New Zealand Commerce Commission kicks Sky/ Vodafone NZ merger for touch

NEW ZEALAND

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In what appears to be only the second New Zealand merger blocked on non-horizontal grounds – the first being in 2005 – the Commerce Commission (NZCC) has declined to grant clearance for the proposed merger of Sky Network Television (Sky) and Vodafone New Zealand (Vodafone NZ).

The proposed merger was set out in two related clearance applications, both registered on 29 June 2016. One of those applications was from Vodafone Europe BV to acquire up to 51 per cent of the shares in Sky, and another was from Sky to acquire up to 100 per cent of the assets and/or shares of Vodafone NZ. In essence, Vodafone Europe BV would own 51 per cent of the merged entity with the balance being listed on the New Zealand Stock Exchange.

The NZCC clearly saw issues with the proposal from an early stage. On 31 October 2016, NZCC sent a 'Letter of Unresolved Issues' (LUI) to the parties (with a copy on its website), noting it had concerns around vertical and/or conglomerate effects. (A LUI essentially provides the applicant(s) with a further opportunity to provide additional information or submissions to allay the NZCC's concerns, such as divestment undertakings; this is the first time we are aware of the NZCC publishing a LUI.) These concerns arose from the following factors:

- the merged entity would have substantial market power by virtue of its portfolio of content, including premium content such as live rugby;
- the merged entity would have an increased incentive and ability to make buying Sky on a standalone basis relatively less attractive than buying it in a bundle (with mobile and/or broadband) offered by the merged entity, resulting in customers switching to the merged entity;
- the merged entity would have less incentive to enter into reselling arrangements than Sky would in the counterfactual, meaning rivals would be unable to offer bundles with Sky and mobile/broadband services or offer bundles as attractive as those offered by the merged entity; and
- as a result of the above, one or more rivals may lose customers to such an extent that they no longer provide an effective constraint in a telecoms market, allowing the merged entity to profitably raise prices of a telecoms service above levels that would prevail in the counterfactual.

Apparently the parties were not able to sufficiently allay those concerns, with the NZCC ultimately announcing its decision to decline to grant clearance on 22 February 2017. To grant clearance, the NZCC must be positively satisfied that the proposed merger will not substantially lessen competition. It appears that the NZCC could not satisfy itself as such on this occasion, with the NZCC Chairman, Dr Mark Berry, observing that the NZCC had not been able to exclude the real chance that the merger would substantially lessen competition:

> 'The proposed merger would have created a strong vertically integrated pay-TV and full service telecommunications provider in New Zealand owning all premium sports content […] Around half of all households in New Zealand have Sky TV and a large number of those are Sky Sports customers. […] Given the merged entity's ability to leverage its premium live sports content, we cannot rule out the real chance that demand for its offers would attract a large number of non-Vodafone customers […] If significant switching occurred, the merged entity could, in time, have the ability to price less advantageously than without the merger or to reduce the quality of its service. Given we are not satisfied that we can say that competition is unlikely to be substantially lessened by the proposed merger, we must decline clearance.'

The NZCC's written decision was not available as at 6 March 2017. However, all indications have been that 'live sport', and how that

premium content could be leveraged to the detriment of smaller telecoms players, was the ultimate sticking point. This was summed up by Dr Berry at a media briefing in Wellington, where he was reported as saying 'had the merger not included all premium sports content we would likely have cleared this merger'. Dr Berry expanded on this theory of harm at the media briefing:

> 'The problem we have is that there's this major customer segment, for whom Sky Sports is a must have, and the merged entity would have the ability to leverage that market power to potentially have an adverse impact on Vodafone-Sky's rivals.'

Dr Berry also explained more in the media release:

> 'The evidence before us suggests that the potential popularity of the merged entity's offers could result in competitors losing or failing to achieve scale to the point that they would reduce investment or innovation in broadband and mobile markets in the future. In particular, we have concerns that this could impact the competiveness of key third players in these markets such as 2degrees and Vocus.'

So where do we go from here? While Sky and Vodafone NZ may have been optimistic about a favourable result from the NZCC, presumably they have prepared for the worst and, after licking their battle wounds – Sky shares reportedly fell 14 per cent to their lowest value in eight years immediately after the NZCC's announcement – have several options they could pursue, including:

- **Appeal the NZCC's decision**: Sky and Vodafone NZ have a statutory right under the Commerce Act 1986 to appeal the NZCC's decision to the High Court, and will no doubt be weighing up the costs and benefits of taking such an approach. (The parties did not have to wait long before receiving news that no doubt added fuel to the fire. On 26 February 2017, Spark – formerly Telecom New Zealand, and one of the most vocal opponents of the Sky/Vodafone NZ merger – announced that it had signed an 'exclusive partnership' with Netflix, offering free Netflix for a year on new 24-month 'Unlimited Data' broadband plans.) But with the clearance process taking almost eight months, the parties may be unwilling to commit further resources to protracted legal proceedings when the result is by no means certain.
- **Proceed without clearance**: On its face, simply proceeding with the merger as proposed would be risky and likely to be met by challenge from the NZCC and/or third parties in the courts, including by seeking urgent injunctive relief. (The clearance regime is voluntary in New Zealand, and the parties are not barred from proceeding with a 'declined' merger.) However, this would require an opponent to demonstrate, on the balance of probabilities, that the merger is anti-competitive. (The clearance regime where the NZCC must decline to grant clearance if it is not satisfied that the proposed merger will not substantially lessen competition.) Key players such as Spark and 2degrees have already indicated they would be willing to fight a merger between Sky and Vodafone NZ, including when they successfully sought from the High Court a stay on the proposed merger to consider their legal options if the NZCC had decided to grant clearance. Ultimately, they did not need to exercise that stay.
- **Submit a new application for clearance**: The parties could submit a new application for clearance for an 'amended' merger, under which the parties give an undertaking to divest certain problematic aspects of the original proposal and/or require the Commission to consider new information. (Unlike many of its international counterparts, the NZCC is unable to formally accept behavioural undertakings.) This type of approach has been successfully adopted by parties to a declined clearance application in the past, including for a recent hospitals merger.
- **Strengthen the status quo**: The parties could also seek to strengthen what they referred to in their clearance applications as a 'successful and complementary strategic relationship, under which Vodafone resells Sky's pay television services, and Sky promotes Vodafone NZ's broadband products and refers customers to Vodafone NZ'.

Other recent New Zealand merger news

Print deadline for media merger decision

The NZCC was due to reach a decision in relation to New Zealand Media and Entertainment (NZME) and Fairfax's application for clearance or authorisation by 15 March 2017, having previously indicated in its draft determination on 8 November 2016 that it would be likely to decline to grant authorisation for the merger. The proposed merger would essentially be a 'two to one' in newspaper supply (national dailies) and merge the two largest news websites. There would also be overlap in community publications, magazine supply and radio stations. The proposed merger and relevant parties are discussed in more detail in earlier editions of this newsletter. While the NZCC acknowledged considerable public benefits (through economic efficiencies) in its draft determination, it decided that those benefits were 'trumped' by its quality and plurality concerns. This has raised issues around whether the NZCC exceeded its jurisdiction or misapplied the 'public benefits' test. While some media outlets may be quick to jump to conclusions, the NZCC's decision in Sky/Vodafone NZ should have no bearing on the outcome of this (fundamentally different) merger.

Fire sprinklers blocked

On 3 March 2017, the NZCC declined to grant clearance for Aon New Zealand to acquire the fire sprinkler and alarm inspection business of Fire Protection Inspection Services. In the NZCC's media release, Dr Mark Berry observed that:

> 'the proposed merger involved the two largest national sprinkler inspection firms and would have resulted in most sprinkler inspectors in New Zealand being employed by the same company […] if the proposed merger was to have proceeded, most markets would have been left with only two competing providers. The merged entity would have been in a dominant position as it would have employed the bulk of all inspectors. We were concerned that this proposed merger would have therefore eroded choice, which could have led to higher prices or lower quality services.'

Further consolidation in insurance sector

On 3 March 2017, the NZCC registered an application for clearance from Vero Insurance New Zealand (the New Zealand subsidiary of Suncorp Group – an Australian finance, insurance and banking) to acquire up to 100 per cent of the shares that it does not already own in TOWER. This application comes in the wake of a period of consolidation in the New Zealand insurance sector, including 'approved' acquisitions by IAG (Suncorp's largest competitor in New Zealand) of AMI (cleared in 2012) and Lumley (cleared in 2014). Both parties provide a range of personal and commercial insurance products in New Zealand. The proposed merger also appears to be subject to consent from the Overseas Investment Office.