Sky's Tall Dwarf: an unexpected winner

We got it wrong: we never thought that Sky letting live English Premier League go to Coliseum would help it stave off court proceedings by the Commerce Commission.
But it did.
(First published in NBR).

November 2013

When news of EPL moving to Coliseum came out, I admired *SKY*[1] for allowing this tall dwarf. A tall dwarf is a classic strategy for a dominant company to give the appearance of competition when it doesn't really exist. A well-known sports event, but only watched by 1.5% of viewers, makes for a handy sacrificial lamb. Even if Sky didn't intend this, that was the effect.

Sky dissed my *view*[2] but that didn't surprise me: they couldn't do otherwise.

I didn't think such a strategy would work with the Commerce Commission. I said so in my article: "*The Tall Dwarf is a harder strategy to run with regulators these days: they've heard it all before*".[3]

But this EPL play did work when the Commerce Commission decided not to bring court action against SKY arising out of its contracts with ISPs. In its detailed reasons issued last *Friday*,[4] the exemption given to Telecom by SKY to allow it to broadcast live EPL was one of the few key reasons relied on by the Commission in deciding not to sue.

Why no court action?

Normally the case outlined by the Commission in its report would be a slam-dunk for court action, as the Commission concluded that:

- SKY is "*likely*" to have breached a provision in the Commerce Act (and was "*at risk*" of breaching another provision);
- Its agreements "*appear aimed to hinder competition*" (ie this appears to be deliberate action by SKY);

- A "*breach of the Commerce Act of this kind is serious*";
- That has had the effect that "*Sky is a near monopoly in the supply of pay TV in New Zealand, such that any new entry were it to occur would have significant benefits for New Zealand consumers*";
- The penalty a court might impose for breaches is up to three times commercial gains due to the breach (or up to 10% of SKY's turnover).

Strong stuff from the Commission in relation to a business that is such an integral part of New Zealand life at the "*near monopoly*" level.

Why the call contrary to what seems the obvious one? Says the Commission in its warning letter to SKY:

- the conduct is historic in nature; and
- the alleged breaches "*are unlikely to lead to detriment in the future*".

No court action as conduct is historic in nature?

It's hard enough as it is to have the Commerce Act acting as a deterrent against anti-competitive conduct, even if cases are brought. The Act has major limitations including a fundamental flaw well known for nearly 20 years and not fixed: that's the s36 problem created by court interpretations that would leave most business people bemused as to how we could have reached this position –out of step internationally - and then not have it fixed for so long.

The cases take several years to run (the investigation alone here has taken 18 months). Even if the Commission wins, the penalty is typically much lower than the business gained from the activity. A company can win the war even if it loses the Commerce Act battle; there will be temptation to push the boundaries.

So, if the Commission doesn't run one of the more obvious cases, companies generally will feel more comfortable about taking Commerce Act risks in the future. If I murdered my Mum but there was little risk of me murdering again, I could get off scot-free! It costs a lot of money to prosecute me for murder but the Crown will still prosecute even if it's a complicated and costly whodunit with uncertain outcomes.

The Commission also relies on the argument that a warning letter –as sent to Sky – puts them and others on notice of the Commission's concerns under the Commerce. No, it's the opposite: breach the law in a way that is "*serious*", "*aimed to hinder competition*" and where "*any new entry were it to occur would have significant benefits for New Zealand consumers*" and you get off scot-free? No wonder Sky has come out [on Tuesday in the Dom] saying "*We won't be removing these clauses and it is business as usual*".

It's not readily apparent from the Commission's report why this case is not run: it's surprising such a big judgment call not to sue gets only 8 paragraphs of analysis out of a 395 paragraph report.

Alleged breaches unlikely to be detrimental in future?

That's the other main reason. Said the Commission, among other things, the EPL scenario shows things are changing so there is unlikely to be detriment in the future.

EPL is just one swallow leading into summer airwaves, even if Coliseum won the rights off Sky based on the normal value of the rights. But, as a tall dwarf, the approach has worked a charm, exceeding what I thought was possible by persuading the Commission that the problems are likely to be in the past.

But this is not just about EPL. There are plenty of other reasons to conclude that the key provisions under review may create problems in the future. Some of those possibilities are identified in the Commission's own report.

The discretion as to whether to sue or not should involve broad considerations and not just narrow competition law analysis (that's a separate question). Sky, the way things are going, is not going to lose its dominance any time soon, including for reasons that get little attention from the Commission.

What to do?

The Commerce Act is a blunt instrument in dealing with market problems in broadcasting and communications, even if optimally applied by the Commission. That's why most comparable countries have regulated. On most of the grounds investigated, the Commission had hands tied behind backs, and was unable to solve what appear to be significant problems.

It's been apparent for some years that there are major market failures in broadcasting: for example, there will remain problems in solving

Sky's dominance flowing from premier sports production and broadcast rights, such as for rugby. That will pervasively continue to affect all content plays, largely offsetting welcome forthcoming competition from online content providers such as Netflix. Government, in its narrow focus on the price difference between copper and fibre in relation to its UFB, is heading toward being stung by what is the main issue around migration to UFB: content. Yet Government has no appetite to do what should happen for UFB and for consumers: set up a robust and workable regulatory regime.

It's impressive that Sky management has staved this off so long. Sky looks well placed for this new UFB world. Buy their shares!

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1. www.nbr.co.nz/tall-dwarf

2. http://www.stuff.co.nz/business/8935387/Is-the-Sky-falling

3. http://www.wigleylaw.com/assets/Uploads/English-Soccer-Skys-Tall-Dwarf.pdf

4. http://www.comcom.govt.nz/dmsdocument/11184

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