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Video content and broadband: a marriage made in heaven – but not for Sky NZ

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In the developed world there is now strong convergence between the retail pay TV markets and the retail broadband markets in which suppliers in both markets increasingly compete for the spend of the same consumers. This trend is likely to continue as the capability of fixed and mobile broadband networks continues to improve rapidly over the next few years. The functionality offered by unicast video services is clearly valued by consumers. But the success of the new services, and the extent to which these converged services impact on competition in the relevant retail markets for pay TV and broadband, will depend on the extent to which entrants can gain access to premium content and especially premium sports content.

Recently Plum provided economic and market advice to the third mobile operator in New Zealand, 2degrees, and TVNZ in support of their opposition to the merger between Sky Network Television (Sky) and Vodafone New Zealand (Vodafone). This analysis raises a number of competition issues of much wider relevance. We discuss these issues below.

The impact of high speed broadband on the pay TV market

Traditionally pay TV has been delivered via satellite and terrestrial cable networks. But the growing take-up of high speed fixed broadband services has led to new services being offered and substantial market entry which is changing the nature of competition in pay TV. Four main effects are observed.[i]

First, we have seen strong growth in the proportion of households which purchase pay TV services as part of a bundle with other telecommunication services. The key drivers appear to be the convenience of a single bill and of a single point of contact for service.

Second, we have seen additional entry by over the top (OTT) service providers which deliver audio-visual content on demand (VoD) to fixed broadband subscribers who pay separately for broadband access and video content. There are two main categories here: catch-up services of traditional broadcasters (normally offered free of charge); and standalone content services charged on a pay-per-view or subscription basis (SVoD). Typically these players charge a relatively modest subscription (£6 to £9 per month in the UK for Netflix) when compared with traditional pay TV providers (who might charge £50 plus per month).

75% of UK SVoD users also have a pay TV subscription

Third, at least in Europe, the emergence of unicast VoD services has reinforced the growth of pay TV at the expense of free-to-air TV services. This is occurring for both primary viewing via the main TV set and secondary viewing, where use of tablets and fixed broadband is replacing viewing over traditional secondary TV sets.

Finally, we note that access to video content is becoming increasingly important in the supply of mobile services as operators rollout 4G networks. 4G provides substantially higher data speeds (typically 10 Mbps in download mode) than previous mobile technologies at significantly lower incremental costs per GB delivered. They are therefore more suitable for viewing video content.

The importance of premium sports content to success in pay TV markets

A key factor for success in the growing pay TV market is access to premium content. This includes both premium sports content (especially big events viewed in real-time) and premium entertainment content. There is strong evidence that premium sports content is a good way to attract high ARPU subscribers.

Netflix has been successful in entering the pay TV market in many countries (including New Zealand) with a SVoD service. But this service is based on the supply of premium entertainment – rather than sports – content, and is sourced from both third parties and its own original content.[ii] We note that the Netflix price is set 80-90%

below the prices charged by traditional pay TV suppliers for bundles of content which include premium sport.

We also note evidence that any competitive constraint that new OTT services actually have on traditional pay TV, particularly where that pay TV includes premium sports, is so far only slight. In the UK, Ofcom's most recent Communications Review records that 75% of SVoD users also had a pay TV subscription, indicating that the services are complements rather than substitutes.[iii] Moreover, if OTT SVoD is seen as a substitute for pay TV, then we would expect its generally lower price to be a key reason for users adopting it – but only 15% of Netflix subscribers cited "Cheaper than pay TV" as a reason for subscribing.[iv]

Recognising this trend regulatory authorities in some countries – such as Australia, Singapore and the UK – have imposed regulatory constraints on players who control a substantial proportion of premium content rights, to protect the development of new forms of competition in the supply of pay TV services. No such regulatory constraints operate in New Zealand.

The impact on competition

The developments highlighted above impact on the level of competition in the telecommunications and pay TV markets in a number of ways:

- There is increased competition for end user revenues between traditional telcos (adding video content to their telecommunications offerings) and traditional pay TV providers (adding telecommunications products to their pay TV services so as to be able to supply unicast as well as broadcast services).
- There is growing competition between local pay TV operators and global SVoD providers like Netflix. The latter have significant competitive advantage in terms of their global economies of scale. But when considering access to content, these advantages are largely confined to premium entertainment content. The nature of premium sports content is more country-specific and depends upon which sports are popular in each country. At the same time the unicast Netflix OTT delivery platform is better suited to VoD delivery of premium entertainment than mass delivery of real-time sport;
- Bundling of TV and broadband helps to reduce customer churn and hence customer acquisition and retention costs.[v] This is of significant value to telecommunications operators. For example, it is likely to be the main reason why Vodafone in New Zealand currently resells Sky's content – despite the fact that it enjoys a wholesale margin well below a commercially viable level; and
- The ability for mobile operators to compete in the supply of 4G mobile services will increasingly depend upon access to premium video content.

The OECD, in its Digital Economy Outlook for 2016, has identified another competition issue which arises from pay TV and broadband convergence. Will zero-rating of TV content be pro- or anti-competitive?[vi] The OECD concludes that there may be harm to pay TV competition in the supply of broadband in countries where competition in access is limited.

Conclusion

The analysis shows there is now strong convergence between the retail pay TV markets and the retail fixed broadband markets, and this is likely to continue, but that the success of new services and extent to which competition in the retail pay TV markets will grow depends on the extent to which entrants can gain access to premium content and especially premium sports content.

Our assessment in New Zealand was that combining Sky's dominance of the retail and wholesale pay TV markets with the market power of the largest mobile and second largest fixed broadband provider, Vodafone, would weaken the ability of the combined entity's competitors, and hence lead to a substantial lessening of competition. The New Zealand Commerce Commission agreed – as the attached case study records.

Case study: New Zealand

In 2016 Sky Network Television (Sky[vii]) – a pay TV provider – and Vodafone New Zealand (Vodafone) – a fixed broadband and mobile provider – planned to merge their businesses in New Zealand and sought clearance from the New Zealand Commerce Commission (NZCC).

The NZCC can grant clearance if it is satisfied that the proposed transaction will not have the effect or likely effect of substantially lessening competition in a market. It applies a "with and without test", comparing the likely future state of competition with the transaction (the factual) with the likely future state of competition without the transaction (the counterfactual). The merger clearance regime is voluntary and there are no compulsory notification thresholds.

50% of NZ households subscribe to Sky TV

While New Zealand has well-formed telecommunications and competition law, there are acknowledged shortcomings which can severely constrain their effective application to

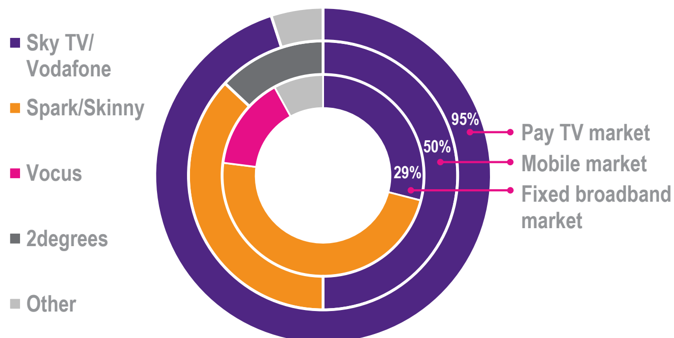
address video content and new market bottlenecks. In particular:

- the definition of “telecommunications” in the Telecommunications Act 2001 (which provides the NZCC with its powers to regulate the sector) explicitly states that it *“does not include any conveyance that constitutes broadcasting”;*
- the regulatory regime does not extend to audiovisual content, so the NZCC is unable to clear the merger on condition that unbundled content be offered to Vodafone’s competitors at wholesale rates;
- the NZCC cannot accept behavioural undertakings as a condition of a merger clearance (such as an undertaking by the merged entity to offer unbundled content to Vodafone’s competitors at wholesale rates);
- there are no open internet or net neutrality principles, voluntary or regulated; and
- the prohibition on abuse of dominance under Section 36 of the Commerce Act 1986 is widely viewed (including by the Commission) as all but unworkable.[viii,ix]

The pay TV, mobile and fixed broadband markets in New Zealand are concentrated. The wholesale pay TV market for the supply of content in New Zealand, like the corresponding retail market, is dominated by Sky: it self-supplies its retail business and resells content to one retail service provider – Vodafone. Sky’s wholesale terms are considered “restrictive”[x] – it requires all of its content to be taken as a bundle without any opportunity to re-brand, requires the reseller to accept that Sky will be its exclusive content provider and offers a wholesale margin considered commercially non-viable.

Post-merger market shares

Share of revenue



Source: Commerce Commission 2015

Note: fixed broadband shares based on subscriber share

In 2013 the NZCC conducted an investigation into Sky’s contracts[xi] and found that the key commitments in the contracts with retail service providers had both the purpose and effect of substantially lessening competition in the pay TV market. It took the view that these effects were unlikely to continue into the future and took no action.

After a lengthy investigation and deliberation in which the NZCC received the largest number of submissions for a clearance, it issued its final decision on 23 February 2017 and declined the merger. It noted:

- Sky Sports had been central to its analysis, and had Vodafone not been acquiring all the key premium sports content it would likely have been cleared;
- an increasing take-up of bundles that include fixed line, broadband and mobile as well as content;
- the merged entity would entice non-Vodafone customers to switch to the merged entity by offering attractive bundles; and
- that over time this would lead to a reduction in competition in both fixed broadband and mobile.

About Plum

Plum has conducted numerous assessments of the state of competition in markets, for operators and regulators around the world. These studies have employed a variety of methods including benchmarking, and the application competition law principles. Plum has undertaken merger analysis in the TMT sector and reviewed competition assessment developed by others.

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References

[i] Plum for the European Commission (December 2014), “Challenges and opportunities of broadcast-broadband convergence and its impact on spectrum and network use”.
[ii] Netflix plans to spend $7 billion on original content in 2017
[iii] Ofcom (August 2016), Communications Markets Report 2016, p64
[iv] *Id. p63*
[v] Tim Burnett (April 2014), “The impact of service bundling on consumers switching behaviour” Working Paper No.14/321, Centre for Market and Public Organisation
[vi] In which a subscriber’s consumption of data used to view TV content does not count towards his or her data allowance.
vii Sky is no longer related to the European company of the same name.
[viii] Dr Mark Berry, New Zealand Commerce Commission Chairman, (2013), “New Zealand Antitrust: Some Reflections on the First Twenty-Five Years”, presentation at Loyola University. http://lawecommons.luc.edu/cgi/viewcontent.cgi?article=1157&context=lucilr
[ix] Donal Curtin, Ex NZ Commerce Commissioner, (July 2016), “Are our laws allowing big companies to get away with anticompetitive behaviour?” http://www.listener.co.nz/current-affairs/money/big-companies-anticompetitive/
[x] TelstraClear, acquired by Vodafone New Zealand in 2012, had rebroadcast Sky content on its cable network in Wellington and Christchurch since 2002. During the negotiation of an extension to its supply contract in 2010, the then CEO Allan Freeth revealed the control exercised by Sky over its distribution partner, calling the deal “restrictive”. http://www.stuff.co.nz/business/industries/3620986/Unhappy-Freeth-turns-on-Sky-TV
[xi] Commerce Commission (October 2013), “Investigation report on Sky TV contracts”