Submission to Commerce Commission in relation to clearance application by Vodafone and Sky

12 August 2016

Public version

Trustpower Limited welcomes the opportunity to provide a submission to the Commerce Commission in relation to the clearance application by Vodafone and Sky.

For any questions relating to the material in this submission, please contact:

Paul Bacon
Trustpower Limited
Durham Street
Tauranga

Private Bag 12023
Tauranga Mail Centre
Tauranga 3143

Email: paul.bacon@trustpower.co.nz
Phone: (021) 791336

1 Introduction and Summary

While there are multiple issues and grounds on which the Vodafone and Sky clearance application should be declined, this submission focusses on two key areas: (1) mobile competition, and (2) wholesale access to content. We do not fully develop all areas, recognising that others will also submit in opposition.

While we oppose the applications, we would consider contracts and other commitments made by the merging parties, recognising that behavioural undertakings are not an option.

In a table at the end of this summary, we link the paragraphs below to the key issues for assessment by the Commission as to wholesaling content, namely: current market; market definition; factual; counterfactual; and the substantially lessening competition (SLC) assessment. The factual, counterfactual, and SLC assessment as to the wholesaling of MVNO services market is dealt with in confidential Appendix A.

1.1 Vodafone conveniently summarises the key concern as to content

In its application to be 51% owner of the new entity, Vodafone claims that Sky's content is not "must have" as there are Pay TV content providers that do not use that content: so it cannot be "must have".

At best, that involves a simple error in the assessment, in part because "must have" is just a convenient descriptor, and no more. However, as we explain below, the applicants are fully aware that the content is "must have".

The real issue is whether there is SLC, however that arises. There is a strong international understanding that live premium sports are essential inputs or "must have". (We also consider that is the case in New Zealand's specific circumstances for first run major studio movies, and premium TV series).

Key though is that Vodafone's stated approach in the application is directly contrary to what Vodafone says internationally. These contrary statements cannot be reconciled and raises wider concerns about the reliability and accuracy of what the applicants say in their applications (concerns that call for careful checking by the Commission of Vodafone's and Sky's internal documents and information).

For example, Vodafone Group states in its 2016 annual report:[1]

> In several markets, incumbents have sought to gain exclusive access to key content rights. … We will also encourage regulators to prevent incumbents from using content – in addition to their dominance in fixed access markets – as a lever to reduce competition.

And in a 2015 submission to Ofcom, Vodafone sought the continuation of an obligation that BskyB be required to provide its content on reasonable terms to other providers because it is "key content":[2]

> Ignoring the effects of 'key content' across wider and traditionally unrelated markets, such as mobile or broadband only customers, will have an enduring and irreversible effect, as the focus moves to TV bundled competition.

What Vodafone Group - rightly - says, neatly sums up the content-based market failure problem that this merger would cause. In Vodafone's words, and expressed in terms of its unequivocally framed concern, the merged entity would have *"key content"* that it would use *"as a lever to reduce competition" "across wider and traditionally unrelated markets, such as mobile or broadband only customers"* and triple and quad play customers. That will have an *"enduring and irreversible effect, as the focus moves to TV bundled competition".*

[1] Vodafone Group, Annual Report 2016, at p12 (available at http://www.vodafone.com/content/annualreport/annual_report16/downloads/vodafone-full-annual-report-2016.pdf).

[2] Vodafone response to Ofcom's consultation: Strategic Review of Digital Communications discussion document (8 October 2015), at pp8-9 (available at http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Vodafone.pdf).

Trust power.

Vodafone cannot have it both ways. It is unsatisfactory that Vodafone has not disclosed its full position, and that it makes statements in its application, declared by statutory requirement to be true and correct, that are directly contrary to what it says elsewhere and what it knows.

This use of a key input that cannot be replicated is the classic problem, well known to telco operators, as to vertically integrated incumbents, of bundling a scarce but key input with services in an otherwise competitive market. The effect is for a supplier to take back a dominant and bottleneck position, via content, when the purpose of operational and then structural separation was to remove such bottleneck control via the local access network.

In the factual, the merged entity's incentives are to do just that. In turn, that means the restrictive price and non-price terms, already causing market failure, will continue and, likely, get worse.

It also means there are broader problems, because the merged entity has fewer or no incentives to cannibalise its satellite service. It has fewer incentives in any event to invest in new online services, such as those that leverage the converged and integrated opportunities that are available.

Video is, all things equal as to price, the major driver for UFB uptake. Therefore, in the factual, there are broader implications for innovation, investment, competition, and consumer choice. UFB uptake will likely be substantially reduced and delayed.

In the counterfactual, the declining retail customers and revenues point to wholesaling content on terms that encourage other RSPs to take up the wholesale offer. In this way, the merged entity can extend its footprint and revenues.

Sky building or acquiring an RSP is unlikely.

The counterfactual will also see Vodafone having incentives, like other RSPs, to develop its integrated and converged offering, just as the Vodafone Group's strategy calls for it to do. Services are increasingly becoming converged and integrated, by way of quad plays etc, where TV content is a key component of bundles with fixed line and mobile. That direction is one of Vodafone's three key strategies, as the 2016 Vodafone Group annual report confirms.

1.2 Vodafone's and Sky's applications contradict Sky's stated position as to competitive effect of OTTs

In their applications, Sky and Vodafone make much of the competitive constraints upon Sky's TV subscription services caused by OTT services such as Netflix and Lightbox. Sky's CEO would not agree (and it is concerning that Sky would make the statements it does in its application, contrary to what its CEO has stated).

As the Sky and Vodafone applications note, NEON is similar to Netflix and Lightbox:[3]

> NEON does not include premium sports, and is therefore much closer to Lightbox, Netflix, Apple TV, etc, in terms of content offered.

The Listener article, "*Sky's 'not at the limits'*", states that when Sky dealt with NEON blockbuster content, Game of Thrones (just as Netflix has similar blockbuster content such as House of Cards):[4]

> Fellet discovered there was little crossover [between Sky's satellite service and NEON], with the average Sky subscriber aged about 50 compared with Neon viewers in their early 20s, so he ran GoT on both. Neon took off and viewership hit an all-time high on Soho.
>
> "It was appealing to two separate segments, so my thinking is who else is better off trying to maximise this market than we are? I already have the content – let me leverage it into these new marketplaces."

---

[3] At [11.11] of the applicants' applications.

[4] The Listener "Sky's 'not at the limits'" (13 June 2016) (http://www.listener.co.nz/current-affairs/business/skys-not-limit/).

In addition to confirming the dominant market power that Sky has in at least two of its target market areas (subscriber markets for linear Pay-TV and for on-demand respectively, marked by differences in ages), this Listener article effectively has the Sky CEO confirming that services such as NEON, Lightbox and Netflix are not a substitute for subscriber linear Pay TV. And vice versa.

There is "*little crossover, with the average Sky subscriber*" and NEON, Lightbox and Netflix.

New entrants such as Lightbox and Netflix do not bring a material competitive constraint. Statements to the contrary in Sky's application are incorrect.

1.3 History shows caution is appropriate in forecasting market conditions in this area

Predicted market conditions in decisions such as Sky/Prime, Igloo, and the 2013 decision not to litigate on Sky's ISP contracts have not eventuated, leaving market problems.

This shows that substantial caution is appropriate before relying on applicants' market predictions indicating there will not be SLC in the future. Sufficiently strong evidence is needed. If there is doubt, the application must be declined.[5]

1.4 Horizontal platform effects

The merger brings together multiple transmission paths for TV content, such as satellite and cable in the HFC footprint (in addition to fixed line and wireless).

In the RBI footprint, only Vodafone-owned RBI-funded services and satellite are available. The Vodafone RBI maximum wholesale commitment is 5 Mb/s, which is relatively slow, but Vodafone can sell at retail higher speed services.

That is also one reason why, in terms of market definition, rural markets are relevant.

1.5 Sky has main live sports rights locked up

The applicants state that the ability of other firms to acquire the sports rights as relevant. It is not. The key rights are locked in for over 4 years and often more (i.e. well past the period for SLC assessment).

1.6 Linking key features on wholesaling content to the Commission's assessment

We set this out in this table to assist with navigating our submission.

Issue	Paras in this submission
Current market conditions	3, 5-8,11-13
Market definition	15
Factual	9
Counterfactual	10
SLC assessment	15

1.7 Mobile services and MVNOs

We turn to SLC in the market of wholesaling MVNO inputs to RSPs, due to the proposed merger.

[5] Commission's Merger and Acquisition Guidelines at [2.21].

1.8 Mobile services – NZ has high retail prices

With the move to triple and quad plays, including mobile and Pay TV services, high volume data is becoming the key mobile service, instead of "plain old mobile voice" and low data services such as SMS.

The Commission's annual telecommunications monitoring report shows that New Zealand's retail mobile pricing for data is higher than nearly all other OECD countries. 1.5 Gb and 6 Gb data services are around 50% and 100% higher than the OECD averages respectively. New Zealand ranks 28th and 33rd out of 34 countries, for the 1.5GB and 6Gb packages respectively. We also show that mobile bundles including high Gb of data cost much more than international comparators.

Ofcom has undertaken a comprehensive econometric analysis of mobile retail pricing in 25 countries, including New Zealand. It concluded that, where there are 4 MNOs, compared 3 MNOs (which is the position in NZ), retail prices:

> "are between 17.2% and 20.5% lower on average in countries where there is one additional mobile operator [above 3 operators] AND a disruptive firm is in the market".

Ofcom say that 2degrees is a disruptive firm in that context. So is Trustpower.

1.9 Primary cause of NZ high retail pricing: concentrated MNO market

The Ofcom report was done in the context of the latest of a number of mergers of 2 MNOs proposed in European countries, reducing the number of MNOs from 4 to 3, namely the UK merger of two MNOs, H3G and O2.

Most mergers have been cleared by the European Commission on the basis that the merging MNOs grant "thick" MVNO terms to at least one competing MVNO. In this way, the MVNO becomes the equivalent of a 4th MNO, as the European Commission firmly recognises that 3 MNOs leads to market failure. The H3G/O2 merger in fact was not cleared, partly as the MVNO terms that were offered were unacceptable.

The Ofcom research demonstrates why having only 3 MNOs, internationally, leads to market failure and why having only 3 MNOs in New Zealand does likewise.

A "thick" MVNO is one in which the wholesaling MNO provides only limited input services such as airtime to the MVNO, allowing the MVNO to structure its retail offerings in the way it wants, to differentiate its products on the market.

That is at the other end of the spectrum from current MVNO offerings in NZ at the "thin" end of the spectrum. They are, broadly, retail minus constructs revolving around the MNOs' own offerings. That is one reason why the MVNO market so far in NZ is small and provides ineffective competition and ability to differentiate services.

That has been caused largely by there only being 3 MNOs with no regulatory obligation to supply, although, in the counterfactual, that is changing, as explained in Appendix A.

Trustpower as an MVNO

Trustpower wishes to be a "thick" MVNO. As above, that would substantially solve the market failure problems and lead to the benefits such as those outlined above (e.g. reduced retail prices potentially in the order of 19%).

Factual, counterfactual and SLC assessment

Confidential communications with the 3 MNOs are set out in Appendix A, as are the factual, counterfactual and SLC analysis, arising out of those communications.

Contents

1 Introduction and Summary ii

2 Structure of submission 2

3 Trustpower Limited 2

4 History shows caution appropriate in forecasting market conditions in this area 3

5 Sky's current services - threshold issue 5

6 Vodafone's application contradicts its "must carry" approach elsewhere 6

7 Live premium sports are "must have" or similar 7

8 "Must have" and first run major studio movies and TV series 8

9 Content-related issues in the factual (with merger) 9

10 Wholesale content - Counterfactual (without merger) 11

11 OTT's competitive constraint is minimal 14

12 Encouraging innovation by Sky 15

13 Horizontal platform effects 16

14 Content-related Market definition 16

15 Conclusion as to content and Pay TV 17

16 The mobile market 17

17 Thin and thick MVNOs 20

18 Competitive pressure -Thick MVNOs are similar to MNOs 21

19 Thick MVNO can drop prices by around 19% - Ofcom 21

20 Market definition in relation to MVNOs 22

21 Factual, counterfactual, and SLC assessment 22

Appendix A Discussions with MNOs – Confidential 23

2 Structure of submission

We deal with the issues in the following order:

a) Overview of Trustpower;

b) Outline as to why caution is needed as to predictions about market place developments indicating no SLC;

c) We then turn to the implications of the merger on access to content in the following order:

   i. Outline of the specific Sky wholesale services;

   ii. Reasons why the Sky premium live sports content (and first run movies) are "must carry" or equivalent;

   iii. What happens in the factual as to content (i.e. after the merger);

   iv. What happens in the counterfactual as to content (i.e. absent the merger);

   v. Why OTT content such as Netflix and Lightbox is not a constraint on the merged entity;

   vi. Why Sky should no longer derive super-profits;

   vii. Outline of horizontal platform effects;

   viii. Content related market definitions;

   ix. Content acquisition markets;

   x. Conclusions as to SLC as to content and TV.

d) We turn then to the implications of the merger in the mobile market in the following order:

   i. Overview current market conditions and deal with MVNOs;

   ii. Mobile retail pricing;

   iii. "Thick" and "thin" MVNOs;

   iv. Overview of European analysis and regulatory decisions, as well as market definition;

   v. Outline our communications with the MNOs in confidential Appendix A, where we also deal with the factual, the counterfactual and the SLC assessment.

3 Trustpower Limited

3.1 Introduction

Trustpower Limited welcomes the opportunity to provide a submission to the Commerce Commission in relation to the Vodafone and Sky clearance application.

Trustpower is a renewable generator-retailer in the New Zealand and Australian electricity markets. Trustpower's unique utility retail offering bundles electricity, gas and telecommunications services (including ultra-fast broadband). Bundling electricity with retail telecommunications offerings does not cause the same issues as Vodafone and Sky bundling "must have" content because (a) the electricity markets are regulated by the Electricity Authority, and (b) multiple suppliers provide electricity at retail and therefore the inputs can be replicated. These bundles are example of pro-competitive bundles benefitting consumers and competition.

Trustpower also provides water storage for irrigation users in the South Island.

Head-quartered in Tauranga, Trustpower owns and operates a total of 23 hydroelectric power schemes (comprising 41 stations), five wind farms, and one diesel peaking scheme, across New Zealand and Australia. As the fifth largest generator-retailer in New Zealand, the company's electricity customer base consists of around 252,000 electricity connections, including some of the largest electricity consumers in New Zealand. Around 27,000 of Trustpower's customers are dual fuel, and over 50,000 purchase energy and telecommunication bundles.

As one of the most experienced wind farm developers and operators in Australasia, Trustpower has also been active in Australia for the past 12 years. The company now has an installed asset base in Australia with a value of around a billion dollars, including Snowtown, which at 370 MW is the largest wind farm in South Australia.

3.2 Trustpower as a participant in the telecommunications market

Trustpower actively pursues innovation as a means to deliver value to consumers. Our success in adding telecommunications and gas services to the company's retail electricity offering demonstrates that 'bundles' are attractive to consumers. Trustpower is currently the only major company that bundles electricity, gas and telecommunications services in New Zealand.

Trustpower has grown from small reseller of under 1,000 telecommunications services in 2004 to its current position providing around 100,000 services to 60,000 customers.

Trustpower provides over 10,000 fibre broadband connections on the Chorus and Ultrafast fibre networks, and over 35,000 xDSL services nationwide. All internet services are delivered on Trustpower's own internet infrastructure, which is duplicated with full redundancy across two third-party data centres. Trustpower provides full technical support internally from its Tauranga and Oamaru centres. No customer services are outsourced.

Trustpower also provides PSTN and calling services to over 35,000 customers via wholesale agreements with Spark Wholesale for PSTN and switchless Non Coded Access calling.

Trustpower's growth has been largely organic, achieved through its ability to bundle telecommunications and energy services, creating currently unique propositions and a superior service model. We are New Zealand's fourth-largest telco, and potentially the fastest growing.

We bring to the New Zealand telecommunications market a unique perspective as a deeply experienced and successful participant in a highly-competitive, regulated market setting – being electricity. We constantly compare and contrast the market rules, structure and competitive behaviour not just between the two markets but between New Zealand and Australia.

4 History shows caution appropriate in forecasting market conditions in this area

This is a threshold issue of some importance in our view.

Each of the Sky/Prime clearance, the Igloo clearance, and the 2013 decision that ISP contracts would no longer breach the Commerce Act, relied closely upon predicted market developments that in the end did not happen in the expected way.

4.1 Example: the 2013 Sky and ISP contract decision

For example, in its 2013 decision not to issue proceedings against Sky as to the ISP contracts, the Commerce Commission expected that market developments were unlikely to continue to cause SLC. Those developments were stated as:[6]

[6] As listed at [290] in the 2013 decision.

a) Telecom is not currently offering Sky's services and has a reduced incentive to remain with Sky;

b) Telecom was granted an exemption (it is expected that this was for the Coliseum EPL offering);

c) Vodafone had recently signed contracts with Sky; and

d) "*entry by other pay TV providers is more likely than it has been in the past*".

We will now deal with each of these points in turn.

As to (a), at the time, and as subsequent history has shown, the fact that Telecom stopped taking the services was not an indicator of no SLC, and subsequent events showed that SLC was not removed. Faced with the restrictive price and non-price terms, even with an exemption, Telecom decided it had no choice but to establish its own content play: Lightbox. The reason why Telecom "*had a reduced incentive to remain with Sky*" was that the price and non-price terms were too restrictive and led to SLC. It does not follow from the fact that it did not continue taking services from Sky that s27 would no longer be breached. It did not take those services in circumstances where the breaches in fact continued and that made acquiring the services untenable for Telecom.

This content play has not been successful, largely due to the key content that Sky has control of, which could not be accessed on reasonable price and non-price terms.

As to (b), the Coliseum and EPL exemption, this acquisition was a failure and was later dropped. Moreover, EPL is a minnow, relative to content such as live rugby tests. The exemption was minor in the scale of things. Additionally, Sky broadcast the EPL matches on a delayed basis, the morning of the overnight games, when many would prefer to watch.

As to (c), that Vodafone signed new contracts is not of itself an indicator that there was no SLC and no breach of s27, just as Telecom not continuing the service and going with its own play does not per se imply no SLC and no breach of s27. It had no real choice but to accept Sky's restrictive price and non-price terms, given that it could not see the Telecom route of having its own content play as viable. Again, history confirms that SLC remained. Each of Vodafone and Telecom chose different business models to deal as best they could with the actual facts, which entailed restrictive price and non-price terms which substantially lessened competition. That Vodafone signed up does not of itself mean that there would no longer be a breach of s27. Essentially it signed up as it had little choice.

A party can choose to sign a new contract, and another choose not to, in relation to the same issue, but that of itself is not an indicator that there is no breach of s27 and no SLC.

Finally, (d). As outlined in this submission, effective competition to Sky has not emerged, and Sky's position is largely reinforced. There has been entry of other Pay TV providers, which was expected to be likely at the time, as stated in the decision, but that has not in practice translated into effective competitive constraints, in part due to the hold over content that Sky has in the first place. We expect that other parties will address the key issue of content acquisition and the power that Sky has in that market. Unfortunately, the Commission focussed only on "entry", at least in its report on why it decided not to take court action when key also is what happens after entry. Para 11 below gives an example of why there has been little competitive constraint on Sky by new entrants.

4.2 Conclusion as to caution on forecasting

History shows that substantial reservations should exist before relying upon applicants' market predictions indicating there will not be SLC in the future. Framed another way, if not demonstrated clearly, with evidence, and to a sufficient standard, that market conditions will emerge to show there is unlikely to be SLC, the Commission ought to decline the merger. If there is doubt, the applications must be declined.

5 Sky's current services - threshold issue

5.1 Importance of accurate treatment of the services

It is apparent from the applications and other material that it will be important to deal in some granularity with the nature of current and potential services over, say, the next two years. For example, closer analysis shows that certain services do not currently solve, and will not solve in the future, the SLC concerns as to premium content, contrary to what the applications maintain.

Significant also is the way in which Pay TV services are developing online, such as the integration between platforms and services. Such integration and convergence is at the centre of Vodafone's strategy. The various types of services should be analysed and considered.

We deal first with current wholesale services and then with future services.

5.2 Sky's current wholesale services

Igloo having recently been terminated by Sky, the current wholesale services are:

a) The supply of the Sky channels to Vodafone for re-transmission via Vodafone STBs to the latter's HFC/cable customers in Wellington, Kapiti and Christchurch;

b) Supply of a mirror of Sky's satellite service to Vodafone customers, via satellite and STB;

c) Sky Go: Sky's relatively low quality of service streaming and on demand service;

d) NEON: Sky's on demand platform, currently resold by Vodafone and 2degrees. As the applications state:[7]

> NEON does not include premium sports, and is therefore much closer to Lightbox, Netflix, Apple TV, etc, in terms of content offered.

e) Fan Pass: Sky's PPV channel for premium sports, currently resold by Vodafone.

5.3 Key features of those current wholesale services

A key feature of those services is that they are standalone services largely identical to Sky's retail services. They are not integrated with wholesale customers' other offerings in a way by which they can work together with those offerings. Nor can elements of the packages be unbundled to add to other services.

United States regulators describe such wholesale services as **synthetic** wholesale offerings, to distinguish them from services that can be integrated and/or unbundled into the RSP's offerings. Vodafone's Sky service via satellite and STB (essentially reselling the Sky package) is quite different from converged and integrated offerings, particularly where some content is unbundled. That distinction is central to the review of similar mergers by US regulators.

5.4 Subscription services

In relation to the subscription-only services, taken by Vodafone, it is understood that the wholesale price is based on retail minus, within a few percentage points of Sky's retail price (save that the Sky service as to the HFC footprint may continue to have a substantially larger delta between retail and wholesale pricing; this is not known).

In any event, the applications in redacted form imply that Vodafone takes the services at little or no net profit and, more likely, at a net loss.

[7] Ibid at [11.11].

It is also expected that the offerings contain highly restrictive terms along the lines outlined in the Commission's 2013 decision on Sky's contracts with RSPs, even if there are some exemptions.

The Commission of course has, and can get, the detail on the price and non-price terms.

What is apparent is that the price and non-price terms are highly restrictive and that Vodafone, following its comprehensive internal review of its content play options, including whether to establish its own Pay TV content service, had little choice but to take the synthetic standalone bundles, despite the poor terms. If it had taken the other main option – developing a content play independently of Sky – that was also a poor option, as Spark's experience with Lightbox shows: that service has gained only limited penetration into the market due to its inability to get key content.

5.5 NEON and Fan Pass provided via RSP channels

NEON can be bought via Vodafone and 2degrees, as part of other services provided by them. Vodafone also sells Fan Pass in largely the same way (2degrees has stopped reselling Fan Pass).

These are services that are even less integrated into the RSPs' offerings, as the Vodafone and 2degrees customers acquire the service directly from Sky, and it is delivered directly by Sky. The RSP is given a code (token) for each new NEON or Fan Pass subscriber, which has been allocated by Sky to the RSP in exchange for payment. Vodafone or 2degrees gives that token to their customers, who load the token on Sky's website in order to activate the standalone service. To do so, the customer's contract for supply of the service is not with the RSP but with Sky, because the customer signs up on the NEON site just like Sky's retail customers (save that payment is not made in that way). The experience with the service is exactly the same for Sky's direct retail customers.

Even if these services entail financial returns to the RSPs that are higher than the returns from the subscription services, they are weak and largely ineffectual competitive constraints in the market.

Moreover, it does not follow that they will continue to be offered in the future.

6 Vodafone's application contradicts its "must carry" approach elsewhere

We turn now to the question of whether or not Sky's content is "must carry" or similar.

Vodafone's denies in its application that the Sky content, including live premium sports, is a "must carry" input and that there is market failure. However, this is directly contrary to what Vodafone has said and submitted on numerous occasions, when arguing firmly against the approach it is now taking in the application.

Vodafone assertively pushes internationally to get regulation to deal with stopping the very thing the applicants seek to do here (and there is no material difference between the internationally stated position and the NZ market). Vodafone also maintains that such content is "must carry" and is causing market failure in the telecommunications markets, even though it says the opposite in its application.

For example, Vodafone stated to the UK regulator in October 2015:

> "Ignoring the effects of 'key content' across wider and traditionally unrelated markets, such as mobile or broadband only customers, will have an enduring and irreversible effect, as the focus moves to TV bundled competition."

And this is stated in the Vodafone Group 2016 annual report:[8]

> **Television and content are becoming increasingly important**

[8] Vodafone Group, Annual Report 2016, at p 12 (http://www.vodafone.com/content/annualreport/annual_report16/downloads/vodafone-full-annual-report-2016.pdf).

> Our goal is to ensure access to premium content where our customers value it. In several markets, incumbents have sought to gain exclusive access to key content rights. In this scenario we will compete to secure access, which may increase our costs. We will also encourage regulators to prevent incumbents from using content – in addition to their dominance in fixed access markets – as a lever to reduce competition.

Further, Vodafone submitted this to UK communications regulator, Ofcom, in October 2015, in opposition to removal of regulated wholesaling of content by BskyB to other Pay TV operators:[9]

> However, this raises the concern that given the rise in converged services, content providers will be incentivised to leverage their rights of such 'key content' and limit distribution, in order to protect market share in adjacent markets. Ofcom has for years been grappling with this issue of dominance in the TV market, however the effects are no longer isolated to TV or even Pay TV. Ignoring the effects of 'key content' across wider and traditionally unrelated markets, such as mobile or broadband only customers, will have an enduring and irreversible effect, as the focus moves to TV bundled competition. [✂] Vodafone ultimately remains concerned that if access to this content cannot be secured on Fair, Reasonable and Non Discriminatory terms, competition and consumer choice across a variety of telecommunications markets will be severely harmed.

Vodafone's submission to Ofcom also states:[10]

> [S]ervices such as pay TV can be provided over a variety of platforms whether satellite, cable, fixed or mobile broadband. As consumers are increasingly attracted to bundled offers of TV, broadband, fixed and mobile voice services, the control of that exclusive content will increasingly steer their overall purchasing decisions. Therefore, exclusive 'must have' content is no longer just a TV issue, but impacts across the whole of the £43bn telecommunications and TV market.
>
> Ofcom's Strategic Review of Digital Communications rightly covers all these issues and accordingly we call upon Ofcom to …. Act upon its concerns to ensure fair access to exclusive premium TV content and prevent market power in content from being used to dominate the adjacent markets of fixed access and mobile.

There is nothing that distinguishes NZ conditions from the position internationally.

7 Live premium sports are "must have" or similar

7.1 No regulation in NZ – contrary to other countries

At least in relation to live sports, regulation in other countries solves the problem of a single provider retaining monopoly rights to content. For example, Australia has anti-siphoning legislation, the U.S. has Program Access Rules, and the UK, until recently, when market conditions changed so that regulation is no longer required, had the Wholesale Must Offer (WMO) obligation on BskyB. (Ofcom's decision in November 2016 confirmed that, but for BskyB now offering commercially realistic and appropriate price terms, the circumstances to continue would still have existed). The UK also has anti-siphoning regulation.

There is no relevant regulation in New Zealand.

7.2 "Must have" and live premium sports

Internationally, live sports rights are regarded as an essential input into a content play and this can be called a "must have" requirement (or some variant on that descriptor). In this context, and given that "must have" is not definitional in nature from a legal perspective, live sports rights are "must have" here and overseas (or, put another way, they engage SLC considerations due to their importance).

[9] Vodafone response to Ofcom's consultation: Strategic Review of Digital Communications discussion document (8 October 2015), at pp 8-9 (http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Vodafone.pdf).

[10] Ibid at pp 2-3.

Ofcom for example, in similar circumstances, regulated access to live sports rights based on its conclusion that they are "must have".[11] As noted above, Vodafone has strongly supported such "must have" content being regulated "*to ensure fair access to exclusive premium TV content and prevent market power in content from being used to dominate the adjacent markets of fixed access and mobile*."

As Ofcom explained:[12]

> Sky's position in sport arises from the unique ability of broadcast TV to reach a large live audience, and Sky's control of the live broadcast rights for many of the most important sports. This is unlikely to change in the next few years.

The applicants contend in the applications that the likes of Spark can provide Pay TV services without live premium sports and therefore such content is not "must have". But that is defining or using "must have" out of context and without regard to correct SLC considerations. In the end, this is not about whether in any sense the content is "must have" but about whether there is SLC, however that arises and whichever descriptors are used.

For example, equally suitable descriptors of the status of this content, for SLC assessment purposes, include Vodafone Group's own descriptors in the quotes above, such as "key content" and "exclusive premium TV content".

Having noted that, the experience of new entrants in New Zealand, such as Lightbox, appears to be that unless they have such "must have" content, they cannot compete effectively. The SLC considerations are not just about entering the market but also the position over time, in terms of sustainable competition (essentially, the focus is also on conditions of expansion not just entry). New entry alone is not enough. We expand on this at para 11 below.

The problems caused by retention of key content such as this in New Zealand are considerably more acute than overseas, due to factors such as the fact that Sky is the sole subscription linear TV provider (generally there are more Pay TV providers in other comparable countries), and that it also owns, almost uniquely in OECD countries, a free to air station, enabling it to bundle Pay and free to air rights. In the factual, it will also be highly incentivised to do what only it can do: bundle in also the online rights as well such as subscription video on demand (SVOD) and transaction video on demand (TVOD).

8 "Must have" and first run major studio movies and TV series

We have dealt with live premium sports rights separately only because they are universally recognised as "must carry" content and that alone is sufficient to show that the merger will lead to SLC, without dealing with other areas where there is no market failure in other jurisdictions but there is here. It is submitted that issues related to live sports rights are sufficient to decline the merger, without having to address first run movies and TV series.

However, first run major studio movies and major TV series are relevant too.

Control of transmission of most of the major studio movies in the first run window (and in fact in other windows too), lies with Sky. This is apparent from the lack of such movies on Lightbox and Netflix services (for example, Netflix in the US has around three times as much content compared with Netflix in NZ).

The overall package and Sky offering, including premium entertainment programmes, gives Sky a scale that others cannot replicate, such as in relation to acquiring content. As the Sky CEO was quoted in June 2016:[13]

---

[11] See for example [1.10] in the Ofcom 2010 Pay TV statement under which Ofcom introduced WMO regulation (http://stakeholders.ofcom.org.uk/binaries/consultations/third_paytv/statement/paytv_statement.pdf).

[12] Ofcom 2010 Pay TV statement, at [1.5].

[13] Quoted from Tina Morrison, Sky's 'not at its limits'. Listener June 2016.

> With a much deeper subscriber base, Fellet says, the company can afford to spend more – while expecting profits – on new shows than his internet rivals. Although the average revenue per user for new services is lower than in the past, those customers come at little cost, meaning most of the money goes straight to profit, he says.

9 Content-related issues in the factual (with merger)

This section describes what can be expected to happen if the merger takes place. The main paragraphs underlying this paragraph are paras 3-8, 11-13 and readers are invited to read those paras when dealing with issues as to the factual.

9.1 What the application says the merged company ("VskyV") will do

A key feature of the VskyV merger, reflecting the international trend toward converged services, including quad plays involving content, fixed and mobile, is summarised by the applicants as follows:[14]

> [T]he Transaction will allow the Combined Group to better serve customers' evolving preferences by enhancing the delivery of content across multiple devices and via multiple distribution technologies, including satellite, broadband (UFB and fixed wireless (rural)) and mobile. For instance, the parties envisage that over time they will be able to offer pay-TV subscribers the ability to seamlessly move between delivery technologies and viewing devices, e.g. start watching a show on their television via UFB and then pick up where they left off on another device, e.g. their mobile phone via WiFi or the user's mobile network. To that extent, the mobile market is relevant in the sense that over time new technologies are likely to see more pay-TV content delivered over such networks – be that content served up by Netflix, TVNZ OnDemand, SKY or others.

9.2 Vodafone's strategy

This convergence will implement one of the three key strategies of the international Vodafone Group, namely, in the words of the Vodafone Group's 2016 annual report, *"Convergence: Connectivity and content, wherever you are".* This overall strategy explains where Vodafone, as 51% owner of the merged entity, is heading. As context for this strategy, Vodafone's 2016 annual report explains:[15]

- "Customers are increasingly converging or unifying communications by sharing content between their fixed and mobile devices – phone, tablet, laptop or TV
- Television and content, when bundled with broadband, are becoming increasingly important drivers of customer demand
- The growing demand for converged services drives data usage, which in turn requires the combination of mobile and fibre infrastructure"

9.3 The broader picture

The application, and Vodafone's strategy, outlines the overall trends internationally, as reflected in the Commission's latest Annual Telecommunications Monitoring Report and elsewhere.

Given that satellite transmission is only one-directional, moving Pay TV content to the internet enables this convergence and integration, developing better services for consumers, with rich communications in both directions.

[14] Applicants' Applications at [11.21]

[15] Vodafone Group's annual report At page 12

9.4 The merged company has contrary incentives

However, the merged company ("VskyV") has a satellite service that will not be shut down until well past the period relevant to SLC assessment, as Sky's CEO confirmed at the media conference after the proposed merger was announced, noting 2021 as the earliest date. (There are a number of reasons for this, but one is that online transmission cannot service a substantial part of the New Zealand market, at least until well past 2020, and it is 2021 that Sky's satellite contracts expire).

Further, competitive pressure from other content providers can be expected to put only minimal pressure on the Sky Pay TV service over the next two to three years at least, as we outline at Para11 below.

VskyV therefore has little incentive to innovate with online and converged offerings, the more so as that cannibalises its current service. In relation to satellite, if any part of New Zealand is to be provided with satellite content, then the same satellite and spectrum levels are required for all of New Zealand. With its expanded customer footprint, it can be expected to supply its retail base adequately with synthetic packages based on satellite, and thereby avoid having to wholesale on reasonable terms that encourage uptake by its competitors.

In summary, in the factual, not only is direct competition restrained, but so are innovation and consumer choice as there are no strong incentives to move online (and in fact there are incentives to retain customers and prospects on satellite at least until 2021 (or at least the incentives to move to online are muted and work against for example more innovative online services)).

9.5 Incentives to differentiate on quality of service to retail v wholesale customers

The merged entity would also have the ability and the incentive to provide higher quality services to its own retail customers, even if it wholesales to other RSPs. Discrimination on quality can be just as effective as price, and is likely to happen. A simple example of this is supplying HD content to its retail customers and SD to competitors. However, given the multiple developments likely going forwards, some of which are summarised in the applicants' application as quoted at Para 9.1 above, there are multiple ways in which the merged firm can discriminate on quality of service to its advantage.

9.6 Negative impact on UFB uptake

The applicants in their applications claim that there are benefits related to fibre uptake due to the merger. Our view is that the opposite is the case for the reasons above (and in any event the position is worse in the factual than the counterfactual).

Other than price, the need for high speed and high volume services is the key driver for consumers to take up fibre services. There is little price difference between copper and fibre. VskyV's incentives to retain customers on its satellite service (and/or its incentives not to actively invest and innovate to develop products to encourage their customers to online instead of satellite) has a substantial impact on UFB uptake, with all that entails in terms of innovation, choice, and investment.

9.7 Factual - Implications for competition by other actual/potential Pay TV providers

With the emergence going forward of triple and quad plays bundling Pay TV, fixed and mobile, VskyV will have strong incentives in favour of selling to retail customers, and therefore having restrictive price and non-price terms in wholesale contracts. They will have a highly attractive proposition to consumers, based on the scarce input in the bundle (the content). Any pro-competitive aspects of bundling are substantially outweighed by effectively re-monopolising telco services, this time via content instead of last mile access: the first is not regulated, the second is.

Further, there will be the problems that Telcos have faced in dealing with vertically integrated incumbents over the last mile: sharing of information by the wholesale team with the retail team at VskyV.

With only three MNOs and only a small MVNO sector (with only 20,000 customers), substantial erosion of competition and customer bases at the remaining two MNOs, and more so for fixed line players, can be expected. That is a classic failure caused by, for example, bundling a scare input into services that are otherwise in competitive markets. That ultimately translates into poor consumer welfare outcomes, in terms of competition, innovation and consumer choice.

9.8 VskyV wholesaling in the factual – existing problems become worse

Vodafone, as a vertically integrated operator, supplies wholesale inputs to its downstream competitors in the retail markets. A well-known example is national roaming with 2degrees as customer, seemingly marked by difficulties over many years. We can see for example that 2degrees can only roam at 3G over Vodafone's 4G networks but we expect there are many other problems for 2degrees, and difficulties in the wholesale relationship, based on 2degrees' public comments over a number of years.

[

]

Vodafone is generally not a willing wholesaler in our experience, and we have been told that is the experience of other RSPs as well. We suggest that the Commission makes enquiries of other RSPs in that regard. In the factual, greater difficulties and resistance as to wholesaling are expected, as the merged company moves to leverage its market power and its control of key content.

Sky also is a vertically integrated business, competing in downstream retail markets. Sky has resisted wholesaling other than on restrictive terms, as can be seen from the actual offerings, low uptake as the terms are so poor, and from what potential wholesale customers are saying from their difficult experiences in dealing with Sky. We expect other submitters will address their experiences.

Each of the applicants separately exhibit the behaviour and culture of making things difficult in relation to wholesaling to competitors. These are problems well known in the fixed line telecommunication sector – they remain in the mobile sector – and are the primary reason supporting operational and then structural separation. Behaviour such as delay, deny, and degrade, margin squeeze including by bundling in "must have" inputs, use of the wholesale customer's confidential information, strategies, etc, by the vertically integrated operator to attack the customer's business, and so on.

Each of those behaviours and cultures, amalgamated under one roof, with the underlying ability and incentives arising from the merger, such as the new bottleneck (key content) replacing the old bottleneck (fixed line access), are a recipe for the merged entity making wholesale dealings even less palatable than they are already.

10 Wholesale content - Counterfactual (without merger)

The paragraphs in this submission that are most relevant to the counterfactual, underpinning this paragraph, are Para 9 and the other paragraphs listed there.

As Sky points out in its application, its retail subscriber base and revenues over its satellite service are declining. This calendar year has seen a marked decline in subscribers, relative to earlier years. It is therefore unlikely that the status quo can continue, and that major changes are required if Sky remains as a standalone entity.

10.1 Sports rights locked in for over four years

It can be taken as given that Sky has the relevant live sports rights until well after the period during which SLC is to be assessed (that is a fact relevant to both the factual and the counterfactual). It is irrelevant that, in a few years' time (e.g. 2021 for live rugby) the broadcast rights come up for bidding again. For example, Sky have the rights for the following sports up to the following dates:

a) Olympics: 2024

b) Cricket: 2020

c) NRL: 2022

d) Rugby: 2021

What are the options for Sky?

10.2 Acquire or build RSP?

Sky either acquiring an RSP, or developing RSP capability, does not appear to be a viable option to deal with this. Without an existing large online customer base, as Vodafone would offer, or a customer base that could quickly be developed, the RSP option does not appear to be tenable. Building an RSP from scratch, or acquiring an RSP, other than Vodafone or Spark, would not provide sufficient scale (or at least, not quickly enough to deal with the problem).

10.3 There are growing incentives to wholesale Sky content

In light of the declining Sky satellite subscriber base and revenues, coupled with customer migration to and the expansion of online services, Sky faces increasing incentives to expand the footprint of Sky viewers beyond its retail customer base, by proffering price and non-price terms to RSPs, which encourage the RSPs to resell Sky services. In the balance between (a) retaining and gaining retail customers, and (b) eroding that and selling by wholesale to a broader footprint (and also, as Ofcom points out,[16] keeping Sky's competitors out of the relevant content acquisition markets), Sky's incentives are moving to wholesaling on less restrictive price and non-price terms.

In a number of scenarios available to Sky, competition and innovation are enhanced. While Sky offering unbundled content, enabling fully integrated and converged online offerings, would be the strongest outcome, less fulsome changes will still lead to improvements in competition and innovation. For example, Sky supplying its content to enable reselling online as the same Sky branded bundle of channels, but on less restrictive price and non-price terms, is pro-competitive and pro-innovation (including as to UFB uptake).

10.4 The UK experience supports that conclusion

In November 2015, Ofcom removed the obligation on BskyB to supply prime sports channels to other Pay TV channels such as BT and TalkTalk. This involved removal of the Wholesale Must Carry (WMO) obligation on BskyB introduced by Ofcom in 2010, based on regulated prices that are substantially less than BskyB's retail prices for the same sports channels (around 55% less). The regulation permitted the other Pay TV channels to aggregate that sports content with other content sourced by the other channel.

[16] See e.g. Ofcom 2010 Pay TV statement at [1].

The reason for removal of the regulated requirement was that market pressure on BskyB had reached the point where it had incentives to supply at wholesale on reasonable terms due to its declining retail revenues.

10.5 Bundling issues

In the counterfactual, the incentives to wholesale on reasonable terms also substantially reduce the competition and market failure caused by bundling of "must carry" content into triple and quad play bundles.

10.6 Vodafone and Pay TV in the counterfactual

As noted above, the major strategy for the Vodafone group internationally is retail convergence including as to fixed, mobile and content offerings such as quad play. Just as Spark and others have incentives to provide pay TV content, so will Vodafone in the counterfactual.

In the counterfactual, where wholesale price and non-price terms become more reasonable and acceptable to RSPs, Vodafone likely would:

a) create its own Pay TV offering, incorporating elements of Sky's content, in competition with Sky and other providers including RSPs; or

b) obtain a less converged service from Sky (for example, online HD (i.e. better than Sky Go) re-transmission of Sky channels), instead of or as well as reselling the Sky satellite service. However, this would be at more reasonable price and non-price terms; or

c) some variant of those options.

In all those scenarios, competition is enhanced, as is innovation including as to UFB uptake.

10.7 UFB uptake and investment enhanced

As we explained when dealing with the factual, the status quo, as well as the future post-merger, has a substantial restraining effect on UFB uptake and investment. Essentially, keeping customers for Pay TV on Sky satellite is a major factor in holding back fibre uptake (as customers often don't need the faster speeds absent Pay TV requirements). This has substantial negative welfare effects in terms of choice, innovation and investment. We submit that on the SLC analysis, this should be a first order consideration.

However, in the counterfactual, with wholesaling to RSPs on reasonable price and non-price terms likely, the RSPs will transmit primarily via UFB. Given high volume content (typically, TV), in addition to price, is the main driver for fibre uptake, this substantially drives uptake, innovation, investment and consumer choice.

In addressing BskyB's retention of premium content and the impact on investment and innovation as to fibre networks, Ofcom explained:[17]

> - Improved access to 'must-have' content will incentivise investment in new means of distributing content, such as faster broadband networks. In the longer term this will result in a range of innovative new services for consumers.
>
> - We also expect to see improved choice of wider bundles which include broadband, voice and TV services, with a variety of suppliers able to compete effectively across all three of these key communications markets…..
>
> ….

[17] Ofcom 2010 Pay TV statement, at [1].

A key driver of investment in superfast broadband is the ability to distribute video content in greater volumes and at higher quality than is currently possible. …. Despite these technological changes, some underlying characteristics of the pay TV sector remain. Particular content holds enduring appeal for large numbers of viewers and is concentrated on pay TV – live top-flight sports and first-run Hollywood movies. Access to this content remains key for the development of any new platform, and is critical to ensuring effective competition.

In particular, new broadband networks will have the ability to offer consumers an unprecedented choice of content, and access to that content on demand. This is a significant driver for investment in superfast broadband, but new content distribution platforms will not develop if they are denied access to key 'must-have' content.

10.8 Imperfect market solutions

The market conditions will not fully solve for the market failure, and thus WMO-type regulation is still needed, but there is substantial lessening of competition in the factual relative to the counterfactual.

11 OTT's competitive constraint is minimal

11.1 Vodafone's and Sky's applications contradict Sky's stated position

In their applications, Sky and Vodafone make much of the competitive constraint upon Sky TV subscription services due to OTT services such as Netflix and Lightbox. Yet Sky's CEO in June 2016 effectively stated the opposite in the Listener, when addressing NEON, which, as the applications state,[18] is similar to Netflix:

NEON does not include premium sports, and is therefore much closer to Lightbox, Netflix, Apple TV, etc, in terms of content offered.

The Listener article, "*Sky's 'not at the limits'*", describes how Sky dealt with NEON blockbuster content, Game of Thrones, just as Netflix has similar blockbuster content such as House of Cards (highlighting added): [19]

The internet has spawned new business models, but Fellet is determined to view that as an opportunity.

"Yep, we have lost core subscribers, but … we have grown pretty fast in the over-the-top business. We are better off than anyone else to exploit that, because at the end of the day, we think our greatest strength is our content."

……

The battle over different viewing models even happens within Sky. Newcomer Neon vied with traditional channel Soho to offer GoT, each arguing it would lose subscribers if it went on the rival service." **However, Fellet discovered there was little crossover, with the average Sky subscriber aged about 50 compared with Neon viewers in their early 20s, so he ran GoT on both. Neon took off and viewership hit an all-time high on Soho.**

"It was appealing to two separate segments, so my thinking is who else is better off trying to maximise this market than we are? I already have the content – let me leverage it into these new marketplaces."

In addition to confirming the dominant market power that Sky has in at least two of its target market areas (subscriber markets for linear Pay-TV and for on-demand respectively, marked by differences in ages), this Listener article has the Sky CEO confirming that services such as NEON, Lightbox and Netflix are not a substitute for subscriber linear Pay TV. And vice versa.

[18] Ibid at [11.11].

[19] The Listener "Sky's 'not at the limits'" (13 June 2016) (http://www.listener.co.nz/current-affairs/business/skys-not-limit/).

Effectively, there is "little crossover, with the average Sky subscriber" and NEON, Lightbox and Netflix.

11.2 The U.S experience supports that conclusion

New entrants in the U.S. such as Netflix have had substantially greater impact on Pay TV than in New Zealand, illustrated by the much larger content inventory Netflix provides in the U.S relative to its content in New Zealand (the difference in part if not largely being due to Sky's dominance in local acquisition markets). Netflix US has around 3 times the content that Netflix NZ has.

Regulatory activity in the U.S provides insights.

The most recent of a number of cable, Pay-TV and telco mergers in the US is the merger of three cable companies (which offer telco and Pay TV services), namely, Charter, Time Warner, and Bright House, into a company currently called "New Charter". If cleared, the merger will create one of the largest national Pay TV and telco providers in the U.S.

FCC under communications regulation has cleared the merger subject to certain conditions including behavioural undertakings.

Subject to court approval, and again on the basis of behavioural and other commitments, the Department of Justice (DoJ) has given competition law clearance.

In its application to the court to approve the merger, on terms, DoJ has filed a competitive impact statement that conveniently summarises its more detailed views elsewhere.[20]

Despite the high public profile of Netflix and other similar OTT providers, the competitive impact statement confirms they have only around 5% of the revenues that the larger Pay TV operators such as Time Warner and Comcast have.[21] Their impact in that sense is relatively minimal.

Moreover, the larger Pay TV operators (the equivalent of NZ's Sky TV) are not particularly concerned about the impact of the likes of Netflix. As the competitive impact statement notes (where "vMVPD" is the online variant of large Pay TV providers such as Time Warner):[22]

> the [merger applicants'] internal documents show that they have typically been comparatively less concerned about competition from certain SVOD providers, like Netflix, that do not offer live or current-season programming, and more concerned by the threat posed by vMVPDs like Sling TV and SVODs like HBO NOW that offer current season content.

12 Encouraging innovation by Sky

It could be argued that Sky should retain the ability to achieve high earnings and super profits, in light of the risk it took in early years (and that such an approach does not lead to SLC as it encourages innovation in consumers' interests in the long run: otherwise investment and innovation incentives are chilled).

However, Sky is well past the period when super-profits are appropriate or necessary to reward risk and innovation. As Ofcom has said in the similar circumstances in the UK:[23]

> This review has shown that Sky has earned high returns for a sustained period. The riskiness of Sky's early investments will have demanded such returns for a period. However, despite the fact that Sky's more recent investments have entailed lower levels of risk, Sky's returns remain at a high level and appear unlikely to be competed away in the future.

[20] The competitive impact statement is at https://www.justice.gov/atr/file/850161/download

[21] Time Warner/Bright House/Charter competitive impact statement at page 8 (see last footnote).

[22] At page 9 in the competitive impact statement noted in the last footnote.

[23] Ofcom 2010 Pay TV statement at [1.45] (available at http://stakeholders.ofcom.org.uk/consultations/third_paytv/statement/).

13 Horizontal platform effects

The applicants claim there are few if any horizontal effects. However, that fails to recognise the overlapping transmission paths by which content is delivered to consumers. For example, the acquisition would combine, in the same company, transmission by HFC/cable in Wellington, Christchurch and Kapiti, with transmission by competing satellite. In addition, satellite transmission is combined with fixed line and mobile transmission in many areas (urban and otherwise).

13.1 Rural

In the RBI footprint, satellite and RBI – which is an FWA service provided by Vodafone - are often the only actual or potential competitors for transmission of TV content. Particularly significant is that Vodafone's wholesale obligations (which are in the form of contract and deed,[24] not regulation) are limited to the relatively low sub-HD speed 5 Mb/s service.[25] Vodafone is able to offer its retail customers a higher speed and quality service over its RBI-funded infrastructure, more suited to HD and other higher end TV services, but does not wholesale to other RSPs. Therefore, in much of the rural footprint, competition is removed or substantially reduced.

14 Content-related Market definition

As noted above, we do not address all market definition issues.

14.1 Rural markets

For the reasons in the above paragraph, geographic dimensions beyond national markets call for different geographic markets. For example, there are markets in the rural footprint (or, possibly, the RBI footprint) for the retail provision of pay TV services, the wholesale provision of pay TV services, for retail of broadband services (divided also into fixed and mobile) and the provision of services for the transmission of pay TV.

14.2 Broadband services retail markets

The applicants incorrectly maintain that there is only a relevant market for provision of fixed line broadband services (a market which should extend to any fixed location broadband service such as FWA). As the applications make clear, mobile services, quad plays, etc, are central to the applicants' proposed services.

In addition to the market for retail fixed broadband services, relevant markets include retail of mobile broadband, a broader market for all broadband, and markets on a similar basis for the rural or RBI footprint.

14.3 Wholesale pay TV services

Also for the reasons in the last section of this submission, there are markets (including a rural market) for wholesaling pay TV services.

[24] Vodafone's Deed of Undertaking dated 22 September 2011.

[25] This is the "Enhanced RBI Broadband Service", as defined in [4] of the Rural Broadband Agreement between the Crown and Vodafone (as cross-referenced in the deed of undertaking). That enhanced service is the same as the basic service, with higher throughput and latency metrics.

14.4 Separate or sub-markets for linear Pay TV such as Sky, and on demand OTT such as Netflix?

At Para 11, we outlined why services such as Netflix and Lightbox are only a minimal competitive constraint on linear Pay TV services such as the Sky service. As the Sky CEO observed, viewers of the Sky satellite linear service are older than viewers of NEON (and NEON is similar to Netflix and Lightbox, as the applications state). Hence they are not material substitutes for each other.

This implies separate markets or sub-markets for each category. Alternatively, the analysis ought to have regard to the minimal substitution between the two types of services.

Alternatively, for the reasons at Para 11, the concern may lie more around lack of substitution in the broader Pay TV market as Sky's competitors cannot get relevant content as it is locked up by Sky's contract with upstream content providers.

14.5 Content acquisition markets

We have not addressed these in detail as we expect that other parties that are content acquirers will provide evidence. What is apparent is that these markets are relevant and impact downstream markets.

15 Conclusion as to content and Pay TV

This paragraph summarises the SLC assessment. Underpinning it are the factual and counterfactual paragraphs (Paras 9 and 10 respectively) and the paras referred to therein.

The merged entity in the factual has it leveraging its key content rights (or "must carry" content) into adjacent markets by, for example, bundling that content with fixed and mobile services. That content is unlikely to be wholesaled on reasonable price and non-price terms. The merged entity has the incentive and the ability to foreclose.

Additionally, because key content is not available, other content providers such as Netflix and Lightbox are unlikely to be an effective constraint (and in any event are not substitutes).

This leads to failure of competition, investment and consumer choice, including due to lowered UFB uptake.

In the counterfactual, it is likely that Sky will wholesale on terms encouraging RSP uptake, in order to expand its footprint, given that retail subscribers and revenues are declining. UFB update will also increase.

For that and the reasons set out in more detail above, the factual relative to the counterfactual entails substantial lessening of competition.

16 The mobile market

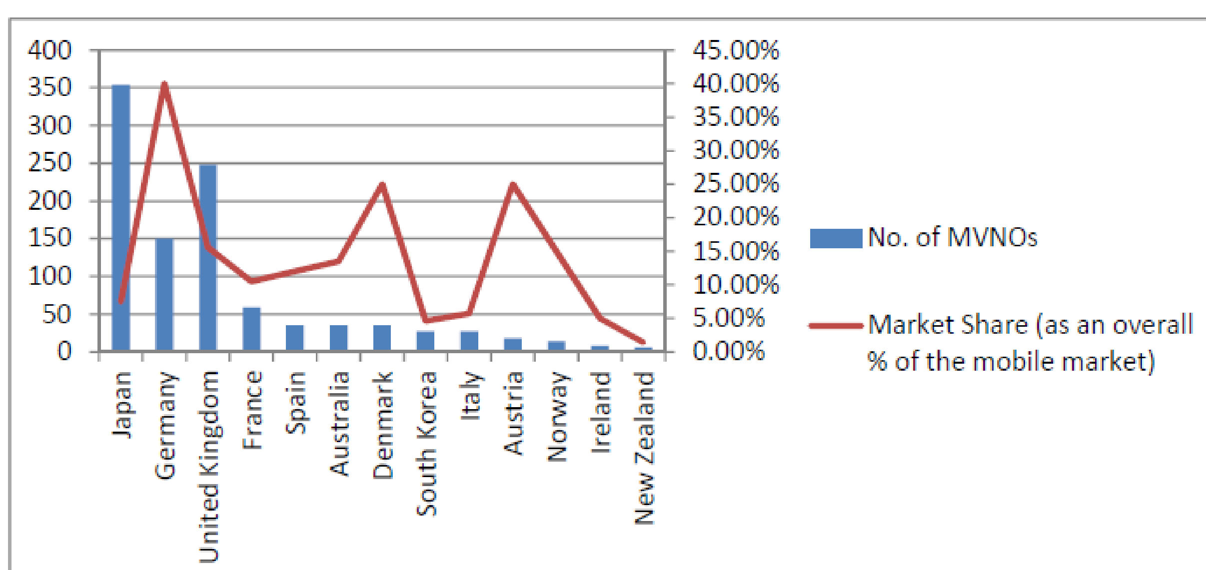
We turn now to the implications of the merger in the mobile market. First we overview current market conditions and deal with MVNOs. We address mobile retail pricing, and then return to "thick" and "thin" MVNOs. We outline our communications with the MNOs in confidential Appendix A, where we also deal with the factual, the counterfactual and the SLC assessment. The body of the submission overviews European analysis and regulatory decisions, and also deals with market definition.

16.1 The New Zealand MVNO market

There is only a "handful" of MVNOs (around six) in New Zealand, with 20,000 customers as at June 2015.[26] Therefore the competitive impact of MVNOs is minimal and largely immaterial.

New Zealand stands out amongst developed economies for the very low level of services-based competition in mobile markets downstream from the MNOs. Most developed countries have highly dynamic services-based competition, with dozens, and sometimes hundreds, of MVNOs competing against each other and against the retail arms of the vertically integrated MNOs.[27]
As the graph below shows,[28] MVNOs across a range of other developed countries can account for anywhere between 10% to 40% of retail market share. In contrast, New Zealand has around 6 MVNOs, accounting for less than 2% of the retail mobile base.

Number of MVNOs tracked against market share



The presence of a vigorous MVNO sector is not necessarily a function of a mobile market being larger than that found in New Zealand. As the above graph shows, countries which face similar challenges of scale and which have 3 or fewer MNOs, such as Norway, Australia, Ireland and Austria, have many more MVNOs, accounting for 6 to 20 times more market share than the current pool of New Zealand MVNOs.

16.2 New Zealand has high mobile data retail prices

The Commerce Commission's 2015 Annual Telecommunications Monitoring Report concludes that New Zealand's entry level mobile plans compare well with other countries. However, given the rising demand

---

[26] Commission's 2015 Annual Telecommunications Report, p28.

[27] For more detail, see our submission, *Promoting a vibrant mobile market in New Zealand*, on MBIE's Telecommunications Act review, at http://www.mbie.govt.nz/info-services/sectors-industries/technology-communications/communications/regulating-the-telecommunications-sector/review-of-the-telecommunications-act-2001/submissions/Trustpower%20submission%20attachment%20MVNO%20report.pdf.

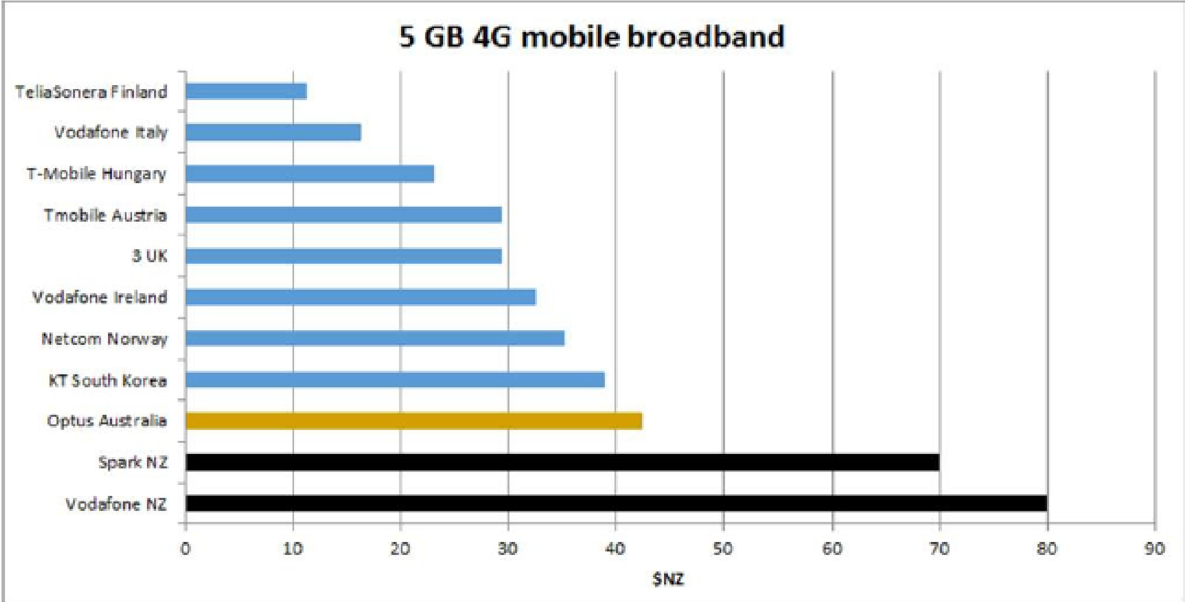
[28] Data drawn from a variety of sources, primarily OECD, 2014, "Wireless Market Structure and Network Sharing", OECD Digital Economy Papers, No. 243, OECD Publishing; and McKinsey & Company, Virtually mobile: what drives MVNO success, June 2014, p3; Pyramid Research, Market Opportunities and the Evolution of MVNO Business Models in Western Europe, 2014. For a more comprehensive list of sources see Attachment B in the document in the last footnote.

for high bandwidth data services, along with Pay TV bundles including mobile, outlined above, the future driver of consumer welfare will be in mobile broadband, not 'plain old mobile voice' and simple data services like SMS.

That Commission report[29] shows that New Zealand's retail mobile pricing for data is higher than nearly all other OECD countries. The 1.5 Gb and 6 Gb data services referred to in the Commission's report are around 50% and 100% higher than the OECD averages respectively. New Zealand ranks 28th and 33rd out of 34 countries, for the 1.5GB and 6Gb packages respectively).

New Zealand compares poorly on mobile plans bundling higher calls and data usage compared with other countries' mobile operators, as set out in the following graph.[30]

Comparison of New Zealand higher value monthly plans to comparable jurisdictions



Most of those countries with low price points for 5GB 4G services have a robust level of MVNO activity based on overall market share.

While the presence or absence of significant MVNO activity alone may not drive the differences between mobile pricing in New Zealand and other countries, mobile markets which are more dynamic than New Zealand's invariably have a 'critical mass' of MVNOs in the competitive mix. These MVNOs are operating at all levels of the value / quality chain, including the 'higher' end of the market. This is driving better pricing outcomes for consumers.

While price competition benefits consumers, MVNOs can be more than just resellers and in overseas markets the MVNO model is being used to deliver significant service and product innovation. We have summarised these benefits for New Zealand at Section 3 in our report, *Promoting a vibrant mobile market in New Zealand*.[31] They include:

---

[29] At page 40 of the Commission's 2015 Annual Telecommunications Monitoring Report.

[30] Data drawn from variously publicly available sources, including information available from each operator.

[31] http://www.mbie.govt.nz/info-services/sectors-industries/technology-communications/communications/regulating-the-telecommunications-sector/review-of-the-telecommunications-act-2001/submissions/Trustpower%20submission%20attachment%20MVNO%20report.pdf.

- Innovation in customer service;
- Innovation in pricing;
- Innovation in bundling;
- Innovation in niche marketing;
- Innovation in products and services.

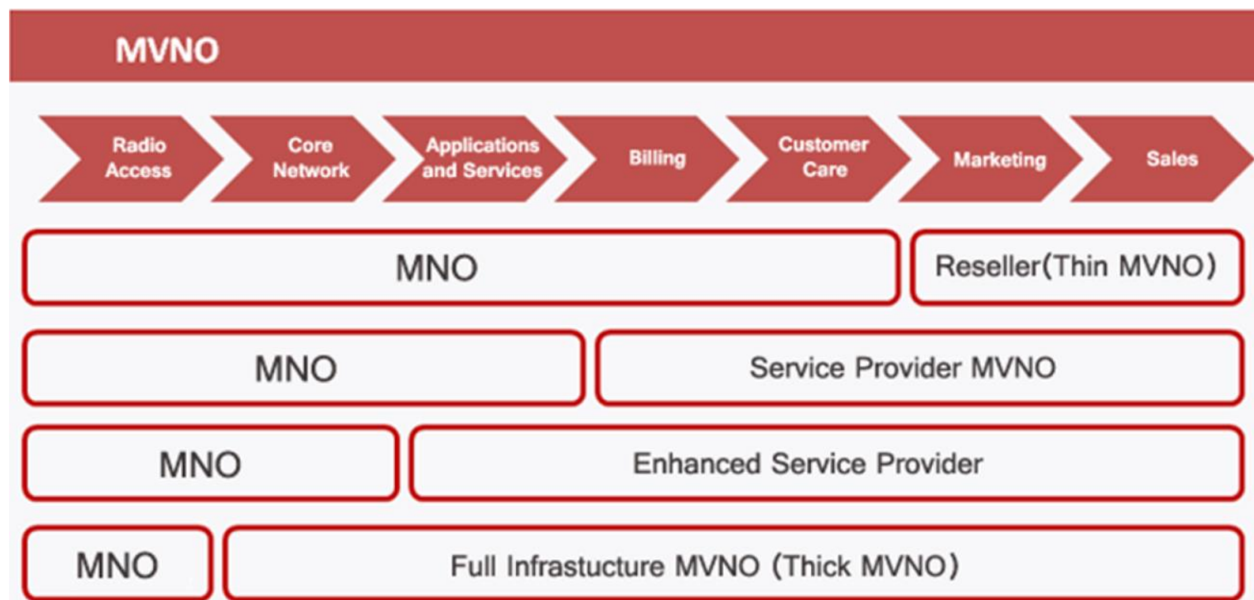
Later in this submission, we refer to econometric analysis by Ofcom as to mobile retail pricing in 25 countries, including New Zealand, indicating as New Zealand has only three mobile operators, retail prices are higher by around 19%.

17 Thin and thick MVNOs

Our understanding is that NZ MVNOs so far have largely been limited to constructs involving products that reflect the MNO's own services, with pricing often of a retail minus nature. The position is similar to Sky's poor wholesale terms for content, in that MNO offerings thus far are limited and do not permit effective competition by MVNOs. The price and non-price terms are not viable as a basis for an effective retail offering by MVNOs. The failure of MVNOs to make traction shows this.

In the range of MVNO offerings, such MVNOs are at the "thin" end of the MVNO spectrum, by which more of the services are undertaken by the MNO instead of the MVNO. "Thick" MVNOs have more of the services being provided by the MVNO. Additionally, there is more flexibility for the MVNO. For example, a thick MVNO is more likely to acquire bulk airtime (effectively, data) from the MNO (possibly on a basis which commits to buying a minimum amount of airtime/data). That frees up its choices as to products, customer service, marketing, etc.

There are a number of models for implementing MVNOs, ranging from a reseller model (thin) to a full infrastructure MVNO (thick), as per the diagram below.



Trustpower is not interested in the top two layers of "Reseller" or "Service Provider MVNO". As noted above, those options have proven to be unworkable and too constrained. They also do not provide the space for innovation to deliver effective competitive pressure on MNOs.

The lower two options, particularly the full infrastructure MVNO, give greater flexibility for the MVNO to create innovative and differentiated services.

Within those two lower layers, one option as well is for the MNO to provide a MVNE service (mobile virtual network enabler). The MVNE platform provides the access and information to support an "Enhanced Service Provider" or the "Full Infrastructure MVNO" models (the lower two layers in the diagram above).

Trustpower has had communications with the three MNOs as to options and these are outlined in the confidential Appendix A. There is also reference to those discussions at Para 8.7 above.

18 Competitive pressure - Thick MVNOs are similar to MNOs

In the European Union, a number of mergers between two MNOs have been cleared by the European Commission, which reduce the number of MNOs from four to three, on terms that the merging MNOs agree to sufficiently robust and reasonable MVNO terms with at least one third-party MVNO. Those terms are at the "thick" end of the MVNO spectrum, and involve selling airtime on a bulk basis, with pay-as-you-go as well as minimum commitment options. [32]

The decisions reflect the conclusion that three MNOs instead of four causes competition and market failure, including non-coordinated anticompetitive effects on the retail mobile market, and tacit collusion.[33] Effectively the thick MVNO provides the constraint that an MNO would provide.

As our preference is to have a thick MVNO, that can solve issues arising from having only three MNOs.

19 Thick MVNO can drop prices by around 19% - Ofcom

A March 2016 Ofcom report, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing,*[34] analyses the position in 25 developed countries including New Zealand, It concludes that retail prices for mobile services:[35]

> "are between 17.2% and 20.5% lower on average in countries where there is one additional mobile operator [above three operators] AND a disruptive firm is in the market".

2degrees is treated by Ofcom as a disruptive firm.

Ofcom's conclusion is based on the difference between three and four mobile operators as the report was prepared in the context of the European Commission's review of the proposed merger in the UK between MNOs, H3G and O2 (Telefonica UK), which would take the number of operators from four to three. Ofcom concluded:

> "Combining the two sets of confidence intervals indicates that prices could be between 17.2% and 20.5% lower on average in countries where there are four or more mobile operators AND a disruptive firm is in the market. By implication, this may suggest that removing a disruptive

[32] See for example the Summary of Commission Decision on clearance of the Liberty and BASE merger in Belgium (Case M.7637) decided 4 February 2016, at [32].

[33] See for example the clearance of the Liberty and BASE merger in Belgium (Case M.7637) decided 4 February 2016.

[34] http://stakeholders.ofcom.org.uk/binaries/research/cross-media/disruptive-firms-econometrics/research_document.pdf.

[35] At page 17 of the Ofcom report, *A cross-country econometric analysis of the effect of disruptive firms on mobile pricing*.

> player from a four player market (as is proposed in the H3G/O2 merger in the UK) could increase prices by between 17.2% and 20.5% on average, all else being equal."

The European Commission has declined the H3G and O2 merger, in part because the MVNO offering to solve the three MNO problems were not acceptable.

As outlined above, a thick MVNO can be effective as the added fourth mobile operator to achieve similar benefits to those identified by Ofcom. The Ofcom report notes non-price retail improvements too, as well as reduced retail pricing.

20 Market definition in relation to MVNOs

We have already submitted there is a relevant market for the supply of retail mobile services.

There is also a market for the wholesale supply of MVNO services to RSPs.

21 Factual, counterfactual, and SLC assessment

This is set out in confidential Appendix A.

Appendix A Discussions with MNOs – Confidential