PUBLIC VERSION

Sky TV / Vodafone merger clearance

Response to Commission's information request

5 October 2016

Executive Summary

Spark welcomes the opportunity to respond to the Commission's further questions in relation to the proposed merger between Sky and Vodafone. In summary, in answer to the Commission's questions:

1. **The merger substantially lessens competition relative to the status quo** – In response to your question about the status quo as counterfactual, Spark considers that, without the merger, even if Sky refuses to make its services available to RSPs on commercially reasonable wholesale terms, nascent competition in media content will continue to emerge. Spark anticipates that it will be in a position to invest in and develop a sufficiently compelling media proposition that can be bundled and/or co-marketed with broadband to enable it to compete effectively in the market. Broadband competition will continue to be robust across all segments of the market. In the status quo as counterfactual:

    a. Content markets will continue to evolve – as the content platforms and other content offers that Spark invests in become available through devices on broadband and mobile channels the emerging competitive pressure will build on Sky such that it is likely to improve the quality and breadth of its OTT services and to lead it to consider its pricing and package structures. By contrast, with the merger, within the short term Sky would have both an enhanced power and incentive to block access to quality content to RSPs, such as Spark, and to undermine the ability for other RSPs to monetise any competitive media proposition by engaging in anti-competitive bundling and launching defensive propositions. While the merged entity is likely to still review its product set in the short term, it will likely only do so to the extent required to defend against substantially less effective competitive propositions, provide content on its own platforms exclusively, and do so as part of an exclusionary strategy. In the short to medium term this will likely result in Spark and others substantially reducing investment in content and media offerings, and Sky's market power will be effectively extended, enhanced, and entrenched.

    b. Without vertical integration there is no one monopoly provider – we expect that Sky will continue to seek out opportunities to sell and cross sell its services with broadband as it and Vodafone do today but without the ability or incentive to engage in anti-competitive bundling. Competition in the high and lower ARPU segment of the broadband market will continue to be robust with RSPs continuing to invest, innovate and improve services and value inclusions. By contrast, with the merger, it is likely that the merged entity will engage in a profitable (over the medium term) strategy of anti-competitive bundling to gain substantial share of high ARPU customers, foreclose access to wholesale inputs and substantially reduce the scope for RSPs to compete in the high ARPU segment of the broadband market. Over time this will likely lessen competition in other segments of the broadband market.

    c. Sky will seek to monetise currently unutilised mobile content rights – Without the merger Sky will likely seek to grow revenues through the commercialisation of its currently unused mobile content rights. Mobile providers will compete for the opportunity to provide some or all of Sky's content as part of their mobile service offering. Content and other value add service offerings in mobile will become increasingly prevalent. By contrast, with the merger, the mobile content rights will likely be limited to high ARPU mobile customers of the merged entity. Mobile television will be less prevalent in New Zealand than other developed nations.

2. **Sky Sports is a must have - [ ].**[1] Sky Sport is clearly a “must have” for a substantial number of Spark customers.

3. **Broadband and content market competition lessened** - **[ ]**

   In response to the questions posed by the Commission, **[ ]**

   [ ]

   a. **[ ]** Competition in the market for content services would substantially reduce. Consumers will have reduced content choices and Sky will successfully extend its market power in pay TV and content markets more broadly.

   b. Competition in the market for the supply of high quality value inclusive broadband services would substantially reduce **[ ]**.

   c. **[ ]**

   d. **[ ]**

      In Spark's view, the difference between the factual and the counterfactual can be illustrated by reference to the developments in the UK market. In the counterfactual, for the reasons described above, Spark will have incentives to continue to develop its content offering. Similarly in the UK, as a result of BSkyB wholesaling (which will increase in New Zealand in the counterfactual), there has been an incentive for BT to enter the content market to compete with BSkyB (which has organically grown in the broadband market, rather than simply merging with the second largest telecommunications operator). The growth of various pay TV providers in the UK that wholesale content to and from one another, including premium sport, means there is competitive tension in the provision of content, and focus on brand, quality of the offer and service wrap.

      In the factual, the merged entity will have all the premium sports content locked-up for the foreseeable future, and an immediate 30%+ market share, which they will immediately be incentivised to increase, using exclusivity over sport to achieve this. This will create a perpetuating cycle where they can use these newfound benefits on top of their existing business model to out-bid any other player for premium sports content when the next sports rights cycle happens in 2019-20. In the counterfactual, due to the incentives on Sky to wholesale on commercially reasonable terms, Spark would be much more likely to be able to successfully bid for some of that sports content, and the market for the acquisition of and provision of premium pay TV sports content is much more likely to play out in a manner similar to the UK model, with incentives for parties to wholesale to each other to maximise the value of the rights (rather than Sky/Vodafone being able to use premium sports rights as a way to grow broadband market share through anti-competitive bundling).

4. **Mobile competition** - While **[ ]**, the ability to control costs, the ability to achieve economies of scale, and the ability to differentiate on network quality are better for Spark’s mobile business than its broadband business, Spark also has significant concerns about the impact on the mobile market (such as outcomes that could arise through the merged entity zero-rating and bundling premium content and mobile). In response to the merger, Spark would likely continue to invest in a range of competitive value-added inclusions to its mobile

[1] **[ ]**

packages - including other contestable multimedia, smart living, health and other mobile applications, which provide scope for continued and evolving competitive responses and innovation in response to the merged entity's premium sports lock-up.

However, **[ ]**. Again, this would likely result in Sky/Vodafone being able to charge more and win more customers at the same time, with the resulting loss in market share to Sky/Vodafone putting significant pressure on **[ ]**:

a. **[ ]**

b. **[ ]**; and

c. **[ ]**

5. **Spark's previous resale arrangements with Sky were uneconomic** - **[ ]**:

a. in FY2012 **[ ]**,

b. in FY2013 **[ ]**; and

c. in Fy2014 **[ ]**.

The terms on which the Sky reseller services were provided to Spark were unreasonably restrictive and, combined with the way in which they were enforced by Sky, prevented Spark from providing any competitive content services. The current Sky wholesale terms recently presented to Spark by Sky **[ ]**. We consider the current reseller arrangements (which will likely endure with the merger) to be evidence that the merger will effectively foreclose the ability of Sky resellers to provide any media content or services in competition with Sky content and Sky services.

Introduction

This is Spark’s confidential response to the Commission’s request to provide further information to assist the Commission to understand how Spark’s residential broadband and mobile operations could be affected by the potential loss of subscribers to the merged entity (and subsequent loss of revenue). The information requested includes information on:

1. **[ ]**.
2. **[ ]**.
3. **[ ]**:
    a. **[ ]**;
    b. **[ ]**.
4. **[ ]**:
    a. **[ ]**
    b. **[ ]**;
    c. **[ ]**.
5. **[ ]**:
    a. **[ ]**; and
    b. **[ ]**.
6. Whether the proposed merger between Vodafone and Sky is likely to substantially lessen competition relative to the status quo as counterfactual.

We have also had the opportunity to review the cross-submissions of the merging parties, and aspects of our response to the Commission's information request refer to those cross-submissions (in particular, to identify the parts of those cross-submissions that we consider to be incorrect, disingenuous, or deliberately obscure).

Response to Commission questions

Spark's responses to questions 1 to 5 are set out in Annex Three. Spark's response to question 6 is set out below.

As a general observation of Sky and Vodafone's submissions and cross submissions, Spark 's view is that the parties have failed to address in any meaningful or substantive way the concerns raised by Spark in relation to the proposed transaction.

Spark's concerns go unanswered and unaddressed, other than by way of glib, unsubstantiated and generic statements of principle - without linking those statements of principle to the specific facts in question in this case, or Spark’s concerns are inconsistently treated. That cannot be sufficient to satisfy the Commission that the transaction will not substantially lessen competition.

The onus is of course on the applicants to satisfy the Commission, on the balance of probabilities, and in light of all the evidence available to the Commission, that a substantial lessening of competition will not arise as a consequence of the transaction. If there is doubt, then the Commission must decline the merger. At this stage, at least in what is publically available, the parties have presented very little evidence to overcome that burden. This is particularly concerning given the history of Sky's previous mergers and investigations, where Sky has predicted no detrimental competitive effects from its actions, and that has subsequently been shown to have been an incorrect prediction. In all the circumstances, we think that the Commission must at least have serious doubts about the likelihood that the parties' current prediction is correct, when they assert that the proposed transaction will not substantially lessen competition.

Whether the proposed merger substantially lessens competition vs. the status quo

Market developments overseas demonstrate that the status quo in New Zealand will evolve in the short-to-medium term to an industry where consumers increasingly demand pay TV content delivered via a broadband and mobile media, instead of via traditional satellite media; Sky itself predicts this.

For these reasons, the status quo will not endure as the relevant counterfactual for more than 18-24 months. Beyond that, due to significant changes in consumer demand and developments by competitors including Spark, the counterfactual will necessarily evolve beyond the status quo. The Commission needs to consider the evidence of this in assessing the Sky/Vodafone transaction. More detail on those developments are set out below.

However, in response to the Commission's question, Spark confirms that it also considers that the proposed transaction would create a substantial lessening of competition in comparison to the status quo.

The status quo

As the Commission is aware, the status quo currently involves:

- Sky selling Sky Basic + Sky Sports to retail customers at the retail price (~$95 per month[2]) at which buyers are willing to buy the profit-maximising quantity - thereby preserving its monopoly rents in that market.
- Sky having a reseller agreement with one RSP (Vodafone) that is priced on a claimed ECPR basis and includes the key commitment restrictions. Based on Spark's experience as a Sky reseller on an ECPR basis, that reseller agreement does not contain sufficiently attractive terms or sufficient margin for Vodafone to offer particularly attractive bundle prices to New Zealand consumers, nor to heavily promote the Sky/Vodafone bundle. At present, the offers available through purchasing a Sky/Vodafone bundled are limited to:[3]
    - o Free My Sky each month (worth ~$15 per month for those that want My Sky); and
        - Free Sky Sport for a year (worth ~$270 to $300 in total, as Sky standalone customers get free Sky Sport for 2 months, and other current offers provide free Sky Sport for 3 months);[4] or
        - Free Soho for a year (worth ~$120 in total).

[2] Sky Basic is $49.91; Sky Sports is an additional $29.90 and My Sky is $15 per month (Spark understands this to be the typical package of services purchased by subscribers to Sky Sports). https://www.sky.co.nz/subscribe
[3] http://www.vodafone.co.nz/tv/sky-with-broadband/package-discounts/
[4] http://www.freesamplegiveaway.co.nz/free-stuff/get-sky-sports-free-3-months/

Accordingly, the bundled offer has not driven material market share changes as consumers access similar (or sometimes even better) pricing through choosing standalone broadband and Sky Sport packages.

- Sky not having any partnerships or arrangements with any mobile providers in New Zealand to offer Sky Sport + mobile bundles, or to unmeter mobile data for viewing Sky Sport content. Accordingly, Sky's exclusive long-term control of premium sports content has not driven any market share changes in the mobile market.

This is because, due to its ECPR pricing model, Sky is currently indifferent as to whether consumers purchase Sky Sport directly from Sky or via Vodafone.

This means that in the status quo (assuming no change in today's current dynamics, which, as noted above, is unrealistic):

- The pay TV and New Zealand premium sport content rights remain uncompetitive, with a dominant Sky adopting pricing and strategies that entrench its substantial market power in those markets and its preference for consumers to receive that content via its own satellite distribution network;
- The broadband markets remain vigorously and workably competitive (i.e. largely unaffected by the substantial market power of Sky in upstream markets given its indifference towards outcomes in the broadband markets and preference for satellite distribution); and
- The mobile markets remain vigorously and workably competitive (i.e. largely unaffected by the substantial market power of Sky in upstream markets given its indifference towards outcomes in the mobile markets and preference for satellite distribution).

In the status quo as the counterfactual:

- Content markets will continue to evolve – as the content platforms and other content offers **[ ]** become available through devices on broadband and mobile channels the emerging competitive pressure will build on Sky such that it is likely to improve the quality and breadth of its OTT services and to lead it to consider its pricing and package structures.
- We expect that Sky will continue to seek out opportunities to sell and cross sell its services with broadband as it and Vodafone do today but without the ability or incentive to engage in anti-competitive bundling. Competition in that segment of the broadband market targeting high and low ARPU customers will continue to be robust with RSPs continuing to invest, innovate and improve services and value inclusions. By contrast, with the merger, it is likely that the merged entity will engage in a profitable (over the medium and long term) strategy of anti-competitive bundling to gain a substantial share of high ARPU customers, foreclose access to wholesale inputs and substantially reduce the scope for RSPs to compete in the high ARPU segment of the broadband market. Over time this will likely lessen competition in other segments of the broadband market.
- Sky will seek to monetise currently unutilised or under-utilised mobile content rights – Without the merger Sky will likely seek to grow revenues through the commercialisation of its currently unused mobile content rights. Mobile providers will compete for the opportunity to provide some or all of Sky's content as part of their mobile service offering. Content and other value add service offerings in mobile will become increasingly prevalent. By contrast, with the merger, the mobile content rights will likely be limited to high ARPU mobile customers of the merged entity. Mobile television will be less prevalent in New Zealand than other developed nations.

Finally, in relation to Sky's admission to the Commission that it adopts ECPR pricing, Spark notes that the adoption of such a pricing model is inconsistent with Sky's claims in its submission that it does not have market power over premium sports content. If Sky thought that there was a credible prospect of an RSP outbidding it for sports content rights in a way that materially facilitated new pay TV sports entry/competition, it would wholesale to that RSP at a level below ECPR in recognition of that potential threat. The fact it does not demonstrates its awareness that the "vicious circle" will continue to ensure its dominance in premium sports content in New Zealand. Sky's awareness of that vicious circle is also reflected in the comments in the EM: "**Sky TV has the key sports broadcast rights locked up for a number of years and its penetration levels are a critical attraction for the relevant codes**."

The factual

By contrast, in the factual, within the short term Sky/Vodafone would have both enhanced market power and the incentive to block access to quality content to competing RSPs such as Spark, and to undermine the ability for other RSPs to monetise any competitive media proposition by engaging in anti-competitive bundling and launching defensive market offers. While the merged entity is still likely to still review its product set in the short term (eg introducing "Sky lite"), it will likely only do so to the extent required to defend against weakened competitive alternatives and as part of an exclusionary strategy.

The combined Sky/Vodafone is likely to refuse to wholesale Sky Sports content to other third party RSPs and mobile operators on commercially attractive (possibly even ECPR) terms, and/or terms that are comparable to the internal transfer price to Vodafone within the combined Sky/Vodafone.

Indeed, Sky has made it clear that going forward, to the extent it continues to wholesale to other RSPs, it will only wholesale at a price that makes it indifferent as to whether consumers purchase directly from Sky or from the RSP. Once Sky is combined with Vodafone, that "indifferent" wholesale price will also include any margin that Sky/Vodafone will lose from broadband and mobile products if a consumer were to instead purchase a triple-play or quad-play bundle from that other RSP. Once that additional broadband and/or mobile margin is included in Sky/Vodafone's pay TV wholesale price, it will be even more uneconomic for other RSPs to try to compete with the combined Sky/Vodafone in the downstream provision of triple-play/quad-play bundles to consumers.

This is because Sky/Vodafone will be incentivised, via its long-term control of premium sports content, to take advantage of that control to force more consumers to purchase broadband or mobile services from Vodafone. Obviously Sky does not have any such incentive at present to do so.

The fact that Sky will have such an incentive in the factual is illustrated, for example, by the prosecutions of other businesses overseas that similar have control over exclusive premium sports content. For example, in May 2016 the Competition Commission ("COMCO") imposed fined of CHF 71,818,517 on Swisscom for abusing its dominant position "with respect to live broadcasting of Swiss football and ice hockey championship games on pay TV":[5]

> COMCO established that with its subsidiaries, Swisscom holds a dominant position in live broadcasting of games of the Swiss football and ice hockey championships as well as of certain foreign football leagues on pay TV. This is because Swisscom subsidiary Cinetrade owns long-term and comprehensive exclusive rights regarding the broadcast of sports content on Swiss pay TV.
>
> Swisscom has abused this dominant position in several respects. It has refused to supply some competitors with broadcasts of live sports for their platforms at all. To other competitors such as Cablecom, Swisscom has only granted

[5] https://www.weko.admin.ch/weko/en/home/latest-news/press-releases/nsb-news.msg-id-61823.html

> access to a reduced range of sports content. Furthermore, the competitors, unlike Swisscom, could only offer their customers the sports content in combination with the basic package of Teleclub.

COMCO's concerns reflect the "must have" nature of premium sports content, and reflects the incentives on businesses that control such content to foreclose access to that content to competitors (which will be, following the proposed merger, other RSPs and mobile operators in New Zealand).

The increasing prevalence of triple-play and quad-play bundles, and Sky's own OTT Fanpass service, all point towards a combined Sky/Vodafone having even greater incentives to withhold content from other RSPs in the future (i.e. 2 -3 years from now). In particular, as bundled offerings become more attractive, as they are overseas, Sky/Vodafone will have every incentive to use bundling strategies to increase the likelihood of consumers switching the entirety of their bundle to Sky/Vodafone.

While Spark is not suggesting that premium sports content is a "must have" for all New Zealand consumers, indeed there are many consumers that have no interest in sports, it is a compelling and non-replicable "must have" source of entertainment for a significant proportion of New Zealanders. Spark considers that Ofcom's definition of "key content" is apposite: it is "content that is capable of influencing the choice of pay TV provider for a significant number of consumers."[6] Ofcom's analysis of the importance of premium sports content was "supported by a number of other pieces of evidence including the amounts paid for sports rights, statements by market players, international case studies and the number of consumers who pay for premium sports content". Those same factors apply in New Zealand.

Impact in broadband market

Spark estimates that approximately **[ ]** New Zealand households currently have both Sky Sport and broadband (out of a total of **[ ]** New Zealand households that subscribe to Sky Sport). That means that approximately **[ ]**% of all broadband customers in New Zealand are also Sky Sport subscribers. Given the pricing of the Sky packages, that **[ ]**% is also likely to reflect a large proportion of customers with a high ability and willingness to pay for premium content (the high ARPU broadband and potentially also mobile customers of the current set of RSPs and mobile operators).

This represents a significant opportunity for the combined Sky/Vodafone to increase the cost of standalone Sky Sport (above ~$95 per month) to force those customers to instead purchase a Sky Sport + Vodafone broadband bundle. The incremental broadband market share and revenue will significantly exceed any potential loss from potentially losing a proportion of the small number **[ ]** of Sky Sport subscribers that currently do not purchase broadband. That strategy, which the combined Sky/Vodafone will have the ability and incentive to pursue, does not represent pro-competitive bundling, as claimed by the applicants, but rather anti-competitive bundling whereby over the period those customers contract with Sky/Vodafone, the merged entity is able to charge more and get more customers.

This would be the classic example of anti-competitive bundling that the Commission has previously cautioned against **[ ]**:[7]

> Bundles can be pro-competitive, but also can be an instrument to leverage market power from a monopoly to a potentially competitive market. Firms can bundle products for strategic reasons, to artificially raise entry barriers, to limit

[6] http://stakeholders.ofcom.org.uk/binaries/consultations/wholesale-must-offer/statement/review_of_wmo_sStatement.pdf

[7] **[ ]**

> the market available to competitors and to adversely affect their ability to compete.
>
> …
>
> Firms can also use a bundle discount anti-competitively. It is the horizontal equivalent of a vertical price squeeze. A firm with market power in good C and facing competition in good D can price a C+D bundle in such a way as to make it impossible for equally efficient, independent producers of good D to compete. One way that this can be accomplished is by it over-pricing good C and under-pricing good D. The diversified firm is thereby able to leverage market power in respect of one good to another, by reducing rivals' profits and driving them out of the market.

The combined Sky/Vodafone will be able to engage in such tactics (i.e. increase the price of Sky Sports) and win significant market share from other RSPs without lowering the price of broadband services or increasing broadband quality - i.e. charging more and getting more customers.

As Ofcom has noted:[8]

> While there is a degree of differentiation in the broadband and telephony elements that providers include in their triple-play bundles (in particular, broadband speeds), **content is still one of the most important ways in which triple-play providers differentiate their bundle from competing providers**. This is generally borne out by our survey evidence, which shows that triple-play consumers consider content-based reasons to be similarly important as a reason for choosing pay TV provider. [Emphasis added]

It is deliberately disingenuous, and a bald denial of the known conditions for problematic anti-competitive bundling, for Sky/Vodafone to compare its post-merger ability to exclusively bundle Sky Sport + broadband with, for example, Spark's bundles with Lightbox and Spotify. Spark does not have any market power in the provision of general OTT entertainment content (Lightbox), which competes against similar OTT offerings in the likes of Netflix, Neon, Quickflix, Freeview, etc. Spark reiterates that offerings such as Lightbox and Netflix are complementary to, rather than substitutable, for premium sports content. Nor does Spark have any market power in the provision of streaming music content (Spotify), which competes against the likes of Apple Music, iHeart Radio, Pandora, Tidal, Amazon, Google, etc.

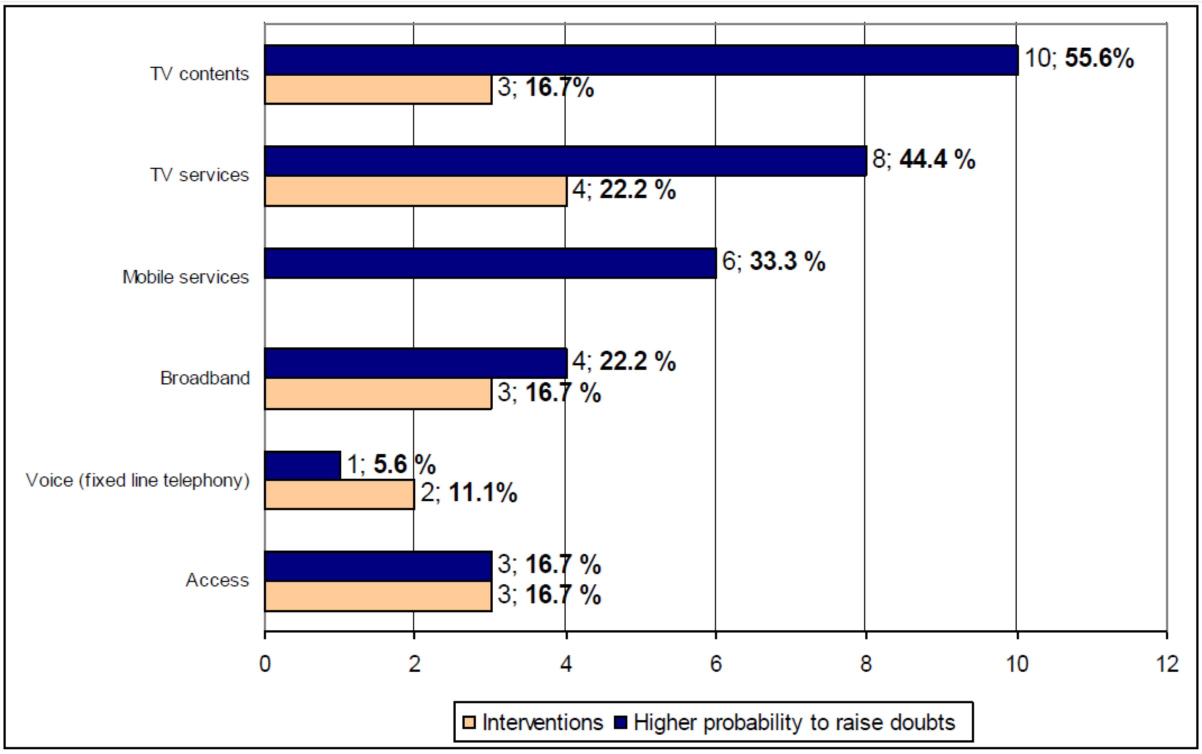
By contrast, the Commission has already previously found that Sky has market power in the acquisition of premium sports content and the provision of pay TV services in New Zealand, including over content that is a "must have" for a significant proportion of New Zealand households. As outlined in our submission, there is significant academic and regulatory literature that premium sports content is a "must have" source of market power.

Indeed, a survey of 17 national competition regulatory authorities ("NRAs") found "that TV content is the issue that has the highest probability of raising doubts regarding the replicability of bundles... the majority of NRAs mentions the relevance of premium contents, such as live sports events or first run movies" - as set out in Figure 1 below.[9]

[8] http://stakeholders.ofcom.org.uk/binaries/consultations/wholesale-must-offer/statement/review_of_wmo_sStatement.pdf

[9] http://berec.europa.eu/doc/publications/berec/erg_09_49rev1_draft_report_on_technical_replicability_of_bundles.pdf

Figure 1 - Share of services included in bundled offers regarding probability to raise doubts on technical replicability



Source:
http://berec.europa.eu/doc/publications/berec/erg_09_49rev1_draft_report_on_technical_replicability_of_bundles.pdf

It is also deliberately misleading for Vodafone to seek to dismiss the concerns it has raised about premium sports content overseas as relating to fixed access incumbency. A plain reading of the Vodafone quotes in Spark's submission make clear those concerns were raised in the context of premium content - in particular sports content. To re-quote, in case that is necessary, Vodafone's overseas submissions referred to concerns in relation to "live sports event", "leverage[ing] their content advantage to drive subscribers to their communication networks", "key content", "access to this content… on Fair, Reasonable, and Non Discriminatory terms", "the exclusive availability of the content highly valued by these customers", etc. There is no reference to fixed access incumbency in those quoted concerns. Spark trusts the Commission is not taking Vodafone's bare (and misleading) denial of those quotes at face value.

In the factual, Sky/Vodafone will be able to offer non-replicable Sky Sport + broadband and/or Sky Sport + mobile bundles that will drive significant broadband market share to Vodafone at the expense of other RSPs. In an environment where **[ ]** of the market will, in effect, have as their only sensible option purchasing broadband from Sky/Vodafone:

- It is inevitable that some RSPs will exit due to significant migration of customers/market share to Vodafone, as well as the significantly enhanced stickiness (lower churn) of that customer base to Vodafone;

- Sky/Vodafone will use this strategy to attract the highest ARPU customers - customers that purchase fixed-line, broadband and, potentially, mobile services in a bundle will be significantly higher ARPU customers than customers for only standalone (e.g. broadband alone) products; and

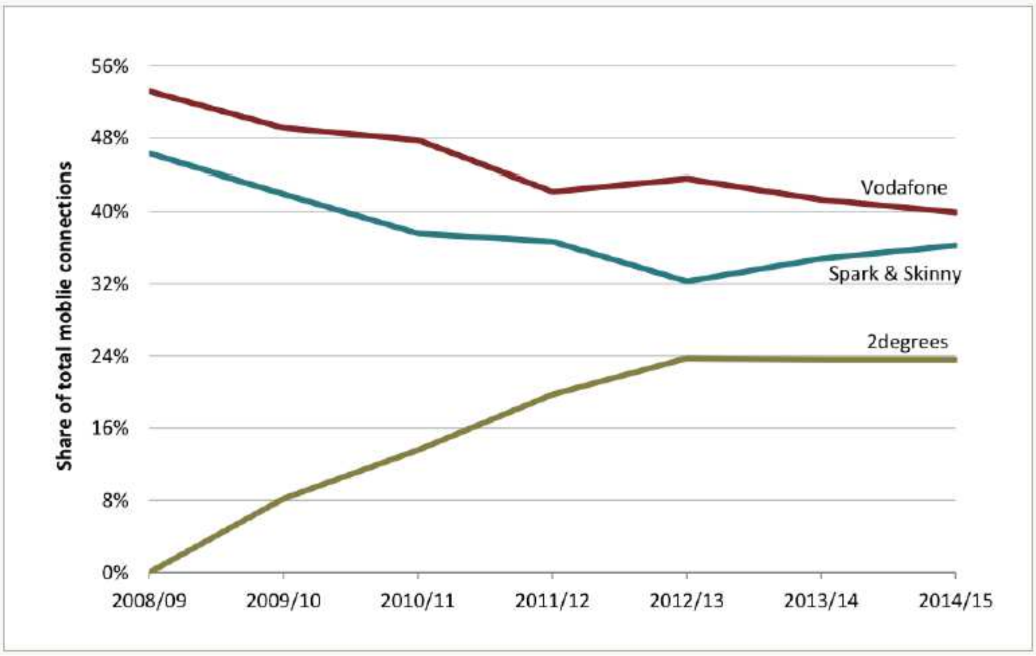
- Others, including Spark, **[ ]**.

Impact in mobile market

The effects of the merger are also likely to felt keenly in the mobile market even as compared with the status quo (where mobile sports content initiatives have not developed in the same way as they have overseas, due to the dominance of Sky in New Zealand and its continued refusal to make mobile content rights available on a wholesale basis to mobile network operators).

At present, according to the Commission's statistics, Vodafone is currently the largest mobile network operator in New Zealand - as set out in Figure 2 below.

Figure 2 - Commerce Commission mobile connection share



In the factual, the combined Sky/Vodafone will have the incentive and ability to leverage Sky's market power in premium sports content to gain mobile market share:

- In a similar manner as outlined in relation to broadband above, the combined Sky/Vodafone will have both the ability and incentive to increase the cost of standalone Sky Sport (above $95 (including My Sky) per month) to force customers to instead purchase a Sky Sport + Vodafone mobile bundle; and/or

- Unmeter Sky Sports content over the Vodafone mobile network. Given the increasing demand of New Zealand consumers to watch content on mobile devices, the ability (which the combined Sky/Vodafone will have) to offer unmetered Sky Sports content on Vodafone's mobile network. Sky/Vodafone will be able to subsidise that unmetering through its broader pay TV + RSP operations.

Based on current market shares in the New Zealand mobile market, if **[ ]** of consumers regard Sky Sports content as "must have" or highly compelling content, that will broadly translate to:

- ~**[ ]**% of current 2degrees customers that highly value Sky Sports content (i.e. **[ ]**% of the total market); and
- ~**[ ]** % of current Spark customers that highly value Sky Sports content (i.e. **[ ]**% of the total market).

The combined Sky/Vodafone will have the ability and incentive to attract a significant proportion of those customers to its mobile network by increasing the cost of standalone Sky Sports and/or unmetering Sky Sports content over the Vodafone mobile network in an unreplicable way.

While margins, the ability to control costs, the ability to achieve economies of scale, and the ability to differentiate on network quality are better for Spark's mobile business, vis-a-vis its broadband business, Spark also has significant concerns about the impact on the mobile market.

In response to the merger, Spark would likely continue to invest in a range of competitive value-added inclusions to its mobile packages - including other contestable multimedia, smart living, health and other mobile applications, which provide scope for continued and evolving competitive responses and innovation in response to the merged entity's premium sports lock-up. However, **[ ]**.

Again, this would likely result in Sky/Vodafone being able to charge more and win more customers at the same time, with the resulting loss in market share to Sky/Vodafone putting significant pressure on the ability of Spark and 2degrees to compete with Sky/Vodafone - including by:

- The significant migration of mobile customers/market share to Vodafone, as well as the significantly enhanced stickiness (lower churn) of that customer base to Vodafone;
- Sky/Vodafone attracting the highest Average Revenue Per User ("**ARPU**") customers; and
- Leaving other mobile providers with **[ ]**.

The likely counterfactual

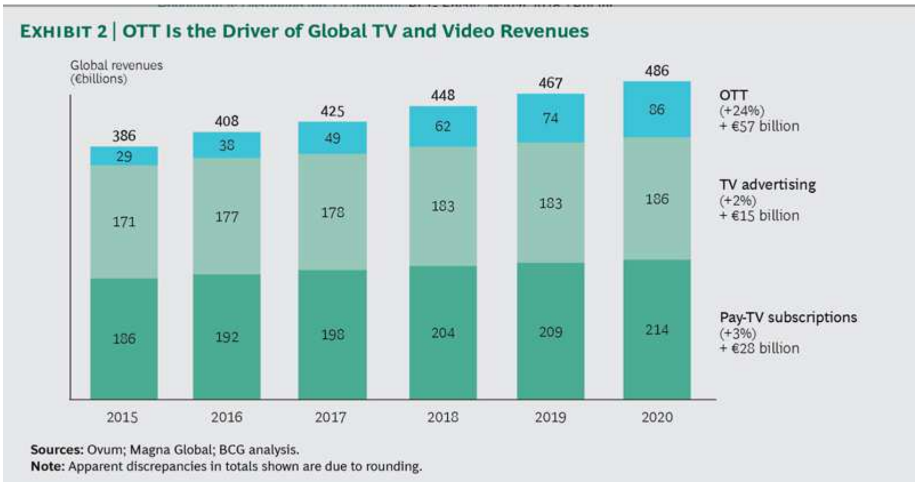
As noted above, Spark does not see the status quo persisting as the relevant counterfactual beyond the next 18-24 months (and the market developments may well come sooner than that).

In the absence of the merger there will be a number of developments in the relevant markets, both from consumer demand changes and developments by Spark that mean the Commission needs to also consider a counterfactual that is different from the status quo in assessing the Sky/Vodafone transaction, to properly consider the most likely counterfactual scenario(s). Accordingly, Spark disagrees with Sky and Vodafone's (unsubstantiated) assertion that the counterfactual put forward by Spark is unrealistic. What is unrealistic is to present a static or stable market in the face of obviously dynamic conditions, and an accelerating rate of change that has been recognised by commentators and government agencies.

Spark's view on this was set out in its submission, including by referencing the Sky / Vodafone Explanatory Memorandum (the "**EM**"), which stated that "**Sky, and the entire media industry, is at a crossroads**". That evolution is the very reason for the merger currently under consideration. Ignoring that evolution risks ignoring a significantly material and relevant development that the Commission needs to take into account to appropriately perform the forward looking analysis that it is required to in assessing the merger.

Accordingly, in responding to the Commission's question, Spark considers it most helpful to start by providing additional context for its view why that evolution is inevitable in New Zealand in the short-to-medium term:[10]

> For the television business, OTT isn't just the next big thing. It's poised to be the biggest thing—the industry's key driver of growth and disruption—over the next several years. Between 2015 and 2020, global revenues deriving from OTT video are projected to increase from €29 billion to €86 billion, a growth rate that will outstrip that of both TV advertising and pay-TV subscription revenues. (See Exhibit 2.)



> The OTT landscape has created some significant challenges for satellite and cable providers in particular. Fears of cord thinning or outright cord cutting—subscribers opting for smaller bundles or jettisoning service entirely—haven't been unfounded. In 2015, the US pay-TV market saw its biggest customer exodus ever: a net loss of some 560,000 customers. In Europe, where OTT has been less popular but is rapidly gaining ground in many markets, growth in pay-TV subscriptions is expected to slow as well.
>
> Indeed, OTT's trajectory is now particularly steep outside the US. In Europe, subscriptions to online video-on-demand services increased by 50.3% between 2014 and 2015. Central and Southern Asia saw an even more remarkable 159.4% jump over the same period. (By comparison, North America—starting from a much higher base—saw a 20.7% increase.)
>
> Yet for distributors with a broadband offering, the outlook need not be doom and gloom. While it has meant significant investment and effort, some established players are already staking out a position in OTT, offering skinny bundles together with broadband. And for one US distributor, the bet seems to be paying off. After experiencing several quarters of net subscriber losses, it was able to add tens of thousands of new customers in the fourth quarter of 2015. While much of this growth can be attributed to traditional products, online offerings clearly played a role: some 15% of this provider's total video subscriptions are now centered on skinny bundles.

This evolution is already driving significant change in the existing business models of pay TV providers, including incumbent pay TV operators increasingly also offering pay TV "lite"/ "skinny bundle" offers:[11]

[10] https://www.bcgperspectives.com/content/articles/telecommunications-how-telcos-can-become-videos-next-big-star/

> Already there are some good examples of providers taking a more varied approach. In the UK, Sky offers Now TV, a lower-priced, OTT-only service that works via a small streaming device connected to a TV, or on mobile devices through a partnership with Vodafone. In the Netherlands, KPN offers an app-based skinny bundle called Play, which brings 22 linear channels and on-demand content to phones and tablets (and to TVs via Google's Chromecast streaming device) without requiring customers to get their fixed or mobile broadband from KPN. Crucially, these players also offer more traditional-looking fat bundles. They are, in effect, de-averaging their offerings and providing choices—a necessary step if they are to capture the largest possible share of the market.

To provide the Commission with additional information on these changes in business model, Annex 1 includes an article entitled: "*Why Pay TV operators are accelerating OTT investments including Pay TV Lite*".

Another particularly pertinent example is the launch, by satellite pay TV provider Dish Network, of an OTT subsidiary, Sling TV, in 2015:[12]

> Internet TV services like the one Dish Network offers are the best way to get Millennial viewers in the pay TV ecosystem, according to Roger Lynch, CEO of Sling TV and EVP of advanced technologies at Dish.
>
> "Don't let the Millennials and the next generation not get involved in pay TV," Lynch said, speaking at the company's recent quarterly earnings call. "Let's give them a skinnier bundle of channels, but let's make sure it's attractive channels and the right price for them."
>
> Lynch described the traditional linear pay TV business as a "mature to declining" business. "And that ARPU just goes down," he said, as consumers continue to shift away from linear TV. Dish Networked reported losing 23,000 pay TV subscribers during the last quarter. According to estimates from MoffettNathanson, Dish likely lost 178,000 pay TV subscribers, but gained 155,000 new subscribers for Sling TV. The firm estimates Sling TV has 394,000 subscribers in total. "We hope that an OTT customer today is as valuable or more than a linear TV subscriber we would get today, because the linear model is challenged," Lynch said
>
> "We realize that, all things being equal, we'll probably lose subscribers in linear TV," Lynch said. "We hope we'd gain subscribers in OTT and Sling TV. And when we put those two together, we hope that our subscriber count grows positive in the future as opposed to negative."
>
> By the same token, pay TV networks are losing subscribers and viewers. Lynch said these content owners are now more open to the idea of distributing content online and in skinny bundles. "We think Sling TV offers a pretty attractive alternative to our content providers for them to get incremental subscribers and get involved in an advertising model that's more lucrative than linear TV," Lynch said. "They're pretty much all interested in that."
>
> ...

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[11] https://www.bcgperspectives.com/content/articles/telecommunications-how-telcos-can-become-videos-next-big-star/

[12] http://rethinkresearch.biz/articles/ott-customers-will-become-more-valuable-as-linear-tv-declines/

> One large difference between traditional pay TV business and the nascent Internet TV business is that OTT subscribers expect a degree of flexibility in service terms that is virtually unheard of in the pay TV environment. Subscribers expect to be able to sign up for a free trial and they expect the sign-up process to be straight forward and simple; on the other hand, they also expect to be able to cancel the service whenever they want. This “easy in, easy out” scenario is completely foreign to traditional pay TV providers like Dish Network, and one that the company is struggling to measure success against.
>
> “OTT is a little different,” said Charles Ergen, Dish Network CEO. “People can move in and out of it pretty easily because you do it all on the Internet. And there’s also probably seasonality to OTT that’s maybe a little bit different than what we see in linear TV.”
>
> ...
>
> “We’re far enough along to know that for certain customers – particularly Millennials and particularly to people who are not in the pay TV universe today or not in the pay TV universe in a big way – we know that it’s a pretty attractive product for them,” Ergen said. “We know that we’re bringing our content partners new incremental subs that they’re not able to get at any other way. So I think the future is probably pretty bright for OTT in general and hopefully for Sling.”

Accordingly, in the counterfactual within the next 5 years it is inevitable that Sky's existing business model will need to change – e.g. the satellite distribution will come under competitive pressure from UFB-based distribution and lower cost and easier to use streaming devices (such as ROKU streaming sticks, Google Chromecasts, Apple TVs and bespoke, Pucks, etc) with increasing functionality. This will mean that Sky has to think strategically about the future of its business and how this plays out and we are already seeing this in practice.

The Sky / Vodafone EM also notes these clear trends that will necessitate changes in its business model:[13]

- the completion of the rollout of the UFB over the next three years will result in widespread access to high speed broadband (with a target of 80% fibre to the home), increasing the availability and potential of OTT services; and
- there are clear trends away from “linear viewing” among younger age groups;
- Sky TV does not have a meaningful broadband or telephony offering (fixed or mobile) for its customers (apart from its “discount” offer through Vodafone), leaving it in a strategically weak position in terms of customer attraction and retention;
- while Sky TV has the key sports broadcast rights locked up for a number of years and its penetration levels are a critical attraction for the relevant codes, Sky TV will need to keep on successfully bidding to renew those rights. Costs are likely to continue to increase; and
- the outlook for Sky TV earnings and cash flows beyond FY17 is unclear. In a rapidly changing environment there is inevitably a high degree of uncertainty. Sky TV’s corporate plan projects a return to earnings growth, albeit modest, in FY18 and beyond. The experience from other traditional media sectors such as newspapers and free to air television is that they have experienced steadily deteriorating margins and earnings once the new technological or competitive dynamic has taken hold.

[13] Sky Network Television Limited "Notice of Meeting and Explanatory Memorandum Relating to the Merger of the Businesses of SKY and Vodafone NZ".

In a world of increasing OTT provision of content, RSPs are recognised as being increasingly valuable distribution partners for pay TV providers:[14]

> First, operators excel at providing ubiquitous connectivity over both fixed and wireless networks — a capability that has cost them huge sums of money to develop, and that no one else possesses — and ongoing upgrades to their next-generation networks will give them the ability to provide a variety of advanced services. These include upgraded traffic management and tiered quality of service, "big data" and customer analytics, advanced security and location-based services, and sophisticated cloud computing.
>
> Second, they maintain a dense, fully integrated, and scaled-up distribution footprint. This includes their strong retail network, with the ability to reach millions of users; supply chain and logistics services; an established billing and CRM relationship with their customers; and the ability to collect huge amounts of demographic, behavioral, and usage information about their customers. These assets allow operators to offer selected OTT companies access to their distribution footprint and to the customer relationships they have already established.

While Sky has sought to submit that it would not have any greater incentives to have partnerships with RSPs (because for example, it says it has already launched Fan Pass without RSPs), Sky's arguments do not hold water when compared to the business practices of significantly larger OTT providers overseas, such as Netflix- which has reached distribution arrangements with a number of RSPs around the world, including Telecom Italia; Japan's SoftBank; Vodafone NZ; Deutsche Telekom in Germany; Bouygues Telecom in France; Com Hem in Sweden; and Virgin Media and YouView in the UK:[15]

> Netflix's deal with Telecom Italia to allow consumers to access the service via TIMvision's set-top box is a part of an increasingly common strategy for Netflix to extend and maximise its reach through strategic partnerships with local operators. Netflix is collaborating with local players in several European markets: Deutsche Telekom in Germany and Bouygues Telecom in France, Com Hem in Sweden, Virgin Media and YouView in the UK. With those kind of partnerships Netflix is further establishing itself as 'premium online channel', bringing complementary services to pay TV operators' propositions and opened to creating synergistic partnerships with market incumbents. The partnerships with an established pay TV player may provide Netflix with number of benefits, including potential access to a customer base that is ready to pay for video services, seamless integration into living room entertainment ecosystem, as well as potential collaboration in marketing activities to help both parties to control the marketing spend, which has traditionally been a significant component of the online video player's cost-base.
>
> Telecom Italia reported 350,000 subscribers to its TIMvision services, including IPTV customers with TIMvision set-top boxes and standalone SVoD subscribers. TIMvision customers pay €5 a month for access to TIMvision and extra €45 for the box. In order to be able to access Netflix via TIMvision set-top box customers will be required to buy a separate subscription to Netflix (from €7.99 for a basic pack).
>
> Potential partnerships with Vodafone and Orange would bring Netflix 784,000 and 129,000 potential users, respectively. Vodafone currently has agreements in place in both the UK and Germany to distribute Netflix via its mobile platform.

[14] Strategy&. Enabling the OTT revolution. How telecom operators can stake their claim. Retrieved from: http://www.strategyand.pwc.com/media/file/Strategyand_Enabling-the-OTT-Revolution.pdf
[15] https://technology.ihs.com/548048/netflix-partners-with-telecom-italia-in-italy-while-spanish-telcos-are-still-considering-the-deal

> In Spain, where the company is branded as Vodafone with ONO, the digital cable infrastructure should support the deployment of a Netflix application should an agreement be reached, however there will remain the question of STB hardware compatibility. Orange has a much smaller addressable television audience in the market however with 3.3 million fixed line and 4G subscribers across Orange and its fixed line acquisition Jazztel, there is certainly a sizable addressable market.
>
> For pay TV operators, partnership with Netflix allows them to increase the selection of content available without exposing the operator to content acquisition risk, as well as share the marketing costs. The application of integrated searches (like in YouView and Virgin) would allow content discovery boundaries to be removed increasing the perceived content catalogue and in turn perceived value. Pay TV operators are also preserving customer engagement by providing customers access to a popular service while ensuring the viewing experience remains associated with the pay TV environment via set-top box.
>
> For operators partnering with Netflix agreements such as this are an effective way to bolster consumer offerings with a limited commitment. Far from being a detractor from the platform Netflix in this context becomes a part of the operators offering than a third party channel. For Netflix these agreements are fully compatible with their screen agnostic strategy; the key is to be seen on as many platforms as possible creating a standard experience across all devices.

Netflix has said while partnering/wholesaling deals with broadband RSPS “are not deterministic of our fate...but they are certainly helpful.”[16] As Spark noted in its submission, Sky's increased need/desire to partner with an RSP has been described as one of the key reasons for the merger: [17]

> At an operational level, the Combined Group will have the management capability, breadth of infrastructure and other resources to allow it to respond optimally to changing competitive dynamics, technological developments or regulatory change in the markets in which it operates. **Whereas for a standalone Sky TV the rollout of the UFB is principally a threat (because it facilitates consumer access to competing OTT services), for the Combined Group it will provide an opportunity to lower distribution costs and deliver new products using Sky TV’s content in different ways**. [Emphasis added]

Sky's subsequent claims that it would have no greater incentive to work with RSPs in the counterfactual vis-à-vis the status quo, including no need to change its current (unattractive) wholesale pricing arrangements and restrictive terms, cannot be read consistently with the claim in its submission that:

> In the counterfactual, SKY's reseller and retransmission agreements would remain in place. SKY would continue to have incentives to wholesale on the same basis. That is, SKY will continue to offer wholesale access to its pay-TV service at SKY's retail price, minus avoided cost, including restrictions on bundling SKY's pay-TV services with other pay-TV services, and restrictions on the acquisition of other content exclusive from SKY.

It is manifestly untrue for Sky to claim it will have no greater incentive to wholesale to RSPs in the future than it does at present. Within three years we envisage that, without the proposed merger, Sky will accordingly have substantially greater incentives to enter into more commercially reasonable

[16] http://www.wsj.com/articles/netflix-gets-star-treatment-from-broadband-firms-abroad-1429222400
[17] Sky Network Television Limited "Notice of Meeting and Explanatory Memorandum Relating to the Merger of the Businesses of SKY and Vodafone NZ".

wholesale terms for the distribution of its services, and ultimately its premium Sky Sports channels, with Spark and a range of other RSPs and mobile providers.

Indeed, prior to the announcement of the proposed merger, **[ ]**.

More recently, since the announcement of the merger, **[ ]**. We accordingly view it as a strong indication of the wholesale terms likely to emerge if the proposed merger goes ahead (see the discussion of the factual).

To provide further context on Spark's view on the likely counterfactual, in addition to the background above about the significant changes in consumer preferences, it is perhaps most logical to outline **[ ]**. We will then move on to discuss Sky's likely incentives, absent the merger, in light of the significant changes in consumer preferences **[ ]**.

Media Play

As noted in Spark's submission, Spark's insights from its first 2 years as a content provider are that OTT television content is gaining in popularity, but without a sufficiently attractive bundle of key premium sports content it provides a weak competitive constraint, if any, to the Sky TV packages and services; that OTT is currently more a complement to traditional Sky Basic + Sky Sports; and it is not possible, in the face of Sky's market dominance (including due to the lack of any anti-siphoning legislation in New Zealand to temper Sky's dominance, as well as its vertical integration with Prime across pay TV and free to air (**FTA**) television markets) to achieve sufficient subscription levels to maintain a competing sports package- hence the decision to close the Lightbox Sport partnership in early 2016.

[ ]

[ ]

- **[ ]**
- **[ ]**

[ ]

[ ]

- **[ ]**
  - **[ ]**
  - **[ ]**
  - **[ ]**
  - **[ ]**
  - **[ ]**; and

- **[ ]**[18]
    - **[ ]**
- **[ ]**:
    - **[ ]**
    - **[ ]**

[ ]

If the merger did not proceed, **[ ]**. As Sky's subscriber numbers continue to fall, commercial drivers will change for Sky. In order to maintain the scale of its distribution – and accordingly its value to rights holders as a preferred content buyer– there will be commercial incentives for Sky to ensure that its content reaches the broadest possible audience, by focussing more and more attention on the OTT delivery of content.

In a world where Sky needs to enter commercially reasonable wholesale deals with RSPs, we expect that those wholesale deals will include the following:

Sky content will be made available in digital form without the current restrictions that Sky imposes on bundling its content with content from other providers. There will be no Key Commitments as we know them today and no exclusivity as to content provision. This will include Sky wholesaling its content **[ ]** to other RSPs.

Sky will likely develop and launch a number of "Sky Lite", "skinny bundles", or different option tiers, which enable consumers to purchase lower priced packages of Sky services (either on the basis of an ala carte type selection by customers or on the basis of "lite" channel packs put together by Sky), available both at retail and wholesale. The development of "lite" and "skinny bundle" offerings by incumbent pay TV operators is becoming increasingly commonplace overseas, as pay TV respond to the changing demands of consumers. It is unclear whether Sky characterises the offer of these bundles as a change in its business model. Given it does not offer them today, it would seem to Spark that these offers do involve a change in its business model.

Sky, in its submissions, denies it will change its business model in the counterfactual. That simply does not ring true given the developments overseas - for example, in announcing the launch of €2.99 per month premium content lite bundles in Germany, the CEO of Magine TV said:[19]

> ... this new model of premium content viewing reflects an international consumer shift towards an on-demand and personalised entertainment. "Viewers only want to pay for what they actually watch. The German TV industry is moving towards a model with frictionless content distribution, where the core value is the amazing content, and not the complex contracts. Magine TV is becoming the catalyst for this change. We are standing up for the viewer while working very closely with the industry," he declared.

As Sky increasingly needs to shift its distribution to OTT, and offer Sky lite bundles, the wholesale rates for Sky services, channels or tiers will be more closely linked to the rates set in the UK – reflecting an efficient cost-reflective and commercially sustainable price.

[ ]

[18] **[ ]**

[19] http://advanced-television.com/2016/02/18/magine-introduces-german-pay-tv-lite/

[ ] In other words, market participants will each have sufficiently strong commercial incentives to wholesale content to each other.

In the most likely counterfactual world where "lite" and skinny bundles proliferate, and it is in Sky's interests to enter into commercially reasonable deals with RSPs, New Zealand consumers see a proliferation of a range of different triple-play and quad-play bundles from different RSPs that include Sky premium sports content. This will increase the level and intensity of competition among broadband and mobile providers, as each will be able to differentiate on the basis of price, quality, and service, whilst also being able to offer consumers the premium content that they value.

The fact that Sky, in the likely counterfactual, could not just continue with its current (out-dated) business model is also evidenced by the significant changes that Foxtel is currently making to its business model in Australia. In recent times, Foxtel has:

- Announced that it is enabling the content of streaming competitors Netflix and Stan to be accessible through its set top box:[20]

> "Our customers also want access to content that we don't own or don't license ... If our customers want to have Netflix, then they'll be able to have Netflix on our box," Tonagh said.
>
> A Foxtel spokesperson told AdNews that: "Initially the plan is to be open to other services via our recently announced puck device, but the plan is to eventually have a similarly open platform for future versions of our iQ set top box."

- Significantly lowered the prices of its OTT pay TV content:[21]

> [Foxtel] overhauled its pricing model to make its offering more attractive to the generation of streamers.
>
> Foxtel announced it was releasing new packages under its Foxtel Play banner that ranged from $9 to $15 per month, with the aim to get the pay TV business more inline with its streaming rivals Netflix and Stan. The move also gives Foxtel another finger in the steaming pie, with it already owning a stake in Presto.

- Significantly lowered the pricing, and structure, of its traditional linear pay TV bundles:[22]

> CEO of Foxtel Richard Freudenstein has today announced the company is going to slash its prices for new subscribers and rework its offerings as it seeks to combat the entry of new cheap online streaming services to the market.
>
> Speaking at the ASTRA Conference this morning the pay-TV boss said the company is set to halve the price of its basic package from $50 to $25, telling the audience he is "absolutely confident" the new pricing structure will drive a subscriber growth and a "seismic shift in the Australian media environment".
>
> "We will significantly reduce the price of our entry package so all the people who have long wanted Foxtel, but didn't think it fitted their budget, will look at us again," said Freudenstein.
>
> …

[20] Read more at http://www.adnews.com.au/news/foxtel-to-add-netflix-and-stan-to-its-offering#ltAmql1VdiUI6sHZ.99
[21] Read more at http://www.adnews.com.au/news/foxtel-to-add-netflix-and-stan-to-its-offering#ltAmql1VdiUI6sHZ.99
[22] https://mumbrella.com.au/foxtel-boss-flags-major-changes-tackle-threat-streaming-rivals-249430

> Today's announcement saw one of the biggest revamps of the pay-TV operator's pricing and packaging in its history, along with the company providing new details on its iQ3 and triple-play strategies, as well as a reworking of the Foxtel OnDemand online service, which is being renamed Foxtel Anytime.
>
> "Last year a good proportion of our subscriber growth came from IP (internet based) products. Growth in our IP offering is an important part of our strategy – there is a significant segment of the population who really value the flexibility of these products, for example they may be relatively light TV watchers or they may be highly mobile.
>
> "There are many reasons why Foxtel does not suit some people and we want to be sure we have something which meets their needs."
>
> In an attempt to drive new consumer uptake of Foxtel, Freudenstein said the entry level price would drop from around $50 a month to $25 with the Sports package moving to $25 as well, meaning many sports fans could access the pay-TV for $50 a month. However the company has restructured its packages moving some of the more desirable channels including Soho, FX and Lifestyle You into bolt-on premium packages.

The likely counterfactual vs. the factual

By contrast, should the proposed merger go ahead, as noted above, Sky/Vodafone will be incentivised, via its long-term control of premium sports content, to take advantage of that control to force more consumers to purchase broadband and/or mobile services from Sky/Vodafone. The result of those incentives will be that the combined Sky/Vodafone is likely to refuse to wholesale Sky Sports content to other third party RSPs and mobile operators on commercially attractive terms, and certainly not on terms that are comparable to the internal transfer price to Vodafone within the combined Sky/Vodafone.

In comparing the factual against the status quo, we have already outlined the significant detrimental effects on competition that will arise in the broadband and mobile markets from those incentives and conduct (as outlined above).

In comparison to the likely counterfactual, the factual will also give rise to a substantial lessening of competition in the provision of premium pay TV content.

As noted above, in the likely counterfactual Sky will in the short-to-medium term be incentivised to wholesale content at more competitive, non-ECPR and less-restrictive terms.

In the factual, Sky will (most likely) refuse to wholesale content to other RSPs, or at best (as outlined in its submission) will continue to only wholesale content on its current terms. This is demonstrated by **[ ]**. This demonstrates what Sky's incentives will be going forward in the factual, and shows that Sky is acting as if it is already a merged entity.

Sky/Vodafone persisting with restrictive terms and ECPR pricing will prevent any meaningful competition for premium pay TV content occurring at the retail level. As the Commission will know, ECPR pricing has been internationally identified as problematic, because it:[23]

- entrenches monopoly rents/ inefficiencies in retail pricing;
- forces a lack of dynamic competition (where the incumbent is "insulated" from competition);
- raises barriers to entry; and

[23] *Albion Water Ltd v. Water Services Regulation Authority and Dŵr Cymru* [2006] CAT 23 (6 October 2006) at [650].

- risks a price squeeze.

As the Court of Appeal clearly has stated:[24]

> ... ECPR is not, by itself, sufficient to ensure efficiency. If a firm obtains monopoly profits, its opportunity cost will include monopoly profits. Similarly, monopoly rents in the form of inefficiencies in a monopolist firm's provision of a service, giving rise to higher costs, will be preserved. ECPR can therefore preserve the allocative or consumption inefficiency that results from the monopolist's excessively high final product prices.

As Spark sees it, in a world where Sky can leverage its exclusive control of premium sports content to increase broadband and mobile market share and revenue, and will have incentives to exclusively use Vodafone as its RSP distribution channel on terms not available to other RSPs, the combined Sky/Vodafone will:

- Refuse to wholesale premium sports content to other RSPs, including to Spark's Platform, or (to avoid regulatory attention from an outright refusal) will only do so at uneconomic pricing levels and on restrictive terms (including by insisting on the Key Commitments that the Commission previously considered represented a breach of ss27 and 36 of the Commerce Act);
- Be able to successfully employ a blocking strategy against **[ ]**;
- Be less likely to introduce "lite" bundles of premium sports content as to do so would only cannibalise its own revenues without any competitive threat against it, or it will introduce fewer "lite" bundles at higher prices and more slowly than it otherwise would in the counterfactual; and the likely effect on the Spark business is that without the ability to develop a compelling media proposition (which necessarily includes a sufficient package of premium sports content)[25] to bundle with broadband and mobile in competition with the merged entity, Spark will not be able to offer a compelling competitive alternative to the approximately **[ ]**% of the broadband market that value premium sports content as Sky/Vodafone will be able to amend the prices of standalone sport to increase its broadband revenue and market share. Spark's view on the likely effects of that conduct on the broadband and mobile markets is outlined above.

[24] *Telecom Corporation of New Zealand Limited v Commerce Commission* [2012] NZCA 278 at [81].
[25] As evidenced by the failure of Spark's Lightbox Sport venture.

Annex 1:

Why Pay TV operators are accelerating OTT investments including Pay TV Lite

September 22, 2015

Anyone in Belgium can sign-up to 'Be tv Go' and get access to live and on-demand content including exclusive US and European series and movies. There are 24-hour passes for sports.

Pay TV is still growing but OTT is growing faster - much faster. And that fact sums up both the threat and the opportunity that OTT video presents to platform operators.

As a result, many operators are now moving beyond TV Everywhere (authenticated multiscreen viewing for existing set-top box subscribers) to provide their own standalone OTT services that target different consumer segments, either with SVOD (Subscription VOD) or Pay TV Lite (generally a sub-set of the full Pay TV offer, made available on short contracts and with more a la carte freedom) or both. In some cases it is becoming possible for operators to use the same headends for all their multiscreen and OTT distribution, making operations easier.

Other Pay TV operators are integrating third-party SVOD, like Netflix and Maxdome, into their set-top box platforms to expand their role as an 'experience provider' and to help keep customers on-platform. We are also seeing OTT used instead of satellite or IPTV to make full-flavour Pay TV bouquets available to customers who could not previously get them for technical reasons.

Earlier this year, NAGRA commissioned the research and strategy consultancy MTM to explore the opportunities for Pay TV operators in the OTT market and this included a look at operator strategies and rationale for investment. The company surveyed 90 senior executives worldwide and included a programme of in-depth interviews with operators, premium OTT providers and Pay TV broadcasters.

MTM found that the performance indicators executives wanted to most improve, using OTT, were increasing customer satisfaction, reducing churn, enhancing brand and image, and growing ARPU. Other drivers, rated in importance between 1-5 (and with the average rating shown here) included: Attract new audience segments (4.3), capture viewing share across mobile devices (4.2) and provide a new channel to market (3.7).

In simple terms, Pay TV operators are focused on TV Everywhere, off-net services that target new customer segments and OTT services that "super-serve customers on set-top box platforms" over the next three years. According to MTM, 80% of the respondents think Pay TV operators will increasingly use linear premium OTT services to offer higher quality content formats like 4K and additional services that supplement their linear broadcast.

MTM also lists the success factors for OTT video according to their level of importance. The top five are: Offer a service through a mobile/tablet app; Provide an integrated user experience across devices; Provide innovative pricing options like day passes; Appeal to a broad range of audience segments; Bundle third-party OTT services with your own service.

We are already seeing the results of this thinking. DISH Network, as one example (the US satellite Pay TV operator) has integrated Netflix onto its STB platform and given the SVOD giant a channel slot on its EPG. It has also launched Sling TV, its standalone Pay TV Lite OTT offer. DISH was the first of the Pay TV Lite providers to explicitly describe its service as "a viable alternative for live television to the millennial audience," which is how DISH President and CEO Joseph P. Clayton introduced the service.

Clayton added at launch: "This service gives millions of consumers a new consideration for Pay TV. Sling TV fills a void for an underserved audience."

Simon Trudelle, Senior Product Marketing Director at NAGRA, which provides a range of multiscreen and OTT solutions to the Pay TV industry, says there is an appetite among Pay TV operators for targeting a new consumer segment that up until now was hard to convert into subscribers. "They are mostly younger people without families but with a passion for some kinds of content. They are not signing up for Pay TV but getting their content somewhere else."

Eric Abbruzzese, Research Analyst for TV & Video at ABI Research, says Pay TV Lite presents a very promising market opportunity, although it is immature. "Even so, being early to market will be beneficial in the long run, by allowing a product the opportunity to grow along with the changes in the market, rather than spend a long time in R&D and miss a lucrative launch window." He adds: "Any provider looking to capitalise on a younger – on average – demographic should look towards Pay TV Lite."

There are a few concerns about Pay TV Lite, most notably the need to avoid cannibalizing the full-flavour Pay TV offer. And in May, Jeff Heynen, Research Director for Broadband Access and Pay TV at IHS warned that the net result of operator OTT services aimed at cord-nevers and cord-cutters "will be slower revenue growth globally, as OTT services carry a lower ARPU."

Whether true or not, that does not reduce the strategic imperative that some operators are attaching to Pay TV Lite. This business model feeds a desire for a more a la carte approach to buying content that can only be accommodated up to a certain point on the full-flavour services.

With its new Stream offering (announced this summer as a Beta product), Comcast will provide an example of Pay TV Lite that is only available to your own broadband customers. In Europe it is more common to use Pay TV Lite services to reach out to anybody, regardless of whose broadband service they take.

Typically the European Pay TV Lite pioneers own their own Pay TV channels or content rights. The Belgian cable operator VOO provides a good example. The company owns the Pay TV channel Be tv, originally distributed on the VOO network and via partners in Belgium (like cable operators Telenet and Numericable) and also in Luxembourg (with Orange). Now there is an OTT version of the service, free to existing Be tv subscribers and available as a standalone offer to non Be tv customers.

Anyone in Belgium can sign-up to 'Be tv Go' and get access to live and on-demand content including exclusive US and European series and movies. There are 24-hour passes for sports. The service can be viewed on PCs, iOS and Android tablets, as well as the Microsoft Xbox One. Manuel Hannart Sánchez, Product Manager Pay TV at VOO/Be tv, says the company wanted to give everyone in Belgium the chance to subscribe. "We wanted to make Be tv available everywhere."

Sky in the UK was early to market with a Pay TV Lite offer, called NOW TV, which also includes 24 hour (and weekly) sports subscriptions. The company said at launch: "NOW TV is a very, very important means for us to talk to a new audience and so plays an increasingly important part in our distribution story and in the way we monetise our content investments."

Simon Trudelle at NAGRA first talked publicly about the trend for finer Pay TV market segmentation last autumn. He said then: "We have reached an inflection point in the Pay TV industry where OTT delivery and connected devices are opening the way for more granular segmentation of the viewing population, according to what they are willing to pay and what their interests are."

"This segmentation is becoming a broad reality and it is probably time for every service provider to join the fray and launch [OTT] services and monetise new consumers and new experiences. Sometimes this means going off-net. It definitely means creating more targeted content bundles and presenting them to consumers who are movie-centric or sports-centric, and so on."

Sky Deutschland is perhaps the best example of a Pay TV operator going down this road. The company has full Pay TV and its Pay TV Lite service called Sky Online (launched in October 2014) but also its own SVOD service, Snap. This is viewed as a direct alternative to Netflix, with thousands of titles including box-sets.

According to Richard Broughton, Research Director at research firm Ampere Analysis, the market for Pay TV lite is growing and one of the aims for operators is to capture an audience base that in the past was unwilling to pay for a full Pay TV offer. "Another incentive [to launch] is to capture audiences that might be thinking about migrating away from Pay TV in favour of lower cost alternatives, or who have already migrated away."

There are health warnings attached to Pay TV Lite offers. Eric Abbruzzese (ABI Research) points out that churn rates are expected to be higher than for full Pay TV because of shorter contracts. There will be some higher marketing costs - though offset by a reduction in OpEx for this kind of offer (no truck rolls, for starters). And you risk your brand name if you produce an unpopular product.

There is not just the risk, but the certainty that there will be some cannibalisation, he reckons. "However, those that drop subscriptions in favour of Lite were likely to drop their subscription in the near future anyway, so losses should not be substantial. It will not be as negative as losing the customer outright."

Annex 2

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Annex 3 - Response to Specific Data Requests

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