REPORT TO THE MINISTER OF BROADCASTING AND THE MINISTER FOR COMMUNICATIONS AND INFORMATION TECHNOLOGY, FEBRUARY 2009

Television broadcasting: competition issues

Executive Summary

1. This paper brings together the views of the Ministry of Economic Development (MED) and the Ministry of Culture and Heritage (MCH) on competition in the television broadcasting market, and on whether there is a need for industry-specific regulatory powers for this sector.

2. The paper responds to the request of the Minister of Broadcasting and the Minister for Communications and Information Technology for officials to review submissions from interested parties on a discussion papers on broadcasting released in early 2008, and to make recommendations relating to competition issues.

3. The paper considers:

   - The purpose of regulation for competition reasons
   - The adequacy of the current regulatory regime for broadcasting
   - The extent of competition in the broadcasting market and likely market trends
   - The case put forward by submitters for and against introducing industry-specific regulatory powers
   - Options for regulation of the broadcasting sector for competition reasons.

4. As noted, this paper focuses on competition issues. Accordingly it is not about achieving social and cultural objectives for broadcasting (including public service broadcasting objectives). However, the paper does note that there are linkages between the two: for example, regulatory interventions may help achieve both competition and social and cultural objectives at the same time, and the less competitive the broadcasting market (in terms of diversity of choice) the more likely it is that the government will need to consider other interventions to help achieve its social and cultural objectives.

5. Key conclusions of the paper are that:

   - All other main OECD countries take a much more pro-active approach to regulating their broadcasting markets than New Zealand, which appears to be unique in relying on ex post application of general competition law to regulate the broadcasting market

- The television broadcasting market in New Zealand is more competitive (with more choice of providers, channels and information and entertainment options) than when the current regulatory regime was put in place approximately 20 years ago. At the same time, there is less choice in New Zealand than in most overseas markets (although this is characteristic of many markets in New Zealand)

- Likely market trends include:

  - Continuing increase in the range of information and entertainment options, including over the internet
  - The continuing dominance of Sky in the pay-tv market
  - Continuing pressure on the revenues of FTA broadcasters from audience fragmentation and market penetration by Sky

- There is no strong case at present for the introduction of specific regulation for the broadcasting sector

- There are some risks relating to competition in the broadcasting market in the future, including in relation to access to premium content and transmission platforms. However departments disagree on the magnitude of those risks.

6. Officials consider that there are two main options available to Ministers to address risks in the broadcasting market. These are:

   Option One: *Amend the Telecommunications Act to include broadcasting*, so that:

   - a widened Telecommunications Commissioner (a ‘Communications Commissioner’) may undertake market studies of broadcasting and make recommendations to Ministers as to whether particular services (e.g. access to broadcasting platforms or premium content) should be regulated

   - the Minister of Broadcasting (in consultation with the Minister of Communications and Information Technology), on the recommendation of the Commission, may add specific services to Schedule 1 by Order in Council. (The effect of this is that the Communications Commissioner may regulate the specific service or facility, but only if Ministers have first agreed that the service or facility should be regulated).

   Option Two: Take no further action at this time, but

   - make a general statement about the Government’s determination to maintain a competitive and diversified broadcasting market, and

- continue to keep a watching brief on market developments.

7. MCH favours *Option One (Amend the Telecommunications Act to include broadcasting)*. It considers that this option:

- pro-actively manages risks relating to anti-competitive behaviour by Sky in relation to premium content and terms and conditions for access to its platform (satellite capacity, set-top box and EPG[1]), including the cumulative effect of incremental increases in Sky's position in the market. The Sky platform is arguably an essential facility as any national television broadcaster seeking to enter the market must have a presence on the Sky platform to be viable, due to the large share of households that access television via that platform.

- enables the Commerce Commission to consider future potential market issues relating to a converged telecommunications and broadcasting market including the provision of broadcasting-type services over next-generation networks (NGN)

- incentivises market participants to avoid anti-competitive behaviour

- enables faster responses to the development of competition issues: delaying responses until problems have occurred may be too late

- is in line with the pro-active approach of other OECD countries generally.

8. MED favours *Option Two (take no further action at this time).* It considers that:

- there is no strong case for regulating the broadcasting market at this time. The current market appears adequately competitive and there are no compelling indications of future issues

- if the Government has concerns about the commercial viability of FTA broadcasters, there is a range of options available to it

- general competition law is adequate to deal with many potential competition issues relating to anti-competitive activity (such as exclusionary contracts). While general competition law is not up to the job of dealing with issues relating to terms and conditions for access to essential facilities, no such facilities have been identified at this time. MED does not agree that the Sky platform is an essential facility for new broadcasters, as alternative transmission options are available.

[1] Electronic Programme Guides, which provide programme information and may provide interactive features.

- there are costs and risks with regulation and extending regulatory powers (including direct costs, the tendency for regulation to increase in scope and complexity over time, and the potential chilling effect on investment and innovation), so the case for new regulation needs to be strong

- if it proves necessary in practice, it would be possible to extend the scope of the Telecommunication Act to include broadcasting in relatively short order (if necessary as a matter of urgency).

9. Officials note that Ministers will need to take decisions on their preferred approach and direct officials as required. Officials also note that MCH is providing advice for the consideration of the Minister of Broadcasting on a broadcasting 'Programme of Action' in relation to public service broadcasting and other (non-competition) issues.

Introduction

10. This paper brings together officials' views on competition issues in the broadcasting market in New Zealand. In particular it provides a response to the question:

- Is the current regulatory regime for broadcasting adequate, or should new regulatory powers be introduced (and if so, what)? In particular, should the Telecommunications Act be extended to cover broadcasting in a converged communications sector?

11. To answer this question, the paper considers:

- the purposes of regulation for competition reasons
- the current regulatory regime for broadcasting in New Zealand
- the current broadcasting market in New Zealand and market trends
- specific competition issues and concerns.

12. The paper is primarily based on a review and analysis of submissions and cross-submissions on discussion papers on digital broadcasting[2] released by the previous Government in 2008. A list of submitters is attached as Appendix A. It is also based on a review of selected literature, particularly OECD reviews of broadcasting.

13. The paper is not a full competition study, which would involve detailed review and analysis of the different markets in broadcasting, covering market structure, conduct and performance.[3] Rather, it is essentially a review of the

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[2] Digital Broadcasting: Review of Regulation
Volume One: The implications for regulatory policy of the convergence between broadcasting, telecommunications and the Internet
January 2008
http://www.mch.govt.nz/publications/digital-tv/DigitalBroadcastingReviewofRegulationVolumeOne.pdf

Digital Broadcasting: Review of Regulation
Volume Two: Discussion Paper
January 2008
http://www.mch.govt.nz/publications/digital-tv/DigitalBroadcastingReviewofRegulationVolumeTwo.pdf

Consultation Paper
Broadcasting and New Digital Media: Future of Content Regulation
January 2008
http://www.mch.govt.nz/publications/digital-tv/ConsultationPaperFutureofContentRegulation.pdf

[3] This would cover matters such as the constraints in each market posed by existing competition and potential competition (looking at market structure and conduct in each market) plus any other

case put forward in submissions for and against new regulation for the overall television broadcasting sector.

Scope of the review

14. An OECD study (2004) on "*The Implications of Convergence for Regulation of Electronic Communications*"[4] lists the following objectives for Government policy in the communications sector:

Economic objectives

- Promote and sustain competition and choice as a means of minimising price and maximising quality of communications services
- Encourage investment and innovation
- Maximise the contribution of the communications sector to economic growth and performance
- Efficient allocation of spectrum

Social and cultural objectives

- Affordable access to a universal service specified in terms of telephony, broadcasting and internet access
- Plurality of voices in the media
- Cultural diversity and national identity reflected in content
- Consumer protection and privacy

15. The OECD study takes the view that it is best to consider separately policies to achieve economic and competition objectives (in particular to promote and sustain competition) and social and cultural objectives. At the same time, the study recognises that the same broad set of policy measures (eg relating to market dominance) may deliver on both competition and social/cultural objectives (such as diversity of voices).

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factors imposing competitive constraints, with conclusions as to overall market performance in each sector.

[4] OECD 2004, *The Implications of Convergence for Regulation of Electronic Communications*, Report presented to the Working Party on Telecommunications and Information Services Policies, DSTI/ICCP/TISP(2003)5/FINAL.

16. By and large New Zealand's regulatory regimes do seek to maintain a clear separation between competition policy and policies to achieve social and cultural objectives. The reasons for maintaining this separation include:

- Polices are more likely to be effective and efficient if they are clearly targeted at identified problems and objectives
- Improved accountability for regulatory bodies (multiple and conflicting objectives reduce transparency and effectiveness)

Unnecessary regulation is more likely to be avoided: in some cases delivery of social and cultural objectives is more efficiently achieved through non-regulatory mechanisms (such as specific funding provisions for local content).

17. Accordingly, this paper focuses on the regulatory regime to achieve competition objectives and does not consider social and cultural objectives. Separate work is programmed to review the policy settings for achieving social and cultural objectives (and specifically the delivery of public service broadcasting objectives).

Why is competition important?

18. Competition plays a key role in efficiently allocating limited resources to produce goods and services to meet consumer demands. Markets without effective competition are likely to be characterised by limited choice, high prices, poor service and quality, and weak innovation and investment.

19. All OECD countries maintain regulatory regimes to ensure competitive markets. (Appendix B provides a brief summary of how competition is usually thought about from a regulatory perspective).

20. However, all OECD countries (as far as we know), take a more pro-active approach than New Zealand to addressing barriers to entry and significant market power in broadcasting. These approaches involve either pro-active, *ex ante* use of general competition law[5] or supplementing competition law by using industry-specific *ex ante* regulatory measures (including licensing). These measures also often have a strong focus on social and cultural objectives.

21. New Zealand's approach is unique in *ex post* reliance on general competition law to provide penalties and remedies (and the threat thereof) to address (or

[5] General competition law overseas (for example in the EU) often allows a competition regulator (rather than the courts) to impose penalties on activities it considers breach competition law, and to accept undertakings from market participants to act in certain ways to avoid threatened penalties. (Parties can appeal to the courts if they consider the regulator has incorrectly applied competition law). This contrasts with New Zealand where the Commerce Commission in unable to impose penalties itself for anti-competitive conduct, but must take a prosecution in court, and where the Commission does not have the power to accept undertakings.

prevent) competition issues in broadcasting.[6] [7] The focus of this paper is to consider whether this approach remains appropriate.

What is covered by the term broadcasting in this paper?

22. For this paper, the term broadcasting refers to television broadcasting. Television broadcasting covers "television-like" services, comprising linear audio-visual programming[8] compiled by a broadcaster and delivered by any means, whether terrestrial, satellite, internet or mobile network to any device, whether television set, computer, or mobile or portable equipment. The review does not relate to radio broadcasting, on-demand audio-visual material or user-generated content.

What is meant by markets in this review?

23. Market definition is important. It seems likely that there would be significantly different answers to a question about whether a market is competitive (and whether there are significant barriers to entry and expansion) if one is talking about the *combined* pay-tv and FTA television broadcasting market, or *separate* pay-tv and FTA markets. Similarly, there would likely be a different answer again in considering the market for television *transmission* facilities.

24. For the purposes of this review, we have kept it simple, focusing essentially on the *overall television broadcasting market*, meaning a combined FTA and pay-tv market, and considering whether there are barriers to entry and expansion in this market. This recognises that FTA broadcasters are in competition with pay-tv (as well as each other) and that Sky operates in both markets. It is also in line with submissions on the broadcasting review, where broadcasters and commentators alike see FTA broadcasters competing both with each other and with Sky, and Sky competing with FTA broadcasters.

[6] While it is correct that New Zealand relies on *ex post* general competition law to regulate the broadcasting market, two ex ante regulatory measures have been put in place in the broadcasting sector for competition reasons:

- First, access obligations have been imposed on the three DTT (digital terrestrial television) multiplex operators through their licences: Kordia must grant access to new FTA TV channels, and do so on certain terms; TVNZ and MediaWorks must do the same, if they have any unused capacity after 11 March 2010

- Second, under section 88 of the Copyright Act 1994, "must-offer" applies to FTA channels, for the benefit of pay-tv cable retailers (the only cable TV operator in New Zealand at present is TelstraClear).

[7] Hong Kong shares with New Zealand a very limited reliance on ex ante regulatory measures in the broadcasting sector, but it is not an OECD member.

[8] In the sense of a programme schedule, as distinct from "on demand" audio-visual material. While the boundaries between broadcasting and on-demand services are blurring, it remains relevant to consider broadcasting as a distinguishable activity.

The issue of concern to submitters was whether this overall market requires regulation to facilitate and maintain competition (and to achieve public service broadcasting objectives). We have taken a similar focus here.[9]

Current regulatory regime

25. As noted, New Zealand relies on its general competition law, the Commerce Act 1986, to maintain a competitive broadcasting market.

26. The Commerce Act has three key provisions which are intended to maintain the conditions for a competitive market:[10]

- *Section 27*, which prohibits contracts, arrangements or understandings that have the purpose or have, or are likely to have, the effect of substantially lessening competition in a market

- *Section 36*, which prohibits a person taking advantage of a substantial degree of market power for the purpose of restricting entry to, preventing or deterring competitive conduct in, or eliminating any person from that or another market

- *Section 47*, which prohibits the acquisition of assets of a business or shares if this would have or be likely to have the effect of substantially lessening competition in a market. (The Commission may give a clearance for an acquisition which it considers will not result in a substantial lessening of competition,[11] or it may grant an authorisation for an acquisition where it considers there will be net benefits to the public).

27. By and large (and thinking across sectors and market generally), MED considers that section 27 (prohibiting anti-competitive arrangements) and section 47 (relating to business acquisitions) work reasonably well and effectively. There is some uncertainty about the effectiveness of s27 and s47 in circumstances *before* a competitive market has developed, and about the

9 This approach contrasts with that taken by the Commerce Commission when it analysed whether to clear Sky's application to acquire Prime. The Commission defined pay-tv and FTA broadcasting as separate markets. (This is a conservative approach: if the Commission concluded, as it did, that the acquisition would not substantially lessen competition in either market, then it would be highly unlikely to substantially lessen competition in a wider or combined market). Similarly, where the level of competition in the pay-tv market is of concern to policy makers and regulators, analysis focuses solely on that market. For example, Ofcom (the UK regulator for telecommunications and broadcasting) is currently considering new market rules to improve competition in the pay-tv market: as a consequence it defines premium content as (inter alia) content which has broad audience appeal and is exclusive to pay-tv.

10 Additionally, Part 4 of the Act provides for regulation (such as price control) where goods or services are provided in a market with little or no competition or prospect of competition (in particular by natural monopolies).

11 A crucial decision under this provision was the Commerce Commission's clearance in November 2005 of Sky's acquisition of the broadcasting assets of Prime.

effectiveness of s47 in dealing with "creeping acquisitions",[12] but as a general rule these provisions do the job for which they were designed.

28. Section 36 is considered to be less effective, in particular in dealing with disputes over access to what is loosely referred to as "essential facilities" (which are facilities or services or assets that firms need access to in order to compete in the market). [13] Disputes arise in particular where the owner of the facilities is a vertically integrated firm involved in downstream markets, which creates a strong incentive to make access difficult or expensive for competitors in those markets.

29. The main reasons why s36 has proven problematic in dealing with disputes concerning access to essential facilities include:

- Cases are very complex and costly. In particular it is extremely difficult to prove that the test for anti-competitive conduct has been met. Detailed and hypothetical analysis is required.

- A cause of action only arises after conduct has occurred and cases take a long time to get a resolution (up to six years if all appeal rights are taken). By this time, considerable harm may have been caused in the market. Potential entrants are often discouraged and turn their attention elsewhere.

- It is generally difficult for the courts to impose remedies which provide for access to the facilities on an on-going and effective basis. The courts are generally unable or unwilling to put in place and monitor regimes on access pricing or for resolving technical disputes. The courts do not have the

[12] "Creeping acquisitions" relate to small acquisitions which, one by one, may not result in a "substantial lessening of competition", but which cumulatively may have a material impact. The Crown's radio spectrum allocation policies have in recent years included pro-competitive rules (such as acquisition caps and "use or lose" provisions) because of uncertainties about the effectiveness of s47 in dealing with "creeping acquisitions" as well as concerns about the potential for spectrum hoarding.

[13] The New Zealand High Court has determined that there is no general obligation on firms under s36 to supply goods and services to their competitors. The courts have determined that two criteria must be met before an obligation to supply can exist:

- access to the good or service must be "essential" – that is, it must not be practically duplicable, there must be no close substitutes for the facility or input, and it must be a necessary facility or input for competition in the pleaded market; and
- the defendant firm must control the facility or input. If the same facility or input is available elsewhere, then the firm would not be dominant or hold a substantial degree of market power in the pleaded market.

Regarding the terms and conditions of supply, the precedent-setting case in New Zealand is Telecom vs. Clear Communications where the Privy Council determined that it was not anticompetitive for a firm to supply its competitors at a price which recovered the opportunity cost to the firm of that supply. At this price, only existing or potential competitors that are equally or more efficient than the incumbent would be viable.

investigative powers of a regulator, and are generally unable to monitor the ongoing conduct of a firm, periodically review access terms or head-off potential anti-competitive behaviour.

30. For over a decade, following passage of the Commerce Act and deregulation in the late 1980s and early 1990s, New Zealand relied solely on general competition law to provide for competitive markets in all sectors, including markets where entry was dependent on access to essential facilities, such as telecommunications, electricity and gas. Concerns arose however, that the costs, time, ineffectiveness and uncertainty of court action under s36 effectively discouraged entry into these markets. For this reason, industry-specific regulation was put in place in telecommunications, electricity and gas to require incumbents to provide access to essential facilities on reasonable terms and conditions and in a timely manner.[14]

31. The regime put in place for telecommunications, in 2001, following a Ministerial Inquiry into Telecommunications, had the following broad provisions relating to competition:[15]

- Establishment of a Telecommunications Commissioner within the Commerce Commission

- A requirement for telecommunications service providers to provide access to particular services (set out in Schedule 1 to the Act) to other telecommunications service provides (i.e. competitors). Pricing principles and other principles for access terms and conditions were specified in Schedule 1

- The ability of the Telecommunications Commissions to make a determination on access terms and conditions

- Power for the Telecommunications Commissioner to make recommendations to the Minister of Communications to add new services to the list of regulated services (Schedule 1) where that would be in the long-term interests of telecommunications users

[14] By and large, other countries did not rely on their general competition law to regulate utilities like telecommunications, electricity and gas. Instead, they put in place industry-specific regulatory and licensing regimes when they deregulated. Interestingly, and perhaps instructively, New Zealand subsequently went further than most other countries in telecommunications and electricity by requiring comprehensive *structural separation* between non-competitive (essential facilities) and competitive service *in addition to* providing for industry-specific access regulation.

[15] A separate part of the Act provides for “Telecommunications Service Obligations” (in effect social obligations, like universal service and free local calling). It requires all telecommunications service providers to pay for TSOs (with contributions to be determined by the Telecommunications Commissioner), and it provides powers (and processes) to introduce new TSOs.

- Powers for the Telecommunications Commissioner to monitor market developments and undertake market studies.

32. A key issue considered in this paper is whether a similar regime should be introduced for broadcasting, or, more specifically, whether the Telecommunications Act should be broadened to include broadcasting.

33. With regard to any widening of the Telecommunications Act, sub-options would be to:

    (i) Extend the scope of s9A to enable the Commerce Commission to monitor and undertake market studies of a widened communications market, including broadcasting; *or*

    (ii) In addition to (i), enable a widened Telecommunications Commissioner (a 'Communications Commissioner') to make recommendations to relevant Ministers (Communications/Broadcasting) as to whether any particular services should be added to Schedule 1 (regulated services) by Order in Council; *or*

    (iii) In addition to (i) and (ii), populate Schedule 1 with particular services (eg access to set-top boxes and EPGs) as part of any amending legislation (as was done when the Telecommunications Act was passed).

34. The limitations noted above regarding s36 do not mean that we necessarily require an industry-specific regulatory regime for broadcasting. That issue needs detailed consideration, and is the subject of later sections in this paper. What it does say however is that it would be unrealistic to rely on s36 to provide effective redress for any anticipated competition problems in broadcasting relating to access to essential facilities. Such 'facilities' might include set-top boxes[16] and EPGs,[17] transmission facilities and, possibly, in some circumstances, premium content.[18] Whether there are significant access issues here is considered in later sections.

Current broadcasting market and future trends

35. The next section:

- Summarises the current retail broadcasting market

- Assesses the extent to which it is competitive

[16] Devices that sit near to a TV to act as a tuner and, in the case of pay-tv, a decoder of encrypted signals.

[17] Electronic Programme Guides.

[18] For example, if a dominant broadcaster had acquired long-term rights to all or most premium content such that entrants and competitors could not compete.

- Identifies some likely near-term high-level trends and considers the impact on competition in the market. (Specific competition issues are considered in a later section).

Current retail broadcasting market(s)

36. Table One summarises the current retail television broadcasting market(s) based on the transmission mechanism and population coverage.

Table One: Television channels

Model	Transmission mechanism	Channels	Estimated population coverage (%)
FTA	**Analogue VHF**	TV1	99
		TV2	99
		TV3	95
		C4	75
	Analogue UHF	Prime	>90
		Maori Television	85
		TAB Trackside (part-time)	85
		8 – 10 Regional channels	Regional
	Digital terrestrial (Freeview HD)	TV1, TV2, TV3, C4, Maori TV, TVNZ6, TVNZ7, Sports Extra, Parliament TV + Chinese TV8, tvCentral[19]	75
	Digital satellite (Freeview)	TV1, TV2, TV3, C4, Maori TV, TVNZ6, TVNZ7, Sports Extra, Parliament TV + Stratos, Cue, Te Reo	100
Pay-TV	**Analogue UHF (Sky)**	3 channels I channel (part time with TAB Trackside)	85
	Digital satellite (Sky)	80+ channels	100
	Digital satellite (UBI World)	75+ channels	100
	Digital satellite (Vision Asia)	8 channels	100
	Digital cable (TelstraClear)	70+ channels[20]	Regional

Free-to-air (FTA) television

- There are two main FTA providers, TVNZ and TVWorks, and a number of smaller channels, including:
  - Maori Television (funded primarily by the Government)

[19] tvCentral is broadcast in the Waikato region only

[20] Resale agreement with Sky; wholesale agreements with FTA broadcasters

- Prime (owned by Sky, following clearance by the Commerce Commission in 2005)
- Several newer channels, such as Stratos and Parliament TV
- 8 to 10 regional channels.

- TVNZ operates four channels, TV One and TV Two and another two digital-only channels, TVNZ 6 and TVNZ 7, on the new Freeview platform. TVNZ is fully government-owned. It operates under a charter with the Government, which sets out its public broadcasting obligations. Some 90 percent of its revenue is from advertising and other commercial activities, with the balance directly or indirectly from Government (charter funding, NZ On Air, and Te Mangai Paho). TVNZ 6 and 7 (which are advertising-free) commenced operations in 2007 and 2008 respectively with $79m in Government funding spread over 6 years.

- TVWorks operates two channels, TV3 and C4 (music TV). TVWorks is owned (ultimately) by Ironbridge Capital, which is an Australian private equity fund.

Freeview

- Freeview is a not-for-profit organisation established by TVNZ, TVWorks, Maori Television and Radio New Zealand to package and promote FTA digital tv and radio services. Freeview currently has the capacity for approximately 18 channels. It currently carries all national FTA TV channels except Prime, which is not a member of the Freeview consortium.

- Freeview was launched in 2007 with a satellite service, and a high definition-capable terrestrial service was launched in April 2008. The Government provided funding assistance of $25m over 5 years for the terrestrial service. Market penetration levels as estimated from set top box sales are at 12.6 percent (December 2008), which is ahead of Freeview's forecasts.

Pay-tv

- The market has one major pay-tv operator, Sky, which offers more than 80 television, radio, audio music and games channels on a subscription basis. It commenced operations in New Zealand in 1991. About 90 percent of its service is now provided by satellite and the rest by a UHF service.

- Sky is a publicly listed company on the NZX and the ASX. It is about 45 percent owned (ultimately) by News Corporation, which is a diversified international media and entertainment company based in the USA and operating world-wide.

- Sky has about 765,000 subscribers (end 2008) which is a market penetration of about 45 percent of NZ households.

- The number of Sky subscribers shows continuing but slowing growth over the last few years:

Year ending June	**2005/06**	**2006/07**	**2007/08**	**2008/09** (est.[21])
Total subscribers	667,000	711,000	749,000	779,000
% change		+6.6	+5.3	+4.0

- There are two new small, specialist pay-tv operators (UBI World TV and Vision Asia) focusing on ethnic groups and offering channels by satellite, with transmissions originating in Australia.

- TelstraClear provides cable tv in Wellington and Christchurch, but this is essentially a re-selling service of Sky tv.

Internet television

- Both Sky and TVNZ offer on-demand tv for specific content via the internet. Sky's service is by subscription, while TVNZ's is free. (TVNZ initially had both free and paid content, but subsequently went to a fully free model supported by advertising).

- Linear broadcasting of some international TV channels is also available on the internet (e.g. from www.livestation.com).

IPTV

- IPTV refers to the provision of digital television services delivered using Internet Protocol on a dedicated and discrete service provider network. It enables high quality services, and potentially triple play offers of television, internet and telephony. IPTV differs from internet television (which as the name implies, is delivered over the internet) in that it is a dedicated and managed end-to-end service. It is usually delivered by telcos using their telecommunications lines and/or cable TV and satellite capacity.

- While some telcos, particularly Telecom have investigated and trialled providing IPTV, no IPTV services are currently available. The Commerce Commission has expressed doubt about the prospects for IPTV in New Zealand.[22]

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[21] Sky's 2008 annual report
[22] "Discussion paper on Next Generation Networks", 24 December 2008. http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/Inquiries,ReviewsandStudies/ContentFiles/Documents/NGN%20Discussion%20Paper_Final%20_241208.pdf

Mobile

- Selected Sky TV content is available to customers on Vodafone mobile phone packages.

<u>Market shares</u>

37. Tables Two and Three show audience shares for "primetime" (6pm to midnight) and for daytime plus primetime (6am to midnight) respectively.

38. Market shares by company are estimated for the end of 2008 as follows:

Retail TV broadcasting market (pay and FTA[23]): Prime-time (6pm to 10:30pm)

- TVNZ 52% [TV One 31%, TV2 21%]
- Sky (inc Prime) 25% [Sky Network 19%, Prime 6%]
- TVWorks 22% [TV3 19%, C4 3%]

Retail TV broadcasting market (pay and FTA): All day (6am to midnight)

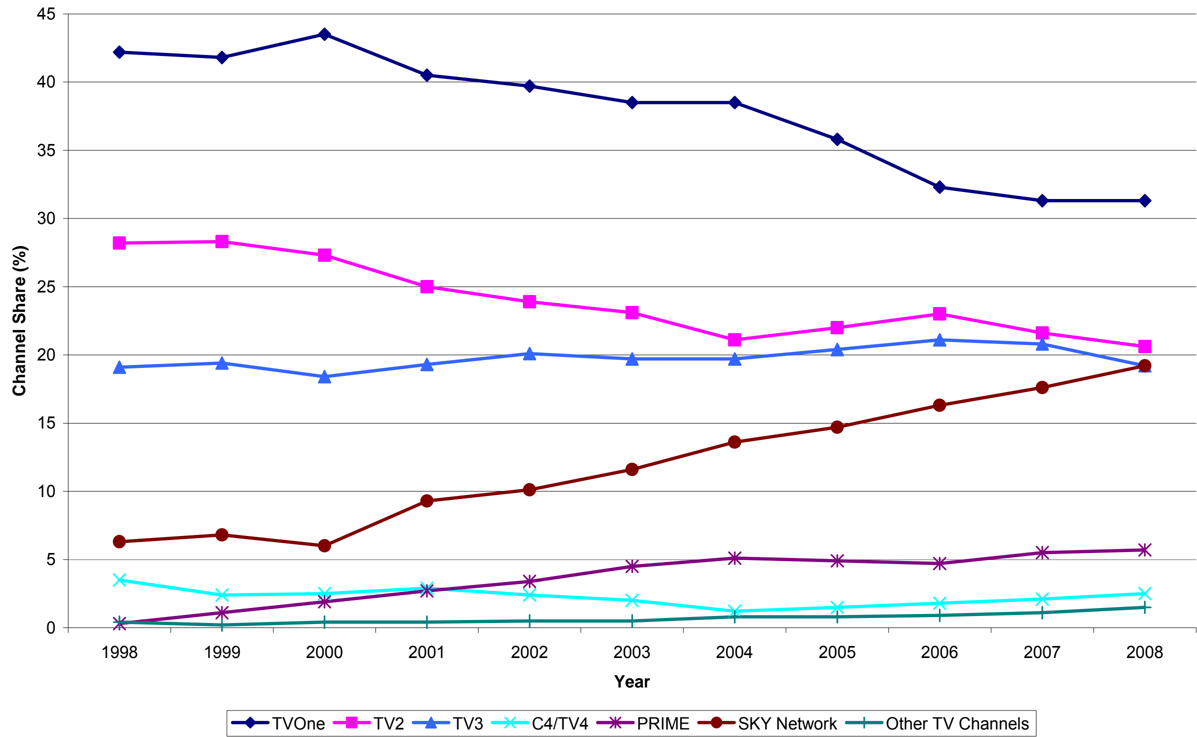
- TVNZ 45% [TV One 27%, TV2 18%]
- Sky (inc Prime) 34% [Sky Network 28%, Prime 6%]
- TVWorks 20% [TV3 17%, C4 3%]

39. It is noteworthy, that Sky's market share has been steadily increasing since 2000. It is unclear the extent to which this trend will continue. In the FTA market, TVWorks (TV3, C4) has generally maintained market share over the last decade in the face of competition from Sky, while TVNZ (TV One and TV2) has lost market share.

40. With regard to the pay-tv market, it is evident that Sky has a very high market share (likely well over 95%).

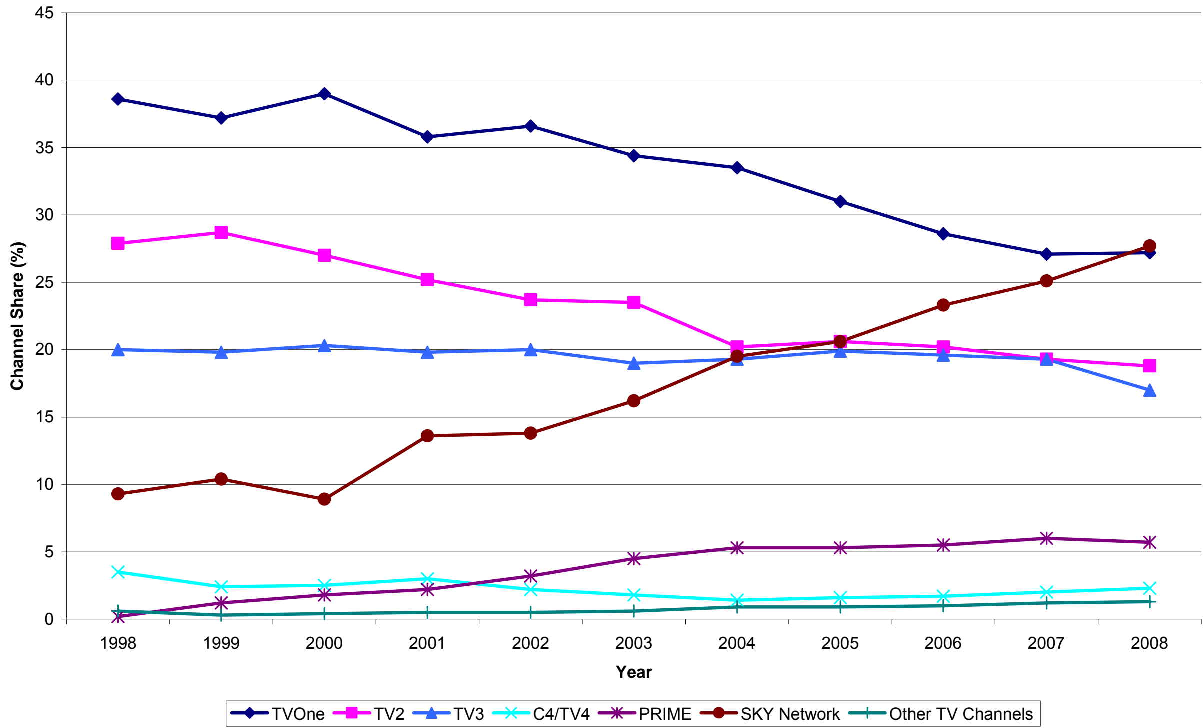
[23] The FTA market share includes audiences viewing FTA channels via Sky's set-top box.

Table Two: Prime-time (all people aged 5+ from 6pm to 10:30pm)



Note: Up to August 2000, reported viewing was only to the Sky Channels on the UHF service, From August 2000 onwards viewing to the Sky Satellite channels is included. Period: 1 January to 31 December. Source: AGB Nielsen Media Research

Table Three: All day (people aged 5+ from 6am to midnight)



Note: Up to August 2000, reported viewing was only to the Sky Channels on the UHF service, From August 2000 onwards viewing to the Sky Satellite channels is included. Period: 1 January to 31 December. Source: AGB Nielsen Media Research

How competitive is New Zealand's television broadcasting market?

41. As noted at the start of this paper, for the purposes of this review, the television broadcasting market in New Zealand is defined to cover both pay-tv and FTA television (rather than separate pay-tv and FTA markets).

42. When thinking about the effectiveness of competition in a market, the following questions usually arise:

- Do consumers have real choice (of providers and services)?
- Is there evidence of excessive prices?
- Is there evidence of poor quality, poor service, and/or lack of innovation and investment?
- Are there significant barriers to entry and expansion (and exit)? This is a key question, since market power is difficult to sustain in the absence of such barriers.

Do consumers have real choice (between suppliers and services)?

43. There is little doubt that New Zealand consumers have far more choice of television services than used to be the case. When the Broadcasting Act, which set up the current regulatory framework was passed in 1989,[24] there were three channels provided by two broadcasters on one transmission platform (VHF).[25] Consumers now have a choice of well over 100 channels from multiple broadcasters, including a wide range of special interest channels. Consumers can chose between pay-tv and FTA television, and a range of transmission mechanisms (VHF, UHF, satellite, mobile and internet).

44. Having said that, there is less choice (of providers and channels) available to New Zealand viewers than in many OECD countries, and in particular there is only one significant pay-tv provider and three main FTA providers. This is likely to be largely a function of New Zealand's small and spread-out population and its isolation (which limits satellite coverage and terrestrial coverage from neighbouring countries). The issue to be considered further in later sections is whether it is also a function of barriers to entry.

Is there evidence of excessive prices?

[24] The Broadcasting Act abolished requirements for broadcasting licences. This allowed for market entry by any party able to secure spectrum (which was made available at auction where demand exceeded supply, and on a first-in-time basis elsewhere) subject only to the Commerce Act and meeting content standards.

[25] The main competition complaint at that time was from TV3, which argued that the then TVNZ's ownership of two channels enabled it to compete unfairly with TV3 by segmenting audiences between its two channels.

45. Excessive prices would tend to indicate lack of competition. FTA television does not charge consumers (by definition), but does charge advertisers. Officials are unaware of any evidence that advertising rates on FTA demonstrate sustainable market power.

46. More contentious is whether Sky's subscription prices are excessive. In submissions, some of Sky's competitors come close to implying they are. TVNZ also argued that Sky's bundling of blocks of channels (rather than allowing *a la* carte subscriptions) is indicative of market power. Sky strongly disputes claims of excessive prices, arguing that its subscription rates are lower than or comparable with pay-tv operators in major overseas markets (although it acknowledges that it offers fewer channels)[26] and it says that packaging of services is normal pay-tv practice.

47. Sky's overall level of profitability (around $100m per annum) has not sparked claims of excessive profit-taking. The current reported profit represents an 8.2% return (after tax) on equity investment. Sky also reported accumulated losses exceeding $220m prior to 2003.

48. Some commentators have argued that Sky's subscriber numbers are likely to plateau, and that it will need to drop its prices if it wants to significantly increase its subscriber numbers. This is likely to conflict with its wish to increase per subscriber revenue, especially if the pace of subscription growth slows.

Is there evidence of poor quality, service, innovation or investment?

49. It is hard to argue that there is any compelling evidence of the poor quality, poor service, poor innovation and low investment that are often characteristic of non-competitive markets. Instead, there is clear evidence of reasonably timely introduction (taking into account New Zealand's relatively low per capita GDP by OECD standards) of new services including new channels, and new technologies such as widescreen, high definition tv and personal viewing recorders. Arguably, the increase in special interest channels (on Sky, in FTA, and in new pay-tv services) indicates a reasonably healthy market. MCH notes however that there are no IPTV services, the new FTA channels (TV6 and 7) aer largely public-funded, and the new pay-tv services are focused on ethnic groups and originate from Australia.

Are there significant barriers to entry?

50. This is a key question in competition studies, since market power is only likely to be sustainable over time if there are significant barriers to entry and

[26] Sky's annual reports show a total rise of 8% in revenue per satellite subscriber over the 2004 to 2008 period, although no information is provided to show the extent this rise is from additional services purchased (for example pay movies) or simply general price increases. In any event, prices rises of this magnitude are in line with CPI movements.

expansion (and exit). Barriers to entry may be structural, strategic or regulatory.[27] Clearly there are always barriers to entry that relate to the investment required, the need to win customers away from incumbents and so forth. The issue however is whether there are barriers that can and should be removed, and/or that are the consequence of anti-competitive behaviour by incumbents. This is a more complex issue, and is the subject of detailed discussion in later sections of this paper.

Likely general market trends affecting the extent of competition

51. The following sub-section offers some thoughts (based on submissions and OECD material) about market developments affecting the extent of competition in the broadcasting market over the next 5 or so years. Officials discern the following broad trends:

(i) *Continuing increase in availability of tv programming services over the internet*

52. As noted earlier, while internet television is already available in New Zealand, there is doubt that IPTV (which is a dedicated network providing high quality television services) will emerge in the near future, notwithstanding its availability in most OECD countries. The Commerce Commission considers that there are impediments to the commercial viability of IPTV in New Zealand, including cost, coverage, and the nature of New Zealand's subscription TV market. [28]

53. However, both on-demand content and linear programme material (ie television broadcasting) over the internet (internet television) is expected to continue to increase. Market penetration is unlikely to be dramatic, at least for the next few years. High quality (and particularly high definition) tv requires considerable bandwidth (high Mbps), which in turn requires ultra-fast broadband to the home. Even with the government's ultra-fast broadband initiative, and Telecom's undertakings under the operational separation agreement, it will take a number of years to achieve a high level of population coverage. Viewers also need to pay ISP charges for premium capacity.

54. The expected increase in television content on the internet is likely to increase the extent of competition in the television market, but mainly through providing more TV services from international broadcasters. It is unlikely that there will be a material increase in the availability of *local* (New Zealand sourced) TV services, because the internet is simply a medium for transmission of existing TV broadcasting services. (That is, the development

[27] See Appendix B for definitions.

[28] "Discussion paper on Next Generation Networks", 24 December 2008, pp 17 and 21. http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/Inquiries,ReviewsandStudies/ContentFiles/Documents/NGN%20Discussion%20Paper_Final%20_241208.pdf

of a new medium for transmission is unlikely, in itself, to increase the quantum of tv broadcasting services in New Zealand). However, the internet will continue to increase commercial pressures on TV broadcasting by increasing the availability of entertainment options, including self-generated and on-demand audio-visual material.

(ii) Continuing dominance of Sky in the pay-tv market

55. Notwithstanding the recent emergence of new Australian-sourced pay-tv operators (UBI World and Vision Asia, which essentially provide channels for minority ethnic groups), it is unlikely that any serious competitive threats will develop to Sky's dominance in the pay-tv market. Absent any regulatory interventions, Sky is likely to continue to secure the bulk of premium live sports, and is unchallenged for the pay-tv window for blockbuster movies. It also has a high level of sunk investments in subscriber equipment (satellite dishes and decoders), an attractive programme package, a dominant position in several delivery platforms (satellite, UHF and mobile) and a strong incumbency position, making it very difficult for new entrants into the pay-tv market.

56. Sky (in common with other broadcasters) will however be faced with the continuing development of alternative sources of information and entertainment, particularly on the internet. Moreover, further significant growth in revenues is likely to depend on increasing per-subscriber revenues (requiring higher prices) or subscriber numbers (which may require lower prices).

57. News reports[29] in early 2008 indicated that TVNZ was considering pay-tv options on "Freeview Plus" such as pay-per-view channels offering premium content. Officials are not aware of the status of any pay-tv plans by FTA broadcasters, and consider that commercial viability is likely to be challenging.

(iii) Continuing pressure on FTA broadcasters

58. FTA broadcasters are likely to continue to come under commercial pressure, particularly from Sky as it continues to gain audience share (albeit at a slower pace). Increased market penetration of Sky results in lower audience shares for FTA broadcasters even though all FTA channels (except advertising-free TVNZ 6 and 7) are available on Sky.[30] FTA broadcasters, which depend on advertising revenue, will also continue to come under commercial pressure from audience fragmentation generally, including from diversification of entertainment and information sources (including the internet), the availability

[29] The Independent, 5 March 2008.

[30] Households with Sky spend less time viewing FTA channels than households without Sky.

of multiple channels, and the market penetration of personal viewing recorders (PVRs) which allow viewers to skip through ads.

59. Loss of market share by FTA platforms in general was anticipated in the 2006 study conducted by Spectrum Consultants for MCH which noted:

> "The continued rise in penetration of multichannel platforms will further erode FTA viewing share. As audience fragments, FTA advertising revenues will come under increasing pressure".

60. However Spectrum went on to note that reduced market share does not necessarily translate directly into reduced advertising revenue:

> "International experience suggests that the FTAs will be able to defend their share of advertising revenue better than their share of viewing. They remain the only real mass market option for advertisers, allowing them to increase their premium or 'power ratio' over time."

61. Analogue switch-off may also increase pressure on FTA broadcasters. Viewers unable to view digital transmissions will need to decide on new digital viewing equipment, with a possibility that some will subscribe to Sky rather than purchase their own (FTA) set top box.

62. The pressure on advertising revenue for FTA broadcasters may impact on the achievement of public service broadcasting objectives, in that FTA broadcasters may be increasingly constrained in their ability and willingness to fund local content, which is generally significantly more expensive than international content.

63. In summary, the prognosis for the next 5 to 10 years is for continued domination of Sky in the pay-tv market and thus a very strong presence in the overall market, a continuing increase in entertainment choices for consumers particularly through the internet, and on-going competitive pressure on FTA broadcasters.

Specific competition issues: overview

64. The following sections consider the case for and against new, *ex ante,* pro-competitive regulation, based largely on submissions. As such it is not a full competition analysis based on a detailed market-by-market analysis. Rather it essentially considers whether there is a case for further regulation.

65. Most submissions on the digital broadcasting review discussion papers released in January 2008, including FTA broadcasters and the Commerce Commission,[31] argued that a more robust regulatory regime should be

[31] The Commission submitted that the general powers in the Telecommunications Act for the Telecommunications Commissioner to undertake market studies in telecommunications should be extended to broadcasting. It did not however recommend that any particular service should be regulated at this time by inclusion in Schedule 1.

applied to broadcasting. Sky and some others (such as the NZ Rugby Board) disagreed.

66. A range of arguments were put forward by those advocating an industry-specific regulatory regime for broadcasting. Many of the arguments were intertwined, but for the purposes of analysis and comment they can be unpacked as follows:

   1. The powers of the Telecommunications Commissioner under the Telecommunications Act should be extended to broadcasting because of the convergence of telecommunications and broadcasting

   2. There is a need for “marketplace rules” (i.e. industry-specific regulation) in order to maintain a fully competitive market. In the absence of such rules, Sky will develop considerable market power. Particular issues relate to:

      i. Access to premium content
      ii. Access to set-top boxes and electronic programming guides (EPGs)
      iii. Access to transmission facilities
      iv. Access to telecommunications platforms (mobile networks and the internet)
      v. Bundling of telephony, internet and pay-tv
      vi. Technical standards and interoperability
      vii. Access to spectrum

   3. Rules covering the above matters are needed to maintain the viability of FTA broadcasting in order to ensure the achievement of public service broadcasting objectives and programme quality and choice generally

   4. All other OECD countries regulate their broadcasting sectors (via regulation or by imposing licence conditions) and New Zealand should follow suit.

67. The issues and arguments under (i), (ii) and (iv) are addressed first, followed by more detailed consideration of the specific competition issues identified in (ii).

The powers of the Telecommunications Commissioner under the Telecommunications Act should be extended to broadcasting because of the convergence of telecommunications and broadcasting

68. The argument here is that the lines between broadcasting and telecommunications are becoming blurred as a consequence of the digital revolution, and that it is important for a regulator to be able to maintain neutrality between different types of technologies (‘technology neutrality’). Some submitters noted that there was a strong trend overseas for the regulatory regimes and regulatory institutions for telecommunications and

broadcasting to be ‘converged’ to reflect the technological and commercial convergence of these sectors.

69. We agree that there is a significant blurring of the traditional clear distinctions between telecommunications and broadcasting as a consequence of the digital revolution. (Convergence has been defined as “the ability of consumers to obtain multiple services on a single platform or device or to obtain a single service on multiple platforms or devices”). However, television broadcasting (as defined earlier as the provision of a linear programming schedule of ‘television-like” material excluding on-demand and user-generated material) remains a distinct activity. The fact that it is now possible to receive such broadcasting over what has traditionally been considered telecommunications devices and platforms or networks (such as mobile devices and networks and the internet) does not alter (at least for the moment) the distinctive nature of television broadcasting at the retail level.

70. Additionally, care needs to be taken when considering the overseas trend to converge broadcasting and telecommunications regulators and regulatory regimes.

71. In the first place, much of this convergence relates to regulating matters like content standards and delivering public service broadcasting requirements. As discussed earlier, this is a separate issue to competition regulation, and needs separate consideration on its own merits.

72. In the second place, a key reason overseas for converging broadcasting and telecommunications regulators and regulatory regimes is that, with convergence, jurisdictional disputes and overlap between them have become increasingly common. In our case, as noted earlier, we do not *have* a broadcasting regulator and regulatory regime (relying instead on general competition law). Hence jurisdictional disputes have not arisen in our case, neutralising one of the key drivers overseas for converged regulators and regulatory regimes.

73. Moreover, convergence is generally regarded as *increasing* the extent of competition in broadcasting markets (as well as in telecommunications markets). It reduces bottlenecks by allowing content to be delivered on different platforms and by creating new market opportunities.

74. Thus, “convergence”, *by itself*, is not a sufficient reason to extend the regulatory regime for telecommunications to television broadcasting. This is not to say here that the telecommunications regime should not be widened to cover broadcasting, simply that convergence as such is not a sufficient reason for doing so.

Marketplace rules are needed to maintain the viability of FTA broadcasting in order to ensure the achievement of public service broadcasting objectives

75. This argument is strongly put by TVNZ in particular, which regards itself as New Zealand's public service broadcaster. However, as discussed earlier, this issue is outside the scope of this paper, which is limited to competition issues.

All other OECD countries regulate their broadcasting sectors (via regulation or by imposing licence conditions) and New Zealand should follow suit

76. It is correct, as noted earlier, that all other OECD countries take a pro-active approach to regulating their broadcasting sectors, usually for a mix of economic/competition and social/cultural reasons. New Zealand is an outlier in relying essentially on its general competition law to regulate competition issues in the broadcasting sector.

77. No submitters argued that we should have a more pro-active regulatory regime for broadcasting *simply* because other countries have done so. There was clear recognition that there needs to be good reasons for widening the scope of regulation.

78. Thus, the case for a new regulatory regime for broadcasting in New Zealand needs to consider specific, identified competition issues. This is the subject of the following sections.

Access to premium content

79. This was the most contested competition issue and is arguably the most important.

80. A wide definition of premium content is possible, covering any high-rating tv programme, including material produced by a TV broadcaster itself, such as local news and reality and celebrity shows. However, the issue in contention relates to access by competing broadcasters to premium content where rights to TV broadcasts are sold by third parties.

81. In its consideration of Sky's application for clearance to purchase Prime, the Commerce Commission considered that premium content of this type covered:

- Live sports
- 'Blockbuster' movies
- First-run TV series.

82. It is generally agreed, both here and overseas, that access to premium content is critical for attracting audiences, and therefore, in the case of FTA broadcasters, advertising revenue, and, in the case of pay-tv, subscribers. No mainstream broadcaster is likely to be able to survive without access to premium content. Thus, any broadcaster that can 'lock up' long-term rights to

all or most premium content potentially has the capacity to dominate the retail market and exercise market power.

83. A number of overseas governments have taken strong steps relating to live sports in particular. The European Commission has taken a particularly vigorous approach to ensure that a single pay-tv operator cannot lock-up all premium sports. (It has done this by *ex ante* enforcement of general competition rules in the EU Treaty.)[32] It argued that access to premium sports is "decisive" and that absence of regulatory intervention risks dominance of (pay-tv) broadcasting markets by one pay-tv operator. Its concern is that long term exclusive rights packages may foreclose the market to new entrant broadcasters, particularly new pay-tv operators.

84. To prevent this, the EC requires the sellers of TV rights to premium sports (essentially football) to unbundle broadcasting rights into several packages (so that no one broadcaster can acquire all rights to a particular sport) and to not enter long-term exclusive contracts (especially with rights-of-renewal). Other provisions require the acquirers of rights to premium sports to offer rights to other broadcasters at reasonable prices (such as "retail-minus"[33]) to undertake delayed broadcasts.

85. Some other countries, such as Australia, the US, the UK, France and Ireland, have "anti-siphoning" legislation,[34] which restricts broadcasting of a specific list of live sports to FTA. This seems primarily motivated by social and cultural considerations (to ensure wide access to iconic sports events for 'national identity' reasons), but it also has the effect of limiting the attractiveness of subscriptions to pay TV.

86. Submissions from FTA broadcasters argued that New Zealand needs 'pro-competition' measures. In this regard the focus was almost solely on live sports. The main arguments put forward were that:

- Sky has secured almost all premium sports content, particularly rugby and cricket (and the next two Olympics). This drives high up-take of subscriptions to Sky. Those submitters consider this to be undesirable for a range of reasons, including:
    - Erosion of the competitive position of FTA broadcasters (by constraining their advertising revenue). This is turn puts pressure on

[32] The EC competition authority has threatened sports bodies with ex post penalties under Article 81 of the EU Treaty (agreements harmful to competition) unless the sports bodies complied with its rulings.

[33] Retail prices minus costs saved by not retailing.

[34] 'Anti-siphoning' is the term used in Australia and the USA. In the UK, France and Ireland, the term is "lists of events of national importance".

the ability of FTA broadcasters to provide local content, and jeopardises pubic service broadcasting objectives

  - Enabling Sky to out-compete FTA channels for other premium content, and to cross-subsidise Prime (which it is able to run at a loss). This is unfair competition and puts up the cost of premium content to other FTA channels

  - That it amounts to a "tax" on New Zealanders wanting to watch premium sport and/or prevents those unable to afford a Sky subscription from readily watching nationally important sport. This, TVNZ argued, has reduced interest in sports in New Zealand

- Some submitters considered that it was particularly problematic that Sky has acquired Prime, as an FTA channel. This, it was argued, enables it to acquire both pay-tv and FTA rights and risks foreclosing the FTA market to other FTA broadcasters.[35]

87. TVNZ and TVWorks advocated several rules to address this issue, along the following lines:

- "Anti-siphoning" legislation to require iconic sporting events to be made available for live FTA broadcasting. TVWorks considered that this would be a relatively short list, comprising:

  - Olympics
  - Commonwealth Games
  - Rugby World Cup
  - Tri-nations matches involving the All Blacks
  - Cricket One Day Internationals (5 per year)

- Alternatively, requiring Sky to on-sell rights to (briefly) delayed broadcasts of key sports events

- "Unbundling" rules, preventing sports bodies selling pay-tv and FTA rights to a single owner

- Compelling Sky to offer more individualised packages of channels (an *'a la carte'* menu)

- Requiring Sky to divest Prime.

[35] TVWorks used the example of rights to movies, where there are two "windows" offered to broadcasters, one for pay-tv and one for FTA screenings. It argued that Sky, as the sole provider of pay-tv, and as an owner of an FTA channel, could outbid FTA broadcasters by offering a combined bid for pay-tv and FTA rights, making it clear to the distributor that it would not acquire pay-tv rights as a stand-alone offering. FTA broadcasters could not match Sky's offer because they cannot obtain revenue from pay-per-view screenings. TVWorks said that "this scenario has occurred more than once in the last three years".

88. Sky has strongly rejected these arguments. Its main response is that:

- FTA broadcasters are free to compete for sports rights and do so. It noted that FTA broadcasters have obtained rights to a number of important sports events, either on an exclusive basis or jointly with Sky. These include:

  - Olympics 2004 and 2008. (Note: however that Sky has acquired rights to the next two Olympics)
  - Rugby World Cup 2003 and 2007
  - IRB rugby sevens
  - International netball
  - Commonwealth Games 2006
  - Various motor racing sports

- Restricting the right of sports bodies to package and sell tv rights in the manner they want to would severely affect the revenues of those sports bodies. This perspective was strongly endorsed by the NZ Rugby Union and New Zealand Cricket in particular

- Anti-siphoning rules could have perverse outcomes: for example, in Australia, anti-siphoning legislation has reduced the availability of live sports broadcasts to viewers because FTA channels have not used all their rights

- Sky did not, and could not afford to, cross-subsidise the acquisition of other premium content to foreclose the market to other FTA broadcasters.

Comment

89. A number of the key arguments put forward in favour of regulating access to premium content (notably live sport) are not relevant to a competition review, and so are not considered further. These are the arguments relating to:

- Meeting social objectives in terms of ensuring free and universal access by all New Zealanders to particular sports events

- Whether or not regulatory interventions would be good for particular sports

- The effect of Sky's acquisition of rights to live sports events on the ability of FTA broadcasters to meet public service broadcasting objectives.

90. On the access issue from a competition perspective, it does seem clear that Sky has secured (often on a relatively long-term basis) a substantial share of key sports rights, particularly rugby, and that this is an important driver of the uptake of pay TV. This in turn puts considerable competitive pressure on FTA broadcasters.

91. However, the important issue is whether this forecloses, or enables Sky to foreclose, access to most or all of the range of premium content for FTA broadcasters on an on-going basis.

92. The Commerce Commission examined this issue in detail when considering Sky's application in 2005 for a clearance (or authorisation) to acquire Prime.

93. The Commission concluded that Sky was not able to prevent access to premium content in general. The Commission noted, inter alia, that:

- The market for premium content is wider than premium sports, and includes blockbuster movies and first-run tv series

- Pay-tv and FTA operate under different business models. FTA broadcasters seek mass audiences in primetime on an on-going basis (every night), in order to attract audience ratings and advertising revenue. To do that, they need access to first-run TV series (and the FTA "window"[36] for movies) in particular. The business model for pay-tv is to provide a compelling reason for consumers to pay a subscription. To do this pay-tv operators focus on must-see sports, the pay-tv "window" for movies and a wide range of special interest channels.

- FTA broadcasters therefore compete vigorously with each other (and with Sky) for high rating first-run TV series in particular. TVNZ and TVWorks have been and continue to be successful in this regards and hold contracts for the output of all the main TV studios, including Disney, Warner Bros, Granada and Twentieth Century Fox.

- It is highly unlikely that it would be a rational or achievable commercial strategy for Sky to out-compete FTA broadcasters for contracts for all or even most premium content, not least because there is a range of offerings in the market-place.[37]

- It is unlikely that Sky could use its dominance in the pay-tv market to get advantageous arrangements for Prime in the FTA market, for example, for movies (by threatening not to acquire pay-tv rights unless it was also sold FTA rights at concessional prices). The Commission considered that sellers have strong countervailing power and would be unlikely to allow this strategy to succeed.

[36] Rights to movies are sold in multiple windows, to maximize the revenues of movie studios. The main windows are: movie theatre screenings, DVD release, on-demand viewing, pay-tv, FTA

[37] The claims of the FTA broadcasters to the Commission that Sky would be able to use Prime to dominate the FTA market have not been borne out to date (although the acquisition was less than three years ago). Prime's audience ratings have only slowly increased and are now around 6 percent.

94. Officials consider that the Commission's analysis concerning access to premium content is generally robust although MCH considers that the number of key deals available for premium content is quite small and that the threat of regulation over the last three years is likely to have influenced Sky's behaviour.

95. While we do not think there is a strong case for introducing powers to regulate access to premium content for competition reasons at this time, departments differ on the risks of problems emerging in future and more particularly on whether or not preventative steps should be taken at this time (covered in later sections).

Access to set-top boxes and EPGs

96. Many OECD countries have some form of "must carry" regulation, requiring pay-tv operators to carry all FTA channels or public service broadcasting channels. By and large these rules apply to cable tv operators, and they have been extended in some cases to satellite pay-tv operators. These rules appear to have a number of motivations:

- To increase the reach of public service broadcasting material (cable has a high level of penetration in some countries)
- To facilitate market entry by new FTA broadcasters and/or competition from existing FTA broadcasters by increasing their audience reach and therefore advertising revenue
- To minimise equipment costs for consumers (i.e. all channels can be received on one set of equipment).

97. In its submission, TVNZ argued that because Sky is 'vertically integrated' it should be subject to the same sort of separation as Telecom (with operational separation) or electricity (ownership separation between lines and energy). It argued that Sky, as a vertically integrated business, has incentives to deny or frustrate (or set unreasonable terms and conditions for) access to its 'essential facilities', being its set-top box and EPG, in order to create difficulties for FTA broadcasters. The best way to reduce these incentives, and discipline Sky's behaviour, would be to impose separation requirements.

98. TVNZ and Freeview also argued that:

- All FTA channels should be required to be available for broadcast (unencrypted) on Freeview. (This in effect is a "must offer" requirement, rather than a "must carry" requirement). This requirement would affect Prime, which is the only major FTA channel not on Freeview, and Trackside. The objective appears to be to increase the attractiveness of the Freeview platform to viewers (and improve convenience to viewers).

- There should be a "must carry" requirement on Sky (ie Sky must carry all FTA channels on request), and a regulator should have powers to set terms and conditions for access to the Sky set-top box and EPG.

- At the same time, there should be no "must offer" requirement imposed on FTA channels to be available on Sky's set-top box. (TVNZ currently does not allow TVNZ 6 and 7 to be accessed on Sky).

99. Freeview and TVNZ acknowledged that this would be "asymmetric" regulation (requiring all FTA channels to be made available on Freeview, but not on Sky, unless the FTA broadcaster wanted this), but argued that this would be a "pro-competitive measure" to help counter the market position of Sky (presumably because both provisions increase the attractiveness of Freeview to consumers).

100. Sky objected to these representations. It argued, *inter alia*, that:

- it has a strong incentive to carry as many channels as it can (including FTA channels) in order to increase its attractiveness to subscribers. It says it does not carry TVNZ 6 and 7 because TVNZ will not allow it to

- it does not provide Prime to the Freeview terrestrial HD platform because of the costs of doing so (including Freeview charges and, more significantly, Kordia's transmission charges)[38] but says it will do so when it is commercially viable (when marginal revenue covers the additional costs). Prime has remained encrypted on Sky's satellite platform as Sky claims that its sports rights contracts require encryption to limit potential "leakage" to other markets[39].

- it should be left to commercial negotiations to settle on terms and conditions for access.

Comment

101. MED and MCH have differing views on this issue.

102. MED considers that TVNZ's arguments for imposing separation or "must carry" requirements on Sky do not appear to be strong. Considerations are:

- It is hard to argue that Sky's set-top box and EPG are "essential facilities", because it is clearly possible for broadcasters to enter or remain in the market

[38] Sky estimated these costs at about $2.2m a year in its submission. However, MCH notes that the costs for standard definition transmission are likely to be much less than this (at an estimated $450,000).

[39] Officials accept that there are contractual limitations, but note that the new (since 2007) satellite platform does not have potential "leakage" to Australia.

without accessing Sky's set-top box.[40] This is in contrast to the telecommunications and electricity markets (where separation and *ex ante* regulatory requirement have been imposed) because there were (and remain) strong 'essential facilities' in these markets which entrants have to access in order to compete.

- Sky's argument that it has incentives to carry all FTA channels appear valid. It does have an incentive to offer any channels available to it to increase the attractiveness of a Sky subscription, and very little if anything to gain from frustrating access. Indeed, refusing to carry key FTA channels, such as TVOne, TV2 and TV3, would likely significantly increase uptake of Freeview.

- Analogies with Telecom are flawed:

  - Telecom's copper local loop network was created at a time when it enjoyed a legal monopoly, while Sky has established its platform in a sector open to competition

  - Installing an alternative set of copper local loops around the country would be financially impossible for any competitor; establishing a new satellite platform with new set-top boxes is much more affordable (UBI World and Vision Asia are following this model)

  - There is no difficulty with vertical integration as such: concerns only arise where there are essential facilities which the vertically integrated company is refusing or constraining access to. There is no evidence this is the case in terms of Sky's facilities.

103. Overall, MED considers that there does not seem to be strong case for a "must carry" or "must offer" regulatory intervention in order to promote competition, and there seems to be no good reason why the parties should not be left to come to commercial agreements as they see fit.[41] The current strong growth in Freeview may help the negotiating position of FTA

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[40] The OECD (2008) makes the point that "must carry" regulation was generally introduced in OECD countries at a time when there was a scarcity of spectrum for television broadcasting. This precluded new entrant broadcasters competing with incumbents; hence the "must carry" rules (particularly for cable TV) to enable new broadcasters to enter the market. The OECD comments that the time for "must carry" rules may have passed, and instead that consideration should be given to "must offer" rules (i.e. requiring certain broadcasters to make their content available to viewers on different platforms).

[41] In MED's view, the strongest case for "must carry/must provide" regulations would seem to be to compel TVNZ to make TVNZ 6 and 7 available on Sky to access a wider audience for public service broadcasting reasons. Also, possibly the strongest case for regulatory intervention could have been made *prior* to the launch of Freeview, to save consumers from the need to invest in two set-top boxes. However, any such regulation would probably have prevented the launch of Freeview, thereby precluding one source of facilities-based competition.

broadcasters (in that refusal by Sky to carry mainstream FTA channels is likely to increase the uptake of Freeview).

104. MCH considers that Sky's platform does have essential facility characteristics in that it has a near monopoly in the pay-tv market, and has an overall market penetration of some 45 percent of households. MCH considers that this means that new entrant broadcasters must get access to Sky's platform in order to reach all viewers and be commercially viable. This gives Sky the opportunity to either frustrate access (for example if the competitor is a pay-tv operator) or to set unreasonable or excessive terms and conditions for access. It notes that the new entrant pay-tv operators (UBI World and Vision Asia) originate from Australia and are very small and specialised.

105. Accordingly, MCH considers there is a requirement for a regulatory response in order to deal with the risk of Sky denying or frustrating access to its platform including its EPG.

Access to broadcast transmission facilities

106. Arguably, the strongest natural monopoly/essential facilities in the broadcasting sector are the sites and terrestrial transmission facilities of Kordia. Indeed, one of the reasons why Kordia (formerly BCL) was separated out from TVNZ and set up as a separate SOE was to encourage it to provide "open access" to its facilities and to remove any incentives to favour TVNZ.

107. Kordia has now acquired Orcon, and is offering telecommunications services, and may also offer television-like services as part of a bundled package at some point in the future. However, the acquisition of Orcon seems unlikely to lead to serious incentives for Kordia to create difficulties for broadcasters wanting to access its transmission facilities.

108. It is arguable that Kordia has incentives to restrict access to its sites and transmission facilities to potential competitors (such as Johnston, Dick and Associates) in the broadcasting *transmission* market. This is a potential issue. However, it does not seem a sufficient reason by itself to introduce regulatory powers absent a pressing case, but it does merit a watching brief.

109. TVNZ claims that Sky has taken out an option on spare capacity on the Optus satellites covering New Zealand, thereby constraining the ability of other potential users.[42] Sky responded that TVNZ had the opportunity to contract for this capacity but did not take it. In any event, even if jurisdiction issues did not arise, it is unlikely that this issue merits a regulatory response at this time.

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[42] Sky has a contract for capacity on the upcoming D3 satellite and has been equipping its dishes to access this capacity. Freeview is not promoting such equipment and their viewers cannot effectively use that satellite at this time.

110. Officials note that there is still scope for further transmissions on the present D1 and D2 satellites, and the upcoming D3 satellite, and there are alternative transmission mechanisms available for broadcasting, so it is not evident that satellite capacity constitutes an essential facility. Potentially there may be an issue following analogue switch-off, where it is unlikely to be commercially viable to extend terrestrial digital broadcasting beyond around 80 percent market share. This will increase the likelihood of satellite facilities becoming a bottleneck.

Access to telecommunications facilities, such as mobile networks and the internet

111. The issue here is whether there are any essential facilities which competing broadcasters need access to in order to provide broadcasting services, and where the owners of such facilities also compete in the broadcasting market and (therefore) have the incentive (as well as the ability) to exclude competing broadcasters.

112. The internet would not appear to be an issue in this regard, since it is open access. The regulatory powers in the Telecommunications Act ensure open access for service providers to the underlying telecommunications infrastructure providers.

113. Currently there are two mobile networks (Telecom and Vodafone) and a third network is planned (New Zealand Communications). None of these mobile operators are broadcasters as such, and accordingly are unlikely themselves to have incentives to act anti-competitively by preventing access to their networks by competing broadcasters.

114. We understand that Vodafone has contracted with Sky to make Sky available to Vodafone mobile phone subscribers. The terms and conditions of the contracts are not known. However, concern has been raised that they contain provisions which preclude the mobile phone operator carrying broadcasting material other than that provided by Sky. If the contracts do contain such provisions, it is not clear that this is a major competition concern. More importantly for this review, if there *are* exclusionary provisions which have the purpose or effect of substantially lessening competition in a market (in this case for receiving broadcasting content on mobile devices), this would appear to be a s27 issue. (As noted earlier, MED's concerns about the effectiveness of general competition law relate to the effectiveness of s36 in ensuring access to essential facilities, not s27).

Bundling of telephone, internet and pay-tv

115. Concerns have been raised from time to time about the potential for market dominance if and when a communications company offers a compelling "triple play" comprising telephone services (fixed and mobile), internet and broadcasting (pay-tv) services.

116. By and large triple play packages overseas are provided by IPTV operators, but, as noted earlier, there is doubt as to whether IPTV will develop in New Zealand. More likely scenarios are a company with a strong market position offering a compelling triple play package.

117. Sky's dominance in the pay-tv market (particularly its access to 'must-see' content like live sports) does put it in a very strong position for triple-play offers: that is, without Sky there is unlikely to be a compelling triple play offer.

118. MED considers that several bundling scenarios can be envisaged:

Scenario one: There is only one attractive (because it involves Sky) triple play offering in the market because Sky has an exclusive deal with one telco (or other enterprise).

- *Comment*: This is the most plausible scenario, but seems unlikely to be a competition concern. The main commercial discipline on this is the ability of consumers to purchase each component of the package (or other bundles) separately. (A Sky-Telecom voice-television bundle was marketed by Telecom, but was not particularly successful).

Scenario two: A variant on scenario one is that there is only one attractive triple play offering in the market because Sky itself offers a triple play (and does not make Sky available to other enterprises wanting to offer a triple play package)

- *Comment:* Sky would be unable to use only its own facilities (contracted satellite capacity) for such a triple play package because the inherent lag in two-way communications via satellite makes it unsuitable for high quality voice communications, and the absence of a wideband return path makes it unsuitable for internet communications. Thus Sky would need to contract with competitor telcos in order to offer a triple play service. In this case, the same comments as scenario one apply.[43]

Scenario three: Pay-tv (Sky) is unavailable *except* as part of a triple play package (i.e. customers have to take telephone and internet services from one supplier if they want Sky)

- *Comment*: This seems an unlikely commercial scenario not least because it would appear likely to meet strong consumer resistance.

Scenario four: Only Sky (and no other broadcasting material eg from FTA broadcasters) is available in a triple play offering because the contract with Sky precludes offering any other broadcasting material.

[43] There have been reports that Sky may migrate from satellite to ultra-fast broadband when it is available. However, in that event, the same competition considerations concerning scenario one would apply.

- *Comment*: It is not clear that this is problematic. Consumers would retain the ability to access the broadcasting content they want through other mechanisms (terrestrial or satellite broadcasting and the internet[44] in particular), with the possible exception of access via mobile devices. Regarding the latter, the earlier comments relating to access to mobile networks apply.

Scenario five: on triple play generally, a telco with control of the underlying network (e.g. fibre to the cabinet or home with sufficient bandwidth to carry high quality television) and offering a triple play bundle might be tempted to deny access (to that network) to competitors wanting to offer a competing triple play service.

- *Comment:* Clearly, the Telecommunications Act is designed to preclude such a scenario. Furthermore, the Government's ultra-fast broadband initiative puts it in a position to require open access provisions if this proves necessary.

119. MCH considers that the above analysis does not adequately deal with risks of Sky developing or extending its market power. It considers that these risks include increased audience fragmentation and pressure on the content market. It also notes a sixth scenario whereby no IPTV or triple play offering emerges due to a lack of competition.

Technical standards and interoperability

120. In principle, this is a potentially significant issue, and the adoption of poor or incompatible standards could be very expensive for consumers and/or have poor competition outcomes. In practice, to date, industry participants have collectively adopted optimal technical standards, including DVB-T and MPEG-4 standards which make high definition television possible. Thus, there is no pressing need for powers to mandate standards. If a compelling need for government intervention does arise, legislation could be considered at that time (probably the threat of legislation would be sufficient to secure a satisfactory outcome).

Spectrum

121. Current policy settings for spectrum, in general terms, are to:

- reserve certain quantities of spectrum for 'public good' uses (including fully public service broadcasting use)

- auction management rights to spectrum for 20 year periods to the highest bidder where demand for spectrum is likely to exceed availability

[44] However, quality will remain an issue until ultra-fast broadband is widely available.

- allocate licences on a first-come-first-served basis where spectrum is readily available

- consider, on a case by case basis, imposing pro-competition rules as a condition of management rights (or licences), such as 'use or lose' requirements (to prevent hoarding) and restrictions for a set period on the quantity any one party can acquire.

122. By and large, spectrum is not regarded as a barrier to entry or expansion in tv broadcasting (unlike in the past when only limited quantities of spectrum – on VHF - were available and suitable for TV broadcasting).

123. 'ASO' (Analogue Switch-Off) will free-up a significant amount of premium spectrum (the "digital dividend"). This spectrum will be suitable for both broadcasting purposes (such as more high definition channels) and telecommunications purposes (such as mobile broadband in rural areas).

124. The Government has undertaken to indicate a provisional switch-off date when 60 percent of households have digital-capable television (likely in 2009), and to set a date-certain at the earlier of 2012 or when 75 percent of households have digital receivers. The Government has also promised to undertake a review in 2009 to develop policies for the allocation of "digital dividend" spectrum.

125. Submissions from FTA broadcasters and Freeview argued that (a) an earlier rather than later date for ASO is required to realise the benefits of the digital dividend and (b) freed-up spectrum should be reserved for broadcasting purposes (more specifically for FTA broadcasting and Freeview) rather than being auctioned to the highest bidder (which would include telecommunications users). Telcos took a different view on the latter issue. These matters will need to be considered as part of the 2009 review.

126. The Commerce Commission recommended that it should take over spectrum policy and management issues relating to telecommunications and broadcasting in the context of its recommendation that the mandate of the Telecommunications Commissioner should be extended to broadcasting.

127. If the Government does conclude that the regulatory powers relating to telecommunications should be extended to broadcasting, it would be appropriate to consider jurisdiction over spectrum policy and regulation at that time. In the meantime, spectrum issues *by themselves* would not appear to be a reason to regulate broadcasting.

<u>What of the future?</u>

128. This review has not identified a strong case for introducing new regulation covering the broadcasting sector to address clear and current competition concerns. (The review has not addressed the achievement of public service

broadcasting objectives and makes no comment on whether new measures are merited here).

129. Clear and current competition concerns were present prior to the introduction of industry-specific regulatory interventions for telecommunications, electricity and gas: indeed, it was evident that competition was unlikely to develop in these sectors *without* regulatory intervention, in particular because competitors needed access to the facilities of the monopoly incumbent in order to compete. These conditions do not exist in broadcasting: we already have a workably competitive market, and there are no obvious essential facilities that entrants or existing competitors need access to in order to provide broadcasting services and which are unavailable to them as a consequence of anti-competitive behaviour by an incumbent with market power.

130. However, while there does not appear to be a good case for putting in place powers to regulate broadcasting to address *current* market circumstances, the question remains as to whether there are likely future developments that would warrant regulatory intervention for *preventative* or *pre-emptive* reasons.

131. To test this, the next section considers a set of '*what if*' scenarios. The likelihood of the scenario arising is commented on and, where appropriate, an appropriate government response is considered.

<u>What if Sky refuses to carry TVNZ (or TVWorks) on its platform?</u>

132. At present, Sky carries all FTA channels (except TVNZ 6 and 7 which TVNZ does not make available), duplicating the Freeview satellite transmissions. The terms and conditions of carriage are not known, but officials understand that TVNZ's contract with Sky for carriage is up for renegotiation in 2010. It is possible that Sky could refuse to continue to carry TVNZ channels (and/or TVWorks channels when its current contracts expire) for anti-competitive reasons. (The possibility that Sky may set unreasonable terms and conditions is covered in the next section).

133. Arguably, Sky has an incentive to act in this way to weaken FTA broadcasters by reducing their audience share (because viewers who currently access FTA channels via Sky would no longer be able to do so). Reducing audience numbers watching FTA channels reduces the advertising revenue of FTA broadcasters: this in turn reduces their ability to compete with Sky (including Prime) for premium content and advertising revenue.

134. However, more plausibly, Sky appears to have more to lose than to gain by refusing to carry FTA channels. In the first place, while there would be some erosion of the audience share of FTA channels, it is not clear how severe this would be, given that most viewers can access FTA channels via other platforms (VHF), and, increasingly, Freeview. Secondly, not carrying FTA channels would likely boost the uptake of Freeview, which is unlikely to be in

Sky's interests. (Freeview tuners become more attractive to customers if mainstream channels are exclusive to it).

135. Thirdly, Sky's business model is to make subscriptions to Sky as attractive as possible. As noted by the Commission, this involves carrying 'must-see' sports and blockbuster movies, and as many other channels as possible covering a wide range of interests. Dropping FTA channels goes against this model.

136. Finally, refusing to carry FTA channels would likely create a significant customer backlash, and may increase pressure on the government to consider regulation of Sky. This seems likely to be a risk that Sky would hesitate to take.

137. Overall then, MED considers it is unlikely that Sky would refuse to carry some or all FTA channels. (Indeed, officials consider that it is likely that Sky, if asked, would provide a formal commitment to carry or make available specified FTA channels).

138. However, if it *did* occur, MED considers that the government should consider its options at that time. The options include doing nothing (on the grounds that FTA broadcasters clearly have alternative transmission options available to them), to threatening to regulate or actually regulating (by extending the powers of the Telecommunications Act to broadcasting).[45]

What if Sky sets onerous terms and conditions for carrying FTA channels?

139. This is a more likely scenario than outright refusal to carry FTA channels. Sky is in a reasonably strong position to demand that FTA channels pay for carriage on Sky, particularly if they want a duplicate high definition transmission (which requires considerably more bandwidth than standard television). Any revenue that FTA broadcasters pay to Sky is revenue unavailable to purchase local and premium content, and weakens the competitive position of FTA broadcasters.

140. However, MED considers that FTA broadcasters are not without bargaining power. In particular, FTA broadcasters know that:

- they have alternative transmission options to Sky, including Freeview
- there is little or no cost to Sky to simply provide a link on its set-top box and EPG to the Freeview satellite transmission (so any claims by Sky about high costs lack credibility)
- if Sky's terms and conditions for duplicate high definition transmission on Sky's satellite platform are onerous, they would be able to portray this as amounting to refusal to supply, knowing that, for the reasons noted in the previous section, Sky will be reluctant to not carry FTA channels.

141. Accordingly MED considers that there is a reasonable balance of bargaining power between Sky and FTA broadcasters and that there is no good case for Government/regulatory intervention in the negotiations.

142. MCH considers that it would be preferable for the Government to take a more active role in deterring Sky from using its network ownership to set onerous terms and conditions for carrying FTA channels. MCH considers that the bargaining power referred to by MED as the reason for not implementing this would only apply to existing broadcasters in a strong FTA market. Should the market weaken, as MCH predicts, the FTA broadcasters would not be in a strong bargaining position, and nor will any new market entrants.

What if Sky succeeds in acquiring all live sports and sufficient first-run tv series so that FTA channels rapidly lose audience shares?

143. MED agrees with the Commerce Commission's view that this is an unlikely scenario. The Commission concluded (in its assessment of Sky's proposed acquisition of Prime) that this would not be a rational or commercially viable strategy on the part of Sky because of the quantity of premium content available from various sources and the costs involved (relative to available revenue). Moreover, in practice, FTA broadcasters have demonstrated a willingness and ability to acquire rights to first-run tv series, which are the mainstay for the FTA business model. (An earlier section has a more extensive discussion on this issue).

144. MCH is concerned that competition from Sky for premium content puts up the price of premium content, which reduces the funds available to FTA broadcasters for production and purchase of local content. It considers that there is only a limited number of important 'premium content' suppliers.

145. MCH has twin concerns about price ratcheting and/or loss of premium content altogether. This, in combination with the resulting loss in advertising revenue associated with loss of premium content is sufficiently concerning to justify the market being kept under review by a regulatory body so that preventative action could be taken if required.

What if FTA broadcasters become commercially unviable (because they continue to lose market share to pay-tv and/or because of audience fragmentation) and either exit the market or screen only low quality material?

146. It is clear that FTA broadcasters collectively have steadily lost market share to Sky over the last 7 or 8 years. What is not clear is the extent to which this erosion will continue. It is an error to simply project forward existing rates of attrition of FTA's market share. Having started at nearly 100 percent they could only lose market share. There will be a point at which the uptake of Sky plateaus, when the cost of a subscription exceeds the marginal utility to non-

subscribers. Some commentators[46] consider this point is close unless Sky drops its prices.

147. It is also important to remember that the all-day market share of FTA broadcasters, excluding Prime (but including FTA channels watched on Sky's platform), is about 65 percent compared to Sky's approximately 34 percent (including Prime's 6 percent). FTA's market share of prime-time is higher at 74 percent, with Sky at 22 percent. FTA channels appear to retain a competitive offering especially in terms of local news programmes (which can lock-in viewers for prime-time) and first-run TV series.

148. Nonetheless, FTA broadcasters are likely to continue to lose market share (most likely at a slowing rate), and the prospect of reduced commercial viability clearly exists.

MED's views

149. Any continuing erosion of market share and commercial viability of FTA broadcasting (because viewers prefer alternatives or because of audience fragmentation) is not a competition concern. Competition policy is not meant to be about protecting particular businesses or business models. It is meant to be focused on preventing anti-competitive or extortionate behaviour, and removing (inappropriate) barriers to entry. In this instance, we are talking about a scenario where FTA broadcasters lose market share (if that proves to be the case) because they have a less attractive business model, not because of anti-competitive behaviour or barriers to entry.

150. Thus, while MED accepts that FTA broadcasters may come under increasing commercial pressure, with consequences for choice and the extent of local content, it does not consider that this is a *competition* issue which merits a traditional competition response. Rather, the issue is about the achievement of social and cultural objectives (in particular, public service broadcasting objectives[47]). In MED's view, if and when the government considers that its social and cultural objectives are not being sufficiently met by the market, it has various responses open to it. These include:

- regulatory measures (such as 'anti-siphoning' legislation for key sports)

- increased funding for public service and local broadcasting content through NZ on Air

[46] For example, Australian communications commentator, Paul Budde in his recent review of the New Zealand broadcasting market.

[47] In effect, public service broadcasting can be defined as broadcasting services (in terms of quality, quantity or coverage) not provided commercially by the market but which the community (through the government) wants or considers important.

- improving the commercial viability of TVNZ through ownership mechanisms (eg by reducing the dividends TVNZ pays, removing or amending charter requirements, or providing capital injections)

- assisting FTA broadcasters generally by making spectrum available at low or nil cost.

151. MED does not agree with the argument that new entrant broadcasters must have access to the Sky platform (satellite capacity, set-top box and EPG) in order to provide broadcasting services because 45 percent of households have Sky (with the corollary that the broadcasters cannot reach 45 percent of the market except through Sky). In practice, new broadcasters are not dependent on the Sky platform to reach the 45 percent of households with Sky, since alternatives are available to them (such as leasing spectrum and facilities from other broadcasters and/or Kordia and/or satellite operators: further spectrum can also be made available by the Government if required). While there may be costs involved for the new entrant broadcaster in putting in place alternatives that is not a competition issue unless Sky's platform is, in fact, an "essential facility".

152. MED considers that the above review of 'what if' scenarios has not revealed any compelling competition reasons to set up a broadcasting regulator and regulatory regime. MED considers that the scope of competition regulation should not be extended lightly and absent strong risks to the development or continuation of a competitive market, given the costs and risks or regulatory intervention, including the tendency of interventions to expand in scope and complexity over time. The Government can re-visit decisions concerning regulatory settings at any time, and can and should in the meantime make its wish to see a competitive and diversified market known to market participants.

MCH's views

153. MCH agrees with MED that there is currently no clear and compelling evidence of significant competition problems in the television market. MCH considers, however, that: there is a reasonable likelihood of competition problems arising in the future; that the Commerce Act is inadequate to address those problems; and that substantial weakening of the free-to-air broadcasting market would have public interest implications.

154. The current market is characterised by: a monopoly in pay TV with structures to control the gateway to the consumer; the pay platform's ownership of a national FTA broadcaster (Prime) which allows it to bundle free and pay rights together and strengthens its ability to compete for the acquisition of premium content; and a content and platform provider with a subscriber base of some 750,000 households, putting Sky in a strong position to negotiate terms of access to other platforms and to set terms for access to its own network. These terms have the potential to act as barriers to competition by

either excluding other services, or setting unreasonable costs or terms of access (such as a broadcasters' position on the electronic programme guide).

155. This market structure combined with competitive actions to date by the major broadcasters indicates the potential for competition problems to arise. Such actions include: Sky's progressive acquisition of the rights to broadcast most significant sporting events, including the next two Olympics; its exclusive arrangements with Vodafone for mobile content; and its decision not to transmit Prime on the Freeview platform. (Prime was an original member of the Freeview consortium.)

156. The risk is increased by the impact of technological convergence, which leads to audience fragmentation across multiple channels and delivery platforms. The public's access to the increased content available through technological advances depends on new providers being able to reach sufficient audience numbers to support such content. They need to be able to maximise audiences by transmitting their services on all major platforms. As such, the Sky platform is arguably an essential facility – any national television broadcaster seeking to enter the market must have a presence on the Sky platform to be viable, due to the large share of households that access television via that platform.

157. The cumulative effect on the FTA broadcasters of Sky exerting market power in the areas of access to platforms and content acquisition would be significant, resulting in a likely vicious circle, in the form of: a loss of FTA broadcasters' audience share and a concomitant loss of advertising revenue; a consequential inability to secure premium content or to support diverse local content, and a loss of bargaining power in relation to access to platforms.

158. The New Zealand national television market is already characterised by a very small number of providers: TVNZ, Mediaworks, Māori Television, and SKY (incorporating Prime). Of these, there is a risk that Mediaworks could pull out in adverse conditions. A substantial weakening or collapse of FTA broadcaster(s) would be counter to the aim of competition policy in that it would significantly reduce competition in the television broadcast market, decreasing the number of providers and limiting consumer choice with a consequent diminution in competitive pricing, quality and service.

159. Such an outcome would also undermine the achievement of the government's broadcasting objectives. A functioning democracy is supported by the universal (free-to-air) availability of a choice of broadcasting providers, particularly in the field of news and current affairs where it is important that the information provided via television is not controlled by a small number of proprietors. If FTA broadcasters are significantly weakened commercially, support for local content through contestable funding will be compromised as such a policy requires broadcasters to have sufficient resources and incentives to feature subsidised content. The availability of non-subsidised local content would also be affected with flow-on effects on the capability of

the wider screen sector. Increasing public funding might mitigate some of these impacts, but at a high and steadily increasing cost.

160. The Commerce Act (s. 36 in particular) is acknowledged to be inadequate to deal with the competition problems that MCH considers are likely to arise. The timeframe for any remedy under the Act is likely to be ineffective. In addition, it is not clear whether the pay platform meets the test for an essential facility, whether access to content supplies is covered, nor whether the Act provides a basis for dealing with the cumulative impact of actions which, if assessed individually, might not meet the legislative test.

161. MCH therefore recommends that the Telecommunications Act be amended to allow the Commerce Commission to undertake market studies in broadcasting and to make recommendations to the Minister to add particular services to Schedule 1 by Order in Council if evidence of competition problems arises. This would be in line with the pro-active approach of other OECD countries generally. Adopting a "wait and see" approach would entail some risk of any action in response to competition problems coming too late.

Regulatory options

162. The main regulatory options available to Ministers are as follows:

(i) Take no further action at this time.

This option could involve:

- making a carefully worded statement about the Government's determination to maintain a competitive and diversified broadcasting market, and
- continuing to keep a watching brief on market developments.

(ii) Amend the Telecommunications Act (s9A) to allow the Commerce Commission to undertake studies on the broadcasting market

(iii) Amend the Telecommunications Act to:

- *allow the Commerce Commission to undertake studies on the broadcasting market and make recommendations to Ministers to regulate particular services (e.g. access to set-top boxes or regarding premium content)*
- *Enable the Minister of Broadcasting (in consultation with the Minister of Communications and Information Technology), on the recommendation of the Commission, to add those services to Schedule 1 by Order in Council*

The effect of this is that the Commission would be able to regulate matters relating to carefully defined services and facilities, but only if Ministers had first (a) received a report from the Commission recommending that such services and facilities be added to Schedule 1, and (b) agreed to that recommendation. (Note: Ministers have no subsequent powers relating to specific determinations of the Commission regarding matters regulated pursuant to Schedule 1).

(iv) Amend the Telecommunications Act as in (iii) above, and specify particular services in Schedule 1.

These specified services might include:

- Requiring pay-tv operators with a dominant market share (ie Sky) to carry FTA channels on request of FTA broadcasters
- Determining reasonable terms and conditions (where the parties are unable to agree) for carriage of FTA channels on the pay-tv platform and for EPG listings and facilities
- Preventing pay-tv operators broadcasting a specified list of premium content programmes (including certain live sports) except where FTA broadcasters do not want to broadcast these programmes
- Requiring pay-tv operators to on-sell rights to third-party FTA broadcasters to broadcast a specified list of sports programmes on a delayed basis, and to set the terms and conditions for such on-selling if the parties are unable to agree

(v) Introduce comprehensive new broadcasting legislation covering both competition and social and cultural issues (including content standards and public service broadcasting).

163. Officials agree that there is no strong case at present for options (iv) and (v), and they are not considered further here.

164. Option (ii), which provides powers for the Commerce Commission to (only) undertake market studies concerning broadcasting, has been suggested by the Commission.[48] Ministers would have no powers to provide for the

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[48] Section 9A says that the Commission:

- *must* monitor competition in and the performance and development of telecommunications markets, and publish reports
- *may* conduct inquiries, reviews and studies (and if it does so, must publish its reports)

The Telecommunications Act allows the Commission to use section 98 powers in the Commerce Act. Section 98 provides powers for the Commission to compel parties to provide information, including confidential and not-readily-available information.

regulation of any particular services as a consequence of any studies. Any responses to the market studies would require further amendments to the Telecommunications Act.

165. The Commerce Commission does not currently have powers to publish studies relating to any sector in isolation from related regulatory provisions (ie regulation of that specific sector, such as telecommunications) and/or in relation to contraventions of the Commerce Act. Undertaking such studies would amount to providing policy advice. If Ministers were minded to extend the functions of the Commission in this way, it would seem best to provide generic powers in the Commerce Act covering all sectors, rather than focus the new functions solely on broadcasting.

166. Accordingly, officials consider that the two main options (re-numbered) for consideration by Ministers are as follows:

Option One: *Amend the Telecommunications Act to include broadcasting*, so that:

- a widened Telecommunications Commissioner (a 'Communications Commissioner') may undertake market studies of broadcasting and make recommendations to Ministers as to whether particular services (e.g. access to broadcasting platforms or relating to premium content) should be regulated

- the Minister of Broadcasting (in consultation with the Minister of Communications and Information Technology), on the recommendation of the Commission, may add specific services to Schedule 1 by Order in Council. (The effect of this is that the Communications Commissioner may regulate the specific service or facility, but only if Ministers have agreed that the service or facility should be regulated).

Option Two: Take no further action at this time, but

- make a general statement about the Government's determination to maintain a competitive and diversified broadcasting market, and

- continue to keep a watching brief on market developments.

167. MCH favours the first option, and MED the second.

If the option to extend s9A to broadcasting (with no other regulatory provisions) was adopted, careful consideration would need to be given to the extent of the Commission's powers and obligations in this regard, given that the broadcasting market would not actually be subject to any form of regulation (unlike the telecommunications market).

Conclusions and recommendations

168. Officials agree that there are no clear and present competition concerns that justify setting up new regulation for broadcasting at this time. However, departments disagree on:

- The extent of future risks to the achievement of the government's objectives for the broadcasting market

- Whether it is necessary or desirable to strengthen the regulatory regime for broadcasting, and in particular extend the Telecommunications Act to cover broadcasting.

169. MCH considers that there are a number of material risks to the current level of competition in the market, and to the achievement of government's broadcasting objectives; that it makes sense to pro-actively manage these risks; and that this requires the limited extension of the watch-dog powers of the Telecommunications Commissioner, to cover broadcasting. In particular, MCH considers that the on-going viability of FTA broadcasters, and therefore diversity of choice and content, the provision of local content, and quality of content will be put at risk in the absence of action by the government. It notes that there is a trade-off between regulatory and fiscal responses: that is, if the government is unwilling to consider regulatory responses it will need to consider fiscal responses in order to deliver on its overall broadcasting objectives. It also considers that fiscal assistance may not always be the most effective response.

170. MCH considers that the establishment of a broadcasting regulator does not imply heavy-handed regulatory interventions, since the existence of a regulator should be sufficient to constrain behaviour in the marketplace.

171. Accordingly, MCH recommends that officials be directed to report back to Ministers on amending the Telecommunications Act to include broadcasting.

172. MED does not consider there is a compelling case to regulate the broadcasting sector at this time, including to pre-empt possible future problems. MED considers that:

- General competition law is generally up to the job of preventing anti-competitive conduct and business acquisitions. (It is not up to the job of ensuring effective access to essential facilities, but there are no such facilities in the broadcasting market at this time)

- FTA broadcasting is likely to remain viable and competitive, and the scenarios which put FTA broadcasting at risk are not particularly plausible

- There are a range of non-legislative options open to the Government to meet social and cultural objectives if required

- If and when competition concerns emerge that are not amenable to effective responses under general competition law, the government would be able to consider appropriate responses at that time. It would be possible to extend the Telecommunications Act to broadcasting in short order (only relatively simple amendments would be required).

173. Accordingly, MED recommends that Ministers agree to take no further action on competition issues at this time. However, MED considers that it would be desirable for Ministers to remind interested parties that the government is determined to maintain a competitive and diversified broadcasting market, and that it will continue to monitor developments in the market.

Appendix A: list of submitters on the digital broadcasting review
(The electronic version of this paper has links to submissions)

Two consultation documents were issued in January 2008: a main consultation document (A); and a smaller consultation document on content issues (B). Some respondents made separate submissions on each consultation document and, where this is the case, a "link A" and a "link B" are provided.

Advertising Standards Authority	Internet NZ (A) Internet NZ (B)	Screen Directors' Guild
APRA AMCOS	Jackson R	Skinner D
Arkle B	Kordia	Sky Network TV
Barclay B	Lealand G	Screen Prod & Dev Assoc (A) Screen Prod & Dev Assoc (B)
Bonlor Communications & TV Antennas	Library and Information Advisory Commission	Society for the Promotion of Community Standards
Broadcasting Standards Authority	Mainland Television	Sport and Recreation Council
Brook Asset Management	Maori Television	Te Huarahi Tika Trust (A) Te Huarahi Tika Trust (B)
Buchanan A	National Library	Telecommunications Carriers' Forum
Commerce Commission	NetSafe (A) NetSafe (B)	Telecom (A) Telecom (B)
Creative NZ	Newspaper Publishers' Association	Television Media Group
Cue TV	New Zealand On Air	TelstraClear
Dorrington D (A) Dorrington D (B)	Nga Aho Whakaari	Te Putahi Paoho
E-Cast Limited (A) E-Cast Limited (B)	No Match Technologies	Terris J
Ellis N	Norris P - NZ Broadcasting School	The Documentary New Zealand Trust
Escher P	Northern Wairoa Community Radio Trust	The Maori Language Commission/Te Taura Whiri
Fairfax Media	NZ Press Council	Trademe
Foundation for Advertising Research	NZ Racing Board	Triangle Stratos (A) Triangle Stratos (B)
Fox D	NZ Rugby Union	Telecommunications Users' Association of NZ
Freeview	Office of the Clerk of House of Representatives	Thompson P - Unitec (A) Thompson P - Unitec (B)
Google	Ott A	TVNZ (A) TVNZ (B)
Hakkenberg L	Preston E(A) Preston E(B)	TV Works (A) TV Works (B)
Hay D	Public Service Association	Unforgettable Music Society
Hazelwood W	Qualcomm	Vector
Health TV	Radio Broadcasting Association (A) Radio Broadcasting Association (B)	Vodafone
Hearing Association	Radio New Zealand (A)	Webretail

	Radio New Zealand (B)	
Hectors World (A) Hectors World (B)	Raymond C	Winger B
HP	Recording Industry Association	Zanker R - NZ Broadcasting School
Human Rights Commission	Rhema Broadcasting Group	One submission withheld

Appendix B: Competition issues

The 'competition' problem is often categorised as being of two types:

- *extortionary behaviour* - a firm (either unilaterally or collectively with other firms) has substantial market power and is able to reduce output and raise price above the supply cost without customers switching away; or

- *exclusionary behaviour* - where a firm (either unilaterally or collectively with other firms) excludes an existing or potential rival from competing in a market. However, this type of exclusionary behaviour is only anticompetitive if it enables the firm (or firms) to engage in extortionary behaviour (as described above). That is, if the exclusionary behaviour has the purpose or likely effect of strengthening or maintaining substantial market power.

A competition problem generally results in harm to customers in the immediate market in which market power is exercised and harm to downstream end users of the goods or services. If the competition problem arises unilaterally, then the firm would likely have a relatively high market share so that it can influence supply of the good or service independent of competitors.

Markets that have a competition problem are characterised by excess prices, relatively poor quality, or limited innovation in the goods or services supplied. However, for such a problem to be enduring, the market must also be characterised by high *barriers to entry* (including barriers to expansion and exit).

There are three main types of barriers to entry:

- *structural* - being natural or technical features of the market, such as the existence of economies of scale, scare resources, economies of scope, network effects, etc (Natural monopolies are an example of where there are strong barriers to entry – essentially it is uneconomic to duplicate assets required to compete – so that competition is absent and likely to remain so).

- *strategic* - behaviour of the firms within the market, such as predatory pricing, bundled products, exclusive deals;

- *regulatory* - government policy and regulation imposed on the market.

Thus, in thinking about competition issues and regulatory responses, focus should be on barriers to entry and on ensuring that the competition regime deals satisfactorily with anti-competitive behaviour. Note however, that harm to competitors does not in itself imply the existence of a competition problem (since the competitive process is about out-competing rivals): analysis is required to determine whether there are barriers to entry which the government can and

should address and/or whether the regulatory regime deals adequately with anti-competitive conduct.