11 November 2016 **PUBLIC VERSION**

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From
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Dear Susan

SKY/Vodafone: SKY submission in response to letter of unresolved issues

1. This submission responds to the Commission's letter of unresolved issues, dated 31 October 2016.

2. SKY submits that there is ample evidence for the Commission to be satisfied that there is no real chance of the proposed transactions substantially lessening competition in any market. This includes the national retail market for the provision of residential fixed-line broadband services, and the national retail market for the provision of mobile services.

3. SKY submits that the evidence already provided to the Commission, and analysis based on that evidence, establishes that the proposed transactions will provide benefits to consumers by enabling the combined entity to improve services and bundles of services, and increasing competition in telecommunications markets.

4. SKY acknowledges that competitors of the merged entity are not happy about the proposed transactions. However, they have been unable to produce evidence that establishes competitive detriment. As a result, the Commission should conclude that it is increased competition that those parties are concerned about.

5. In this submission, we address:

   (a) the framework for assessing whether a conglomerate merger will have the effect, or likely effect, of substantially lessening competition in a market;

   (b) why there is no real chance that the proposed transaction could result in one or more of the merged entity's rivals in the broadband market or in the mobile market losing scale, to an extent that prevents them from providing an effective constraint on the merged entity and substantially lessens competition. In particular, we address why:

(i) the merged entity will have incentives to continue to sell standalone SKY. This means that the merged entity will have incentives to ensure that standalone SKY remains an attractive product. The Commission's theory of harm, under which the merged entity drives so many customers away from rival telecommunications providers that they are no longer able to provide an effective constraint on the merged entity, does not hold; and

(ii) the merged entity will have the same incentives as SKY in the counterfactual to resell SKY services, and on the same terms as SKY offers today. Rival telecommunications providers will continue to have the ability to offer bundles of telecommunications and SKY services, bundles of telecommunications and other services, or standalone telecommunications services that can compete with a SKY/Vodafone bundle. Rival telecommunications providers will continue to provide an effective constraint on the merged entity, and there will be no substantial lessening of competition; and

(iii) if and when fibre is unbundled in 2020, smaller broadband providers will be just as able to compete with the merged entity; and

(iv) premium live sport content is the content least likely to be consumed over mobile networks. Putting aside the merged entity's incentives to wholesale, the merged entity's rivals in markets for mobile services will continue.

6. As part of that analysis, we also address the Commission's concerns that the merged entity's portfolio of premium content rights, including for live rugby, may enable the merged entity to pursue the strategies of concern to the Commission.

Framework for assessing conglomerate mergers: effect or likely effect of substantially lessening competition in a market

7. As set out in paragraphs 11.6 to 11.8 of the clearance applications, the Commission has previously recognised that bundling is generally pro-competitive. It is only in very limited circumstances that bundling may have the effect of substantially lessening competition.

8. The Commission states in the letter of unresolved issues that it is not yet satisfied that the proposed transaction will not have the effect or likely effect of substantially lessening competition in a market, because "*one or more rivals may lose customers to such an extent that they no longer provide an effective constraint in a telecommunications market, allowing the merged entity to profitably raise prices of a telecommunications service*".[1]

[1] Paragraph 19.4 of the letter of unresolved issues.

9. In particular:

   (a) in relation to the broadband market, the Commission is not yet satisfied about the effect of the proposed transaction on medium-sized broadband providers (rather than the largest broadband providers); and

   (b) the Commission is concerned about reductions in rivals' scale that may limit their ability to offer bundles to compete with the merged entity's bundles or that may limit the effectiveness of their bundles as a competitive constraint on the merged entity, rather than the proposed transactions forcing rivals below minimum scale.

10. SKY submits that the test set out in sections 47 and 66(3) of the Commerce Act is not directed at protecting any individual rival of the parties to a proposed transaction. Rather, the relevant test is whether a proposed transaction will substantially lessen competition in a market. Applying the test to the Commission's theory of harm, the question is whether the proposed transactions will sufficiently reduce the scale of the merged entity's rivals so that the merged entity no longer faces a constraint from rivals, or faces such a diminished constraint as to constitute a substantial lessening of competition. SKY submits that it is simply untenable to conclude that the proposed transactions could have that effect.

11. This is consistent with the Commission's previous decisions regarding the competition effects of bundling. The Commission recognised in *Vodafone/TelstraClear* that:

> "*the effect of conglomerate mergers can often lead to an increase in output if the merged entity takes into account the increased demand for a complementary product when it sets the price of the other product. As such, bundling is often pro-competitive and can lead to lower prices for consumers.*"[2]

12. The Commission's previous decisions have identified the circumstances in which bundling may give rise to competition issues. In *BlueScope Steel/Pacific Steel*, the Commission described the potential for vertical or conglomerate competition issues in the following terms:[3]

> "*We have considered whether or not the proposed acquisition would create or increase the ability and incentive of the merged entity to foreclose competitors at different levels in the supply chain by offering bundled discounts or by tying purchases of flat and long steel products together.*
>
> *In order for such a strategy to be possible and profitable, two factors would have to hold:*
>
> *90.1 that the merged entity has a "must-have" product for which there are few good, cost-effective alternatives;*
>
> *90.2 that tying or bundling the sale of this "must-have" product to a second product, which has substitutes, forecloses a competitor(s) for that second product.*

[2] *Vodafone/TelstraClear* [2012] NZCC 33, at [420].
[3] *BlueScope Steel/Pacific Steel* [2014] NZCC 8, at [89]-[91].

Any losses made by discounting the bundled product would be recouped once producers of the second product are foreclosed (or are rendered less competitively effective). The market power of the merged entity in the second product may thus be enhanced and competition may be lessened."

13. Similarly, in *Vodafone/TelstraClear,* the Commission described the potential for anti-competitive bundling as follows:

"*[Bundling] could raise competition concerns if bundling prevented rivals obtaining sufficient scale to be viable. Alternatively, bundling might take the form of predatory pricing. It would also have to be likely that following any foreclosure, Vodafone would be well positioned to exercise enhanced market power, such as increasing prices, resulting in a substantial lessening of competition.*

Bundling may be a concern in this case if the merged entity acquired the ability and incentive to foreclose its rivals. We note that pro-competitive bundling can also have an exclusionary effect as a result of superior competitive performance. An additional requirement before bundling becomes a concern, therefore, is that foreclosure would need to have the effect of substantially lessening competition.[4]

…

The Commission notes that for there to be a substantial lessening of competition as a result of anti-competitive foreclosure via bundling, the conditions of entry would need to be such that an exercise of market power by Vodafone post foreclosure would not attract price disciplining entry or expansion. "[5]

14. Paragraph 19.4 of the letter of unresolved issues suggests that the Commission is applying the test set out in sections 47 and 66(3) of the Commerce Act in a way that focuses on "*whether one or more rival may lose customers to such an extent that they no longer provide an effective constraint in a telecommunications market*", as opposed to whether rivals are forced below minimum viable scale. However, the test still requires the Commission to consider the collective constraint that rival telecommunications providers will provide on the merged entity in the factual, and SKY and/or Vodafone in the counterfactual - not merely the proposed transactions' effects on those individual rivals in isolation.

15. The effectiveness of the constraint collectively provided by competitors of the merged entity will not be diminished so as to constitute a substantial lessening of competition. In particular, the rights to premium live sports currently held by SKY are not 'must have' inputs in New Zealand's telecommunications markets.

Application of framework to the Commission's letter of unresolved issues

16. For the reasons below, there is no real chance that the merged entity could use SKY/Vodafone bundles to win enough customers for there to be a substantial lessening of competition:

[4] *Vodafone/TelstraClear*, at [408] and [409].
[5] *Vodafone/TelstraClear,* at [423].

(a) Undermining standalone SKY would be too risky, given SKY's decreasing subscriber base, and the limited number of SKY subscribers who currently purchase SKY in a bundle. A strategy based on undermining standalone SKY is extremely unlikely to cause rival telecommunications providers to lose so many customers that they can no longer provide a competitive constraint on the merged entity, to the point where competition is substantially lessened.

(b) The merged entity will have the same incentive to wholesale as SKY currently has. Telecommunications providers will continue to compete by offering discounted standalone services, and differentiated bundles that may or may not include SKY services. There is no real chance that a bundling strategy could prevent rival telecommunications providers from providing an effective competitive constraint on the merged entity, to the point where competition is substantially lessened.

(c) The possible unbundling of fibre in 2020 will not increase the likelihood of the proposed transactions substantially lessening competition in the broadband market. In particular, broadband providers will continue to be able to purchase the existing fibre service from Chorus, and will not be required to make additional investments.

(d) In any case, key content rights, particularly for premium live sports, will expire around the same time that fibre unbundling takes place. Rival telecommunications providers have the opportunity to start planning for both of those events now.

(e) The increasing consumption of content over mobile networks will not increase the likelihood of the proposed transactions substantially lessening competition in the mobile market. The source of the Commission's concerns is that SKY currently holds the contracts for a number of rights to premium live sport. However, when and how consumers watch live sport makes premium live sport the content least likely to be consumed over mobile networks.

Undermining standalone SKY would be too risky

17. Contrary to what the Commission says in paragraphs 23-28 of the letter of unresolved issues, there is no real chance that the merged entity could pursue a strategy of making standalone SKY less attractive than purchasing SKY in a bundle from the merged entity, so that enough SKY subscribers are driven to purchase the bundle to reduce the scale of rival telecommunications providers to the extent of preventing them from providing an effective competitive constraint. This is because such a strategy would be far too risky, and likely to be unprofitable.

18. Such a strategy needs to be considered in the context of:

(a) SKY's increasing content costs; and

(b) evidence of the elasticity of demand for SKY's services, such as SKY's decreasing subscriber numbers; and

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(c) the fact that a discounted bundle of SKY and telecommunications services is already available, but:

(i) there has been limited uptake of discounted SKY and telecommunications bundles; and

(ii) despite the availability of discounted SKY and telecommunications bundles, SKY's subscriber base has continued to decline.

19. As set out in paragraph 29 of SKY's submission in response to the letter of issues, SKY's content costs have increased as follows:

Table 1: SKY's content costs

	FY12	FY13	FY14	FY15	FY16
Cost of content rights	[REDACTED				
Cost of content rights as a percentage of revenue					]

20. SKY has forecast that its content costs for FY17 **[REDACTED]**.

21. SKY has already provided the Commission with evidence that its subscriber base is declining. Annexure D of SKY's clearance application provided a breakdown of SKY's subscriber numbers for its satellite service, for NEON, and for FANPASS, through to 31 May 2016. Updated figures are set out below:

Table 2: SKY subscriber numbers (linear, residential service) broken down by package[6]

	30 June 2012	30 June 2013	30 June 2014	30 June 2015	30 June 2016	31 October 2016
Broadcast Tier	[					
Basic Only						
Basic+Sport						
Basic+Movies			REDACTED			
Basic+Sport+Movies						
Introductory						
TOTAL						]

[6] SKY's subscriber numbers as at 30 June 2012, 30 June 2013, 30 June 2014, and 30 June 2015 were set out in SKY's clearance application. We have repeated them here, for ease of reference.

Table 3: Number of subscribers to NEON and FANPASS (as at the end of each month)[7]

	January 2016	February 2016	March 2016	April 2016	May 2016
NEON	**[**		**REDACTED**		
FANPASS					**]**
	June 2016	**July 2016**	**August 2016**	**September 2016**	**October 2016**
NEON	**[**		**REDACTED**		
FANPASS					**]**

22. Over the past year, SKY has **[**

REDACTED

].

23. The merged entity will not have an incentive to engage in a strategy of making standalone SKY less attractive than SKY in a SKY/Vodafone bundle, because of:

(a) the risk that the merged entity will lose a significant portion of its revenue as SKY customers cancel their subscriptions; and

(b) the risk that the merged entity will also lose telecommunications revenue, as disgruntled former SKY customers switch to other telecommunications providers. This process would likely be accelerated by rival telecommunications providers responding to the merged entity's bundled offer with their own bundles.

24. Such offers from rival telecommunications providers are likely to be as successful as a SKY/Vodafone bundle. As at 30 September 2016, **[REDACTED]**[8] of households subscribed to SKY Sport. At the end of FY16, **[REDACTED]** of subscribers to SKY Sport purchased SKY services in a bundle with Vodafone services (approximately **[REDACTED]** of all households). However, there are a number of other services that could also be included in bundles with telecommunications services, for which there is greater demand and that are more widely consumed than premium live sport. Examples include:

(a) electricity; and

(b) general entertainment content; and

(c) online video content on sites such as YouTube and Facebook, consumed on a daily basis by 45% of New Zealanders in April and May 2016;[9] and

[7] Subscriber numbers for NEON and FANPASS as at the end of each month for the period February 2015 to May 2016 (inclusive) were set out in SKY's clearance application. We have repeated the subscriber numbers for the period January 2016 to May 2016 (inclusive) here, for ease of reference.
[8] Using Statistics New Zealand's most recent estimate of the number of households in New Zealand (1,706,800 as at 30 September 2016), and the number of SKY Sport subscribers (**[REDACTED]**) as at the date of that estimate.
[9] NZ On Air, "Where are the Audiences? 2016", 28 July 2016.

(d) music streaming services, consumed on a daily basis by 33% of New Zealanders in April and May 2016.[10]

25. SKY submits that the fact that SKY services may be included in a bundle does not automatically make that particular bundle more attractive than any other bundle. As long as a bundle enables a household or individual to make savings on services demanded by that household, a household or individual would be indifferent as to the particular services across which those savings are achieved.

26. The risk that customers may choose to purchase telecommunications services from elsewhere, whether in a bundle or not, will undermine any attempt to use a strategy of reducing the attractiveness of standalone SKY to remove any competitive constraint from rival telecommunications providers. The very strategy designed to win customers from rival telecommunications providers could also drive customers towards them. This means that there is no real chance that such a strategy could substantially lessen competition (regardless of the ARPU of any switching customers).

27. In relation to some of the specific concerns highlighted by the Commission in the letter of unresolved issues, the Commission states at paragraph 25 that, "*as UFB is rolled out, the opportunity to retransmit Sky over fibre will increase. To the extent this is a lower cost means to distribute Sky and leads to lower prices, Sky's subscriber base could increase. This would increase the scope for the merged entity to attract more broadband customers and foreclose more of the market through bundling.*" At paragraph 27 of the letter of unresolved issues, the Commission further states that the process of consumers switching to UFB may present an opportunity for the merged entity to offer consumers multi-play bundles, to reduce competition in telecommunications services.

28. However, with the rollout of UFB, SKY is experiencing increasing content costs, including as a cost per user. This is because, as SKY has previously submitted, the lower distribution costs for OTT services has facilitated new entry in pay-TV markets. That has had the effect of reducing SKY's subscriber numbers, while also increasing competition for premium content rights.[11]

29. Further, for as long as SKY needs to continue to offer a satellite service to subscribers who cannot or do not want to receive SKY's OTT services or a multicast service, no matter how SKY's subscribers are distributed between SKY's OTT services (distributed over fibre) and SKY's satellite service, the merged entity will continue to face considerable fixed costs for its satellite service. The merged entity will need to continue to recover those costs. SKY is currently **[REDACTED]**. SKY expects that, even with the increasing update of OTT services, the merged entity will **[REDACTED]**. In addition, the costs of satellite distribution (not including decoders) are fixed, and do not vary according to the number of subscribers receiving the satellite service.

[10] NZ On Air, "Where are the Audiences? 2016", 28 July 2016.
[11] See Table 1.

Incentives to wholesale, and differentiated competition in telecommunications bundles

30. In paragraph 19.3 of the letter of unresolved issues, the Commission states that it is concerned that "*the merged entity would have less incentive to enter into reselling arrangements than Sky would in the counterfactual, meaning rivals would be unable to offer bundles with Sky and mobile/broadband services or offer bundles as attractive as those offered by the merged entity*".

31. The Commission goes on to say that:

    (a) because "*it is unclear how many Sky bundle customers of rival TSPs would otherwise purchase Sky through Vodafone or on an standalone basis…it is…unclear where the merged entity's incentives will lie, and we are concerned that the merged entity may consider that it is better off not offering terms to TSPs for its content that would allow TSPs to compete effectively with the bundle offered by the merged entity*" (paragraph 34 of the letter of unresolved issues); and

    (b) the merged entity "*may be prepared to incur short term losses (and lose actual or potential subscribers) with the knowledge that rival TSPs' inability to offer a competitive bundle will mean the merged entity could raise margins on telecommunications services once the competitive constraint from these TSPs is diminished*" (paragraph 35 of the letter of unresolved issues).

32. Both of those concerns rely on the assumption that, if rival telecommunications providers are unable to offer bundles that are identical (or largely identical) in price and other characteristics to those offered by the merged entity, rival telecommunications providers will be unable to compete with the merged entity. It also assumes that the rights to premium live sport content currently held by SKY are 'must have' inputs in New Zealand's telecommunications markets. SKY submits that is not the case.

33. The Commission has not adopted the "enthusiastic wholesaler" counterfactual put forward by many submitters, and has acknowledged at paragraph 30 of the letter of unresolved issues that "*the merged entity may not go so far as to outright refuse to supply*".

34. The following paragraphs outline:

    (a) why, in order to wholesale at all, the merged entity will need to offer terms to rival telecommunications providers that are workable. Those terms are likely to be the same as the wholesale terms offered by SKY today, and that SKY is likely to offer in the counterfactual; and

    (b) SKY's negotiations with other telecommunications providers to date; and

    (c) the importance of differentiated competition in telecommunications bundles, and why that means that rival telecommunications providers will not, in the factual or the counterfactual, need to rely on bundles with SKY services in order to remain competitive in telecommunications markets; and

(d) why a decision by the merged entity not to wholesale any "extra" products it may develop in the future are unlikely to significantly affect the scale of other telecommunications providers.

In order to wholesale at all, wholesale terms need to be workable for telecommunications providers

35. As previously outlined, SKY faces increasing content costs, and increasing competition in pay-TV markets. SKY considers that the increasing prevalence of OTT services are a major driver of the recent decreases in SKY's subscriber numbers, and will continue to put considerable downward pressure on SKY's revenue (because of the effect on SKY's subscriber numbers), and upward pressure on SKY's costs (by increasing SKY's content costs).

36. This means that the merged entity will continue to have incentives to wholesale SKY services. In particular, as previously outlined to the Commission:

(a) wholesale arrangements enable SKY to access customers that it may not otherwise have. This is why SKY offers extra margin in its wholesale arrangements for so-called "new to SKY" customers; and

(b) that extra access is obtained through:

(i) discounts offered by resellers to customers who buy bundles. SKY sets its wholesale prices on the basis of SKY's own retail price, minus SKY's best estimate of its avoided costs. If a reseller is able to sell SKY more efficiently than SKY, for example, by sending a single bill for all products the reseller offers in a bundle, that creates scope for the reseller to earn more margin and/or offer discounts to its customers. SKY notes that Spark offers its Lightbox service to its broadband customers as a free value-add, and Spotify to many of its mobile customers as a very heavily discounted value-add, in order to drive uptake of its services; and

(ii) extra marketing effort **[REDACTED]**. For example, **[REDACTED]**; and

(iii) building on telecommunications service providers' pre-existing relationships with households.

37. However, in order to wholesale its services at all, the merged entity will need to ensure that wholesale arrangements are carefully calibrated, so as to:

(a) not undermine standalone SKY. For example, **[REDACTED]**;[12] but

[12] As outlined above, the merged entity will not have the ability or incentive to engage in a strategy that, without technically constituting a hard tie, effectively forces consumers to purchase SKY in a SKY/Vodafone bundle.

(b) still leave enough scope for resellers to benefit from the arrangements.

38. In particular, if the merged entity offers wholesale terms that are priced so that there is no possibility of rival telecommunications providers offering bundles that can compete with those offered by the merged entity, those potential wholesale partners will simply walk away.

39. Importantly, rival telecommunications providers could develop bundles that compete with those offered by the merged entity in a number of different ways. They could include offers of bundles of telecommunications services and non-SKY services (discussed further below), and bundles that include telecommunications services, SKY services, and other services (such as electricity).

SKY's negotiations with other telecommunications providers

40. The Commission has referred to submissions from telecommunications providers, in which telecommunications providers state that they currently choose not to sell bundles with SKY services because SKY does not offer sufficiently attractive terms (as opposed to telecommunications providers not needing SKY services in order to compete).

41. Vodafone has entered into a reseller arrangement with SKY, on the basis that the terms are sufficiently attractive to Vodafone to make the reseller arrangement worthwhile. As the Commission is aware, the key terms of SKY's agreements with Vodafone are **[REDACTED]**

(a) **[REDACTED]**

(b) **[REDACTED]**

(c) **[REDACTED]**[13] and

(d) **[REDACTED]**

42. If Vodafone is able to make those terms commercially viable, other telecommunications providers should also be able to do so. If those telecommunications providers have decided that those terms are not "sufficiently attractive", that is not because SKY has offered them terms that prevent them from selling bundles that are able to compete with standalone SKY, or with the SKY/Vodafone bundle. Rather, it may be because they see themselves as deriving greater benefit from pursuing other strategies, such as competing in telecommunications markets on the basis of price, or by selling telecommunications services in bundles that include other services (such as electricity). This

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13 **[REDACTED]**

further supports SKY's and Vodafone's submissions regarding the strength of differentiated competition in telecommunications services.

43. SKY has attempted to enter into wholesale arrangements with parties other than Vodafone for a number of years. While SKY has successfully reached agreements for NEON and FANPASS, SKY has been turned down in relation to its traditional service a number of times. **[REDACTED]**[14] **[REDACTED]**.

The importance of differentiated competition

44. SKY and Vodafone have described a number of different types of offerings in telecommunications markets, that do not include SKY services. They include:

    (a) "no frills" or discounted offerings, such as those offered through Spark's Bigpipe and Skinny brands, and 2degees' offer of a $10 monthly discount to its Pay Monthly mobile customers; and

    (b) Spark's offer to its broadband and mobile customers of free WiFi from Spark's national network of telephone booths; and

    (c) Spark's offer to some of its mobile customers of free subscriptions to Spotify Premium; and

    (d) Spark's offer to its broadband customers of free subscriptions to Lightbox; and

    (e) Spark's offer to its broadband customers and some of its mobile customers of free internet security suites, powered by McAfee; and

    (f) Trustpower's offer of broadband and energy bundles.

45. Of those examples, only the "no frills" or discounted offerings are targeted at low ARPU customers. The other examples are likely to appeal to high ARPU customers, and, in some instances, are only made available to higher ARPU customers, on plans or contracts with higher price points.

46. As NERA points out in its report:

    (a) consumer preferences are heterogeneous, not homogenous. Other RSPs can and do successfully compete in telecommunications markets without offering SKY; and

    (b) Vodafone has offered discounts on, and promotions of, SKY for a number of years. However, around **[REDACTED]** of SKY Sports subscribers purchase standalone SKY, rather than a SKY/Vodafone bundle, and Vodafone's broadband market share has been trending downwards; and

    (c) consumers benefit from differentiated, dynamic competition.

47. SKY understands that the Commission has asked Vodafone for data about the success of its promotions of SKY, and that this point will be addressed further in Vodafone's submission.

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[14] **[REDACTED]**

48. An example of telecommunications providers' ability to compete with a SKY/Vodafone bundle, by bundling their services with other services, is the success of Trustpower's bundles of telecommunications services with electricity and gas:

(a) in Trustpower's Annual Report for the financial year ending 31 March 2016, Trustpower reported that, in the 2016 financial year:[15]

(i) the number of Trustpower customers who buy two or more utilities from Trustpower increased by 25,000, from 52,000 to 77,000; and

(ii) the number of Trustpower telecommunications customers increased by 24,000, from 38,000 to 62,000; and

(b) it appears[16] that a significant number of Trustpower's telecommunications customers purchase those services in a bundle:

(i) if one assumes that all of Trustpower's 31,000 gas customers purchase gas from Trustpower in a bundle with electricity, this leaves 46,000 Trustpower customers who purchase two other utilities in a bundle, ie, who purchase telecommunications services from Trustpower in a bundle. This accounts for almost 71% of Trustpower's telecommunications customers, and is an extremely conservative estimate – in addition to assuming that all of Trustpower's gas customers purchase a gas/electricity bundle, it assumes that none of Trustpower's gas customers also purchase telecommunications services from Trustpower; and

(ii) applying those same assumptions to Trustpower's customer connections data for 2015 indicates that, in 2015, at least 28,000 Trustpower customers purchased telecommunications services from Trustpower in a bundle.[17] This accounted for almost 74% of Trustpower's telecommunications customers in 2015; and

(iii) according to (i) and (ii) above, Trustpower sold at least 18,000 new bundles that included telecommunications services in the period 1 April 2015 to 31 March 2016; and

(c) Trustpower's investor briefing for November 2015 reported that "two out of three new customers were taking a bundled service including telco services". Trustpower's chief executive also commented that, in relation to the costs of implementing Trustpower's multi-product strategy, "*I actually think we're getting a better bang for buck in many ways in that we're gaining customers that are taking more than one product and we're able to use the fact that there's a second product as part of that acquisition process*".[18]

[15] For completeness, for the financial year ending 31 March 2016, Trustpower reports having 370,000 total utility accounts, consisting of 277,000 electricity connections, 62,000 telecommunications connections, and 31,000 gas connections. Those figures include 77,000 customer accounts for two or more utilities.
[16] Trustpower's Annual Report for the financial year ending 31 March 2016 does not specifically disclose the number of Trustpower customers who buy telecommunications services from Trustpower in a bundle.
[17] For the financial year ending 31 March 2015, Trustpower reported 304,000 total utility accounts, consisting of 242,000 electricity connections, 38,000 telecommunications connections, and 24,000 gas connections. Those figures included 52,000 customer accounts for two or more utilities.
[18] Jenny Ruth, *Trustpower can't see any need for new generation* (8 November 2016) National Business Review <https://www.nbr.co.nz/article/trustpower-can%E2%80%99t-see-any-need-new-generation-jr-p-196407>

49. The growth in the number of customers purchasing telecommunications services in a bundle from Trustpower can be compared with **[REDACTED]** purchasing a SKY/Vodafone bundle (under either the reseller or retransmission agreement) over the period 1 April 2015 to 31 March 2016.

50. Based on the above, and the further evidence provided by Vodafone, it is clear that bundles that do not include SKY services have, so far, been an effective competitive constraint on the SKY/Vodafone bundles offered by Vodafone, and the rights to premium live sport content currently held by SKY are not 'must have' inputs in New Zealand's telecommunications markets.

51. There is nothing to suggest that this will change in the future. Differentiated competition will continue to be an important feature of New Zealand's telecommunications markets, and, as outlined later in this submission:

    (a) the unbundling of fibre in 2020 will not change rival telecommunications providers' ability to offer differentiated bundles; and

    (b) although consumers increasingly consume content over mobile devices, the nature of the content that they consume means that this trend will not reduce the competitive effectiveness of bundles that do not include SKY services (for sport or other content).

"Extra" products developed by the merged entity will not significantly affect rivals' scale

52. The Commission has indicated that it is concerned about the potential competition implications of the merged entity developing new sports highlights or sports interview products, that it may offer exclusively to Vodafone customers. This is in the context of SKY currently holding contracts for a number of premium sports rights.

53. From a consumer's perspective, sport loses its value when it is not live. The Commission has recognised this in its previous decisions:

    (a) in the *SKY/Prime* clearance decision (2006),[19] the Commission reported that "*Industry participants stated that the nature of live sport, such as its uniqueness or its unpredictability, sets it apart from other programming such that a premium is charged for the rights to live sporting events. By screening the event in a delayed format or in an edited form, the uniqueness (and therefore its value) is reduced as the outcome of the event may already be known to the viewer*"; and

    (b) in the *Igloo* clearance decision (2012)[20] and in the *Contracts Report* (2013),[21] the Commission found that "*Sports rights are not sold through windows, reflecting the value to viewers of live or recent sport events over historic sporting events*".

[19] Commerce Commission Decision No. 573 *Sky Network Television Limited and Prime Television New Zealand Limited* 8 February 2006, at [102].

[20] Commerce Commission *Investigation report: The joint venture between Television New Zealand and Sky Network Television Limited, Igloo* 16 May 2012, at [103].

[21] Commerce Commission *Investigation Report on Sky TV contracts* 8 October 2013, at [395].

54. While some consumers may find sports replay, sports highlights or interview packages attractive, they will never drive any significant changes in the scale of rival telecommunications providers, such that they could no longer provide an effective constraint on the merged entity. In essence, such packages will never be sufficiently popular or compelling to drive such material changes in customer numbers as to result in a substantial lessening of competition.

55. This is particularly the case for interview packages and delayed coverage highlights packages, as they are, in nature, really only general content packages. However, replay packages will also never drive such material changes in customer numbers so as to result in a substantial lessening of competition.

The unbundling of fibre in 2020 will not increase the likelihood of the proposed transactions substantially lessening competition in the broadband market

56. The Commission has expressed concern that "*smaller broadband suppliers who have invested in those assets (and those that are planning to)…may not be able to achieve scale…to recoup their investment*", and may then "*leave the market or become forced to retrench*". In particular, the Commission is concerned that they may not be able to respond to the merged entity's offers, which may reduce their scale and ability to grow, and consequently reduce the competitive constraint they provide. We have interpreted those concerns as relating to the possible unbundling of fibre in 2020.

57. Although the details of fibre unbundling have not yet been confirmed, SKY understands that, if/when fibre is unbundled, telecommunications providers will still be able to purchase existing fibre services (Layer 2) from Chorus on a wholesale basis. That is, they will not be forced to make any new investments. The unbundling of fibre presents an opportunity to telecommunications service providers to make new investments to differentiate their services from their competitors', but will not unavoidably change any telecommunications service providers' costs. SKY refers the Commission to Vodafone's submission for further detail on this point.

58. Further, as NERA points out, even if telecommunications service providers do choose to take an unbundled fibre product, and thereby incur an increase in fixed costs, those costs would be sunk. It would not be rational for those sunk costs to drive telecommunications service providers to leave the market. Instead, those telecommunications service providers are likely to compete more vigorously, in order to recover their costs. Because variable costs would form a smaller proportion of overall costs than would be the case if they had not made the sunk investment, such providers would be incentivised to give greater discounts than would be the case if they continued to face the high variable costs associated with retailing a bundled product obtained from Chorus.

59. As well as Spark, SKY submits that many of the mid-sized telecommunications service providers will have access to sufficient resources to enable them to compete vigorously. For example:

(a) Vocus is listed on the ASX with a market cap of close to NZ$4.8 billion. Vocus recently merged with M2 Group, and is a leading telecommunications provider of data centres, dark fibre and international internet connectivity across Australia, New Zealand, Singapore and

America. The fact that Vocus already provides dark fibre in Australia puts Vocus in a very strong position to compete if and when dark fibre is unbundled in New Zealand.

(b) Trustpower is one of New Zealand's largest electricity generators and retailers. Trustpower is listed on the NZX, and Infratil, the infrastructure giant, holds a 50% shareholding in Trustpower. Trustpower recently acquired a 65% shareholding in King Country Energy, for $78 million.

(c) 2degrees' majority shareholder, Trilogy International Partners, recently announced that it will float its stake in 2degrees on the Canadian sharemarket. A press release issued on 1 November 2016 by Alignvest Acquisition Corporation and Trilogy International Partners stated that:

> "*AQX / Trilogy believe that each of 2degrees and NuevaTel occupy favorable positions within their respective markets. Each operates in an attractive, stable three player market; has meaningful market share; is poised to benefit from the switch from voice to data usage; has the opportunity to grow through ancillary businesses; has demonstrated significant profitability; is benefitting from recent capital investments; and owns its own infrastructure.*
>
> *Trilogy management believes both its New Zealand and Bolivian subsidiaries will deliver substantial growth over the coming years. In New Zealand, this growth is expected to come from (i) continued market share and postpaid subscriber growth, (ii) expanded bundled solutions to target the previously underserved business segment, and (iii) cross-selling fixed solutions to the existing mobile subscriber base.*"

The possible unbundling of fibre coincides with the expiry of SKY's key contracts for premium live sports rights

60. The unbundling of fibre will coincide with the time that SKY's contracts for key sports rights expire:

(a) SKY's contract with the SANZAR unions expires on 31 December 2020; and

(b) SKY's contract with New Zealand Cricket expires on 31 March 2020, or at the end of the 2019/2020 NZ cricket season; and

(c) SKY's contract with Netball New Zealand expires on 31 December 2021.

61. There is no guarantee that the merged entity will continue to hold the live rights to those entities' sports events once SKY's current contracts expire, and when fibre is unbundled. The merged entity's rivals in various markets will be aware that SKY's contracts for key sports rights expire around the same time as when fibre is unbundled (for example, TVNZ referred to when SKY's contracts expire in its submission to the Commission of 12 August 2016). Like the merged entity, if it is consistent with their strategies, the merged entity's rivals will be in a position to prepare for both the unbundling of fibre, and the process of bidding for key premium live sports rights (including establishing any partnerships they consider necessary to fund the cost of those rights).

The increasing consumption of content over mobile will not increase the likelihood of the proposed transactions substantially lessening competition in the mobile market

62. Consumers are increasingly consuming content over mobile networks, on mobile devices. However, in SKY's experience, the content being consumed over mobile networks is not live sport content. Instead, the content tends to be general entertainment content. SKY understands that music and short videos (such as YouTube clips) are also substantial drivers of the increase in the use of mobile data.

63. SKY considers that this is the result of:

(a) consumers preferring to watch sport live, and on the best screen available. This takes into account factors such as screen size, picture quality, and comfort for the duration of an event. For example, SKY's figures indicate that **[REDACTED]**. Consumers are more willing to consume other types of content (such as TV series, music, and short videos) at any time, anywhere, on any screen, and for short durations of time (such as while commuting on public transport), than they are for sport; and;

(b) the well-publicised nature of major sports events. As a result of (a) above, viewers of sports events tend to arrange their schedules so as to be able to watch sports events uninterrupted and on the best screens available, at the times that sports events are happening; and

(c) the social nature of the way that consumers watch live sport. Consumers often watch premium sports events (such as All Blacks matches) in groups, with friends and family. The devices usually connected to mobile networks (such as smartphones and tablets) do not tend to be conducive to group viewing; and

(d) the types of consumers that are driving the increase in consumption of content over mobile. The increase in consumption of content over mobile is being driven by the younger demographic. However, that same age group is consuming less and less linear content (and, as identified above, sport is most valued when it is consumed live, not on demand).

64. In relation to the consumption of sport online (whether over broadband or mobile networks), AC Nielsen's *New Zealand Connected Consumers Report*[22] found that:

(a) **[REDACTED]** of "online" New Zealanders use internet TV to watch sport available to New Zealanders on local TV, and not easily accessible to New Zealanders on local TV. This can be compared with **[REDACTED]** of online New Zealanders who watch **[REDACTED]** on internet TV; and

(b) other genres that are watched online more commonly than sport include **[REDACTED]**

[22] Based on a survey of 2,002 "online" New Zealanders, aged 15 and over, from 1 to 13 October 2015.

65. AC Nielsen's findings are consistent with global trends, both in relation to the consumption of sport generally, and the consumption of linear TV over mobile networks and devices:

(a) a recent *Economist* article, *Angling for the future of TV* (29 October 2016), reported that:

(i) "a vital bulwark of pay-TV [in the United States of America], live sports, has shown unusual weakness; ratings for American football have declined compared with a year ago"; and

(ii) 18-24 year olds in the United States are now watching 48 fewer hours of linear TV per month than they did in 2010, compared with an average decrease in linear TV viewing hours across all age groups of 16 hours per month. This is consistent with recent decreases in the number of SKY Sport subscribers (even when netted off against new FANPASS subscribers).

(b) Deloitte's *Mobile Consumer Survey 2015 – The Australian Cut*[23] found that, in Australia, just 3% of consumers use smartphones to watch "live TV". This can be compared with:

(i) 36% of consumers who use smartphones to watch short videos; and

(ii) 9% of consumers who use smartphones to watch video news stories; and

(iii) 6% of consumers who use smartphones to watch catch-up TV; and

(iv) 5% of consumers who use smartphones to stream films and/or TV series.

66. A number of research surveys have found that, of all ages, younger people tend to consume the most content online, whether over broadband or mobile networks:

(a) NZ On Air's *Where are the Audiences? 2016* report[24] found that:

(i) "15-39 year olds consume all online media … significantly more each day than 45+ year olds"; and

(ii) among 15-39 year olds, "online video consumptions via sites such as YouTube and Facebook has overtaken linear TV"; and

(iii) "younger New Zealanders are among those most likely to have adopted ..[the] key technologies of SVOD, online video, on-demand video, and music streaming".

(b) AC Nielsen's *New Zealand Connected Consumers Report* found that:

(i) those aged under 35 were more likely to use multiple locations to access the internet than those aged over 35; and

(ii) those aged 15-24 were most likely to use mobile phones to access the internet.

(c) Research New Zealand's *A Report on a Survey of New Zealanders' Use of Smartphones and other Mobile Communications Devices 2015*[25] found that social media apps, business and

[23] Based on a survey of 2,000 Australian consumers, aged 18-75, in May 2015.
[24] Based on a survey of 1,404 New Zealanders, aged 15 and over, in April and May 2016.
[25] Based on a survey of 1,075 New Zealanders, aged 18 and over, in February and April 2015.

banking apps, and apps for games and other entertainment were all most likely to be reported to be used by 18-34 year olds, followed by 35-54 year olds, and then those aged 55 and over. News and weather apps were equally as likely to have been reported to have been used by 18-34 year olds and 35-54 year olds; and

67. Looking more closely at what content the groups most likely to use mobile networks tend to consume:

(a) AC Nielsen's *New Zealand Connected Consumers Report* found that **[REDACTED]** of 15-24 year olds, and **[REDACTED]** of 25-34 year olds, reported to have used SKY GO in the four weeks before the survey. That can be compared with:

(i) **[REDACTED]** of 15-24 year olds and **[REDACTED]** of 25-34 year olds who used YouTube; and

(ii) **[REDACTED]** of 15-24 year olds and **[REDACTED]** of 25-34 year olds who used TVNZ OnDemand; and

(iii) **[REDACTED]** of 15-24 year olds and **[REDACTED]** of 25-34 year olds who used Netflix; and

(iv) **[REDACTED]** of 15-24 year olds and **[REDACTED]** of 25-34 year olds who used 3NOW.

(b) Research New Zealand's *A Report on a Survey of New Zealanders' Use of Smartphones and other Mobile Communications Devices 2015* found that, of consumers whose preferred device is a smartphone:

(i) 63% watch movies or YouTube clips on their smartphones; and

(ii) just 36% of consumers watch TV or listen to the radio on their smartphones.

68. Further detail and evidence about what is consumed over mobile networks is set out in Vodafone's submissions.

69. So, although consumer preferences are changing, those changes in preferences do not support a large increase in the consumption of live sports over mobile networks and devices.

70. Instead, they support an increase in the consumption over mobile of other content that is widely available from sources other than SKY. In that context, it is extremely unlikely that the merged entity could use those changes in consumer behaviour to win so many customers from rival mobile providers so as to substantially lessen competition in the mobile market.

71. This is supported by information that Vodafone has provided about consumer preferences. That information shows that consumers value price offerings and free Netflix significantly more than they value free SKY Sport.

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Conclusion

72. Rival telecommunications providers will provide an effective competitive constraint on the merged entity. The merged entity will continue to have incentives to wholesale SKY services on terms that are workable for the merged entity's wholesale partners.

73. However, even putting those incentives aside, rival telecommunications providers do not, and will not, need access to the premium live sports rights held by SKY in order to effectively compete in New Zealand's telecommunications markets. Any changes in New Zealand's telecommunications market shares that could result from the proposed transaction will not be of a magnitude that could be described as a substantial lessening of competition.

Confidentiality

74. Confidentiality is sought for the information in this letter that is highlighted and in square brackets. We are also providing you with a public version of this letter.

75. We request that we be notified of any request made under the Official Information Act for the information, and be given the opportunity to be consulted as to whether the information remains commercially sensitive at the time that the request is made.

76. These requests for confidentiality are made because the information is commercially sensitive, and disclosure would be likely to unreasonably prejudice SKY's commercial position.

Yours sincerely

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