

## Statement of Unresolved Issues

### AlphaTheta/Serato

29 May 2024

#### Introduction

1. On 10 October 2023, the Commerce Commission registered a clearance application (the Application) from AlphaTheta Corporation (ATC) seeking clearance to acquire 100% of the shares of Serato Audio Research Limited (Serato) (the Proposed Acquisition).<sup>1</sup>
2. To clear an application, we must be satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. Since registering the Application from ATC, we have published:
  - 3.1 a Statement of Preliminary Issues (SoPI) setting out the issues that we considered important at the start of our investigation in deciding whether or not to grant clearance;<sup>2</sup> and
  - 3.2 a Statement of Issues (Sol) setting out the potential competition issues that we had identified following our initial investigation.<sup>3</sup>
4. The SoPI and Sol also provided background information about ATC and Serato as well as the industry in which they operate. These documents are available on our website, along with public versions of the submissions we received following publication of the SoPI and Sol.
5. This Statement of Unresolved Issues (SoUI) sets out the potential competition issues that have not been resolved to date and that we therefore continue to test. This is so ATC and Serato (the Parties) and other interested parties have an opportunity to comment and provide us with additional information.

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<sup>1</sup> A public version of the Application is available on our website at: <https://comcom.govt.nz/case-register>.

<sup>2</sup> The SoPI dated 26 October 2023 is available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0021/332292/AlphaThetaSerato-Statement-of-Preliminary-Issues-26-October-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0021/332292/AlphaThetaSerato-Statement-of-Preliminary-Issues-26-October-2023.pdf)

<sup>3</sup> The Sol dated 7 February 2024 is available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0029/342776/AlphaTheta-Serato-Statement-of-Issues-7-February-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0029/342776/AlphaTheta-Serato-Statement-of-Issues-7-February-2024.pdf)

6. In reaching the views set out in this SoUI, we have considered information provided by the Parties and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition concerns may arise, as the investigation continues.
7. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by 13 June 2024.

### **The concerns we continue to test**

8. On the basis of the information collected to date, we are currently not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.
9. While we are still investigating and have made no final decisions, we continue to have concerns that the Proposed Acquisition would substantially lessen competition due to horizontal unilateral effects resulting from a loss of competition in the market for the supply of DJ software in New Zealand. We also continue to have concerns that the Proposed Acquisition would be likely to substantially lessen competition in the DJ hardware market in New Zealand due to vertical effects and due to the merged entity's access to sensitive information of rivals post-acquisition.

#### *Primary areas of concern*

10. In relation to potential unilateral effects for DJ software, our unresolved concerns with respect to the Proposed Acquisition are primarily that:
  - 10.1 ATC and Serato appear to compete closely for the supply of DJ software;
  - 10.2 we are not satisfied that competition from the remaining competitors in the market is likely to be sufficient to constrain the merged entity; and
  - 10.3 based on the evidence before us, we are not satisfied that entry or expansion is likely in a timely manner, and at sufficient scale, to significantly constrain the merged entity.
11. In relation to potential vertical effects for DJ hardware, our unresolved concerns with respect to the Proposed Acquisition are primarily that:
  - 11.1 it appears that the merged entity may have the ability and incentive to foreclose rival DJ hardware providers through its control of an important input, being Serato's DJ software; and
  - 11.2 any foreclosure would be likely to substantially lessen competition in the relevant DJ hardware market.
12. We are also concerned that the Proposed Acquisition would substantially lessen competition for the supply of DJ hardware due to the merged entity's access to

sensitive information of rivals, which could make it harder for rivals to compete and reduce the constraint they impose.

### *Secondary area of concern*

13. In addition, we have not ruled out concerns in relation to vertical effects for DJ software. However, we consider that, if they arise, it is likely to be implemented by the merged entity in combination with a hardware foreclosure strategy.
14. We discuss these outstanding concerns in more detail below.

### **Process and timeline**

15. We have agreed with ATC to extend the period in which to decide whether to clear or decline the Application until **27 June 2024**, However, this date may change as our investigation progresses.<sup>4</sup>
16. We would like to receive submissions and supporting evidence from the Parties and other interested parties on the issues raised in this SoUI. We request responses by close of business on **13 June 2024**, including a public version of any submission.
17. All submissions received will be published on our website with appropriate redactions.<sup>5</sup> All parties will have the opportunity to cross-submit on the public versions of submissions from other parties by close of business on **20 June 2024**.
18. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) so that we can work with you to accommodate your needs where possible.

### **The Parties**

19. ATC and Serato are both present in the DJ segment of the music industry. ATC supplies DJ hardware and DJ software and Serato supplies DJ software. DJ software can be used to create various effects when mixing different songs and for organising music ahead of mixing (for example, creating playlists and preparing tracks to be exported). DJs use software in conjunction with various forms of DJ hardware (such as mixers and controllers).
20. ATC is a global company headquartered in Japan. ATC develops, manufactures and sells DJ hardware under the Pioneer DJ brand and DJ software under the rekordbox brand. Pioneer DJ hardware and rekordbox software are available worldwide.

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<sup>4</sup> The Commission maintains a clearance register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

<sup>5</sup> Confidential information must be clearly marked (by highlighting the information and enclosing it in square brackets). Submitters must also provide a public version of their submission with confidential material redacted. At the same time, a schedule must be provided which sets out each of the pieces of information over which confidentiality is claimed and the reasons why the information is confidential (preferably with reference to the Official Information Act 1982).

21. Serato is a DJ and music production software company that was founded in New Zealand. Serato's DJ software is available worldwide and is integrated with over 90 pieces of DJ hardware made by various brands, including Pioneer DJ.

### **Market definition**

22. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.<sup>6</sup>
23. When assessing relevant markets, we consider whether in response to a price increase:<sup>7</sup>
- 23.1 customers would switch sufficient purchases to alternative products or services to make the price increase unprofitable (known as 'demand side' substitution); and/or
  - 23.2 suppliers would easily, profitably and quickly switch to producing or supplying the products or location in question (known as 'supply side' substitution).

### **What we said in our Sol and submissions received**

24. In our Sol, we expressed the view that the appropriate markets for assessing the Proposed Acquisition are the:
- 24.1 national market for the supply of DJ software (including laptop applications but excluding mobile apps and music production software) (the DJ software market); and
  - 24.2 national market for the supply of controllers and all-in-one systems.

#### *National market for the supply of DJ software*

25. For DJ software, in the Sol we expressed a view that mobile apps did not appear to be sufficiently close substitutes for laptop applications to warrant being included in the relevant product market, although we noted that there is some evidence to suggest that certain mobile apps are likely to impose some constraint on laptop applications. We were also of the view that there are likely to be separate markets for DJ software and music production software, and that there are unlikely to be separate customer markets for different types of DJs.
26. Both ATC and Serato submitted that the market for DJ software includes mobile apps. In support of this, the Parties submitted that:

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<sup>6</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

<sup>7</sup> Commerce Commission, *Mergers and Acquisitions Guidelines* (May 2022) at [3.16].

- 26.1 there are two main functions of DJ software, which is preparation (organising, preparing libraries and editing/remixing songs) and performance (ie, live DJing):
- 26.1.1 while DJs may still prefer to prepare music on laptops, mobile apps are becoming increasingly popular for preparation;<sup>8</sup> and
- 26.1.2 mobile apps provide all the functionality and processing power required for performance, and have some advantages (such as the ability to immediately start mixing from personal libraries and the engagement available from a touchscreen).<sup>9</sup>
- 26.2 mobile apps (in particular Algoriddim) are compatible with many controllers (and conversely many laptop applications included in the Commission’s market definition are not) and hardware manufacturers promote compatibility with mobile apps for some products;<sup>10</sup>
- 26.3 the growth of laptop applications would have been higher without mobile apps;<sup>11</sup> and
- 26.4 screen size is irrelevant for performance because DJs limit their interaction with the laptop when performing, nor does it limit the use of mobile apps to beginners only.<sup>12</sup>
27. ATC submitted that the threat from mobile apps led to the development of the performance function for its rekordbox mobile app.<sup>13</sup> While rekordbox was initially developed as a music management tool it has since been updated to include performance functionality. [

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<sup>8</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [5.12]-[5.14] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [42].

<sup>9</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.27]-[4.28] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [39]-[40].

<sup>10</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.29]-[4.37] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [30]-[36].

<sup>11</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.44]-[4.47] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [52].

<sup>12</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.24]-[4.28] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [29]. Serato further submitted that mobile apps have some advantages over laptop applications, because they can be used to mix music stored on the phone and the touchscreen offers a more intuitive and tactile engagement than a laptop.

<sup>13</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.11].

<sup>14</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [48].

28. According to ATC, there are a wide variety of mobile apps which are not exclusively focused on beginners (as some apps have versions for professional DJs) and there are examples of well-known DJs using mobile apps for performing.<sup>15</sup> Serato submitted that mobile apps being attractive to the “next generation” of DJs should not be interpreted as mobile apps only being suitable for beginners.<sup>16</sup> The Parties submitted that the Digital DJ Tips Global Census, which did not reflect strong use of mobile apps by respondents, is not representative of the industry because it is skewed towards older DJs and therefore does not accurately reflect mobile app usage, which is more common among younger DJs.<sup>17</sup>
29. ATC also said that [  ].  
[  ].<sup>18</sup>
30. ATC submitted that there is significant supply side substitution between laptop applications and mobile apps, with numerous examples of developers of laptop applications expanding into mobile apps.<sup>19</sup>
31. Lastly, ATC submitted that embedded software (software that comes with “all-in-one” systems) and music production software should also be included in the market, as excluding them does not reflect the facts or make commercial common sense.<sup>20</sup>
- 31.1 Embedded software (such as inMusic’s Engine DJ) that comes with all-in-one systems allows DJs to carry out core DJ performance functionality.<sup>21</sup>
- 31.2 Music production software (such as Ableton) can be used for editing music and for preparation and is also used by some DJs for performance.<sup>22</sup>

*National market for the supply of controllers and all-in-one systems*

32. For DJ hardware, in the Sol we expressed the view that the relevant market for DJ hardware should be defined more narrowly to include only certain types of hardware. As DJ software is primarily used with controllers, we considered this type of hardware to be our starting point for market definition. We also included all-in-ones in our market definition as they may be substitutable hardware for some users of controllers. We excluded other types of hardware, such as DJ players and mixers, as we did not consider them to be sufficiently close substitutes for controllers.

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<sup>15</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.17]-[4.21].

<sup>16</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [56].

<sup>17</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.38]-[4.43] and Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [45]-[46].

<sup>18</sup> ATC “Confidential submission on Confidential Sol” (9 April 2024) at [1].

<sup>19</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.49].

<sup>20</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [1.5(a)].

<sup>21</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.52].

<sup>22</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [5.5].

33. The Parties did not submit on our proposed market definition of the national market for the supply of controllers and all-in-one-systems. Based on the information currently before us, we consider there to be a relevant market for the supply of controllers and all-in-one systems.

#### **Our current view of the relevant market for DJ software**

34. Having considered the Parties' submissions, we remain of the view that the DJ software market we defined in the Sol is appropriate. We recognise that there is not necessarily a clear distinction between competition for laptop applications and mobile apps, and that there may be a degree of substitutability between them for some DJs. We further recognise that the products in question display some dynamic elements, such that substitution may change over time. For example, over time new forms of DJing have emerged and suppliers of DJ hardware and software have responded through launching new products. Both the hardware and software markets appear to be growing swiftly. This means that, in time, the nature of substitution between laptop applications and mobile apps may change. However, we are not satisfied that mobile apps are, or will be in the period relevant to this assessment, a sufficiently close substitute for laptop applications such that they belong in the relevant DJ software market.
35. First, although the Parties submitted that mobile apps are similar in functionality to laptop applications and that their usage is growing swiftly (especially by younger DJs), there no evidence to suggest that the growth of mobile apps has impacted on the growth of the Parties' laptop application software or their respective revenues, or is likely to in the future.<sup>23</sup> This may suggest laptop applications and mobile apps are not close substitutes, and that mobile apps are targeting a different customer group.

35.1 Serato is [ ]<sup>24</sup> [ ].

35.2 The following graph provided by ATC shows that rekordbox's laptop application users are [ ].

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<sup>23</sup> In its Sol submission at [4.44]-[4.47] ATC submitted that the growth of laptop applications would have been even higher without mobile apps. While this may be true, at this point in time we have not been provided any evidence to show this.

<sup>24</sup> [ ].

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Source: ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.7(c)].

36. [ ] mobile apps having been available to DJs for a relatively long time. Mobile apps and DJing on a smartphone or tablet are not new developments. Algoriddim was founded in 2006,<sup>25</sup> and other mobile apps CrossDJ and edjing were both released in 2012.<sup>26</sup> Even if we accept that the early iterations of mobile apps may have been fairly limited, DJs have now had the ability to DJ using their mobile phone or tablet for over 10 years. If mobile apps are a viable substitute for laptop applications, we would have expected to hear them named as alternatives for DJing with during our interviews with market participants. We would have also expected to see [ ] and [ ].

37. Second, the overall evidence continues to suggest mobile apps are being used by a different customer group.

37.1 The Parties suggest that the growth in mobile apps is coming from younger DJs rather than beginners.<sup>27</sup> Even if mobile apps are attractive to younger DJs, or the "next generation" of DJs, and not just beginner DJs, this still suggests that apps may be targeted at a different customer set to the Parties' (whose software may be aimed at more experienced DJs, and for use with DJ hardware). We are considering whether mobile app producers are creating software focused on being easy for beginners to use, and that doesn't require DJ hardware.

37.2 An ATC internal document suggests that [ ], stating:<sup>28</sup>

37.2.1 [

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<sup>25</sup> <https://www.algoriddim.com/company>

<sup>26</sup> The Application, at [6.18] and <http://world.edjing.com/about>

<sup>27</sup> Although an internal document suggests that [

<sup>28</sup> [ ]].



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37.3 [

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].<sup>30 31</sup> [

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37.4 ATC claims that it released a new version of its rekordbox mobile app in 2023 in response to the competitive threat from mobile apps.<sup>32</sup> We plan to seek further information in respect to this claim.

37.5 [ ] told us it sees mobile apps used more by beginner DJs rather than professionals. It also said it was unclear whether app usage is growing among DJs.<sup>33</sup> This is consistent with what we had heard from market participants prior to issuing the Sol. We have yet to hear first-hand that mobile apps, aside from Algoriddim, are a viable option for DJs that use laptop applications.

37.6 Although it appears that some professional DJs have had success using mobile apps to perform and win competitions, we would like to hear from other groups of DJs, for example at-home or semi-professionals who use laptop applications who would switch to using mobile apps to DJ with. We also understand that [ ]<sup>34</sup>

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<sup>29</sup> [ ].

<sup>30</sup> [ ].

<sup>31</sup> Another internal document from Serato states [

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<sup>32</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.11(a)].

<sup>33</sup> Commerce Commission interview with [ ].

<sup>34</sup> inMusic “inMusic’s Response to Serato Audio Research Limited’s Submission in Support of AlphaTheta Corporation’s Clearance Application to Acquire Serato” (21 November 2023) at IV(d)(ii)(2).

38. The lack of widespread integration with DJ hardware may reflect the fact that DJ hardware providers do not seek to integrate their hardware with mobile apps. The exception to this is Algoriddim, which is arguably the most successful and well-integrated mobile app. However, Algoriddim appears to have achieved this success through addressing a market that Serato and other DJ software providers do not.<sup>35</sup> (We discuss this further below.) Other mobile apps generally rely on the user integrating the hardware with the software themselves (that is, making the software work with a piece of hardware), meaning that mobile app producers are at a further disadvantage when competing against laptop applications that are already integrated with DJ hardware.<sup>36</sup> The lack of integration of mobile apps likely limits their ability to be viewed as a good alternative to laptop applications.
39. Third, despite the Parties' submissions, there appear to be differences between the features and functionality available between laptop applications and mobile apps. We are still considering the Parties' arguments on screen size and the extent to which a smaller screen may make mobile apps less attractive to users of laptop applications, especially when using DJ software for preparation.
40. We do, however, accept the Parties' submissions that mobile apps have some advantages, such as being able to immediately access music libraries or streaming services on a mobile phone, and that mobile phones and tablets have the benefit of offering the ability for a DJ to use their surfaces as touchscreens to mimic the feeling of DJing (although we note that this would only be an advantage if the user does not plan on using the app with DJ hardware). In the next stage of our investigation we will continue to assess the extent to which the advantages of mobile apps may offset any disadvantages. We note, however, that any current advantages do not seem to have translated into significant switching from laptop applications.
41. The Parties rely heavily on one mobile app in particular (Algoriddim, which also has a laptop application) to justify including mobile apps within the same market as laptop applications. Algoriddim does appear to be the strongest mobile app in terms of features, and has been an early adopter of some innovations in the industry (such as stems). Despite this, we do not consider there is currently sufficient evidence to show Algoriddim's mobile app is a sufficiently close substitute to include in the same market as laptop applications. We continue to consider that Algoriddim's mobile app and other mobile apps are best assessed as an out of market constraint.
- 41.1 Like other apps, the market feedback is that Algoriddim is more focused on beginner DJs.<sup>37</sup>
- 41.2 The Parties submit that Algoriddim is compatible with many controllers. However, this is inconsistent with  
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<sup>35</sup> Commerce Commission interview with [ ].

<sup>36</sup> [ ] told us that it is easier for consumers to buy a piece of hardware that already has the software integrated (Commerce Commission interview with [ ]).

<sup>37</sup> Commerce Commission interviews with [ ] and [ ].

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[

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42. We do not consider the evidence provided by the Parties around music production software belonging in the relevant market to be persuasive. While some DJs may use music production software to DJ, we have not seen any evidence to suggest that it is a sufficiently close substitute for laptop applications to justify including in the relevant market. For example, even though (as ATC notes) the 2024 Digital DJ Tips Global Census shows 22% of DJs are regularly producing music and that many appeared to own music production software, music production software did not appear in the chart “What software do you use to DJ?”. As such, we consider it appropriate to treat music production software as a constraint from outside the market.

43. We also do not consider the evidence provided by the Parties around embedded software belonging in the relevant market to be persuasive, as this type of software is currently only able to be used with the DJ hardware in which it is embedded. Given this limited usability, this type of software is unlikely to be a sufficiently close substitute for laptop applications to be included in the relevant market.

44. We are not satisfied that supply side substitution is sufficient to justify including mobile apps in the relevant market. We have instead considered the constraint from mobile app suppliers as a potential entrant rather as part of the market.

44.1 First, supply side substitution requires that a firm can enter a market with little or no investment.<sup>41</sup> We do not consider the evidence suggests switching between developing laptop applications and mobile apps meets that standard. As we noted in our Sol, developing these requires writing to a different platform, which implies additional investment. For example, ATC stated that it has [ ] development staff dedicated to its rekordbox mobile app and is spending [ ] annually on research and development.<sup>42</sup>

44.2 Second, the examples that ATC provided are where a supplier of a laptop application has developed a mobile app. However, we are testing whether the laptop application market definition should be expanded to include mobile apps. As such, relevant examples would be where mobile app suppliers have developed laptop applications quickly and without significant cost in response to a price increase for laptop applications.

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<sup>38</sup> [ ].

<sup>39</sup> [ ].

<sup>40</sup> [ ].

<sup>41</sup> *Mergers and Acquisitions Guidelines*, above n 7 at [3.16].

<sup>42</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [4.11(b)].

45. We invite submissions on:
- 45.1 the compatibility of mobile apps other than Algoriddim with DJ hardware providers;
  - 45.2 the proportion of mobile app users that use mobile apps with DJ hardware compared with using mobile apps on a smart phone or tablet;
  - 45.3 the extent to which DJs can (and do) use mobile apps for preparation;
  - 45.4 statistics around mobile app usage, and the age of mobile app users;
  - 45.5 switching data between mobile apps and laptop applications; and
  - 45.6 the extent to which mobile apps are driving innovation in the DJ software industry.
46. We also invite submissions from DJs that use mobile apps to DJ on why they use a mobile app and how mobile apps compare to laptop applications. We are particularly interested in hearing from DJs that have switched from using laptop applications to using mobile apps, and from those that use a laptop application as well as a mobile app.

### **With and without scenarios**

47. Assessing whether a substantial lessening of competition is likely requires us to:
- 47.1 compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the merger, often referred to as the factual) with the likely state of competition if it does not (the scenario with the merger, often referred to as the counterfactual); and
  - 47.2 determine whether competition is likely to be substantially lessened by comparing those scenarios.
48. With the Proposed Acquisition, ATC would acquire 100% of the shares in Serato. Our current view is that the most likely counterfactual is a counterfactual where Serato remains independently owned, ie, ownership is either retained by Serato or a third party that continues to operate Serato independently.

### **Competition assessment: horizontal unilateral effects for DJ software**

49. Horizontal unilateral effects arise when a firm merges with or acquires a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors, if any) such that the merged entity can exercise market power and profitably increase price above (and/or reduce quality or innovation below) the competitive level that would prevail without the merger.<sup>43</sup>

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<sup>43</sup> *Mergers and Acquisitions Guidelines*, above n 7 at [3.62].



*Submissions received*

54. In its Sol response, ATC submitted that rekordbox and Serato are not each other's closest competitor as the two have:<sup>44</sup>
- 54.1 different histories (rekordbox started as a library management tool and then developed into performance software, while Serato started as performance software); and
- 54.2 different users (Serato is predominantly used by "scratch" DJs while rekordbox is primarily used by house/techno DJs).
55. ATC also submitted that the Digital DJ Tips Global Census results are not representative of the DJ industry as they reflect older, more experienced DJs.<sup>45</sup> ATC further submitted that [ ]<sup>46</sup>
56. In its Sol response, Serato submitted that the competition between Serato and rekordbox is not particularly strong as, in its view, rekordbox [ ]<sup>47</sup> In support of this, Serato submitted that ATC's history of innovation in the DJ hardware space is [ ]<sup>48</sup> It further submitted that the [ ]<sup>49</sup> and that rekordbox's market position reflects ATC's success as a hardware provider.<sup>50</sup> Serato says that it is therefore more influenced by Algoriddim, VirtualDJ and Traktor.
57. Serato also submitted that rekordbox and Serato have different customer bases and target markets. Serato compares the two as follows.<sup>51</sup>
- 57.1 Serato has a stronger presence [ ]<sup>51</sup>
- 57.2 rekordbox has a stronger presence [ ]<sup>51</sup>
- [ ] Serato also says that many rekordbox users like rekordbox's preparation feature which allows users to organise playlists and export music to a USB drive for use on Pioneer DJ CDJs or other embedded hardware.

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<sup>44</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.7].

<sup>45</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.8].

<sup>46</sup> ATC "Confidential submission on Confidential Sol" (9 April 2024) at [4].

<sup>47</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [80].

<sup>48</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [89], [92] and [94].

<sup>49</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [89].

<sup>50</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [96].

<sup>51</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [99].

58. Serato also submitted that revenue figures are not a reliable source for market shares (given these figures don't take into account free DJ software and because revenue earned from a product does not necessarily equate to a customer using that software, particularly if the hardware supports multiple kinds of software), and that monthly average user (MAU) data is a better indicator.<sup>52</sup>

*Our current view*

59. We remain of the view that the evidence supports Serato and rekordbox being close competitors for DJ software in New Zealand.

60. First, while the two firms have different origins and are perhaps used more for DJing with one type of music over another, the evidence supports that Serato and rekordbox compete closely.

60.1 Serato and rekordbox both provide an offering that DJs can use for both performance and preparation.<sup>53</sup> While rekordbox was originally used for preparation, it has had performance functionality for many years. We however accept that some rekordbox users may only be using the preparation feature to export music to a USB for later use with DJ players or all-in-one systems. If Serato does not offer the same ability to export music, then those DJs may not consider the two pieces of software to be substitutable. In the next stage of our investigation we will be seeking further information on the number and proportion of DJs who are likely to be using rekordbox for this purpose and whether Serato offers a similar feature.

60.2 There does not appear to be a distinct line between what sort of music is suited for each kind of software, and these distinctions may differ country by country:

60.2.1 ATC's submission references the results of a survey it conducted, which found that while [ ] of rekordbox users said that they play house/techno music, [ ] of respondents also said that they usually played hip hop music (more than one answer was able to be given).<sup>54</sup>

60.2.2 An internal document from Serato looked at [

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<sup>52</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [109]-[111].

<sup>53</sup> [

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<sup>54</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at FN 70.

<sup>55</sup> [ ].

60.2.3 We are therefore not convinced that there are specific characteristics or features of each type of software that makes them markedly more suited for DJing with one type of music over another.

60.3 Second, we continue to consider the internal documents support that [

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60.4 Aside from the documents identified in the Sol, an internal document from Serato says that [

].<sup>56</sup> Another internal document from Serato not identified in the Sol [

].<sup>57</sup> [

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61. [

].<sup>58</sup> [

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62. Third, we continue to consider that, on balance, the interview evidence supports that rekordbox and Serato are close competitors.

62.1 ATC submitted that [ ]<sup>60</sup> [ ], as noted in the Sol, the DJs we spoke to identified rekordbox as the likely alternative (or one of the alternatives) if they were not using Serato.

62.2 We spoke with [ ] to better understand the popularity of DJ software products domestically. [ ] told us that most

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<sup>56</sup> [ ].

<sup>57</sup> [ ].

<sup>58</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [89].

<sup>59</sup> [ ].

<sup>60</sup> ATC “Confidential submission on Confidential Sol” (9 April 2024) at 5.



of its customers are using either Serato or rekordbox, and that it is unclear which software is best as both have different pluses and minuses and are better suited to different types of music. Despite this, [ ] still considers the two to compete and told us that this competition drives innovation within the industry.<sup>61</sup>

63. Fourth, we continue to consider that, on balance, market share evidence supports that rekordbox and Serato are close competitors. However, we do agree with Serato that market shares (both using MAU and revenues) can be difficult to interpret.

64. Since the Sol we have continued to refine our market share estimates, and note the following:

64.1 In our Sol we overestimated the Parties' market share and underestimated VirtualDJ's market share.

64.1.1 In the Sol we estimated the Parties had [ ] on a global basis based on revenue and [ ] on a New Zealand basis. We now consider the Parties' combined share is likely to be [ ] on a global basis and [ ] on a New Zealand basis.

64.1.2 VirtualDJ is a much more significant player than we had previously thought and based on revenue is likely to be [ ].  
(We discuss the constraint of VirtualDJ in more detail in the next section.)

64.2 There are other potential issues with the market shares which may result in the Parties' market shares being over- or underestimated.

64.2.1 The different strategies of the DJ software providers make it more difficult to directly compare revenues. [ ]

[ ]<sup>62</sup> By contrast, Serato generates its revenue from sales to consumers and businesses.

64.2.2 Some third parties did not provide us with full information, and we have had to estimate some figures (including New Zealand revenues in some instances).

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<sup>61</sup> [ ] told us that the competition pushes the other to come up with something new and gave the example of Serato implementing a new feature and then rekordbox later adding a version of that feature that wasn't as good. Commerce Commission interview with [ ].

<sup>62</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [110].

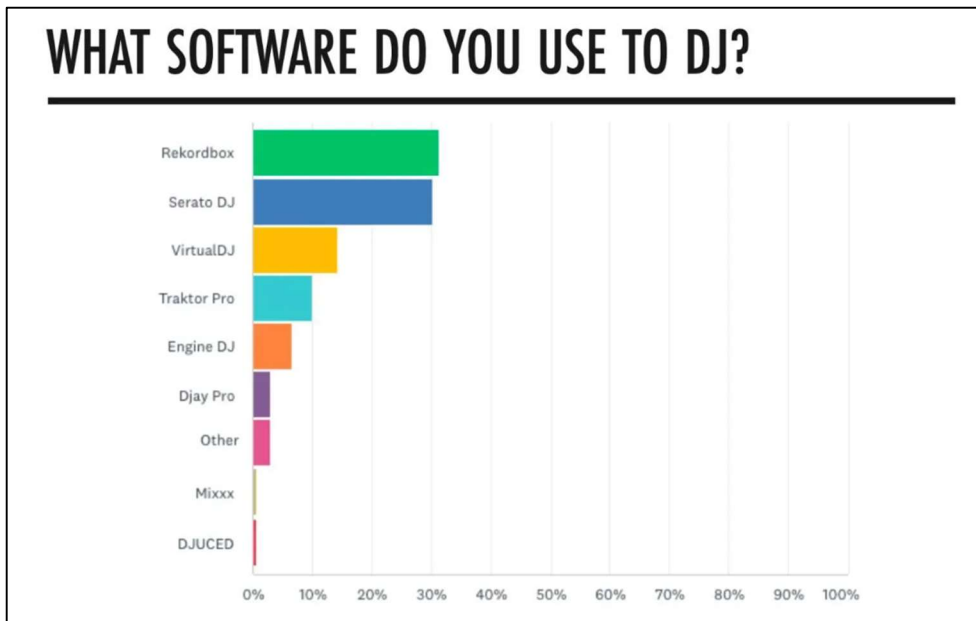
65. For these reasons the shares may not fully reflect the degree of constraint between market participants. We have considered this information as one part of the broader set of evidence.

66. In our Sol we set out that the Digital DJ Tips Global DJ Census results for 2023 suggested that the Parties compete closely. We agree with the Parties that the Census may not be representative of all DJs (for example, approximately 45% of the DJs surveyed in 2024 are 45 or older, and approximately 33% are from the US). However, we continue to consider that it may be representative of the DJs that matter to the Parties and have received no evidence that younger DJs or DJs from different countries have different preferences that would matter for our competition analysis.

66.1 The Parties both [redacted], including in an [redacted].<sup>63 64</sup>

66.2 Serato told us that its [redacted].<sup>65</sup> [redacted].

67. The Census results for 2024 have since been published and continue to suggest Serato and rekordbox compete closely. The 2024 Census surveyed nearly 15,000 DJs, approximately 60% of which use either Serato or rekordbox when DJing:



Source: Digital DJ Tips 2024 Census.

63 [redacted].

64 [redacted].

65 [redacted].  
Commerce Commission meeting with Serato and ATC (29 April 2024).

68. The combined share of the Parties has been relatively stable between the 2023 and 2024 Census results, although in 2023 Serato was the most popular software among those surveyed while in 2024 rekordbox has taken this position. This might further suggest close competition between the Parties.
69. Finally, while the Parties submitted that the clauses in the SPA will ensure that both Parties will be incentivised to continue competing,<sup>66</sup> at this point we are not satisfied we can rely on the SPA. We discuss this in more detail at [112-117].
70. We invite further submissions on:
- 70.1 the features of the Parties' DJ software that makes them more suited to performing different styles of music;
  - 70.2 the percentage of rekordbox users that use the software purely for preparation vs performance;
  - 70.3 how the preparation functions of Serato and rekordbox compare, including the export to USB feature;
  - 70.4 how rekordbox and Serato compare in terms of functionality and features when used for preparation and when used for performing; and
  - 70.5 whether older and younger DJs have different preferences, and if so, how these might matter to our assessment.

### **Constraint from rivals**

#### *What we said in our Sol*

71. In the Sol, we expressed the preliminary view that although the merged entity would face some competition from other DJ software providers, we were not satisfied that these rivals would provide sufficient constraint to prevent the merged entity from imposing a SSNIP (a small, but significant, non-transitory increase in price). This is because it was unclear whether these rivals have the level of hardware integration or reputation to replace the competition lost with the Proposed Acquisition.
72. Feedback from market participants on DJ software rivals was mixed, with rivals either considered to be for beginners (VirtualDJ and Algoriddim) or lacking in features (Traktor and EngineDJ). Hardware manufacturers told us that Serato is the most important software to integrate their hardware products with, as none of the other brands of software are as popular or have the same quality.
73. While in the Application ATC submitted that mobile apps and music production software would be constraints on the merged entity post-acquisition, in the Sol we found that mobile apps are only likely to be an option for beginner DJs (rather than all DJs) and that music production software will only act as a constraint if the

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<sup>66</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.9] and Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [79].

software includes the functionality needed to DJ and if the user is already familiar with that software.

*Submissions received*

74. In its Sol response, ATC submitted that the DJ software industry is highly competitive, with a range of software providers (including inMusic, Native Instruments, VirtualDJ, Algoriddim and music production software Ableton) being well placed to continue to innovate and expand over the next five years.<sup>67</sup> ATC also submitted that [ ]<sup>68</sup>

75. Serato submitted that competition from the “broad range” of other providers offer compelling alternatives to the Parties and will continue to constrain the merged entity post-acquisition.<sup>69</sup> Serato also submitted that [ ]<sup>70</sup>

76. [ ]<sup>71</sup> [ ]

] <sup>72</sup>

77. Serato further submitted that the Sol significantly understated the constraint from mobile apps, arguing that as most developments in the DJ software industry (such as stems technology that isolates parts of a song) have been driven by mobile apps, the constraint they are providing is strong and increasing.<sup>73</sup> Serato also submitted that music production software will continue to act as a constraint as it is a viable option for a competitively significant portion of DJs.<sup>74</sup>

*Our current view*

78. We remain unsatisfied that the existing constraints in the market are sufficient to replace the constraint that would be lost with the Proposed Acquisition in the DJ software market.

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<sup>67</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [6.12].

<sup>68</sup> ATC “Confidential submission on Confidential Sol” (9 April 2024) at [1].

<sup>69</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [103].

<sup>70</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>71</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>72</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>73</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [104].

<sup>74</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [112].

79. As set out above at paragraphs [35]-[41], we do not consider mobiles apps to be a close substitute for laptop applications. We are continuing to assess whether we have underestimated the constraint provided by mobile apps post-acquisition. However, at this stage we are not satisfied that constraint from mobile apps would impose a strong constraint on the merged entity.

79.1 To the extent we accept Algoriddim has contributed to advancements within the laptop application market, at this point it seems mainly Algoriddim itself, rather than mobile apps as a category, that is driving innovation. For example, an internal document from Serato refers to [ ]<sup>75</sup> and, as ATC submitted, [ ]. We are continuing to seek further information on the extent to which other mobile apps have driven innovation in the laptop application market.

79.2 Market feedback is that mobile apps, including Algoriddim, are more focused on beginner DJs. Algoriddim [ ]<sup>76</sup> We are continuing to test the extent to which Algoriddim could grow to become a stronger constraint on the merged entity.

80. We are still considering whether existing laptop application providers such as VirtualDJ and Traktor will be sufficient to constrain the merged entity.

80.1 VirtualDJ is likely to be the strongest constraint on the merged entity. As outlined above, our updated market shares calculations indicate that VirtualDJ will be the merged entity’s biggest competitor post-acquisition. [ ]<sup>77</sup> During our initial investigation, market participants we spoke with suggested that VirtualDJ was not in the same league as Serato, and it was not mentioned as an alternative option to DJ with by the DJs we spoke with.<sup>78</sup> Accordingly, we had not assigned much weight to the constraint provided by VirtualDJ post-acquisition. We recognise ATC’s submission that [ ], and we continue to assess the constraint that VirtualDJ provides and the extent to which it could replace the lost competition from the Proposed Acquisition.

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<sup>75</sup> [ ].

<sup>76</sup> [ ].

<sup>77</sup> Commerce Commission interview with [ ].

<sup>78</sup> [ ].

- 80.2 We continue to consider that we cannot place much weight on Traktor post-acquisition due to its [ ] and potentially more limited set of features compared to some of its competitors.
81. We also continue to consider we cannot place much weight on the constraint embedded DJ software such as Engine DJ and DJUCED would provide post-acquisition as this type of software is currently only able to be used with inMusic DJ hardware and Hercules DJ hardware respectively. In addition, [ ] told us that DJUCED is technically behind compared to other software providers and only provides the basic features needed to DJ.<sup>79</sup>
82. For the reasons set out at paragraph [42] above, we do not consider music production software to be a close substitute for either of the Parties' software, and as a result would provide little to no constraint.
83. We invite further submissions on:
- 83.1 the extent to which mobile apps (aside from Algoriddim) such as edjing, CrossDJ or PCDJ impose a competitive constraint on the merged entity;
  - 83.2 the extent to which users of laptop applications (particularly those using Serato and rekordbox) view mobile apps as a viable alternative;
  - 83.3 the extent to which Serato and rekordbox laptop application users view existing laptop application suppliers as alternatives;
  - 83.4 data on customers switching DJ software providers and their reasons for switching; and
  - 83.5 examples of innovations in the DJ software industry from mobile app producers.

### **Entry and expansion**

#### *What we said in our Sol*

84. In the Sol, we considered that entry by new DJ software providers or expansion by existing DJ software providers would not likely be sufficient to prevent an exercise of market power by the merged entity in the supply of DJ software. We were of the view that there appeared to be significant barriers to entry and expansion, including time to develop the software, the significant costs required to do so, some of which are sunk, and difficulties with convincing customers to switch software providers. We did not consider that new entry or expansion was likely to be sufficient in extent, or would occur in a timely fashion, to constrain the merged entity.

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<sup>79</sup> Commerce Commission interview with [ ].

*Submissions received*

85. In its Sol response, ATC submitted that barriers to entry and expansion in the DJ software market are low, especially for existing DJ software providers, because:<sup>80</sup>
- 85.1 The time to develop and improve DJ software is not a barrier to entry, but rather a cost that all market participants incur. ATC said it took [ ] to develop the performance element of rekordbox.
  - 85.2 Sunk costs are not a barrier to entry, as existing software providers are also subject to these costs and face similar expenditure for attracting new users.
  - 85.3 The marginal costs associated with DJ software are low, and it is a highly scalable product. DJ hardware manufacturers are well placed to enter/expand in the DJ software market in response to a price rise or decrease in quality.
  - 85.4 Although there can be difficulties with getting DJs to switch providers, DJs will switch if their existing provider does not replicate a new feature or in response to a price rise or quality decrease. Further, switching difficulties do not apply to new users who have not yet established loyalty to a software.
86. Serato submitted that the time and cost associated with entry and expansion were overstated in the Sol, and that only [ ] of its [ ] R&D spend for 2022 was spent on funding ongoing R&D for its DJ software product.<sup>81</sup> Serato further submitted that ATC's expansion into DJ software is evidence that DJ hardware providers face low barriers to entry as they are readily able to expand by using their existing presence in the market.<sup>82</sup>
87. According to Serato, rivals are well placed to expand in a timely manner, and an existing rival does not need to offer something completely new in order to expand.<sup>83</sup> Serato also submitted that switching is more feasible than the Sol suggests (particularly due to the rise in cloud-based libraries), and that there is compelling evidence to suggest DJs will switch providers based on an increase in price or decrease in quality.<sup>84</sup> Serato further submitted that there are effective strategies that can be used to overcome difficulties with switching, such as creating software with a similar look/feel to existing products.<sup>85</sup> Lastly, Serato submitted that its analysis of customer churn data, which shows the rate of customers no longer using any Serato product, is evidence of customers switching.<sup>86</sup>

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<sup>80</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.13]-[6.26].

<sup>81</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [115].

<sup>82</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [118].

<sup>83</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [116].

<sup>84</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024), at [122]-[130].

<sup>85</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [119].

<sup>86</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [128]-[130].

*Our current view*

88. We continue to consider that there are likely to be significant barriers to entry and expansion. As an initial point, we consider that the Parties' definition of a barrier to entry (that is, only those costs that existing software providers do not face) may be too narrow.<sup>87</sup> We instead consider that it is appropriate to consider any conditions that have the potential to prevent, impede or slow entry and expansion.<sup>88</sup> If such conditions were present, then it would make it less likely that entry and expansion would be able to replace any competition lost from the Proposed Acquisition.
89. First, we continue to consider that the time and cost to develop software is likely to be a major barrier to entry and expansion.
- 89.1 The time to develop the software remains a concern, as estimates from other market participants indicate that developing the software is a lengthy process. While it may have taken ATC [ ]<sup>89</sup> to develop the performance element of rekordbox, it already had somewhat of a head start having previously developed the library management side of the software. This development may therefore be more incremental expansion and the time to develop a new product may take longer. We do however recognise that the most likely constraint may come from a player with an existing product, who develops it to be a closer competitor to the merged entity. There may also be a difference between the time to develop software and when it has reached a scale that imposes a strong competitive constraint in the market. We are considering this further.
- 89.2 We also have mixed evidence on the cost of developing a software product. The costs of development may hinder new entry and therefore may limit competition. Serato estimates that it spent [ ].<sup>90</sup> However, Serato is an established player. Serato's investment may therefore be more incremental compared to the investment that other rivals may face to reach a point they are viewed as a strong alternative to Serato. The cost might include not only development costs but also advertising costs to convince DJs that the product is a viable alternative. We continue to consider that costs are likely to be a barrier that will inhibit

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<sup>87</sup> For example, the OCED stated "Some scholars and practitioners have argued that an obstacle does not count as an entry barrier unless it is something that the incumbent firms did not face when they entered. Others contend that an entry barrier is anything that hinders entry and has the effect of reducing or limiting competition, regardless of its other characteristics. A number of other definitions have been proposed over the years, but so far none of them has emerged as a clear favourite, at least not among economists". OECD "Barriers to entry" (DAF/COMP(2005)42, 6 March 2006) at 17.

<sup>88</sup> This is consistent with the High Court's decisions in *Commerce Commission v New Zealand Bus* and *Air New Zealand v Commerce Commission*. In those cases, the Court emphasised that the question of whether conditions in a market qualify as a barrier to entry, however defined, is less important than considering whether those conditions have the potential to prevent, impede or slow entry and expansion.

<sup>89</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [6.19(a)].

<sup>90</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [115].



rivals from imposing a strong constraint on the merged entity. However, we are considering this further.

89.3 The cost of entry and expansion may be largely sunk. That is, once the investment in development has been made, it may not be possible to recover them except through successful trading. This increases the risk of investing in entry and expansion. Failing to reach a sufficient scale means the investment may be lost. The difficulty to reach a scale to recoup the costs may potentially rise if ATC takes actions that inhibit the ability of DJ software providers to integrate with Pioneer DJ hardware. Gaining this compatibility may therefore be an additional barrier new entrants would face, particularly as hardware providers that already supply their own DJ software may not be incentivised to develop compatibility with rivals' software products. This would particularly be the case if new DJ software developers were unable to integrate their product with Pioneer DJ hardware. We discuss this in further detail in paragraph [110.4] below.

90. Second, we continue to consider that there are likely to be high switching costs for DJs.

90.1 The rise in the use of cloud-based music streaming services may reduce barriers to consumers switching DJ software providers. For example, it appears that rekordbox, Serato, Algoriddim, VirtualDJ and Traktor are all compatible with music libraries such as Beatport, Beatsource and Soundcloud. Despite this,  
[  
].<sup>91</sup>

90.2 While Serato's  
[  
].

91. Third, we do not consider there are clear examples of entry in the laptop application market that indicate ease of entry.

91.1 There does not appear to have been a major new entrant to the DJ software market since rekordbox (which first launched in 2009 as preparation software and then in 2015 with performance software), and participants in the DJ software market are all relatively mature. While the lack of entry may be because there are no opportunities in the market (because existing players are already serving customers well), it may also be because entry is more difficult than the Parties have argued.

91.2 Although some existing hardware manufacturers have entered the DJ software space (such as inMusic and Hercules) indicating that entry is not

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<sup>91</sup> [ ].

insurmountable, we remain of the view that such expansion is unlikely to be sufficient in extent to constrain the merged entity. This is because these products are at this stage only compatible with the hardware providers' products and cannot be used with some of the hardware that Serato users own. As a result, they do not appear to be widely used and at this point appear unlikely to materially constrain the merged entity. It may require significant investment of the nature described earlier to make these products attractive to Serato users.

91.3 While ATC did have success in quickly growing its market share in the DJ software space, it did so off the back of a very strong presence and reputation in the DJ hardware market. Being able to leverage its existing large user base inevitably gave ATC an advantage in growing its user base for DJ software. This is a reason we consider that ATC may impose a strong competitive threat to Serato. Other DJ hardware providers do not have ATC's presence in the DJ hardware market, so would not have the same ability to do this. We are therefore not persuaded we can assume that ATC's success in DJ software would be achievable for all DJ hardware providers that wanted to enter the DJ software market.

92. We invite further submissions on:

92.1 what level of price rise or quality decrease would prompt consumers to switch DJ software providers;

92.2 the extent to which DJs would consider switching software, and why, including any data or evidence around switching;

92.3 past examples of the cost of and time involved in developing DJ software and the period it took to recoup those costs; and

92.4 what steps existing DJ software competitors could take to increase their market share and win new customers.

### **Competition assessment: vertical effects for DJ hardware**

93. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical effects. This can occur where a merger gives the merged entity a greater ability and/or incentive to engage in conduct in a market that raises rivals' costs in a related market and prevents or hinders rivals from competing effectively in that market (which we refer to as "foreclosing rivals").<sup>92</sup> Foreclosure strategies can include refusing to supply competitors an input that is essential for them to compete (total foreclosure), raising the price it charges competitors to access that input or reducing the quality of that input supplied to competitors (partial foreclosure).

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<sup>92</sup> *Mergers and Acquisitions Guidelines* above n 7 at [5.1]-[5.15].

### Summary of what we said in our Sol

94. In the Sol, we considered that the Proposed Acquisition raised concerns that the merged entity would have the ability and incentive to use its market power in the DJ software market to foreclose its rivals in the DJ hardware market, and that such conduct could substantially lessen competition. We were not satisfied that the SPA provisions would provide sufficient safeguards to prevent foreclosure or that MIDI mapping would be a substitute for full integration.

### Summary of our current view

95. We consider there is insufficient evidence to be satisfied that the Proposed Acquisition would not be likely to cause a substantial lessening of competition due to vertical effects for DJ hardware. Our unresolved concerns are:
- 95.1 The merged entity has the ability to foreclose its hardware competitors through control of an important input (Serato).
  - 95.2 Our incentive analysis indicates that the merged entity has the incentive to foreclose rival hardware manufacturers as it could stand to gain greater profits in the DJ hardware market than it would stand to lose in the DJ software market.
  - 95.3 Such foreclosure would likely have an adverse impact on competition. There do not appear to be effective counterstrategies hardware rivals could employ to defeat any foreclosure (for example, hardware rivals are unlikely to be able to develop their own DJ software that would be able to compete with Serato).
96. We explore each of these points below.

### Ability to foreclose

#### *What we said in our Sol*

97. In the Sol, we considered that the merged entity may have the ability to foreclose rivals, due to Serato being seen as an essential trading partner by [ ]. These providers told us there are no good alternatives to partner with aside from Serato.
98. We also considered that there were a range of potential mechanisms that the merged entity could use to raise rivals' costs, such as:
- 98.1 raising the cost of the Serato licence fee (and other engineering fees);
  - 98.2 refusing to integrate, delaying integration or integrating less effectively (such as only allowing certain features to work with a controller); and
  - 98.3 gaining access to sensitive information (including unreleased products and user device data) (which we discuss separately below).

99. We did not consider that MIDI mapping (manually assigning buttons on a hardware product to control features of the software) is likely to be a substitute for full integration as it does not allow for the same depth of integration and may result in a lower quality outcome for the user.
100. We were also not satisfied that certain provisions in the SPA that require ATC to continue to operate Serato as it is currently being operated would prevent foreclosure of rivals.

*Submissions received*

101. ATC submitted that there is no credible likelihood of vertical foreclosure in the DJ hardware market.
102. ATC submitted that for a foreclosure theory of harm to be made out the Commission would need to conclude:<sup>93</sup>
- 102.1 there is a real and substantial risk that during the period until the end of the [ ] (the Contingent Consideration Period), ATC would engage in the conduct identified in breach of the SPA; and
- 102.2 that absent the SPA conditions there is a real and substantial risk that ATC would have the ability and incentive to foreclose rivals, and that this would have the effect of causing an SLC.
103. ATC submitted that the terms of the SPA preclude the theoretical conduct during the Contingent Consideration Period.<sup>94</sup>
- 103.1 The SPA contains [ ] contingent payments based on [ ]<sup>95</sup>
- 103.2 The SPA contains protections for the sellers to ensure the buyer does not interfere with the business. ATC submitted that the SPA protections would prevent all the examples that the Sol identified as potential means of foreclosure and that Serato employees (who stand to gain from the earnout) will be motivated to enforce the protections. The protections include:<sup>96</sup>
- 103.2.1 “[ATC] undertakes to the Sellers that it will, during the Contingent Consideration Period, act in good faith and, using all reasonable endeavours, support the growth of and operate and manage [Serato] with a view of maximising the [relevant profit metric]” (clause 6.1, Schedule 11);

<sup>93</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.5].

<sup>94</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.7]-[7.35].

<sup>95</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.7]-[7.8].

<sup>96</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.19].

103.2.2 “[ATC] will ensure that [Serato] is managed in a prudent manner consistent with the 12 months immediately prior to Completion” (clause 6.2.1, Schedule 11); and

103.2.3 “[ATC] will ensure that [Serato] does not (without the prior written consent of the Sellers’ Representative)...materially change the nature or scope of its Business as presently conducted...” (clause 6.2.9(a), Schedule 11).

104. ATC submitted that, even absent the SPA provisions, it would have no ability to foreclose hardware competitors. This is because:<sup>97</sup>

104.1 Serato is not an essential input – it has a [ ] market share based on MAU, there are a large number of alternative DJ software options and rival DJ hardware suppliers market their products with DJ software partners other than Serato (eg, in FY23 the top three best-selling DJ controllers were compatible with three DJ software applications).

104.2 The DJ software market is dynamic – it is highly unlikely Serato would become essential by the time the Contingent Consideration Period ends in almost five years’ time given the strong growth of mobile apps and DJ hardware with embedded software.

104.3 There is no mechanism to foreclose – ATC could not prevent non-ATC hardware users from using existing versions of Serato and it is possible to MIDI map Serato software to DJ hardware.

105. Serato also submitted that the Proposed Acquisition will not substantially lessen competition in the DJ hardware market due to vertical effects.

106. In support of this, Serato submitted that Serato DJ software is not “must have” now, and will be even less likely to be one after the Contingent Consideration Period ends.<sup>98</sup>

106.1 The proportion of DJ hardware products that are marketed with Serato as the primary software has declined rapidly. In FY18, Serato was the primary software for 100% of DJ controllers released whereas in FY24 this percentage dropped to [ ].

106.2 In FY24 only [ ] of new hardware supported by Serato bears Serato branding.

106.3 Rival hardware providers have been launching products without official support from Serato (with Serato support coming later) or have launched products with no Serato support.

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<sup>97</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.49]-[7.64].

<sup>98</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [142] and [186].

107. Serato also submitted that the protections in the SPA would prevent foreclosure because.<sup>99</sup>
- 107.1 The foreclosure conduct described in the Sol would be a breach of the SPA obligations.
- 107.2 The Serato sellers and key employees are [ ], so would be greatly motivated to ensure ATC adheres to the [ ].
- 107.3 The [ ] are robust and enforceable, and not “watered-down” protections that are difficult to prove or enforce. While there are potential risks associated with litigation, ATC has much more to lose and is thus more likely to be wary of litigation risk due to the damage to ATC’s reputation and goodwill.
- 107.4 Serato will not be less motivated to enforce the SPA at the end of the term because the earnout is based on [ ].
108. Serato submitted that its existing agreements with DJ hardware providers prevent it from foreclosing those rivals.<sup>100</sup> These contracts require Serato to engage with its hardware partners, and run until at least [ ] and longer for some parties.

*Our current view*

109. At this point we are still not satisfied that the merged entity would not have the ability to foreclose.
110. We continue to consider that Serato is likely to be an essential trading partner by [ ].
- 110.1 The evidence supports the Parties’ claims that hardware is less frequently being released with Serato as the only official supported software. However, we do not consider this is sufficient to show that Serato is not an essential trading partner.
- 110.1.1 Although hardware is now being released with support for multiple DJ software, the vast majority of DJ hardware is still shipped with support for Serato. For example, we estimate based on CY22 data, around [ ] of controller and all-in-one units shipped by inMusic, Reloop and Roland (who are some of ATC’s major DJ hardware rivals) come with Serato pre-mapped.
- 110.1.2 An ATC internal document states [ ]

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<sup>99</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [143]-[151].

<sup>100</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [157]-[160].

].<sup>101</sup> Even though ATC has developed its own DJ software (rekordbox), ATC still considers it necessary to integrate its products with Serato and pay royalties for that privilege.

110.1.3 The most common alternative laptop applications that DJ hardware is shipped with (aside from Serato) are rekordbox and Algoriddim. However, we are not satisfied these are likely to be good alternatives for rival DJ hardware providers.

- (a) If ATC was engaging in a foreclosure strategy, then it is unlikely to make rekordbox (which it owns) available to rival DJ hardware providers. Even if it was made available, rival DJ hardware providers are unlikely to see rekordbox as an option since it would expose them to similar risks they face with Serato.
- (b) Algoriddim appears to be targeted at a different group of customers (ie, customers that own Apple products) and therefore is unlikely to be a good alternative for DJ hardware providers who wish to sell to non-Apple users. That is, adding integration with Algoriddim grows the opportunities for DJ hardware providers to make sales but does not replace the need to integrate with Serato. This evidence is consistent with the views of [ ] all of which view Serato as essential to the success of their products.<sup>102</sup>

110.2 The growth of embedded software in all-in-one hardware is unlikely to be a strong constraint. There will continue to be customers that purchase controllers for use with laptops and DJ hardware providers will wish to offer those products with Serato. In 2022 only ATC and inMusic sold all-in-one controllers. All-in-ones seem to make up [ ] of the total DJ controller sales.<sup>103</sup>

110.3 The use of mobile apps is growing. However, as we identified above, we are not satisfied that this is sufficient to impose a strong constraint on Serato for DJ hardware providers. As we note earlier in the paper:

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<sup>101</sup> [ ].

<sup>102</sup> [ ] stated that Algoriddim was focused on iOS, iPhone and iPad and was for consumers whereas Serato was more for professional (Mac and PC). Commerce Commission interview with [ ]. [ ] said that dJAY Pro (ie, Algoriddim) was likely the closest alternative to Serato but it was not the solution because the market would not accept it and it was not [ ] market. Commerce Commission interview with [ ].

<sup>103</sup> For example, the Digital DJ Tips Global Census shows that the number of all-in-one users is only a small proportion of controller users. [ ].

110.3.1 we are yet to see any clear evidence that the growth of mobile apps is at the expense of laptop applications used with DJ hardware – they instead seem targeted at a different customer group; and

110.3.2 it is unclear at what point in the future mobile apps will become a good alternative to Serato for DJ hardware providers, if at all. Mobile apps have been present for a number of years (edjing and Algoriddim’s djay were released in 2012 and 2006 respectively).<sup>104</sup>

110.4 The growth of alternatives could also be impeded through the actions of ATC. ATC supplies around [ ] of the DJ hardware market.<sup>105</sup> The ability of DJ software to work with that hardware is likely to materially affect the likely profitability of entry and expansion. ATC could raise barriers by preventing rival DJ software from working with Pioneer DJ devices, [ ].

110.4.1 [ ]  
[ ]<sup>106</sup>  
[ ]<sup>107</sup>

110.4.2 One of [ ] concerns with the Proposed Acquisition is ATC preventing [ ] software from being compatible with Pioneer DJ hardware. [ ] told us that this would have a “massive impact” and be the “worst case” scenario.<sup>108</sup> It also told us that it has had experience with [ ]  
[ ]<sup>109</sup>

110.4.3 [ ] said that it is “very afraid” that ATC could want to close off its access to Pioneer DJ hardware.<sup>110</sup> As an estimated [ ] of [ ] users use the software with Pioneer DJ hardware, being cut-off from that hardware would cause it to lose a lot of its customers.<sup>111</sup> [ ] said that ATC locking out all DJ software competitors would effectively “kill” the competitors and any future innovation.<sup>112</sup> Such conduct

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<sup>104</sup> See paragraph [36].

<sup>105</sup> See AlphaTheta/Serato Statement of Issues at Table 3.

<sup>106</sup> [ ].

<sup>107</sup> [ ].

<sup>108</sup> Commerce Commission interview with [ ].

<sup>109</sup> Commerce Commission interview with [ ].

<sup>110</sup> Commerce Commission interview with [ ].

<sup>111</sup> Commerce Commission interview with [ ].

<sup>112</sup> Commerce Commission interview with [ ].



would prevent developers being incentivised to create DJ software because most DJs appear to want to buy Pioneer DJ hardware.<sup>113</sup>

111. At this point we continue to consider that the ability to MIDI map is insufficient to prevent foreclosure.

111.1 While MIDI mapping may be possible, the submissions have not allayed our concerns that the Proposed Acquisition will make it more difficult for customers to use rivals' hardware. Some customers may be unable to MIDI map, or simply put off from purchasing those devices due to the inconvenience.

111.2 If MIDI mapping was a good alternative, it is unclear why the DJ hardware providers would put so much effort in working with Serato to integrate their products and then pay a fee to Serato for all the devices sold.

111.3 One DJ that we spoke with said that integration with Serato is important, and that they would think twice about using any gear that doesn't naturally integrate, or would be difficult to integrate, with Serato.<sup>114</sup>

111.4 [ ] suggested that it is a lot easier for consumers to buy hardware that already has the software integrated, rather than have to work to make the hardware and software compatible.<sup>115</sup>

111.5 In addition, we understand that some features of DJ hardware devices such as screens typically require a deeper level of integration through HID mapping.<sup>116</sup>

112. At this point we continue to consider that the SPA protections are not sufficient to prevent foreclosure. In the Sol we described three different mechanisms the merged entity could implement to foreclose rivals by raising their costs. These were:

112.1 raising the cost of the licence fee (and other engineering fees);

112.2 refusing to integrate, delaying integration or integrating less effectively (such as only allowing certain features to work with a controller); and

112.3 tying or bundling products.

113. These foreclosure mechanisms do not involve outright refusal to engage with rivals, rather they involve what could entail subtle steps to, over time, make it incrementally more difficult for rivals to engage and compete.

114. In its submission on the Sol, ATC described in detail how any steps it takes to implement these mechanisms would result in it being in breach of the provisions of

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<sup>113</sup> Commerce Commission interview with [ ].

<sup>114</sup> Commerce Commission interview with [ ].

<sup>115</sup> Commerce Commission interview with [ ].

<sup>116</sup> Commerce Commission interview with [ ].

the SPA. Specifically, ATC argues that breaches of clause 6.1, clause 6.2.1 and clause 6.2.9(a) of Schedule 11 (set out above at paragraph 103.2) would arise.<sup>117</sup>

115. In essence, ATC argues that any steps taken to implement the potential foreclosure mechanisms described above would mean that it has:
- 115.1 not acted “in good faith” using “all reasonable endeavours” to support the growth of Serato (in breach of clause 6.1);
  - 115.2 failed to manage Serato in a “manner consistent with the 12 months immediately prior to Completion” (in breach of clause 6.2.1); or
  - 115.3 materially changed the “nature of scope of the Business as presently conducted... (in breach of clause 6.2.9(a))”.
116. We acknowledge these arguments, however we remain concerned that the merged entity will be able to engage in mechanisms of foreclosure, despite the clause 6 provisions.
117. This is for the following reasons:
- 117.1 Third party hardware manufacturers will not have the ability to enforce the clause 6 provisions of the SPA, nor will the Commission, as these are only able to be enforced by the sellers of Serato.
    - 117.1.1 The clause 6 provisions have been drafted and included in the SPA with the financial interests of the Serato sellers and management in mind. The provisions were not designed or envisaged, at the time the SPA was entered into, to mitigate third-party competition concerns.
    - 117.1.2 Any steps ATC may take to foreclose hardware rivals seeking to partner with Serato will not necessarily negatively impact the financial interests of Serato’s management. As detailed below, there are scenarios where we consider it would be in the interests of the merged entity to exclude hardware rivals.
    - 117.1.3 In such scenarios, there would be no incentive on the Serato sellers to enforce the clause 6 protections. inMusic provides the example of brand licensing “Serato” for Pioneer DJ hardware products.<sup>118</sup> Provided this potential action remained in the financial interests of Serato sellers (ie, had a positive outcome), which it would, the clause 6 protections would provide no meaningful mechanism to address the competition impact of this action.
  - 117.2 In addition, even if the Serato sellers were incentivised to enforce the protections, there are a range of very subtle mechanisms that ATC could use

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<sup>117</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.16]-[7.31].

<sup>118</sup> inMusic Cross Submission on the Statement of Issues (25 April 2024) at [48(c)].

to foreclose hardware rivals that would, at least arguably, not technically breach the SPA provisions. The more subtle the form of foreclosure, the more onerous it will be for Serato to prove that ATC is in breach of the clause 6 provisions.

117.2.1 As noted by Serato,<sup>119</sup> the clause 6 obligations are premised on the general requirement that ATC will “act in good faith” and, using “all reasonable endeavours” support the growth of Serato and maximise [ ].<sup>120</sup> In order to demonstrate that ATC has failed to meet the expectations established by these legal concepts, Serato will be required to engage in considerable factual analysis and legal argument regarding the nature of ATC’s breach and the alternative options available to it at the time. This will be a resource intensive exercise where the format of foreclosure is subtle and incremental over time.

117.2.2 Even if it could be established that ATC has failed to, for example, offer Serato products to Serato’s existing and prospective customers, provided ATC can show that it has nonetheless acted in good faith with a view to supporting the growth of Serato, it will be able to contest whether it has in fact breached the protections established by the SPA.

117.2.3 The fact of this contestability, in and of itself, raises competition concerns. It means that enforcing the protections will be resource intensive for the sellers and this will have bearing on whether they take up the argument.

117.2.4 For the duration of the Contingent Consideration Period, the interests of the Serato sellers rest on the working relationship with ATC remaining functional. As a result, we consider the Serato sellers will be reasonably cautious about raising disputes with ATC about subtle forms of foreclosure, such as minor increases in fees charged to rivals, or slight variations in the software offered to rivals.

117.3 In addition, it appears that the Parties could waive or renegotiate the clause 6 protections by mutual consent. [

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117.3.1 This means that the scope for the sellers to identify a breach of the protections is reasonably limited, as the SPA mandates [

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<sup>119</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at p 59.

<sup>120</sup> [

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117.3.2 It is also unclear as to how the terms of the SPA beyond Schedule 11 would apply, if at all, to any breach of the clause 6 protections that Serato seeks to enforce. As noted below, we seek further information on this point.

117.4 Finally, even if the SPA provisions do offer some protections, they are only in place for five years. Following the expiration of the provisions (which may be brought forward by mutual agreement), ATC will be free to take all of the actions that the clause 6 protections preclude.

118. We invite further submissions on:

118.1 the extent to which third parties will be able to enforce the protections established by clause 6, Schedule 11 of the SPA;

118.2 the likelihood of the sellers of Serato enforcing subtle breaches of the clause 6 protections, where the breach is in Serato's financial interests;

118.3 the legal mechanism Serato would rely on to enforce a breach of the clause 6 protections, including whether the terms of the SPA provide for this; and

118.4 the likelihood of foreclosure of third parties following the expiration of the clause 6 protections in five years.

### **Incentive to foreclose**

#### *What we said in the Sol*

119. In the Sol, we considered that the merged entity would likely have the incentive to foreclose. This is because:

119.1 margins for DJ hardware are high compared to margins for DJ software (which means the potential gains are high compared to the potential losses), meaning only a relatively small number of customers would need to switch to ATC's Pioneer DJ products to make foreclosure worthwhile; and

119.2 there may be many customers of rival DJ hardware providers that would be willing to switch to ATC's Pioneer DJ products because Serato software is so popular (which increases the likelihood that the merged entity would realise the potential gains).

#### *Submissions received*

120. ATC submitted that it has no incentive to breach the SPA and to suggest otherwise would be 'pure speculation'.<sup>121</sup> ATC would be subject to monitoring and significant

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<sup>121</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [7.37].

financial consequences,<sup>122</sup> and a breach of the SPA would cause significant damage to ATC's reputation.<sup>123</sup>

121. ATC submitted that there is no prospect of the SPA being renegotiated.<sup>124</sup> ATC would not be willing to pay Serato's valuation of the business – this was the reason for the earnout. There is no reason why Serato would waive the SPA conditions as it would adversely affect the earnout.
122. ATC submitted that it has no incentive to foreclose because:<sup>125</sup>
- 122.1 Engaging in foreclosure would reduce the value of the Serato business and trigger an impairment risk for ATC's parent company.
- 122.2 ATC has no history of attempting to foreclose its rivals.
- 122.3 A foreclosure strategy is not consistent with ATC's strategy.<sup>126</sup>
- 122.4 Growing DJ software is just as important as ATC's hardware business.
- 122.5 Engaging in foreclosure would damage ATC and Serato's reputations.
- 122.6 The foreclosure conduct may breach the law.
123. ATC also submitted that it would not be profitable for it to engage in foreclosure.<sup>127</sup>
- 123.1 Serato users would not be likely to switch to Pioneer DJ and are more likely to be loyal to their hardware and switch software; and
- 123.2 the Commission has not taken into account the financial consequences of foreclosure, including breach of the SPA and loss in value of Serato.
124. NERA submitted a report on behalf of ATC.<sup>128</sup> The submission mainly focuses on the incentive to foreclose.
- 124.1 To implement a foreclosure strategy, ATC would need to compensate Serato for missing out on the earnout (which NERA refers to as 'cashing out' the SPA). ATC would need to recoup the cost of that cash out through the

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<sup>122</sup> [

] (Commerce Commission interview with ATC (20 February 2024).

<sup>123</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [7.39]-[7.44]

<sup>124</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [7.32]-[7.35].

<sup>125</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [8.1].

<sup>126</sup> [

] Commerce Commission interview with ATC (20 February 2024).

<sup>127</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [8.3]-[8.5].

<sup>128</sup> NERA "ATC/Serato: Issues raised in the Sol" (8 April 2024).

foreclosure. This significantly increases the critical diversion ratios [ ] making it unlikely that ATC would have an incentive to foreclose.

- 124.2 Foreclosure would harm competition and innovation resulting in the overall market shrinking. This would reduce the incentive to foreclose.
- 124.3 A large proportion of Serato Lite users do not upgrade to Serato Pro and stop using the software altogether. These users should be excluded from the vertical arithmetic. Excluding these users significantly increases the critical diversion ratio [ ] making it unlikely that ATC would have an incentive to foreclose.
- 124.4 There are many Serato users that have existing devices who would not be affected by the foreclosure. There would be a delay for the full effects of foreclosure to take place, which reduces the strength of the effect.
125. Serato submitted that it would be unlikely that the Parties would be able to negotiate terms to “cash out” of the SPA.<sup>129</sup>
- 125.1 ATC would need to make an exceptional offer (however this would not likely be economically rational for it to do).
- 125.2 The vertical arithmetic model does not account for the cost of cashing out.

*Our current view*

126. At this point we are still not satisfied that the merged entity would not have the incentive to foreclose.
127. The Parties submitted that Serato would not be willing to waive its rights under the SPA without compensation and that it is unlikely they would be able to negotiate a value for the cash out. We accept there may be challenges in reaching a value that both Parties would agree on given their differences in valuation. We continue to consider this point.
128. If the Parties were able to negotiate a cash out, we do not agree that this would necessarily make foreclosure unprofitable. The Parties’ main argument is that, by engaging in a foreclosure strategy, ATC would need to recoup the cost of the cash out. This would significantly increase the critical diversion ratio (the number of customers of non-ATC hardware that would need to switch to Pioneer DJ to make foreclosure profitable) to a level that it is unlikely to achieve.
129. However, we consider that this approach does not recognise that through ‘cashing out’ of the SPA, ATC avoids the cost of the earnout. Avoiding the earnout would be a saving for ATC and ignoring this exaggerates the cost that ATC would incur from

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<sup>129</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [152]-[156].

negotiating a cash out. It is the difference between the cash out and the earnout that represent the additional cost that the foreclosure strategy would need to recoup.

129.1 If the cash out was greater than the earnout then it would represent an additional cost for ATC to recoup and therefore reduce the incentive to foreclose. In this case the cost to be recouped would be the difference between the cash out and the earn out (rather than the full cash out as the Parties suggest).

129.2 If the cash out was the same as what ATC would have paid under the earnout, ATC would face no additional cost to a foreclosure strategy. The results from the vertical arithmetic model that was in the Sol (which we considered indicated an incentive to foreclose) would still apply.

129.3 If the cash out turned out to be less than the earnout, then it would represent a cost saving to ATC which would increase the incentive to foreclose.

130. In a submission, NERA argued that the cash out is an additional cost.<sup>130</sup> NERA’s reasoning is that ATC was only willing to pay a certain value upfront (\$USD 65million) and therefore ATC’s expectation of the value of the earnout payments is zero. Accordingly, NERA claims the cash out would represent an additional cost that would need to be recouped if ATC engaged in foreclosure. We do not accept this argument. For the earnout to be zero would require that [ ].<sup>131</sup> We do not think it realistic that ATC would have had that expectation.

130.1 Serato’s projected [ ]. Serato included in its management presentation to potential buyers projections of [ ].<sup>132</sup> [ ]. ATC itself stated in the Application that the earnout is expected to represent a material proportion of the consideration.<sup>133</sup>

130.2 An ATC internal document, used to justify the purchase of Serato, [ ].<sup>134</sup>

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<sup>130</sup> NERA [ ].

<sup>131</sup> [ ].

<sup>132</sup> [ ].

<sup>133</sup> The Application at [3.2].

<sup>134</sup> [ ].

131. We are not satisfied that NERA's other arguments are sufficient to change our view that the merged entity would have an incentive to foreclose.
- 131.1 Although foreclosure may result in the market shrinking, at this point we have not seen any evidence to show the strength of this effect.
- 131.2 We do not agree that it is appropriate to exclude certain users of Serato Lite from the calculations. Serato earns revenue on all customers that purchase a device with Serato Lite through royalty and integration fees, regardless of whether these customers will continue to use Serato into the future. As such, they represent a potential loss to Serato which should be accounted for in the model.
- 131.3 Some customers who already own devices (or who buy existing devices) may not be affected by foreclosure. However, innovation is a source of competition in the market and hardware providers frequently release new products.<sup>135</sup> The foreclosure could adversely affect the constraint imposed by new releases of ATC's DJ hardware rivals. We are interested in further information about the extent to which new releases are important for competition in the market, and how often customers buy new devices.
132. As we note earlier, it is possible that ATC could engage in conduct where the breach is uncertain. While Serato may be eligible for contractual damages, if there is uncertainty over whether a breach occurred, the damages may be less than what ATC would need to pay under the earn out.
133. We invite further submissions on:
- 133.1 the likelihood of the Parties being able to negotiate a cash out;
- 133.2 the likely difference between the cash out and the earnout; and
- 133.3 the extent to which new releases are important for competition in the market.

### **Impact of foreclosure on competition**

#### *What we said in the Sol*

134. In the Sol we considered whether the competition lost from potentially foreclosed competitors was sufficient to have the likely effect of substantially lessening competition. We considered that:
- 134.1 there were unlikely to be counterstrategies that rivals could employ to defeat the foreclosure;

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<sup>135</sup> For example, recent releases by hardware producers include ATC's Omnis-Duo all-in-one system and DDJ-REV5 controller.



- 134.2 it is unlikely that sufficient efficiencies or new innovations could emerge and be passed on to customers that would offset the harm to competition; and
- 134.3 it was unclear that the impact on ATC's credibility or reputation in the market, or any legal requirements on ATC to continue to supply Serato's DJ software to rivals would be sufficient to prevent foreclosure.

*Submissions received*

135. ATC submitted that it would not engage in foreclosure as it would damage its reputation. Engaging in foreclosure would result in:<sup>136</sup>
- 135.1 an immediate loss of revenue and trigger an impairment risk for ATC's parent company; and
- 135.2 result in a massive outcry from Serato users.
136. Serato also submitted that foreclosure would adversely affect its reputation.<sup>137</sup>
- 136.1 An important selling point of Serato is broad compatibility. This allows a DJ to show up at a club with confidence they can perform using Serato. If Serato was to limit that compatibility, this would significantly reduce its reach and generate customer backlash.
- 136.2 Implementing a foreclosure strategy concerning DJ software and hardware would highly likely tarnish the reputation of the merged entity, affecting not just the DJ market but potentially souring its standing within the music production sector.

*Our current view*

137. We continue to hold the views set out in the Sol that any foreclosure is likely to impact competition.
138. We are not satisfied that rival DJ hardware providers have any counterstrategies that they could employ to defeat the foreclosure.
- 138.1 For the reasons set out in [89] it is unlikely that hardware rivals would be able to develop their own software due to barriers to entry and expansion. In summary:
- 138.1.1 Serato's DJ software has been developed over many years. It is likely that developing an equivalent software would be costly and time consuming, without any guarantee that customers will accept the software.

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<sup>136</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [8.1].

<sup>137</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [181]-[183].

138.1.2 Market participants have indicated that DJs are reluctant to switch between software providers.

138.2 It is unlikely that rivals would be able to compete effectively by supporting or acquiring another software provider. As noted above, the evidence does not suggest there are any other software providers that have the same brand strength as Serato. rekordbox might have been an attractive DJ software for DJ hardware providers to partner with but would not be an option under a foreclosure strategy.

139. We are not satisfied that the Proposed Acquisition will create sufficient efficiencies, or – to the extent they are created – that they will be passed on to consumers given our concerns over unilateral effects.

140. We are not satisfied that we can rely on reputational effects to prevent ATC seeking to engage in foreclosure.

140.1 We recognise that the most extreme foreclosure strategies could adversely affect ATC's reputation (such as immediately ending interoperability for all products). However, ATC could engage in partial foreclosure strategies which are less obvious (such as making the integration with rival DJ hardware providers longer or less effective). This would limit any reputation damage.

140.2 It is difficult to know with certainty the strength of the reputational effects ATC describes and whether they would be sufficient to ensure ATC would not interfere with Serato. However, Serato did not appear willing to rely on the strength of reputational effects since otherwise it would not have required the clause 6 provisions in the SPA.

140.3 We do not agree that the conduct would necessarily have the negative financial consequences that ATC suggests. Our analysis suggests that foreclosure is likely to be profitable and therefore enhance ATC's value.

140.4 Serato raised concerns that foreclosure would mean DJs would be in doubt whether they could use Serato when they arrive at a club. We understand that Pioneer DJ equipment is commonly used in clubs.<sup>138</sup> The foreclosure could have the impact of reinforcing Pioneer DJ's position in clubs. That is, clubs may be even more likely to choose Pioneer DJ in future to ensure the hardware is compatible with Serato.

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<sup>138</sup> For example, [ ] said that Pioneer owns the club space (Commerce Commission interview with [ ]). [ ] estimated that around 70-75% of clubs used Pioneer equipment (Commerce Commission interview with [ ]). [ ] said that Pioneer gear is typically found in clubs in Auckland and Wellington (Commerce Commission with [ ]).

### **Foreclosure at the end of the SPA**

141. We are still considering whether the merged entity is likely to have the ability and incentive to foreclose once the protections of the SPA have ended and whether this would amount to an SLC.
142. In most cases we consider whether an SLC is likely over a one-two year timeframe. However, doing so is convention rather than a legal requirement, and we do consider different timeframes where appropriate, on the facts of the relevant markets and proposed acquisition. In the current instance, we are of the view that it would be appropriate to consider a longer timeframe to take into account what might occur once ATC is no longer bound by the SPA provisions.
143. At this stage, there is insufficient evidence to satisfy us that laptop application competitors or mobile app producers will offer sufficient options for DJ hardware producers to partner with, such that Serato will not be an essential input over the next one-two years. The extent of any risk of foreclosure occurring in the next three-five years is less clear.
144. We have considered whether there is basis to hold the view that the conditions that result in the potential ability and incentive to foreclose now are likely to hold in five years' time, once ATC is no longer bound by the SPA provisions. However, there are some factors that make this unclear.
- 144.1 As the market does have some dynamic characteristics, market conditions could change significantly over that period. There may be new DJ techniques and the relative market positions of the participants may change significantly.
- 144.2 The five-year time period means rivals would have more time to develop an alternative to Serato.
145. On balance, we are not satisfied that an SLC is not likely due to potential foreclosure on the expiration of the SPA provisions after five years. We invite submissions on this point.

### **Access to sensitive information**

#### *What we said in the Sol*

146. In the Sol, we considered that the merged entity's potential access to DJ hardware rivals' sensitive information (such as upcoming innovations or customer information) through integrating rivals' DJ hardware with Serato's DJ software after the Proposed Acquisition could substantially lessen competition for the supply of DJ hardware.
147. This is because it could result in DJ hardware rivals being less incentivised to innovate if there is a risk that ATC could appropriate their ideas, or less inclined to integrate their products with Serato's DJ software, which would make their products less attractive. Both outcomes would reduce the constraint that rivals impose on the merged entity.

*Submissions received*

148. The Parties submitted that the Proposed Acquisition will not substantially lessen competition due to the merged entity's access to its DJ hardware rivals' sensitive information because there will be sufficient protective measures in place.
149. ATC submitted that such protective measures include:<sup>139</sup>
- 149.1 Serato implementing a confidentiality protocol (Protocol) post-acquisition to protect hardware partners' confidential information (in addition to Serato's existing confidentiality obligations with individual hardware partners);
- 149.2 ATC offering to enter into individual agreements with hardware partners to appropriately safeguard any confidential information provided to Serato within the Serato business without interference from ATC; and
- 149.3 the SPA provisions addressing any risk of ATC using competing manufacturers' confidential information. ATC submitted that if it were to breach these provisions, rival hardware manufacturers are likely to end their partnering arrangements with Serato or take legal action against Serato for breaching the relevant partnering agreement(s), hardware protocols and/or NDAs.
150. ATC disagreed that a hardware rival's perceived risk that ATC may access its confidential information would negatively impact innovation, given the Protocol and other measures.<sup>140</sup> ATC does not consider that hardware rivals choosing not to work with Serato will have less attractive products or have the effect of an SLC.<sup>141</sup>
151. ATC explained that in previous instances it has shared, in advance of release to the market, [ ]<sup>142</sup> [ ]<sup>143</sup>
152. Serato submitted that there will be sufficient measures to protect hardware rivals' planned innovations, customer information and incentives to compete, and to protect against the risk of coordination.<sup>144</sup>
- 152.1 The type of information to be shared with Serato will depend on the hardware partner's chosen level of Serato's involvement in the development of a new hardware and, according to Serato, even active involvement from Serato requires limited information sharing. Serato also noted that hardware

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<sup>139</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [10.4]-[10.6].

<sup>140</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [10.7]-[10.9].

<sup>141</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [10.10]-[10.11].

<sup>142</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>143</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>144</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [206]-[212].

partners that choose to limit the information shared with Serato will not experience significant competitive disadvantage.

152.2 Hardware partners have other protective measures within their control, including implementing the Protocol, partnering with other software providers or limiting the information they share with Serato (eg, by involving Serato after a product’s launch or announcing a new hardware before it becomes available).

153. Serato submitted that [

].<sup>145</sup> Further, users can [ ].<sup>146</sup>

154. Serato also expressed a view that:

154.1 Hardware prototypes would only need to be shared with Serato for software integration as late as two months prior to launch;<sup>147</sup> and

154.2 From its perspective, [

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#### *Our current view*

155. Serato’s argument that the information shared during the hardware/software integration process is not commercially sensitive is at odds with what market participants have told us. For example, one hardware provider told us that every piece of information shared during that process is commercially sensitive,<sup>149</sup> while another told us that the information provided to Serato during the integration process is its “absolute strategy” for taking on the competition.<sup>150</sup> Both hardware providers agreed that there would not be a way to retain the same level of integration with Serato without providing as much commercially sensitive information.<sup>151</sup> We continue to consider this point.

156. While we acknowledge the mechanisms proposed in the Protocol, we remain concerned that the proposed Protocol has material limitations.

157. The Protocol is intended to restrict the flow of confidential information from hardware partners that collaborate with Serato. We have identified the following

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<sup>145</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [217].

<sup>146</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [217].

<sup>147</sup> Serato “Submission in response to Commerce Commission Statement of Issues” (9 April 2024) at [202].

<sup>148</sup> Commerce Commission meeting with Serato and ATC (29 April 2024).

<sup>149</sup> Commerce Commission interview with [ ].

<sup>150</sup> Commerce Commission interview with [ ].

<sup>151</sup> Commerce Commission interviews with [ ].

limitations to the mechanisms intended to preclude the flow of confidential information from a hardware partner to ATC, via Serato:

157.1 [

].

158. Likewise, it is difficult to place weight on ATC's offer to enter into individual agreements with hardware partners to appropriately safeguard any confidential information provided to Serato. The Commission is unable to require that such arrangements are entered into and would not be privy to the negotiation and enforceability of any such future arrangements.<sup>152</sup>

158.1 We seek further information on how, post-acquisition, it is expected that hardware partners will be able to properly negotiate and enforce the safeguards ATC has offered to enter into.

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<sup>152</sup> ATC has provided the Commission with an early draft of such an agreement proposed to be entered into with [ ]. It is notable that the remedies section of the proposed agreement remains undrafted, and therefore difficult for the Commission to take comfort in the fact of these contemplated future arrangements.

159. Finally, ATC submitted that the terms of clause 6 of Schedule 11 of the SPA would “comprehensively address” any risk of ATC using competing hardware manufacturers’ information.<sup>153</sup> For the reasons set out in paragraph [117.3] above, we remain concerned that ATC could negotiate with Serato sellers to waive the clause 6 protections. Such renegotiation would extend to the measures ATC argues would preclude it from using sensitive information gained about hardware rivals.
160. Even setting that aside, we remain concerned about relying on protections designed specifically to safeguard Serato sellers’ financial interests to limit the sharing of rivals’ sensitive information between ATC and Serato:
- 160.1 Third-party hardware manufacturers will not have the ability to enforce the clause 6 protections. Only the Serato sellers have that ability, and there are likely to be a range of scenarios where it is not in their interests to seek to enforce a breach due to information sharing.
- 160.2 Third party hardware manufacturers will also have no visibility of whether a breach has occurred, or the ability to police information flows between Serato and ATC. While rival hardware manufacturers may seek to end their partnering arrangements with Serato if a breach is discovered, this action is premised on rivals first being able to identify that a breach has occurred.
- 160.3 The clause 6 obligations rest on ATC. While ATC’s “use” of the information may, according to ATC’s submissions, amount to a breach of clause 6, there is nothing in the SPA to preclude Serato from sharing the information with ATC in the first place. If a confidentiality breach arose due to the actions of Serato (intentionally or otherwise) it is highly unlikely that Serato would turn around and enforce a breach of clause 6 due to concerns that ATC had subsequently “used” the information.

## Conclusion

161. At this point, we are concerned that the Proposed Acquisition would give the merged entity access to commercially sensitive information of its rivals and that this would adversely affect competition. We invite further submissions on the points regarding the proposed Protocols and SPA mechanisms noted above. In addition, we seek further information on:
- 161.1 the extent of commercially sensitive information the merged entity would receive from hardware providers in advance of any product release, and the timeframe for sharing hardware prototypes;
- 161.2 whether there are ways that the Parties could eliminate or reduce the risk of sensitive information being shared between Serato and ATC post-merger; and

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<sup>153</sup> ATC “Submission by AlphaTheta Corporation on the Statement of Issues” (8 April 2024) at [7.37].

- 161.3 the extent to which competition could be adversely affected if ATC's hardware rivals did not share information with Serato until after a new hardware product's launch.

## Competition assessment: vertical effects for DJ software

### *What we said in the Sol*

162. In the Sol we considered that the Proposed Acquisition is unlikely to raise concerns that the merged entity would have the ability and incentive to foreclose its rivals in DJ software market if the market was considered in isolation.
- 162.1 ATC may have market power in the market for the supply of DJ hardware because of its [ ] market share and strong brand recognition. We also understand that it may be technically feasible for ATC to prevent software integration.
- 162.2 However, if this market is considered in isolation, it is unclear whether ATC would have the incentive to foreclose its DJ software competitors. This is because the margin on DJ hardware sales is high when compared to that of DJ software, so a large proportion of customers would need to be recaptured by ATC to make software foreclosure profitable.

### *Submissions received*

163. ATC agrees with the Commission's view that it would not have an incentive to foreclose DJ software providers. ATC further submitted that:<sup>154</sup>
- 163.1 ATC does not have the ability to foreclose since:
- 163.1.1a high market share, particularly in a dynamic market, does not necessarily indicate substantial market power; and
- 163.1.2 DJ software providers already have the technological capability to make their software compatible with ATC's hardware without any support from ATC, and the same providers will also be able to counter any preventative measures ATC may attempt.
- 163.2 ATC would not have the incentive to foreclose since it would be profitable to ensure widespread use of its products.
164. Serato submitted that it is not correct that existing rival DJ software providers need to grow before they become viable partners for rival hardware providers because DJ software competitors are already at a viable scale, DJ software competitors are already able to map to hardware providers without assistance and it is unlikely that rival providers could be pushed below a viable scale.<sup>155</sup>

<sup>154</sup> ATC "Submission by AlphaTheta Corporation on the Statement of Issues" (8 April 2024) at [9.1]-[9.6].

<sup>155</sup> Serato "Submission in response to Commerce Commission Statement of Issues" (9 April 2024) at [189]-[192].



### *Our current view*

165. We continue to hold the same views as expressed in the Sol. We do not consider it likely that the Proposed Acquisition would result in a substantial lessening of competition for DJ software when considered in isolation. However, as we set out above, we consider that ATC could inhibit rival DJ software providers integrating with Pioneer DJ devices to raise barriers and support foreclosure of DJ hardware rivals.
- 165.1 Consistent with ATC’s position, we consider that market share alone is not sufficient to conclude that a firm has market power. However, as we noted in the Sol, ATC seems to have held that market share over a period and has strong brand recognition, and it is possible that it has market power.
- 165.2 The evidence is that it is technically possible for DJ hardware providers to prevent DJ software from interoperating.
- 165.3 Although Serato said that rivals do not need integration with ATC to reach sufficient scale as we identified earlier the evidence suggests the inability to reach around [ ] of the market<sup>156</sup> would affect the decision to enter and invest in expansion in a market. While there may be niche entry, it is unclear that such entry would be sufficient to be a good alternative to Serato.
166. We invite further submissions on the ability and incentive the merged entity would have to foreclose DJ software competitors, as well as the extent to which ATC would be incentivised to foreclose these competitors as part of a broader strategy to foreclose DJ hardware rivals.

### **Next steps in our investigation**

167. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **27 June 2024**. However, this date may change as our investigation progresses.<sup>157</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
168. As part of our investigation, we are identifying and contacting parties that we consider will be able to help us assess the issues identified above.

### **Making a submission**

169. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. We welcome any further evidence and other relevant information and documents that the Parties or any other interested parties are able to provide regarding the issues identified in this Sol.
170. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference “AlphaTheta/Serato” in the subject line of your email, or by mail

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<sup>156</sup> See AlphaTheta/Serato Statement of Issues at Table 3.

<sup>157</sup> The Commission maintains a clearance register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **13 June 2024**.

171. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) so that we can work with you to accommodate your needs where possible.
172. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
173. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.