RUSSELL McVEAGH

14 November 2016

Susan Brown
Commerce Commission
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Public version
By email

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Dear Susan

SKY / VODAFONE CLEARANCE APPLICATION

1. **[ ]**.

2. **[ ]**:

   (a) **[ ]**.

   (b) **[ ]**.

   (c) **[ ]**.

   (d) **[ ]** support the Commission's concern that the merged Sky/Vodafone will be incentivised to take advantage of Sky's content to achieve increased mobile revenues through quad-plays and increasing mobile data usage on Vodafone's network. This reinforces that Sky/Vodafone's incentives will be to foreclose access to content from other RSPs.

   [ ]

3. **[ ]**:

Public statements by Sky / Vodafone in this clearance process	**[ ]**
"The Combined Group does not supply any "must have" inputs that either Sky or Vodafone competitors require to participate in telecommunications or pay-TV markets." "the evidence is that Sky services are not 'key inputs' which are needed to compete effectively in the telecommunications markets."[1]	**[ ]**[2]
The submitters argue that consumers' increasing preference to consume content OTT and on demand will drive Sky to become an "enthusiastic wholesaler"... The submitters do not explain: (a) why Sky would need to wholesale	**[ ]**

[1] Clearance Application.
[2] **[ ]**.

on the terms they describe to deliver OTT and on-demand content; or (b) why Sky could not provide such services on its own (as it already does), or continue its current approach to wholesaling.[3]"	
"None of the economics reports supporting the third party submissions explain why Sky would need to rely on resellers delivering Sky's content via their fixed or mobile networks, as opposed to Sky selling its own "Over the Top" (**OTT**) proposition."[4]	**[ ]**.
"Some incorrectly speculate that Vodafone can somehow make [its wholesale deal with Sky] work due to its cable network in Wellington and Christchurch. It is entirely unclear how the nature of the network over which content may be delivered **has any bearing on the commercial terms** that Sky might offer a party seeking wholesale content."[5]	**[ ]**
Spark asserts that Sky Basic+Sports customers only subscribe to Sky in order to access Sky Sports.[6]	**[ ]**
Blue Reach (at 3.13): For many years, Sky's strategy has been to discourage wholesaling competition and favour selling to its retail customers. This is inconsistent with Sky's incentives... **Sky [is] indifferent as to whether consumers purchase Sky services from Sky directly, or from a reseller**.	**[ ]**
"The Covec report builds up its counterfactual from an assumption that Sky-Vodafone intends to gain most revenue synergies through "upselling" Sky to Vodafone's existing customer base. However, this is not correct..."[7]	**[ ]**

4. **[ ]**.

Broadband market shares

5. We agree with the Commission that little weight should be given to **[ ]**.

6. In particular, the forward looking test that the Commission is required to conduct in assessing likely effects on markets is not a test modelled on current pricing, but a test modelled on likely pricing given the **abilities** and **incentives** that the merged entity will have post-merger.

7. As noted in Spark's submission of 11 November 2016, given the importance that **[ ]**% of households place on purchasing premium sports content, Spark expects that a significant proportion of these customers would switch to the merged Sky/Vodafone over time in response to the various levers that Sky/Vodafone could pull to incentivize such switching - including, for consumers approaching "switching events" such as switching to UFB.

[3] 9 September 2016 response from Buddle Findlay.
[4] 11 September 2016 response from Vodafone.
[5] 11 September 2016 response from Vodafone.
[6] 9 September 2016 response from Buddle Findlay.
[7] Footnote 21 of the NERA report.

8. Forward looking market share modeling that does not take into account the impacts of:

   (a) the merged firm being able to, and having incentives to, alter various pricing/quality aspects to drive market share growth; and

   (b) the expected significant uptake of UFB in coming years (where "*Long form video content is likely to be a major driver behind consumers' uptake of high speed broadband over the first few years...")*,

   does not include all the relevant factors that the Commission is obliged to take into account in conducting its forward-looking competitive assessment analysis.

9. **[ ]**.

[ ]

[ ]

[ ]

10. **[ ]**.

11. **[ ]**.

12. As noted above, Spark expects that Sky/Vodafone will be able to win significant market share at the expense of other RSPs through a combination of increasing the price of the standalone Sky Sport service, and decreasing the price of Sky/Vodafone multi-play bundles - in particular, by increasing the price of the standalone Sky Sport service. The impact of Sky/Vodafone pulling those levers, **[ ]**, need to be taken into account in assessing the likely effect of the merger on overall broadband market shares.

13. Spark's expectation is that Sky/Vodafone will be able to win significant broadband (and mobile) market share at the expense of other RSPs if it pulls all the pricing and quality levers that will be at its disposal post-merger.

Margins

14. **[ ]**. In circumstances where Sky is today, in effect, a pay-TV monopolist - such that it recognises an obligation to resell content at ECPR - **[ ]** the merger will allow it to maintain monopoly rents, that in the counterfactual would be otherwise eroded by increased content competition. This of itself suggests a substantial lessening of competition is likely.

15. The way Spark and the other submitters have described this as occurring is through the creation of a product bundle that has no close substitutes (due to the inclusion of Sky Sport). The merged entity then has a number of levers it can pull to increase share, by moving Sky subscribers who do not buy Vodafone broadband to Vodafone, by upselling Vodafone customers to encourage them to buy pay-TV, and by taking advantage of the fact that a large number of households will shift to UFB or RBI in the next few years, which is a churn event that causes people to consider switching broadband providers.

16. These actions increase the customer retention costs for the existing broadband suppliers, and increase their customer acquisition costs, given the stickiness effect of content bundling on telecommunications offers. The net outcome, **[ ]**, is to allow the merged entity to grow its share of both broadband and pay-TV penetration and reduce its churn without any material incremental cost. By contrast, rival's costs have been raised, and the merged entity has a greater margin than its broadband and mobile competitors to continue to reinvest in ensuring its sport offering cannot be replicated, so the gap between its offer and the next closest substitute widens over time.

17. This is not an academic possibility. It is simply replicating in the broadband and mobile markets - as UFB and RBI as a churn event, and new OTT offers make content more important to the competitive dynamic - the way pay-TV has become a more distant substitute for free-to-air TV since the acquisition of Prime, as the free-to-air broadcasters have increasingly been unable to bid for premium sport content as their costs have risen, and revenues fallen over time.

Quad-plays and mobile data revenue uplift

18. **[ ]**.

19. This supports the Commission's concern that the merged Sky/Vodafone will be incentivised to take advantage of Sky's content to achieve not only increased broadband revenues, but also increased mobile revenues, thereby increasing its incentives to foreclose access to its content to other RSPs (i.e. because, in addition to broadband revenues, it does not want to forego mobile revenues as well).

Concluding comments

20. **[ ]**, support the concerns outlined by Spark that the merger is likely to give rise to a substantial lessening of competition in the broadband, mobile, and pay-TV markets.

21. The points raised in this letter reinforce that the Commission needs to weigh the assertions made by Sky and Vodafone with an appropriate degree of caution.

Yours faithfully
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