky (26 March 2012), email from Buddle Findlay (5 April 2012).

277 Letter from Sky to the Commission (23 March 2012).].

278 Ibid.

279 Telephone call with Fetch TV (2 April 2012).

280 [ ].