Submission to the Commerce Commission by InternetNZ in relation to Vodafone and Sky applications for clearance

11 November 2016

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1. This second submission addresses in particular the letter of unresolved issues (LOUI). We are particularly grateful to the Commission for releasing the LOUI publicly. We believe this will help us and other parties better assist the Commission.

2. We deal with the following three issues, noting that we retain the concerns and submissions in our earlier submissions, particularly as to horizontal markets, as to zero rating and other forms of differentiation such as prioritisation, and as to net neutrality:

   a. The implications of zero rating over mobile including in the context of the merged firm wholesaling content;
   b. The effects of the merger on UFB uptake;
   c. The magnification of market problems by zero rating and other strategies.

3. We would also be happy to discuss with the Commission any ways in which we can help with this review, while still achieving the right outcomes, on what is a critical clearance application for Internet stakeholders, whether consumers or providers.

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1. Zero rating mobile content, and wholesaling

1.1 Third party submitters and reports on their behalf maintain that Sky will have incentives to offer its content under genuine wholesale arrangements, in the counterfactual.

1.2 The applicants, and their expert, NERA, say that is unrealistic. They raise, among other issues, the alternative of Sky's content being provided OTT to consumers, thereby by-passing wholesaling.

1.3 The opportunity to zero rate content may help provide the answer to this, at least in relation to mobile downloads of Sky content.

1.4 It is well recognised, including by the applicants, that mobile downloads of video content will likely strongly increase including by way of triple and quad plays. Those plays are likely to become increasingly integrated.

1.5 The applicant, Vodafone, is already allowing its Irish mobile customers to download Vodafone's own content, with HD quality, on a zero rated basis (where third party content such as OTT is not zero rated). We have outlined this is some detail in our earlier submissions. Data caps are very low, and charges beyond the data cap are high, for mobile in the context of multiple monthly downloads of films and TV shows.

1.6 To illustrate the retail pricing of the different treatment between zero rated and charged content, we said this about the position for Vodafone in Ireland, and the comparable position here:

> *2.11 The cheapest cost on the cheapest plan, to download a two-hour movie over mobile, over the lowest quality(SD), once relatively low data caps are reached, is NZD $11 in Ireland and NZD $25 in NZ. (The highest cost is NZD $65 in Ireland, and NZD $700 in NZ, respectively). Data caps are quickly exceeded on normal multiple film and episode downloads.*
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> *2.12 That is for SD. In Ireland, Vodafone includes HD in the zero-rated provision of its own content. The cheapest cost of downloading a two-hour HD movie in Ireland, outside zero rating, once data caps are exceeded, is NZD $45 (in NZ it is NZD $108). The cost of the most expensive plan would be, per HD movie, NZD $270 in Ireland (and NZD $3,000 in NZ)*

1.7 What can be seen from this is that larger volume video downloads, outside zero rated, is largely prohibitive. It is difficult to see how any OTT competitor of Vodafone Ireland could survive in enabling mobile viewing of its content, given these rates.

1.8 The LOUI raises the prospect of Sky providing, in the counterfactual, an online equivalent of its current linear satellite service. (see Para 17).

1.9 Unless in the counterfactual an RSP enables a zero rated service to Sky for such OTT service, or some viable variant, that OTT service does not appear to be anywhere near a workable commercial proposition for Sky. The download cost for the mobile consumer would be prohibitive. The overall retail price for downloading such a linear service would be completely unviable.

1.10 That implies that the only way that Sky can make an online based mobile service viable is to enter an arrangement with the RSP involving some form of payment to the RSP in exchange for, for example, zero rating of the Sky downloads. That might be in the form of a full wholesale agreement, or it might be some other commercial agreement, which is really just a variant on the same theme.

1.11 This implies that there may well be genuine wholesaling, or some variant of that, instead of pure OTT.

1.12 High (and sometimes unlimited) data caps for fixed line, currently available, does not of itself mean that there will be no issue as to fixed line in the future. The likely substantial increase in video downloads, such as Sky's linear TV service going online, as noted as a possibility in the LOUI, may drive RSPs to impose caps. That may lead to a market environment were zero rating over fixed line broadband by the merged firm becomes a viable strategy.

2. The effects of the merger on UFB/RBI uptake

2.1 As we have already submitted, it is generally accepted that the two main drivers for UFB uptake by consumers are price and downloading content particularly video. Migration of Sky viewers to UFB, particularly given the substantial market power that Sky has as to premium content, and the importance of that content to viewer, therefore has major implications for UFB uptake, investment and innovation. Similarly as to RBI.

2.2 In assessing the counterfactual and the factual, it is therefore key that the effect on each of the factual and the counterfactuals upon UFB and RBI uptake is included in the assessment.

2.3 Encouraging OTT online, and/or encouraging wholesaling of content over online channels, is likely to strongly encourage such UFB/RBI uptake, particularly where it includes Sky's premium content. It may be that is more likely to be achieved in the counterfactual, as there are greater incentives on Sky to migrate customers away from satellite to online via either OTT (which is generally available), and/or via genuine wholesaling to broadband and mobile RSPs. (Satellite will remain a major feature of the markets until well past the period for the counterfactual assessment.[1]

2.4 On the other hand, in the factual, Sky has some incentives to retain customers on satellite – the marginal cost of extra satellite transmission is low or nil -save to the extent they can leverage the market power into triple and quad play seamless bundles. Innovative uses of UFB and RBI are less likely in the factual as competition is limited.

2.5 In summary, we suggest that the factual and counterfactual analysis should look closely at the effects on UFB and RBI uptake, investment and innovation. Dynamic efficiencies are generally more significant in the assessment than static efficiencies such as retail price.

3. Zero rating etc magnifies market problems

3.1 Our earlier submissions, focussed on zero rating and other strategies, have implications not just as to other content providers. As we said in our last submission:

> *7.6 Essentially, as to the submissions by other opposing parties, and their experts' reports (particularly TVNZ, 2degrees and Spark), the degree of SLC is magnified by the zero-rating of Vodafone/Sky's own content to its customer base.*

3.2 Zero rating is an issue too when considering the relationship between the merged company as a vertically integrated operator, its downstream RSP competitors, and consumers. The merged entity has the ability and the incentive to zero rate its own content to its mobile customers, and the applicant, Vodafone Europe BV, is doing that already in Ireland.

3.3 Differentiating services by the merged firm, and leveraging "must have" content, is not just a matter of price levers (although zero rating in reality is a price issue). It is another dimension on which the merged firm can expand its customer base by using the "must have" content.

3.4 Again, that is a matter for consideration in the factual and counterfactual assessment.

[1] As Sky's CEO and CFO confirmed in their media and analyst briefing following release of Sky's 2016 annual results